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Stock-Outs Cause Walkouts

by Daniel Corsten and Thomas Gruen

Reprint F0405E

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Retailers find stock-outs annoying, just like everybody else. But they live with gaps in their inventory because they figure the fix is more expensive than the problem. After all, they tell themselves, when customers can't find the products they're after, they'll usually substitute similar items for the missing ones. Maybe some profit will be lost in the swap, but that's a marginal cost of doing business. Right?

Not so fast. Let's take a closer look at what can happen when our shoppers reach for, say, their favorite brand of soap and come up empty-handed.

Along with our colleague Sundar Bharadwaj, a marketing professor from Emory University, we studied survey data from more than 71,000 consumers in 29 countries to learn how they react to stock-outs. When they can't find the precise product they're looking for, consumers typically do one of five things. They find a substitute of the same brand, they substitute a different brand, they delay their purchase until the item's back in stock at that particular store, they don't buy the item at all, or, worst for retailers, they buy the item at another store. (See the exhibit "What They *Really* Do.")

Depending on the product category, 7% to 25% of consumers faced with a stock-out will continue shopping but won't buy a substitute for their desired item at the store; 21% to 43% will actually go to another store to buy the item. (See the exhibit "What They *Really* Want.") Overall, our study suggests, retailers can lose nearly half of intended purchases when customers encounter stock-outs. Those abandoned purchases translate into sales losses of about 4% for a typical retailer. For a billion-dollar retailer, that could mean $40 million a year in lost sales.

Fixing a Hole

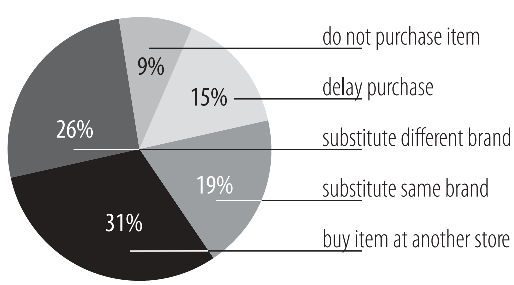
For all the supply chain fixes and tracking technologies thrown at the problem, stock-out rates worldwide are stubbornly lodged at about 8%. It doesn't have to be that way. In a related study we did of more than 600 retail outlets in 29 countries, we found that retailers themselves are responsible for most stock-outs—a conclusion that's at odds with the findings of some previous, smaller studies.

In our study, 72% of stock-outs were due to faulty in-store ordering and replenishing practices—retailers ordering too little or too late, generating inaccurate demand forecasts, or otherwise mismanaging inventory. Just 28% of stock-outs, we found, could be attributed to replenishment and planning problems in the supply chain. These included product droughts created by suppliers; category planners who mismanaged shelf space, promotions, or new product introductions; or supply chain managers who misjudged long-term demand.

Fixing the stock-out problem requires new IT

What They *Really* Do

A study of more than 71,000 consumers worldwide shows that they have little patience for stock-outs. When consumers can't find the precise product they're looking for, fewer than half, on average, will make a substitute purchase, and nearly a third will buy the item elsewhere.



solutions and systemic changes that cut across functional boundaries within and between retailers, in the supply chain, and among suppliers. U.S. food retailer H.E. Butt Grocery (H-E-B) and UK grocer J. Sainsbury, for example, have recently implemented improved IT systems that can more accurately calculate stock-outs based on point-of-sale (POS) data, or the lack thereof—that is, by recognizing when an item should have been sold but wasn't. By closely monitoring the POS data for its 1,450 fastest-selling items, H-E-B was able to reduce its stock-out rate by 22.5% in eight weeks. Sainsbury's similarly tracks its 2,000 top items, and its sales have risen by up to 2%.

On the organizational side, another UK retailer, Tesco, has extended its supply chain director's responsibilities to include managing the store shelves—which means the store managers are no longer responsible for ordering items and replenishing shelves, the supply chain is. Supply chain and category management teams now work closely together to improve coordination of shelf space, promotions, and new product introductions.

Reducing stock-outs can be difficult and expensive. But the cost of assuming that little can be done—or that it doesn't really matter—may be higher still, in both dollars and customer loyalty. In a business with perilously thin margins, can you afford to ignore the bare shelf space?

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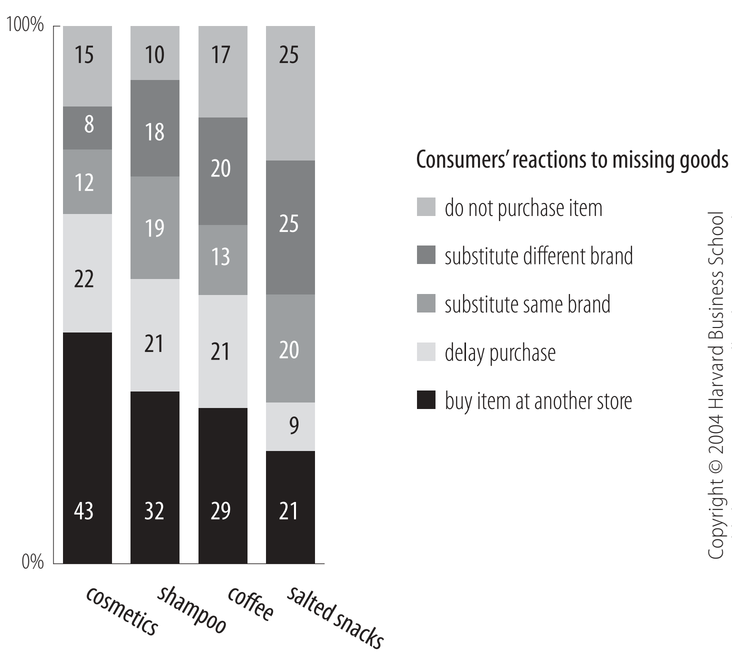
What They *Really* Want

Consumers' responses to stock-outs depend on what, exactly, is missing from the shelves. Researchers looked at U.S. consumers' reactions to missing goods in 11 categories ranging from personal hygiene products to snack foods. (Four representative categories are shown here.) Customers showed particular loyalty to their favorite cosmetics; 43% said they'd leave a store that didn't stock a specific item and buy the product elsewhere. Salted snacks, on the other hand, inspired far less allegiance among customers; only 21% would go in search of the snack at another store. Retailers should focus more on fixing the holes in high-loyalty inventories than on reducing stock-outs across the board.



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