



Looking for \$3 Million?

How managing inventory better can produce stunning results

By Angel Abcede || aabcede@cspnet.com

Phil Settle obsesses over the perfect order.

Not a utopian society, but what managers fill out to bring in the right mix of goods, brands and price points to turn notoriously thin c-store margins into ever-increasing, year-over-year profit.

For retailers such as Settle, the scan-in, scan-out daydream typically involves zero out-of-stocks; high-turn, high-margin

sales; and an uncluttered, relevant customer experience.

While perfection for most is a journey, Settle, director of marketing for the 172-store Flash Foods Inc., Waycross, Ga., is as close as he's ever been, and light-years ahead of most.

Where others track overall categories, Settle knows how many 2-liter Diet Pepsis, 12-ounce Cokes or king-sized Her-

shey's with almonds are in each store on any given day. There's no over-ordering in fear of running out, leaving shelves streamlined, clean and more profitable.

The differentiator for Flash Foods is item-level inventory. It's a method of accounting widely accepted in other industries that retailers are coming back to, spurred by declining gasoline and tobacco sales.

By comparison, most operators use retail-cost accounting as a way to value and track goods. As items come into the store, managers note categories and value boxes, cases and crates at retail price. They gauge that value against what's sold at the register. In contrast, item-level principles value goods at what the retailer paid vs. retail price and track each 2-liter bottle, single-serve soda and candy bar.

And Flash Foods' effort has freed up \$3 million from inventory.

Impressive, yes, but what's more surprising is how retailers such as Settle continue to stand on high ground over the competition, given most c-stores today scan at the register and technology overall is both cheaper and more powerful.

The truth is that item-level ordering presents another dynamic, forcing store-level staff to go from receiving in bulk to counting each item. While easy to imagine, the shift means new disciplines, retraining and change at all levels.

So while the perfect order may be every retailer's dream, most take a pass. Instead, many rely on sales and store-purchasing data, manufacturer-supplied reports and services (though biases may exist, some suppliers tout objectivity), instinct, or simply reordering what's run out, regardless of potential theft or shrink.

In a *CSP Daily News* survey, 38% of respondents said they employed item-level inventory. Another 7% said they

were in the process of rolling it out.

But Jenny Bullard, CIO of Flash Foods and a colleague of Settle's, says those numbers are probably high. When Bullard was a panelist last fall at a NACS workshop, the moderator asked the packed room of about 200 if they practiced item-level inventory. Only five hands went up.

"It's because people have different ideas of what it is," Bullard says, citing that some may scan items but still do retail-cost accounting, or do item level for only one category. At Flash Foods, item level covers the whole store. "There are very few of us who've done it the way we do it."

One technology provider, Temple, Texas-based PDI, says 5% to 10% of its customer base is at true item level, with a far larger group (a little less than half) having "site-level item inventory for key categories."

The financial and operational benefits are compelling. Here are numbers that Settle and other retailers, manufacturers and technology providers have seen:

- ▶ Inventory cuts of 10% to 25%.

- ▶ Sales increases of 1% to 3.5%.

- ▶ Out-of-stocks cut by 60% to as much as 90%, with one technology provider reporting an out-of-stock rate of less than 1% for its c-store clients. Typical industry out-of-stocks are 7%, the provider says.

- ▶ Return-rate cuts of 66%, says one retailer, with a newfound awareness of expiration dates, slow movers and other factors that lead to returns.

- ▶ Spoilage reduction of 30% to 50%.

Once the transition is complete, store managers won't need to walk the store filling out order sheets, says Melissa Hadley, retail solutions manager for The Pinnacle

Corp., Arlington, Texas. With items getting scanned in upon arrival, managers simply push a button and let the computer do the order. "The guesswork is removed, the right mix of products in the right quantities are ordered," she says, "and you end up with more of the products you do need and less of the ones you don't."

"It's a game changer," says Greg Gilkerson, president of PDI, pointing out that item-level adoption is a likely sign of forward-thinking retailers. "It's superior execution in all facets of the business. ... The candidates for item level are focused. They are typically the best operators and have a real appetite for information and know how to use it."

Item-Level Barriers

No one interviewed for this article disputes the power of item-level inventory.

► The Right Technology

To track an item-level inventory, Melissa Hadley of The Pinnacle Corp. says an enterprise software solution must have:



Home office

- ▶ Pricebook— The solution for maintaining the item catalog and facilitating POS scanning.
- ▶ Advanced merchandising strategies— These include promotions and combos and "mix-match," as well as provide for operational control for linked items and restrictions on sales, age, day-part and tender.
- ▶ Loyalty solutions and business intelligence systems can also play an important role in item-level inventory goals.



Store Level

- ▶ Back office— The solution managers use to reconcile daily paperwork for sales and cash, fuel inventory and merchandise inventory.
- ▶ Computer assisted ordering—A solution that uses the transaction sales data to generate store orders.
- ▶ A POS that can scan items and provide the back office system with the transaction data to support item level.
- ▶ Hand-held inventory management solutions that allow for receiving merchandise into the store by item and the ability to audit the data on a routine basis.

Item-Level Tips

Here's a short list of benefits as well as challenges of item-level inventory:

Benefits:

- ▶ Reduced inventory, freed up cash and just-in-time retailing
- ▶ Elimination of markup, markdown tracking
- ▶ Reduced register adjustments and chance for abuse
- ▶ Better foodservice accounting and ingredient tracking or "menu explosion" capability
- ▶ Turn tracking
- ▶ Electronic replenishment

Challenges:

- ▶ More complicated auditing or counting processes
- ▶ The need for a detail-oriented culture
- ▶ DSD vendors unable to give timely invoices electronically
- ▶ Operational "buy-in," with false perceptions of labor and workload requirements
- ▶ Time-sensitive data entry that, if not done, can throw off reports, invoices and orders

Sources: PDI, The Pinnacle Corp.

It's the optimal solution for understanding what sells and what doesn't. It's key to having "the right stuff."

"Item level is not an easy thing to take on in any organization," says Jay Dempsey, manager of merchandise technology for Love's Travel Stops and Country Stores, Oklahoma City. "It starts with how effective you are at site level in ordering merchandise, getting it in and processing the paperwork efficiently."

Dempsey is implementing item-level replenishment, working toward item-level inventory at the chain's 285 stores and considering it a multi-year process. He describes the problem as moving from one routine to a more rigid one. That transition gets more complex the more stores, employees and supplier partners involved.

That extra level of discipline, Hadley of Pinnacle agrees, represents the greatest barrier for most operators: "[It's the] cultural shifts that need to take place in order to make these new additions a success."

With item level, store managers have to count and scan items coming into the store, as well as produce reports and reorders by set times of the day or week. Cashiers have to scan everything individually instead of hitting the "multiply" key for products in the same category with the same price, and account for anything damaged or lost. Pricebook managers have stricter deadlines. And vendors must be automated, timely and in sync.

At any point, things can derail, with issues including lack of executive-level support, departmental discord, technology costs and resistance at the store level.

Change comes easier when operations is able to hire from the likes of Wal-Mart and Home Depot, companies that prioritize detail. "They're already used to doing things with a major focus on item level," Dempsey says.

That outside perspective, combined with strong support from the chain's owners, was pivotal for PAJCO Inc. The Cape Girardeau, Mo.-based retailer of 30 stores got into item-level inventory in 2006, partly because key executives came from finance, medical supply and manufacturing fields, where cost tracking and item-level detail were priorities.

"In manufacturing, we tracked down [products] to the minute detail," says Duane Statler, PAJCO's vice president of information management. "We produced millions of an item [at low margin], so everything squeezed out meant more to the bottom line."

Many Drivers, One Car

With c-stores, item level is often an afterthought because of limited staffing. Dempsey of Love's says different departments have different motivations, vying for a specific benefit without realizing the need for one piece: item-level inventory.

For buyers and category managers, "it's all about improving in-stock conditions, replenishment and invoice validation," he says. "For accounting, it's about inventory valuation. And for operations it's all these things, but more so visibility into what shrink might be and better control over how to keep [theft down]."

From a global perspective, European retailers tend to be more financially driven, wanting item level to more accurately value inventory, according to Uri Bettesh, head of merchandising products for Retailix, Plano, Texas. "In the U.S., it's the opposite," he says, citing a decidedly U.S. focus on product movement. "They think: I need to go to demand-driven replenishment, so I need item level."

But having underlying motivations doesn't always lead companies to item level. Bullard of Flash Foods says companies may have a goal of scanning items into the store to better manage inventory, but don't take it into their books. Some have gotten only part of the way, falling victim to failed implementation.

Step by Step

Chains that have achieved high levels of item-level inventory adopt other, similar steps, with automating the ordering process being first. Flash Foods started with cigarettes back in 2000, with a category rollout in 2005. At the time, it cut \$1.4 million in slow-moving inventory and return reduction.

The work in that category uncovered

► Foodservice Twist

From an item-level perspective, the industry bugaboo of foodservice may make for strange bedfellows. For years, retailers have yearned to excel in the high-margin category only to have their own zero-waste, packaged-goods mindset drag them back to reality.

"We found retail [cost accounting] detrimental to roller grills," says Catherine Porter, senior manager of customer marketing for convenience stores for Sara Lee Foodservice, Downers Grove, Ill. "If you throw out two hot dogs, you're assuming a lost sale of \$1.11 per hot dog. But you didn't throw away the condiments or the bun."

Item level provides a better measure for profit and doesn't penalize stores for shrink that doesn't exist. That said, shrink will never go away. "No one's going to buy the last, sad hot dog on the grill," she says. "You can minimize what you're throwing away, but if shrink is at zero, you're not selling as much as you could."

inefficiencies in their manual processes as well. "Anyone manually ordering doesn't take the time to figure out what's selling," Settle says.

With ardent support from the chain's owners, employees spent 2006 to 2007 developing systems and then started their rollout. Some of the steps included:

- ▶ Working with their technology provider, The Pinnacle Corp., to access and augment item-level software.

- ▶ Training in-house auditors on scanning and inventory taking.

- ▶ Making sure the pricebook was correct, accurate and in sync with vendors. What helped in Flash Foods' case was having its own warehouse, which pared down the number of vendor connections required.

- ▶ Manipulating variables within the software to obtain the best order.

An initial consequence was a "significant" amount of overstated inventory. "I bring it up because taking that adjustment could be a factor in your decision to move to item level," he says. "It can hit the [profit and loss] area."

Of course, the path chains follow will differ. For Dempsey of Love's, engaging the chain's many suppliers is his biggest challenge. "You have to be tied electronically to suppliers to be able to do electronic purchase orders and

receive advanced shipment notifications (ASNs)," he says. "The data needs to be in sync at all levels to flow smoothly."

Culture Wars

For retailers considering item level, buy-in is critical. For Flash Foods, that meant an interdepartmental task force, constant communication and weekly meetings. Settle spent a lot of time with vendors and suppliers, and Bullard worked on the technology end.

In the field, the biggest hurdle was trust. One recurring issue was minimum display quantities. Typically, managers need a minimum quantity of any given product on hand. The software would tell them one thing, but their instincts told them another.

"You wouldn't believe the number of times we had to explain the system," Bullard says. "People didn't trust the technology."

Sometimes change meant doing nothing. Take markdowns, for example. Bullard says retail-cost accounting required systems to track any promotional markdowns, or employees to write notes as they sold those items. If they didn't, the end-of-day retail inventory value would be off by the discount.

With item level, retailers go by the cost of the goods, so noting markdowns or

markups isn't necessary. "Cashiers were so engrained at looking at retail price," Settle says. "We had to get them to stop worrying about selling at the right price and, instead, focus on receiving at the correct cost."

Item level often cuts complexities that could be costing money, Gilkerson says. For instance, tracking markdowns on cigarette cartons—the store's highest-cost items—is a "confusing area to get right," even with automation, he says: "Those steps are not needed with item level."

Other things that go away are stockpiles of boxes in the back room, Settle says. Statler of PAJCO agrees, saying he can tell when a store does item level: "It's just a cleaner look."

But to succeed, employees need to own the process. "If I see that product is damaged, I cannot throw it into the return area or in the garbage," says Bettesh of Retailix. "I need to tell the system that it is out and take [the count] one unit down."

They need to know their actions or inactions affect store audits, Bettesh says. "Even when you take an item and put it on an endcap, you did something," he says. "Even though your total is in balance, the plan-o-gram [program] needs to know."

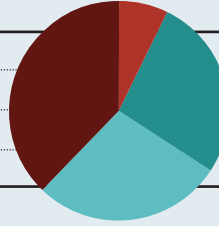
That commitment leads to store-level "readiness," says Ann Marie O'Connor, director of retail for RedPrairie, Alpharetta, Ga. Most recently, the software provider has focused on readiness in its solutions. "As an example, when you have a big promotion, how do you know the products are there, available and on time?" she says. "It's about the flow-through of product—associate awareness, managing shrink, rebates and ensuring products and [point-of-purchase] materials are set."

Item-Level Movement

A little less than half of the retailers responding to a *CSP Daily News* poll in November said they have or are implementing item-level inventory. But definitions of item level and how pervasive its use through the store may pare down these numbers.

Do you currently have item-level inventory in place?

● Yes	38%
● Yes, we're rolling out right now	7%
● No, but we're looking at it	27%
● No	28%



Source: *CSP Daily News* poll. Based on 45 respondents.

Hard, Soft Costs

Determining cost for item level is difficult. Providers have different pricing models, costs rise depending on software features, and larger chains can leverage scale to reduce per-store costs.

Retailers and suppliers interviewed say a low-level pricebook solution can run about \$5,000. A midtier with item-level inventory may run in the range of \$5,000

to \$10,000. To develop a system from scratch, one retailer guesses \$200,000.

Many providers use a licensing model, with upgrades coming over time. Some of them are free, some not. Others charge a per-store ongoing fee.

The scan-in element means software and the hand-held device, which combined can cost \$2,100 per site plus training.

So for many, cost is a barrier. Chris

Kiernan, director of retail applications for ADD Systems Inc., Flanders, N.J., recalls one customer saying, "Everyone is looking to make money off me and margins are so short ..."

"[Retailers] want to manage on a more detailed level," Kiernan says. "But without item level, you can't do that."

Time is also an expense. For instance, cleaning the current catalog file of inactive items—items in the system but not in the store, items not sold in the last 26 weeks—have to be removed, possibly taking an entire month, says Bettesh of Retailix.

Dempsey of Love's says pricebook maintenance becomes more of a challenge because of "the intensity in the level of data integrity and amount of timely detail needed to maintain ... item level."

The intensity trickles down. For Love's, the HR department, along with divisional marketing managers, had to develop item-management curriculums and extend training periods. For Flash Foods, the auditing time doubled, which resulted in the doubling of auditors.

In considering manpower, Bettesh recommends creating an analyst's position. "Now that you have real-time data, it's beneficial to analyze and find the root cause of [any] anomalies," he says.

Supplier Help

Retailers reluctant to make the item-level leap have options. Suppliers and wholesalers for years have offered retailers tools, plan-o-grams and customized reports, but bias remains a concern.

Last August, Minneapolis-based General Mills Convenience launched a new website (generalmillsconvenience.com) to educate retailers about category management and provide reporting applications they could populate with their own sales data.

“We’ve built an objective tool that empowers retailers to make decisions,” says Drew Helmey, associate channel marketing manager for General Mills. “Our product might be No. 5, and that’s OK. It’s up to us to make that better. We first want to contribute to the health of the category.” The website offers tools that can bring geographic and competitive metrics into play, assessing unit and dollar sales and turns.

Retailers have other options on this front. The “Grow My Store” section of kelloggsconvenience.com offers planograms based on category and space needs, says Lisa Costigan, business unit manager for convenience for Kellogg Co., Battle Creek, Mich. Also, profit calculators allow retailers to input their store’s velocity for each Kellogg product and see potential weekly, monthly and annual profit.

By looking at labor, space-to-sales and other factors, Terry Holshouser, director of category strategy and insights for The Hershey Co., Hershey, Pa., says his company works with retailers to understand “true” costs.

What shocks retailers most is what they’re missing out on, says Kelly Fulford, category development manager for General Mills. “We provide a dollar-opportunity calculation, so if you ... delete lower-performing items, it shows you what’s going to happen with sales,” she says. “It’s eye-opening to see missed opportunity.”

The data often leads to dramatic changes at the store, says Paul Metko, president of Convenience Store Automation Inc., Appleton, Wis. When retailers realize that coolers take up 10% to 15% of floor space but account for 50% of sales, they start thinking more coolers, fewer gondolas, he says.

It also sheds light on day-part effects and product placement. “Get gondolas

with wheels,” he says. “You can move products around during the day to where they sell better.”

The result is better decisions, says Gilk-

erson: “You’ll have new loss-prevention figures, customer-loyalty reporting, operational metrics based on time and item-level detail you couldn’t see before.” ■