

# Disrupting the Downturn

## Avoiding the Lost Sale Through the Science of Merchandising

Retailers are faced with a new reality – declining brick and mortar store sales productivity, and a heightened need for a clearly, differentiated value proposition to maintain and grow market share. While the e-commerce industry continues to grow at a rapid rate, it still remains a relatively small portion of most retailers’ overall business. However, e-commerce has an increasingly meaningful impact on shaping customer expectations and purchasing behavior across all channels. The changing dynamics require new approaches in order to meet the challenges and opportunities presented by a digitally savvy consumer. Whether it’s called omnichannel or customer-centric retailing, the customer is driving the change. In order to survive and thrive in this new retail reality, retailers need to consider what they can do to “avoid the lost sale”.

HRC Advisory conducted a study with Senior Merchandising and Planning Executives across a variety of retailers including Department Store, Specialty, Discount, Big Box, and Off Price sectors (see Fig. 1). The study focused on what retailers are and/or could be doing to better position their business to thrive and grow in these transformational times.

**We explored key questions including:**

- What are retailers doing to avoid the lost sale?
- How are traditional retail practices being adapted to optimize the new retail dynamics?
- How is customer data and science being leveraged to inform buying and planning practices?

Fig. 1a: Study Participants by Retail Sector

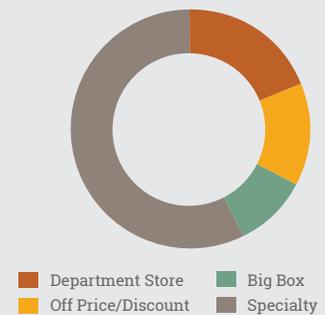
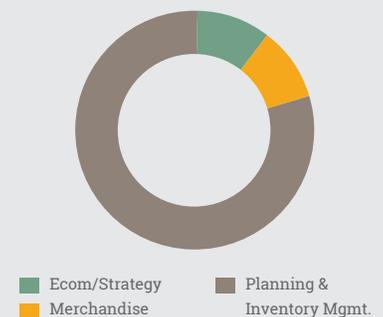


Fig. 1b: Study Participants by Executive Role



### Avoiding the Lost Sale

1. Offer the customer the convenience of any time/anywhere inventory through new fulfillment options (driven primarily by customer preferences while balancing costs)
2. Leveraging an expanded online assortment to provide additional options both for the online customer and customers in the store
3. Provide the customer with a highly relevant product offering, compelling services by leveraging customer data
4. Deliver an integrated experience to the customer across channels by improving the coordination and visibility of process, organization and systems
5. Focus on flexibility in all people, process and technology changes

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## Top Five Ways Retailers Can Avoid the Lost Sale

**1. Offering the customer the convenience of any time/anywhere inventory through the implementation of new fulfillment options.** When retailers were asked what they were doing to avoid the lost sale, 84.5% of retailers surveyed (across all sectors) indicated that they are focused (currently or over the next 12 months) on enabling new fulfillment options. Not only do fulfillment capabilities have the ability to protect sales, but it also has the potential to increase average order value (AOV). Macy's CEO recently stated that the company's "click to collect" service (currently in pilot) results in the customer spending 125% of the intended order amount.<sup>1</sup> Of the fulfillment capabilities being delivered by retailers, most are focused on the ones that have high customer visibility and demonstrate their omnichannel capabilities. Similar to the Gap's "reserve in store program" that launched in 2013 which was considered a "game changer."<sup>2</sup> However, without effectively designing and implementing the appropriate changes to back end planning and inventory management practices, these capabilities can have a significant impact on the retailer's cost structure. Only 10% of retailers surveyed have the capabilities to effectively fulfill from store. Fulfillment from store is a way for the retailer to contain costs, by drawing on inventory that is in close proximity to customer demand and/or leverage excess inventory to meet demand. This permits retailers to effectively leverage inventory within the network to fulfill online demand while preserving margin; rather than liquidating later in life to brick and mortar customers. Even fewer retailers (less than 15% of retailers surveyed) have started to make the necessary changes to planning and forecasting processes to reflect the impact of the new fulfillment capabilities. Most retailers still utilize traditional brick and mortar planning practices. Without an understanding of how to reflect and plan demand as well as sales and inventory differently going forward, the retailer will simply chase demand and incur additional costs.

**2. Leverage an expanded online product assortment to grow omni channel market share and allow the assortment in the stores to be more focused on the local customer.** Most retailers in the study acknowledged that their online assortment was at least equal in size, if not bigger than their largest stores. However 66.2% of retailers are primarily focused on size and color extensions to address the realities of constrained brick and mortar space and slow inventory productivity. 42.5% of retailers in the study indicated that they had or were exploring "online exclusives" beyond color and size extensions to new categories and brands. For those retailers that had implemented category extensions, approximately 40% were doing so for categories which are not economically justified to be carried in physical stores, but can be profitable when offered online. "Exclusive" product (whether online or in stores) plays a key role to increasing market share from all channels. Customer behavior for the online channel is highly measurable (such as conversion rate, average order value, shopping behavior). As a result, assortment expansions online provide an important way to test new ideas/products in order to identify opportunities to capture incremental sales, both online and in store. When coupled with store level localization initiatives and supported by additional fulfillment capabilities, the expanded online product assortment can be used as a tool in store to capture sales and maximize inventory productivity.

84.5%

ARE FOCUSED ON  
FULFILLMENT  
CAPABILITIES



### Order Fulfillment

The process from the point of order to the delivery of the product to the customer including the return of merchandise. Retailers offers several ways to fulfill the order that include:

- i. Reserve online, purchase in store
- ii. Purchase online and pick up in store
- iii. Fulfill from store (pick up or deliver to home)
- iv. Return to Store
- v. Return to DC

< 50% ARE ACTIVELY EXPLORING "ONLINE EXCLUSIVES"

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ONLY **9%** ARE LEVERAGING CUSTOMER DATA IN A FORMAL WAY

**3. Provide the customer with a more relevant product offering and compelling services by more effectively leveraging customer data.** The single most important tool to avoid the lost sale is to ensure that what the customer sees and experiences in both the bricks and mortar store and online is “compelling and relevant”. The importance of understanding what motivates the customer (the target customer) to make a purchase and the identification of opportunities to grow that market basket/average order value through visibility to customer behavior across channels has never been more important. Many retailers have collected years of customer data, but aside from marketing purposes, very few (9%) are leveraging that data in a structured way as part of their buying and planning. Retailers must recognize that customer data is a “collection of data points” from various sources that can be leveraged to inform the mix of product and when, where and how to offer specific items in the assortment to the customer. Customer data comes from a number of structured and unstructured sources that needs to be integrated to better understand the customer. Once . integrated, a profile will emerge that will be far more robust and actionable than transaction data alone. According to survey participants, most retailers’ customer data resides in disconnected silos across the organization. 87.2% of retailers in the study acknowledged that the ability to harness and apply customer data insights to their merchandising practices is a key area of focus in the next few years and represents a significant opportunity to grow sales. Yet, nearly two thirds of retailers studied are in the very early stages of efforts to organize that data to support an enterprise view of the customer across all purchase channels and banners. Although cited as one of the highest future priorities, few had a clear path forward beyond modest initial data collection and integration initiatives. Ultimately, by informing merchandising decisions with customer data, retailers should experience a more focused assortment in stores (e.g. right mix of styles, colors, sizes) which should result in an overall sales and margin lift. Better customer data allows retailers to make faster decisions, identify and react to changes, and make buying and planning decision with greater confidence. Farla Efros, EVP/COO of HRC Advisory stated, “The effective accessibility of relevant customer data will allow retailers to develop more targeted product assortments.” We found that only 18% of retailers studied are effectively clustering their stores to better reflect their localized customer preferences. With personalization capabilities becoming more crucial in an omnichannel era with often declining mall traffic, retailers need to make the necessary investments to design and develop, then operationalize localized assortments to capitalize on personalization capabilities.

**4. Deliver an integrated experience to the customer across channels by improving the coordination, flexibility and visibility across processes, organizations and systems.** Most retailers (more than 87.2% of those studied) indicated that they have taken initial steps toward or are planning to initiate an organizational change that would more fully integrate roles and processes across purchase channels. Few retailers (less than 15% of those studied) have extended the integration of people and process beyond the Merchandising and Planning functions to other key touch point areas like marketing, fulfillment and e-commerce operations. Across 88.2% of retailers studied, e-commerce operations and Marketing remain separate silos, and as a result, require significant manual effort to provide the customer with a seamless experience. According to VP Merchandising & Strategy, HRC Advisory Krista Spano, a good example of this challenge is “the impact that the item set up



MORE THAN  
**87.2%**  
OF RETAILERS  
BELIEVE THE ABILITY  
TO HARNESS CUSTOMER  
DATA IS CRITICAL OVER  
NEXT 3 YEARS

**80%+**  
HAVE OR WILL  
IMPLEMENT (IN THE  
NEXT 12 MONTHS)  
KEY ORGANIZATIONAL  
CHANGES TO MORE  
CLOSELY ALIGN WITH  
THE CUSTOMER  
SHOPPING EXPERIENCE



**+75%** HAVE EFFORTS UNDERWAY TO CLEAN UP, ORGANIZE AND INTEGRATE VARIOUS SOURCES OF CUSTOMER DATA

process has on the organization. The process required to get an item ready for sale online and in stores demands a much higher degree of planning and coordination across several areas of the organization in order to make sure all the necessary components related to the item (e.g. content, images, inventory location and pricing) are in place as soon as possible in order to ensure that the product is available for sale in all channels when the customer wants it." Many of the retailers studied are still using manual processes to coordinate item set up efforts, and most feel that they could do a better job of bringing the product to market more quickly to provide them with a competitive advantage.

**5. Focus on flexibility in all changes to organization, role, process and technology.**

One of the primary reasons why retailers have not fully integrated their organizations or migrated to a more "responsive" processes (e.g. one that allows the retailer to plan the level of detail and cadence according to the business and channel) is due to inflexible systems and organization structure. Given the rapid pace of change, any new system must provide the ability to be flexible as the business continues to evolve. When faced with a system selection, consider how customer and process needs will change as e-commerce becomes an increasing significant part of the business.

## Top Five Factors Impacting Retailer Progress

**1. Practices are still largely based on the heritage of brick and mortar retailing.**

Retail organizations plan and manage the business at a pace that does not support the dynamics of retail today (e.g. formal reforecasting merchandise plans is still primarily a monthly process across all businesses). Retailer skillsets are more oriented toward the brick and mortar businesses. For most retailers, Buyers and more senior levels have spent most of their careers in a "brick and mortar" world. As a result, retailers do not fully leverage the insights derived from the e-commerce business (which is highly measurable) and are not applying those insights across the business).

**2. Retailers want to be customer focused, but lack a roadmap to define what data points are relevant and how to leverage that data across key buying and planning decision points.** Furthermore, customer data remains in silos in the marketing function, untapped by Merchandising. 78.2% of retailers studied indicated that efforts are underway to clean up, organize and integrate the various data sources to provide an "enterprise" wide view of the customer. In some cases, despite loyalty programs that have been in place for years, customer data quality is poor.

### 3. Making choices to meet competition rather than customer.

50% of retailers studied rated their omnichannel capabilities as lagging behind the competition. It is clear to us that retailers are not necessarily making careful and cost-effective choices about the capabilities they should deploy based on what they know to be important to their customer.

### 4. Without localization, personalization efforts will deliver inadequate results.

Until retailers can operationalize how they deliver localized assortments, personalization efforts will yield inadequate results (e.g. personal offers on products that the customer does not necessarily want may require deeper discount to drive purchase behavior).

### 5. Price transparency has severely impacted pricing strategies. 74.3% of retailers indicated that they had migrated to the same prices across all stores and channels. 45% of retailers are considering varying prices across channels and stores at end of life (post initial markdown). Although many retailers indicated that they had different promotional offers across online and stores, very few were implementing personalized offers as a means to address price transparency. Interestingly, most retailers indicated that their strategy applied to their entire assortment and were not considering varying prices across stores and channel on products that were less "price sensitive" and less likely to be the candidates for intense price comparison shopping or showrooming. These retailers are effectively valuing their differentiators other than price at zero, by going straight to "price matching".

This study was very helpful in informing us about the progress that retailers are beginning to make to adapt their practices, tools and organizations to thrive in today's new retail reality. While a number of retailers are beginning to evolve, there is a long path ahead to cost-effectively delivering the capabilities that are valued by customers and to achieve the desired ROI.

Farla Efros, EVP/COO of HRC Advisory stated, "Retailers must first recognize that there has been a meaningful shift in power toward the consumer due to the emergence of numerous new choices to buy, and much increased price transparency. In order to mitigate this shift in power and to maintain more power, retailers must decide how to adequately differentiate on the right combination of unique and/or exclusive curation of products that are valued by the customer, exceptional service and a special in store experience that will never be matched or beaten by new online competitors." In conclusion, there is a tremendous amount of work and investment to be made to decide what capabilities and differentiators matter most to your particular customer and how these realistically and cost-effectively support and communicate these operationally.

<sup>1</sup> Macy's CEO Terry Lundgren in a presentation for investors at the Goldman Sachs 21<sup>st</sup> Annual Global Retailing Conference, 9/4/2014

<sup>2</sup> Forbes Magazine "Gap Executive Reveals How Retailer Struck Gold With 'Game Changing' Reserve In Store Program", Barbara Thau, 11/22/2013

## Notes on Survey Methodology and Analysis

HRC Advisory conducted detailed survey interviews with executives. The survey included 35 retail respondents including Specialty Apparel, Specialty Non-Apparel, Department Store, Discount, Dollar/Variety, Health & Beauty/Rx, Big Box, Grocery and Convenience stores. Participating criteria included annual revenues that range from innovative multi-channel smaller retailers to multi-billion \$\$ retail chains. At least 50% of the companies surveyed are publicly traded.



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