10 Actions Retailers Must Take to Lower Inventories and Prevent Margin Erosion

High inventories pose a huge problem for retailers maintaining profit margins this year in a cooling economy. They can fix this problem by deploying a platform providing a real-time, enterprise-wide view of inventory, in combination with demand sensing and inventory optimization powered by artificial intelligence (AI). Using this solution will enable them to take 10 specific actions to streamline inventories to maintain profits.

With a recession looming, retailers face the problem of controlling inventories in order to avoid markdowns and maintain profit margins. They entered 2023 with higher-than-normal inventories, having increased stockpiles as a buffer against supply chain disruptions stemming from the Covid-19 pandemic. Now they face the daunting task of rightsizing inventories in the face of a slowdown in consumer spending and persistent high inflation.

In order to set proper inventory levels, retailers need to use the latest technology for a clear, granular picture of their stock holdings across their entire network of stores, distribution centers (DCs), and fulfillment centers (FCs) in conjunction with a picture of real-time demand across all sales channels.

By having a platform for demand and inventory visibility supported by AI-powered demand planning and inventory optimization solutions, retailers gain the necessary clarity around consumer buying behavior in relation to current on-hand stock across the organization. By improving the supply-demand alignment, they don't have to lower prices to remove unwanted stock in stores or on warehouse shelves, and, in doing so, they preserve their profit margins.

The Challenge of Record High Inventories

The Covid-19 pandemic disrupted supply chain operations on a global scale, resulting in unpredictable transit times and supply shortages. Although companies did consider other inventory management strategies to ensure product availability – such as sourcing diversification and supply base regionalization – the most common practice to address disruptions was to increase inventories, according to the global management consulting firm McKinsey & Company.

That inventory buildup puts retailers in a precarious position going into 2023 because of the headwinds facing the global economy. According to Lora Cecere, the founder of the firm Supply Chain Insights, companies are entering this year with 2022 inventory levels at the highest they have been in a decade.

Moreover, excess inventory isn't showing signs of going away. Retailers are struggling to reduce their stockpiles of goods as indicated by the latest data from the US Commerce Department on the Inventory to Sales Ratio. The ratio measures the amount of inventory in the retail network against the extent of sales. November 2022 shows that the inventory to sales ratio was 1.24 compared to November 2021 when it stood at 1.10. On top of that, the ratio for November 2022 had crept up from October's 1.22.

The high inventory to sales ratio is a clear sign that retailers are struggling to reduce stockpiles and align product availability with consumer demand. American consumers cut back on retail spending this past holiday season, pinched by rising interest rates, still-high inflation, and concerns about a slowing economy. Although major retailers offered markdowns to clear their shelves of inventory, retail sales saw the biggest monthly decline for the past year in December 2022, according to the Commerce Department.

With sales slipping and on-hand inventories remaining high, retailers heading into 2023 need to keep stock levels closer to actual demand to avoid further pileups that lead to price margin erosion. But the complexity of omnichannel demand with inventory pulls from multiple retail channels makes maintaining product availability while keeping stock to a minimum especially challenging for retailers serving both online and in-store consumers.

Overcoming Excess Inventory and Margin Erosion with A Single Source of Truth

To maintain product availability in an omnichannel retail environment without overstocks, retailers need a centralized view of on-hand inventory and changing demand. The stumbling block is that most retailers don't have the technology that gives them a central view of their enterprise. Crucial information on inventory and demand remains scattered across the retailer's organization in disparate, siloed applications such as Enterprise Resource Planning (ERP), Inventory Management, Order Management, Point-of-Sale systems, and E-Commerce systems. Combining these systems and applications into a single view on one platform would give the retailer a unified, enterprise-wide view of changing demand and real-time, on-hand inventory.

But seeing real-time inventory and demand isn't the only functionality the platform should have. Retailers also need data-driven insights to address the complexity of balancing supply and demand in an omnichannel retail environment. Analyzing all the data collected by the central platform requires the use of artificial intelligence to mine the ocean of data for useful, actionable information. AI does this by using machine learning algorithms to reveal data trends and patterns in events (e.g., the sale of an item, the time of a sale, the transfer of stock, etc.). In doing so, it offers a greater level of accuracy than traditional business intelligence tools. When AI is applied to understanding demand and optimizing inventory, it gives a retailer the power to identify shifts in consumer behavior across all retail channels for improved inventory management.

For a retailer managing inventory in the face of fluctuating demand across multiple retail channels, the platform provides a single source of truth for the organization to use for immediate decision-making and long-range planning. A single source of truth makes it possible for the organization to work in concert to make immediate course corrections on replenishment, allocation, and fulfillment while also putting both historical and granular data in context to support long-term planning.

10 Actions to Fight Profit Erosion

Implementing a platform such as the one described above enables a retailer to take 10 actions to avoid excess stock and maintain profit margins in the face of rising inflation and an economic slowdown.

Specifically, a retailer can:

1. ***Leverage the single source of truth to react to changes in shopping behavior by generating actionable views***

   Information about available inventory across the retailer's network should be the same on any data destination system (e.g., an app, the web, a mobile device, an online marketplace, a social post, a search engine, etc.). Because every store or warehouse is now a fulfillment point, retailers need to have a concurrent view of the status and location of products to ensure product availability to meet omnichannel demand and avoid overstocking.

2. ***Optimize inventory quantity and mix at the DC and store level to ensure the right products are in the right place at the right times to meet customer demand***

   Because most retailers still use past history and spreadsheet calculations for buying products and determining inventory needs, they overreact to point-of-sale data showing a sales spike. Retailers need to employ artificial intelligence to interpret demand signals and determine true changes in consumer buying behavior. With this intelligence, they can make smarter decisions on inventory replenishment and network placement.

3

Enable more precise inventory demand forecasting to drive smaller assortments for higher sales and lower inventory

AI-driven demand forecasting is more accurate in determining inventory needs when working in conjunction with a real-time data platform. Using up-to-the-minute data gives the retailer actionable intelligence to respond to true demand changes and make course adjustments to hold only a minimal amount of inventory.

4

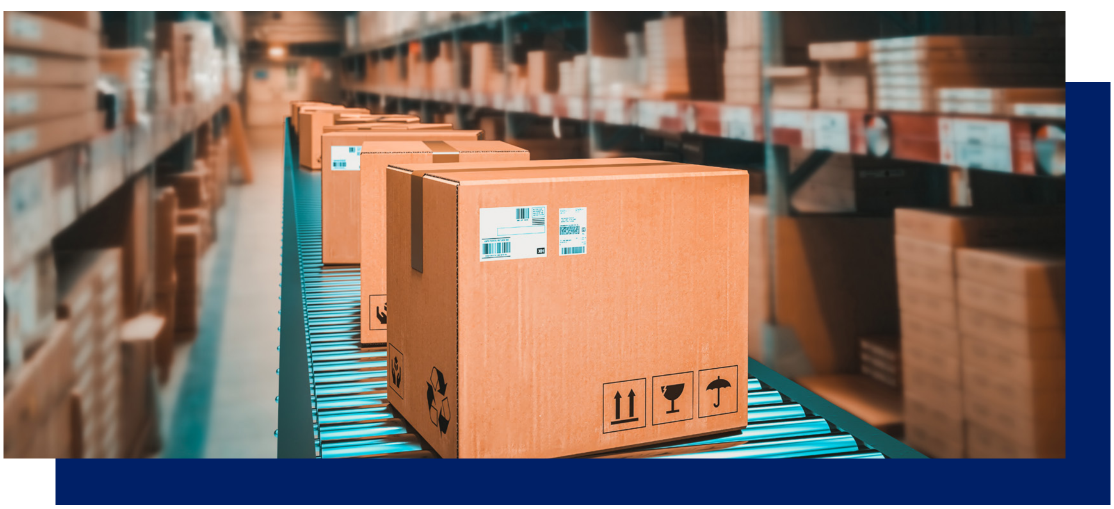
Allocate and replenish Stock Keeping Units (SKUs) in real-time to maintain product availability for margin preservation

Retailers can no longer afford to have monthly or even weekly reviews to determine inventory buying and stock allocation. They must have a granular, real-time picture of individual item holdings so inventory planners and allocators can shorten the review period for replenishment buying to a single day in order to maintain stock minimums and boost inventory turns.

5

Track items returned online or at the store so the retailer has a constant view of available inventory for reallocation.

With CNN reporting that return rates for items bought online are between 15 and 30 percent, a retailer has to know how soon and where the item will be available to be resold to avoid overstocking. Because returns notifications are often held in applications distinct from store inventory systems, a single source-of-truth platform gives everyone in the organization updated status information on a returned item. Knowing when and what items will be returned to a store lets a retailer avoid ordering unnecessary replenishment stock.



6

Support a shift in merchandising strategy from a product- to a customer-centric view.

To avoid overstocking, merchandisers now have to buy and replace inventory based on shopper behavior rather than using the traditional practice of advance buying based strictly on prior history or assumptions on shopper wants. Keeping the customer front-of-mind means using real-time data to capture those behavior patterns quickly while also using that view of inventory to fulfill consumer demands from any store or channel.

7

Enable the use of product pricing rules to maintain margins

Pricing discrepancies between online and in-store postings force a retailer to mark down items to maintain customer goodwill. The solution is to have the platform act as a single source of truth to disseminate and enforce pricing rules across the enterprise.

8

Support the adoption of a Merchandising, Inventory, and Operations Execution (MIOE) strategy

Similar to Sales and Operations Planning (S&OP), MIOE is a collaborative process that brings together siloed teams to determine what products to buy. MIOE allows retail management to look at a current snapshot of inventory to see how it's tracking against the retailer's open-to-buy plan.

9

Leverage machine learning to better forecast new product introductions and the impact of promotions

A form of self-learning artificial intelligence, machine learning (ML) can analyze past introductions to find correlations with a new product for determining the initial amount of needed inventory. ML can also be used to examine past promotions to determine the impact of a promotional lift so inventory planners can buy just the right amount of product to meet demand.

10

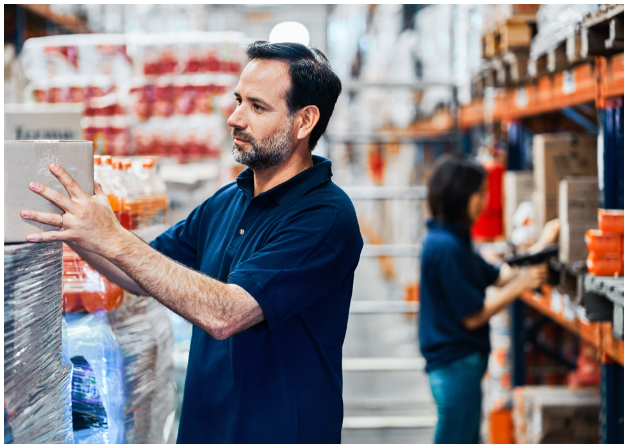
Leverage the entire inventory network to fill orders

A real-time view of on-hand inventory enables the retailer to fill orders from stores where sales for an item are languishing. Instead of having to mark down the item to clear it from the store shelf, the retailer can choose to have the store with slow-selling products act as the fulfillment center for an online order.

No Time To Delay

Retailers found themselves behind the eight ball when the Covid-19 pandemic caused a supply chain upheaval. If they don't take action now to rightsize inventories, they'll find themselves once again in trouble as the economy sours and inflation persists.

By using a real-time data platform, coupled with AI-powered solutions for demand and inventory management, retailers have the single source of information and insights they need to maintain the delicate balance between too little and too much inventory. They will achieve faster inventory turns, higher sell-through rates, and fewer mark downs, and, by doing so, maintain their price margins during an economic slowdown.



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