Chapter 3

Analysis of Financial Returns and Risks of Implementing RFID for Supply Chains

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ABSTRACT

Radio Frequency Identification (RFID) is believed to change how supply chains operate today. While RFID’s promise for improved inventory visibility and automation in inventory management is making many supply chain players hopeful for increased sales and reduced operating costs, these benefits do come at a cost and involve risks. This paper presents a financial returns analysis that captures RFID’s costs and benefits, and quantifies the financial risks of implementing RFID for various business sizes and products with different unit profits to understand when RFID makes business sense. More precisely, the returns analysis is performed using an econometric model to understand how break-even sales volumes, unit profits, tag prices, return on investment, and risks vary between a manufacturer and a retailer in a supply chain. The results are extended to multi-product cases as well. A sensitivity analysis is also performed to understand the returns in pessimistic and optimistic scenarios.

INTRODUCTION AND SCOPE

Efficient supply chain management is a crucial determinant of being a successful and profitable business. One possible way to achieve increased efficiencies in supply chains is through the use of Radio Frequency Identification (RFID), which can enhance the decision-making capability of information and decision support systems through accurate real-time data collection. RFID is the automatic identification and tracking of objects using radio frequency transmission. The objects can be practically anything such as cars, library books, toll tag devices, baggage at the airport, sponges used for surgical procedures, live animals, or even persons like hospital patients (Chao, Yang, & Jen, 2007; Al-Ali, Sajwani, A-Muhairi and Shahenn, 2007; Rivera, Mountain, Assumpcao, Williams, Cooper,
RFID tags store product information in an electronic product code (EPC). As illustrated in Figure 1, EPC from various RFID tags (that can be at item, box, container and truck level) is read via readers, and gets communicated to a middleware software (also known as Savant) which then identifies detailed information about the detected product from several database servers (known as the object naming service (ONS) and product markup service (PMS) servers). Next, the detailed product information gets communicated to local information system databases which in turn is fed into various enterprise resource planning (ERP) and supply chain management (SCM) applications for supporting planning and execution decisions. (The reader can refer to Terry (2004), Laran (2005) for more details on the information systems architecture and Wamba, Bedavid, Lefebvre, & Lefebvre (2006) for a description of a system architecture in a retail sector implementation.)

Although radio frequency technology has been known for a long time, the popularity of RFID is rising nowadays because of the decreasing price of the tags, advances in EPC standards development, and the mandated adoption of RFID by US Department of Defense and large retailers such as Wal-Mart, Target and TESCO for all of their top suppliers (Spekman and Sweeney II, 2006).

**RFID Benefits**

With recent advances, it seems that RFID deployment has a big potential to transform supply chain management as it automates identifying and tracking the items through the entire supply chain, and creating a virtual database that is attached to the product. As described earlier, this data can be fed into supply chain information systems to enhance...