

Next-Generation Consumer-Centric Merchandising

Over 20 retail executives, RIS News, AMR Research, and strategy consultants from RPE Consulting led a fascinating day of interactive discussion and insight at a recent event in Dallas. Titled Next-Generation Consumer-Centric Merchandising, the day consisted of workshop roundtables where retailers and industry experts shared experiences on how their merchandising departments are adapting to the new realities of the retail environment. Following is a synopsis of the outcome of the workshops

Process change in merchandising is being forced by the current environment. Rationalization of assortment, down market offerings by luxury brands, the explosion of private label, cross-channel merchandising and replenishment, and the enhanced focus on localization are all challenges (and opportunities) that retailers are faced with based on economic conditions. Even if we could turn back time and could have somehow avoided the implosion of the economy, a new consumer dynamic is upon us. Retailers have to adapt to the new realities of real-time information, borderless competition, and negligible customer loyalty in order to survive in today's world. And the core of retail, merchandising, will have to lead the change.

Kevin Sternecker, retail analyst at AMR Research led the day's activities with a passion for the subject matter rarely seen. As the title suggests, Consumer-Centric Merchandising is an approach designed to incorporate consumer demand across the entire merchandising function from front-end space planning all the way back through the supply chain. No longer is it acceptable to approach merchandising in a linear, silo-based fashion. Rather, merchandising should be viewed holistically, incorporating cross-functional inputs into an engine that enables retailers to make better decisions based on consumer-demand preferences and enable executives visibility into the myriad of decisions being made simultaneously in merchandising, such as price, promotion, space allotments and assortments.

Easier said than done. Before a system can be implemented to enable consumer-centric merchandising, a very important issue must be addressed – the cultural mindset within the organization. Merchandising executives must be willing to shift the organization's mindset away from siloed, product-centric decision-making to one involving interdepartmental collaboration and consumer-centricity. This is no small feat within many organizations but it is necessary to their survival. Fortunately, our group of retailers in Dallas was for the most part somewhere along the continuum of cultural transformation. A quote by one of the retailers became the mantra of the day which was "What got us here is not going to be what will get us there." This was affirmation that systems must follow, and understandably, many



have a good deal of work to do in that regard. Retailers including JC Penney, The Container Store, Zale Corporation, Golfsmith International, Sally Beauty Supply, Pier 1, and Blockbuster participated in three workshops that delved into the following areas: **Demand Forecasting & Planning, the Convergence of Assortment Planning and Space Execution and Lifecycle Price Management.** Some of the key takeaways from those workshops are detailed below.

Demand Forecasting & Planning

Sternecker began the discussion by detailing several trends that are occurring in demand forecasting and planning. These include utilizing forecasts to feed the supply chain for more accurate store replenishment, the use of unified forecasts to enhance efficiency, better use of data for increased granularity in planning, and attribute based forecasting.

While these may seem like broad trends and ultimate goals in the area of demand forecasting and planning, the workshop indicated that most retailers are entering into this level of sophistication. Each workshop posed three questions to each of the tables for discussion.

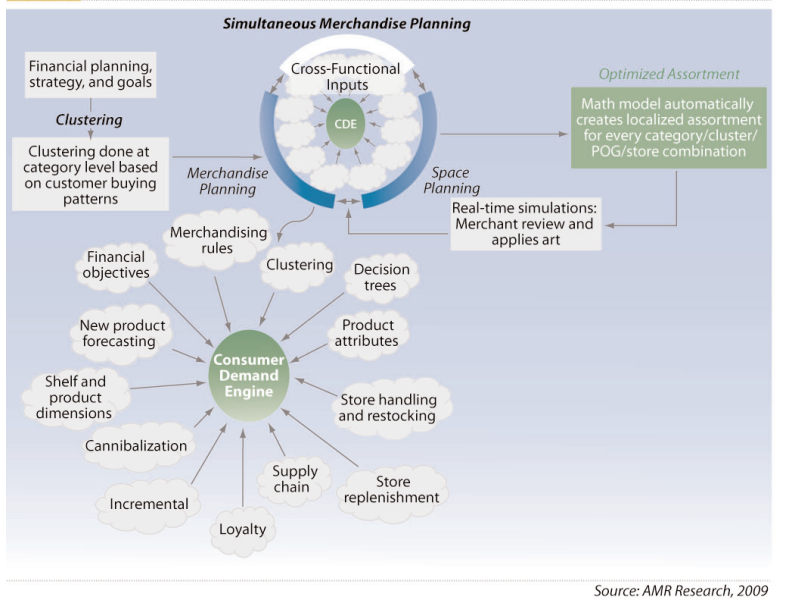
1. WHAT TYPES OF DATA DO I NEED TO COLLECT TO PROVIDE GOOD FORECASTS?

There is no shortage of data for retailers to access as they look to generate accurate forecasts. Of course, systems must be in place to aggregate the data effectively enough to use for forecasting purposes. By and large, the retailers in the workshop

“What got us here is not going to be what will get us there.”

Consumer Centric Approach to Planning

Figure 2: Recommended model of merchandising process that drives consumer-centric store presentations



are using POS data as the primary source for forecasting and, in the majority of cases, this data is not being integrated with other data in any meaningful way. One of the retailers was in varying stages of looking at pricing and promotional data with POS Data and another is working on integrating space planning information into the forecast.

However, opportunities do exist around using syndicated data such as Nielsen or IRI to gain visibility into the customers who are not buying. In addition, loyalty card data or credit card data are other sources retailers can use to make more accurate forecasts, and none of the retailers at the workshop were using these sources currently. Several did point to the fact that their current systems are not capable of accurately integrating data and hence, hinder their abilities to forecast as accurately as they'd like.

2. WHAT IS THE ROLE OF STORES IN THE FORECASTING PROCESS?

This was a hotly debated question with quite diverse opinions. Answers ranged anywhere from "a store's role is to execute the forecast" to "we are tying feedback from our stores to enable us to localize our plans." One retailer has gone as far as putting an executive in place to keep in touch with top selling stores to learn where there is potential and what is not selling. Of course, some retailers are required by what they sell to offer much more localized assortments, and this should mean more reliance on stores for input. It proved to be true among our group of retailers.

Finally, a few of the participants reported that as a large chain it is too difficult to focus on individual stores for feedback. Again, this speaks to the cultural and systems based shifts that need to occur to be able to maximize the opportunity around store-level feedback.

3. WHO "OWNS" THE FORECAST AND HOW DO I DEFINE SUCCESS?

"Meeting plan" was the straight answer from the majority of the group, while one retailer commented that properly planning enough demand throughout the season was the definition of success. One could argue, of course, that success metrics in a truly customer-centric merchandising organization should be increased sales due to proper assortment and in-stock position or increased margins due to lower markdown requirements.

The encouraging news was that by and large the retailers are using a collaborative process between buyers, merchants, space planners, etc. to develop the forecast, with all having some form of ownership. The merchant is the where the buck must stop, but it is good to see that the retailers see the forecast as a team sport.

"The buck must stop with the merchant, but retailers must consider the forecast as a team sport involving many sources."

Workshop 2: Convergence of Assortment Planning and Space Execution

During this session Sternecker delved into the heart of the subject matter and took the audience through a rating exercise to help them determine where their organization lies in the evolution of migrating from a standard, linear merchandising model to a customer-centric model. Each retailer rated their progress from 1-5 on the following questions:

- Are consumer demand preferences used at the heart of your merchandising systems and decisions?
- Will your merchandising system recommend a starting point for your assortments, space allocations, everyday pricing and promotions?
- Does your system deliver insights on shopping behaviors of consumers who are not in your stores?
- While making a merchandising decision, does your system provide visibility for all other decisions currently underway, i.e. promotion plans, pricing, space allotments?
- Does your supply chain receive automated store/item replenishment/ allocation increments and decrements based on the upstream merchandising decisions?

The higher the number, the further along the retailer was in executing on a consumer-centric approach. He proceeded to detail the number of solution providers in the space that enable retailers to “cross the chasm” as it was described.

1. WHERE/HOW DO ASSORTMENT AND SPACE PLANNING FIT WITHIN A MATURE CONSUMER-CENTRIC MERCHANDISING FRAMEWORK?

Very few retailers in the room could accurately answer this questions as very few have “crossed the chasm” to a consumer-centric approach. Although one retailer is

DEMAND-BASED MERCHANDISING

A Perspective from RPE

WHAT ARE THE TOP MERCHANDISING STRATEGIES RETAILERS SHOULD FOCUS ON IN ORDER TO ADAPT TO CONSUMERS’ NEW SHOPPING HABITS?

Jim Lizotte: Price optimization and true demand forecasting will be key to retailers being able to survive the drastic changes in shopping behaviors. Through recent client engagements, we’ve found that the most important aspect of any successful merchandising initiative (whether long or short term) must be tied back to a company’s strategic plan(s). Keeping focus on one, three and five year goals, while executing at the tactical level, not only allows companies to show the “quick wins” but also leverages those successes over the long haul.

Cliff Epstein: Reduction of average retail price is a top merchandising strategy to focus on for retailers. Also, an increase in marketing such as promotions and sales so that the customer perceives they are getting a bargain. Retailers must provide value to customers at the store level so when

ready to buy the item is in stock. With reduced inventory and assortment being the trend, a retailer must at least be in stock on key items and key looks that the store stands for. It is okay to be lean on the fringe items but not on the key items.

WHERE CAN A RETAILER MOST QUICKLY BENEFIT FROM IMPLEMENTING A MERCHANDISING SOLUTION OR PROCESS?

Jim Lizotte: Demand forecasting is probably the solution with the quickest overall business benefit. Improved sell through, reduction in inventory and better vendor control are just some of the factors the lead to quick ROI. RPE has worked with many clients that have witnessed the benefits mentioned above and have truly gained internal efficiencies after we’ve helped them to formalize, document and execute a demand forecasting business process.

Cliff Epstein: Consistency of information, i.e. one ver-

sion of the truth, can provide quick returns. Standardization of process across the organization in planning, allocation and/or replenishment are important. Identification of exception oriented information should focus on the most important issues first.

WHAT DO YOU RECOMMEND THE TOP THREE FOCUS AREAS SHOULD BE AS RETAILERS PREPARE THEIR MERCHANDISING PLANS FOR THE HOLIDAYS?

Jim Lizotte: While three areas may be optimum, given the current economic conditions, price optimization should be a focus for retailers as they move towards the end of the year. Retailers want to sell the merchandise they have, but don't want to give it away. Customers are shopping with a clear focus on price. Working with both new and existing clients, we've found that guiding a retailer toward which price optimization model works in their environment (one size does not fit all) has had remarkable effects on inventory and sales — selling more at the right price and then exiting as quickly as possible to avoid leftovers.

Cliff Epstein: The top three focuses include:

- 1) Realism and conservatism regarding sales expectations. Don't buy into the theory that the recession will end in "the second half of the year."
- 2) Prepare to turn inventory faster than historically. Go back to at least two holidays ago and use that as a basis for comparison.
- 3) Reduction of average retail by both re-assorting mix of inventory and planning out promotions and markdowns thoroughly to get seasonal inventory in line by season's end

WHERE SHOULD RETAILERS PRIORITIZE LOCALIZATION OF ASSORTMENT IN THEIR MERCHANDISING STRATEGIES AND ARE THERE SEGMENTS WHERE LOCALIZATION DOESN'T MAKE SENSE?

Cliff Epstein: Seasonal merchandise should be top priority from a localization standpoint. Categories such as outerwear and swimwear are perhaps the most representative of items that are prone to localizing errors. In general the introduction of seasonal merchandise by market is a key priority. Sizing needs – this is key for categories such as footwear, where if retailers don't have the right sizes, a customer will walk away. Retailers can sometimes get away with the next size up in a shirt but a shoe must fit. Volume and physical size of store must be taken into account to ensure that the specific items that a store is selling are prioritized for that store's inventory assortment. Localization

doesn't make sense if it calls for specific different skus that are not large volume generators. Over the past several months, we've been able to help clients refocus their localization efforts and help them avoid spending significant amounts of time and money on very small profit generators. The focus is on moving more towards the understanding of how much and what types (Key Item and/or Assortment Planning) of inventory can fit in a store as well as in a particular area (Space Planning) of the store.

WHAT IS MORE IMPORTANT IN MAKING BETTER MERCHANDISING DECISIONS – SALES DATA OR CUSTOMER DATA? WHY?

Jim Lizotte: It really comes down to the best use of both sales and customer data. The future of consumer centric retailing will force companies to not only understand demand but also why that demand is present – demographics, causal, etc. While some companies may find the total amount of available data to be daunting, knowing what to do with it is key. We've helped several retailers determine the best mix of sales and customer data which has lead to dramatic reductions in inventory – mainly by getting the right items to the right stores. As an offshoot, we've seen that clients have been able to refocus their buyers/planners time (because they're no longer chasing inventory) to other cost fighting measures such as vendor compliance thus helping to streamline the supply chain.

Cliff Epstein: Customer data must translate into sales data for it to be worth anything. The important thing to understand is what makes this particular customer unique and how does that uniqueness get satisfied in terms of sales. To understand that certain stores are urban vs. suburban vs. rural is great, but if the end result is that they all buy the same thing, then clearly sales data is the key. However, a customer can't buy what isn't available, so there must be a certain amount of customer data to understand what an assortment may be missing, to potentially grow the business. Final answer is that retailers have a base of sales data and they must use the customer data as a vehicle to grow additional opportunities.



Integrating people, process and IT.

developing assortment models based on demographics for store clusters, most of the audience admitted to not having integrated systems to enable assortment and space planning models. In other words, the linear approach to merchandising is alive and well in retail. Of course this speaks to business process changes prior to consideration of new systems, and as AMR put it, “a change in organizational DNA”

2. HOW DO YOU GO “LOCAL”?

Localized assortment is certainly all the buzz in the industry today and the audience, by and large, sees localization as a benefit to pursue. In the effort to provide better localized assortment, some of the retailers recommended studying store and store-cluster data. One retailer recommended tracking competitive data, including advertising. Another retailer uses demographic data to gain visibility into consumer preference. It should be noted, however, that not all of the retailers see localization as the way to go. One retailer, in fact, has made a decidedly opposite decision: to keep costs down, assortment and pricing is consistent across the country.

3. WHAT ARE THE EMERGING SUCCESS CRITERIA FOR GOOD ASSORTMENT AND SPACE PLANS?

Good feedback was provided by the audience as they are using multiple criteria to define success. These include:

- Better customer conversion
- Improved margin turn
- Growing profitable sales
- Increased Market share, including acquisition of new customers.
- Increased trust between partners looking at data

AMR recommended that for organizations to evolve into a truly consumer-centric approach to merchandising, the metrics for performance must change.

Benefits can be substantial ...

Table 2a: Lifecycle pricing benefit opportunities

Initiative	Cost Reduction	Ad Response Rate
Promotion Planning and Advertising Execution	5% to 10%	+ 6% to 8%

Source: AMR Research, 2008

Table 2b: Lifecycle pricing benefit opportunities

Initiative	Sales	Units	Gross Margin
Price Determination/Revenue Optimization			
Base Price (non-promoted)	+ 1% to 3%	+ 0% to 1%	+ 2% to 5%
Promotional Prices	+ 1% to 12%	+ 1% to 9%	+ 5% to 20%
Markdowns	+ 0% to 5%	+ 5% to 10%	+ 6% to 10%

Source: AMR Research, 2008

Workshop 3: Lifecycle Price Management

Price and promotion optimization continue to be of high priority across most segments of retail. According to a study from AMR referenced at the event, 60% of retailers had plans to either add, replace, or improve their promotion optimization system and close to 50% planned to do the same with initial price or markdown optimization

Kevin walked the audience through the benefits that lifecycle pricing can provide retailers that include real margin improvements across the board:

1. WHO SETS BASE PRICE, PROMOTIONS AND MARKDOWNS IN YOUR ORGANIZATION?

We had quite a diverse representation of retailers in our audience for the event and it proved to yield just as diverse a response as to who sets price, promotions and markdowns within each organization. While many retailers agreed that the buyer has final say, retailers are looking to a variety of sources for input on pricing. These include marketing, store operations, vendors, and increasingly merchandise planning. The same answers were given for markdowns

2. WHAT SYSTEMS AND PROCESSES DO YOU USE TO SET THESE PRICES? OPTIMIZATION?

While research shows that price and promotion optimization tools are of high priority in the industry, our audience is clearly relying far more on the 'art' of merchandising as opposed to the 'science'. Several retailers cited 'street smarts' as the tool used to set prices. In addition, Excel spreadsheets were the "technology" of choice among our audience, and while the desire was there by some, there remains a great divide among those who agree with the concept of lifecycle price management and those that are willing to execute.

3. HOW READY? WHAT ARE THE HURDLES IN YOUR ORGANIZATION TO ADOPTING LIFECYCLE PRICE OPTIMIZATION?

While Kevin explained that technology has advanced to the point that pricing recommendations can be made by systems while simultaneously providing tangible reasons behind those recommendations (hence helping justify the decisions for retailers), the fact was that the same hurdles exist as they do for any technology – budget, time to implement, and ultimately perceived need.

Summary

The beauty of retail is that there is no 'one-way' to succeed. There is almost as many different business models out there as there are customer types. However, regardless of the level of maturity our audience has achieved either culturally or technologically, there was little disagreement for the need to listen better to the needs of the customer base.

For retailers to begin the process of evolving their merchandising strategies to a customer-centric approach, the following suggestions are offered:

PATHWAY TO CONSUMER-CENTRIC MERCHANDISING:

- Senior executive sponsorship must be broadly achieved

"There is a great divide among those who agree with the concept of lifecycle price management and those willing to execute it."

- Enterprise mindset change moving away from selling products to delivering what consumers want to buy
- Understand that consumer insights represent a “way of life” not a “point in time”
- Initiate a thorough review of current process/technology and identify points of opportunity where consumer insights should be introduced (Rule: Actionable insights are most effective when they are available at points of decision)

ACTION:

- Implement incremental inclusion of consumer insights – crawl/walk/run
- Adjust business processes and improve collaboration in and outside of the organization
- Refine KPI’s to focus on consumer centric results and behaviors (Demand Sensing, Shaping & Responding, Collaboration, & Transparency)
- Aligned performance incentives with new KPI’s
- “Rinse and repeat” ■

“Actionable insights are most effective when they are available at points of decision.”

Winning Approach

By Kevin Sternecker

During the course of the day, AMR shared their observations of traditional implementation strategies “The Beaten Path” and contrasted these steps and results with a recommended “Winning Approach” to achieving consumer centric merchandising. The stakes are high. Companies reporting implementation failures experience cost overruns reaching into the millions of dollars. AMR’s “Winning Approach” includes a thorough review of existing processes with an eye focused on decisions where consumer demand preferences can be realized and executed. Following identification, AMR recommends a focused search to determine the best solution for a given area of insight and then taking the necessary steps to realize full integration within the prescribed business processes. Companies fail when they try to solve all of their consumer demand sensing needs with one shiny solution that exists outside of the main-stream of the merchandising process. Merchant adoption increases dramatically when insights are revealed seamlessly within the everyday decision process. AMR’s “Winning Approach” to realizing consumer centric merchandising delivers financial results faster with the potential of self-funding future consumer focused advancements. ■

