

Managing the Merchandise Planning Process

CHAPTER 12

Questions

- What is the merchandise management process?
- How are merchandise management processes different for staple and fashion merchandise?
- How do retailers forecast sales for merchandise categories?
- What trade-offs do buyers consider in developing merchandise assortments?
- How do retailers plan their assortments and determine the appropriate inventory levels?
- How do multistore retailers allocate merchandise to stores?
- How do retailers evaluate the performance of their merchandise management process?

Merchandise Management

- Process by which a retailer offers the correct quantity of the right merchandise in the right place at the right time and meets the company's financial goals.
- Sense market trends
- Analyze sales data
- Make appropriate adjustments in prices and inventory levels



Merchandise Management and Investment Portfolio Management

- Dollars to invest in inventory
- Invest in “hot” merchandise
- Save a little for opportunities (open to buy)
- Monitor portfolio of merchandise (stocks)
- Sell losers (markdowns)



Traders on the stock exchange floor manage a portfolio of stocks, and retail buyers manage a portfolio of merchandise inventory. Both continuously assess the risks associated with their purchase decisions.

Buying Organization

Merchandise Group

Each merchandise group is managed by a general merchandise manager (GMM), senior VP

Department

Departments are managed by a divisional merchandise manager (DMM),

Classification

A group of items targeting the same customer type, such as girls' sizes 4-6

Category

Each buyer manages several merchandise categories (e.g., sportswear, dresses, swimwear, outerwear categories for girls' sizes 4-6

SKU

The smallest unit available for inventory control
Size, color, style

Merchandise Category – The Planning Unit

- A merchandise category is an assortment of items that customers see as substitutes for each other.
- Vendors might assign products to different categories based on differences in product attributes
- Retailers might assign two products to the same category based upon common consumers and buying behavior

Category Management

- The process of managing a retail business with the objective of maximizing the sales and profits of a category
- Objective is to maximize the sales and profits of the entire category, not just a particular brand

Breakfast cereal category vs. Kellogg
Corn Flakes

Men's knitted shirts vs. Polo shirts

Diary product category vs. Carnation
milk products



Category Captain

Selected vendor responsible for managing a category

- Vendors frequently have more information and analytical skills about the category in which they compete than retailers
- Helps retailer understand consumer behavior
- Creates assortments that satisfy the customer
- Improves profitability of category

Problems

- Vendor category captain may have different goals than retailer

Evaluating Merchandise Management Performance - GMROI

- Merchandise managers have control over
 - The merchandise they buy
 - The price at which the merchandise is sold
 - The cost of the merchandise
- Merchandise managers do not have control over
 - Operating expenses
 - Human resources
 - Real estate
 - Supply chain management
 - Information systems
- **SO HOW ARE MERCHANTS EVALUATED?**

Measuring Sales-to-Stock Ratio

- Net Sales/Average Inventory at Cost
- Retailers report on an annual basis
- If the sales-to-stock ratio for a three-month season is 2.3, the annual sales-to-stock ratio will be 9.2
- Estimation of average inventory
 - Use information system: averaging the inventory in stores and distribution centers at the end of each day
 - Divide the sum of the end-of-month (EOM) inventories for several months by the number of months

Types of Merchandise Management Planning Processes

Two distinct types of merchandise management systems for managing

- Staple (Basic) Merchandise Categories

- Continuous demand over an extended time period
- Limited number of new product introductions
- Hosiery, basic casual apparel
- Easy to forecast demand
- Continuous replenishment

- Fashion Merchandise Categories

- In demand for a relatively short period of time
- Continuous introductions of new products, making existing products obsolete
- Athletic shoes, laptop computers, women's apparel

Merchandise Management Process

1. Forecasting sales
2. Developing an assortment plan
3. Determining the appropriate inventory level

Developing a Sales Forecast

- Understanding the nature of the product life cycle
- Collecting data on sales of product and comparable products
- Using statistical techniques to project sales
- Work with vendors to coordinate manufacturing and merchandise delivery with forecasted demand (CPFR)



Types of Merchandise

Staple Merchandise

Predictable Demand

History of Past Sales

Relatively Accurate Forecasts



Fashion Merchandise

Unpredictable Demand

Limited Sales History

Difficult to Forecast Sales



Factors Affecting Sales Projections

Controllable

- Promotions
- Store Locations
- Merchandise Placement
- Cannibalization

Uncontrollable

- Seasonality
- Weather
- Competitive Activity
- Product Availability
- Economic Conditions

Forecasting Fashion Merchandise Categories

Retailers develop fashion forecasts by relying on:

- Previous sales data
- Market research
- Fashion and trend services
- Vendors



Forecasting Fashion Merchandise Categories

- Previous sales data
 - Many items in a fashion category are often similar to items sold in previous years.
- Market research
 - Activities range from informal, qualitative research about trends affecting the category to more formal experiments and surveys.

Forecasting Fashion Merchandise Categories

- Fashion and trend services
 - There are many services that buyers can subscribe to that forecast the latest fashions, colors, and styles.
- Vendors
 - Vendors have proprietary information about their marketing plans and tend to be very knowledgeable about market trends.

Forecasting Service Retailers

- Due to the perishable nature of services, service retailers face more challenges than fashion retailers.
- Offerings perishes at the end of the day, not at the end of the season.
- Must devised approaches for managing demand so that it meets, but does not exceed capacity.

Developing an Assortment Plan

- **Assortment plan** is a list of the SKUs that a retailer will offer in a merchandise category and reflects the variety and assortment that the retailer plans to offer in a merchandise category
- **Variety** (breadth) is the number of different merchandising categories within a store or department
- **Assortment** (depth) is the number of SKUs within a category.
- **Product availability** defines the percentage of demand for a particular SKU that is satisfied.

Determining Variety and Assortment

Buyers consider

- Retail strategy
 - The number of SKUs to offer in a merchandise category is a strategic decision
- GMROI of the merchandise mix
- Trade-off between too much versus too little assortment
 - Increasing sales by offering more breadth and depth can potentially reduce inventory turnover and GMROI by stocking more SKUs
- Physical characteristics of the store
- Complementary Merchandise



Product Availability

- The percentage of demand for a particular SKU that is satisfied
- Level of support or service level
- The backup (buffer) stock in the model stock plan determine product availability
- The higher product availability, the higher the amount of backup stock necessary to ensure that the retailer won't be out of stock on a particular SKU when consumers demand it

Product Availability

Factors considered to determine the appropriate level of buffer stock and thus the product availability for each SKU

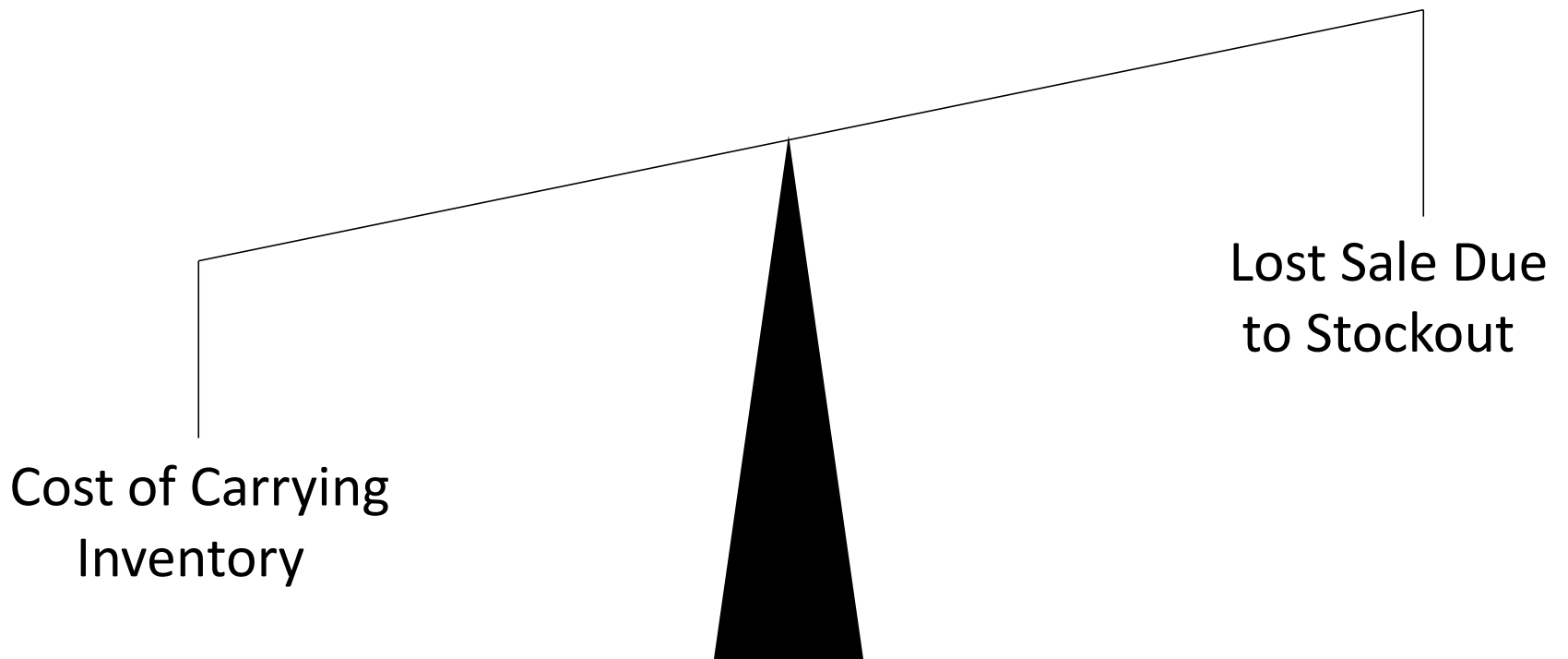
- ABC Classification of merchandise (inventory)
 - A – higher product availability
 - B – medium product availability
 - C – lower product availability is acceptable
- Fluctuations in demand
- Lead time for deliver from the vendor
- Frequency of store deliveries

Staple Merchandise Planning

- Buyer Determines:
 - Basic Stock or Assortment Plan
 - Level of Backup Inventory
- System:
 - Monitors Inventory levels
 - Automatically reorders when inventory gets below a specified level

Basic Stock

- Indicates the Desired Inventory Level for Each SKU



Determining the Level of Backup Stock

More
Backup
Stocks
Needed
with

- Higher product availability (service level) retailer wishes to provide to customers
- Greater the fluctuation in demand
- Longer lead time from the vendor
- More fluctuations in lead time
- Lower vendor's Fill rate (% of complete orders received from a vendor)

Order Point

The point at which inventory available should not go below or else we will run out of stock before the next order arrives

Order point = sales/day (lead time + review time) + buffer stock

- Assume Lead time = 3 weeks, review time = 1 week, demand = 100 units per week

$$\text{Order point} = 100 (3+1) = 400$$

- Assume Buffer stock = 50 units, then

$$\text{Order point} = 100 (3+1) + 50 = 450$$

We will order something when order point gets below 450 units.

Fashion Merchandise Management Systems

- The system for managing fashion merchandise categories is typically called a Merchandise Budget Plan

Merchandise Budget Plan

Plan for the financial aspects of a merchandise category

- Specifies how much money can be spent each month to achieve the sales, margin, inventory turnover, and GMROI objectives
- Not a complete buying plan-- doesn't indicate what specific SKUs to buy or in what quantities



Evaluating the Merchandise Budget Plan

- Inventory turnover GMROI, sales forecast are used for both planning and control
- After the selling season, the actual performance is compared with the plan
 - Why did performance exceed or fall short of the plan?
 - Was the deviation from the plan due to something under the buyer's control?
 - Did the buyer react quickly to changes in demand by either purchasing more or having a sale?

Open-to-Buy System

The OTB system is used after the merchandise is purchased

Monitors Merchandise Flow

Determines How Much Was Spent and How Much is Left to Spend



Allocating Merchandise to Stores

Allocating merchandise to stores involves three decisions:

- how much merchandise to allocate to each store
- what type of merchandise to allocate
- when to allocate the merchandise to different stores

Type of Merchandise Allocated

Retailers classify stores according to the characteristics of the stores' trading area



Laptops and Lattes: The most eligible and unencumbered marketplace

Laptops and Lattes are affluent, single, and still renting. They are educated, professional, and partial to city life, favoring major metropolitan areas such as New York, Boston, Chicago, Los Angeles, and San Francisco. Median household income is more than \$87,000; median age is 38 years. Technologically savvy, the Laptops and Lattes segment is the top market for notebook PCs and PDAs. They use the Internet on a daily basis to trade stocks and make purchases and travel plans. They are health conscious and physically fit; they take vitamins, use organic products, and exercise in the gym. They embrace liberal philosophies and work for environmental causes

Rustbelt Retirees

Rustbelt Retirees can be found in older, industrial cities in the Northeast and Midwest, especially in Pennsylvania and other states surrounding the Great Lakes. Households are mainly occupied by married couples with no children and singles who live alone. The median age is 43.8 years. Although many residents are still working, labor force participation is below average. More than 40 percent of the households receive Social Security benefits. Most residents live in owned, single-family homes, with a median value of \$118,500. Unlike many retirees, these residents are not inclined to move. They are proud of their homes and gardens and participate in community activities. Some are members of veterans' clubs. Leisure activities include playing bingo, gambling in Atlantic City, going to the horse races, working crossword puzzles, and playing golf.



SOURCE: <http://www.esri.com/library/whitepapers/pdfs/community-tapestry.pdf>.

The assortment offered in a ready-to-eat cereal aisle should match the demands of the demographics of shoppers in a local area

Analyzing Merchandise Management Performance

Three types of analyses related to the monitoring and adjustment step are:

- Sell through analysis
- ABC analysis of assortments
- Multiattribute analysis of vendors

ABC Analysis

- An ABC analysis identifies the performance of individual SKUs in the assortment plan.
- Rank - orders merchandise by some performance measure determine which items:
 - should never be out of stock
 - should be allowed to be out of stock occasionally
 - should be deleted from the stock selection.
- A items: 5% of SKUs, represent 70% of sales
- B items: 10% of SKUs, represent 20% of sales
- C items: 65% of SKUs, represent 10% of sales
- D items: 20% of SKUs, represent 10% of sales

Multiattribute Method for Evaluating Vendors

The multiattribute method for evaluating vendors uses a weighted average score for each vendor. The score is based on the importance of various issues and the vendor's performance on those issues.



Evaluating Vendors

- A buyer can evaluate vendors by using the following five steps:
 1. Develop a list of issues to consider in the evaluation (column 1)
 2. Importance weights for each issue in column 1 are determined by the buyer/planner in conjunction with the GMM (column 2)
 3. Make judgments about each individual brand's performance on each issue (the remaining columns)
 4. Develop an overall score by multiplying the importance of each issue by the performance of each brand or its vendor
 5. Determine a vendor's overall rating, add the products for each brand for all issues

Keywords

- **inventory turnover** Net sales divided by average retail inventory; used to evaluate how effectively managers utilize their investment in inventory.
- **gross margin return on investment (GMROI)** Gross margin dollars divided by average (cost) inventory.
- **return on assets** Net profit after taxes divided by total assets.
- **sales-to-stock ratio** The net sales divided by average inventory at cost. It is one component of GMROI and is similar in concept to inventory turnover except the numerator is expressed at retail (net sales) rather than at cost (cost of good sold)
- **staple merchandise** Inventory that has continuous demand by customers over an extended period of time. Also known as *basic merchandise*.
- **fashion merchandise** Category of merchandise that typically lasts several seasons, and sales can vary dramatically from one season to the next.

REFERENCES

- Levy, Michael (2019) Retailing Management 10th edition. Irwin / McGraw – Hill
- Goworek, Helen (2015) Retail Marketing Management: Principles and Practice, Pearson
- Levy M., Wetz, B. (2012). Retailing Management: New York: Mc Graw Hil
- Levy, Michael (2009) Retailing Management 8th edition. Irwin / McGraw – Hil
- Yudelson, Jerry. Sustainable Retail Development: New Success Strategies . New York: ICSC, 2009.
- Jerath, Kinshuk, and Z. John Zhang. “Store-Within-a-Store.” Journal of Marketing Research, forthcoming. Kramer, Anita. Dollars & Cents of Shopping Centers/The SCORE 2010 . Washington, DC: Urban Land Institute, 2010.