

# Merchandising

*The following is a transcript of an interview with **Brian Hume**, president and founder of **Martec International** as he discusses the issues and trends impacting retailers and the strategies and technologies that can help them stay ahead.*

Q

Let's talk about merchandising. What are some of the challenges that retailers are facing in assorting their stores?

A

One of the biggest challenges is how do I tailor that assortment down to individual stores? When David Glass was the CEO of Wal-Mart somebody asked him the question once, how do you manage a thousand stores, or two thousand stores? And his answer was, one store at a time. And what he meant by that is in the Wal-Mart process, in their case, the store manager has a big impact on how they manage their store. They have a lot of relative autonomy compared to other retailers.

Now a lot of retailers don't operate like that, but actually, they'd like to achieve the same goals. And therefore, if you have let's say 600 stores, it's impossible for anybody to plan the assortment uniquely for each store. It's just not physically possible to do it. Once you go beyond 10 or 15 stores the work just becomes too big for anybody to do it at a sensible price.

So what you do is you take all the stores in the chain, you look at the different data that's relevant to managing assortment and inventory at the store-level. So obviously, sales are a critical factor. Weather patterns are a critical factor. Things like the local demographics in that store area. Those kinds of factors, the strength of the local competition, whether you've got a lot of competitors in one neighborhood, or whether you've got relatively light competition impact your decisions on how to manage stores.

You collect the data on all of those relevant factors, and then you go through a clustering process using the relevant data. You cross the stores that you end up with with groups of stores that are approximately the same size in sales, approximately the same weather, approximately the same demographics, approximately the same competitive lineup so that within that individual cluster the average store is reasonably representative of all the stores in that cluster. So the average store for the chain will be a fairly meaningless concept, but the average store within that cluster will be a much more meaningful concept.

And in reality you find that people, depending on the size of their chain, can run with something like 10 to 50 clusters depending on how large the chain gets. And then you build the assortment for the average store in that cluster. So let's say you've got 30 clusters for example. You effectively build 30 variations of the assortment plan and the one that applies to cluster 17 applies to all the stores in cluster 17. Well, it's maybe not quite as sharp as if you did every store individually, but it's very sharp compared to having an average assortment for the chain as a whole, and it's at a work level that you can afford and manage.

Q

**Assigning store attributes and clustering them is really a trend that we're seeing as well.**

A

It's a very important development for people because people are beginning to get smarter. Twenty years ago, what we did is we analyze sales by store and we said, if your sales are between \$3 and \$5 million we put you in this cluster. If your sales are between \$10 and \$15 million we put you in this cluster. And we didn't really pay enough attention to demographics, competitive lineup and things like that.

Nowadays, we've gotten much smarter about that. But of course, you are making that clustering process more sophisticated. You need more information. And there are more elements to the analysis to get there. And therefore, again, the right kind of performance management tools can help you do that much more successfully.

Q

**What kind of strategies are retailers putting into place for getting this balancing act right, particularly in using performance management systems?**

A

One of the first challenges is to understand the degree of substitution between products. So for example, a man goes into a department store to buy a white shirt. And you're out of stock in his size in a white shirt. Well, you know what? They're not going to buy a colored shirt. If someone came looking for a white shirt, usually because it's their work uniform, or it's a special occasion, and they actually want a white shirt. If you don't have their size in a style they like they're going to go somewhere else.

Now, the same customer comes in and they want a casual shirt for the weekend. They don't come in with a design in mind. They come in and what they do is they look at your selection. And you have to have enough selection in their size, and you have to have at least one choice they like in their size. And if all those things come together they can make a purchase, and they go out thinking they got good service.

So when you translate that into inventory management terms you'd say, for the man's white shirt I need a 95, 96, 97, 98% service level, at the style, color, size. I need to have that person's size 97% of the time. On the weekend casual shirt, as it were, at the individual style size color I could have a 70% service level in the way that I would measure it in my information system. But the customer can perceive a 90% service level because there's a choice they're happy with and they can make their choice and make their purchase. So there's a perceived service level the customer gets, which is actually much higher than the statistical service level, if you like, that my information system would tell you that I've got.

Now, one of the core things is to say which products have a high degree of substitution? And which ones don't. So soup, for example. If a customer goes into a soup market to buy soup and they're looking for tomato soup, the degree of substitution is very, very small. If they were looking for tomato soup they really want tomato soup. If they come in and they're looking for some kind of beef and vegetable soup and you've got alternatives the degree of substitution is actually very high.

So the first thing is to understand which are the products where there's very, very little substitution, and in those products I need a very high service level, and therefore I allocate more of my inventory dollars into those high service level categories. Which products have a high degree of substitution, and I need a relatively low service level as I measure it statistically, but I need enough availability that the customer gets a higher perceived service level and then I can put proportionately less inventory dollars into those categories, and therefore, if I get that balance right my overall inventory investment cost comes out to be acceptable and everybody gets a win, win.

Q

**If you had to give a retailer one piece of advice around best practices for either measuring their merchandise performance, managing inventory, or planning assortment what would you advise them to do?**

A

The first thing I would say is make sure you've got your merchandise hierarchy really well defined so that when you aggregate information at the different levels at the hierarchy the aggregations that you get are really meaningful.

And then I would go back and look at the various decisions that you can make and I would say, optimize that decision to the most relevant level in the hierarchy. Some decisions you just have to make are the individual style, size, color, or the individual product flavor, or whatever is the lowest unit of measure that's applicable to that product category.