Optimizing Assortments to Reinvigorate Retail:

Benchmark Report 2012

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Executive Summary

Last year, in our annual report on the state of retail merchandising, retailers told us they had made significant changes in the way they plan and merchandise their assortments. Amid concerns about underperforming inventory and existing system limitations, many were moving away from home-grown applications and turning to more industry-standard solutions. At the same time, they wanted more tools to support optimizing their product assortments. We predicted a coming wave of market basket analytics to support those efforts.

This year, while that wave is in full effect and progress has most certainly been made, we see a drastic difference in the perceived **value** of these new merchandising tools and retailers' **understanding** of how they can be effectively used to improve the product mix they put in front of increasingly-empowered consumers.

Key Findings

- Most merchants place a similar value on new merchandising tools – regardless of size or sales performance. However, *understanding* of these tools varies drastically; *only one third of mid-market retailers ($50 million - $999 million in annual revenue) report a solid understanding of modern merchandising tools and techniques.*
- While out-of-stocks and inventory performance remain top-of-mind (particularly for large retailers and those who sell fast moving goods), retailers' concerns about understanding customer preferences - and their own ability to respond to those preferences with new ideas about pricing and promotions - have become their top business challenges.
- The best performers are *far* more focused on integrating planning with cross-functional teams: *47% of Winners (vs. a meager 14% of laggards) identify this as a key means to improving their merchandise processes.*
- 34% of all respondents plan to optimize their assortments against new key customer segments in the coming year. Another 24% plan to include initial price optimization in their processes in 2013, and 22% will incorporate promotion optimization.
- Laggards finally recognize that their merchandising efforts are too important and complex to be managed within spreadsheets: 25% will be spending the coming years eradicating their spreadsheet-run merchandising systems.
- **Data cleanliness** does remain an issue for smaller retailers, likely a direct result of their holding onto legacy (or homegrown) systems and their reticence to move to more modern merchandising tools.
- While FMCG retailers mostly lag behind other segments in both current technology usage and forward-looking processes, they are most bullish on the notion of changing their compensation and incentives to be more aligned across the company.
- Operationally, the best performers "know what they don't know", and have a generally better understanding of what they need to change to improve their merchandising strategies; by comparison, laggards are asking for more customer segmentation information, but at the same time, citing stalled performance on their inability to identify new merchandising ideas – ones that would appeal to new customer preferences - quickly.
- NO retailers in the mid-market report the use of **market basket analytics**, while 51% of the largest retailers and 44% of the smallest retailers report these technologies are implemented.

- Mid-market retailers report the least interest in **Customer segmentation** and **planogram optimization technologies**. Fully 58% and 69% respectively report they have no plans to use these tools and techniques. This lags all other retailers (including the smallest) significantly.

BOOTstrap Recommendations

We offer four key recommendations for next steps retailers can take at the end of this report. Within, we call upon retailers to become more predictive, responsive, automated, and scientific, all of which are designed to help a retail operation become more nimble within a global economy that is still very, very uncertain.

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Research Overview

A unique combination of forces including continued economic uncertainty, the omni-channel phenomenon powered by the consumerization of IT, the emergence of a new generation of merchants, and retail's brand globalization have driven the industry to one conclusion: *localized assortments driven by customer and store attributes are necessary to support the best possible sales while controlling inventory and costs*. Little doubt remains that the art and science of retail merchandising have changed irrevocably.

In this fifth annual Merchandising Benchmark Report, we set out to see what progress has been made in changing merchandising processes within retail companies both large and small.

We found disturbing trends among mid-sized retailers, and more positive shifts among those who over-perform on annual comparable sales. Mid-market results, in particular, are alarming. However, as we'll see below, the industry's overarching appreciation of automated tools and techniques continue to rise.

The Need to Divine Demand Takes Center Stage

RSR believes the first step to creating an optimized assortment is a solid demand forecast. Customer analytics are almost equally important. Our retail respondents agree (Figure 1).

Figure 1: Forecasting the Linchpin of Merchandising Success

How Important are the Following to your Retail Success?

■ Extremely Important   ■ Somewhat Important   ■ Not Very Important

	Extremely Important	Somewhat Important	Not Very Important
Retail Forecasting (demand forecasting, forecasting for replenishment, etc.)	75%	25%	
Customer Analytics	71%	25%	4%
Localized assortments	48%	42%	10%
An optimized, end-to-end merchandising lifecycle	48%	45%	6%
Unified pricing, promotion and assortment modeling	47%	42%	11%
Lifecycle price optimization	29%	62%	9%

Source: RSR Research, August 2012

While the notion of a solid demand forecast is certainly not new, it has moved from a supply chain tool to a merchandising tool. Advances in hardware computing power make sku-level forecasts

not only feasible, but imperative. The omni-channel phenomenon has also given most retailers a breadth of customer information previously available to only catalog and pure play eCommerce retailers. Again, hardware advances make the aggregation and analysis of this data possible[1].

In essence, the twin tools of forecasting and customer analytics make optimized localized assortments possible. The economic environment and omni-channel effect make them necessary.

For the Most Part, Understanding of Tools and Techniques Grow

In 2010 we observed that merchants' understanding of their tools and techniques lagged behind their enthusiasm, most especially among the largest retailers[2].Clearly the industry has matured (Figure 2).

Figure 2: Merchants Gain Understanding of Tools and Techniques

% Rating Themselves as Having a "Solid" Understanding of Merchandising Tools and Techniques

■ 2012 ■ 2011 ■ 2010

	2012	2011	2010
Forecasting	68%	73%	61%
Assortment Optimization	60%	51%	44%
Integrated Merchandise Planning, Allocation and Replenishment	53%	59%	46%
Promotion Optimization	52%	43%	43%
Lifecycle Price Optimization	33%	33%	26%
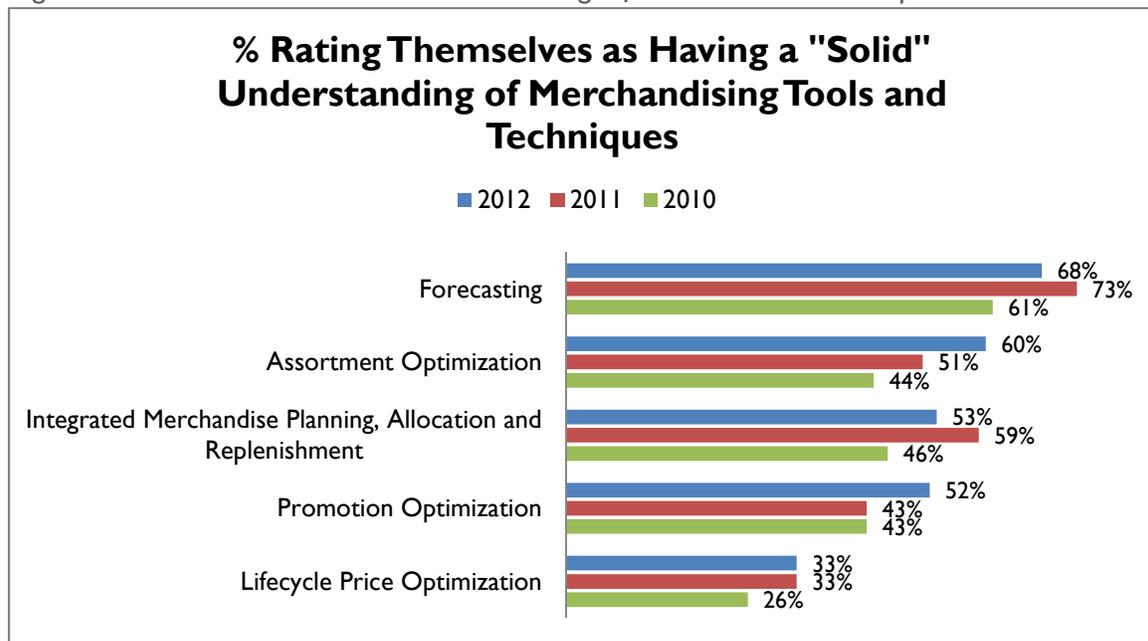
Source: RSR Research, August 2012

While there has been a slight dip in some areas, in general we can see that over the past two years, retailers have grown savvier about the tools at their disposal, commensurate with their belief that these tools and techniques will help them grow their business. The largest retailers have definitely educated themselves, with more than 75% of those with annual revenue exceeding US $1 billion reporting a solid understanding of most tools and techniques.

As we mentioned at the start of this section, **our greatest concern is for those retailers in the mid-market, with revenue between $50 million and $999 million in annual revenue**. *Only a third of these retailers report a solid understanding of most of the tools and techniques above – the only exception being forecasting – where they still lagged all other respondents (50% vs. ~75% respectively),*

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[1] For a full discussion of the Omni-channel phenomenon, see *Omni-Channel 2012: Cross-Channel Comes of Age*, Brian Kilcourse and Nikki Baird
[2] *Defining Twenty-first Century Merchandising: Benchmark Report, September 2010*, Paula Rosenblum and Nikki Baird, p2

Defining Winners and Why They Win

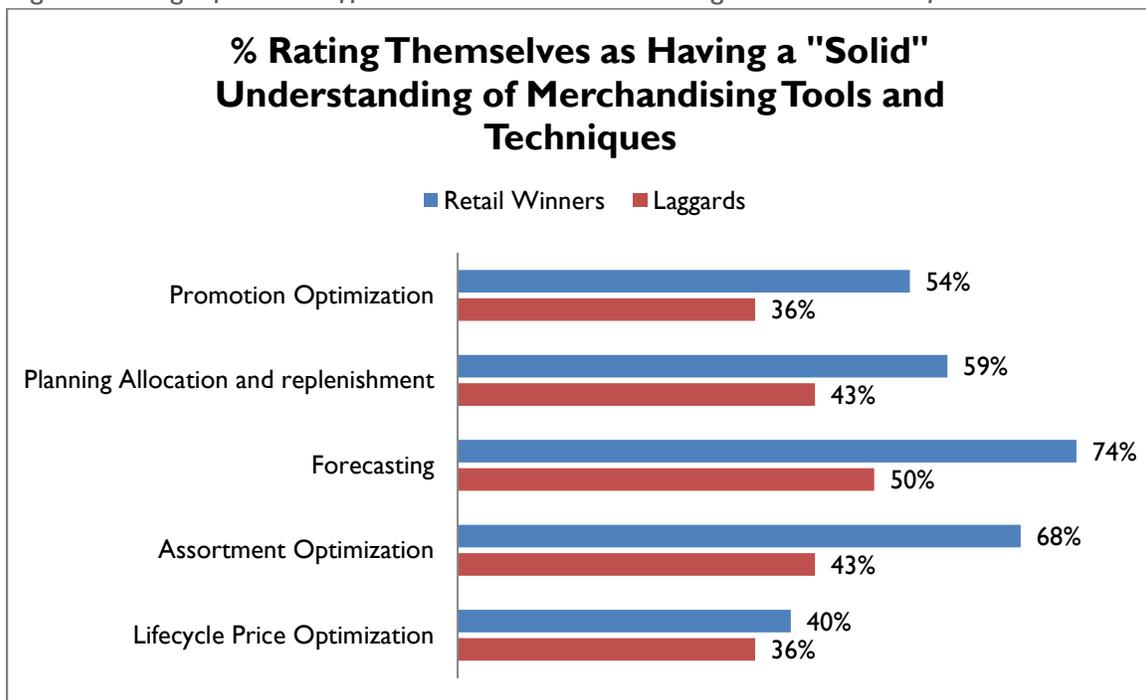RSR's research always focuses on a category of retailers we call "Retail Winners". Our definition of Retail Winners is straightforward. We judge retailers by year-over-year comparable store/channel sales improvements. Assuming industry average comparable store/ channel sales growth of **three percent**, we define those with sales above this hurdle as "*Winners*," those at this sales growth rate as "average," and those below this sales growth rate as "*laggards*" or "also-rans." It is consistent throughout much of RSR's research findings that Winners don't merely do the same things better, they tend to do different things. They think differently. They plan differently. They respond differently.

To illustrate some of these differences, let's take a look at the percentage of respondents rating themselves as having a solid understanding of merchandising tools and techniques (Figure 3).

Figure 3: Significant Differences in Understanding Based on Performance

% Rating Themselves as Having a "Solid" Understanding of Merchandising Tools and Techniques

■ Retail Winners ■ Laggards

Category	Retail Winners	Laggards
Promotion Optimization	54%	36%
Planning Allocation and replenishment	59%	43%
Forecasting	74%	50%
Assortment Optimization	68%	43%
Lifecycle Price Optimization	40%	36%

Source: RSR Research, August 2012

In general, respondents rate the *value* of these tools about equally, regardless of sales performance, but clearly *understanding* differs, often dramatically. It is hard to imagine a successful technology initiative that supports a group of merchants without an understanding of the techniques.

This is not to say that we "blame" laggards for their problems. There's an old saying in retail that sales cure almost all ills. However, on the flip side, a lack of sales creates a self-perpetuating destructive cycle. Sales laggards tend to focus on staying afloat. In today's world, that often means "promotional madness." That promotional madness may keep revenue flowing, but it has a negative impact on gross margin. Hence, it's not surprising to see the data in Figure 4. *While a majority of Retail Winners and Average Performers have seen gross margins either remain the same or stay stable over the past three years, two-thirds of laggards have seen them remain the same or DECREASE.*

Changes to Selling Gross Margin Over the Past Three (3) Years

■ Retail Winners   ■ Average Performers   ■ Laggards
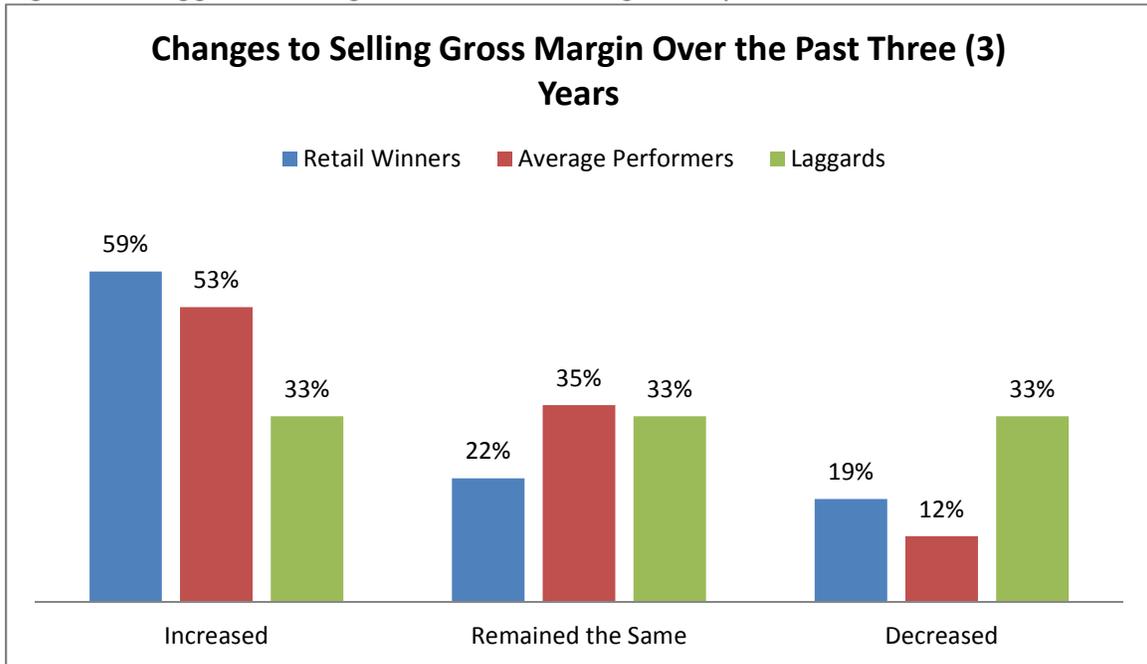
Source: RSR Research, August 2012

Methodology

RSR uses its own model, called the "BOOT," to analyze Retail Industry issues. We build this model with our survey instruments. Appendix A contains a full explanation of the methodology.

In our surveys, we continue to find differences in the thought processes, actions, and decisions made by retailers who outperform their competitors and the industry at large – Retail Winners. The BOOT model helps us better understand the behavioral and technological differences that drive sustainable sales improvements and successful execution of brand vision.

Survey Respondent Characteristics

RSR conducted an online survey from May - August 2012 and received answers from 96 qualified retail respondents. Respondent demographics are as follows:

- Job Title:

Senior Management (CEO, CFO, COO)	34%
Vice President	15%
Director/Manager	34%
Internal Consultant	9%
Internal Staff & Other	8%

- 2011 Revenue (US$ Equivalent):

Less than $50 Million	36%
$51 - $999 Million	23%
$1 - $5 Billion	23%

Over $5 Billion	17%	

- Selling Format:

Fast Moving Consumer Goods	32%	
General Merchandise and Apparel	66%	
Restaurant and Leisure	4%	

- Products sold:

Basics/replenish Items (non-food)	28%	
Seasonal merchandise	15%	
Short Lifecycle/Fashion merchandise	28%	
Food and Drug	30%	

- Headquarters/Retail Presence:

United States	53%	58%
Canada	5%	25%
Latin America	5%	16%
Europe	13%	21%
United Kingdom	1%	11%
Asia Pacific	20%	32%
Middle East	1%	12%
Africa	1%	8%

- Year-Over-Year Comparable Store Sales Growth Rates (assume average growth of 3%):

Worse than Average (Laggards)	18%	
Average	39%	
Better than (Retail Winners)	44%	

Business Challenges

The Customer is King – For Real

In prior years we focused our business challenge question on product: inventory performance, planning efficiencies, and competitive differentiation. This year, given all the discussion about the empowered consumer, we decided to add some customer-focused options. As we can see from Figure 5, these customer-focused choices completely change the color and tenor of responses.

Figure 5: Innovation and Understanding the Customer Take Center Stage

Top Three (3) Business Challenges

■ 2012 ■ 2011

Challenge	2012	2011
Inability to identify new ideas and innovate quickly on price, promotion and customer preferences	44%	
Understanding customer preferences	37%	
Underperforming inventory	37%	51%
Out of stocks remain a persistent problem	27%	42%
Fractured planning processes make us less efficient	26%	44%
Consumers expect more localized assortments than we provide	25%	22%
Our stores are a "sea of sameness" - our product mix is undifferentiated	19%	31%
Promotional reliance leading to brand equity erosion	21%	
We're stuck in our product selection: some retailers out-price us, some out-style us	19%	27%
Siloed merchandising strategies in each selling and communications channel	15%	
Segment blurring - competition from unexpected places	16%	36%

Source: RSR Research, August 2012

This is not to say that out-of-stocks or other inventory concerns are not major issues within the retail enterprise…certainly they are. But when asked to play "lifeboat" and pick their top-three concerns, retailers cleave to the customer.

This is the overall picture, however, and when we dive into various cross-cuts of the data, significant differences emerge.

Business Challenges Differ Depending on Retailer Size

Some of the differences in top-three business challenges by revenue are intuitive and obvious, while others are somewhat counter-intuitive.

Intuitive and Obvious:

- **The larger the retailer, the greater the concern about out-of-stocks**. Only 12% of the smallest retailers (< $50 million in annual revenue) cite out-of-stocks as a top-three concern vs. 42% of the largest retailers (>$% billion in annual revenue).
- **The larger the retailer, the greater the pressure to implement localized assortments**. Only 18% of mid-market retailers cite consumer expectations for more localized assortments as a top-three business challenge vs. 50% of the largest retailers.
- **The larger the enterprise, the more siloed and fractured planning processes**: Only 18% of retailers with annual revenue under a billion dollars cite this as a top-three concern vs. close to 40% for their larger counterparts.
- **The smallest and largest retailers are concerned about product selection**.

Counter-intuitive and Not-so Obvious

- **Retailers with revenue over $5 billion are far less concerned about underperforming inventory than virtually all other retailers** – with only 17% citing this as a top-three business challenge. We can only assume that their ready access to working capital and (likely) more sophisticated forecasting technologies reduce their concern.
- **The smallest retailers (annual revenue under $50 million) are most concerned about an undifferentiated product mix**. More than a quarter of respondents in this revenue bracket cite it as a top-three concern vs. less than 15% of all others, and only 8% of the over $5 billion retailer. It can be argued that this is part of the phenomenon known as "The Amazon Effect." While the smallest retailers curate their assortments carefully, they likely do not have the mass to support development of truly unique products, potentially leaving them vulnerable to lower priced competitors like Amazon. It can also be argued that with curated assortments being core to their value proposition, the smallest retailers obsess about them all the more – these assortments are key to their survival.

Challenges also Differ Depending Products Sold

Differences here were not surprising, but nonetheless worthy of note:

- Almost half of retailers selling fast moving consumer goods (FMCG) cite **out of stocks** as a top-three business challenge, vs. only 17% of those selling general merchandise and apparel (GMA).
- GMA retailers are far more likely than those selling FMCG to cite **understanding consumer preferences** as a top-three challenge (41% vs. 29% respectively).
- GMA retailers are far more likely than those selling FMCG to cite underperforming inventory as a top-three challenge (46% vs. 25% respectively).
- GMA retailers are far more likely than those selling FMCG to cite **siloed merchandising strategies** as a top-three challenge (20% vs. 4% respectively).

Retailer Performance Drives Different Concerns

When we look at the data based on retailer performance, differences emerge as well.

Average performers have surprisingly different priorities:

- 52% identify an **inability to identify new ideas and move quickly** as a top-three concern vs. 47% of winners and only 21% of laggards
- 44% cite **promotional reliance leading to brand equity erosio**n as a top-three concern vs. 6% of retail winners and 14% of laggards.
- 44% also cite **understanding customer preferences** as a top-three concern vs. 35% of winners and 29% of laggards.

Laggards are caught in a clear inventory conundrum. While 57% of laggards cite out-of-stocks as a top-three concern, they also cite **under-performing inventory** as one of their top-three (43%).

Clearly better technology and improved processes are needed to support laggards in balancing their inventory. We'll investigate their use of technology to support efforts in this critical area later in this document.

Retail Winners highlighted four specific areas of concern: **identifying new ideas** and rapid innovation (47%), **underperforming inventory** (44%), **understanding customer preferences** (35%) and **fractured planning processes** (35%).

Over the past five years, we have seen the number of retailers citing fractured planning processes as a top-three concern continuing to decline. We expect this trend to continue as retailers adopt more enterprise-wide analytics and forecasting engines, and we expect Retail Winners to be at the forefront of these initiatives.
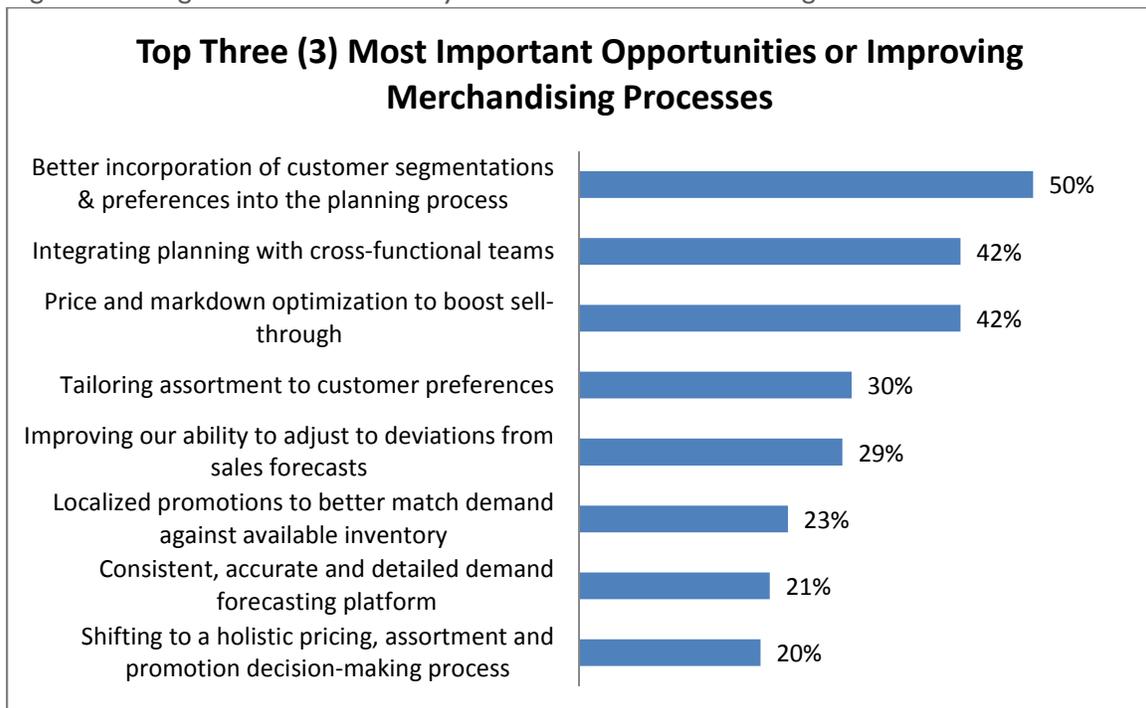
The same can be said about the emerging field of customer analytics using both structured and unstructured data. We generally see Retail Winners among the first to experiment with these technologies and expect to see them take the lead in this area as well.

Opportunities

Preference Info Required…

Retailers believe their merchandising processes would greatly benefit from better incorporation of customer segmentation and preferences into the planning process (Figure 6).

Figure 6: Segmentation the Key to Better Merchandising

Top Three (3) Most Important Opportunities or Improving Merchandising Processes

Opportunity	Percentage
Better incorporation of customer segmentations & preferences into the planning process	50%
Integrating planning with cross-functional teams	42%
Price and markdown optimization to boost sell-through	42%
Tailoring assortment to customer preferences	30%
Improving our ability to adjust to deviations from sales forecasts	29%
Localized promotions to better match demand against available inventory	23%
Consistent, accurate and detailed demand forecasting platform	21%
Shifting to a holistic pricing, assortment and promotion decision-making process	20%

Source: RSR Research, August 2012

The consumer's new power is undeniable, and any insight that helps retailers predict what she'll want more effectively – sometimes before she even knows it – is the top opportunity to improving current merchandise processes.

However, this data is even more interesting when broken down by respondent group:

- Retailers selling fast moving consumer goods (FMCG) are hungrier for **segmentation and preference information**: 59% identify it as their top opportunity. These high-volume sellers understand that knowing more about the consumer than their competitors represents one of their only means to remain relevant, particularly when the products they sell are becoming more available (and in more unexpected places) each day.

- The best performers are *far* more focused on **integrating planning with cross-functional teams**: *47% of Winners (vs. a meager 14% of laggards) identify this as a key means to improving their merchandise processes*. RSR has been a strong proponent of this strategy for as long as we've been conducting research. While it may be difficult to get these teams up and running, their value cannot be overstated. And though they do require time and human resources, retailers can no longer avoid them. The value is just too great.

- Mega retailers are disproportionately interested in shifting to a **holistic pricing, assortment, and promotion** decision-making process. In fact, interest in holistic decision making is remarkably low for most of our retail respondents, and only begins to pick up once they hit $5 billion in annual revenues (just 14% of small retailers, 13% of mid-sized retailers, and 19% of those with sales from $1-$5 billion select it as a top opportunity). *If growing retailers are looking for a lesson in ways to avoid complexities as they scale, a move to a holistic pricing, assortment, and promotion process sooner than later will certainly avoid a lot of headache down the road.*

…But What of It?

While the Technology Enablers section of this report will take a deep dive into the current and budgeted technologies that retailers pursue, those *processes* which retailers plan to implement in 2013 provide near-term opportunities to improve merchandising efforts. Based on what we saw in Figure 6, it comes as little surprise to find 34% of respondents plan to optimize their assortments against new key customer segments in the coming year (Figure 7).

Figure 7: Near Term Plans

Status of Merchandise Processes at Your Company

■ In Use ■ Implementing Now ■ Planned for Next Year ■ No Plans

Process	In Use	Implementing Now	Planned for Next Year	No Plans
Initial demand forecast as the basis for next year's plan	58%	21%	10%	11%
Bottoms-up plan	48%	16%	8%	28%
In-season demand forecasting for price, promotional or assortment planning	47%	20%	13%	20%
Reconciliation of bottoms-up and top-down plan	43%	19%	10%	29%
Promotion optimization	41%	10%	22%	27%
Assortment optimization	39%	29%	16%	16%
Markdown optimization	34%	21%	18%	28%
Reconciliation of plan against distribution capacity	34%	20%	13%	33%
Initial price optimization	31%	22%	24%	22%
Size optimization	27%	12%	20%	41%
Optimization of assortment against key customer segments	26%	16%	34%	24%

Source: RSR Research, August 2012

Another 24% plan to include initial price optimization in their processes in 2013, and 22% will incorporate promotion optimization.

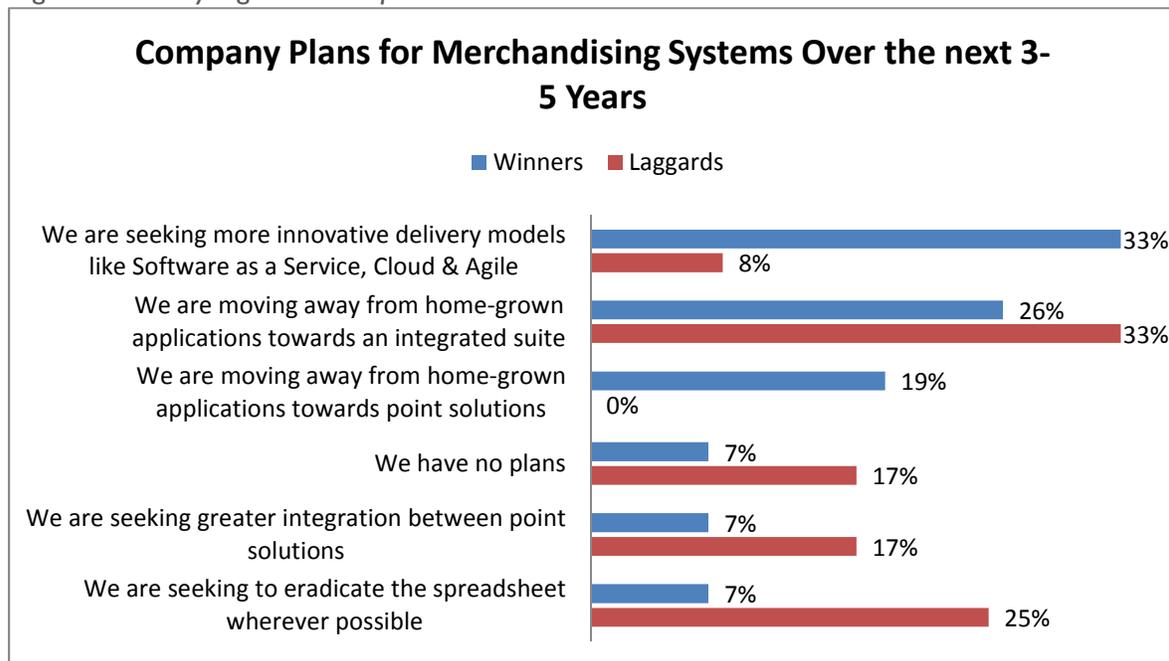However, as usual, differences emerge by retailer performance:

- More Winners have been employing a bottoms-up plan – and for longer – than their average and lagging competitors (52% of Winners have had this process in use for more than a year, vs. average retailers' 19% and laggards' 29%). What's more, laggards seem to have little understanding that this a problem they need to fix: **None** are in the process of implementing a bottoms-up planning approach, only 7% plan to in 2013, and a dramatic 50% have no plans of any kind to emulate Winners' in this area.
- Laggards are also drastically behind in their understanding of the importance of assortment optimization. While 42% of Winners are already using assortment optimization, those who aren't already on board know they need to be; 27% of Winners are in the process of implementing right now, and another 15% have plans to do so next year. By comparison, 39% of lagging retailers have absolutely no plans to incorporate assortment optimization.
- These differences are even more dramatic when viewed for FMCG retailers, who lag in adoption of virtually every merchandise process on our list.

These data points beg the question: despite all of their interest in customer segmentation and consumer preferences, what benefit do retailers anticipate will come of this information if they have no way to act on optimizing assortments accordingly, or even have a pre-established plan in place to adjust in the first place?

A Glimpse into the Future

We can glean some insights by looking at Winners' and laggards' overall long term approach to their merchandising systems (Figure 8).

Figure 8: Varying Roadmaps

Company Plans for Merchandising Systems Over the next 3-5 Years

■ Winners   ■ Laggards

	Winners	Laggards
We are seeking more innovative delivery models like Software as a Service, Cloud & Agile	33%	8%
We are moving away from home-grown applications towards an integrated suite	26%	33%
We are moving away from home-grown applications towards point solutions	19%	0%
We have no plans	7%	17%
We are seeking greater integration between point solutions	7%	17%
We are seeking to eradicate the spreadsheet wherever possible	7%	25%

Source: RSR Research, August 2012

Both Winners and laggards recognize the time has long since passed to migrate away from home-grown merchandising applications, but that is where their similarities end. Winners, instead,

are seeking more innovative delivery models, including Software as a Service, Cloud-based and agile merchandising systems.

Of particular note is the 25% of lagging retailers who say that the statement that best describes their company's plan for the next 3-5 years is to eradicate spreadsheet-run merchandising systems. In a way, this is a positive turn of events. Underperformers are recognizing the need to abandon this antiquated way of managing their merchandise plans. Merchandise planning remains one of the most complex components of modern day retailing and when managed poorly generally results in weaker return on inventory investment. On the other hand, it is still discouraging to see so many acknowledge that the spreadsheet is still the cornerstone of their merchandise operations efforts. In this area, Winners have clearly moved on.

Where We See the Biggest Opportunities

It has become almost trite to say it, but Retailers can no longer predict the future by looking at the past. Instead, we see enormous opportunities in using predictive analytics to determine future selling trends (smoothing out anomalies caused by singular events like out-of-stocks, snow storms, and stock imbalances), continuous re-forecasting based on current sales trend (particularly important in our uncertain economic times), and continuous re-evaluation of store and customer segmentation definitions. We no longer live in a static world. Optimization is the outcome of an iterative process whether a retailer is selling short, medium or long-lifecycle merchandise.
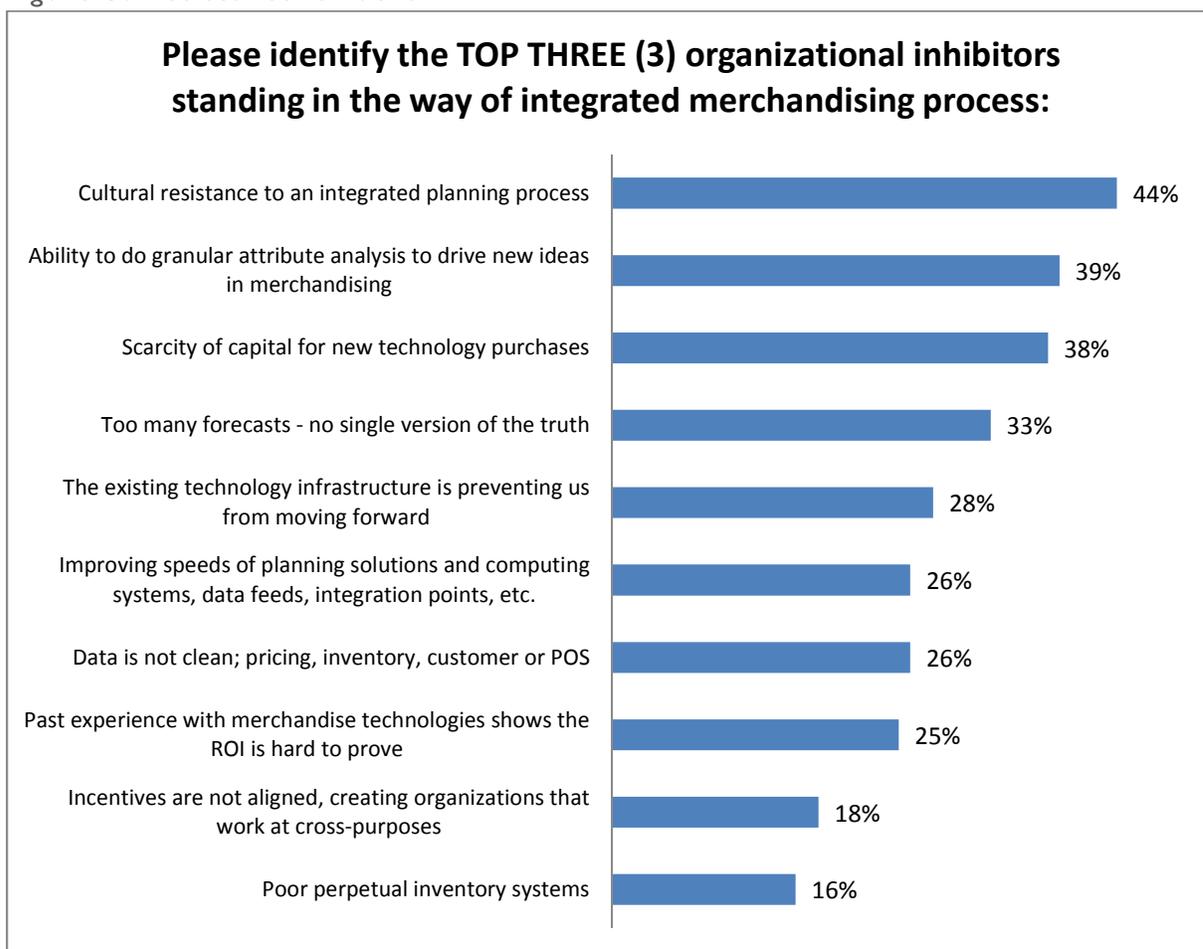
Let's now see what stands in the way of seizing more of these opportunities.

Organizational Inhibitors

The Human Factor

For the third year in a row (and anecdotally far longer than that), cultural resistance to an integrated planning process is the most frequently cited inhibitor to forward progress (Figure 9).

Figure 9: Resistance is Futile

Please identify the TOP THREE (3) organizational inhibitors standing in the way of integrated merchandising process:

Inhibitor	Percentage
Cultural resistance to an integrated planning process	44%
Ability to do granular attribute analysis to drive new ideas in merchandising	39%
Scarcity of capital for new technology purchases	38%
Too many forecasts - no single version of the truth	33%
The existing technology infrastructure is preventing us from moving forward	28%
Improving speeds of planning solutions and computing systems, data feeds, integration points, etc.	26%
Data is not clean; pricing, inventory, customer or POS	26%
Past experience with merchandise technologies shows the ROI is hard to prove	25%
Incentives are not aligned, creating organizations that work at cross-purposes	18%
Poor perpetual inventory systems	16%

Source: RSR Research, August 2012

In some ways, the data in the chart above can be viewed as a positive: resistance to change is always inevitable, and implies that the organization is prepared to make that change.

In both 2010 and 2011 studies, retailers concerns were more data driven; they reported significant problems trusting the cleanliness of their pricing, inventory, customer and POS data (39% in 2010, 49% in 2011). This year, only one in four retailers (26%) cites data cleanliness as a top inhibitor. That's straightforward progress in an area retailers *can* control through their information systems and procedures: you may not be able to change human nature's ingrained resistance to change, but cleaning up the information stream that dictates your every merchandising decision? That's in retailers' control, and they are making progress.
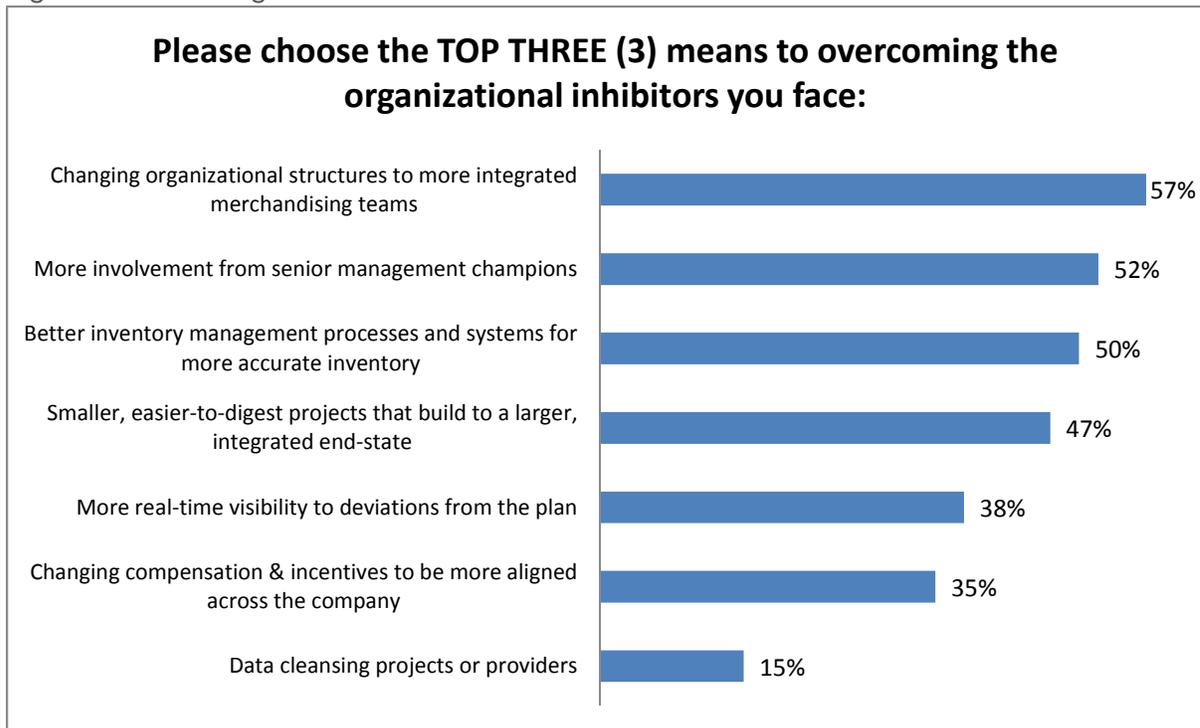
There were some differing results by respondent group:

- Fewer Winners (14%) are concerned about **incentive misalignment** (creating organizations that work at cross-purposes to each other). Average performing retailers have the hardest time getting these incentives aligned, as 37% report it a top-three inhibitor.
- Not surprisingly, Winners have fewer problems **freeing up capital for new technology purchases** (25% vs. average performers' 53% and laggards' 43%)
- **Data cleanliness** does remain an issue for smaller retailers, likely a direct result of their holding onto legacy (or homegrown) systems and their reticence to move to more modern merchandising tools Similarly, they report "**the existing technology infrastructure is keeping us from moving forward**" at a much higher rate than any other revenue band (43% of small retailers, only 8% of 1-5 Billion retailers cite existing infrastructure as a top inhibitor). Our take-away here is more directed towards technology vendors than it is towards the retailers themselves. *It's imperative to make cost-effective, easy to implement technology solutions available to small-to-mid-market retailer*. We expect to see different delivery models like Software as a Service and other on-demand options made available in the coming years to support this demand.
- Mega retailers, while reporting slightly more difficulty proving merchandising systems' ROI, are much less inhibited by their ability to drive new ideas via granular attribute analysis; virtually all other retailers report their inability to conduct granular attribute analysis as a serious roadblock to better merchandising processes (46% of $1-5 Billion retailers cite this a top inhibitor)

Restructuring Required, Particularly for Mid-Market Retailers

Retailers know that in order to get past these roadblocks, they need to change their organizational structures and create more integrated merchandising teams (figure 10).

Figure 10: Getting Past the Problems

Please choose the TOP THREE (3) means to overcoming the organizational inhibitors you face:

Changing organizational structures to more integrated merchandising teams	57%
More involvement from senior management champions	52%
Better inventory management processes and systems for more accurate inventory	50%
Smaller, easier-to-digest projects that build to a larger, integrated end-state	47%
More real-time visibility to deviations from the plan	38%
Changing compensation & incentives to be more aligned across the company	35%
Data cleansing projects or providers	15%

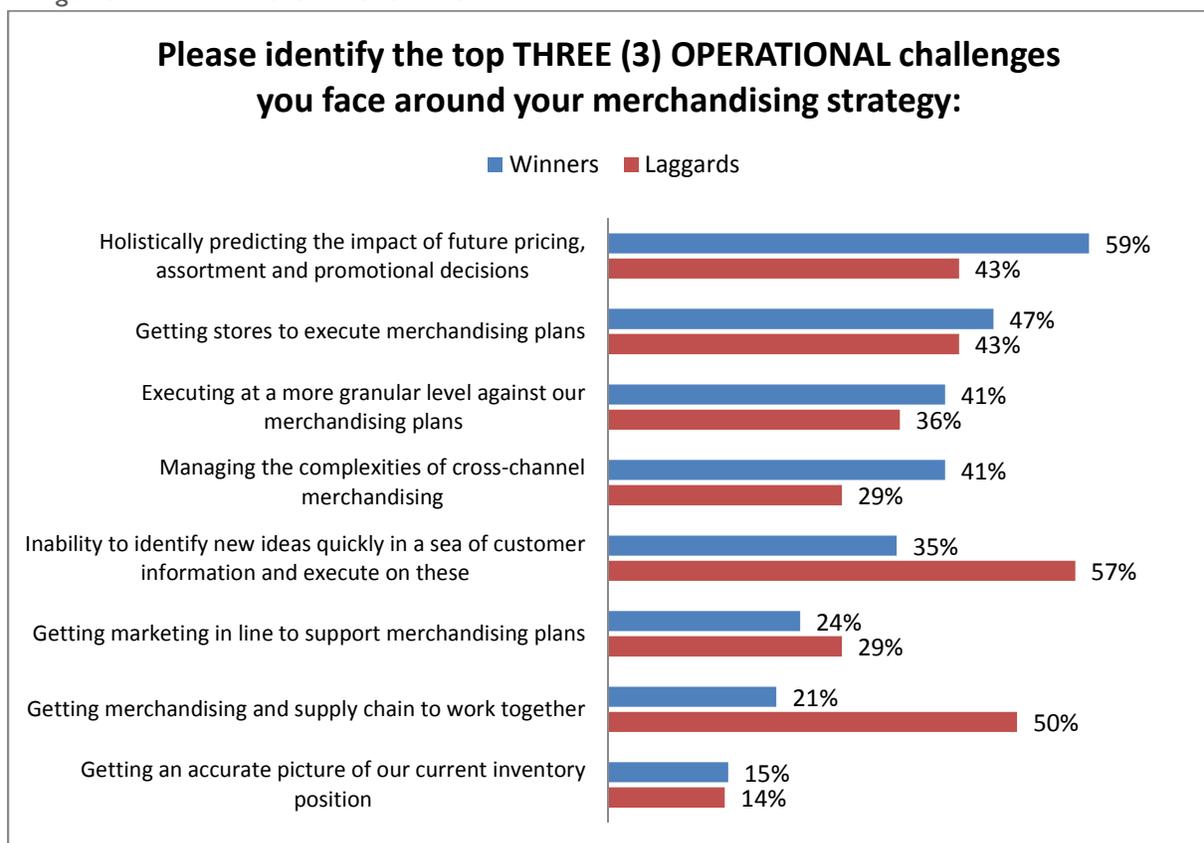*Source: RSR Research, August 2012*

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Interestingly, retailers selling fast moving consumer goods are most bullish on the notion of changing their compensation and incentives to be more aligned across the company (45%, compared to GMA's 30%), one of the few areas where they do not lag behind other segments in both current technology usage and forward-looking processes. Some other variances by demographic:

- FMCG retailers are more eager for **better inventory management process and systems** to improve inventory accuracy (65% vs. 46% of GMA retailers)
- Mid-market retailers appear far less aware of the **value of senior management champions** (only 33% of those with sales of $51-$999 million see the need for such advocates). By way of comparison, 70% of the largest retailers see this role as a vital component to getting past internal roadblocks. This is a vital and missed opportunity for the mid-market.

Operational Differences

Operationally, the best performers have a generally better understanding of what they need to change to improve their merchandising strategies (Figure 11).

Figure 11: Winners in the Know

Please identify the top THREE (3) OPERATIONAL challenges you face around your merchandising strategy:

■ Winners ■ Laggards

Challenge	Winners	Laggards
Holistically predicting the impact of future pricing, assortment and promotional decisions	59%	43%
Getting stores to execute merchandising plans	47%	43%
Executing at a more granular level against our merchandising plans	41%	36%
Managing the complexities of cross-channel merchandising	41%	29%
Inability to identify new ideas quickly in a sea of customer information and execute on these	35%	57%
Getting marketing in line to support merchandising plans	24%	29%
Getting merchandising and supply chain to work together	21%	50%
Getting an accurate picture of our current inventory position	15%	14%

Source: RSR Research, August 2012

Winners "know what they don't know": 59% cite the ability to **holistically predict the impact of future pricing, assortment and promotion decisions** as their top operational challenge. Based on what we've already seen in Figure 6 in the Opportunities section of this report, the largest retailers have a greater need for systems to help make these informed predictions with more

confidence. Winners are also more aware of the need to **better manage the complexities of their cross-channel merchandising efforts** (41% to laggards' 29%).

Laggards, on the other hand, have two very different operational challenges.
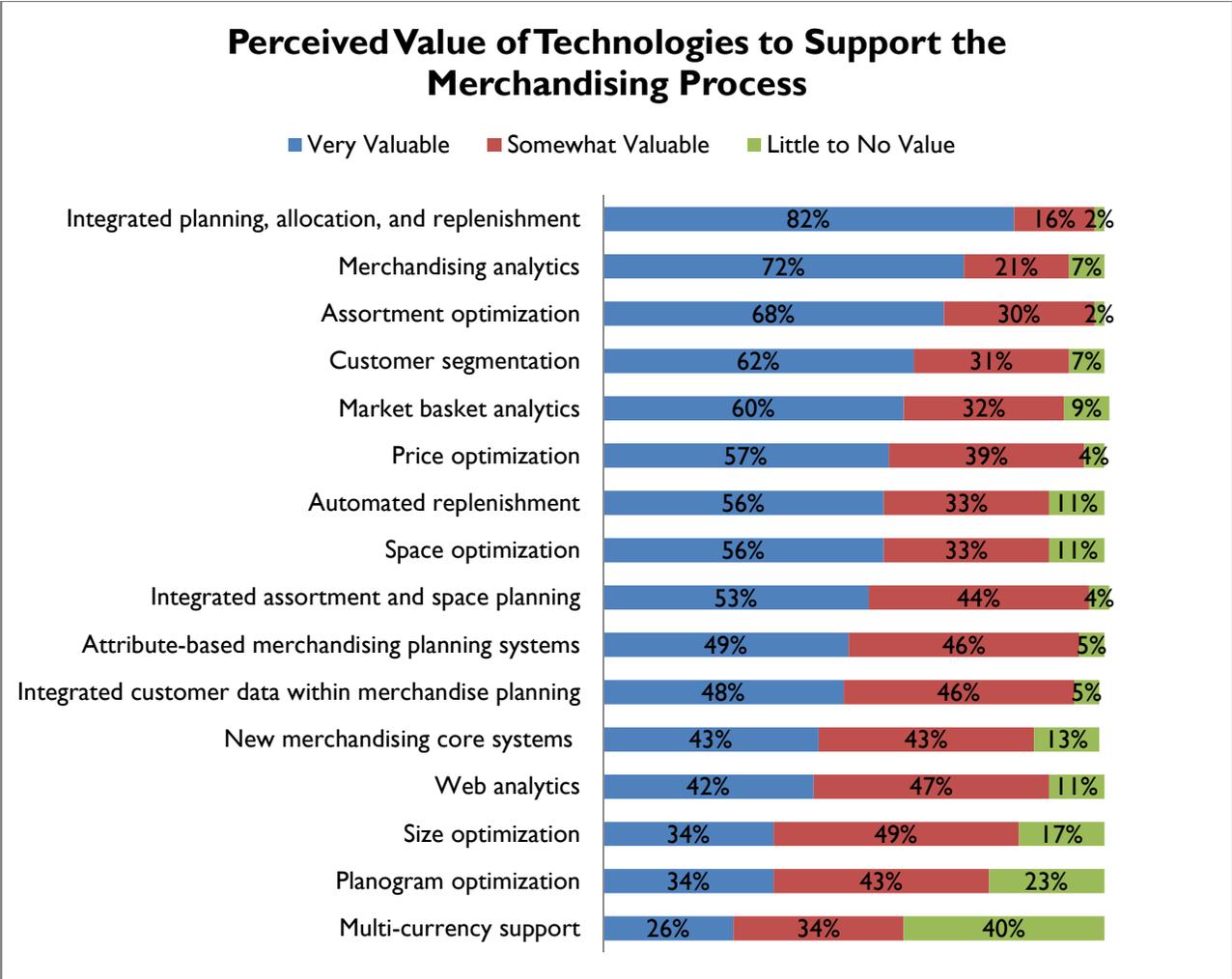
- First, they are more than twice as likely to cite **merchandising and supply chain's current inability to work together** (50% of laggards compared to 21% of Winners cite this issue). Last year, this issue was the top operational challenge for all respondents (59% in 2011, and a nearly consistent 60% in 2010). Winners have clearly made inroads in their internal alignment for meeting common goals.
- But just as importantly, laggards have a much harder time **identifying new merchandising ideas quickly**, even as they collect a sea of customer information. This is an interesting paradox. Given their self-defined desire for more segmentation and preference information (as stated in the Opportunities section of this report), we can only reiterate our question: "how can more data be helpful in absence of the internal alignment, processes, and technologies required to execute effectively?"

Technology Enablers

If Optimization is the Goal, Which Technologies are Most Important?

Retailers can choose from a multitude of tools to support assortment optimization. We gave our respondents a long laundry list of technologies and asked them to rate relative value to support their merchandising processes. All require a strong forecasting engine for optimal usage. Aggregate results are in Figure 11.

Figure 9: Perceived Value of Various Technologies to Support Merchandising

Perceived Value of Technologies to Support the Merchandising Process

Legend: ■ Very Valuable ■ Somewhat Valuable ■ Little to No Value

Technology	Very Valuable	Somewhat Valuable	Little to No Value
Integrated planning, allocation, and replenishment	82%	16%	2%
Merchandising analytics	72%	21%	7%
Assortment optimization	68%	30%	2%
Customer segmentation	62%	31%	7%
Market basket analytics	60%	32%	9%
Price optimization	57%	39%	4%
Automated replenishment	56%	33%	11%
Space optimization	56%	33%	11%
Integrated assortment and space planning	53%	44%	4%
Attribute-based merchandising planning systems	49%	46%	5%
Integrated customer data within merchandise planning	48%	46%	5%
New merchandising core systems	43%	43%	13%
Web analytics	42%	47%	11%
Size optimization	34%	49%	17%
Planogram optimization	34%	43%	23%
Multi-currency support	26%	34%	40%

Source: RSR Research, August 2012

On the surface, this data is somewhat unremarkable, but interesting differences emerge when looking at both retailer performance and size.
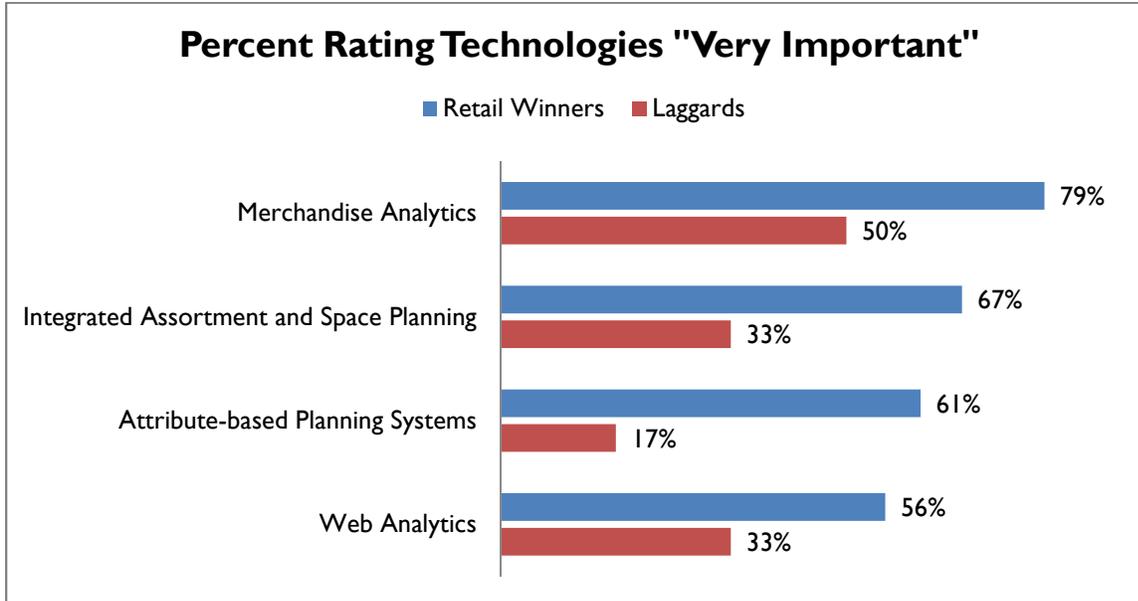
Several technologies are rated more highly depending on performance including:

- Attribute-based planning systems
- Integrated assortment and space planning
- Merchandising Analytics

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- Web Analytics

Differences are illustrated in Figure 12:

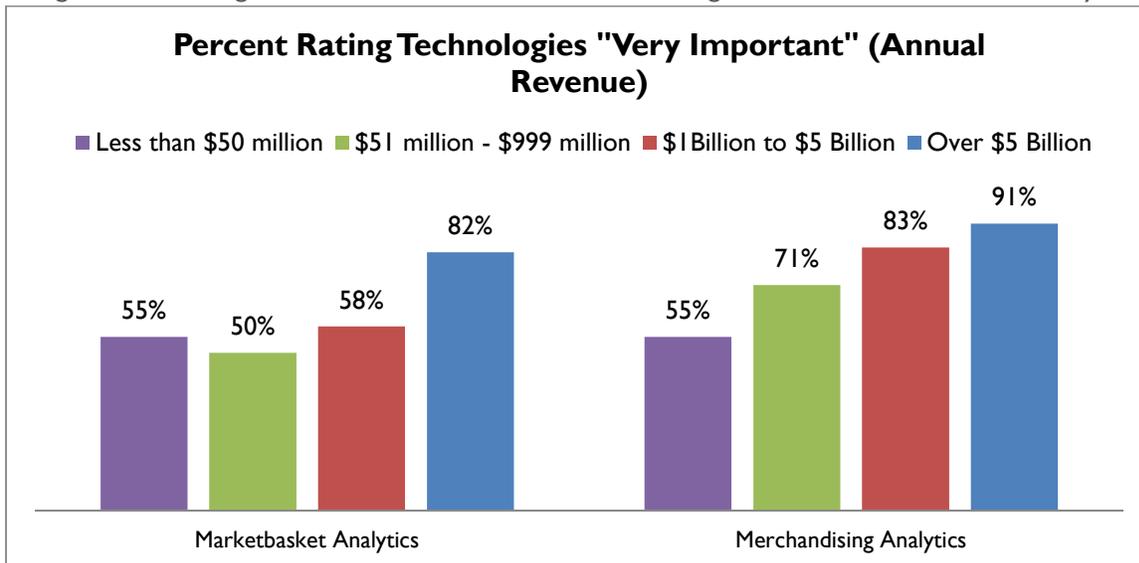*Figure 10: Retail Winners Prize Certain Technologies Differently than Peers*

Percent Rating Technologies "Very Important"

■ Retail Winners ■ Laggards

Technology	Retail Winners	Laggards
Merchandise Analytics	79%	50%
Integrated Assortment and Space Planning	67%	33%
Attribute-based Planning Systems	61%	17%
Web Analytics	56%	33%

Source: RSR Research, August 2012

A conclusion we can draw from these differences is consistent with many of our other benchmark survey findings: *Retail Winners generally excel at finding steps to a goal as opposed to shooting directly for that goal*. So while assortment optimization is the goal, Retail Winners perceive more value in the analytics that drive decision-making than making the decision itself.

Similarly, there are some technologies that become "must haves" as a retailer gets larger. Merchandise and market basket analytics certain fall into that category (Figure 13).

Figure 11: Larger Retailers Need Merchandising and Market basket Analytics

Percent Rating Technologies "Very Important" (Annual Revenue)

■ Less than $50 million ■ $51 million - $999 million ■ $1Billion to $5 Billion ■ Over $5 Billion

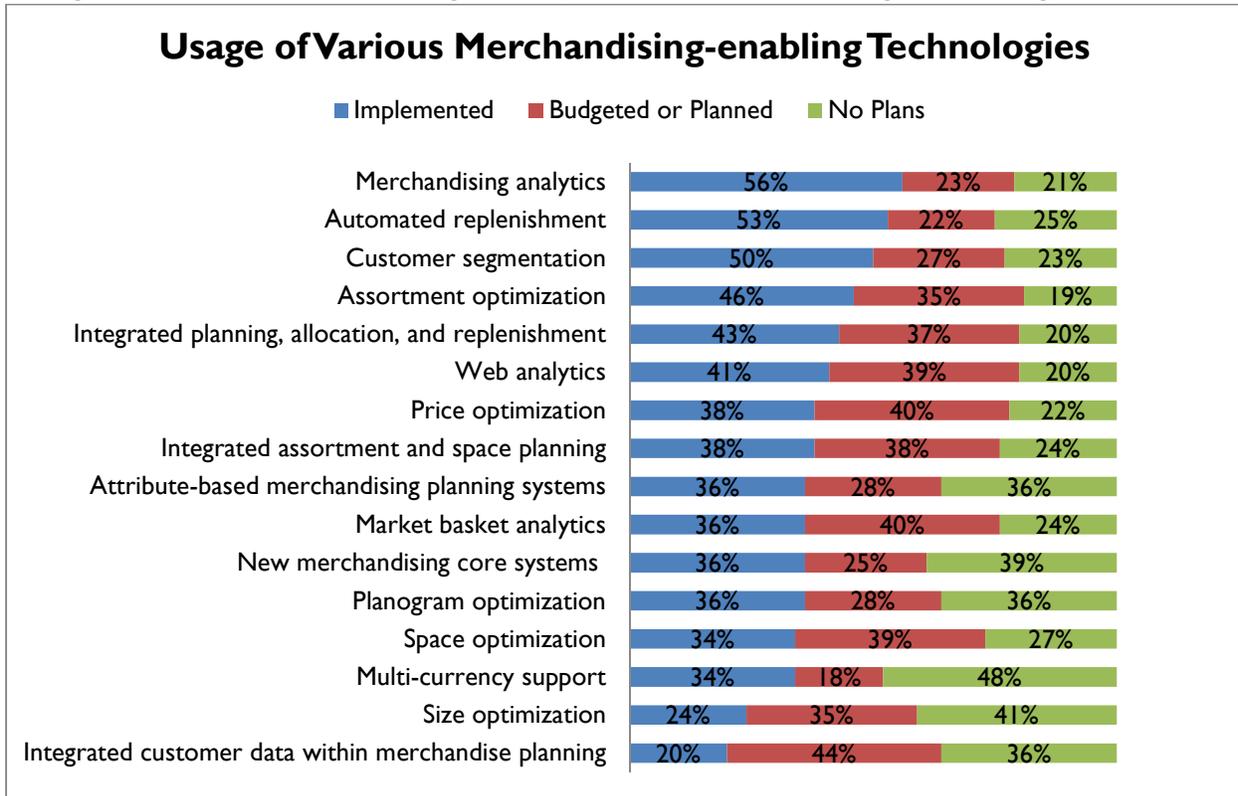|	Less than $50 million	$51 million - $999 million	$1Billion to $5 Billion	Over $5 Billion
Marketbasket Analytics	55%	50%	58%	82%
Merchandising Analytics	55%	71%	83%	91%

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Far-flung retailing empires have a greater need to automate analysis of product movement and affinities than their smaller counterparts. In fact, we were surprised more differences did not emerge, particularly in planogram and size optimization.

Having Seen the Importance, Let's Investigate Implementation Status

We've established our respondents' opinion on a large list of technologies. Now we'll look at implementation status (Figure 14).

Figure 12: Retailers have Big Plans for New Merchandising Technologies

Usage of Various Merchandising-enabling Technologies

Implemented ■ Budgeted or Planned ■ No Plans

Technology	Implemented	Budgeted or Planned	No Plans
Merchandising analytics	56%	23%	21%
Automated replenishment	53%	22%	25%
Customer segmentation	50%	27%	23%
Assortment optimization	46%	35%	19%
Integrated planning, allocation, and replenishment	43%	37%	20%
Web analytics	41%	39%	20%
Price optimization	38%	40%	22%
Integrated assortment and space planning	38%	38%	24%
Attribute-based merchandising planning systems	36%	28%	36%
Market basket analytics	36%	40%	24%
New merchandising core systems	36%	25%	39%
Planogram optimization	36%	28%	36%
Space optimization	34%	39%	27%
Multi-currency support	34%	18%	48%
Size optimization	24%	35%	41%
Integrated customer data within merchandise planning	20%	44%	36%

Seemingly, the message in the chart above is straightforward, but again, we see some significant differences when we look at both performance and revenue band.

Different Technologies in Use Depending on Retailer Performance

We found some interesting differences based on performance.

- Retail Winners are far more apt to use **Space Optimization** technologies (26% vs. 8% of all others)
- Average performers were far more likely to have done a refresh on **core merchandising technologies**, with 42% having done so more than a year ago. Forty-six percent of Winners and 58% of laggards report no plans to perform this upgrade. Success tends to inhibit a decision to "rip and replace" while persistent failure makes the funds to do so very scarce.

- Perhaps the most dramatic difference of all was in the area of **Merchandise and Market basket analytics**. Seventy-five percent of Retail Winners have implemented this technology (42% more than a year ago, 33% within the past year), but only 25% of laggards have moved forward. Of those, 2/3 have implemented within the past year. This is consistent with laggards placing less importance on the technologies as we saw above.

The Mid-Market Lags in Tech Adoption, Sometimes Dramatically

Earlier in this document we expressed concern about the tools and techniques used by retailers in the mid-market (those with annual revenues from $50 - $999 million). The following data reflect those concerns, along with other differences across retailer bands.

- The largest retailers (over $5 billion in annual revenue) have been using **assortment optimization technologies** the longest, with 38% implemented for longer than 1 year, while more of the smallest (under $50 million in annual revenue), and lower tier 1 retailers (revenue between $1 billion and $5 billion) have implemented within the past year (31 and 33% respectively). Only the mid-market retailers ($51 million - $999 million in annual revenue) have yet to budget for this. Thirty-three percent report they're planning to implement, but without budget, we can expect to see a two-year lag time to implementation at minimum.
- **Price optimization** has been in use at 25% of retailers at all revenue levels EXCEPT the mid-market retailers. Fully 31% of those respondents report they have no plans to implement this technology.
- **Space optimization** is clearly the realm of the largest tier 1 retailers. While only 8% of all other respondents report having implemented the technology for more than a year, 63% of the largest retailers report long-term implementations while another 25% have implemented within the past year. Interestingly, 25% of the smallest retailers have implemented in the past year as well.
- The larger the retailer, the more likely it is to use **automated replenishment.** From a low of 13% at the smallest retailers, long-term implementations rise across revenue bands to 75% for those with over $5 billion in annual revenue.
- Perhaps most surprisingly, NO retailers in the mid-market report the use of **market basket analytics**, while 51% of the largest retailers and 44% of the smallest retailers report these technologies are implemented.
- Similarly, mid-market retailers report the least interest in **Customer segmentation** and **planogram optimization technologies**. Fully 58% and 69% respectively report they have no plans to use these tools and techniques. This lags all other retailers (including the smallest) significantly.

As a general rule, mid-market retailers are aspirational tier 1 retailers. We worry that their lack of appetite for some core technologies may hamper their success as they continue to grow. "Crossing the chasm" from mid-market to tier 1 involves more than just opening stores. It typically also involves a shift in infrastructure. More than a few retailers have stumbled when they discovered that the technologies and processes that supported them well at $500 million per year were unable to support a billion dollar business.

BOOTstrap Recommendations

To paraphrase Charles Dickens, "It is the best of retail times, and the worst of retail times." On the one hand, we have tools and techniques at our disposal that allow us to sense-and-respond to consumer demand faster than ever before. But the global economy remains so uncertain as to send continuous mixed signals, forcing us to get even more nimble. This leaves us with three main recommendations:

Get Predictive

Predictive forecasting using sophisticated tools are a must for today's merchant. The hardware can support the software, and the software works. Modeling demand is critical, as is planning with cross-functional teams. As we build to a more holistic forecast that takes channel and supply chain vagaries into account, we must build more holistic organizations that support them as well.

Get Responsive

We live in exceptionally erratic times. Even the best forecast can be thrown into disarray by extraneous events that occur outside retail: weather anomalies, economic upheaval, and social unrest. This makes the ability to continually re-model and reforecast critical to a successful year.

The omni-channel phenomenon only increases our need to respond and react. We may have a perfect aggregate forecast by both customer segment and geography, but miss the mark in assessing the customers' path to purchase. If the customer decides to buy on-line and have product delivered, we must have an efficient and effective means to satisfy her needs. The holistic organization is critical to helping fill this unanticipated demand across various channels.

Get Automated

Particularly for the mid-market retailer, it's really time to use the tools that larger retailers use for merchandise operations support, while retaining the uniqueness of your product offerings. Consider newer technology delivery models like hosted services and Software as a Service to minimize up-front costs and accelerate time to value.

As a general rule, retailers who avoid these models do so because they fear loss of control ("How can I trust my data to an outside provider?") or for financial reasons (I don't want to have the cost of these systems be "above the line." I want them to be capitalized.). This may be a sound long-term strategy, but it's not going to be helpful short-term. You can shift strategies later, and bring tools on-site as needed. In fact, you can plan for it from the start. But it's really important to start.

Get Scientific

One of the things we love about retail is its emotional aspect. Just as shopping is an emotional experience, selling is also emotional. No one will ever change the visceral impact of a gorgeous product. But our visceral responses to consumer trends really need to change. We've historically been a very detailed business ("Retail is Detail"). However, we cannot manage today's retail enterprise from the bottom-up. We need alerts, analysis and aggregation to solve today's problems. Luckily, those tools and techniques are available to us, and many have adopted them. We just have to finish the job.

Appendix A: RSR's Research Methodology

The "BOOT" methodology is designed to reveal and prioritize the following:

- **B**usiness Challenges – Retailers of all shapes and sizes face significant **external** challenges. These issues provide a business context for the subject being discussed and drive decision-making across the enterprise.
- **O**pportunities – Every challenge brings with it a set of opportunities, or ways to change and overcome that challenge. **The ways retailers turn business challenges into opportunities often define the difference between Winners and "also-rans."** Within the BOOT, we can also identify opportunities missed – and describe leading edge models we believe drive success.
- **O**rganizational Inhibitors – Even as enterprises find opportunities to overcome their external challenges, they may find **internal** organizational inhibitors that keep them from executing on their vision. Opportunities can be found to overcome these inhibitors as well. Winning Retailers understand their organizational inhibitors and find creative, effective ways to overcome them.
- **T**echnology Enablers – If a company can overcome its organizational inhibitors it can use technology as an enabler to take advantage of the opportunities it identifies. Retail Winners are most adept at judiciously and effectively using these enablers, often far earlier than their peers.

A graphical depiction of the BOOT follows:
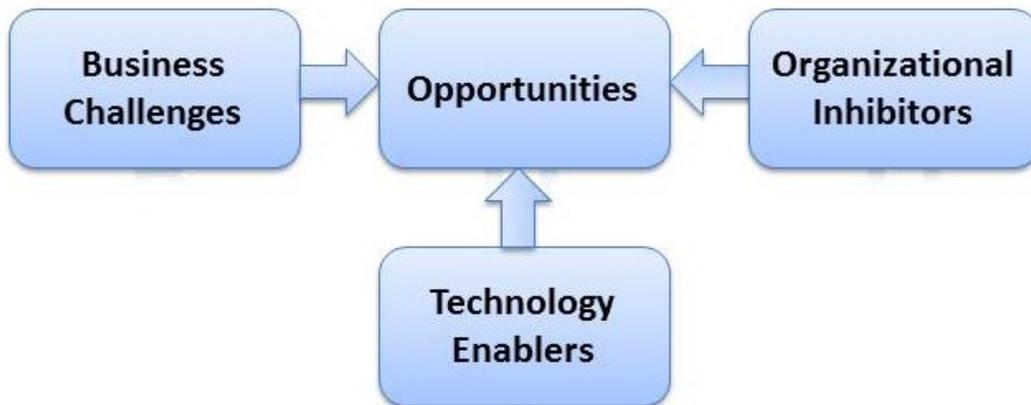
Appendix B: About RSR Research

Retail Systems Research ("RSR") is the only research company run by retailers for the retail industry. RSR provides insight into business and technology challenges facing the extended retail industry, providing thought leadership and advice on navigating these challenges for specific companies and the industry at large. We do this by:

- **Identifying information** that helps retailers and their trading partners to build more efficient and profitable businesses;

- **Identifying industry issues** that solutions providers must address to be relevant in the extended retail industry;

- **Providing insight and analysis** about a broad spectrum of issues and trends in the Extended Retail Industry.