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Retailers experiment with ways to reduce excess inventory and manage logistics challenges

Article

The trend: Retailers are adopting multiple inventory management tactics—from keeping more stock on hand to SKU rationalization to leveraging predictive analytics—as they attempt to keep up with demand amid supply chain snarls and labor shortages.

More art than science: Because retailers rely heavily on the previous year's performance to plan future inventory needs, the rapid shifts in consumer behavior over the past two years have made it incredibly difficult for companies to predict what and how much they'll need to stock, and how soon they need to order.

- **In April, only 9% of shipments from Asia arrived on schedule in North America**, per eeSea data cited in The Wall Street Journal.
- That number ticked up to 11% this month, but it's still a far cry from the 59% on-time rate in May 2020, or even last year's 17% on-time rate.

Stocking up: The most common response to supply chain delays has been to stock up on inventory. But that approach has its costs, as retailers could get stuck with excess product that either spoils (if perishable) or has to be marked down, eating into profits.

- Both **Walmart** and **Target** cited **excess inventory as a drain on profits** in the first quarter, as shoppers prioritized grocery and experiential spending over other general merchandise categories.
- **Abercrombie and Fitch** CEO **Fran Horowitz** said on the company's most recent earnings call that the retailer used clearance sales to get rid of excess inventory caused by supply chain delays, which brought down overall profit margins in Q1.

Trimming down: Another popular tactic has been to **reduce the number of SKUs**, which enables brands to focus on producing items with high demand (or high profit margins) and make manufacturing more efficient.

- **Utz**'s CFO **Ajay Kataria** said on the Q1 earnings call that the company was continuing with "incremental and strategic SKU rationalization" as it seeks to **prioritize high-performing, high margin brands over lower-margin, private label products**.
- **DSW** has **reduced the number of brands it carries by 25%** since 2019, stocking mainly brands and products the company knows will perform well.
- While SKU rationalization makes sense from a production standpoint when resources are limited, brands do lose sales—and potentially customers—by phasing out SKUs, and must find opportunities to make up for those lost revenues.

Working smarter: As it becomes more difficult to use past behavior to model future sales, many retailers are turning to predictive analytics to provide additional insights.

- **Suzy Davidkhanian**, eMarketer principal analyst at Insider Intelligence, notes that predictive analytics enable retailers to understand what factors led to lost sales and how to avoid those same circumstances, as well as how best to match sales to forecasts.
- Some fashion retailers, like **Shein** and **Revolve**, are using data analysis to quickly ramp up production on styles that perform well and avoid spending on excess inventory.

Looking ahead: With delivery delays showing no signs of letting up, retailers have to strike a balancing act between having enough inventory on hand to meet customers' needs and taking into account how the possibility of a recession could impact consumer spending.

Cost Decreases Attributable to AI Use According to IT Professionals Worldwide, by Business Function, June 2021

% of respondents

	Decreased by less than 10%	Decreased by 10%-19%	Decreased more than or equal to 20%
Manufacturing	23%	27%	37%
Product and/or service development	22%	24%	23%
Marketing and sales	21%	35%	27%
Human resources	20%	26%	40%
Risk	17%	20%	41%
Service operations	12%	24%	51%
Supply chain management	15%	27%	36%
Strategy and corporate finance	10%	28%	30%
Total	**19%**	**28%**	**33%**

Note: among respondents whose organizations have adopted AI; cost decreases for fiscal year 2020
Source: McKinsey & Company, "The State of AI in 2021," Dec 8, 2021

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