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Wal-Mart's Inventory Deload* and Project Remix** Initiatives are the New Imperatives for 21st Century Retailing

by Bill Bishop

The Benefit

Traditionally, most successful retailers focused on increasing sales and market share in an effort to improve financial results. But now, their focus is expanding to include asset turnover, which will impact manufacturers/suppliers as well as other retailers.

Wal-Mart's bold Inventory Deload and Remix initiatives highlight what is now expected to be the focus of a growing number of successful retailers, i.e., improving asset utilization/turnover.

This issue of *Competitive Edge* looks at the issues and implications of these new Wal-Mart initiatives.

Wal-Mart has consistently demonstrated a willingness to innovate and a commitment to strong financial performance; however, their recent stock performance indicates that more innovation is necessary.

We believe that the recent Inventory Deload and Project Remix initiatives represent a broad-scale, innovative effort that along with their new marketing focus, are the keys to Wal-Mart improving their future financial performance.

These initiatives are also important because they signal a shift in how retailers drive results. There are broad implications—not just for Wal-Mart suppliers but for the entire marketing channel for food and other consumable goods.

**Deload is a broad-based effort to reduce inventory levels at both distribution center and store. Evidently, the goal is to reduce the working capital requirement and increase asset turnover.*

***Project Remix focuses on the sales velocity of individual SKUs, with dual goals: a) rationalizing assortment by eliminating low- to non-contributing SKUs, and; b) reducing distribution costs and improving service levels by segmenting fast- and slow-moving SKUs into different distribution systems. The ultimate goal is to increase inventory holding power and, at the same time, get product out of the backroom and onto the shelf more quickly and efficiently.*

Understanding what Triggered These Initiatives

There's little question that Wal-Mart senior management hasn't been satisfied with the company's overall performance and are now focusing on strengthening their value proposition while maintaining their low-cost leadership.

While this is easier said than done, it's clear that there's one area of significant potential for reducing costs and freeing up working capital and that's in inventory, i.e., the biggest asset on the balance sheet of most retailers. Wal-Mart's inventory levels appear to have been creeping up. Until recently inventory investment is estimated to have been growing at a rate very close to sales increases, i.e., twice as fast as had been planned.

Expanding the Efforts to Improve Financial Results

The long-standing DuPont Formula provides a simple yet useful backdrop for understanding why Wal-Mart and a growing number of retailers are focusing directly on asset turnover.

DuPont Formula

$$\underset{\textbf{Profit Margin}}{\frac{\text{Profit}}{\text{Sales}}} \times \underset{\textbf{Asset Turnover}}{\frac{\text{Sales}}{\text{Assets}}} = \underset{\textbf{Return on Assets}}{\frac{\text{Profit}}{\text{Assets}}}$$

Traditionally, retailers have used increased sales to improve profitability. The DuPont Formula shows that sales growth benefits performance in two ways:

- Increased profit dollars
- Higher asset turnover

As sales gains have become more difficult to achieve, however, retailers have worked directly on either profit margin or asset turnover. Normally, the first place to turn is the profit margin where strategies to reduce operating and purchase costs are favored.

Wal-Mart's initiatives, however, signal increased attention on asset turnover, and this is new. In fact, asset turnover isn't usually the focus except when a new type of retailer enters the market. For example, both limited-assortment stores and warehouse clubs have very different asset-turnover ratios than do traditional retailers.

Calling Out the Challenges

The logic of Wal-Mart's initiatives is hard to argue with, but there are two questions which must be answered in practice if they're to be successful.

- How will these initiatives impact the shopping experience? Specifically, what will the impact be on the:
    - Perceived variety offered in Wal-Mart stores?
    - Level of out-of-stocks experienced by Wal-Mart shoppers?

  While localization efforts such as the store of the community should, in principle, help answer both of these questions, it won't be easy, and great execution will be required.

- Does Wal-Mart have the management, processes, IT systems, and collaborative relationships in place to successfully execute these new strategies? It would be dangerous to assume that they don't, but only time will tell.

Wal-Mart undoubtedly also recognizes challenges, and companies supplying Wal-Mart will want to address them in their plans.

What Will This Mean for Manufacturers/Suppliers?

Space here doesn't permit a complete discussion of the full impact of these initiatives, but it does provide an opportunity to point out where they will have the greatest impact on manufacturer/suppliers in terms of changes affecting their products both at the shelf and in the backroom.

The Shelf

Considering all the factors at work in these two major initiatives, it makes sense to start at ground zero, i.e., shelf assortment and inventory, where it is expected that a number of low-/non-performing SKUs will be eliminated and the space used to expand the holding power for faster-moving items.

These changes at the shelf should have several significant benefits for shoppers:

- Less inconvenience/dissatisfaction from out-of-stocks.
- Greater shoppability because it'll be easier to locate items on the shelf.
- Faster access to new items because of accelerated speed to shelf.

There may be, however, a significant disadvantage for shoppers, i.e., they probably won't be able to buy as many unique items at Wal-Mart and, as a result will have to visit other stores. Of course, assortment can—and likely will—be augmented to reduce this negative by using supplementary means, e.g., specialty distributors, to support the concept of the community and adding variety, but it can also lead to issues of control and higher costs. But, this doesn't appear to be a corporate Wal-Mart priority at this time.

For manufacturers selling through Wal-Mart's own distribution system:

- Fast-turning products will benefit from these changes through:
  - A lower-cost distribution system.
  - Reduced out-of-stocks and resulting increased sales.
- Slow-moving items will shift to higher-cost distribution and probably experience some delisting of their items.

Direct store delivery suppliers will:

- Benefit when their direct store delivery systems can build the assortment and inventory levels anticipated by Wal-Mart on a store-by-store basis.
- Come under increasing pressure if they cannot duplicate or exceed the new assortment/inventory expectations.

Implications – All of this holds three implications for manufacturers/suppliers:

- ***Every item must contribute to retailer profitability*** – Maintaining an item in distribution will increasingly depend on the performance of that item.
  - Some complementary items will ultimately get credit as transaction-builders, but in the last analysis, each item must pay its own way.
  - This means that new items must be designed, tested, and priced to accomplish this goal.
- ***Case packs must align with sales velocity*** – Store-level order quantities become much more important, and while the segregation of products into fast-/slow-moving distribution systems will help, there will be increasing pressure for manufacturers to adjust case-pack quantity to provide a more appropriate "days of supply" on the shelf.
- ***Stocking labor must be reduced*** – Display-ready cases will be more important in this environment, and there will be a need to design pallets and modules to increase the likelihood that all of this product can be moved to the display floor and that there will be little or no back-stock (which increases retailer handling and facility costs).

All suppliers will ultimately have to deal with the fact that there's a financial advantage that accrues to retailers—for a range of different reasons—when they don't pay for the products until they've sold them to the consumer and, as a result, have no inventory investment.

Traditionally, this has been done through terms and it will continue to be so. But scan-based trading appears to be another way for retailers to more quickly reach this goal.

The Backroom

The impact in the backroom is likely to receive less attention but will still be significant. We expect that these initiatives will cause Wal-Mart—and ultimately other retailers—to look for ways to reduce backroom inventory as well as backroom space.

From the retailer's point of view, these assets are not productive, and if they could be eliminated, they would immediately affect asset turnover and, in turn, improve financial results. And, all of this occurs before the retailer accounts for the reduced labor and increased product damage caused by a full backroom.

For shoppers, this will mean that more of the inventory in the store will be on the display floor, which should help reduce dissatisfaction from out-of-stocks and make it easier to find many products. At the same time, the store may have a less "finished feel" since the display area is now also serving as a storage area.

Implications – The implications for suppliers depend on whether the product moves through the warehouse or is through direct store delivery.

- ***Computer-aided ordering will become more important*** – For products moving through the warehouse, it's likely that Wal-Mart will depend even more on computer-aided ordering to integrate these "last few feet" of product handling into the supply chain, which will increase the importance of:

  - The scannability and accuracy of the product labels.
  - The synchronization of data in the master files.

  This will also focus more attention on case pack, since it will tend to determine the days of supply on the shelf in a computer-aided environment.

- ***Conditions for check-in will become more challenging*** – For product coming through direct store delivery, the changes impacting the backroom may have significantly more important implications.

  All direct store delivery suppliers requiring detailed check-in are likely to see the physical space available for check-in shrink. This means:

  - The check-in process is likely to take more time and be less efficient.
  - There will be even greater advantage to being able to "opt out" of the detailed check-in and move to some form of honor check-in, check-in based on advanced shipping notices, and perhaps even scan-based trading.

- ***Pressure to reduce back-stock will increase*** – Direct store delivery suppliers of fast-moving and/or bulky products that require back-stock that's pulled forward by merchandisers between deliveries will eventually feel pressure to reduce that back-stock, which in turn will dictate significant changes in the behavior of their supply chain and the positioning of inventory in the store.

Next Steps

As Wal-Mart and other retailers focus more attention on increasing asset utilization/turnover, there will be a need for manufacturers and other suppliers to revisit their supply chain strategies to ensure that they have the capability to create value all the way to the shelf.

Willard Bishop has helped manufacturers selling product through both warehouse an direct store delivery understand how to get the most out of their retail resources and can help you plan a course of action that addresses the asset swings that are likely to take place in the coming years.

We can help you model the financial implications and develop a strategy to realign balance sheet objectives. For more information on how we can help, please contact Paul Weitzel at (847) 756-3717, paul.weitzel@willardbishop.com.

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