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Growing Demand for Local Products Impacts Inventory for Suppliers

By Randy Fields

Consumers have made it clear that they are looking for more local and specialty products in their supermarkets. This is the most recent – and perhaps most pronounced – phase in the evolution of consumer tastes and preferences. It is a trend that started reshaping supermarket inventories nearly 20 years ago.

As a result, more retailers are "localizing" inventories. This practice gives store management purchasing discretion on a portion of the inventory being sourced from local and smaller suppliers. Operators also believe that if consumers can find the local products they want at their local stores, and not on some big, national web site, they are in a stronger position to drive shopper loyalty.

Supermarket retailers trying to capitalize on this trend are also creating a competitive strategy against threats from online competitors like Amazon. According to the Food Marketing Institute's "2018 Industry Speaks" survey, 90 percent of participating supermarkets confirmed that expanding inventories to include more local and organic products is an important differentiation strategy.

This trend comes with operational and financial complications for both the retailer and its suppliers, however. Store inventories have ballooned from 7,000 SKUs 20 years ago to more than 40,000 SKUs today. And these levels continue to climb as companies embrace localization to protect their market share and profitability. Yet, localization just might hasten the death of certain banners, unless steps are taken to control the additional expense and lost sales that will almost certainly result from expanding SKU counts, increasing direct store deliveries (DSD) and causing a higher number of out-of-stock (OOS) items in stores.

It's well known that OOS not only continues to plague retailers and suppliers, but it is a problem that has surpassed $100 billion across the industry, according to Grocery Manufacturers Association (GMA) studies. Even after more than 20 years of research on the topic, companies continue to experience OOS in excess of 10 percent of sales, and as high as 13 to 15 percent for promotional items.

And things are about to get even worse, especially as retailers continue their shift toward carrying more local products. The two primary operational and financial forces that will cause the most strain include SKU proliferation and the growth of direct store delivery (DSD).

First, consider the impact SKU proliferation will have on stores. SKU counts have grown at a faster rate than sales, meaning stores are stocking more SKUs to generate the same level of sales. And with shelf space largely unchanged, the number of units on hand for each SKU – which represents the safety stock for that SKU – will need to be reduced. For these reasons, the expansion of SKUs will almost inevitably increase OOS and lost sales across the store, which will erode shopper loyalty.

How so, you may ask? It's a simple mathematical equation. The more complex the inventory, the harder it is to forecast. Expanding SKU counts will increase lost sales from OOS — unless steps are taken to improve forecasting.

Now let's look at the impact caused by the growth of DSD. It's safe to assume that most local suppliers will use DSD as their route to market rather than go through the warehouse or distribution center. With local suppliers using DSD for these new SKUs, retailers will face forecasting challenges, inventory complexity and additional expenses for check-ins at the store.

Left unchecked, local item inventory expansion will lead to a downward spiral of expense and shopper defection, two factors that may ultimately threaten the very existence of certain supermarket operators. That is not a good result for suppliers either. However, these detrimental situations can be avoided. By taking a few simple steps, companies can still reduce OOS, lost sales and operating expenses. Calculated efforts can even relieve pressure on the balance sheet, while enabling retailers to continue localizing store inventories. These steps include:

Improve Visibility for the DSD Supplier: When DSD suppliers gain visibility of sales and inventory trends at the SKU/store level, they can modify orders and deliveries to reduce OOS. This can be done dynamically each day, even at the route-level.

Automate Ordering: Many suppliers aren't equipped to forecast accurately, even if they have access to the critical data they need. Thus, the next step is to automate their ordering processes with tools designed to optimize forecast accuracy.

Convert Suppliers to Scan-based Trading: Scan-based Trading (SBT), a process where suppliers maintain ownership of inventory until items are scanned at the retailer's point of sale, is more attractive than ever. When suppliers convert to SBT, retailers get immediate balance sheet relief from their inventory carrying costs. Just as importantly, suppliers now have all the incentive they need to manage inventories for maximum return and sales performance.

The shift to more local products has the potential to negatively impact retailers and most – if not all – of their suppliers due to the issues associated with SKU proliferation and OOS. The key for trading partners is to coordinate their supply and demand chains more than ever before.

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