CANCEL AND CHASE DOES NOT CUT IT ANYMORE

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BEST PRACTICES FOR INVENTORY MANAGEMENT

Retailing can be like gambling: retailers place bets on inventory investments long before the customer sees the product. As retailers gain new perspectives on consumers' increasingly changing tastes, they adjust their inventory commitments to manage their risks and maximize revenue. This adjustment process is often called "cancel and chase:" cancel orders for bad bets while chasing more inventory of goods ones. Retailers put a lot of chips on the table with their inventory investments; inventory is a large share of working capital and typically equivalent to 10-15% of Annual Sales(1), and managing this investment prudently is key to maintaining profitability and ensuring solvency.

Unfortunately, the typical "cancel and chase" playbook doesn't cut it anymore, and the COVID-19 crisis highlights the need for an updated approach. Retailers who "cancelled" as the world went into lockdown risked compromising their customer experience, supply chain and liquidity. Those who sought to "chase" as the world re-opened struggled to take delivery of key items due to a clogged supply chain. Instead, a cross-functional approach that brings in new partners to improve the retailer's inventory position, vendor relationships and liquidity forecasting is key to managing inventory. Adopting this approach is crucial for retailers to thrive in and out of a crisis.

BE SURGICAL WITH "CANCELLATIONS"

Customers dictate what they want and when they want it. Retailers will lose customers to competition if the right inventory is not accessible. While a sweeping cut to On Order and Open-to-Buy is the likely response to try to reduce inventory levels, a strategic and surgical approach is critical to maximize future Sales, Margin and ultimately, liquidity. Various functions can own revenue targets in a silo; however, it is essential that Merchandising, Planning, Sales and Finance work together to guide a demand-led approach that protects the assortment architecture and avoids changes that don't make sense in practice.

STOP SPECULATIVE INVENTORY BUYING.

Stop holding an abundance of extra inventory to give customers the option to "chase." This investment quickly becomes unsellable if customers don't replenish.

ADJUST SELL THRU AND TURN EXPECTATIONS.

Prepare for merchandise categories to experience shifts in consumer demand as a result of the crisis. This enables organizations to be mindful of liable inventory and maintain balance across the product pyramid.

LOOK TO THE FUTURE.

Use current trend and historical data to understand what customers will want tomorrow. Too often, retailers chase and spend open to buy dollars on what's trending now and don't have enough inventory dollars to support future seasonal demand. A best-selling pair of jeans in January won't displace the demand for shorts in June. Future inventory purchases need to support future consumer demand.

UNDERSTAND YOUR CHANNEL MIX.

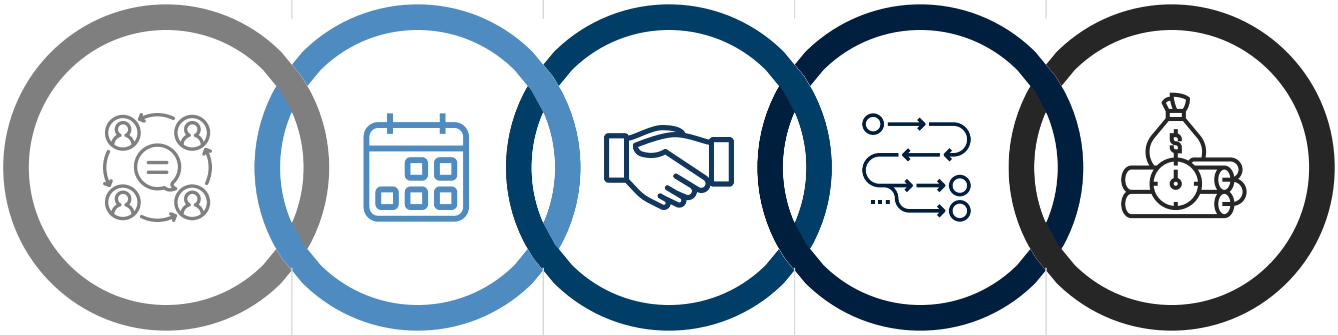
Ensure inventory can shift to the right channel and remain in the path of purchase with the customer. Be able to adjust quickly to demand in digital vs. brick and mortar.

OPTIMIZE AGED INVENTORY.

Liquidate aged inventory when it no longer factors into a company's Asset Based Loan (ABL) or borrowing base if it can generate quick cash. Replacing with new receipts that support the assortment architecture can be advantageous in terms of the borrowing base and support future sales. To generate liquidity – and avoid Bankruptcy – it takes a combination of liquidation and buying the "right" receipts. Turning "bad" inventory into sales and profit is a balancing act that includes inputs and processes from all cross-functional partners.

COLLABORATION ON INVENTORY THROUGHOUT THE SUPPLY CHAIN IS KEY

While a disruption in the supply chain is inevitable with any change in inventory, partnerships with suppliers are vital for short and long-term success. Create wins that are beneficial to you and your suppliers by leveraging your sourcing team's expertise. Retailers need suppliers just as much as suppliers need retailers.



INTERNAL COMMUNICATION

Ensure Sourcing and Procurement teams understand the strategy behind the change in Sales and inventory levels. Don't keep them in the dark and expect that they can manage the supply base.

CALENDAR MANAGEMENT

Work with internal partners and suppliers on time and action. The amount of flexibility is tied to calendar management.

VENDOR PARTNERSHIP

Be transparent with your vendors on the state of the business and work together on payable terms, discounts, and projected inventory levels.

PRODUCT FLOW

Partner with suppliers who can support inventory flow by holding goods or expediting goods depending on the need for inventory. This can lead to downstream benefits in terms of liquidity.

LIABILITIES

Work with your vendors to use liable goods if possible as cancellations will happen.

ENGAGE THE FINANCE TEAM TO STAY ON TOP OF ONGOING INVENTORY CHANGES

During a crisis, Finance teams often ramp up daily or weekly liquidity forecasting, which is only as accurate as the inputs Finance receives from the broader inventory management process. Aligning on these four touch points will allow the Finance team to provide product teams with actionable and insightful liquidity management:

DAILY / WEEKLY SALES.

Inform Finance of sales forecasts so that they have visibility into when cash will come in the door.

CUSTOMER COMPOSITION.

Align on the composition of customers who are generating the demand. This is crucial to forecasting liquidity as customers may have varying payment terms. Additionally, the Finance team may be able to borrow against certain customers' receivables.

VENDOR LEVEL PURCHASES.

Know vendor payment terms and lead times so that Finance can model cash-disbursements against vendor-level inventory flows.

INVENTORY COMPOSITION.

Forecast future inventory composition. Retailers often borrow against their inventory, and the amount they can draw is based on a detailed set of rules and calculations. For example, the Retailer may only be able to finance current inventory, with anything over 90 days old being ineligible.

REVISE YOUR PROCESS TODAY

Consumer demand and retail performance had been changing before COVID-19 and will continue to evolve after the pandemic. While the concept is not new to retailers, inventory management is a process and discipline that requires consistent strategy, execution, and revision. A&M's Consumer and Retail Group has proven results in helping retailers avoid the pitfalls that can damage their long-term profitability, and strengthen themselves through a better inventory position, improved vendor relationships and more accurate liquidity forecasting.   Adopting a strong inventory management process today is crucial for retailers to thrive as customers will continue to change with the world around them.

Sources

1. http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/wcdata.html

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