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Growing Pains

By Alan Barnett

As contrarian as it may seem, small- to mid-sized (SMB) retailers often will encounter the greatest risk to their survival during periods of rapid expansion. In recent years, SMBs have been able to rush to financial markets after 12 to 18 months of successful business for a cash infusion. Once a company is flush with cash, management focuses are on the commitments made to external groups. Opening new stores and spurring comp store growth with remodels become paramount. What often is overlooked or minimized is that the support side of the company may be developing cracks in its foundation.

These cracks come from a strained infrastructure. They can lead to late shipments, incorrect shipments, IT and communication breakdowns, accelerated staff turnover in merchandising, planning, IT, HR and other departments. Often this occurs when companies reach specific sizes or "inflection points" in their evolution. These breakdowns do not occur throughout the growth cycle. Inflection points are encountered when a company grows beyond what the existing business processes and infrastructure can support.

There are many minor or obscure parts of an operation not considered to be growth-related concerns by the responsible departments and are invisible to senior management, yet if they go awry the business may falter. Note the following three examples:

Example 1: A mid-sized retailer continued its aggressive expansion after going public. The IT department had strong, quality leadership. It was responsive to the organization and insightful in its use of new technology. The department directors and their staffs were very busy but not overwhelmed; they had balance in their lives. But as an expanding now public company, the directors were experiencing ever-increasing demands on their time and the CIO who used to pick up some of the excess work now had no time. He was consumed by SOX and PCI in order to allow his team to focus on their responsibilities. Almost overnight the IT department was stretched to its limits.

In addition, the company ERP merchandising system was old and while it was efficient for 150 stores, it was not for 400 stores - the company's four-year growth target.

Example 2: Hypothetical company ABC has a typical monthly receipt of 100,000 units spread of 40 percent, 30 percent, 20 percent and 10 percent by week. If you assume capacity is double at 200,000 units per month or 50,000 per week, what happens when the volume reaches 150,000 units? Based on receipt history the potential exists for receipts of 60,000 to 80,000 units the first week.

The excess receipts will clog the DC, delay shipments and potentially lead to merchandise being sent to the wrong stores.

Example 3: Rapid growth can have a major impact on the buying and allocation departments. In this example it is likely that no product classifications were added as the company expanded. Therefore it is unlikely the staffs of these departments were increased since they are organized by classification in most retailers.

If they were already stretched to keep payroll low in support of the "success story," what happens when 25 percent to 50 percent more merchandise has to be ordered and eventually distributed to a larger number of stores?

Unless staff was added and trained in advance of the expansion, the new volume will lead to an increased percentage of late orders, a greater risk of ordering and allocation errors, an increase in markdowns and a slowdown in turn. This stress will lead to higher office staff turnover.

Surviving growing pains

These inflection points require companies to change the way they operate to survive, as they grow. Just as the nature of a company changes when it grows from one to three stores, it will change again when the store count is between 15 and 20 stores. The founder no longer has the ability to know every nuance of each store. The buyers cannot speak to all store managers every week, and lose first hand knowledge of their products by door. They become more dependent upon summary reports and systems, but they are slow to change. During this transition, errors often are made.

As companies grow from local to regional and regional to national, there is an increasing need for more sophisticated merchandise and assortment planning processes. A segment of the inflection point concept relates to what happens as the nature of the business changes.

Geographically varied demographic, psychographic and climatic differences need to be built into the merchandising receipt and buying plans in order to maintain or improve gross margin rates.

There are ways to identify the risks and prevent their crippling blows. It requires an effort to objectively evaluate internal operations, prioritize needs, set timelines and address the issues in advance. We all know replacement merchandising, POS and/or DC systems may require up to two years to install.

The human and infrastructure capital requirements to support a company's growth need to be approached with the same forethought as is put into the store opening plan.

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