

RETAIL MANAGEMENT – LECTURE 12

CHAPTER 12 – MANAGING THE MERCHANDISE PLANNING PROCESS

Overview

It outlined the merchandise management process and the steps in the process that buyers go through to determine what and how much merchandise to buy. After creating an assortment plan for the category, forecasting sales, and developing a plan outlining the flow of merchandise (how much merchandise needs to be ordered and when it needs to be delivered), the next step in the merchandise management process is to acquire the merchandise. The process for acquiring merchandise differs for well-known national brands and private-label brands that are available exclusively from the retailer. Thus, the first strategic decision that needs to be made is to determine the type of brands to buy for the category.

Desired Learning Outcomes

1. What branding options are available to retailers?
2. How do retailers buy national brands?
3. What issues do retailers consider when buying and sourcing private-label merchandise internationally?
4. How do retailers prepare for and conduct negotiations with their vendors?
5. Why are retailers building strategic relationships with their vendors?
6. What legal and ethical issues are involved in buying merchandise?

MANAGING THE MERCHANDISE PLANNING PROCESS

Learning Objective 1 – Merchandise Management Overview

Merchandise management is the process by which a retailer strives to offer the appropriate quantity of the appropriate merchandise at the appropriate location at the appropriate time while also meeting the financial objectives of the company. In order to properly manage item inventory, buyers must be in touch with and predict what their consumers will want to buy. However, the ability to discern market trends is only one of the skills required to do so. The capacity to continuously assess sales data and make necessary modifications to prices and inventory levels is maybe an even more vital talent.

The Purchasing Organization is a formalized phrase that means "buying organization."

The merchandise group is the classification level with the highest amount of detail. Within the goods classification scheme, the department is the second level of organization. Divisional merchandise managers are in charge of the various departments (DMMs). The classification level is the third level of categorization and organization used in the process of merchandise management activities. The term "classification" refers to a set of things that are targeted at the same client category, such as girls' sizes 4 to 6. Categories are the next lower level of classification in the classification hierarchy. Each buyer is in charge of a number of different goods categories. In the case of girls' sizes 4 to 6, for example, the buyer is in charge of the categories of athletic wear, dresses, swimwear, and outerwear for girls in these sizes. A stock-keeping unit (SKU) is the smallest unit of measurement that can be used for inventory management. In the case of soft-goods merchandise, for example, an SKU typically refers to a specific size, color, and style.

Merchandise Category—The Planning Unit

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When it comes to making merchandising management decisions, the merchandise category serves as the fundamental unit of analysis. A merchandising category is a collection of items that buyers consider to be interchangeable with one another in some way.

When it comes to managing goods, the category management strategy gives a single buyer or category manager to handle all merchandising efforts for an entire category of products. The practice of categorizing merchandise can assist in ensuring that the store's assortment contains the "best" combination of sizes and vendors—that is, the combination that will generate the greatest amount of profit from the available space. Captain of the Category Some retailers partner with a vendor to assist them in managing a specific category. The vendor, referred to as the category captain, collaborates with the retailer to gain a better understanding of customer buying behavior, produce assortments that meet consumer wants, and increase the profitability of the goods category under consideration. For retailers, selecting vendors to serve as category captains has a number of advantages. It facilitates the management of items and has the potential to improve profitability. In many cases, vendors are better equipped to handle a category than retailers since they have more information about the category than retailers because they are focused on a certain category. In addition, they have gained valuable knowledge from their previous experience managing the sector for other retailers.

Evaluating the Performance of Merchandise Management

The return on assets is made up of two components: asset turnover and the percentage of net profit margin earned. While ROA is an excellent metric for evaluating the performance of merchandise managers, it is not a good measure for evaluating the performance of buyers because they do not have control over the entire retailer's assets or all of the expenses that the retailer incurs. Product managers have little control over anything other than the merchandise they purchase (the retailer's

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merchandise inventory assets), the price at which the merchandise is sold, and the cost of the merchandise purchased. As a result, buyers typically have control over the gross margin, but not over operating expenses such as store operations, human resources, real estate, logistics, and information systems, among other things.

GMROL Gross margin return on inventory investment (GMROI, which is often pronounced "jim-roy") is a financial ratio that measures a buyer's contribution to return on assets (ROA). Essentially, it counts how many gross margin dollars are earned for every dollar of inventory invested by the purchaser. Gross margin return on investment (GMROI) is a combination of the gross margin percentage and the sales-to-stock ratio, which is connected to inventory turnover.

Ratio of Sales to Inventory (also known as the Sales to Stock Ratio) Retailers typically report sales-to-stock ratios (as well as inventory turnover) on an annual basis rather than for a specific period of time during the year. If the sales-to-stock ratio during a three-month season is equal to 2.3, the annual sales-to-stock ratio will be four times that figure, according to the formula (9.2). For example, to convert a sales-to-stock ratio that is calculated based on only a portion of a year to an annual figure, multiply it by the number of similar time periods that occur during the year.

Inventory Turnover Controlling Inventory Turnover Increased inventory turnover can result in increased sales volume, improved morale among sales workers, and more resources available to take advantage of newly available purchasing possibilities. Increased inventory turnover leads to increased sales as customers have access to new items on a more consistent basis. Customers who see new merchandise are more likely to return to the store because they know they will be seeing different merchandise each time they visit the store, which encourages them to do so more frequently. When inventory turnover is low, merchandise begins to appear shopworn, as if it has been on display and handled by consumers for an extended period of time, resulting in minor damage. Increasing the number of fresh products available also helps to boost the morale of sales personnel.

The Merchandise Management Process is comprised of the following steps:

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A buyer's job description includes forecasting category sales, developing an assortment plan for items in the category, and determining how much inventory will be required to meet the expected sales and assortment plan. The buyers then prepare a strategy that details the sales they hope to achieve each month, the inventory required to support those sales, and the funds available for refilling sold product and purchasing new merchandise, among other things. In addition to designing the strategy, the buyer or planners choose what type of merchandise should be distributed to each store and how much should be allocated to each location. After putting together a strategy, the buyer negotiates with sellers and purchases the merchandise.

Processes for Merchandise Management Planning of Various Types Retailers utilize two different types of merchandising management planning systems to manage two different sorts of item categories: (1) staple merchandise and (2) fashion merchandise. Product categories that remain in constant demand over an extended period of time, also known as staple merchandise categories or basic merchandise categories, are defined as follows: It is relatively straightforward to estimate demand for staple products because sales are pretty consistent from week-to-week, and the ramifications of making mistakes in forecasting are not severe. Consider the following scenario: If a consumer overestimates the demand for canned soup and purchases an excessive amount, the store will be left with an excess of inventory for a short period of time. Eventually, canned soup will be sold without the need for discounts or other special marketing efforts on the part of the manufacturer. In part due to the regular nature of the demand for staple products, merchandise planning systems for staple categories are frequently characterized by continual replenishment. It is the responsibility of these systems to continuously monitor goods sales and generate replacement orders, frequently automatically, when inventory levels fall below predefined levels.

Generally speaking, fashion item categories are in high demand for only a limited period of time. New products are being launched into these categories on a regular basis, rendering the present products obsolete in the process. Occasionally, the core product remains unchanged, but the colors and fashions are updated to match what is "in" at the time. Athletic shoes, mobile phones, and women's clothing are just a few examples of the various fashion item categories.

Product categories that fall into the seasonal product category are those whose sales fluctuate considerably depending on the time of year.

Learning Objective 2 – Forecasting Sales

Forecasting Staple Merchandise

Utilization of Historical Sales Year after year, sales of core products remain largely stable. As a result, predictions are frequently constructed by extrapolating historical sales. Due to the availability of extensive sales data, advanced statistical techniques can be utilized to anticipate future sales for each SKU. These statistical estimates, however, are based on the assumption that the factors affecting item sales in the past would remain constant and have the same influence in the future. Thus, while sales of core products are usually predictable, both controllable and uncontrollable factors can have a sizable impact on them.

Adjustments for Variables Within Our Control The opening and closing of stores, the price set for the products in the category, special promotions for the category, the pricing and advertising of complimentary categories, and the location of the merchandise categories in the stores are all controllable factors. Several factors beyond the retailer's control include the weather, general economic conditions, vendor special promotions or new product releases, product availability, pricing, and competitive promotional activity.

Forecasting Fashion Category Sales

Forecasting fashion product sales is difficult since consumers often place orders and commit to purchasing particular quantities three to six months in advance of the merchandise being produced and made available for sale. Retailers obtain information for forecasting fashion goods categories from a variety of sources, including (1) historical sales data, (2) market research, (3) fashion and trend services, and (4) vendors.

Previously Sold Items While many goods in fashion merchandise categories are new each season, many items in a fashion category are frequently duplicates of prior years' sales. Thus, precise projections may be obtained simply by projecting historical sales data.

Market Analysis Fashion merchandise buyers use a number of market research initiatives to assist them in forecasting sales. These activities range from informal, qualitative research into category patterns to more structured trials and surveys.

Services for Fashion and Trends There are numerous services available to purchasers, particularly those in the garment category, that forecast the latest fashions, colors, and styles.

Vendors

Vendors possess confidential information regarding their marketing strategies, such as new product releases and special promotions, which can have a substantial impact on retail sales of their items and the overall merchandise category.

Forecasting Sales for Service Retailers

Service retailers suffer a more severe difficulty than fashion shops do due to the perishable nature of services. Their sacrifice perishes at the end of the day, not the season. If there are vacant seats as a plane takes off or a rock performance concludes, the revenue collected by these seats is permanently lost.

Learning Objective 3 – Developing an Assortment Plan

An assortment plan is a list of SKUs that a retailer will sell in each of its stores under a particular goods category. Thus, the assortment plan shows the breadth and depth of items that a shop intends to sell in a certain area of merchandise.

Varieties and Assortments

The variety, or breadth, of a retailer's product is measured in terms of the number of distinct merchandising categories offered, while the assortment, or depth, of merchandise is measured in terms of the number of SKUs within each category. The terms variety and assortment are used in the context of merchandising planning to refer to a merchandise category rather than a retail firm or location. At the category level, variety refers to the number of distinct item types, whereas assortment refers to the number of SKUs within each type.

Identifying Variation and Assortment Editing the assortment is the process of selecting the variety and selection for a category. When editing an assortment for a category such as jeans, the buyer considers the following factors: the firm's retail strategy, the effect of assortments on gross margin return on investment (GMROI), the complementarities between categories, the effect of assortments on purchasing behavior, and the physical characteristics of the store.

Learning Objective 4 – Setting Inventory and Product Availability Levels

Stock Plan Template

The model stock plan specifies the quantity of each SKU in the assortment plan that the buyer wishes to have on hand in each store.

Product Availability

The number of units of backup stock, also called buffer or safety stock, in the model stock plan determines product availability. Product availability is defined as the percentage of the demand for a particular SKU that is satisfied. Product availability is also referred to as the level of support or service level.

Learning Objective 5 – Establishing a Control System for Managing Inventory

The first three steps of the merchandising planning process—forecasting SKU and category sales, creating an assortment strategy, and creating a model stock plan—quantify the buyer's sales and service objectives. The fourth stage of the merchandising management process is to establish a

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control system for monitoring the long-term evolution of orders, deliveries, inventory levels, and merchandise sales. The goal of this control system is to manage the flow of merchandise into stores in such a way that inventory levels in each category are kept to a minimum while still ensuring that merchandise is available when customers choose to purchase it. The next sections discuss the distinctions between standard and fashion product control procedures.

Inventory Control System for Staple Goods

SKUs in a staple goods category are sold month after month, year after year. Purple paint sales at Lowe's will be roughly the same this month as they were a year ago. If sales of purple paint fall short of expectations this month, additional inventory can be sold the next month. As a result, the flow of SKUs and categories of staple items is managed using an automated continuous replenishment control system. Continuous replenishment analyzes the inventory level of each SKU in a store continually and automatically reorders an SKU when it falls below a specified threshold.

Staple Merchandise Flow

Cycle stock or base stock is inventory whose level fluctuates owing to the replenishing process. The store wishes to lower its cycle-stock inventory in order to maintain a minimal inventory investment. Reordering lesser quantities more frequently is one strategy for lowering cycle stock. However, more frequent orders and shipments with lower quantities increase administrative and transportation costs. Because the retailer's sales of the SKU and receipts of vendor orders cannot be predicted perfectly, the shop must maintain backup stock as a buffer to avoid stocking out before the next order arrives. Backup stock is the amount of inventory required to ensure the availability of merchandise in the face of these uncertainties.

Control System for Managing Fashion Merchandise Inventory

A merchandise budget plan is the management approach for a fashion merchandise category. The merchandise budget plan establishes the anticipated inventory investment in dollars for a certain fashion goods category based on the amount of merchandise bought, delivered, and sold each

month during the selling season. It is a financial plan that details the monthly expenditures necessary to support sales and reach the intended GMROI targets. Additionally, the merchandise budget plan includes the impact on GMROI of the buyer's active intervention to make modifications if real sales fall short of budgeted sales.

System of Open-to-Buy

Following the purchase of merchandise in accordance with the merchandise budget plan, the open-to-buy system is used to monitor actual merchandise flows—what the current inventory level is, when purchased item is scheduled for delivery, and how much has been sold to customers. As with the checks you make, customers must keep track of the product they purchase and when it will be delivered.

Learning Objective 6 – Allocating Merchandise to Stores

Allocation of Merchandise

Retail chains often categorize their stores according to their annual revenues. Thus, A stores generate the greatest revenue and typically receive the most inventory, whereas C stores generate the least revenue and typically receive the least inventory for a category. Along with the store's sales volume, allocators examine the physical aspects of the items, as well as the depth of assortment and amount of product availability that the firm want to represent for the particular store.

Learning Objective 7 – Analyzing Merchandise Management Performance

The monitoring and adjustment process requires three types of analyses: (1) sell-through analysis, (2) ABC analysis of assortments, and (3) multiattribute analysis of vendors. The first study compares the merchandise management plan to actual sales on a continuous basis. The other two studies provide methods for analyzing and modifying the assortment plan based on the plan's individual SKUs and the vendors that supply the items required to fulfill the plan.

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A sell-through study analyzes actual and expected sales to evaluate whether additional merchandise or price reductions (markdowns) are required to meet demand.

Adjustments may be necessary depending on a variety of factors, including previous experience with the goods, intentions to feature the merchandise in advertising, and the availability of vendor markdown money (funds that a vendor gives a retailer to cover lost gross margin dollars that result from markdowns).

Analyze ABC

ABC analyses are used to determine the performance of specific SKUs within an assortment plan. It is used to establish which SKUs should be included in the plan, as well as the amount of backup stock and resulting product availability supplied for each SKU. In an ABC analysis, the SKUs within a merchandise category are ranked according to a variety of performance metrics, including sales, gross margin, inventory turnover, and gross margin return on investment. Typically, this ranking reflects the 80-20 principle, which states that typically 80% of a retailer's sales or profits originate from 20% of its products. This theory implies that shops should prioritize the products that provide the highest profits.

Method for Evaluating Vendors Using Multiple Attributes

The multiattribute analysis approach for evaluating suppliers assigns each seller a weighted-average score. The score is determined by the vendor's performance on a variety of topics.

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Quiz 12 – Managing the Merchandise Planning Process

True or False

1. _____ Merchandise is broken down into categories for merchandising purposes.
2. _____ The key performance measures used to assess merchandise management are GMROI and its components, sales-to-stock ratio, inventory turnover, and gross margin
3. _____ ABC analysis, merchandise is rank-ordered from lowest to highest
4. _____ The multiattribute analysis method for evaluating vendors uses a weighted-average score for each vendor.
5. _____ A sell-through analysis compares actual and planned sales to determine whether more merchandise is needed to satisfy demand or whether price reductions (markdowns) are required.
6. _____ The need to make adjustments depends on a variety of factors, including experience with the merchandise in the past, plans for featuring the merchandise in advertising, and the availability of markdown money from vendors.
7. _____ Retailers are considering the “paycheck cycle” when making merchandise allocation and promotion decisions, particularly in difficult economic times
8. _____ With a push distribution strategy, orders for merchandise are generated at the store level on the basis of sales data captured by point-of-sale terminals.
9. _____ With a pull distribution strategy, merchandise is allocated to the stores on the basis of historical demand, the inventory position at the distribution center, and the needs of the stores.
10. _____ Without the open-to-buy system keeping track of merchandise flows, merchandise could be delivered when it isn’t needed and be unavailable when it is needed.

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11. _____ The open-to-buy system compares the planned end-of-month inventory to the actual end-of-month inventory
12. _____ The merchandise budget plan specifies the planned inventory investment in dollars in a fashion merchandise category on the basis of how much merchandise will be ordered, delivered, and sold each month during the selling season.
13. _____ The order point is the amount of inventory below which the quantity available shouldn't go or the item will be out of stock before the next order arrives.
14. _____ When inventory reaches the order point, the buyer, or system, needs to order enough units to ensure product availability before the next order arrives.
15. _____ The retailer's information system determines the inventory level at each point in time, the perpetual inventory, by comparing the sales made through the POS terminals with the shipments received by the store.
16. _____ The retailer hopes to increase the cycle-stock inventory to keep its inventory investment low
17. _____ Backup stock is the level of inventory needed to ensure merchandise is available in light of these uncertainties.
18. _____ Product availability is defined as the percentage of the demand for a particular SKU that is satisfied
19. _____ Product availability is also referred to as the level of support or service level.
20. _____ If the backup stock is too high, the retailer will lose sales and possibly customers too when they find that the products, they want are not available from the retailer.

Answer key:

1. False
2. True
3. False
4. True
5. True
6. True

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7. True
8. False
9. False
10. True
11. True
12. True
13. True
14. True
15. True
16. False
17. True
18. True
19. True
20. False

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