



Item Transitions: Maximize Profits from New and Exiting Items

Item transitions refer to those periods of activities when the retailer executes the addition of new items and removal of exiting items from a product mix. Adding new items to a retailer's on-shelf assortment offers a chance to increase sales and gross margin. Removing items from an assortment will ultimately eliminate unproductive inventory by sell-off and make space for items with more profitable sales. While these two events sound positive on the surface, they pose logistical challenges to the merchandising, inventory management and store teams responsible for implementing the change. Retailers who excel at item transitions will separate themselves from the competition by increasing profits while also improving customer satisfaction.

The Trouble with Transitions

Transitions could be pure money makers except for one pesky issue – unpredictability. Demand forecasts for new items are notoriously inaccurate. Not only is the initial forecast difficult to predict, but knowing how soon the “new item hype” dies down and more natural demand takes over is hard to consistently master. Exiting items have their own unique challenges. Understanding how the demand forecast for the exiting item reacts to markdowns and new replacement items is a challenge for even the most experienced merchant or inventory analyst.

In addition to dealing with these forecasting issues, a slew of tasks are added to the team's ‘to do’ list that are not part of the regular daily routine. This opens an already complex situation up for more problems. Calculating and placing the correct initial orders to fill the store shelf and supply pipeline makes new items a challenge. For exiting items, determining when to stop orders for each location in the chain and what to do with any residual inventories cause headaches for the already overworked inventory analyst.

Best Practices When Adding Items

There are best practices that have proven successful at many retailers who treat new item introductions not as a nuisance, but as a competitive weapon used against their retail rivals.

These retailers use previously developed and agreed upon Standard Operating Procedures (SOPs) to manage cross-functional partnership and timelines. SOPs help to avoid cross-functional bickering and finger pointing at a time when smooth execution is of the essence. Establishing clear roles, responsibilities and timelines ahead of time and gaining executive signoff on these practices helps to ensure consistent execution. Common tasks imbedded in new item SOPs are calculation of the initial buy quantity, minimum timing requirements from item setup to initial sales date to enable store, warehouse and purchase order preparation, and item component defaults.

Partner with vendors during item introduction to get the initial components accurate and share the additional workload of rollout. Often, initial item setup is the only time an item's replenishment components are reviewed with great detail. Item characteristics such as cost, retail, weight, case pack, cube, seasonal profile, presentation minimum or other system supported attribute are drivers of most future decisions for the SKU. Initial accuracy improves the item's chance of being profitable over its entire lifecycle.



Vendors may have insights into the initial demand forecast values from previous product launches or early test results. If vendor estimates are significantly larger than expected, share the risk of the additional inventory investment through negotiated markdown dollars or asking the vendor to hold incremental product with plans to quickly ship the item when sales meet their estimates.

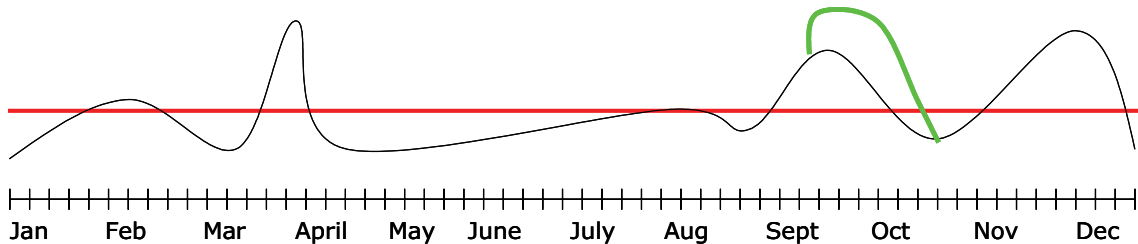
Some components should be established with different values than would be set up for the same item with an extensive demand history. Because of the demand uncertainty associated with new items, increased forecasting frequency is recommended. Although this decision can add unnecessary variation and safety stock to more stable items, the quicker reaction time for demand peaks and valleys justifies the risk in new items where the timeline for consumer acceptance is shortened. Setting higher initial Service Level Goals helps to minimize out-of-stocks so the true demand forecast can emerge without the bias of lost sales impacting the demand history. Be sure to establish reminders to re-set these variables back to normal levels once the demand forecast accuracy improves and uncertainty has diminished.

Creation of initial orders for new items has two goals: initially filling the stores/shelves and filling the pipeline. Filling the store is fairly straight-forward. If rules-of-thumb are used, be careful not to send too much to each store (“send everyone two case packs”). Given the disparity of sales rates across store locations, what may make sense for the larger stores may in fact be several months of supply for slower selling locations. Work with the planogram team to understand shelf capacities by location to avoid sending in excess back-stock if possible. Work with the store team to understand the lead-time needed to add the item into the assortment in order to determine the arrival date requirements. Use of a store replenishment solution enables software to calculate the needs down to each individual store.

Filling the pipeline can be more challenging and often presents more opportunities to improve current practices. Many systems and approaches will “turn on” a location, sending the entire order needed moving through the pipeline in one large shipment. What arrives is more than is needed to be on hand.

Because most replenishment logic orders what is needed on hand plus what is needed to keep product flowing into the location (lead-time stock or on-order), more sophistication is needed when placing initial orders. Work to bring in an order cycle’s worth of product, and add that much product each order cycle until the pipeline is completely filled. Advanced software solutions can assist in this effort.

Another challenge with new item management is the initial reaction to demand forecast fluctuation. Not only is it difficult to understand the initial demand forecast level, but there is normally an initial “new item momentum” bump in sales realized. Advertising, in-store display and the new product packaging attract customers to “try” the new product. Many will not continue to purchase the product after the initial sampling; but determining the exact impact of the new item momentum is difficult. Analyze past new item history and strip away seasonal sales to calculate the new item momentum impact. Use this impact on other new items and fine tune the results. Use a new item designation to generate additional exception reports focused exclusively on these challenging products.



Another unique feature of new items is the interaction with exiting items. Often, a new item is brought in to replace one or several other items in the assortment. Gather the sales history of these replaced items and use this history to jump start the new item. The same approach can be used in replenishment logic by reducing the new item purchases until the inventory of the exiting item is depleted. Using this type of advanced logic will speed demand forecasting refinement and enable new and old product inventories to share the same shelf location – maximizing inventory productivity.

The best forecasting and replenishment systems will offer “Start Dates” to assist in the new item introduction process. Based on the sophistication of the solution, set start dates either at the date sales should begin in the store or at the date when orders should begin. Be sure to accurately account for lead-times and order cycles if the system logic does not automatically address this step for the user.

Vendor economics and ordering rules should be re-analyzed with the introduction of new items. Previous decisions on order cycle length and order volume brackets may be subject to change with the introduction of new item sales volumes. Additional volume impacts the ability to meet truckloads, brackets or minimums, and a deliberate focus on this change will improve vendor and retailer profitability.

Remove Underperforming Items – Not Their Cumulative Profit

The major challenge with exiting items is to control the damage to gross margin often realized when an item is removed from an assortment. Removing the exiting item from the planogram, stopping replenishment and introduction of a replacement item all reduce sales. Typically sales slow before the inventory has been completely sold and markdowns are used to entice customers to purchase more product. Close management of items departing from the active assortment can stop the profit bleed and improve category margins.

Just like in new item best practices, use of exiting item SOPs maximize cross functional coordination. Because the window to act is small with item transitions, sticking with pre-established timelines, roles and responsibilities focuses the team when prompt execution of best practices is most critical.

Vendor shipments to warehouses, and warehouse shipments to stores need to ramp down ahead of store merchandising actions. Be sure to account for all inventory in the pipeline – including import warehouses and on-order, when determining how and when to stop orders.

When dealing with full case inventory in the warehouse, retailers may choose to sell this product to other companies instead of incurring the risk of shipping it to the stores, incurring handling costs and the uncertain markdowns. Sideways selling to closeout companies or returning the products to the vendor are options to be explored before simply pushing all remaining warehouse inventory to the stores.



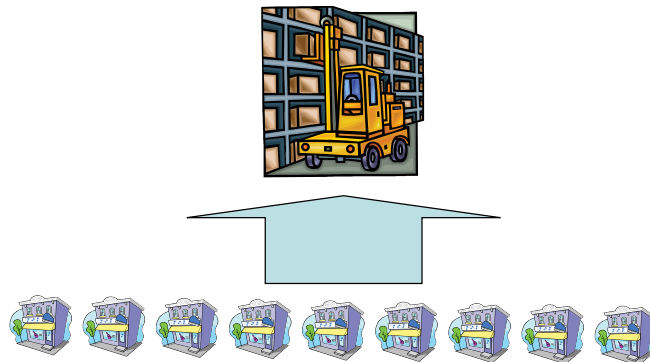
When marking down store product to move the last pieces of inventory, there are ways to minimize gross margin erosion. The days of marking down every store by 40% are over. With several software solutions on the market that analyze the sales lift generated by specific markdown levels, markdowns can be intelligently calculated by item / location. Now, stores carrying several weeks of supply can receive deeper markdowns, while stores with just a few pieces left can be left to sell them at full retail.

Look at the impact on the overall vendor by reviewing vendor minimums, truckload rounding or brackets after the exiting item sales volume is removed from the analysis. It's best to identify these changes ahead of time instead of running into them during the crunch of Monday morning ordering and causing order or receipt delays.

If the forecasting and replenishment system supports the use of outdates – use them. Some outdates represent that date orders and forecasting should cease. The best outdate logic asks the user for the date the item should be out of stock at a store location and calculates dates to stop forecasting, ramp down ordering and take markdowns by location. With the advanced math and logic available in several software solutions, it becomes possible to remove efforts best supported by the system from the user community in order to free them to address issues that cannot be solved by mathematics.

The Next Level: Synchronized Transitions

To take item transition management to the next level, synchronize decisions on transition items at all levels of the retail demand chain. Software solutions can enable retailers to indicate new or exiting item decisions at the store level and let math and logic translate the impact of those decisions up the chain to the warehouse and vendor.



With new items, there are some activities that need to happen before the item begins to sell in the stores. If promotional events or purchase plans are established in the stores, these can be rolled up and time shifted to establish the necessary ordering patterns at the servicing warehouse. In addition, a “future bump” in warehouse demand (shipments to stores) can be calculated based on future store sales and the initial shelf fill order needs. This future bump can then impact orders into the vendor prior to actually having the item on the store shelf.

Once the item begins to sell at the store level, other changes for the warehouse can and should be automated. The future bump for warehouse demand should be deleted. Instead, the demand history used at the store to calculate the initial store demand forecast should be rolled up to the warehouse and that new warehouse history should be used to re-calculate the forward-looking demand forecast and seasonal profile.



Similar logic can be applied for exiting items and synchronization between stores and the warehouse servicing the stores. When setting a future outdate in the store, let the system calculate the reduction in future shipments out of the warehouse and the timing when those shipments will decrease. If there are promotional events or purchases previously rolled up to the warehouse, remove their impact at this time.

When ordering actually stops at the stores for the exiting item, remove the impact of that SKU/Store from the warehouse demand history. Then, recalculate the demand forecast and seasonal profile with the future impact of the exiting item removed.

If these steps seem cumbersome and confusing – they are. But they are steps that must be done either systematically or manually to re-balance the demand chain after addition or removal of an item from the active assortment. And of course this happens every season, if not more frequently. With advanced solutions having proven functionality to address these issues, it becomes a wise investment opportunity for the savvy retail executive.

Cash in During Periods of Change

New item introductions present a rare high margin opportunity for retailers to cash in on early sales and make money in an often razor thin margin business. Exiting items present an opportunity to minimize the prolonged erosion of an item's lifetime accumulated margin when removing the item from the assortment. Consistently outstanding execution of new and exiting item activities enables retailers to delight the customer and reinforce themselves as the retailer of choice in their space. With so much at stake, doesn't it make sense to make item transitions a priority and take your company to the next level?

About RPE

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