

Inventory Counting Practices in the Retail Segment



PCG Solutions, Inc.

PCG Solutions, Inc. is a training, education, and consulting firm focused on retail loss prevention and assets protection. The company was founded in 2002 by Walter E. Palmer, a recognized leader in retail loss prevention. We combine unparalleled industry experience, science-based learning, and extensive research on the industry's most pressing issues, PCG Solutions collaborates with clients to help them better contribute to their organization's bottom line.

Our consulting division uses a structured program assessment to measure company performance in key process areas and identifies improvement opportunities. In addition to program assessment, we also work with retailers in defining strategic approaches to loss prevention that best fit their needs and context; in addressing specific projects or issues; and in providing retainer-based consulting on policy, procedures, and programs.

Our training and awareness solutions focus on retail loss prevention strategies that are designed to meet the challenges of improving execution, reducing losses, and mitigating risk and liability exposures. We deliver effective awareness campaigns with cutting-edge originality and graphic design and employ technology such as e-learning, web-based tracking, and DVD video.

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Chris Richardson is the Vice-President of Operations for PCG Solutions, Inc. In this role, Chris leads the company in project execution, logistical planning, and client support. He also coordinates our benchmark surveys and industry reports. He has over twelve years of experience in loss prevention in the retail and lodging industry. He is an active member of ASIS International and serves as a Vice-Chairman for the Academic Programs in Colleges and Universities Council.

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Introduction

If you were to ask most senior retail executives, “What is the single most important measure of the success or failure of your company’s loss prevention efforts?” the answer you would likely hear is, “Our shrinkage results.” This would not be surprising as shrinkage results affect company profitability, shareholder return, incentive and bonus plans, and resource allocation decisions in most retail organizations.

Therefore, it is a reasonable undertaking to pursue how companies measure this important metric, how often they measure it, and whether this number can be predicted and tracked throughout the year. This paper summarizes the results of a benchmark survey that focused primarily on the frequency of inventory counting and how the count was conducted.

Purpose and Approach

The purpose of this survey was to benchmark retailers’ current physical inventory processes as they relate to the frequency of inventory counting and whether counts are conducted using proprietary personnel or through use of an outside agency. This survey was conducted in July 2007 and involved 15 U.S.-based organizations comprised of eight hard line specialty retailers and seven soft line specialty retailers. The companies ranged in store count from 350 locations to over 4,000 locations and represent over \$132 billion in annual sales in the aggregate. No mass merchandisers, department stores, or grocery chains were in the sample group.

The survey was conducted by interviewing senior-level loss prevention executives within each organization. This allowed for discussion that provided further detail and insight into the participants’ responses.

Survey Results

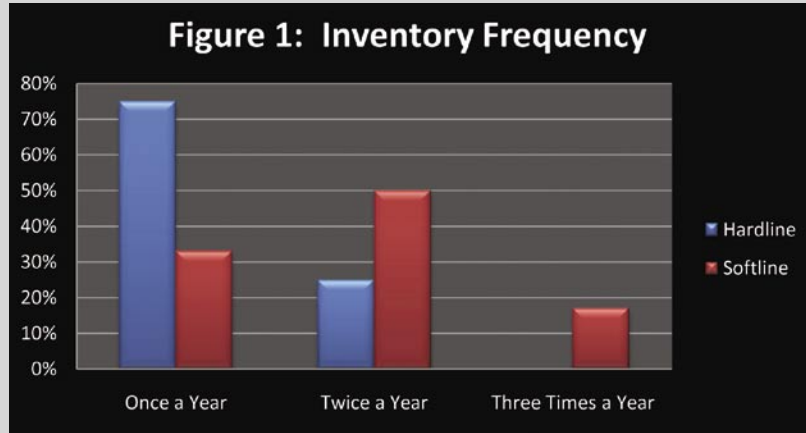
We will present the questions asked of each organization, the responses they gave, any rationale they gave for their approach, and some commentary on the results from an outside perspective. We have broken down the results tables by hard line versus soft line retailers to explore whether different operating formats beget different inventory counting processes.

How often do you conduct physical inventory in each location during your fiscal year?

This question simply seeks to answer how often, as a general rule, physical inventory counting is done in each location throughout the year. It is notable that hard line retailers overwhelmingly depend on one count per year whereas soft line retailers conduct physical inventory, on average, twice a year.

However, this disparity may be somewhat balanced by the different approaches each segment takes toward interim inventory counts (see Figure 4, page 5).

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Are any groups of subset stores counted more frequently?

Whereas the previous question examined the general rule for any one location, this question sought to determine if there were processes in place to count certain stores more often. Overwhelmingly, both hard line and soft line retailers used second counts as a means for following up to initial inventory results. The rationale most often cited by the participants was to conduct follow up inventory counts in their “target” or high shrink locations.

“If a store’s inventory is off by a pre-determined percentage, it is recounted,” was a comment reflective of most respondents. As for the actual selection of stores to be recounted, one of the largest retailers surveyed explained that the subset store selection was a cooperative effort between Inventory Control, Store Operations, and Loss Prevention.



Do you conduct “wave” or “snapshot” inventory counts?

Nearly 90 percent of the respondents conducted their inventory using a snapshot method as the primary approach.

Those retailers who utilize snapshot inventories cited the ease of inventory cut-offs for receiving, shipping, markdowns, and promotional events.

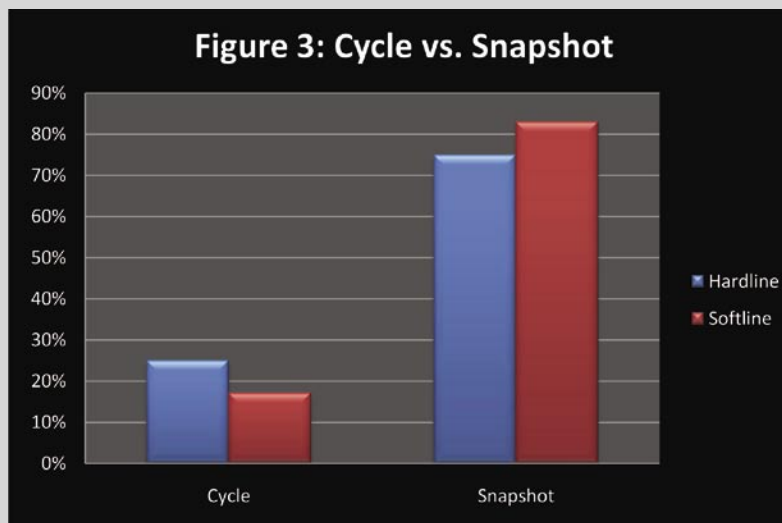
Before giving the responses, there is a need to clarify the terminology we have used on this question. Originally, we asked if the participants were using cycle inventories or snapshot inventories. We used the term “snapshot” to refer to the common practice of taking physical inventory counts in all stores at approximately the same time. This is often done near the end of the fiscal year such as January or June

Use of the term “cycle inventories,” was meant to reflect the practice of taking the physical inventory count of the store all at one time, but splitting the total stores up so that a certain percentage of the stores were conducted in each “cycle.” Some retailers use this method and take several “cycles” of counts throughout the year. However, we have changed our terminology to refer to this methodology as “wave” inventories.

We made this change to allow for the practice of true cycle counts. By this, we mean the practice of counting inventory throughout the year in a store by counting certain sections on periodic basis. Theoretically, this could completely eliminate the need for an inventory where the entire store is counted at one time. We are not aware of anyone who is doing this as the primary means of inventory reconciliation at this time, but this is not an uncommon practice in distribution and warehouse environments.

According to the above terms, here are the responses to the question:

Nearly 90 percent of the respondents conducted their inventory using a snapshot method as the primary approach. The few retailers that utilize a wave method determine their waves by spreading the number of stores counted each month on a proportional basis, e.g. counts $\frac{1}{12}$ of their stores each month. One retailer actually conducts wave inventories throughout the year and then does a snapshot inventory at year-end.



The different approaches each have some unique pros and cons. Those retailers who utilize snapshot inventories cite the following benefits:

- Ability to synchronize shrink results for entire chain for purposes of performance appraisals, bonus payouts, target store selection, and other operational programs.
- Clear “apples to apples” comparisons from year to year without timing issues.
- Allows entire company to treat physical inventory counts as an “event” where there is greater attention to store preparation, training sessions, management attention, etc.
- Ease of inventory cut-offs for receiving, shipping, markdowns, and promotional events which allows for cleaner inventory reconciliation.

Retailers who utilize wave inventories cite the ability to adjust inventory schedules to accomplish various goals.

Those retailers who utilize wave inventories cite the following benefits:

- On-going measurement of shrinkage performance to allow for adjustments to financial accruals throughout the year, i.e. no “surprise” at year-end.
- Regular reporting of results keeps management’s attention on the issue of shrinkage as opposed to it being a once a year concern.
- Ability to adjust inventory schedules to accomplish various goals. For instance, inventory in higher shrinkage stores can be taken earlier in the year to get a worst-case scenario.”
- Greater management coverage and supervision of inventories since a District Manager can attend each location’s inventory which is impossible to do if all stores are being counted at roughly the same time.
- Lower average inventory service costs since rates are higher during peak counting periods such as January or June.

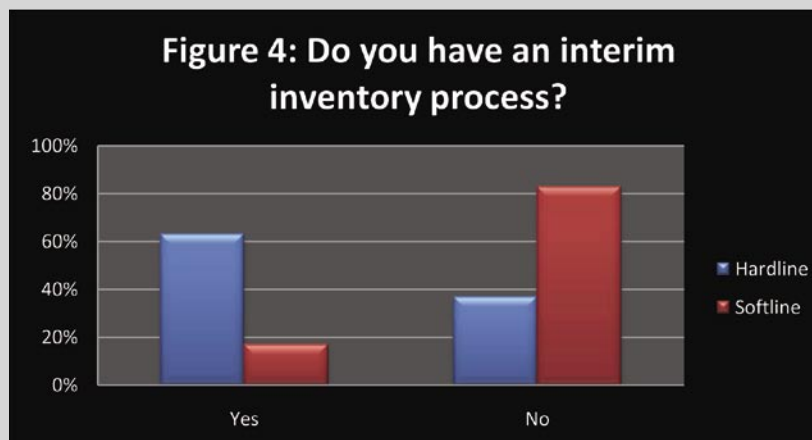
Do you have an interim count process in place?

Over half of all respondents do not conduct interim inventories. However, there is great variance when examining the results by segment. Hardline retailers are much more likely to have an interim counting process in place. This may partially explain why softline retailers are more likely to take multiple inventories in each location (see Figure 1, page 3).

The other factor that may be operating here is the “fashion” orientation of many softline retailers. While hardline retailers generally have many items that are on a replenishment schedule from their warehouse, many softline and apparel retailers are “flow through” operations where an entire seasonal fashion line might be shipped to stores and when it is gone, there is no replenishment as the merchants have moved on to another fashion look or season.

Therefore, there is not much demand from a merchandise replenishment or buyer perspective to get updated inventory counts on that merchandise. However, a hardline retailer may find this information critical not only from a shrinkage perspective, but, as importantly, for the ability to have accurate perpetual inventory counts for replenishment and promotional purposes. This may be one of the operational drivers for the segment variance we see in these responses.

Hardline retailers are much more likely to have an interim counting process in place than softline.

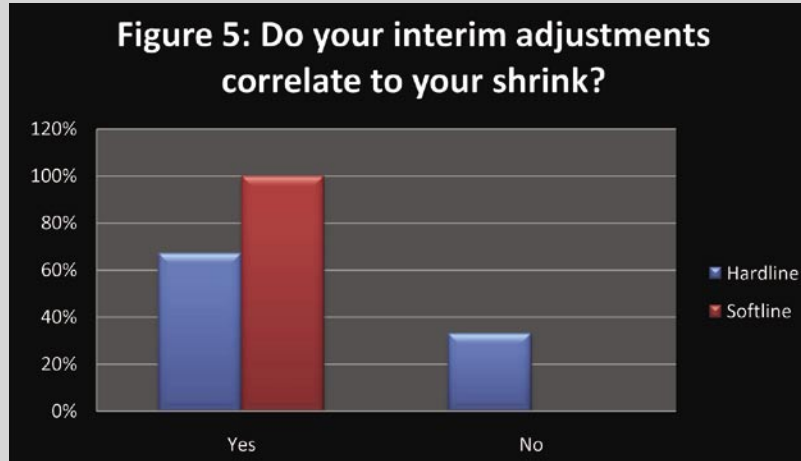


Overwhelmingly, those who conduct interim inventories indicated that they do correlate to shrinkage.

Nearly 90 percent of the respondents outsource their physical inventory process.

Do your interim adjustments correlate to your shrink?

Of those respondents who indicated they conduct interim inventories, they were asked if their interim inventory adjustments correlate to shrink. Overwhelmingly, the group indicated that they do correlate to shrinkage although there was no effort made to identify how they have defined that relationship in their organization.

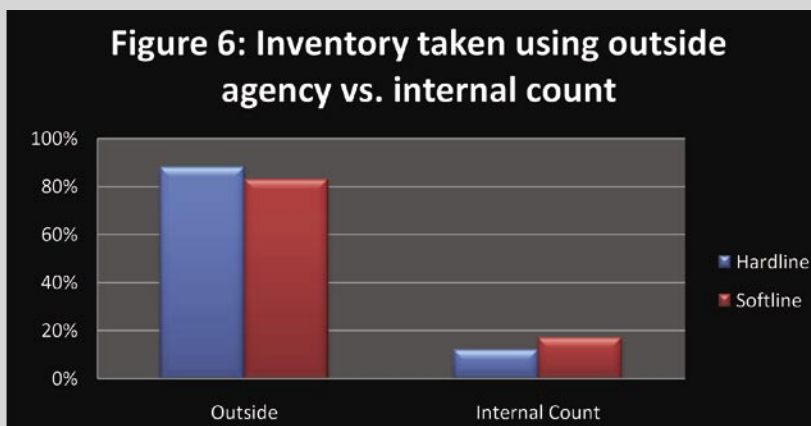


Do you use an outside agency to conduct your inventory counts?

The respondents were next asked if they employ an outside agency to conduct their inventories.

Nearly 90 percent of the respondents outsource their physical inventory process. The majority of retailers who outsource the physical inventory process employ one national agency. Four companies that outsource their physical inventory also have an internal system in place. For example, one company conducts inventory internally in stores with poor inventory results. The stores who had a good inventory in the previous count outsource the process. Another large retailer has outsourced the inventory process for a number of years however, they are piloting an internal physical inventory process.

There were only two companies that relied solely on conducting their inventory internally. They both rented scanning equipment from vendors.



Have you changed your physical inventory process in the last two years?

The retail environment is continually changing as retailers look at ways to improve their operations. As a primary operational function, physical inventory processes are critical to the performance of retailers. The survey gathered information from the respondents on changes in the inventory processes within their company over the previous two years.

Nearly 60 percent of the surveyed companies changed the inventory process in the past two years. The respondents who indicated their inventory process has changed were then asked three follow up questions regarding the changes. The results are detailed in the table below.

How Has It Changed?	Reason For Change	Are The Changes Working?
Expanded pre-count process to 20%	Improve inventory accuracy	Yes
Changed timing of inventory closer to fiscal year	Increase performance goal-setting	Yes
Went from four to six cycles of inventory	Meet store growth demand	No
Changed internal selection of inventory personnel	Make inventory more process-driven	Yes
Moved to internal inventory process from outsourcing	Improve inventory accuracy	Yes
Went from three cycles to two cycles per year	Improve inventory process	No
Changed outsourcing inventory on a quarterly basis and added internal cycle counts	Improve inventory process	Yes
Moved from a snapshot to cycle method	Improve inventory accuracy	Yes

The respondents reported that the changes are working except for the two retailers who changed their inventory cycle counts. Those retailers indicated that changes in cycle counts are making the inventory process more difficult.

Nearly 60 percent of the surveyed companies changed the inventory process within their company over the previous two years.

Commentary and Conclusion

The most significant finding is that most companies still only have one or two measurements of shrinkage per year.

The goals of the original survey were to identify common practices as a benchmark for participants to use in evaluating their own programs and processes. The most significant finding in the results is what that says about the current state of metrics and data in the retail loss prevention world. It is clear from this survey that most companies still only have one or two measurements of shrinkage per year.

The implications of this finding are extremely important. In any business domain, it is difficult to manage performance and results without frequent, reliable measures of outcomes. It would be near impossible to imagine a retail organization that measured sales performance only a few times a year or gross margin or cash flow metrics or personnel turnover or any of the other important drivers of business performance so infrequently.

Therefore, it stands out that most retailers have settled for infrequent measures of shrinkage even in this time of information systems, distributed databases, and dashboards. Of course, the reasons for this state of affairs are most likely reflective of many challenges in developing more frequent measures as opposed to resistance on the part of senior loss prevention executives. Identifying these challenges was not part of the scope of this survey project, but would be a worthy topic for further study and research.

We hope this survey provides you with some solid benchmarking that will inform your thought process and provide impetus for further consideration. If you'd like more information or details from this survey, please contact Chris Richardson, VP of Operations for PCG Solutions, Inc., at (859) 885-0773 or via email at crichardson@pcgsolutions.com.