



Twenty-first Century Merchandising Takes Hold: Benchmark Report 2011

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Executive Summary

In 2010, data gathered from RSR's annual Merchandising Benchmark Report showed a dramatic change in Retailers attitudes towards merchandise operations management. At that time, we defined seven core tenets of 21st Century Merchandising. This year, we gave retailers the opportunity to grade their progress in adopting these tenets. While retailers generally rate themselves between a "B" and a "C," we believe they have understated the extent of their adoption. While the industry still has a way to go, overall we have seen a significant shift. Retailers have gained a better understanding of the technology tools available to them and also increased their appreciation of these tools and techniques. Retailers recognize optimized merchandise operations are critical to their retailing success. Science is now strongly supporting the entire merchandise lifecycle.

Business Challenges

Fractured planning processes have long been a key business challenge for retailers, but since the Great Recession, concerns over underperforming inventory have stressed the enterprise, trumping even out-of-stocks as a top-three business challenge. To gain maximum value from inventory investments, it's critical for merchandising optimization to span products, prices and processes, To facilitate both organizational and operational shifts, retailers are finally moving away from home-grown applications and turning to more industry standard solutions. Retail Winners are leading the charge in this area while their peers are at least attempting to standardize interfaces between the various applications in their portfolio. Ironically, those same Retail Winners grade themselves lower than their peers in their progress in de-siloing their merchandising processes.

Opportunities

In keeping with the theme of integrating the merchandise operations function with the rest of the enterprise, retailers remain bullish on the opportunities afforded by integrated planning with cross functional teams. Fully 2/3 of retail respondents rate this as a high value opportunity – up from 58% in 2010. Merchants are no longer the sole intersection point between customer insights and product plans. Retail Winners in particular rate themselves highly on moving from the world of the Merchant Prince to the world of cross-functional customer insights. We also see an increased interest in bottoms-up planning, along with reconciliation of top-down and bottom up plans to help maximize retailers' inventory investments.

Organizational Inhibitors

While retailers still struggle with traditional issues of getting Merchandising to work with Supply Chain and Store Operations, the Marketing Group has become a new source of organizational grief. Incentives are just not in place to encourage cross-departmental collaboration. However, "dirty data" within the enterprise remains a key concern. However, we can see from the data that in fact, merchandising capabilities have indeed changed strategically, not just tactically. Organizational structures must change to support these strategic changes.

Technology Enablers

Clearly the next generation of Merchant wants tools to support optimizing product assortments. And while adoption may lag value perception, we can see that over the next eighteen months, retailers have big plans to make that adoption a reality. Market basket analytics are a must to hone assortments across categories, rather than just playing "lifeboat" with seemingly poor

performing skus within a category. Similarly, we see retailers taking more steps to adopt appropriate best practices from other retailing segments.

BOOTstrap Recommendations

This year's benchmark report has given us some valuable hints into ways retailers can improve adoption of 21st Century Merchandising tenets.

1. Optimization in merchandising must span products, prices and processes – RSR believes the next step is organizational, not technological. Incentives must be aligned to support cross-departmental cooperation.
2. Insure merchants have a solid understanding of their technology tools – It is time for retailers to be more open about their merchandising successes. Peer groups are the best way to gain better understanding of tools and techniques.
3. Only tinker with assortments after broad cross-category due diligence – Our data indicates that departments with cross-category responsibilities are best suited to support cross-category assortment optimization. These departments certainly need technology tools that can perform this analysis.
4. Look at and consider “best practices” from other retail segments – While we recognize there are only so many best practices that are applicable across segments, the data does not indicate we have reached the end of the line. New advances in high-performance computing can give merchants insights they need to do the most granular bottoms-up and top-down planning – even in a sku-intensive environment.
5. Marketing is an integrated part of merchandise planning and execution – Marketing is here to stay in the forefront of retailing. It behooves retailers to give the chief marketing executive a seat at the executive steering committee.
6. Merchandising capabilities have changed strategically, not just tactically – To make these changes strategic and permanent, it's important to have the IT department as an ally, involved in making the long-term changes necessary to support new approaches.
7. Merchants are no longer the sole intersection point between customer insights and product plans – Cross-functional teams continue to be the “magic bullet” in exploring the new insights Retailers have gained from new channels and social media.

As always a step-wise approach to adoption is the wisest approach. We cannot change a century of merchandising practices overnight.

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Research Overview

Welcome to RSR's 4th annual Merchandising benchmark. We conduct these benchmarks to keep our fingers on the pulse of the heart of Retailing – the process of planning, selecting, distributing and pricing the products we procure for the customers we court. While there are differences across revenue bands, segments, and channels, the fundamentals of merchandising are surprisingly consistent across the industry – and are becoming even more so with each passing year.

A Review: The Seven Tenets of 21st Century Merchandising

It's becoming almost trite to talk about "Twenty-first Century" something-or-other in retail, and yet the change that has overtaken our industry in the past decade is truly stunning. Merchandising operations is no exception, and has been as affected as stores, marketing and other retail departments.

RSR believes three significant developments have driven the shift in Merchandising: 1) Continued exponential increases in computing power makes once theoretical sku-intensive calculations practical, 2) A new breed of merchant has emerged who is comfortable with technology and at ease with handing over once "sacred" tasks to the mechanics of the computer, and 3) An erratic global economy has created so much uncertainty in both commodity prices and their impact on demand that the entire retail enterprise has to work together to mitigate potential impacts.

With this as a backdrop, in 2010's Merchandising benchmark, **we defined seven core tenets of 21st Century Merchandising**. Those tenets are:

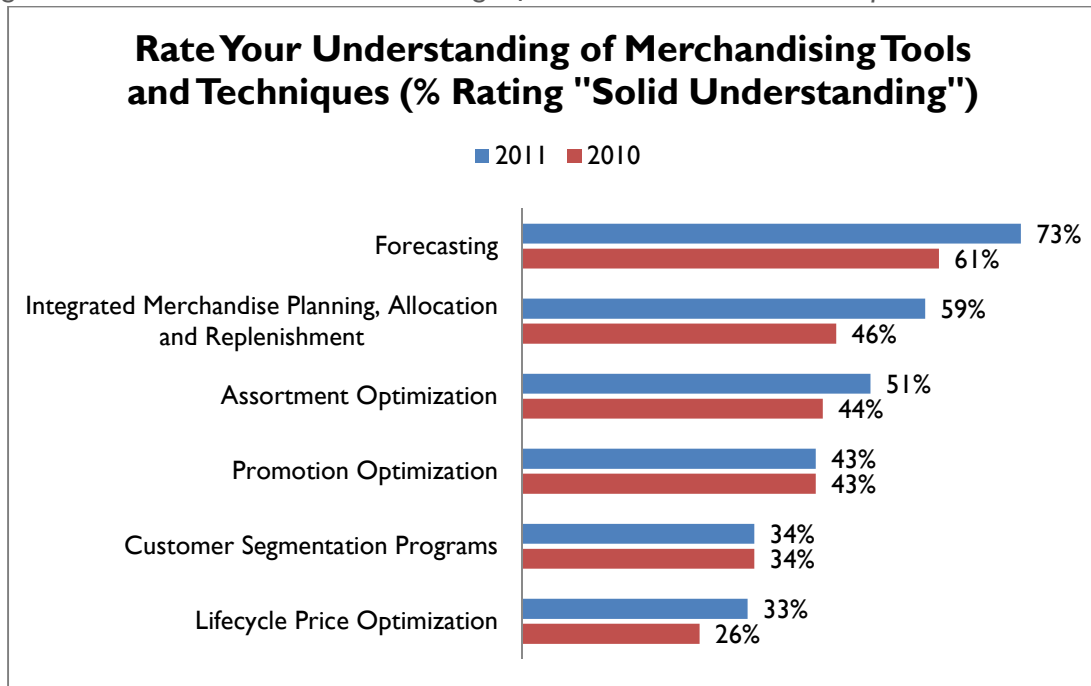
1. Optimization in merchandising must span products, prices and processes
2. Ensure merchants have a solid understanding of their technology tools
3. Only tinker with assortments after broad cross-category due diligence
4. Look at and consider "best practices" from other retail segments
5. Marketing is an integrated part of merchandise planning and execution
6. Merchandising capabilities have changed strategically, not just tactically
7. Merchants are no longer the sole intersection point between customer insights and product plans

Retailers generally grade their enterprises between a B and a C on adopting these tenets. Our goal in looking at this year's survey data was to validate their assessment and determine how much progress has been made in adopting those tenets. Throughout this document, we'll highlight each of those tenets and how well retailers believe they've been applied in their organizations.

Understanding of the "How to" of Optimized Merchandising Grows

In our 2010 Merchandising Benchmark, we observed that retailers had gotten religion around optimized processes and procedures but hadn't yet fully understood how those processes and procedures actually work. This year, we were quickly able to ascertain that understanding is catching up with belief. In other words, the new age of Merchandising is solidifying and **tenet #2 (Ensure merchants have a solid understanding of their technology tools)** seems to be taking hold (Figure 1).

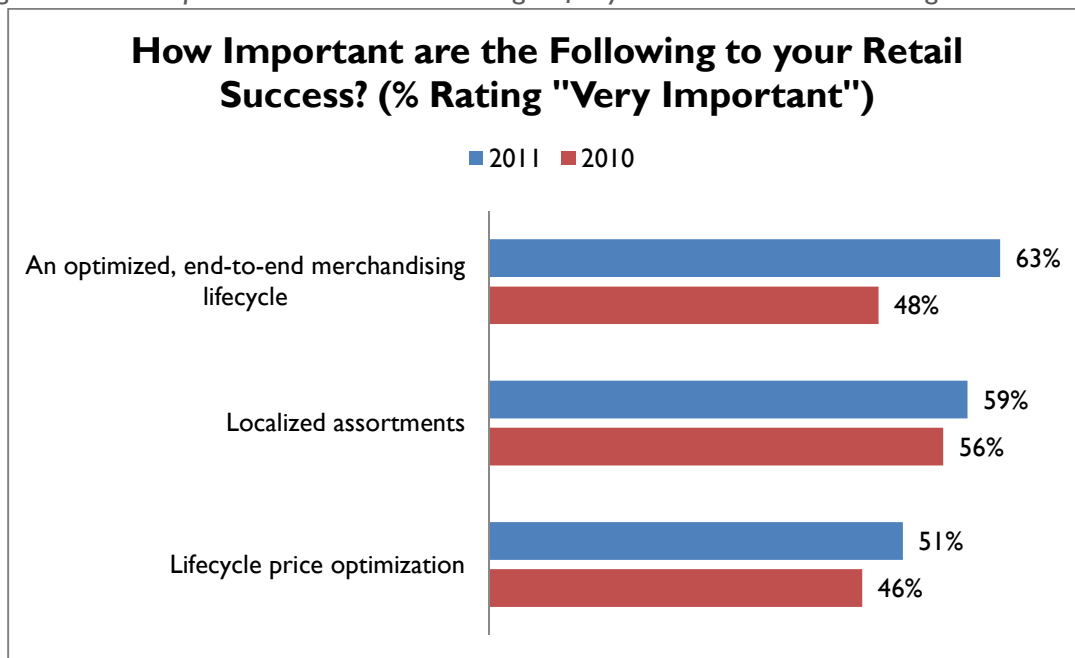
Figure 1: Merchants Understanding of New Tools and Techniques Grows



Source: RSR Research, August 2011

Along with greater understanding of “how” tools and techniques work, we also see a deepening appreciation for the *value* of those tools and techniques. Almost 2/3 of our retail respondents recognize the value of an optimized, end-to-end merchandising lifecycle, up significantly from last year, while they continue to see value in localizing assortments and optimizing prices at the same time (Figure 2).

Figure 2: An Optimized Merchandising Lifecycle Takes Center Stage



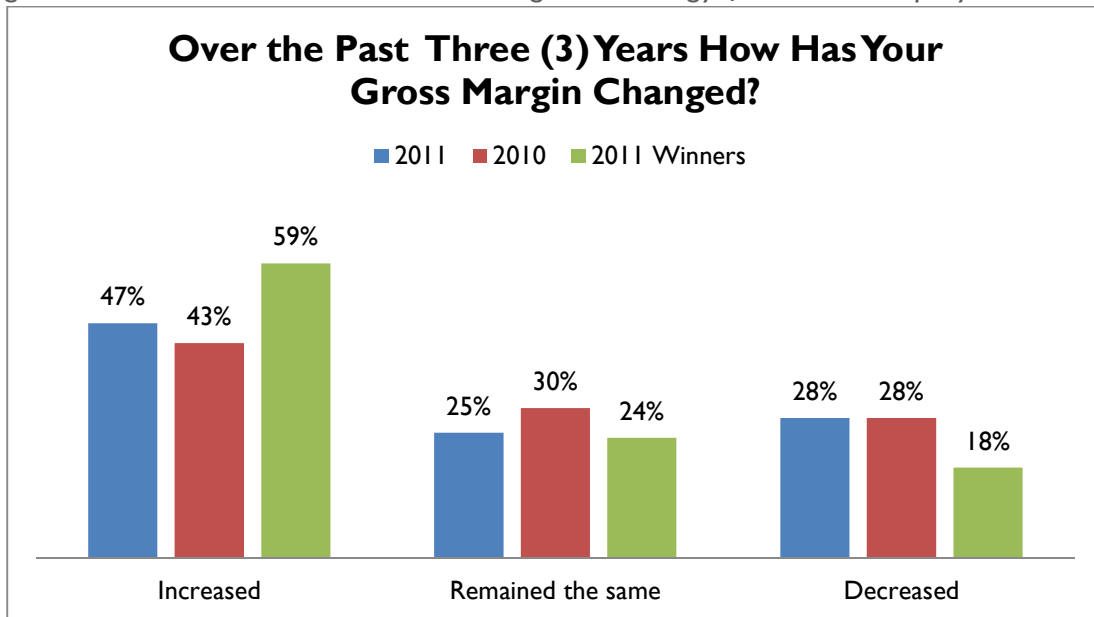
Source: RSR Research, August 2011

The shift is timely – as the global economy remains uncertain, political instability remains a way of life, and commodity prices fluctuate wildly.

Returning to an Age of “Razor-thin Gross Margins”?

We have observed many times that while top line sales may fluctuate, in general almost half of retailer respondents have enjoyed consistent improvements in selling Gross Margin. This year, almost 60% of Retail top-line over-performers, or as we call them, Retail Winners, enjoyed those same improvements (Figure 3).

Figure 3: Most Retailers Now Providing Technology for Store Employees



Source: RSR Research, June 2011

Still, Retailers are indeed concerned about commodity price increases. We asked this year’s respondents how they planned to manage those price increases. Their answers were interesting:

- 40% planned to simply pass them on to consumers
- 20% of all respondents said they’d absorb those costs as long as possible, while 30% of over-performers said they’d hold the line as long as they could
- 39% of all respondents said they would manage a combination of absorbing price differences, passing them along to the consumer and changing package sizes while maintaining the same price point, vs. 30% of Retail Winners

In other words, those who already have disproportionately improved margins are more willing to sacrifice their gains to keep their customers engaged, and have more “wiggle-room” to do so, while their peers will be more likely to pass costs along in some manner or another.

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.

Defining Winners and Why They Win, and Why Laggards Fail

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 **two 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.

Laggards also tend to think differently. They may have spectacular vision, but often fail on execution. They may forget the power and breadth of choices today’s customer has. They fail to re-invent themselves when it becomes obvious their existing business model is no longer working. They don’t change their business processes in an effective manner, and so they either eschew technology enablers, or don’t gain expected Return on Investment on those they DO buy. In good times, they skate by: in tough times these weaknesses come back to haunt them.

Survey Respondent Characteristics

RSR conducted an online survey from May - August 2011 and received answers from 82 qualified retail respondents. Respondent demographics are as follows:

- Job Title:

Senior Management (CEO, CFO, COO)	19%
Vice President	16%
Director/Manager	38%
Internal Consultant	12%
Internal Staff & Other	18%

- 2010 Revenue (\$ Equivalent):

Less than \$50 Million	26%
\$51 - \$999 Million	28%
\$1 - \$5 Billion	37%
Over \$5 Billion	9%

- Selling Format:

Fast Moving Consumer Goods	25%
General Merchandise and Apparel	45%
DIY and Other	29%

- Headquarters/Retail Presence:

United States	58%	62%
Canada	10%	34%
Latin America	2%	17%
Europe	6%	19%
United Kingdom	0%	13%
Asia Pacific	12%	26%
Middle East	6%	15%
Africa	4%	11%

- Year-Over-Year Comparable Store Sales Growth Rates (assume average growth of 2%):

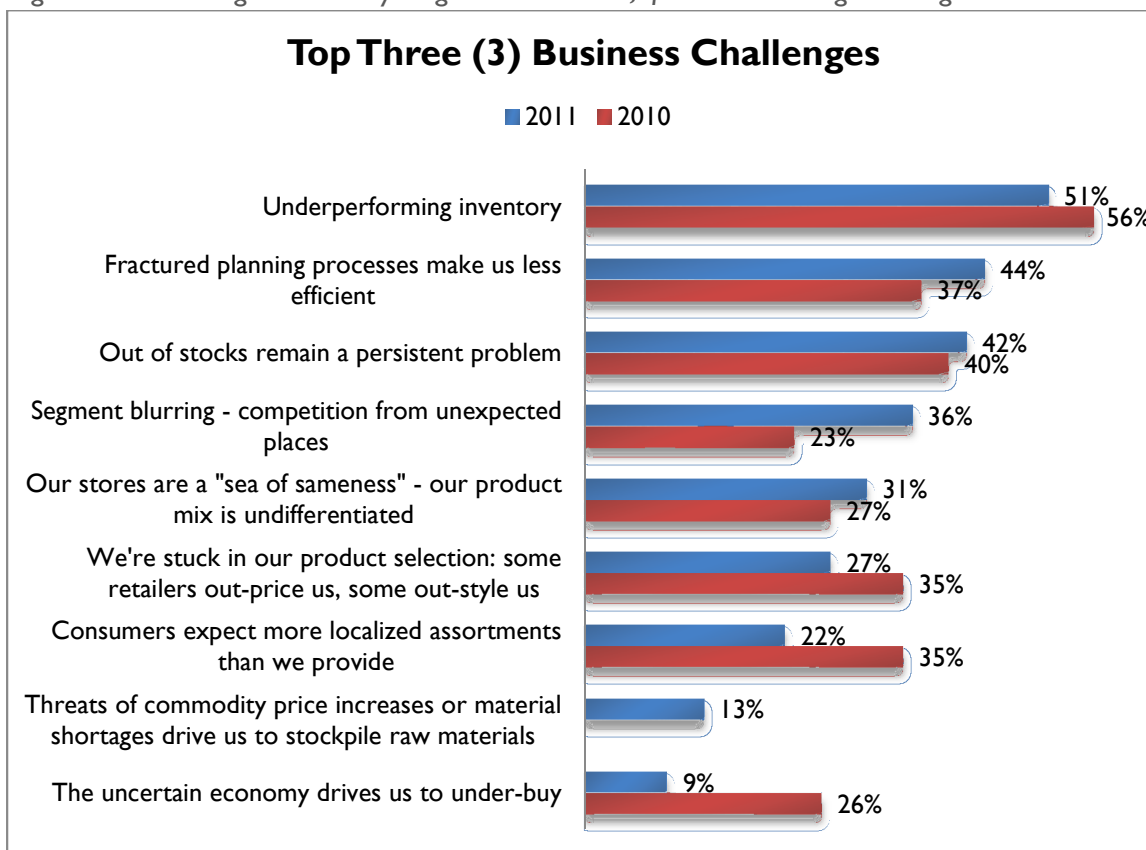
Worse than Average (Laggards)	19%
Average	35%
Better than (Retail Winners)	46%

Business Challenges

Fractured Planning and Inventory Management Remain Key Concerns

Over the past four years, we've seen tidal shifts in the relative importance of various external forces on the merchandising enterprise. Within those ebbs and flows however, fractured planning processes have remained at or near the top of retailers' concerns. And since the Great Recession, underperforming inventory has consistently trumped out-of-stocks as a key business challenge (Figure 4)

Figure 4: Getting Inventory Right is Critical, from Planning through Sales



Source: RSR Research, August 2011

It's interesting to see that as concerns about being under-bought have waned, under-performing inventory has kept its top spot as a top-three business challenge. Even though flat year over year port traffic statistics seem to indicate retailers are maintaining tight inventory controls, retailers remain unconvinced they are buying the RIGHT product. While inflationary concerns remain strong, they are clearly trumped by product related issues.

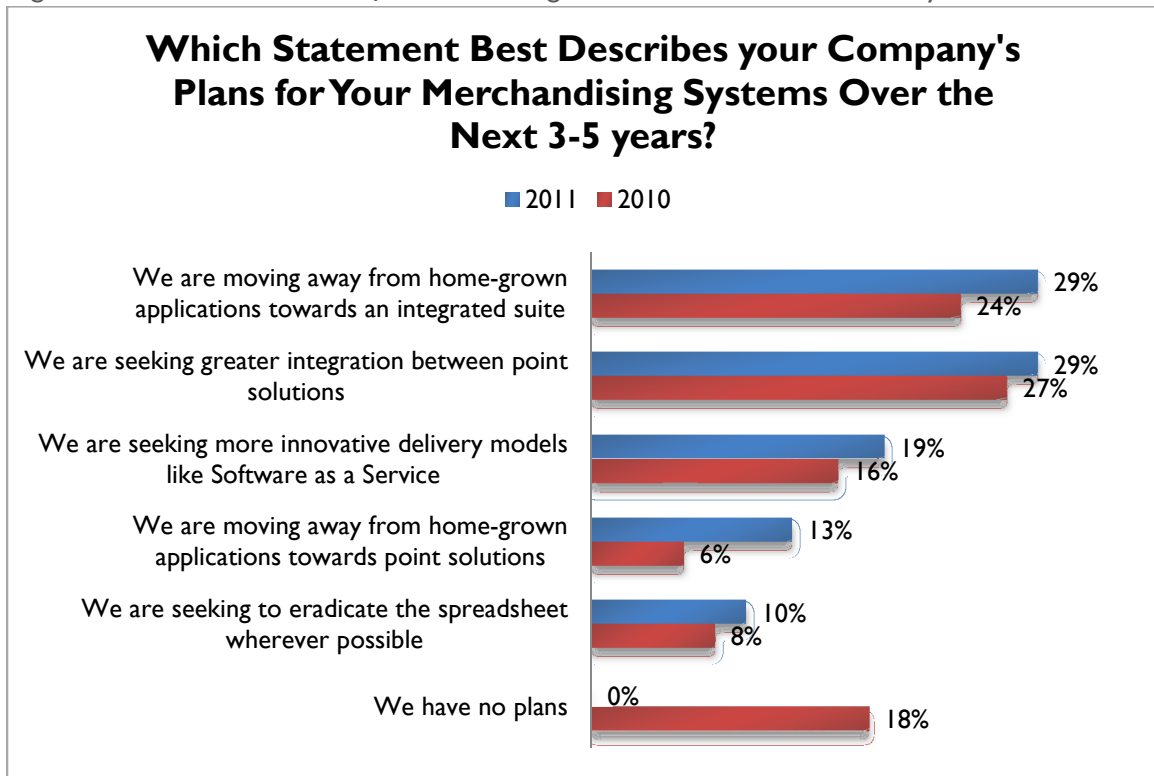
Retail Winners express slightly different concerns than their peers. Only 19% are concerned about their product selection, vs. 27% of the entire respondent pool. They are, however, more concerned about both fractured planning processes and underperforming inventory, with 52%

highlighting the former as a top-three concern and 57% citing the latter. These Winners understand the importance of coordination and precision in managing merchandise operations.

Moving to New Infrastructures to Get Beyond Siloes

One of our 7 critical tenets for 21st century merchandising remains “**Optimization in merchandising must span products, prices and processes**”. To accomplish this, it has become apparent that retailers must overhaul their existing technology infrastructures. Twenty year old infrastructures don’t take into account the need for departments to work together – the systems were most typically championed *by* a single department *for* a single department’s use. And far too many were written by hand. In Figure 5, we can see how retailers’ plans have changed over the past year. While in 2010 almost a fifth of respondents reported no change to merchandising systems, this year every respondent reports at least some form of change afoot.

Figure 5: Retailers Move from Home-grown Solutions to Industry Standards



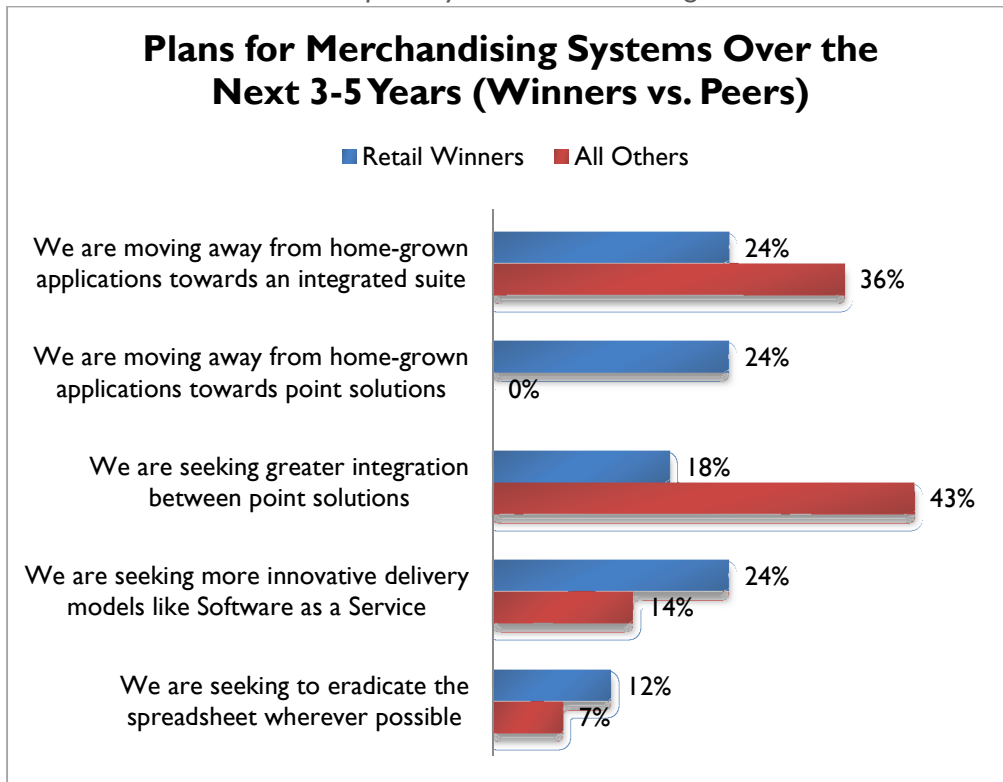
Source: RSR Research, August 2011

However, the data gets even more interesting when we look at differences between Retail Winners and their peers.

Retail Winners Move to Standardized Solutions

The Great Recession created significant capital constraints for all retailers, but most especially for those who were already lagging behind. Many infrastructure decisions were postponed, and more patches were placed on existing solutions. Retail Winners were less likely to be impacted by capital constraints and as such, started about the business of replacing infrastructures that had become roadblocks. In Figure 6, we can see somewhat dramatic differences in strategies:

Figure 6: Retail Winners Completely Eschew Home-grown Solutions



Winners are mostly filling in gaps in their portfolio with point solutions, while all others either look to the basics of an integrated suite or seek to untangle their integration spaghetti with a unified integration backbone.

When All is Said and Done, How Do Retailers Rate Their Progress?

It's instructive to see how retailers grade themselves on optimizing the merchandising process. Retail Winners are more likely to rate themselves a "C" than the overall respondent pool. We believe this subjective analysis is a result of holding themselves to a higher standard. In fact, when asked how well optimization in merchandising spans products, prices and processes, 44% of Retail Winners grade themselves a "C" vs 32% of the total respondent pool. Thirty-two percent of the total respondent pool gives themselves a grade of "B" while only 19% of winners rate themselves that highly.

Winners never rest on their laurels. They continue to stretch themselves to keep close to the curve. They may not be pioneers, but they recognize the challenges they face and act accordingly. Fortunately, they also are most likely to have the capital resources to meet those challenges.

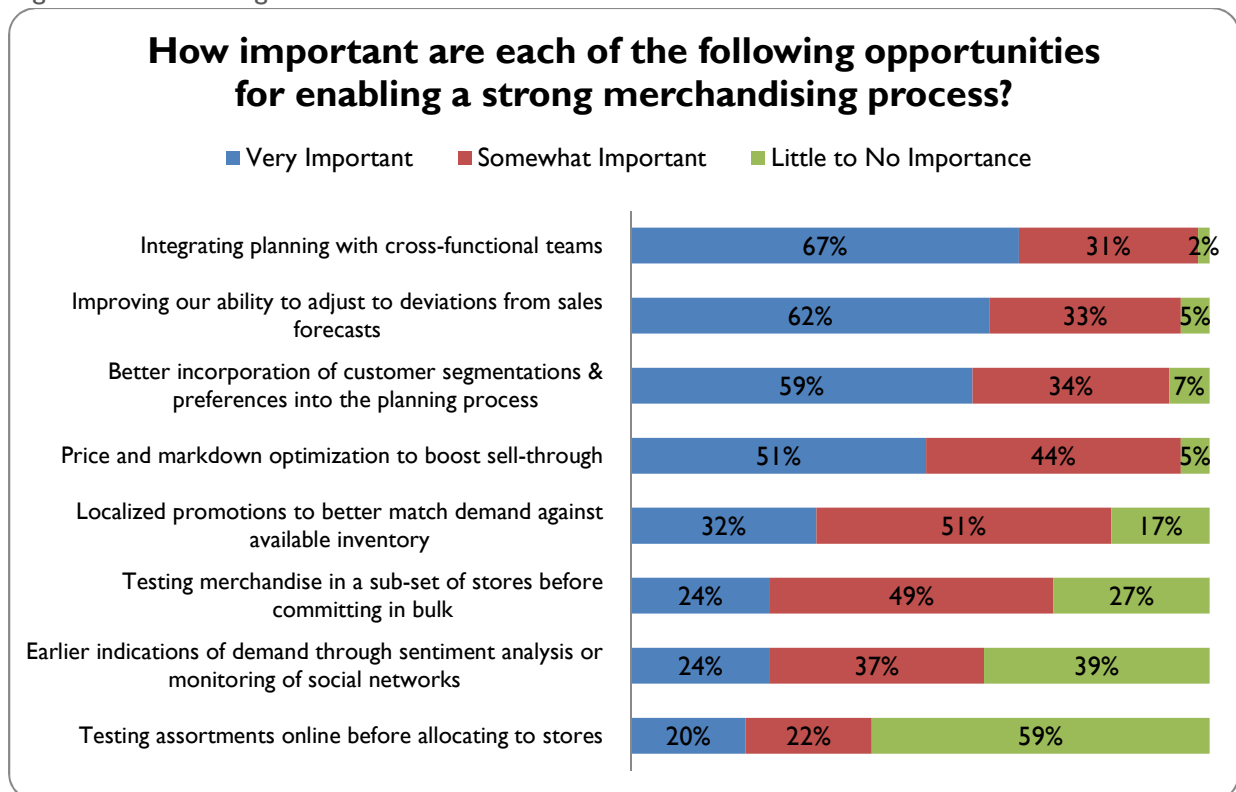
Next we'll take a look at opportunities, and see how our retail respondents stack up.

Opportunities

A Story of Basics Gives Way to Genuine Progress

When it comes to perceived opportunities, at first glance, not a lot appears to have changed in the past 12 months. Retailers still identify the ability to integrate planning with cross-functional teams to adjust to deviations from sales forecasts, better incorporate customer segmentations and preferences, and use price and markdown optimization to bolster sell-through as the most valuable opportunities to fortify their existing Merchandising processes (Figure 7).

Figure 7: A Strong and Stable Pattern



Source: RSR Research, August 2011

However, digging deeper into this data, we see that the *degree* to which retailers are recognizing the importance of cross-functional teams is staggering.

Recognizing the Need to Eliminate Departmental Silos

Last year, 58% of the aggregate respondent base identified the ability to integrate planning with cross-functional teams as very important – a top two opportunity. Just one year later, 67% say it is vital. It has become the most important merchandising opportunity for retailers today.

This maps it directly to the **seventh tenet of 21st century Merchandising: Merchants are no longer the sole intersection point between customer insights and product plans.** Retailers increasingly understand that the days of the “Merchant Prince” have passed, and successful Merchandising truly resides in a combination of technology AND the informed opinions of not only

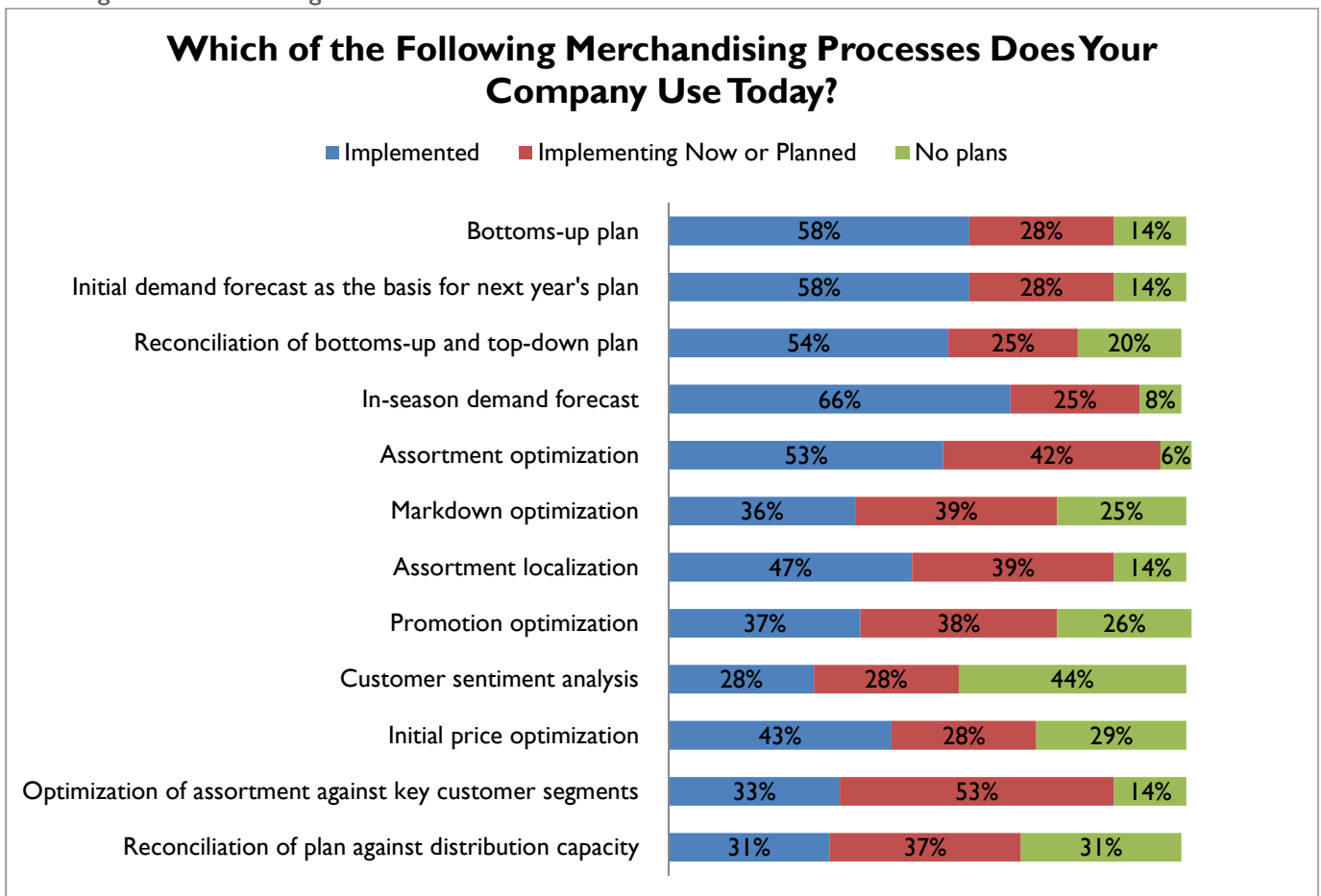
merchants, but also marketing, store operations, ecommerce personnel and other Line of Business executives. The best performers place an even higher priority on cross-functional teams' effectiveness: *76% of Retail Winners identify it as very important.*

It is worth noting, however, that this cross-functional cooperation is where retailers *want* to go: as we will see in the Organizational Inhibitors section of this report, most must still travel a long road to get out of their siloes.

A Matter of Faith

At its core, successful merchandising relies on planning tools a retailer can put full faith and confidence in. Increasingly sophisticated consumers traverse multiple selling channels and have become perennially-moving targets in recent years. The number of channels available and continued economic uncertainty virtually guarantees their product mix will be imperfect. As a result, retailers increasingly tell us their most valuable opportunities are built on trusting the tech-enabled planning solutions readily available in today's marketplace to both set plans and respond to deviations as quickly as possible (Figure 8).

Figure 8: Planning on the Move



Source: RSR Research, August 2011

As retailers' trust in technology grows, we are seeing an uptick in respondents basing their merchandise mix on a bottoms up plan based on an automated demand forecast. Previously deferred purchases have come to fruition. Last year, more than a third of respondents still had no plans to utilize this type of planning method; that number has dropped to 14% in 2011.

Similarly, retailers are committed to reconciling top-down and bottoms-up plans. The 28% of retailers who have no plans to do so has fallen to 20% in 2011. Retailers selling Fast Moving Consumer Goods (FMCG) are taking the lead. All of this year's respondents report at least tentative plans to implement bottoms-up planning processes and 75% are at least preparing to reconcile top-down and bottoms-up plans.

Further, trust in business intelligence on demographics and customer sentiment has led to an increase in interest in assortment localization solutions. Last year, 24% of retailers had no intention of localizing their product assortments; this year only 14% say it is off the table. Perhaps even more tellingly, only 6% of Retail Winners report no plans to localize their assortments. In fact, 47% of Retail Winners already utilize assortment localization, and *29% of Winners are implementing assortment localization solutions as we speak*. This data point alone serves as proof that the retailers believe a successful future removes merchants as the sole intersection point between customer insights and product plans. Planning methodologies are drastically evolving.

An Important Note about Winners

Throughout this section, we've referenced how Retail Winners' perception of opportunities – and their resulting planning behaviors - validate our 7th tenet of 21st Century Merchandising, that merchants should no longer be the most influential component to matching customer insights to product plans. It is worth noting just how differently Winners grade their efforts to date.

Fifty percent of Retail Winners give themselves a “B” as it relates to adopting this tenet, vs. 35% of all respondents. In fact, average and lagging retailers more frequently rate their progress in this department as C, D, or even F-grade work. We believe the writing is on the wall, and more retailers would do well to follow Winners' lead; the time has come to hand the planning keys over to a cross functional team - representative of every department responsible for helping the enterprise meet evolving customer demand – which is well equipped with modern-day planning tools.

Organizational Inhibitors

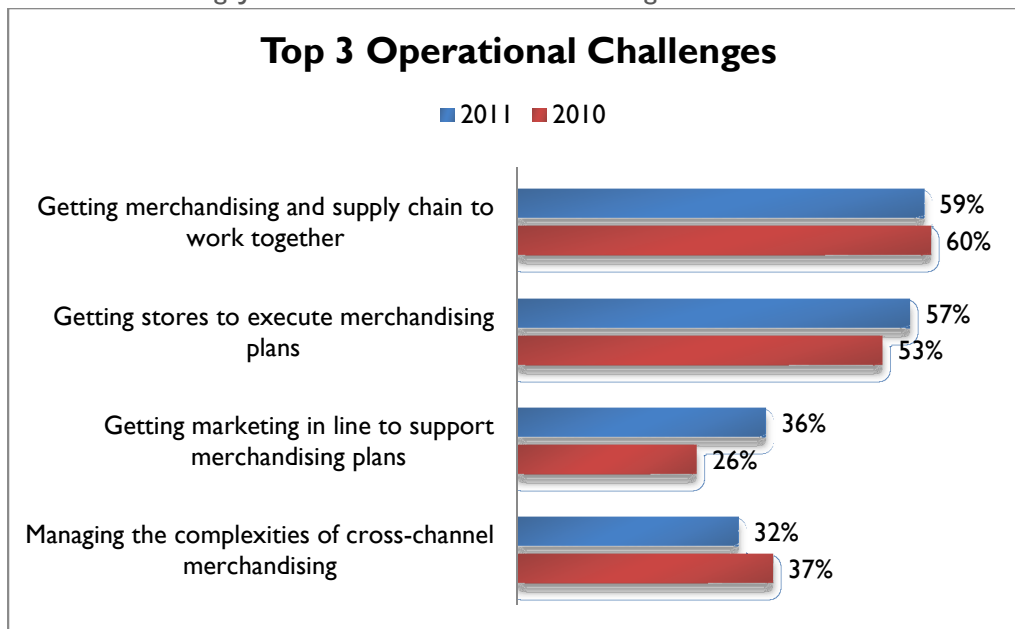
Heartburn and Headaches

In the last section, we looked at where retailers want to take their merchandising efforts. What is preventing them from getting there? As we will see in this section, the list of inhibitors is not short.

Consumers don't buy the way they used to, and that certainly complicates things organizationally. The fact that consumers don't even pre-research purchases in the same way - or in the same social settings OR with the same type of devices OR with even the same connectivity that they did even a few months ago is almost too much to ask a merchandising plan to satisfy. In fact, in virtually all of our recent research reports, this new "channel-less consumer" has most retailers back on their heels in virtually every component of their business.

It is somewhat surprising to see then, here in Figure 9, that fewer retailers today cite the complexities of cross-channel merchandising as an operational challenge. Instead, they are much more comfortable placing the blame squarely on the Marketing department.

Figure 9: Marketing Just Won't Get with the Program



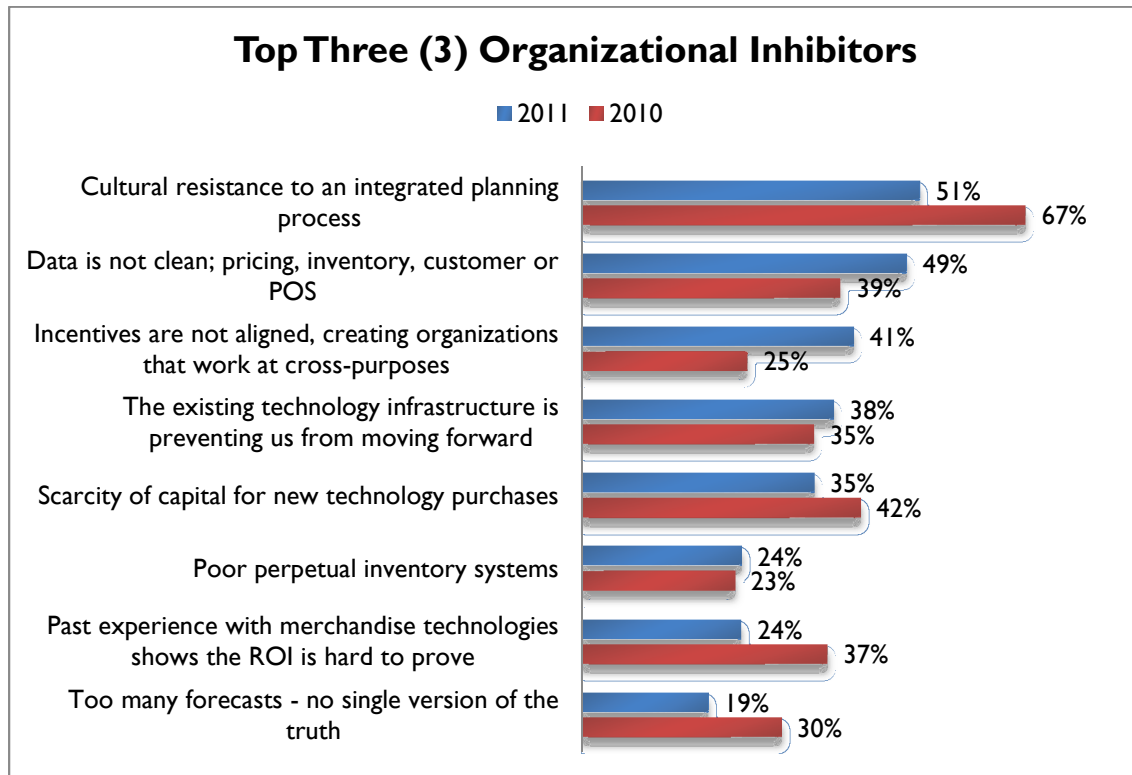
Source: RSR Research, August 2011

Last year, only 26% of our respondents cited the ability to get marketing in-line to support merchandising plans as an operational inhibitor; this year that number jumps to 36%. It's true that a high percentage of our response pool (39%) have merchandising-related job functions, but even still, what can we ascertain from this significant bump in finger pointing? Has the frustration associated with trying to predict merchandising needs for an entirely new type of consumer brought undue pressure on (or from) the marketing department? Do marketers have valuable input into merchandising plans that merchants are resisting? Much of the answer lies in the following page and along with cultural issues, we can see there remains a data problem.

Cultural Resistance Wanes, Data Not Clean, Incentives not Aligned

For most retailers, the data they rely upon is not clean enough to be actionable – for merchants or marketers (Figure 10).

Figure 10: Cleanliness is Next to Process



Source: RSR Research, August 2011

In some ways, it is encouraging to see that in the past 12 months, retailers as a whole have made inroads in overcoming some portion of the challenges and cultural inhibitors they face internally. Fewer cite challenges associated with too many forecasts (down to 19% this year from 30% in 2010), past experience with merchandise technologies showing the ROI too hard to prove (down from 37% to 24%) and perhaps most interestingly, cultural resistance to an integrated planning process (Last year, 67% of respondents cited this as their top inhibitor. While it remains in the top position this year, the number has fallen to 51%).

Instead, clean data is increasingly becoming a problem for retailers of all sizes, segments, and performance levels. Last year's 39% response rate has given way to 49% this year. More, this number is *even higher* for Retail Winners: 67% of Winners report unclean pricing, inventory, customer and POS data as an inhibitor – their top inhibitor by nearly 20 points.

Trustworthy data is the lifeblood of competitive retailing in the modern age. Without it, a retailer cannot be expected to hit the new – and powerful – consumer with the products, service, promotions and prices that cut through the incessant wall of noise bombarding her; what she wants, when she wants it, how she wants to shop for it and how she'll ultimately purchase it are completely reliant on an actionable data stream that eludes marketing and merchandising alike.

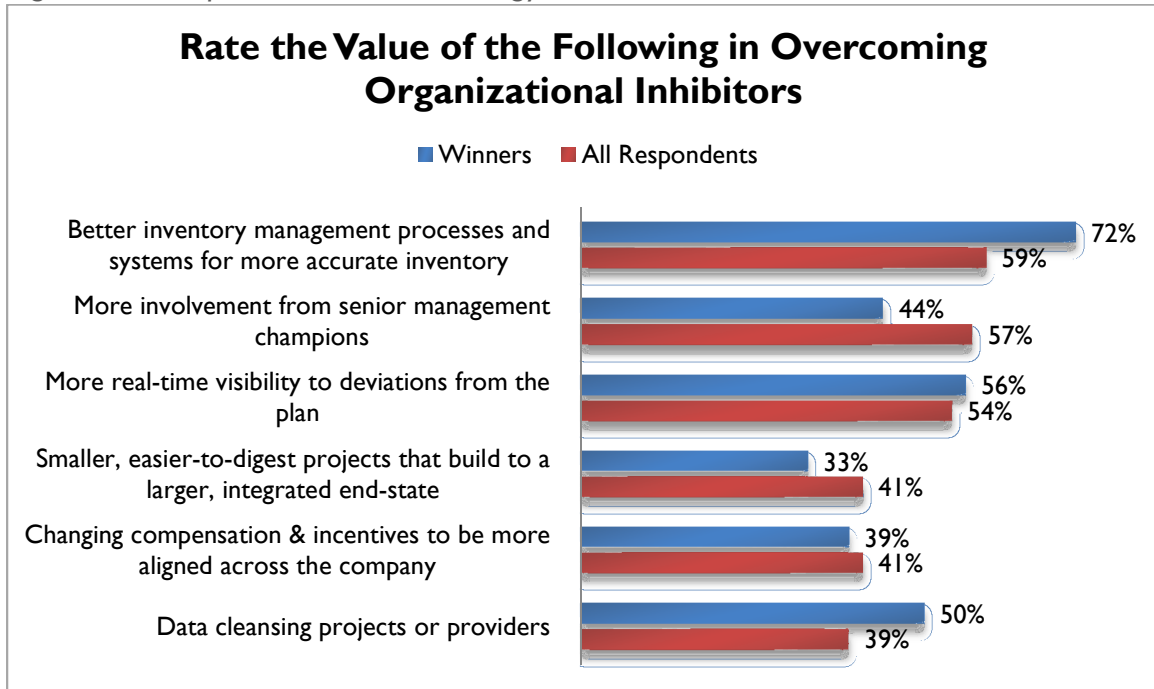
It is therefore no surprise that internal strife between merchandising and marketing would take hold in such an environment.

Further, incentives have still not caught up with reality – retailers continue to ask for A (collaboration), while rewarding B (departmental specific financial incentives, rather than financial incentives to work together).

Winners Take a Stand – And Take Action

As we’ve already noted, Winners are even more bothered by the dirty data conundrum than their peers. They are more determined to crack the problem (50% identify data cleansing projects and providers as very valuable, compared to 39% of the aggregate, Figure 11).

Figure 11: Hope: Still Not a Strategy



Source: RSR Research, August 2011

Winners’ also have varied ideas about how to overcome their additional internal roadblocks. While they are less inclined to believe that more involvement from senior management champions and more unified compensation incentives will solve all problems than do their average and underperforming competitors, Winners are instead focused on something very interesting: better inventory management processes and systems (72% vs. the aggregate’s 59%). Quite simply, *they don’t just hope for better data; they are willing to invest the time and resources to make better data a reality.*

The Times Really Are A-Changing

Lastly, as it relates to our tenets of 21st Century Merchandising, in the ways they perceive organizational inhibitors, Retailers overwhelmingly validate our 6th point: **Merchandising capabilities have changed strategically, not just tactically.** When asked who participates in setting the strategic direction and management of merchandising strategies (and who *should* be), retailers increasingly tell us that the IT department is needed to the help enterprise succeed.

While only 28% of IT departments are currently in the conversation, 35% of retailers tell us they should be, and require more education about the value of merchandising strategies in order to bring value. The exact same percentages apply to store operations – a clear indicator that store ops remains consistently underrepresented in merchandising efforts. If one needs further proof of these two departments potential value-add to cross-functional merchandising teams, consider that 70% of our response pool in 2011 identifies changing organizational structures to more integrated merchandising teams as a primary way to overcome internal roadblocks; that number was only 56% just one year ago.

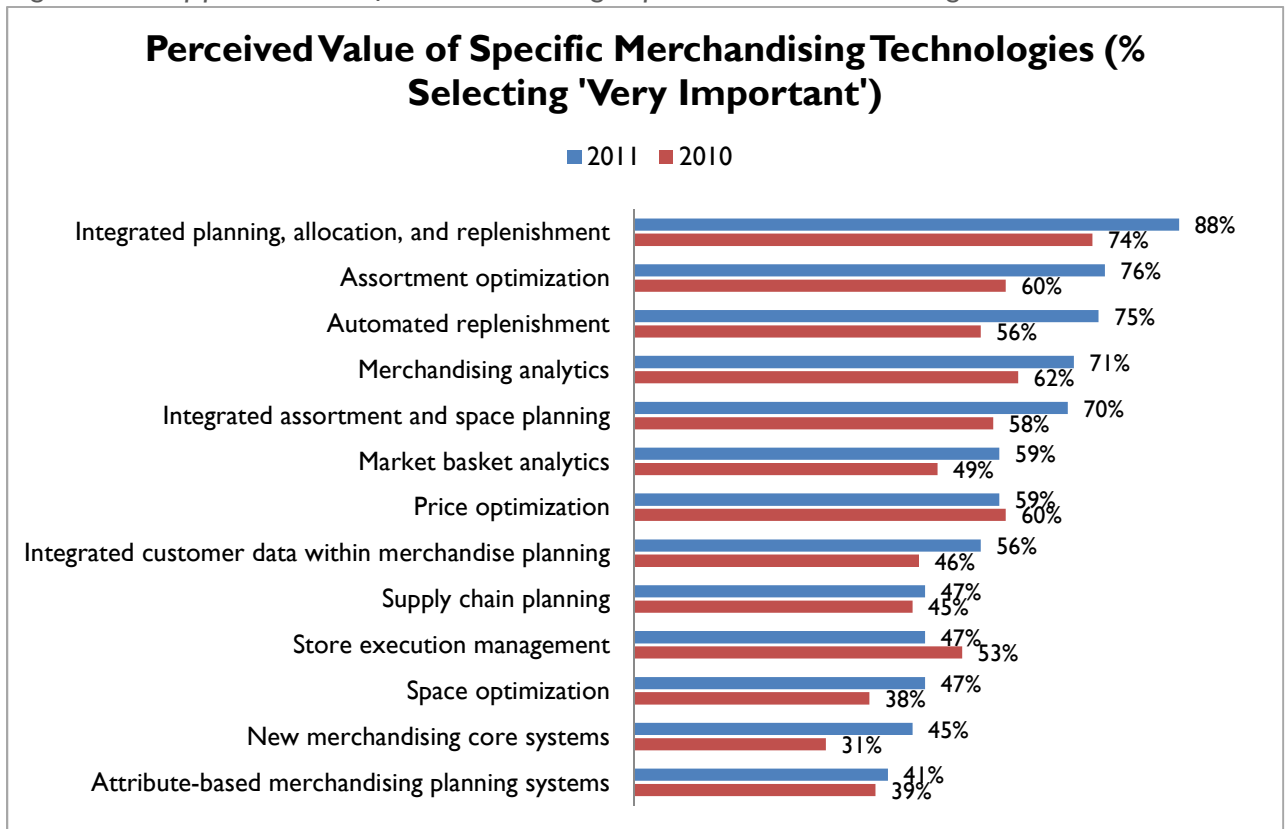
Let's now see the ways Technology Enablers can help.

Technology Enablers

The Next Generation Merchant Wants Optimization Tools

The new Merchant clearly has grown to appreciate the value of optimization technologies. In fact with a few notable exceptions, almost every single merchandise technology is recognized as more important this year than it was last year (Figure 12).

Figure 12: Appreciation of Merchandising Optimization Technologies Increases



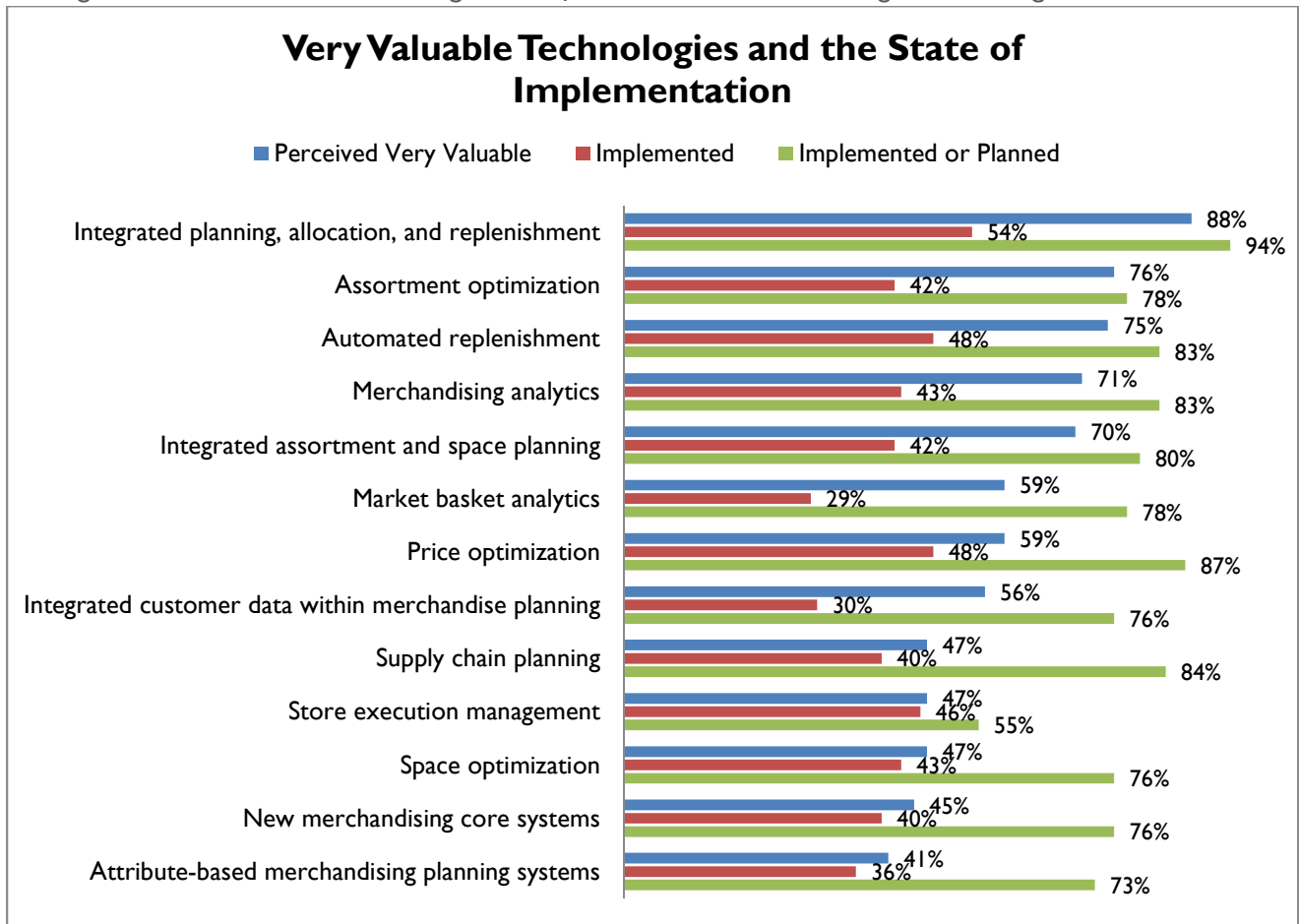
Source: RSR Research, August 2011

In fact, those technologies that have not grown in perceived value tend to have been adopted earlier in the decade, such as price optimization and attribute based planning systems. These applications have received a great deal of positive press, and have demonstrated concrete results.

While integrated planning, allocation and replenishment is, and has been highly prized, it's worth noting the emphasis Retail Winners place on this technology. Fully 94% of Retail Winners identify it as "Very Valuable," driving the overall high value sentiment of 88%.

This might lead us to wonder how many retailers have "put their money where their mouths are" and actually implemented these technologies. If we look purely at existing implementations, we might assume that there's a lot of talk and very little action. However, if we also combine those who have either budgeted or planned implementation of those technologies, a very different picture emerges (Figure 13).

Figure 13: Retailers have Big Plans for New Merchandising Technologies



Source: RSR Research, August 2011

We're not naïve enough to assume that every planned implementation becomes a reality, but even discounting planned implementations by a significant amount, we can clearly see there will be a lot of activity in the coming two years. Retailers will have to juggle priorities between continued channel explosion and its new era of interactive retailing and the nuts and bolts of managing products, but we believe that same channel explosion both demands and facilitates these new technologies. To wit:

- Honing of localized assortments cannot be effectively accomplished without merchandise analytics, assortment optimization, integrated assortment and space planning and market basket analytics.
- Cross-channel retailing cannot be effective without integrating customer data within merchandise planning, and now that we've got this customer data, it should likely be incorporated into merchandise attributes
- The explosion of channels really can't be managed by 1990's era core merchandising systems. We have long gone past the time when we can consider the on-line channel or mobile channel "just another store."
- Retailers selling Fast Moving Consumer Goods must improve their supply chain planning systems to manage the most efficient movement of perishables in a world of rising food prices

What about Our Core 21st Century Merchandising Tenets?

Certainly at least two of our 21st century merchandising tenets are supported by enabling technologies.

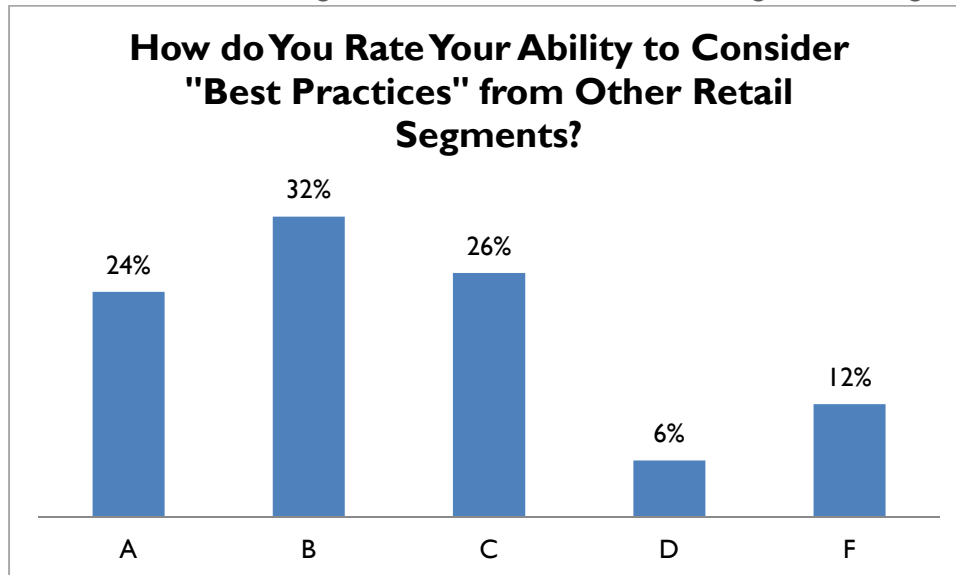
Tinkering with Assortments only After Broad Cross-Category Due Diligence

Retailers mostly (44%) rate themselves a C on their ability to tinker with assortments only after broad cross-category due diligence. Looking at their technology portfolios, they really don't have the tools to do it right. Market basket analytics is probably the single most important technology in supporting this type of cross-category management. Yet only 29% of our respondents have this technology implemented, and likely even fewer have the organizational structure and incentives to support the notion in any case. However, 78% will likely have that capability in place within the next three years. At that time, we expect to see a significant uptick in adoption of that tenet.

Considering Best Practices from other Retail Segments

Retailers rate themselves slightly better at their ability to adopt and embrace best practices from other retail segments (Figure 14).

Figure 14: Retailers have Big Plans for New Merchandising Technologies



Source: RSR Research, August 2011

There is a small bit of evidence to support the relatively higher scores retailers give themselves.

- Retailers selling fast moving consumer goods (FMCG) are planning more implementations of attribute-based planning systems, which traditionally were in the realm of general merchandise and apparel (GMA).
- 29% of FMCG retailers are planning to replace their core merchandising systems, while 38% of GMA retailers have already made that move.

However, on many other fronts, retailers seem to have over-estimated their best practice adoption:

- Far more FMCG retailers have installed store execution management systems than their GMA counterparts (43% and 21% respectively).

- GMA retailers still lag significantly in adoption of Space Optimization (43% vs. 15%)
- FMCG retailers have embraced assortment optimization vs. 21% of GMA retailers
- GMA retailers are planning to adopt automated replenishment systems to catch up with their FMCG peers

The Bottom Line: Great Strides Forward

Overall, our respondents echo what we have heard from technology vendors: Retailers are more open than ever to replacing their infrastructure and “gut feel” mentality with a much more technically-oriented optimized approach. The spreadsheet is still used far too often to run merchandise processes, but moving forward, we see a mix of backbone infrastructures and fill-in-the-blanks point solutions.

BOOTstrap Recommendations

We've spent quite a bit of time in this report evaluating how retailers are making progress towards adoption of the 7 tenets of 21st Century Merchandising we identified in 2010. This year's data indicate retailers are moving in the right direction. As such, our recommendations are designed to help ALL retailers move up in ranking, with step-by-step plans to turn a D into a C, a C into a B grade. One last review of the tenets:

8. Optimization in merchandising must span products, prices and processes
9. Insure merchants have a solid understanding of their technology tools
10. Only tinker with assortments after broad cross-category due diligence
11. Look at and consider "best practices" from other retail segments
12. Marketing is an integrated part of merchandise planning and execution
13. Merchandising capabilities have changed strategically, not just tactically
14. Merchants are no longer the sole intersection point between customer insights and product plans

1. Optimization Must Span Products, Prices and Processes

Clearly the industry is moving in the right direction. All respondents report plans to move to technologies that are less proprietary, with more standard integration points. We believe the reasons retailers rated themselves so poorly is not technological, but organizational. The hang-up remains getting the various departments to work together. While a lot of progress has been made, the emergence of marketing into the mainstream of day-to-day retail operations has added a new pressure point. Technology can solve part of the problem, but senior management mandate and improved compensation strategies are needed to incent appropriate behaviors.

2. Merchants Gaining a Solid Understanding of their Technology Tools

Again, significant progress has been made just in one year. The wisest retailers will join peer groups where they can talk about successes and failures. We are aware that retailers often like to keep their technology successes to themselves. This may have made sense when proprietary applications ruled the day, but at this point, we believe more value will be gained from cooperation than from secrecy.

3. Cross-category Due Diligence in Assortment Optimization

There seem to be two issues preventing improvements in cross-category assortment optimization. Certainly, one is organizational. A group must be formed that is compensated on the performance of the assortment as a whole, rather than the category pieces and parts. We believe this group should reside within the merchandising organization, but not have buying responsibility. Perhaps a reorganized merchandise planning and replenishment group, or a new group within that organization should emerge as the gatekeeper of assortment optimization.

In any case, as we pointed out earlier, this group needs technology to succeed. Market basket analytics are a key tool for cross-category optimization, along with customer segment analysis. We encourage those retailers who have these technologies in their plans to keep them high on their priority lists.

4. Best Practices from Other Retail Segments

Certainly there are limits to the number of practices that are transferrable from segment to segment. However, we have not reached those limits. We believe the richest areas are in market basket analytics post-sales, and the usage of top-down and bottoms-up sku planning pre-sales. Moore's Law and spectacular hardware advances have enabled us to calculate previously unimaginable piles of data. We expect retailers to continue to improve in this area as successes are made public and technology adoption rises.

5. Marketing as an Integrated Part of the Merchandising Team

The emergence of marketing is a bit like a freight train picking up steam – it's pretty much unstoppable. Today's marketing group is much like yesterday's merchant – and often operates on the premise that it's easier to ask for forgiveness than it is to ask for permission. Our best advice in this area is to recognize the realities, and give them a proper seat at the table. Far better to integrate them into the process, rather than find out after the fact that "they've done things that have to be cleaned up."

6. Change Strategically, not just Tactically

As we highlighted in the Organizational Inhibitors section of this report, to create truly strategic change, IT also needs to be involved in the choices merchants make. Specifically, it's time to help IT get data cleaned up, so that cross-functional teams are operating on the same base of data. Data purities problems still plague retailers of all sizes, segments, and performance. Yet Winners recognize that in the age of the new customer, this simply will not do, and requires a shift in approach from tactical to strategic. With the global economy still in wildly unpredictable form, RSR understands that IT budgets, if not already re-frozen, are no doubt tight. However, all of the incredible predictive power that retailers expect from their merchandising planning tools will increase exponentially with cleaner customer data. Consider all methods, large and small, to improve the quality of yours.

7. Merchants No Longer the Sole Intersection Point with Consumers

Winners are rapidly embracing cross-functional teams, where merchants' intuitions are accompanied by the technology-enabled and informed input of store operations, marketing, ecommerce and Line of Business executives. This collaboration is becoming increasingly effective at increasing the success of planning cycles. Quite simply, your organization should embrace them, too.

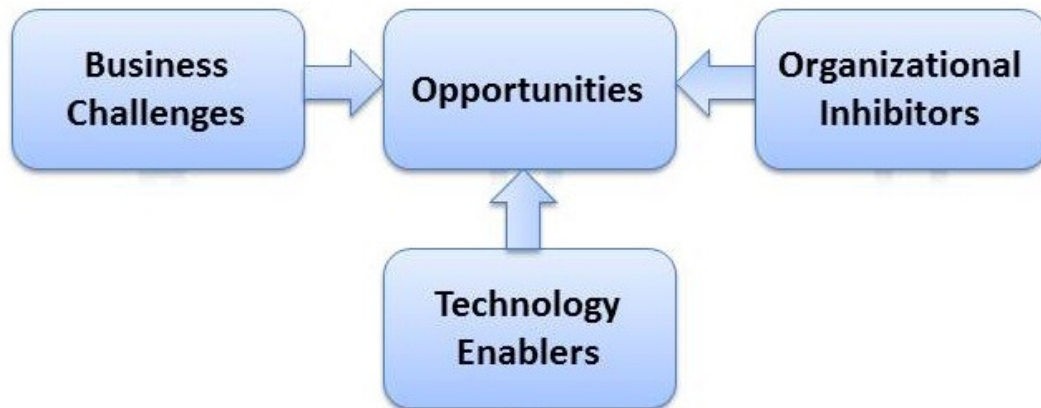
These tenets are deceptively simple to describe, and our recommendations may range from seemingly simple to impossibly complex. As always, a step-wise approach, led by a visionary executive, will move merchandising operations forward. We expect to find even better scores and results in next year's benchmark.

Appendix A: RSR’s Research Methodology

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

- **Business 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.
- **Opportunities** – 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.
- **Organizational 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.
- **Technology 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.

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