

CONSUMER-DRIVEN RETAIL OPTIMIZATION

Harnessing Consumer Insight for More Competitive Merchandising



You finally have a few free hours to shop for yourself. You drive to the mall, find a parking spot, and rush through the mall, straight to your favorite store. When you get there, you are entirely disappointed. The one sweater you are interested in buying is not in stock. The rest of the merchandise is not your style. You quickly leave the store, and continue your search at its competition across the mall.

Overview

How do I know what the right merchandise is for my consumer?

The scenario detailed above makes every retailer bristle. Inventory is one of a retailer's greatest assets, generating both pleasure (profitable sales) and pain (lost and unprofitable sales). A typical apparel retailer loses approximately 15% of sales from markdowns and 10% from lost sales¹. All retailers continuously struggle to minimize these losses, as well as generate profitable sales, by perfecting their merchandising process.

A retailer's merchandising process is ongoing and systematic. It involves defining a brand and style story, determining product pre-lines and retail stocks, buying and allocating merchandise, deciding regional selections, and implementing merchandise promotions. The ultimate judge of each of these steps is the consumer.

Though the consumer is the key influencer of each step in the merchandising process, retailers have limited resources to leverage their input, especially when it comes to anticipating buying trends. Brand, assortment, and promotion decisions are supported by the buyer's scarce tools, ad hoc research and their own judgment and experience.

Over the past few years, retailers have deployed applications that automate and optimize merchandising functions, including assortment, markdown, price and promotion, based on past product performance. These applications have been relatively successful at forecasting demand of core, anniversary merchandise. But they are based on "rear-view mirror" data. Decisions are based on what consumers *have bought*, not what they *will buy*. It generates forecasts of new styles based on old data with questionable comparisons. It makes assessments of new trends based on past consumer behavior. In particular, these retail applications fail to deliver reliable consumer insight of new, emotionally based, and trend-influenced products.

This lack of consumer preference *today* is costing retailers millions with merchandise mistakes, markdowns, missed product lines and wasted open-to-buy dollars. Merchants need to capture consumers' current preference on a large scale when it matters most, before the buyer's order is placed.

¹ The Planning Factory Limited: *What is Merchandise Planning?* By John Hobson.

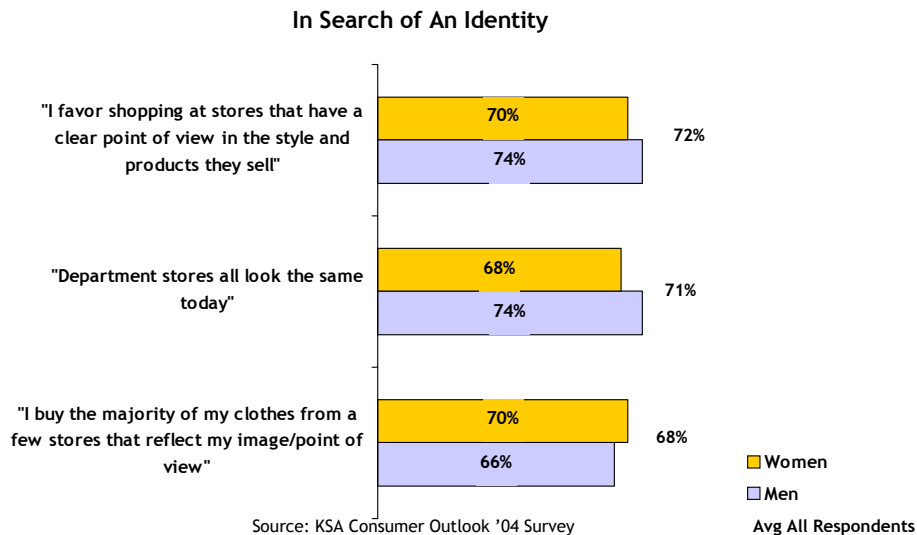
Define a Brand

How do I ensure my store and merchandise makes my consumer say “they get me” when they walk through the door?

The first step in offering relevant merchandise is defining the brand. This step is challenging in today’s environment, as, increasingly, retailers try to be all things to all people and consumer groups splinter.

The brand is characterized by the season, theme, colors, and style and is communicated through multiple channels, including advertising, marketing, in-store displays, and the merchandise itself. If a retailer offers proprietary merchandise, it must create a portfolio that is comprehensible and complementary. If a retailer offers branded product, it must fully understand these brands’ consumer proposition, as well as ensure the merchandise supports the retailer’s overall brand strategy. For example, a teen-focused apparel retailer would confuse its consumers if it carried the same products or used the same imagery as a mass merchant. Clearly defining the brand offering is critical to attracting the consumer in the store.

According to Kurt Salmon Associates’ 2004 Consumer Outlook Survey, 72% of consumers, a higher percentage of men than women, “favor shopping at stores that have a clear point of view in the style and products they sell.” Supporting this data, 71% of consumers agreed, “department stores all look the same today.” Consumers stop to shop when a retailer’s brand is explicit and cohesive.



Not only do consumers shop at stores that have a clear style, but they also shop at stores that reflect their own image. Approximately 68% of consumers, more women than men, stated, “I buy the majority of my clothes from a few stores that reflect my image/point of view.” Defining a brand, including the appropriate mix of proprietary, private label and branded goods, around a target consumer is critical.

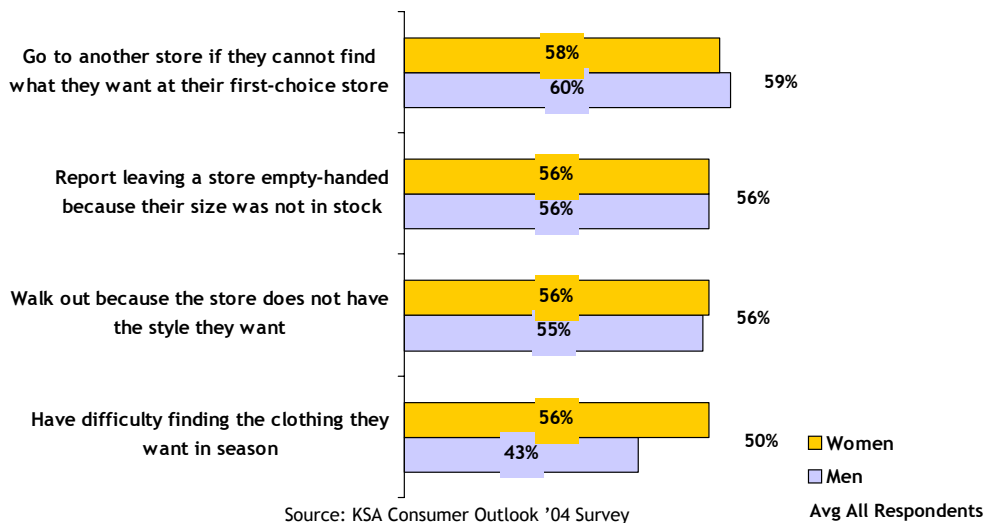
Retailers construct their brand strategy through a blend of internal strategy, trend research, and consumer input. Internal groups in conjunction with external consulting, trend, and design firms give their view of upcoming fads, popular cultures and hot colors, as well as recommend themes for the retailer. Consumers are then polled through focus groups, online surveys, and store intercepts. These consumer interactions offer limited contact and only provide reaction and confirmation to the retailer’s strategy. Since the consumer is the most important benchmark at this stage, they should be taking a more proactive role - helping to construct and evolve the retailers’ brand strategy.

Plan an Assortment

How do I get the “must have” items correct for each of my stores?

With the brand defined, a retailer must then decide how to fill its stores. The merchandise must reflect the brand, as well as continue to mirror the consumers’ interest. Consumers are finicky and frustrated and make their decisions quickly; 59% of consumers “go to another store if they cannot find what they want at their first-choice store.” A retailer’s assortment planning process must succeed in getting the right style, color, size and price to the right store and the right location in that store. Further, it must be in the store at the right time, as over 50% of consumers, up from 39% in 2000, stated they “have difficulty finding the clothing they want in season.”

Selection Frustration



Assortment planning balances a multitude of inputs, including historical product information, store openings, space allocations, merchandise plans, and strategic direction. A bathing suit retailer’s inventory looks very different in winter than summer. A retailer opening new stores and remodeling existing stores needs to factor square footage changes when buying merchandise. With all of this data to manage, the assortment planning process has benefited from the customer demand solutions that have evolved over the past several years. These technology applications streamline, quantify and automate the process. According to the 2004 BearingPoint/NRF Horizons Survey, 61% of retailers are

using or implementing assortment planning software while 49% stated reengineering assortment planning as a strategic initiative.

Though assortment planning is now a more refined process, enabling more focused assortments and inventory investments, it still has a long way to go. Consumer preference is left almost entirely out of the process. Yes, it includes past purchase, demographic and behavior information, but it does not reflect what the consumer thinks *today* about a specific color, style, or emerging trend. Using historic information means retailers are missing days, weeks, and months of changes in consumer preference.

This gap particularly impacts the new and/or trend merchandise, which accounts, on average, for 25% of a retailers' assortment. When forecasting demand of a new product, the retailer tries to find a relevant prior year comparison, but this generates questionable forecasts at best. Retailers also conduct random in-store market testing of new merchandise, but these fail to capture a large sample size or insight on regional differences. Adding consumer preference on a large scale to the assortment planning process would enable more accurate planning and better open-to-buy management.

Understand Local Consumers

How do I merchandise each store to reflect regional preferences?

Confounding the assortment challenge are local stores and consumers. Inventory is customized by region simply for climate reasons; Maine stores do not need a wide selection of bikinis in January. The bigger challenge is adapting merchandise assortments to rapidly changing consumer dynamics. Shifting demographics, varying purchase patterns, growing ethnicity groups, increasing size options (plus size, petite, etc.), and changing preferences (fit, style, etc.) mean merchandise requirements evolve constantly. What is hot in Manhattan may not be as popular in St. Louis. What sold today for plus-size 20 year olds in Dallas will not suit petite 40 year-olds in Boston.

Retailers struggle with the complexity of regional planning. It is time consuming, resource demanding and expensive to tailor assortments locally, yet the more relevant merchandise generates higher revenue and requires fewer markdowns. Increasingly, retailers are taking the micro-merchandising route.

In 2004, 48% of surveyed retailers stated micro-merchandising was a strategic effort, up from 41% the prior year, according to the 2004 BearingPoint/NRF Retail Horizons Survey. Micro-merchandising technology applications are extremely data intensive and, as with the other steps in the merchandising process, automate historic data to generate future merchandise needs. As a merchant's challenge is adapting merchandise selection to rapidly changing trends, including recent and relevant consumer information is central to perfecting regional assortment planning.

Tailoring local market product assortments "allows retailers with double-digit sales growth to see up to 10 basis points of incremental margin and 20%-plus inventory

reductions when this strategy is adopted.²” Retailers are looking for more ways to generate profits. Consumers demand customized products, and reward retailers who offer them.

Set the Promotion

How do I know what promotion, including merchandise and price, is best for my consumer?

The final step in the merchandising process is setting the promotion. Promotions are extremely complex to manage due to the numerous elements involved. Retailers must decide on the appropriate merchandise, price, message, timing, location and promotion vehicle. A promotion vehicle can include discounts, rebates, prizes, tie-ins, or cross promotions. The retailer must settle on the target consumer, and how best to reach this consumer. Despite promotions’ many moving parts, retailers are committed to them, as they are one of the best means to drive consumers to purchase in the short term.

Promotion efficiency and effectiveness is a key issue for retailers: 94% of retailers identified promotions as critically important to their business³. Frustrating merchants, minimal tools exist to develop and forecast their performance. Promotions are typically created based on small consumer samples combined with gut feel, while forecasting is based on past promotion performance. Once again, the consumer is left out of the development process. Further, historic promotion activity is not the optimum way to predict future performance, as it does not account for external factors, such as weather or competitive activity.

Critical Retailer Issues	
Percentage of Retailers That Identified Issue as Critically Important	
New Product Introductions/Implementation	98%
Category Management	98%
Promotion Efficiency/Effectiveness	94%
Variety/Assortment	94%
Private Label	92%
Understanding the Consumer	88%

Source: ACNielsen Survey of Trade Promotion Practices, 2004

Promotions are a critical component of the merchandising process. Delivering the most productive promotion requires two feats: packaging a consumer preferred promotion and forecasting accurate demand. Failing to achieve these leads to costly markdowns from over-stock or lost sales from out-of-stock situations. Retailers can avoid these situations and optimize promotion performance by including broad consumer preference.

² AMR Research: *Retail Technology Decisions for 2005: Time for Tools*. By Alexi Sarnevit. January 14, 2005.

³ ACNielsen: *13th Annual Survey of Trade Promotion Practices*. 2004.

The Affinova Solution

There is a gap in the retailer's merchandising process. Merchants are not adequately leveraging consumer preference to make decisions. And consumers are the ones calling the shots. Consumers have unprecedented control in the marketplace today, and this will only heighten in the future. Retail business models will shift to allow for this control. Customer relationships will be key competitive assets. "Consumers are accustomed to having many choices and will take the initiative to get what they want, how, when, and where they want it."⁴ Retailers need to understand the consumer, and reflect this understanding in their merchandise and planning.

Affinova's retail solutions allow retailers to bring the consumer into the merchandising process in a bold way. Thousands of consumers easily evaluate millions of ideas. Brand strategy, product development, assortment planning, and promotion planning can reflect what the consumer prefers *today*. Affinova improves the merchandising process by enabling retailers to:

- Include thousands of consumers in evolving brand strategy
- Improve the productivity of open-to-buy dollars with real consumer data
- Leverage consumer preferences to minimize markdowns and mistakes
- Determine how consumers are responding to a certain trend
- Manage micro-markets by understanding local demand
- Create promotions that attract the majority of consumers

Affinova uses its patent pending IDEA™ (Interactive Design by Evolutionary Algorithms) technology to evolve the most preferred brands, merchandise assortments, or promotions. Fully utilizing this game-changing technology enables retailers to explore, discover, and evaluate the optimum merchandise presentations.

For more information about how Affinova's retail solutions can help your merchandise process produce vastly superior sell-through and lower inventory costs, please visit www.affinova.com or phone 781.464.4700.

⁴ Retail Forward: *Twenty Trends for 2010, Retailing in an Age of Uncertainty*. April 2003