Retail inventory strategies at the time of Covid-19

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During the Coronavirus lockdown, retailers of all types have been struggling with their supply chain management strategies. Some have seen their inventory levels soar in the face of shop closures and a collapse in customer demand. Others, particularly in the grocery sector, have experienced high and/or erratic customer behaviour especially in advance of lockdowns which led to supply chains being 'emptied'. This increased the costs, especially those related to logistics, required to keep shelves stocked.

In order to meet these challenges, retailers have employed a mix of strategies. To reduce their financial exposure their approaches have included:

- Cancelling or postponing existing orders
- Use of secondary markets or 'factory stores' for marked down product
- Sales as soon as re-opening allowed
- 'Hibernating' stock for use in 2021
- Re-balancing operations to on-line.

Those retailers which already had a major online presence were obviously at an advantage to competitors which were solely store-based. Those which had the visibility and capability to fulfil on-line customer orders from their stores as well as warehouses performed even better still.

Retailers, under the circumstances, which have managed to achieve a successful inventory strategy for the Spring-Summer season, will also be in better shape to restock with new product for the upcoming Fall/ Autumn ranges. This will consolidate their position against retailers still trying to offload unsold goods throughout the season.

The grocery sector experienced different challenges due to high rather than lack of demand. Not only did they experience stockpiling behaviour by customers which placed stress on the supply chains of essential items but customers during the lockdown period started to shop less frequently and with a higher spend. The response of many retailers was to reduce their range of stock-keeping units (SKUs). This reduced supply chain complexity and increased manufacturing efficiency (for example higher fill rates) as well as making it easier and quicker for retailers to re-stock shelves. This is something that hard discounters (such as Lidl and Aldi) have understood for years.

In the longer term some retailers are already talking about near-sourcing strategies, if not already employed. Those with more flexible and agile supply chains (i.e. those able to react to changing market conditions the quickest) will come out of the pandemic the strongest.

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FASHION AND SPORTSWEAR

next

Next is a popular and successful fashion retailer in the UK. The company was forced to shut down its operations completely for a time as it judged staff were not able to work safely in its warehouses. These were opened back up from 14 April.

'The reduction in sales volumes has meant that we have a lot more stock in our warehouses than anticipated. This excess stock would have prevented the intake of new stock and inhibited ongoing operations. This problem has been addressed through the addition of third-party storage facilities in the UK and, in some cases, by holding stock in source countries. We estimate that the additional cost of these facilities in the current year will be in the region of £2m.'

Management cancelled stock that was no longer needed and identified stock it could carry over to future seasons. The retailer saved around £290m on stock purchases although it stressed that it had endeavoured to be fair to its suppliers by committing to pay them in full for orders that were due to leave supplier factories up to 10 April 2020. Orders due to leave supplier factories after this date were cancelled with compensation payments being made towards the raw materials that suppliers have already bought. Cancelled stock amounted to £450m; reduced future buy amounted to £510m. 15% of stock will be carried into Spring Summer 2021, although, of course, this will increase inventory and warehousing costs further.

adidas

Sports apparel brand and retailer, Adidas, was hit first by a closure of stores in Asia in February and then by subsequent stores in Europe and North America in March. Selling mainly through its own stores, it saw revenues drop by 58% in Greater China in the first quarter although e-commerce sales grew strongly – up over 50% in March. The company managed to reallocate some of its wholesale inventory to its e-commerce operation and it believes that this channel will be much more important in the future.

According to management, the company was impacted by a 'high-double-digit million euro' amount related to the cancellation of purchase orders from suppliers in Asia to adjust its inbound flow of inventories. It has followed a strategy of taking some orders whilst cancelling or postponing others. As with Next, a proportion of its spring-summer stock will be re-assigned to 2021. The majority of the remainder of its existing inventories will go through its factory store channels at a discount. This will leave the retailer with capacity to sell fresh stock for the upcoming seasons. The company believes that it will see a peak in its inventory in July.

INDITEX

Inditex, parent group of Zara and the largest fashion group in the world, closed 3,785 of its 7,200 stores as sales dropped 24% during the pandemic. Online sales accounted for just 14% of its total revenues in 2019 and although management are tight lipped on the impact of the crisis, its lack of e-commerce presence must have had severe implications.

The company booked an inventory provision of €287m to account for the impact that the pandemic could have on the net realisable value of its Spring/Summer inventory. Management stated that the company's supply chain continued to function normally, which it claimed demonstrated the flexibility of its business model.

Over the past two years the retailer has moved to a model which allows it to fulfil online customer orders from stores, which will have helped it to reduce inventory holdings. However, if a store is completely closed it is difficult to judge whether staff will have had access to the stock at all.

‘We continue believing very much in this fully integrated approach regarding stores and online. This is one of the key elements of our global strategy. Of course, once things come back to normality we will come back to this approach. What is very important for us is that in the different markets in which our stores are closed we continue offering our customers the possibility of buying our products online.’

GROCERY RETAILING

Overall, giant US retailer Wal-mart ended the quarter with inventory levels 8% lower year-on-year. However, within this picture, the company commented that there was a broad range of inventory levels; some higher than desired, some lower. This no doubt mirrored challenges in its category mix, with essential, lower margin items increasing in sales whilst volumes of higher margin goods, such as fashion, declined (down 14%). Even within higher value categories, however, there was disparity. The retailer saw increased demand for items such as electronics, networking, laptops and bicycles. These products had longer lead times (many being imported from Asia) and so suffered stock outs.

Management expanded, ‘We're working intensely to improve in stocks for high demand items and adjusting order volumes and taking markdowns on items that have moved more slowly. We expect the environment to stay quite volatile in the coming weeks and months.’

The UK’s largest retailer experienced considerable panic buying in March resulting in an uplift in sales of groceries of 30%. It commented that this resulted in some supply chains being ‘cleared’. Part of its response was to reduce the number of SKUs which it stocked commenting that they were, ‘…working closely with supplier partners to simplify our range to get more of the most popular products on shelves.’ Consumers, it added, had reverted to previous shopping habits, that is, doing a large weekly shop rather than more frequent trips.

Its e-retail operations grew very quickly during the crisis. It managed to increase on-line capacity by over 100% in the weeks after lockdown in the UK. In terms of its non-food products, Tesco launched a ‘50% off’ sale of fashion items during the lockdown in order to try and clear existing stock, although this was criticised in some quarters as it encouraged crowding of stores.

France’s leading international retailer Carrefour stated that there had been a change in buying behaviour after the initial stockpiling of dry groceries. There was a particularly pronounced contrast between food (+9.9% in Q1 2020 on a like-for-like basis) and non-food (-3.5% LFL). There was also a marked increase in food e-commerce sales (+45%) and in organic products (+30%). During the pandemic there was a move away from large hypermarkets to more local formats such as convenience stores. Also, consumers visited stores less often, but when they did, they spent more (a seemingly global trend). This would have implications for re-stocking and inventory management strategies. Like Tesco, it also rationalized its product range, allowing more efficient retailing and helping consumer goods manufacturers streamline their operations.

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DEPARTMENT STORES

NORDSTROM

Nordstrom is a major North American department store and faced many of the challenges presented by the Coronavirus: forced store closures (which make up two thirds of its sales) and falling customer demand.

Erik Nordstrom, Chief Executive Officer, commented, ‘With inventory as our biggest lever of flexibility, we reduced receipts by 30% during the first quarter, generated customer demand through increased marketing and promotions, and utilized our fulfillment capabilities to clear inventory held in our stores.’

The result of these actions led to a decrease in inventory levels of 25%. Management’s ‘single view’ of its inventory, by which it means that it has visibility of its stock whether in warehouse or store, allowed it to fulfil customer e-commerce orders from its shops. This was a major advantage over some other retailers who were forced to leave stock untouched in stores until the lockdown was lifted. This has also meant that competitors will be forced into large mark downs when markets re-open to sell off out-of-season products. Whilst Nordstrom has had the ability to fulfil from in-store for a decade, volumes of orders fulfilled in this way rose from 20% of the total to 50%.

Combined with this was the cancellation of many orders – receipts were down as much as 80% in April and May. Management have also been keen to stress that drawing down so heavily on existing inventory has allowed them to bring new products to market in the summer, rather than struggle to sell existing stock.

M&S

EST. 1884

With a high exposure to the fashion sector, predominantly UK retailer Marks & Spencer struggled throughout the crisis. Management stated, ‘…margins are likely to be severely impacted by the surplus of unsold seasonal stock and probable clearance activity in the marketplace.’

It commented that it was reducing its supply pipeline by over £100m and taking ‘extraordinary measures’ to hold over inventory especially clothing which it classed as ‘core’ product. As part of its focus on cost reduction, it has cut its logistics spend by £60m in its Clothing & Home division. Unsold stocks will impact severely on its cashflow position, leading it to draw down on UK government loans.

At its year end in 2020 (end of March), M&S was left with around £500m of Clothing & Home stock and had committed forward orders of £560m scheduled to arrive in the following six months. To address this excess of inventory, management said that it had cancelled late summer stock reducing forward commitment by £100m and carried forward £400m of year-round basic product, albeit creating a short-term increase in stock carrying levels.

Of the unsold seasonal stock, £200m worth will be ‘hibernated’ until Spring 2021 at secured storage facilities. The cost to the company of these steps was £145.3m reflecting the cumulative impact of the combined handling, clearance, hibernation and write-off of the ‘stock bulge’.

It has also taken other longer turn supply chain initiatives. A faster, ‘near-sourcing’ supply chain will be developed, to enable the test and re-order of seasonal fashion lines particularly for the online business. The range of product will be reduced and there will be a shift towards faster moving items. Finally, ‘longstanding issues’ with availability and waste in the Food supply chain will be addressed including the retailer’s contract and relationship with logistics service provider, Gist.

E-RETAILING

Although Amazon has seen significant volume increases, the challenges in meeting the demand came at a cost. The company said it would be spending $4 billion, its expected Q2 profits, on getting products to customers and staff safety throughout the crisis. The inventory held in its warehouses is a combination of its own and that of third party merchants using Amazon's Fulfilled by Amazon (FBA) service.

Some merchants using FBA had their inbound shipments suspended and shipping times extended and so have not been keen to re-stock through Amazon warehouses. Not being able to fulfil orders for FBA merchants effectively brought some companies' businesses to a standstill so it will be interesting to see whether as many will return to in-house operations in the future. Even by focusing resources on essential items, Amazon was forced to push out delivery days from 1 to 4. For non-essential items, delivery times were extended by several weeks in some cases.

What happened inside what used to be called the warehousing 'black box' is key to Amazon. As Brian Olsavsky, Amazon's CFO commented, 'It's really a combination of how long it takes to get things in stock, picked, packed and shipped. The shipping is still pretty fast and is still coming quickly. It's taking longer to get things into our warehouse and out of our warehouse. So that's really the challenge right now is to speed that up.'

CONCLUSION

Retailers played a key role in keeping consumers supplied throughout the crisis but this did not necessarily translate into profits, even for grocery stores. How well they performed relied on the retailing model which they employed; the type of goods they sold and the flexibility and effectiveness of their distribution channels. Those which had invested in omni-channel strategies were best placed whilst non-essential, store-based retailers struggled. Erratic consumer behaviour resulted in lumpy demand which made it difficult for retailers of all types to procure and supply goods efficiently and at low cost.

Many retailers will use the crisis as a catalyst for overhauling their supply chain strategies, both upstream and downstream. Unfortunately for some the crisis has been existential, especially those based in high streets and already struggling to compete against the likes of Amazon.

About Ti

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Ti is a leading UK-headquartered logistics and supply chain market research and analysis company providing:

- Supply Chain and Logistics Market Research Reports
- Global Supply Chain Intelligence (GSCi) online knowledge platform
- Consulting and Market Research projects
- Training, Conferences and Webinars.

Ti has acted as advisors to the World Economic Forum, World Bank, UN and European Commission as well as providing expert analysis to the world's leading manufacturers, retailers, banks, consultancies, shipping lines and logistics providers.

Expertise includes:

- Analysis of the corporate strategies of leading express, freight forwarding and logistics companies.
- Global usage and perception studies of shipper and logistics provider behaviour.
- Micro-economic analysis of key logistics segments: express, freight forwarding, road freight, contract logistics, warehousing, air cargo, shipping and e-commerce logistics.
- Analysis of supply chain strategies employed in industry vertical sectors: pharmaceutical, fashion, high tech, oil and gas, chemical, cold chain, automotive and retail.
- Market sizing and forecasts of key logistics segments.
- Intelligence on emerging markets logistics sectors in Asia, Africa, Latin America, Eastern Europe and Middle East.

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- More than fifteen years of knowledge delivery to global manufacturers, retailers, banks, consultancies, shipping lines and logistics providers
- Unique web-based intelligence portals
- On-going and comprehensive programmes of primary and secondary research