Will local products save supers — or kill them?

massmarketretailers.com/will-local-products-save-supers-or-kill-them/

By Randy Fields

August 19, 2019

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

In response to this emerging trend, more retailers are "localizing" inventories. This practice gives local store management purchasing discretion on up to 5% 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 website, they are in a stronger position to drive shopper loyalty.

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

But the process comes with operational and financial complications. 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 traditional supermarkets 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 (DSDs) and causing a higher number of out-of-stock (OOS) items in stores.

Out-of-Stocks Are a Bigger Problem Than Ever

It's well known that OOSs not only continue to plague retailers, but have surpassed $100 billion in costs across the industry, according to Grocery Manufacturers Association (GMA) studies. Even after more than 15 years of published research on the topic, retailers continue to experience OOSs in excess of 10% of sales, and as high as 13% to 15% for promotional items, GMA reported.

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.

First, consider the impact SKU proliferation will have on store success. SKU counts have grown at a faster rate than sales, which means 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 naturally need to be reduced.

For these reasons, the expansion of SKU counts in stores will inevitably increase OOSs and lost sales, both of which will erode shopper loyalty over time.

How so, you may ask? Well, it's a simple mathematical equation: The more complex the inventory, the harder it is to forecast. As a result, expanding SKU counts will absolutely increase lost sales from OOSs — 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 small, 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 delivery check-ins at the store. Meanwhile, more store labor will be required at the dock, with fewer hands needed in the aisles. Yet, both processes will impact the shopping experience negatively — at a time when most retailers are focused on improving the shopping experience.

The bottom line for retailers when they increase local items in inventory is that SKU proliferation means more complex forecasting challenges, which increases OOSs and lost sales, ultimately driving away even more shoppers. More expense and store labor requirements associated with DSD shipments erode profitability at a time when traditional retailers need cash flow to make big tech and facility investments. This will also adversely impact the shopping experience.

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.

However, these detrimental situations can be avoided. By taking a few simple steps, retailers can still reduce OOSs, 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 retailer and DSD supplier. When retailers and DSD suppliers gain visibility of sales and inventory trends at the SKU/store level, they can modify orders and deliveries to reduce OOSs. This can be done dynamically daily, even at the route level.

• Automate ordering. Most 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. When this happens, supply is better aligned to actual demand — a move that has helped retailers ReposiTrak has worked with increase sales by 3% to 10% across DSD categories.

• Convert more DSD suppliers to scan-based trading. Scan-based trading, a process where immediate balance sheet relief from their inventory carrying costs. Just as important, suppliers now have all the incentive they need to manage inventories for maximum return and sales performance.

The shift to more local products will either put traditional retailers on the road to competitive success or accelerate their demise — their path depends on how quickly they address the issues associated with SKU proliferation and OOSs.

Randy Fields is chairman and chief executive officer of Park City Group, a cloud-based software company specializing in data management, and a cofounder of ReposiTrak. He can be reached at randy@parkcitygroup.com.