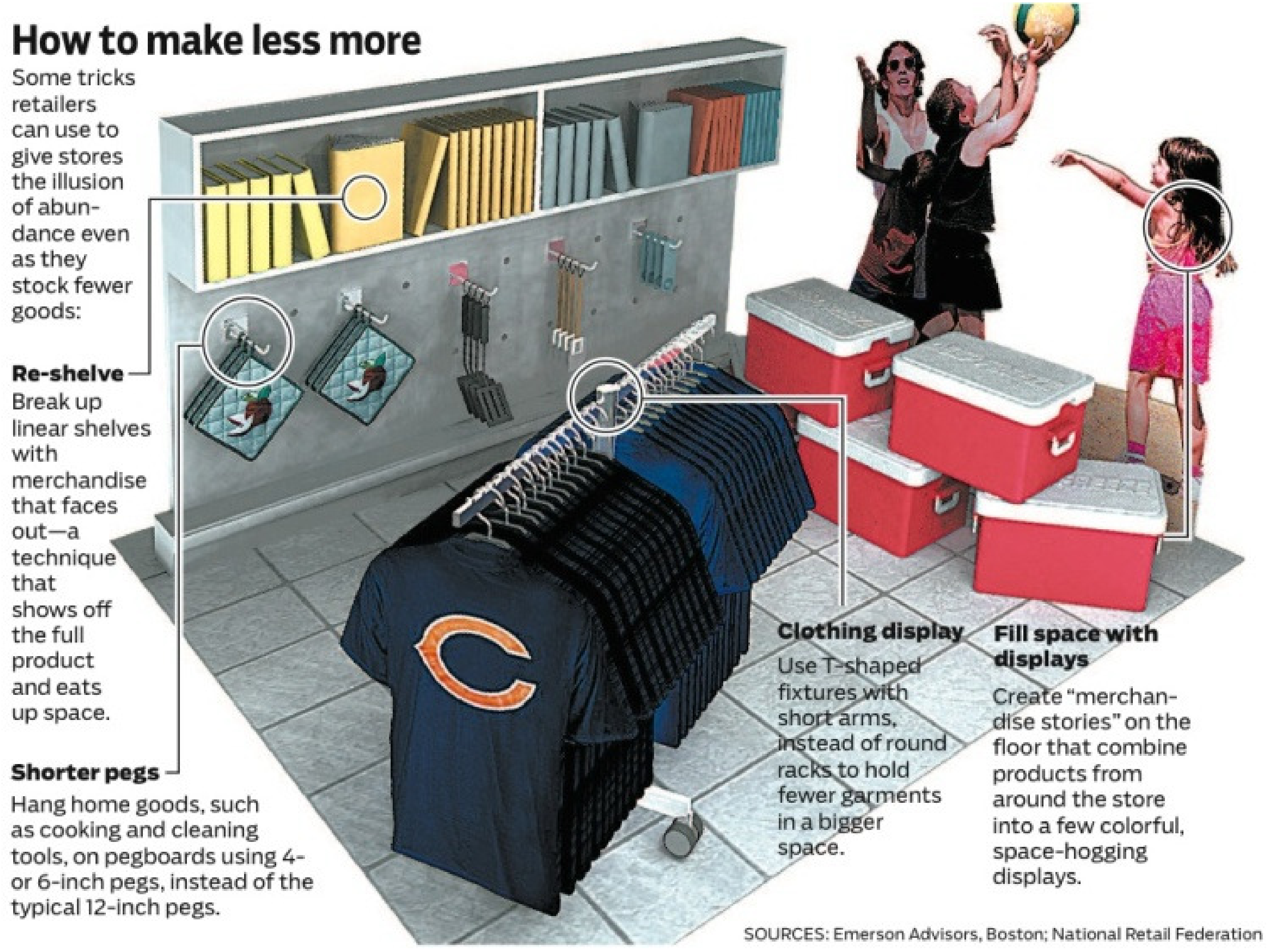
Retailers continue defensive inventory strategy

But with low stocks, stores may be in a bind if sales increase

By Sandra M. Jones Tribune Newspapers September 2, 2009



With the memory of last holiday season's frantic price-slashing fresh in their minds, retailers are going out of their way to make sure they don't get stuck with too many goods this year.

The play-it-safe strategy is meant to protect stores from the steep markdowns that cut into profits and sent dozens of big-name retail chains into bankruptcy after Christmas. But with consumer confidence inching up and economists predicting that the recession has ended, concern is building that this attitude could create new problems for the already-beleaguered retail industry.

Inventories are dropping faster than sales are falling, threatening to leave a trail of what one analyst termed zombie stores" going into the biggest shopping season of the year.

"Zombie stores look like they're going out of business," said Bill Emerson, a retail consultant and an expert in supply chain management. "You walk in and the sound of your feet echo. At best, a store like that looks boring. At worst, it's a struggle to get people to come in and buy product."

The amount of cargo coming into the U.S. -- a proxy for retail inventory -- is at its lowest level in at least seven years, according to a report last month from the National Retail Federation and IHS Global Insight. Import cargo volume at the nation's major retail container ports is forecast to fall 19 percent in 2009 from last year.

Volume for July through September is projected to be down 20 percent from the same period a year ago. October, traditionally the peak month as stores stock up for the holidays, is forecast to be down 18 percent.

"If consumers want something, they are going to have to jump on it," said Madison Riley, senior partner at Kurt Salmon Associates. "Retailers are more willing to have a sale walk [away] than be left in an over-inventoried position."

Still, skittish shoppers ready to spend could get frustrated if what they are looking for is out of stock. Consumers will tolerate a retailer being out of goods once or twice, but soon will shop elsewhere, experts say.

"It's one thing to lose a sale," said Gregory Rubin, chief executive of SD Retail Consulting. "It's another to lose a customer. If you lose too many, you're in trouble."

Investors prefer to see retailers keep inventory lower than sales because it suggests there won't be any unplanned markdowns that will hurt profits. Largely due to lower clearance inventory, most of the major department stores and big-box discount chains posted year-over-year gross margin improvement in the second quarter with the exception of Macy's Inc., according to an Aug. 24 report from Credit Suisse analyst Michael Exstein.

In particular, total inventories at department stores declined 8.8 percent in the second quarter, faster than the 6.9 percent sales decline, according to the Credit Suisse report. It marks the widest margin by which inventory has exceeded sales declines since the downturn began in 2007, the report said.

Specialty stores have experienced even steeper reductions. Ann Taylor, for example, trimmed its inventory 30 percent in the second quarter and plans to continue to be "extremely conservative with our inventory receipts" in the third quarter, Chief Executive Kay Krill told investors last month.

But it is a fine line between keeping inventories lean and disappointing shoppers.

"I'm really worried about the holiday season because we've got low inventories and expectations of promotions," said Paula Rosenblum, managing partner at research and consulting firm Retail Systems Research LLC. "Retailers are under-bought without question."

Retailers did most of their buying for the holidays in the early spring when the economy cast a pall over the nation. And many held back some money to make last-minute buys if consumer spending picks up.

But manufacturers aren't exactly flush with merchandise themselves. Apparel-makers have slowed production in keeping with diminished demand.

Perry Ellis International, the men's clothing and golf apparel manufacturer, is bracing for a change of heart from retailers after months of inventory cutbacks. Chairman and CEO George Feldenkreis told analysts during an earnings call in August that it is quite possible that consumer demand isn't as dampened as sales figures suggest, but rather reflects lower prices rather than fewer units sold.

"Inventories have been very depleted at retail," Feldenkreis said. "And they are going to find themselves in a situation where some of them, if sales just improve a little bit, are really going to be out of inventory and they are going to be chasing inventory."

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