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Consumer Centricity Takes Merchandising Into New Territory

by Nikki Baird and George Lawrie

MARKET OVERVIEW

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with Sharyn Leaver and Elisse Gaynor

EXECUTIVE SUMMARY

Merchandising processes have long suffered from an inability to create closed-loop plans that: stay relevant in execution; reconcile financial objectives against unit plans; and connect supply chain implications and costs to decisions that merchants make. Hampered by inflexible systems that are highly customized or homegrown, retailers have had little opportunity to bring merchandising processes or technology into the modern age. But smart retailers are now shifting toward consumer-centric merchandising to drive merchandising decisions from market segmentation insights. Consumer-centric merchandising — with its demands for greater integration, more data-intensive analysis and optimization, and more complex execution — threatens to overwhelm current systems. Retailers don't need a big-bang replacement to keep up, but they do need to prioritize modular solutions within an overall process strategy.

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NOTES & RESOURCES

Forrester interviewed 13 vendors, including: 4R Systems, 7th Online, Aldata Solution, Deloitte, DemandTec, Escalate Retail, Galleria, i2, Manhattan Associates, Oracle, SAP, SAS Institute, and Tomax.

Related Research Documents

["Trends 2007: Retail IT"](#)

February 6, 2007, Trends

["The State of Manufacturer And Retailer Collaboration 2006"](#)

December 19, 2006, Trends

["Retailers Augment Margins With Merchandise Management Apps"](#)

November 5, 2004, Trends

TARGET AUDIENCE

Business process and applications professional

MERCHANDISING PROCESSES ARE FLAWED JEWELS

Merchandising is the heart of retail. It's at least 80% of right product, right store, and right price. But despite the fact that merchandising processes have been around since the first retailer decided to centralize buying, they haven't evolved much. Merchandising processes today:

- **Start from the wrong place.** Most retailers start from last year's plan. While that seems logical, it's a dangerous place to start, perpetuating last year's obsolete assumptions and ignoring the opportunity to incorporate "in season" learning about patterns of demand. Also, tastes change; trends emerge and die — so starting from last year's plan, rather than a true demand forecast, risks missing major changes in volatile consumer markets.¹
- **Ignore supply chain costs.** In retail, product planning has become so complex and intensive that most retailers no longer consider merchandising part of the supply chain; rather, it's a standalone organization that interacts with supply chain. But the isolation of merchandising decisions from supply chain consequences risks unplanned cost overruns and service degradation. Without a holistic view of the supply chain — from product planning through logistics — and without merchant accountability for the full ramifications of decisions, there is no incentive to minimize supply chain impact. Even worse, there is a risk of chaotic stock-outs followed by urgent inventory shipments and interstore transfers.²
- **Are too fragmented.** People talk about "merchandising" as if it's a single cohesive process. But, just as there is poor coordination between merchandising, supply chain, and marketing processes, there are discontinuities *within* merchandising, too. Different groups create financial plans and product plans, and other departments calculate allocation and replenishments. These responsibility silos and disjointed processes mean that plans never get updated once a retailer starts execution. It's almost impossible to reconcile the multiple plan types and levels, let alone update them in the light of actual results during execution.³
- **Frustrate retailers' response to consumer and manufacturer pressures.** Two-fifths of US consumers now expect retailers to offer them personalized promotions.⁴ Meanwhile, a lack of detailed data from retailers' systems frustrates more than two-thirds of consumer products firms.⁵ Under pressure from both ends of the value chain, almost two-thirds of retailers anticipate increasing the granularity of their assortment in 2007.⁶

Existing Systems Hamper Flexibility

These problems are not new, but retailers continue to struggle to fix them. Beside the enormous cultural impact of some changes, such as deciding to hold merchants responsible for supply chain costs, retailers struggle to fix these problems because it is incredibly difficult to make the system changes needed to support process changes. Existing merchandising systems:

- **Fossilize old working practices and processes.** Merchandising is so close to the core of the business of retail that merchants are reluctant to adopt standard processes and applications. They are tempted to develop custom applications that fossilize arcane working practices and increase costs because they are hard to replace and difficult to support, upgrade, and integrate.
- **Jeopardize agility and collaborative retailing.** The merchandising process has not been well supported by technology, as it tends to be a fluid, ad hoc workflow that is very data-intensive in a world where most apps are designed to support highly structured transactional processes. Forcing that square peg into a round hole has resulted in a lot of custom code, adding to the problem with more hard-wired logic that can't keep up with changing business demands.
- **Burden IT with brittle legacy interfaces.** Retailers have delivered advances in capability, such as assortment planning, by bolting on best-of-breed solutions — because that's much less expensive and risky than contemplating an entire planning and order management replacement. But adding further point solutions exacerbates the problem for retailers; they carry the costs and risks of a heterogeneous application portfolio that they can't easily adapt to new opportunities.

CONSUMER CENTRICITY EXERTS SHATTERING PRESSURE

For all the challenges that merchandising processes have today, the activity around consumer centricity will only make the problems worse. How? By requiring even more complex activities from an already complicated and data-intensive process (see Figure 1). Merchandising apps will need to cope with:

Figure 1 Consumer Centricity Will Require A New Generation Of Merchandising Apps

Consumer-centric change	Process impact	System impact
Consumer insights and customer segmentation become the basis for all decisions at the company	Planning from a customer perspective, rather than a product perspective	<ul style="list-style-type: none"> • Product planning data cut by customer segments • Affinity analysis during the planning cycle
The assortment is customized to address the unique needs of each target segment	Creating unique or localized assortments by store	<ul style="list-style-type: none"> • Store clustering based on customer segments, rather than geography or volume • Supply chain cost modeling • Prepack optimization
Channels are personalized to enable the distinctive experiences of each target segment	Creating distinct customer service experiences by store and across channels	<ul style="list-style-type: none"> • Space optimization • Computer-assisted ordering in stores • Task management • Automated pricing

- **Planning from a customer, rather than category, perspective.** Merchandising groups are organized by category: “women’s wear” and “men’s wear” or “cameras and computers.” But becoming consumer-centric changes that orientation radically. Instead of buying for cameras, a consumer-centric retailer needs to think about the different customer segments interested in cameras and make sure that it carries the products that enable each segment’s “camera” experience. For example, soccer mom Susan who doesn’t really like technology but wants a digital camera to take pictures for making scrapbooks needs a lot more than the camera to enable the experience she’s looking for. A retailer looking to help Susan needs a “Susan” buyer, not a camera buyer.
- **Balancing granularity in the plan against the ability to execute.** In a recent survey, 64% of retail respondents anticipated increasing the granularity of their assortment in 2007, with only 10% of retailers currently creating granular assortments by store.⁷ While merchants are very interested in creating assortments that are customized to the shoppers of each particular store, the ability to actually deliver that assortment is extremely challenging. Pulling it off requires a big supply chain tradeoff: The sales upside in stores from a more customized product assortment had better be bigger than the supply chain costs of getting that customized assortment to store. The problem lies in the granularity itself; when taken to a store level, it will require breaking open case quantity somewhere in the supply chain. As soon as that case is opened, the cost of delivering that product increases significantly.
- **Managing complexity in execution.** Localized or granular assortments create more than just supply chain headaches. When there is no longer any such thing as an “A store” or “B store” — because the combination of demographics and assortment by department and category means every store is unique — store operations moves from managing five- to 10-store clusters to managing hundreds of unique stores. Coupled with more frequent product introductions and more store-specific content, being able to create the planograms, price changes, and store compliance tracking at a store level becomes a critical necessity.

Technology Must Enable The Process

With merchandising apps already in a poor state, it will be highly challenging for retailers to add new capabilities to accommodate consumer centricity requirements. These requirements are not the bolt-ons of the past. Unlike adding assortment planning or price optimization, supporting consumer centricity requires far more integration — and brings processes and data together in completely new ways. Retailers need dynamic apps that can:

- **Incorporate consumer insights into the planning cycle.** If you’re going to plan and buy for “Susan” rather than for cameras, you need a merchandise hierarchy that supports that 90-degree turn on how you view your business. For a lot of retailers so far, this has meant applying customer insights at the store level — by clustering or zoning stores — but not any further. The reality is much more complicated. To be able to truly incorporate consumer insights into merchandising, retailers have to be able to answer questions during the planning process like “Which customer segments have the highest affinity to these products?” or “Which customer

segments will be most affected if I drop this product from my assortment?” — questions that vendors like Escalate Retail are already preparing to answer by integrating merchandise planning with customer segmentation apps.

- Manage an end-to-end — and integrated — merchandising process.** If retailers operate on a demand forecast instead of last year’s plan, they must still reconcile against financial objectives. As planners tweak the assortment and rationalize it to appeal to target customer segments, they have to see both the budgetary and the supply chain impact as well as the workflow they trigger — such as purchase orders or pick orders launched to deliver the assortment. Each store must be able to execute their plans, taking into account the store’s space and demographic eccentricities. Despite recent consolidation, few vendors are able to offer a true end-to-end suite today (see Figure 2). But vendors are starting to show how the power of an integrated suite can take merchandising processes to the next level — as Oracle demonstrated with the release in January of its new promotion planning and optimization solution.

Figure 2 Few Vendors Offer An Integrated End-To-End Solution

	Demand forecasting	Financial planning	Assortment planning	Price opt.	Size opt.	Store clustering	Inventory opt.	Allocation	Replenishment forecast	Replenishment	Space opt.
4R Systems	☐	☐	☐	✓	✓	☐	✓	✓	✓	✓	☐
7thOnline	☐	☐	✓	✓	✓	✓	✓	☐	☐	☐	☐
Aldata Solution	✓	✓	✓	☐	☐	☐	✓	✓	✓	✓	☐
DemandTec	☐	☐	☐	✓	☐	✓	☐	☐	☐	☐	☐
Escalate Retail	☐	✓	✓	☐	☐	✓	☐	✓	✓	✓	☐
Galleria	☐	☐	☐	☐	☐	☐	☐	✓	✓	✓	✓
i2	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	☐
JDA	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
Manhattan Associates	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	☐
Oracle	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓
SAP	✓	✓	✓	✓	✓	✓	✓	✓	✓	✓	☐
SAS Institute	✓	✓	✓	✓	✓	✓	✓	✓	✓	☐	✓
Tomax	✓	☐	☐	☐	☐	✓	✓	✓	✓	✓	☐

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Source: Forrester Research, Inc.

- **Cross the last mile of execution.** Store-specific plans need store-specific execution, but granular plans introduce a level of complexity that most retailers can't handle. Planograms that are not store-specific create headaches and hassles at the shelf — and yield a result far from the careful consumer-centric design that the merchandising organization originally conceived. Price changes and promotions that don't make it to the shelf create customer confusion and result in disappointing brand experiences. And complex local assortments will force many retailers to reconsider centralized buying: Computer-assisted store ordering adds a front-line gut check on whether all that planning and optimization created a reasonable assortment from a store perspective. Technologies like task management, space optimization, store ordering, and even electronic shelf labels all play a role in crossing that last mile of execution.

RETAILERS ARE GRADUALLY COLLECTING NEW MERCHANDISING GEMS

Given resource constraints and the level of risk involved in taking on an entire merchandising suite, it's not reasonable to try to implement a big-bang replacement strategy. Merchants have to prioritize — choosing the pieces that add value and solve problems today, but in the context of a defined longer-term end state (see Figure 3). Some of the retailers taking their first steps toward consumer centricity include:

- **Tesco, with planograms.** With multiple formats that vary widely in size, Tesco was challenged to provide a centralized merchandising strategy that could take into account the unique assortment and space requirements of each store. Tesco implemented Galleria's space optimization tool to help balance product depth against assortment breadth, while accommodating insights into consumer decision-tree logic and product affinities and adjacencies. Tesco generates 25,000 unique planograms per day, and by creating planograms that are specific to stores, it has increased compliance from 30% to 90%.
- **Kohl's, with size optimization.** Nearly three-quarters of Kohl's business is from sized merchandise, and the retailer is in the process of implementing SAS's size optimization solution. Kohl's is creating size profiles by department by store and is working with suppliers to determine the optimal number of prepacks that can be delivered to stores. Kohl's size-profiled more than 50% of merchandise by the end of 2006 and will roll out the remainder in 2007, alongside continuing efforts to update and tailor its assortment. Kohl's anticipates reducing the number of stock-outs by size, leading to revenue benefits in 2007 and 2008.⁸
- **Famous Footwear, with integrated planning.** In pursuing an integrated merchandising process, Famous Footwear not only linked together applications to support a coordinated plan, but also reorganized the merchandising organization into buying teams that literally colocated financial, assortment, allocation, and location planners. Using a mix of JDA, homegrown applications for functions like size optimization, and Excel spreadsheets, Famous Footwear's integrated planning

process enabled the firm to create much more granular assortments — even building in assumptions about the timing of regional tax-exempt weekends. Now that Famous Footwear has established a strong foundation process, the firm plans to build more sophisticated additional capabilities, such as consumer-centric merchandising and demand forecasting.

Figure 3 Sophisticated Consumer Centricity Is Evolution, Not Revolution

	Insight-driven planning	Planning granularity	Differentiated customer experiences
Consumer-centric (The target end state, requiring significant process or technology change)	During the planning process, merchants can validate individual item decisions against affinity to any customer segment; planning is primarily by customer segment, not by category	Within-store clustering by category or class by customer segments	Retailers define the buying process steps for each customer segment and have a cohesive multichannel strategy for participating in or enabling each step
Low-hanging fruit (Things retailers can do with a few system or process changes)	During the planning cycle, merchandising validates that the planned assortment fits with strategic customer segments	Store clustering by customer segments	Stores are merchandised to meet specific target segments; retailers enable cross-channel experiences designed for strategic customer segments
The basics (Things retailers can do today with what they have)	Merchandising and marketing meet regularly to discuss characteristics of strategic customer segments	Store clustering by geography and volume	Stores are trained in selling techniques relevant to strategic customer segments

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Source: Forrester Research, Inc.

RECOMMENDATIONS

IT'S TIME TO PLAN FOR DYNAMIC MERCHANDISING APPS

The new process requirements for consumer centricity will break legacy merchandising apps beyond repair. At the same time, the rise of Web services and service-oriented architectures has taught vendors a lot about how to enable ad hoc workflows and decision-based processes. Taken together, these trends mean it's finally time to start planning that merchandise application replacement project you've been dreading. Although vendors aren't quite ready to come to market to support a holistic consumer-centric merchandising process, here are the steps that you can take now to help you prepare:

- **Hold merchants accountable for supply chain costs.** Even if you have to support it with Excel spreadsheets or a couple of custom-developed choice reports for the short term, don't pursue consumer centricity without first understanding the break point between the sales increase from granular assortments and the increased supply chain costs of delivering that assortment. The only way to do that is to make merchants accountable for all of the supply chain implications of the decisions they make. Do this first as a process change in order to get on the learning curve now.
- **Make the marketing department the stewards of consumer insights — not the guardians.** Marketing rightfully owns the customer data that provides the foundation of insights in a consumer-centric merchandising process. Generally, it's a marketing department that can mine the vast volumes of basket and item attribute data to develop insight into the values that drive consumer behavior. The critical step is to share this data and insight with merchandising so that it can develop assortments that resonate with identified consumer values and buying behavior. Smart retailers are laying the process foundation now for sharing consumer insight data ahead of the availability of integrated apps.
- **Don't cherry pick — have a strategy.** Merchandising apps have been enhanced primarily through bolt-on solutions like markdown optimization. But while it's tempting to cherry pick — for example, to add on space optimization and maybe some assortment planning — it's also risky. Note that even though Tesco and Kohl's both implemented bolt-on applications, they did so in the context of a longer-term strategy, both of which involved becoming more consumer-centric. Consumer-centric merchandising requires a lot more integration than past processes, and cherry picking will lead to more silos, more integration requirements, and more risk of a failed implementation. Instead, start with a plan of attack, prioritize your needs, and implement modularly but with a specific end state in mind. Developing that plan of attack will take time, especially if you have a lot of legacy code, because of the complexities of unraveling those systems and defining an accurate current state — so start now.
- **Pay attention to the vendors' vision.** If you're past the analysis stage and need to move ahead to get systems that support your consumer-centric process, you are going to have to buy into a vendor's vision for how technology will ultimately support the process. While some vendors, such as Oracle and Escalate Retail, have been thinking hard about the challenge, no one has sophisticated support for consumer-centric processes today. And even if you're not at that point, it helps to keep an eye on the market: While every vendor is talking about consumer centricity, they are following different paths to enable it — eventually leading to some significant differentiation in the market.

SUPPLEMENTAL MATERIAL

Companies Interviewed For This Document

4R Systems	i2
7th Online	Manhattan Associates
Aldata Solution	Oracle
Deloitte	SAP
DemandTec	SAS Institute
Escalate Retail	Tomax
Galleria	

ENDNOTES

- ¹ In 2003, there was not a large variance by age in the percentage of consumers who like to shop around before making a purchase — ranging from 63% for the oldest group to 66% for three of the other groups. But in 2006, consumers in the three youngest groups became more likely to shop around, while the two older groups of consumers became less likely to shop around. As a result, the range across age groups widened from a low of 60% for the 65 and older crowd to a high of 69% for the 25 to 39 year olds. See the July 24, 2006, Trends “[The Changing Financial Consumer](#).”
- ² There has been very little progress toward smarter shelves, at least if we are talking about shelves embedded with RFID sensors that are designed to read product-level tags. And, smarter product technology is no farther along than smarter shelves, and in fact, is actually farther behind. The implications of this for stock-out management have not been promising. See the October 4, 2005, Trends “[Smarter Stores: Are We There Yet?](#)”
- ³ Is integration finally coming to retail? It definitely seems much closer than at any time in the past, with signs everywhere. Vendors from Skillnet Solutions to IBM offered store-to-enterprise integration, and Oracle added yet another retail best of breed to its portfolio, going head to head once again with SAP by acquiring POS vendor 360Commerce. While there’s a long way to go to truly integrate their acquisitions; SAP and Oracle both talked about strategies that remove the integration problem from retailers’ hands. See the January 27, 2006, Quick Take “[NRF 2006: Boredom Is Exciting](#).”
- ⁴ With 40% of US consumers demanding personalized promotions and coupons, manufacturers must be able to respond with customized promotions, local assortments, and store-level replenishment. See the March 28, 2006, Trends “[Boosting The Store IQ](#).”
- ⁵ Some 68% of CP firms believe that retailers don’t share enough data or the right types. See the March 28, 2006, Trends “[Boosting The Store IQ](#).”
- ⁶ While only 10% of retailers surveyed for the 2006 Shared Strategy Study by Forrester Research, *Consumer Goods Technology*, and *RIS News* reported that they created unique assortments by store, 64% anticipated increasing the granularity of their assortment in 2007. See the December 19, 2006, Market Overview “[The State Of Manufacturer And Retailer Collaboration 2006](#).”

⁷ With even Wal-Mart, the bastion of supply chain efficiency, on the bandwagon for localized assortments by store, it's no surprise that 64% of retailers and 58% of manufacturers plan to increase the granularity of their assortments in 2007. See the December 19, 2006, Market Overview "[The State Of Manufacturer And Retailer Collaboration 2006](#)."

⁸ Source: Deborah Weinswig, Charmain Tang, and TinaHuang, "KSS: 2Q06 EPS Review — Impressive Gross Margin Impvt Drives Results," Citigroup, August 10, 2006.

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