WHITE PAPER

# Optimizing the Precision of Inventory

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# Optimizing the Precision of Inventory

*After stores begin to re-open, the retail landscape will be very different.*

HRC Retail Advisory and Planalytics advise on how retailers should best position their inventory investments as retailers navigate the new normal.

## Overview

The COVID-19 pandemic has had a profound impact on the retail industry and consumer purchasing. For some retailers, this has brought positive, yet unexpected growth. At the other end of the spectrum, many retailers are in a fight for survival. Traditional brick and mortar retail has already begun to return, although the pace and sustainability of the "retail re-start" is inconsistent at best. Regardless of the retail sector, this pandemic can be summed up as disruptive or abnormal.

As retailers are returning to a "new normal", there will be those who have far too much inventory, others with not enough inventory, and those who simply have the wrong product on the floor — and for some, a combination of all three scenarios. At the same time, these businesses are faced with a real challenge in forecasting what the return of consumer demand is going to be and how their supply chains will function.


One thing is certain: consumer purchasing habits have changed and the future will be different from what they were before the pandemic. This uncertainty is shining a light on the need for inventory optimization to make sure that every product is positioned in the most appropriate physical space when the consumer is ready to purchase it.

As we all know, a meaningful percent of inventory assets lose value as they age, at which time retailers typically take decisive price action in the form of markdowns or promotions to clear excess. To turn inventory into cash at closest to full margin, retailers must more precisely forecast sales at the local item level and make efforts to locate the inventory to enable forecasted sales at or nearest the geographical location that the item is forecasted to sell.

## What Drives Demand at the Local Level?

Some of the biggest demand drivers at the local level are weather, demographics and local consumer preferences. Better understanding these drivers of consumer behavior and analytically incorporating them into location-level item forecasts can meaningfully increase their precision and accuracy.

## Managing Inventory Optimization in a Post COVID-19 World

Inventory optimization strategies must be fine-tuned both for the short term and the longer term. We have summarized below our recommended immediate steps to consider as well as the longer-term strategies to be developed.

1. Manage Inventory More Precisely at a Location Level
   Location-level item forecasts are getting increasingly difficult given the ongoing shift of store-level sales to digital channels and the massive amounts of data analytics required to closely monitor and forecast item sales receipt and sales behavior by location.

   - NOW/IMMEDIATE TERM: Inventory that has been trapped in closed stores since March must be turned into cash, while minimizing the likely margin erosion. Retail asset-based lenders who are, in many instances, financing this inventory are going to have to re-think borrowing bases and how they give their retail borrowers more breathing room as they recover.

     As consumers slowly start returning to stores, their shopping behaviors may be different (fewer trips, social distancing, etc.), but the underlying objective is to purchase items that fulfill a need and bring value.

     As an example, the weather will be much different in May and June as compared to the shut down in March. This will impact the types of products consumers are looking for. Retailers who already had spring items on their floors may not need to significantly discount items to entice sales. The weather at re-opening can be a significant driver of need-based purchasing.

   - MID/LONG TERM: Successful retailers will define more precise location-based inventory strategies. This can include SKU rationalization, inventory consolidation, weatherization and fulfilling online orders from stores. Utilizing weather analytics is a very effective way to drive profitability. For example, this September, retailers (particularly with stores in the East) will benefit from colder temperatures as compared to last September. This de-weatherization process (removing the volatility from the prior year) will drive opportunities to more precisely and factually situate inventory at the local level. In addition to improving demand forecast accuracy and sales, this inventory optimization tactic will improve working capital productivity. Since weather-driven opportunities in September may not persist into October, the window of opportunity to capitalize on consumer demand (particularly when seasonal products are closest to full price and hence full margins) will be limited.

2. Proactively Navigate the New Consumer Demand Landscape
   COVID-19's impact will be detrimental for numerous retailers and will accelerate the need for restructuring or even creditor protection. It will also highlight the need to best understand how the consumer is behaving, which is consistently evolving.

   - NOW/IMMEDIATE TERM: Retailers selling fashion apparel will need to fortify their balance sheets to be able to withstand the shock of the sudden sharp decline in consumer demand. Many of these apparel chains will need to withdraw from numerous weaker locations given the anticipated acceleration of the traffic declines in the weaker locations combined with greater consumer unemployment and financial insecurities.

- MID/LONG TERM: Businesses will need to invest heavily in their (a) digital and omni-channel capabilities to adapt to the acceleration in the shift to digital from stores, and (b) analytical capabilities that can help increase demand forecast accuracy by accounting for local/item level impacts such as weather. As we enter the summer season, retailers will need to take a hard look at their inventory and determine which items are basics that can be cancelled (or packed away for next year) and which items will need to be liquidated or disposed of for being seasonably inappropriate.

3. More Closely Align Supply Chain with Demand As supply chains have been disrupted, a realistic quarter-by-quarter forecast of consumer demand through 2021 will be key to the localization strategy.

    - NOW/IMMEDIATE TERM: Demand forecasts should regularly be reviewed and refined in a systemic and scalable manner. Retailers will need to understand how near-term external drivers will influence total and local demand (such as weather, special events, unemployment rates, mall closings). As consumers begin to return to stores, it is expected that they will continue to take fewer and more focused trips. Weather, holidays, and special events (such as birthdays, graduations) will provide a reason for these trips. Accounting for volatile variables like weather in your demand forecasts in a systemic and scalable manner will help to optimize inventory, reduce waste, avoid lost sales, and increase profitability.

    - MID/LONG TERM: As supply chains adapt to this "new normal", businesses need to leverage analytics and insights to make sure that other localized demand signals are considered. As the pandemic slowly moves into the rear-view mirror, other external demand signals will remain and it is crucial to have a plan to deal with what will be in front of them. The weather is one notable and consistent variable that will continue to drive consumer purchasing. In addition, there is nothing more local than weather. Business should align the receipt and movement of inventory to the timing of the weather. Retailers can use existing analytics and insights to have the right products in each store when the customer is looking to make a purchase.

There is a lot of uncertainly in the retail marketplace today. Every business is determining the best path to not only navigate the current disruption, but to survive and thrive in the long term. There are many "unknowns" that are influencing retailers today. Optimizing the localization of your inventory placement through analytics, tools, and technologies (such as weather analytics) will transfer these to "known" drivers, and increase the profitability of businesses in a scalable and sustainable manner.

 

## About Planalytics

Planalytics, Inc. (www.planalytics.com) is the global leader in Business Weather Intelligence®. Through advanced weather analysis technologies, planning and optimization solutions and industry-specific expertise, Planalytics helps companies assess and measure weather-driven impacts and effectively manage the never-ending variability of climate. Leading retailers, food and beverage companies and consumer goods/services companies use Planalytics to “weatherize their business”, taking advantage of opportunities to increase revenue while deploying strategies to reduce costs and protect margins during periods of risk.

## About HRC Retail Advisory

HRC Retail Advisory (www.hrcadvisory.com) is a leading Retail Strategic Advisory firm that is exclusively focused on assisting retailers to more profitably compete. HRC Advisory has worked with more than 100 retail chain in all stages of the economic cycle, from highly profitable to struggling, has provided us with invaluable insight into the retail economic operating model, key levers of profitability as well as margin, cost and working capital needs. HRC has a reputation for agility, speed and working with a sense of urgency.

 