## Finding Upside in the Downturn: Merchandising Best Practices podcast series
## Segment: One of five

Hi, I'm Kelly Allen. What are some of the issues and trends impacting retailers and consumer product groups today? And what strategies can help them stay ahead? Today you're going to listen in as IBM World Wide Distribution Executive, Patricia Waldron, talks to Brian Hume. Brian is president and founder of Martec International, a leading retail consulting and training practice. Here, Brian shares his observations on merchandising best practices. He also discusses how chains can tune their performance, and find success in the current economy.

Patricia Waldron: Brian, I know Martec does business with retailers all around the world and as we know the economy is pretty challenging at the moment. We see weaker companies that are disappearing, but at the same time there is lots of examples of customers and companies that are prospering. How are they doing that?

Brian Hume: Well, in a study that we completed in the last year… that we completed very recently, we found that fashion retailers are potentially losing up to 20% of their sales because they are out of stock of key sizes and colors. Studies in other segments like grocery have shown that retailers lose 8% of their sales because of out of stocks. So, the first thing to do is to measure the size of lost sales in your company and understand the scale of the problem. Most companies that do this will be horrified by just how big the numbers are. Then look at the root causes of these out of stocks and decide how to address them. The important thing to remember is that in this particular situation, you don't have to win mind share from your competitors to get the customer's business. The customer already likes you, they like your brand, they are in your store, they just couldn't complete the purchase because you don't have the product on the shelf and in this economy, another thing to remember, is that the cost of financing inventory in order to support availability on the shelf is the lowest it has been for many years and therefore, especially at this point in time, carrying the right inventory levels is much more affordable.

Patricia Waldron: I do hear that from retailers as well when I speak to them, but let's go back to something that you said about root causes. When retailers look at their results, what are some of the most common root causes that you see when you work with retailers around their assortment?

Brian Hume: Well, there are three that really stand out on the majority of occasions and the first is before developing the sales plans and the inventory plans, most retailers don't do a thorough analysis of the sales they lost to out of stocks and the thing is once you know the lost sales, you also know the historic demand. You can define the historic demand at the sales plus the lost sales. Then from the point of view of your forward planning, plan next year or the next season using the historic demand rather than the historic sales and then you won't plan to repeat the kinds of mistakes or repeat the missed opportunities that you got last year. The second thing is in many cases, individual retailers merchandise planning and assortment planning processes are often not detailed enough, they are not comprehensive enough. Improving the planning processes can make a huge difference to availability in store and to achieving sales. And the third thing that goes with the merchandising assortment planning really is the whole allocation process. Many retailers have an allocation process that’s too simplistic. Better allocation planning and execution of those allocations can also make a significant difference. And then there are a variety of other things, but those are really the big three; if you take the 80/20 view, those are really the big three that give you the lion's share of the benefit.

Patricia Waldron: What should retailers do once they have made the investment in inventory and they actually have it and are trying to maximize it during in season? What should they focus on?

Brian Hume: Well, obviously in season performance management is very important and the generalization, the earlier you can identify a potential problem or an issue, the easier and more cost effective it would be to respond to it. So, for example, let's imagine we have a product that isn't selling as well as we planned and we end up facing the markdown decision, in other words, we reduce the price in order to make it sell faster. The earlier we identify the fact that it's not selling at the required rate, the smaller the markdown that we will need to take in order to bring that product back on plan. Hence, monitoring the sell through against the plan and detecting the risk of not meeting that plan as early as possible gives us the longest possible time to react and incurs the least markdown cost. In its wider context, measuring performance on a wide range of key indicators, things like sell through, stock turn, availability, and so on, gross margin, things like that and comparing those against plan and against last year is very important. The earlier we can identify a significant variance the more easily and the more cost effectively we can deal with it.

Patricia Waldron: Retailers may use promotions to a greater or lesser degree overall as well as by time of year, by customer, by type of the product; what are some of the best practices from your perspective around promotions?

Brian Hume: Well, promotions are very important to many retailers and depending on which segment of retail you are in, depending which country you are in, the volume of sales that you do on promotion as opposed to regular times can be typically somewhere between 30% and 60% of your entire company sales. So, it’s a very important element of the selling cycle for many retailers and to be honest, a lot of retailers don’t do this very well, but the first thing to do is to define an objective for each promotion. Now, the obvious objective for most people is to generate sales, but there are actually quite a lot of other objectives that people could have. For example, you want to get consumers to sample a new product and hopefully, if they like the new product at the promotional price and the product is successful, they will come back and buy it again at the regular price once the promotion is over. Sometimes you want a promotion to create traffic in the store and you are not looking to make money out of that product; you are looking to make out of the other things that people buy in the store. Sometimes you want promotions to build brand awareness and so on. So, there are a number of different reasons that you could run a promotion.  First thing is to define for each individual promotion what the core objective for that promotion is.  The second step then is to make sure you plan that promotion properly and one of the biggest challenges for people is to estimate the sales list the promotion will achieve and then make sure that you deploy the inventory to support that sales list.  Now, that's quite a tough challenge.  A lot of promotions will generate sales increases in the region of an additional 100% or 200%.  In other words, the rate of sale will double or triple.  On the other hand, there are promotions that struggle to make a 20% lift and obviously, the difference between a 20% lift and a 200% lift has got a very significant impact on your inventory deployment.  So, analyzing past experience with promotions and using that analysis to get the best prediction of the list on this particular promotion is crucially important to deploying enough inventory.  You also have to look at things that will distort performance; so, for example one obvious one is cannibalization.  People generally, when toothpaste goes on promotion, they don't buy twice as much toothpaste as they did before.  They generally switch brands.  So, one brand that is on promotion sees a sales lift, but another brand suffers.  Another effect is what we refer to the halo effect, which is you put product A on promotion and people like the promotion and go for it, but the halo effect is that that sales lift drags with it other products that are related, so for example you might sell… you might have an office supplies business and you sell computer printers and every time you sell computer printers, you sell ink cartridges and you sell paper supplies and that kind of thing.  Now, an experienced retailer would never ever put printers on promotion and also put ink cartridges and paper on promotion at the same time.  So, you decide that for example you will put printers on promotion and then you will make sure that you are selling the ink cartridges and the paper at the regular price because those products will get dragged along as part of the halo effect.  These are areas where having the right kind of data warehouse and the right kind of analysis tools can really provide some meaningful analysis to people like the buying and merchandising department, the marketing department so they really plan these promotions as successfully as possible and then the last part of it is that you then got to monitor the performance so that if the promotion isn't working quite as well as you expected, you can take corrective action rapidly and if you look at some of the leaders in this space now, some of the leading retailers, they will be reacting on the afternoon of the same day, so they launch a promotion this morning let's say, some retailers already have the capability that if it is not working by 2 o'clock in the afternoon, they will be reacting already, and because promotions potentially give you such a huge sales lift when they work, that kind of speed of reaction is very important, but you can't react unless you know that the thing isn't working as well as you planned. So, it's a whole performance management thing, but it's performance management in this case in a very tight time scale that allows you to react and then in a longer time scale, analyze how the promotion worked and feed that knowledge into planning for future promotions.

For more information on how IBM Cognos Software is helping retailers, please visit ibm.com/cognos/retail.  I'm Kelly Allen, thanks for listening.