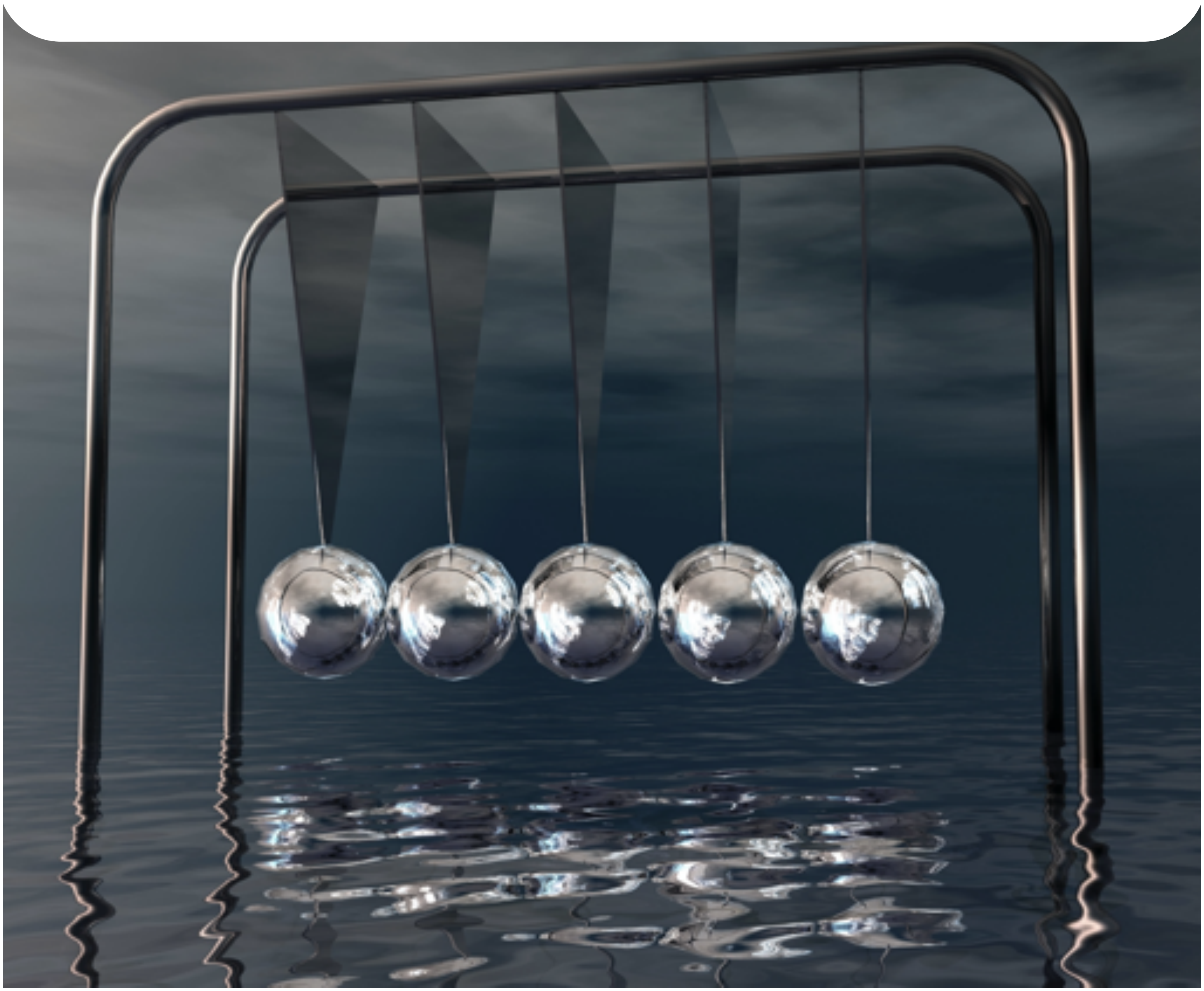
retail consulting and industry thought leadership

Getting to Global: Managing Inventory in a Unified Commerce World



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be selective.

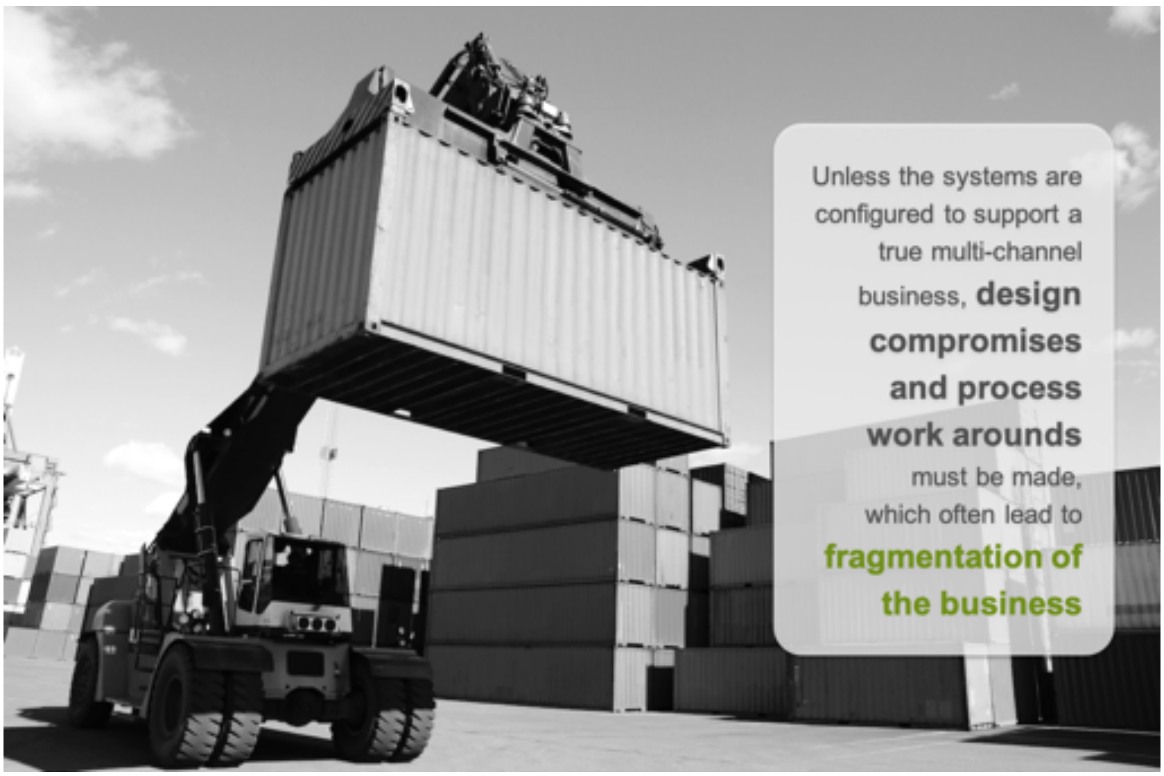
When there is too much of a good thing

Inventory is the lifeblood of any retail or consumer brand company. Appropriate levels in the 'right' places will drive sales and can become a strategic differentiator. At the same time, too much inventory will consume working capital and prohibit long term growth. When an organization branches into multiple channels across a wide geography, inventory will often proliferate, as each group acts independently to secure enough product to achieve their sales objectives. This situation ultimately erodes profits and impacts the brand's viability in the marketplace. Successful retailers and brands manage inventory as a shared asset, a 'common pool.' They are able to leverage inventory in a way that maximizes sales and profits, regardless of channel or even region of the world.

In this point of view, we outline the typical challenges Parker Avery observes relative to effectively managing inventory across channels and throughout different geographies. We then delve into specific methods companies can use to free up their inventory to be most productive and profitable for the entire organization.

The Root of the Issue

More often than not, we see inventory issues arise with brands that began their operations exclusively operating physical retail or 'brick-and-mortar' stores. In this situation, a company employs typical retail models to manage the business, using key tools like open-to-buy (OTB) and initial markup (IMU). In this traditional retail model, store sales are seen as the primary measure of success—and usually drives all other operations within the business.



In addition to the traditional retail mindset, the technologies used to support the business are often architected using a 'closed loop' approach. This means the core merchandising systems support a buy (from vendor) with a single path: get product into the DC and ultimately the stores. Each buy normally has a component of allocations to the stores with a portion held back in the DC for reserve (to support store replenishment). However, this model frequently does not give enough consideration to external customers like other retailers or franchise operations that hang the banner and sell the brand. Including these other operators (or channels) is important because unless the systems are configured to support a true multi-channel business, design compromises and process work arounds must be made, which often lead to fragmentation of the business—along with the key inventory required as its lifeblood revenue source.

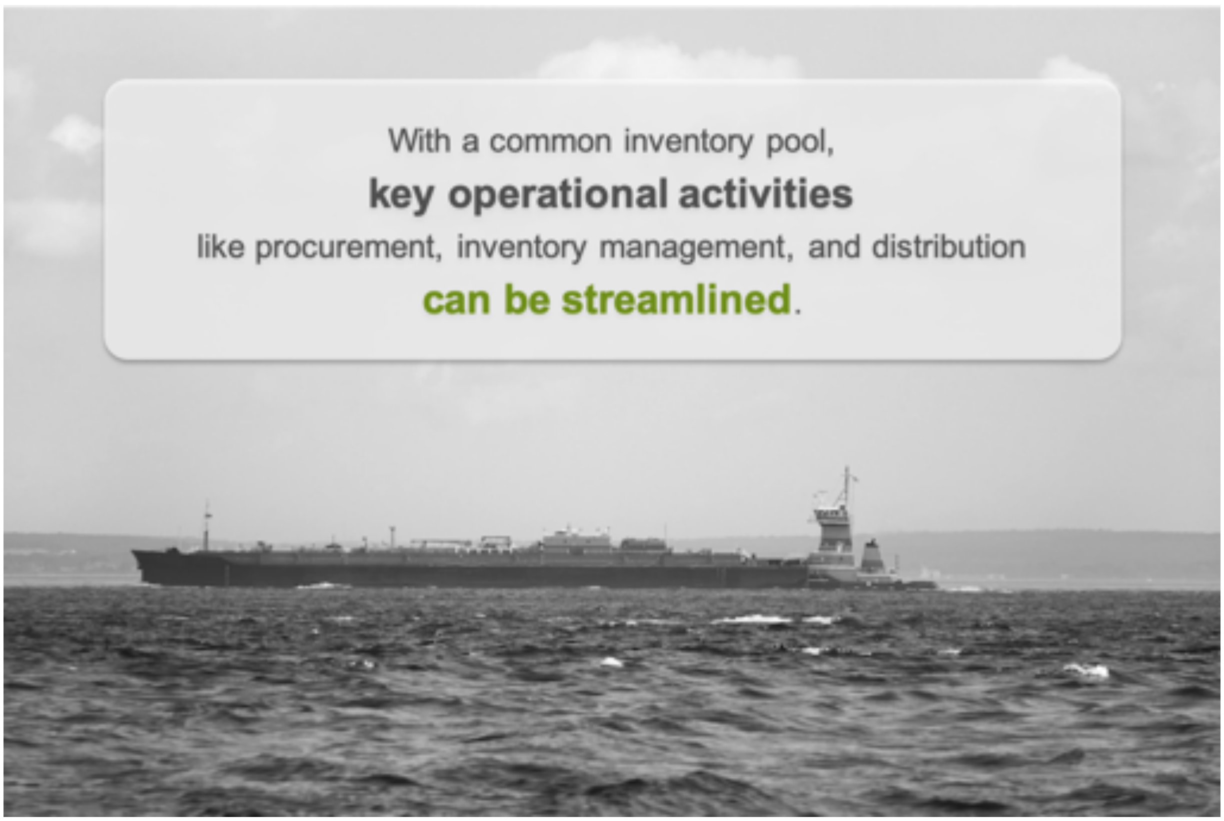
This fragmentation is even more pronounced in retailers where different channels historically managed their own inventories (with the advent of online shopping, mobile shopping, and so on). Only with the onset of the ‘omnichannel’ or ‘unified commerce’ mindset have brands realized they were investing resources and duplicating efforts in managing their inventory—most of which was comprised of identical products and similar assortments.

These fragmentation challenges can be categorized as the following:

- **Unique stock keeping units (SKUs)** by channel or geography. This approach ensures inventory is isolated by channel or business unit because they all have their own (different) SKU for every product. If the product is identical, using unique SKUs essentially guarantees segregation from ordering all the way through to fulfillment.
- **Fragmented procurement**. Even if a common SKU is used, when product is purchased separately across channels, a likely result is segregated inventory—with respect to both quantities received and timing. Further, this approach almost assuredly leads to excess reserve, as each channel accounts for their own reserve *separately*.
- **Different allocation and fulfillment models**. Different channels require different processes to distribute the goods to the customer (or end consumer). In the brick-and-mortar channel, extra inventory quantities are almost always bought so product can be used to replenish initial sales. Existing ‘staple’ or ‘basic’ items may be on a pure replenishment model, since the initial allocation. For wholesale, fulfillment is usually to the customers’ DCs, and the order comes in and goes out together. This works only if demand is captured at the same time as procurement and sales are not beyond what was purchased (as in a custom or ‘make to order’ business).

Why Inventory is Broken

Keeping the business siloed as we just described leads to significant operational inefficiencies. Let's start with the inventory itself. **The more fragmented the inventory, the more investment is required to cover the overall needs of the business**. A common pool of inventory is shared amongst all channels, meaning it can be leveraged easily by the business to support sales and ultimately drive profits.



In addition, **siloed inventory requires considerable hand-offs and duplicate business processes, which are commonly misaligned**. With a common inventory pool, key operational activities like procurement, inventory management, and distribution can be streamlined. Rather than multiple purchase orders (POs) being managed—a *single PO* may be used. This single PO is of course larger, but much more straightforward for the factory and all downstream teams to manage. And because single POs are written for the common pool, the overall quantity required is likely less if a common reserve is purchased—which translates to lower inventory investment.

If the organization has multiple DCs, they will need to ensure the POs target the right locations. The objective is to get the product as close to the customer as possible (the 'last mile'). While this makes sense, it will fragment the inventory to a certain extent. While inventory has to physically go *somewhere* in the supply chain, the intent is to still ensure visibility to it, regardless of location. This enables ultimate flexibility in the event the most profitable utilization of it moves it to a secondary region.

Getting to Global

Let's start with the key changes the organization must embrace. If the channels are used to running 'their business' independently, this mindset will need to be addressed. A common pool means that inventory in a DC needs to be 'owned' by the entire organization (or region) as a whole—not an individual channel. This will impact things like open-to-buy for retail as well as pricing structures across all channels.

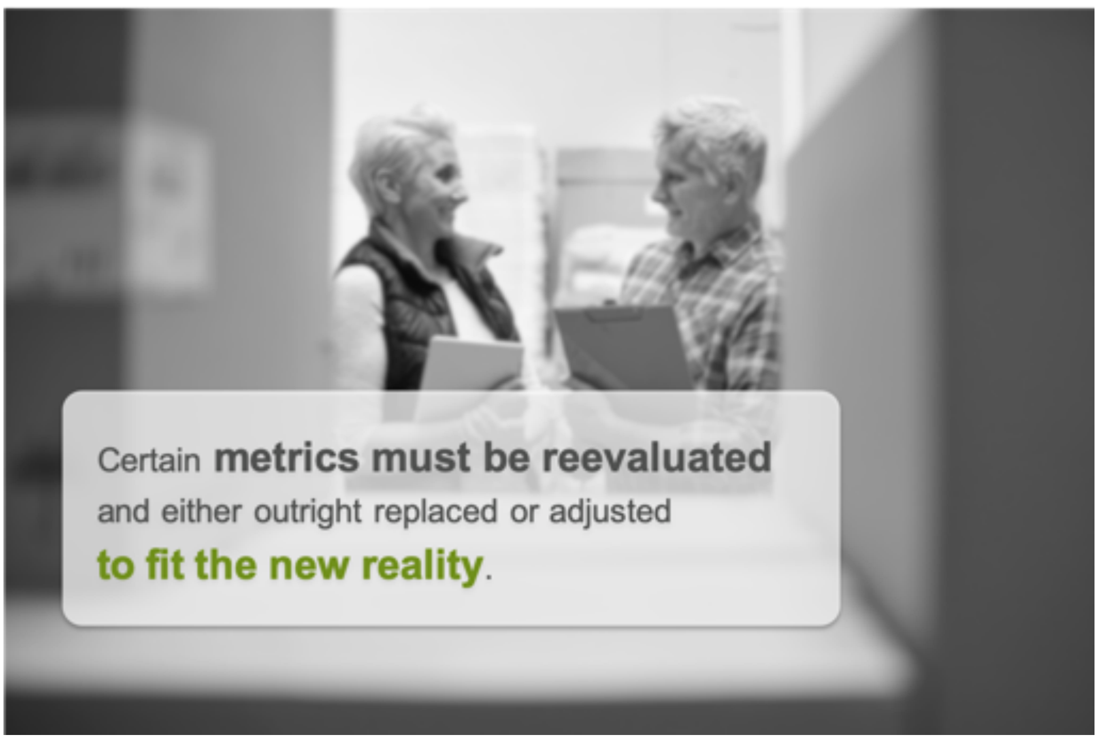
Further, rules need to be put in place to accommodate for shortages. Shortages can occur for multiple reasons, such as the vendor failed to ship what was ordered or additional demand orders were entered after procurement was completed. In this latter case, more product often cannot be bought, and in the rare circumstances when it can, product would likely arrive too late to satisfy the demand requirement. In any of these cases, the organization must evaluate the criteria it will use to determine which channel will end up getting shorted by the supply problem.

Fundamentally, the move to global inventory means the following:

- **Global SKU**. The same product has the same identification number (SKU)—everywhere. This typically entails a significant conversion effort, especially if product pricing has been managed differently for each business unit or channel. Plan the conversion accordingly and with a lot of forethought.
- **Global demand collection**. The assortment plan must incorporate availability windows to ensure demand (external and internal) is coordinated with the timing of supply. This is especially true for high fashion, short lifecycle products. Failing to do this will result in missed orders or overcrowded distribution centers.
- **Global procurement**. Rather than buying in silos, procurement should aggregate the requirements (both forecast and actual orders)

and buy in a collective fashion, meaning fewer POs with higher quantities, as mentioned earlier. This goes hand-in-hand with the demand activities, tying into the product availability window. Essentially, goods should arrive from the factories nearly 'just in time' when this is done well.

- **Inventory allocation** (or available to promise/ATP). It is likely that new supporting systems and new business processes will need to be implemented to 'match' supply and demand. Both quantities and timing must be considered to properly provide the business with insight into issues as they arrive (for example, late or short orders—which can be equally problematic). The systems should report any mismatches as soon as practical to enable the business to determine a proper course of action quickly and efficiently.



- **Simultaneous fulfillment**. In the segmented world, DCs likely had the ability to isolate product from receipt to shipment, and in traditional retail models, inbound inventory was already 'earmarked' for its outbound destination. With global inventory, no such predetermination is required, which means the same units can be leveraged for any channel. That also means that the DC needs to be able to simultaneously process orders across all channels, regardless of their physical configuration (i.e., wholesale: large orders shipping to one destination; retail: smaller orders shipping to individual stores; and direct-to-consumer: lots of orders, with minimal units per order). All product shipping out of the same pool—from the same facility.

- **Product prioritization**. With common pool, when there are product shortages, there must be a process, prioritization, and supporting analytics to determine what channel or location gets the constrained inventory.
- **New/changed measurements (KPIs)**. This is less about process or technology change, but really a driver for the necessary behavioral changes. When common inventory is in play, certain metrics must be reevaluated and either outright replaced or adjusted to fit the new reality. Examples include managing an OTB for retail—since POs and inventory are now common, traditional retail calculations become too complex—and moreover, keeping these measurements in play will undermine the intent of the change. If people aren't measured differently (provided new targets to achieve), they will inevitably resort back to old behaviors and diminish the effectiveness of moving to a global inventory mindset.

Final Word

Making the decision to combine inventory into a global pool will generate rewards by providing significant flexibility—allowing the most profitable (or strategic) channel to be fulfilled, while reducing the overall investment by sharing the risk across all channels.

Much of the change entails the technical challenges including:

- Combining once-segregated inventory into a single pool and possibly a new SKU methodology
- Restructuring ordering systems to work more independently
- Including a system to facilitate the allocation of inventory across varying channels, as well as full transparency and visibility

However, moving to a common pool of inventory also entails a mindset change. In the traditional common pool world, PO responsibility will be moved to a supply side and the brands must ensure supply is available to meet the demand. In addition, every stakeholder shares responsibility for the decision to invest in inventory and reserve for specific products. To facilitate these mindset changes, it is important to review the metrics that drive each of these groups and realign as necessary to facilitate the adoption of required new behaviors and processes.

The most compelling reason to ‘go global’ is clearly the efficiency of the most expensive asset a retailer or consumer products company possesses. Common inventory means a collaborative investment in this asset as well as a total organizational commitment to ensure inventory is holistically optimized for the company.

The Parker Avery Group

The Parker Avery Group is a boutique strategy and management consulting firm that is a trusted advisor to leading retail brands. We combine practical industry experience with proven consulting methodology to deliver measurable results. We specialize in merchandising, supply chain and the omnichannel business model, integrating customer insights and the digital retail experience with strategy and operational improvements. Parker Avery helps clients develop enhanced business strategies, design improved processes and execute global business models.

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