white paper

THE ART OF LOCALIZING INVENTORY //

THE MARKET IS ASKING NEW QUESTIONS. YOU NEED NEW ANSWERS.

Featuring a roundup of insight on innovative practices for localization in inventory management for today's retail leaders.

QUANTUM RETAIL TECHNOLOGY

INNOVATION // THE ART OF LOCALIZING INVENTORY

The term localization is arguably the hottest word in retail merchandising today. Getting the products to the store that the local market wants, in the right quantity, in the right color, in the right size and priced to sell at the highest possible margin is the Holy Grail for any retail merchandiser.

It takes the proper mix of science, retail intelligence and merchandising art in order to ensure that every store in a supply chain carries the right inventory, while maintaining a high service level and market share. In order to adapt to the new market, retailers need to respond to the demands of the consumer and rationalize their assortments at a local level.

Top challenges now and moving forward

Unpredictable consumers

Consumer buying patterns today have become more unpredictable than ever, making past retail data and current forecasts irrelevant. This means that retailers need to have an intelligent way to understand shopper demand at a store, category and product level.

Some retailers seem to have given up, believing that there is no better way than how they have been steering their business for the past 20 years. But as retailers seek out new business tactics to lure back the customers they lost during the recession, they will find that one of the most profitable strategies is creating a customer-centric supply chain.

Source: RSR Research, August 2009

However, they must face the fact that the recession has created a new consumer paradigm. According to a new report by PricewaterhouseCoopers and Retail Forward, entitled The New Consumer Behavior Paradigm: Permanent or Fleeting, customers will not bounce back to their old shopping habits, as "seventy-two percent of all shoppers recently indicated that their shopping behavior has changed significantly or somewhat as a result of the economic environment". The report suggests that shoppers will be more deliberate and purposeful in their spending, giving way to a more practical consumerism. However, it also predicts that these shopper behaviors may change as the recession eases.

Since we know no one can foretell the future to know exactly how and when behaviors will change, our take on this study is that consumer behaviors have changed, will continue to change, that retailers need to actively seek new ways to engage them (especially the younger generations), and be ready to continually adjust their product mix accordingly.

With this new paradigm in mind, retailers must take a step back from their businesses to understand how to engage today's new consumer.

Understanding customer behavior

The current state of the economy has driven the desire to understand the needs of the market at a lower level of granularity. It has caused a need to create local assortments and inventory fulfillment practices that react to local needs. Most retailers' existing processes and systems were developed to meet the needs of the average, not the individual. In order to increase demand in today's markets, the next step for retailers is to take on the challenge of localization.

Responding to local demand

The single biggest challenge that retailers face is aligning their offering to local market demand. Grouping stores together based on size, shape or sales performance will only deliver average results. Retailers need to monitor the changing demand at every store, so they can align their assortment in the way that is most profitable and most strategic.

Channel proliferation

The last decade has seen a huge increase in the number of ways that a retailer can reach out to its customers. This is putting a strain on existing forecasting and replenishment processes and, in many cases, significantly increasing the inventory investment required to support the business, with each of the channels being operated semi-autonomously and little to no sharing of information or consistency of customer experience.

This leaves retailers with many lingering questions:

- Have shoppers changed their buying habits forever?
- Will shoppers remain frugal?
- Will the demand for local products continue to shift distribution patterns?
- How will consumers balance the sometimes competing pressures of price, quality, value and sustainability?

These concerns continue to plague store planners, buyers and category managers alike, leaving them with a chronic issue:

How can they keep up with this new ever-changing customer and how do stores plan and execute for the unknown?

The answer?

Stores must create a new approach to planning and executing, and invest in new strategies and technology for capturing and acting on this consistently changing shopper behavior.

The biggest investment you make

One area that many retailers can improve upon is inventory management. Inventory is one of the biggest investments a retailer can make, yet many retailers are unaware of how to use their inventory processes to achieve a competitive edge. Traditionally, they will carry out assortment planning, allocation and replenishment activities based on a process known as clustering. Each individual store in a retail chain is grouped together with other stores that the retailer believes are similar, for reasons ranging from geographic proximity to square footage to average income of shoppers. Market demographics are often used to try to understand the potential customer base in a cluster based on geography and other common traits. These clusters of stores are then treated the same in terms of type and quantities of inventory stocked. This is based on average performance of items across the cluster.

Certainly, there are some benefits in utilizing market demographics for clustering. They can be very useful in long range planning and in understanding how a retailer’s core offering can be tailored to meet local requirements. This type of demographic data can also be extremely useful when a retailer is planning to open a new store. Since data on behavior in the new store will not be available for some time – at least not for the initial allocation – using data from similar stores in that area only makes sense for helping the store get up and running.

Additionally, many retailers today use market basket analysis, which assumes that if a customer buys one type of product they are likely to buy another as well. For example, if someone purchases a remote control car, they are likely to buy batteries as well. Or if a customer buys a swimsuit, he or she will likely also want to purchase sunscreen. This type of analysis is useful in understanding product affinities, flexing demand across multiple products and understanding the cross-sell and up-sell opportunities in the assortment to drive store-specific ranging.

These current techniques many retailers use today do help improve a retailer’s performance, but at the end of the day, just because stores are similar does not mean they will always perform in the same way. Every store is unique and each item in each individual store is going to behave differently.

This lack of accurate demand forecasting and SKU-store level detail creates a number of inefficiencies in the way retailers use their inventory. Yet it’s crucial because inventory affects everything from out of stocks to markdowns and at the end of the day has the biggest effect of any activity on the bottom line. What is needed is a way to gather insight into product performance at an individual store level, which can then be used to determine which products to stock, how much to order and in which stores to place them to ensure better product availability.

There are three main areas that retailers should focus their localization efforts right now

1. **Assortment planning and rationalization**

   Looking forward in time and planning how to bring inventory into the business based on localized customer demand is essential to deciding how to rationalize a retail assortment. When a retailer can track customer needs in real-time, they can keep their assortments flexible to monitor the profitability and performance of each product. In time, each store will reveal its own patterns and tell the retailer how to best align with the specific needs of customers.

2. **Allocation and Replenishment**

   Removing the simplifications from the inventory planning process and focusing on real-time local demand is crucial. Retailers need to create an agile inventory plan that is highly reactive to local demand fluctuations, allowing the retailer to be flexible and respond to how their customers are behaving now. This enables the retailer to have product available when and where their customers want it.

3. **Inventory placement**

   Some of the best retailers have not scaled back on their investments, but focused instead on where to place their inventory. In a recession, flat is the new 'good', but by putting inventory where there is demand, retailers can increase their sales and profit, while better serving their customers at the same time.

Thinking globally and acting locally

Retailers need to have a supply-chain that is able to be responsive to customer needs, now and in the future, and one that can be efficient at distributing product on a global scale, while tailoring their product offerings to the local market. Retailers need to look for opportunities that leverage intelligent international partners for ideas in technology, analytics, customer service and distribution. This will allow them to extend their reach and scale their capabilities far beyond that which they can manage effectively today.

Reacting to local shopper behavior

Retailers now need a new approach to forecasting, SKU rationalization, assortment planning and order planning. It's time to empower the customer. Retailers that can meet the specific needs of their customers at a local level will become much more successful.

Meeting those needs comes down to stocking the right mix of products and brands. Some retailers have met the challenge of providing lower priced products by creating quality store brands comparable to the popular brand name versions. Take Target for example; Target has created a low-cost brand "Up and Up" to appeal to bargain shoppers, but also offers "Archer Farms" as an upscale, but cost-effective choice. Being able to offer a variety of price points – and utilizing a high-quality, in-house brand – enables the retailer to increase margins, compete with vendor sales and lets the consumer decide what is the best value for them.

Once a retailer has created competitive strategies for its products, it must then begin tracking user data that will measure the difference in demand at each location. There is no point to stock similar stores with the same amount of products. Each store has unique demand and will respond differently to its assortment. When you look at customer trends, you can begin to understand how much to stock of what products at which location, allowing you to localize your stores, based on demand and profitability.

Localization works on two levels:

1. Retailers can look at the unique behaviors of each store - to determine each store's selling patterns by day, to monitor trends for size, brand, quality, quantity, locality, season, etc. With this understanding, a retailer can plan its orders on a store-by-store basis to deliver the right amounts of the products that customers are buying at each location, allowing the retailer to achieve the highest turn rates, rationalize SKUs to reduce inventory to the appropriate levels, increase availability, reduce over stocking and stock-outs and ultimately increase margins.

2. The second concept of localization comes from localizing distribution and utilizing vendors that produce products in a short vicinity of each store. This type of localization is often applied to fresh foods, as well as organic and natural products - where customers prefer to support their local farmers and local brands. This type of shopper is increasingly socially aware and the demand for these products - and corresponding increases in supply - has made them become more affordable.

Some questions that retailers should ask themselves:

What are your customers looking for when they walk into the store? Why are they buying that item? Does their buying strategy map to the one you have for the product? How much are they buying? How often are they buying? Are they buying it at the same store? What are they not buying?

To fulfill changing customer demand in your supply chain, you have to start at the store and it comes down to five seemingly simple aspects: Breadth of product assortment, store location, depth of product quantity, timing, and product objectives. However, integrating and executing on these aspects is not a simple task.

What and where:

There are the tried and true ideas behind why customers select a certain product (the customer product strategy) when supporting cutomer demand: price, impulse buys, destination items, etc. But customers today have a wealth of information at hand when deciding what to buy and therefore can include many new inputs (as well as the tried an true). These customer demand choices indicate their product preferences, will be factors in the customer's buying strategy, and hence need to be included in your product strategy.

Preferential signals (Inputs to the customer strategy): price, convenience, fashion-forward, technological, locally made, organic/sustainable, ethical, necessity, value, quality, size, color, style, brand, culture.

Ideally, you have a host of customer data that lets you not only map customers to purchases, but also links the changing customer buying strategy with your product strategy, and this may be different by location. If you do not have customer transaction and purchase information, you can use product/store level demand as a proxy, perhaps supported with market data. It will be important in this changing environment that these product/location strategies are continually monitored and updated.

Once you can assign the product strategy at a location level, you can tackle the breadth issue, i.e. the assortment. Most retailers cannot operationally manage unique store level assortments and need to assign clusters that are often constrained. Care, supported by process, timely information and optimal systems are needed to manage the conflicts between desired ranges and operational constraints such as space, fixtures and assortment planning groups.

How much and when:

When you assign a strategy to a product/location to drive assortment decisions, this same strategy should be used to drive depth. For example, a key destination item may need a very high service level so that your customer will not be disappointed.

In order to best meet these strategies and keep inventory performance high, the time phased aspects of the local customer demand need to be taken into account:

Circumstantial signals: The time of day or week activity occurs, holidays, local events and promotions, sports schedules, weather, seasonality and regional demand.

Product objectives

To place inventory in the most efficient and profitable way, merchants need to define product objectives, like minimum credible display and service levels, which should be used to decide each inventory placement decision. This enables retailers to make sure every product is in the assortment for a reason.

Though fast-moving products create the most revenue, even slow-moving products need to have a strategy. It's not just about ensuring availability; it's also about choosing the right mix of products and ordering the right amount for each location. This is even more critical in grocery, as perishable products create wastage and erode profit, especially in a retail sector with already slim margins. In the past, retailers have not been able to drill down into individual item behavior on a store-by-store basis because of the complexity and time involved, but modern technologies are changing that.

Retailers who understand the needs of the market at a lower level of granularity and can react to current buying trends will be much more successful. As channels grow and become more complex, planners and strategists require technology with the ability and intelligence to turn real-time data into actionable knowledge.

Putting it all Together

Retailers need to have the ability to assess and continually change with the patterns at each store based on the local signals and behaviors of their customers. In order to increase margin, achieve proper stock levels and align assortments with customer demand, top down simplifications in the inventory planning process must be removed.

Stores that can quickly process customer behavior and turn it into inventory execution will have an immense advantage in today's marketplace. This means creating a dynamic inventory plan that is highly reactive to local demand fluctuations allowing the retailer to be flexible and respond to how its customers are behaving now. This enables the customer to have product available when and where they want it, in the right size, in the right color, and in the right style at every store and in every channel.

Investments that will help retailers pull ahead

The best retailers are prioritizing their investments with processes and tools that will have the largest impact on their business. While initially concerned with maintaining store comps at the expense of margin, retailers have now turned their attention to being profitable. This has meant a focus on inventory - one of their single biggest investments. Retailers need to find ways to better align the inventory that they purchase with their customers.

Retailers need to look at some of the simplifying assumptions they are making in their supply-chain and challenge them. They treat groups of stores the same because it makes maintenance quicker and easier, but does it lead to a better result? Very few stores align with "the average", so does it make sense to use a single pack configuration? It may seem difficult to allocate to local demand, but there are tools that can help each store achieve this. In turn, this kind of process will increase sales by having an offering that fits the space and aligns with the buying habits of each store.

Retailers also need to have the ability to monitor the profitability of every product in every store. It comes down to building strategic financial and merchandising objectives for each product in their inventory and empowering customers to drive the assortment, range and depth.

To become an industry leader, retailers need to seek technology that:

- helps retailers align their assortments with their customers
- monitors local demand in real time
- tracks performance based on the strategic business goals

Positioning retail for an economic turnaround

The current economic environment is a gift for the good retailer. It does them the great service of highlighting all the shortcomings of their supply network and giving them the opportunity to address those challenges. This means removing the assumptions from their processes, taking away the simplifications and dealing with the details. Retailers that embrace the fact that their customers have changed - and that past trends are no longer relevant - will be successful. To do this, they need to align their supply network with what customers are asking for now, not what the retailer assumed they were going to ask for. Retailers need to have a holistic fulfillment process that reaches the length of the supply network and to be built around aligning their inventory investment with local market needs.

Retailers that address these issues will make it through this downturn and position themselves as strong, profitable, successful and reactive market leaders of the future. Those who do not take the opportunity to address their issues will have a very challenging time ahead - whether that challenge comes from the economy in general or from the better, faster and more innovative competition that this economy will create.

GET BACK IN THE GAME //

Are you ready to know exactly what your customers are asking for at every location and to have the ability to react as their wants change? If you are looking for a solution that can drive momentum for your business this year, check out the solutions offered by Quantum Retail.

Our customers see valuable results in 8 to 12 weeks and our implementation approach gives your team access to the system from early on, so you can manage changes to your processes with ease. Quantum Retail continues to help all of its clients drive positive business value more rapidly than anything seen in retail.

Get more resources on how to adapt to the challenges of today's retail market HERE»