Merchandising & The Omnichannel Impact

2017 Prospective View

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Consumers today routinely begin their shopping journeys in the digital space, searching for and selecting the best *solutions* to their lifestyle needs in the convenience of their homes, offices, schools, and while out and about. They have a variety of ways to complete their purchases - in a nearby store, in their "home" store, or delivered direct to their door. For consumers today, *relevance* is most important. They are not interested in slogging through aisles or pages of uninteresting products to find what they are looking for. Retailers that successfully deliver that relevance will enhance their brand's value and create compelling and reliable experiences. This respect for consumers' time and focus on their real needs will be the hallmark of tomorrow's Retail Winners.

When consumers use both the digital and the physical selling environments together in the course of executing a single purchase transaction, they are engaging in Omnichannel shopping. These new Omnichannel shopping behaviors challenge merchants in four ways:
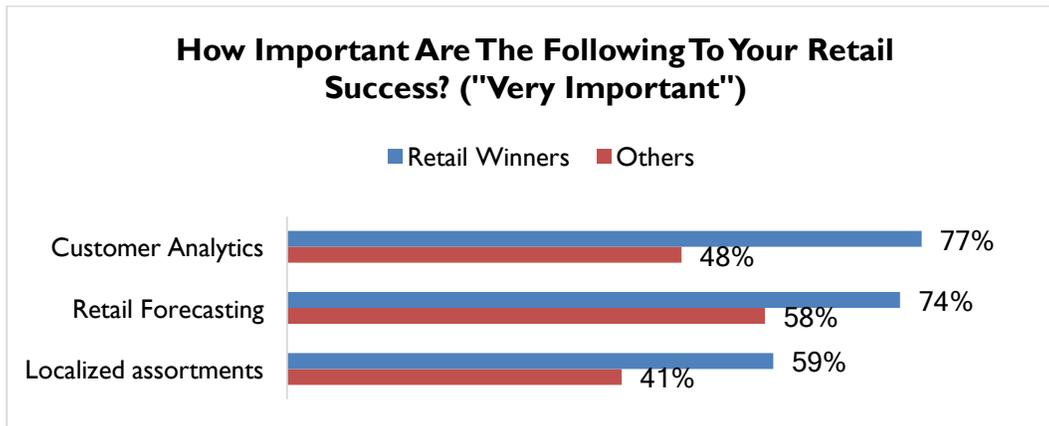
- Millennials have emerged as a key buying segment and retailers struggle to serve them;
- Tailoring assortments to specific customer segments, and making stores and online destinations more appealing have become operational imperatives;
- The constant pressure of hyper-promotionalism on gross margins is forcing retailers to rethink how they plan assortments, prices and promotions across the selling channels; and,
- Omnichannel is having a huge impact on merchants' buying decisions, since merchants must decide not just what to buy, but also how much, and where to allocate the product. While this is not new, Omnichannel has "piled on" to existing problems and made them exponentially more complex.

To meet these challenges, retailers are learning that they need to **gain a more sophisticated understanding of demand, including where and how it is initiated**, and use to that new understanding to create **more focused, even personalized, value offerings**.

The merchandising function is at the heart of every retail business, and retailers clearly understand that their ability to analyze new data in new ways is a key to live by the mantra, "the right product, in the right quantity, to the right place, at the right time, at the right price".

In fact, RSR's 2017 merchandising benchmark study (***Merchandising 2017: The Real And The Unreal***, February 2017) revealed that analytics-driven capabilities are unquestionably "winning" behaviors (Figure 1). RSR frequently cites differences between retailer over-performers in year-over-year comparable sales and their competitors. We find that consistent sales performance is an outcome of a differentiating set of thought processes, strategies and tactics. We call sales over-performers "Retail Winners".

How Important Are The Following To Your Retail Success? ("Very Important")

■ Retail Winners ■ Others

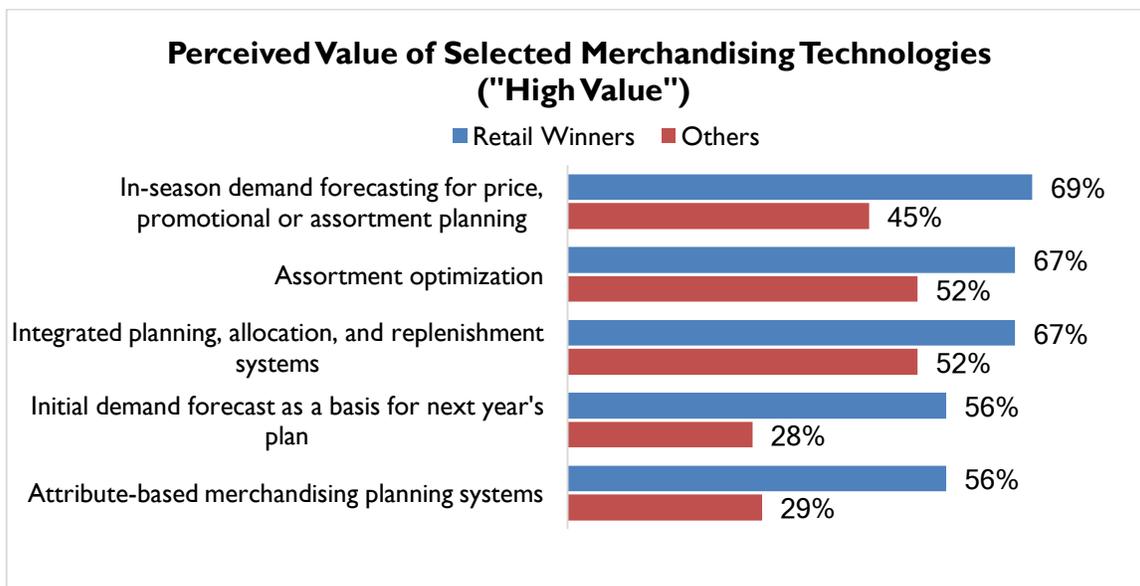|	Retail Winners	Others
Customer Analytics	77%	48%
Retail Forecasting	74%	58%
Localized assortments	59%	41%

Source: RSR Research, February 2017

When we asked how well retailers believe they actually understand these capabilities, we learned that twice as many "Winners" as "others" believe they have a "solid" understanding of what they can do. These findings are nothing short of profound.

Winners go beyond "checking the box" or living on hope; they take the time and effort to internalize the how best to leverage analytics to get the most from these capabilities. We also worry that like with any tool, using merchandising tools without a clear understanding of what they can do often creates more harm than good. The lesson learned? Be sure you understand the capabilities when buying and implementing. There are no magic bullets.

Armed with better capabilities and a better understanding of how to use them, Retail Winners are working hard to transform the Omnichannel impact from a challenge to an opportunity. Figure 2 shows just *how much more* perceived value Winners place on an entire host of modern technological solutions available right now.

Figure 2: It Starts With a Positive Outlook

Perceived Value of Selected Merchandising Technologies ("High Value")

■ Retail Winners ■ Others

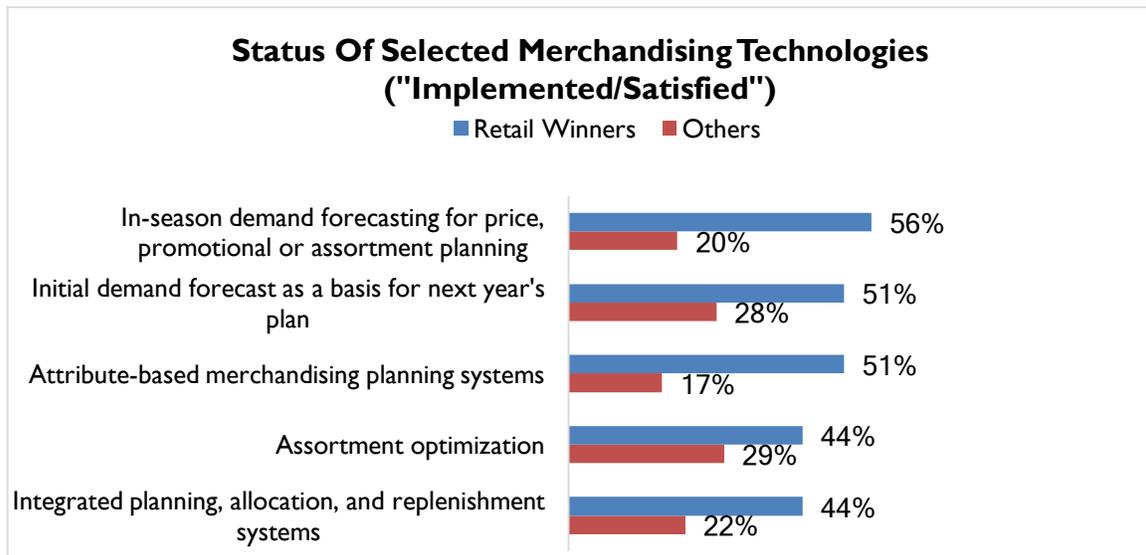|	Retail Winners	Others
In-season demand forecasting for price, promotional or assortment planning	69%	45%
Assortment optimization	67%	52%
Integrated planning, allocation, and replenishment systems	67%	52%
Initial demand forecast as a basis for next year's plan	56%	28%
Attribute-based merchandising planning systems	56%	29%

Source: RSR Research, February 2017

Winners' more optimistic view of the value of information and technology is vitally important. For example, over-performers are twice as likely to expect big things from demand forecasting. They are nearly twice as likely attributing "high value" to attribute-based merchandise planning systems, and their interest in virtually every technology we put before them is greater by double-digits across the board. **Put simply: they know they can't get by any longer without integrating more predictive capabilities into their decision making processes and they understand why this is so.**

It is clear that the battle for Omnichannel supremacy is far from over. As Figure 3 shows, while far more Retail Winners have successfully implemented those high-value merchandising technologies than their lesser-performing peers, about half of Retail Winners admit they have more work to do.

Figure 3: Winners Are In The Lead, But...

Status Of Selected Merchandising Technologies ("Implemented/Satisfied")
■ Retail Winners ■ Others

	Retail Winners	Others
In-season demand forecasting for price, promotional or assortment planning	56%	20%
Initial demand forecast as a basis for next year's plan	51%	28%
Attribute-based merchandising planning systems	51%	17%
Assortment optimization	44%	29%
Integrated planning, allocation, and replenishment systems	44%	22%

Source: RSR Research, February 2017

Still, the head start that Retail Winners have over their average and lagging competitors is huge, and while it is just one aspect of a vast number of things they do differently, one of the most significant aspects is their unflinching interest in new merchandising technologies. This has been consistent for many years. It's a hallmark of a winner's corporate culture, but any retailer can choose to follow their lead, regardless of size, performance, or assortment. All it takes is a willingness to learn.

Merchandising Processes Powered By Better Analytics

RSR has learned in its benchmark studies that winning retailers understand that information is as critical an asset to them as tangible assets like physical stores, DCs, and inventories, as well as their organizational assets like decision makers' years of experience and their internal operational processes.

In fact, in RSR's 2017 Merchandising study, we learned that 62% of Retail Winners believe that a key to their success is "a healthy blend of art and science" (compared to only 49% of other retailers).

Let's discuss how Winners blend art and science in the context of Omnichannel:

A More Sophisticated Approach To Forecasting

In the past, the source of future season plans have been based largely on prior year or season sales of comparable products. The problem with this is that future season sales often became self-fulfilling prophecies. The sins of the past would be revisited in the future, with stores starved for product that could otherwise sell it and sub-optimized turn in stores that were already over-allocated. Of course, retailers always had to understand attributes of local stores and product accordingly but overall, they were blissfully ignorant of missed opportunities,

Now retailers have a new challenge to contend with, the fact that where demand is triggered and where it is fulfilled can be two separate places. In today's world of 24X7 anytime anywhere shopping, demand generation and demand fulfillment are unbound by location. RSR believes that bringing insights from ***Customer Analytics*** early into the demand forecasting process can really pay off in improved gross margin- regardless of retailer size or segment.

In the 2017 study, we noted that 77% of Winners see a "lot of value" in customer analytics. There is one clear area where they hope to use those analytics: *up front* in the merchandise planning process, as opposed to a "sanity check" at the end of the planning process.

Customer Insights Are As Important As Product Sales Trends & Rankings

Bringing customer data into the merchandising process earlier coupled with better demand forecasting can really pay off in improved gross margin, regardless of retailer size or segment. In RSR's 2017 Merchandising benchmark study, we learned that while average and under-performers use customer insights to localize their assortments, over-performing Retail Winners move customer insights to the front of merchandise management processes, as an important input to their demand planning. This in turn affects not only their local assortments, but also their buying.

Localizing Store Assortments

Localized assortments are an outcome of better forecasting. Winners know that they need to match products to the places where they are most wanted / needed.

Optimize Fulfillment For Direct-To-Consumer Orders

In response to pure play retailers' direct delivery capabilities, retailers have tried to offer more fulfillment options to consumers, initially without too much regard for the impact of those options on overall profitability. After all, when Omnichannel fulfillment represented only a small percentage of the business, why look too deeply into the inefficiencies that it introduced? But that lack of concern started to turn into alarm in 2015, as volume built.

The reality of Omnichannel fulfillment is that whenever an order requires inventory from another channel than the one where demand has been captured, **it is a more expensive order to fulfill**.

Conclusion

In this brief paper we have discussed three primary merchandising drivers: demand forecasting, customer analytics, and localized assortments. Our final advice follows:

Demand Forecasting

To address the new challenges that Omnichannel selling creates on forecasting, retailers need to consider the following:

Demand should be the starting point for a forecast, not last year's sales:

- o Capture demand where it is generated, not where it is fulfilled;
- o Capture more granular demand, by location and channel, not only based on SKUs and general location demographics but also by specific customer attributes, for example behavioral model information;
- o Use new data about where and how demand is generated, gleaned from analysis of customer behavioral information captured in the digital channels.
- o Use analytics to understand demand patterns across time. This will help you quickly and accurately detect trend, seasonality and other patterns.

Customer Analytics

When it comes to the art and science of customer analysis itself, we recommend the following points for consideration:

- o Don't fall for generalizations, for example, "all Millennials", "all Boomers", etc.
  - o Even demographic generalizations are misleading! Use customer analysis tools to understand:
    - Which subset come to YOU
    - Which are your best shoppers
    - Which are not buying, or buying enough, how far do they go, when do they stop
    - Online analytics driving how retailers look at "landed" customers
    - How many trips, how frequently
    - ATV (average transaction value)
    - Category level shopper behavior
    - Cross buys, adjacencies

- o Avoid the "Squeaky Wheel Syndrome"
  - o Non-transactional demand signals – those early indicators of demand that can be gleaned from the digital domain, like social media mentions - should be used as advanced customer attributes rather than demand signals. Understanding sentiment as part of consumers' paths to purchase is important.
  - o While sentiment is important to understand, behaviors are what matter most. Know what sequence of behaviors result in sales.

Localized Assortments

Localized, curated assortments are now imperative. To get to an optimized localized assortment, retailers should consider the following:

- Merchandise plans and allocation should be based on the source of demand, not where it was fulfilled.

- Use analytics to find **the best place to sell the ideal product, the soonest**. This should result in better sell-thru, fewer markdowns, and minimize Omnichannel-induced product movement (eg. transfers)

- Develop Online and in-store assortment mix based on where demand is generated – mobile, web, or the stores. Build a local understanding by category which products customers prefer to pick up at the store versus delivered to their doorstep.

- *Phase* merchandise buys, allocation, and replenishment over time, to match demand:

  - Omnichannel has complicated the issue for retailers to the point where retailers are moving from too many transfers to too many store-based shipments to customers. Transfer and ship-from-store activity destroys the profitability of those sales;

  - When the source is far from the point of demand (for example, overseas manufacturers), hold back more until demand patterns come clear is a better decision;

If retailers can follow these simple steps, they'll go a long way towards optimizing their merchandising life cycle and creating a more compelling buying experience for customers. If they don't, they risk being consigned to the dustbin of history.

Appendix A: About The Sponsor

About SAS

SAS is the leader in Retail Omnichannel Analytics. Through innovative analytics, business intelligence and data management software and services, SAS helps customers at more than 83,000 sites make better decisions faster. Since 1976, SAS has been giving customers around the world THE POWER TO KNOW®.

Visit www.sas.com/retail for more information.

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:

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

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

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