P3 Planning: Merchandise Level

E352 – Retail Logistics

SCHOOL OF ENGINEERING

Purpose of Merchandising Strategy

"In large retail stores, merchandise comes in a variety of sizes, colors, makes and models.."

Thus Merchandising strategy & plan becomes essential!

Merchandising Strategy

Merchandising strategy involves setting merchandising direction for the company by:

1. Defining the target market
   - Mass or niche?
2. Establishing performance goals
   - E.g. gross margin return of investment, turnover, etc…
3. Which merchandise classifications to emphasize
   - Based on general trends in the marketplace

Merchandise Planning

- Merchandise planning is the planning and control of merchandise inventory of the retail firm to meet merchandise strategy goals
- Merchandise planners study retail categories past performance and look at trends in the market to project sales targets in the new season
- Resulting merchandise plan tells the buyer and planner how much money is to be spend on a particular category of merchandise monthly so that sales forecast and financial objectives are met

Merchandise Planning Process

Step #1: Define Merchandise Policy to meet Merchandise Strategy Objectives

Step #2: Gather historical information to understand past merchandise plan performance

Step #3: Perform qualitative analysis to meet merchandise plan performance targets

Step #4: Develop the Merchandise Plan

Merchandise Planning Process

Step #1: Define Merchandise Policy to meet Merchandise Strategy Objectives

Step #2: Gather historical information to understand past merchandise plan performance

Step #3: Perform qualitative analysis to meet merchandise plan performance targets

Step #4: Develop the Merchandise Plan

Merchandise Policy to meet Merchandise Strategy Objectives

Merchandise policies considerations to meet merchandise strategy includes:

- Demographics of current and potential customers
- Store's image
- Merchandise quality levels
- Price point policy
- Marketing approach
- Customer service levels
- Desired profit margins

Merchandise Policy to meet Merchandise Strategy Objectives

- Merchandise decisions are constrained by
  - Amount of money available to invest in inventory, and space available in the store
- Merchandise are defined by

a. **Variety**
   - Categories of products in a store (E.g. slacks, sweaters, long sleeve and T-shirts)

b. **Assortment**
   - Number of SKUs within a category (E.g. Levi Strauss carries a high assortment of jeans)

c. **Product Availability**
   - Stock to meet service level

Merchandise Planning Process

Step #1: Define Merchandise Policy to meet Merchandise Strategy Objectives

Step #2: Gather historical information to understand past merchandise plan performance

Step #3: Perform qualitative analysis to meet merchandise plan performance targets

Step #4: Develop the Merchandise Plan

Understanding Merchandise Plan Performance

Gather historical information (e.g. last year) such as:

- Beginning of Month (B.O.M) Inventory
- Purchases
- Sales
- Reductions
  - ✓ Markdowns
  - ✓ Employee Discounts
  - ✓ Shrinkage
- End of month (E.O.M) Inventory

Merchandise Planning Process

Step #1: Define Merchandise Policy to meet Merchandise Strategy Objectives

↓

Step #2: Gather historical information to understand past merchandise plan performance

↓

Step #3: Perform qualitative analysis to meet merchandise plan performance targets

↓

Step #4: Develop the Merchandise Plan

Perform Qualitative Analysis to meet Merchandise Plan Performance Targets

Qualitative analysis to meet targets is a combination of :

1. Customer Profile Analysis

- Who are our best customers, and what are their buying behaviors and attitudes?
- Who do we want our customers to be?

2. Product Department/Class analysis

- Sales, margins, markdowns, returns, inventory carry-overs in the department or class in the retail store
- E.g. a typical family shoe store may have men's footwear, women's footwear, children's footwear and accessories. The men's department may be made up of the following subcategories or "classes": dress shoes, sport shoes, boots and slippers.

Perform Qualitative Analysis to meet Merchandise Plan Performance Targets

3. Key Department Trends

- What are the trends in his market?
- Trend information is available from a number of sources, including trade publications, merchandise suppliers, the competition

4. Major Vendor Analysis

- Do suppliers delivery late or have quality problems?

5. Advertising Review

- The buying and advertising departments work closely together to ensure the company’s investments in this area result in strong retail performance.

Perform Qualitative Analysis to meet Merchandise Plan Performance Targets

6. Visual Presentation Analysis

- How the product is presented affects its sales
- Considerations in visual merchandising includes
  - ✓ Are any special fixtures required?
  - ✓ Where should the product be displayed?
  - ✓ What type of signage is necessary?
- Information concerning delivery dates, promotions and product quantities may affect decisions about what to feature in store windows and key display areas

Merchandise Planning Process

Step #1: Define Merchandise Policy to meet Merchandise Strategy Objectives

↓

Step #2: Gather historical information to understand past merchandise plan performance

↓

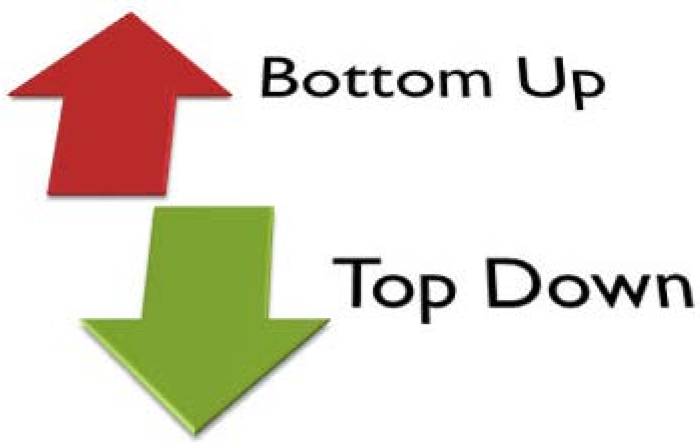
Step #3: Perform qualitative analysis to meet merchandise plan performance targets

↓

Step #4: Develop the Merchandise Plan

Develop The Merchandise Plan

- Larger retail chains build merchandise plan from bottom up
  - Each class of merchandise will have its own plan
  - Combining entire subclasses will give us the strategy for each department
  - amalgamation of all department strategies will give us the total company plan
- Smaller retail chains build merchandise plan from top to bottom



Develop The Merchandise Plan

1. Assemble last year's figures
2. Planned Sales

Affected by

- ✓ Sales Performance Coming Into The Season
- ✓ Monthly Promotions
- ✓ Customer Behavior (Changing trends and concerns)
- ✓ Economic Factors (Unemployment, inflation, events. etc…)

Develop The Merchandise Plan

3. Planned Reductions

- Planned Markdowns
- Markdowns as a percentage of sales by month.
  - ✓ How aggressive are this year's pricing policies compared to cost?
  - ✓ When did we promote the products last year and how will it change this year?
  - ✓ Is the merchandise of lower quality last year?
- Employee Discounts
- Shrinkage

4. Stock-to-sales (S/S)

$$\text{S/S ratio} = \frac{\text{Stock on hand E.O.M (at retail value)}}{\text{Sales for the same month}}$$

- To forecast how much inventory is required to attain monthly sales projections

Develop The Merchandise Plan

5. End of Month (E.O.M) Inventory Levels

	Year	Feb	Mar	Apr	May	Jun	Jul	Season Total
Beginning Of Month (B.O.M) inventory	2013	$50,000	$105,000	$60,000	$40,000	$70,000	$120,000	$445,000
Planned Sales	2013	$70,000	$60,000	$40,000	$35,000	$80,000	$65,000	$350,000
Planned Purchases	2013	$132,000	$21,000	$24,000	$68,500	$138,000	$49,000	$432,500
Planned Employee discount	2013	$3,500	$3,000	$2,000	$1,750	$4,000	$3,250	5%
Planned Shrinkage	2013	$3,500	$3,000	$2,000	$1,750	$4,000	$3,250	5%
End Of Month (E.O.M) inventory	2013	$105,000	$60,000	$40,000	$70,000	$120,000	$97,500	$492,500
Planned Stock-to-Sales Ratio	2013	1.5	1.0	1.0	2.0	1.5	1.5	

EOM Inventory = S.S x Planned sales

- Desired S/S ratios are usually obtained by referencing previous seasons.
- The selected ratio is then multiplied by the projected period sales to get the desired E.O.M inventory level.

Develop The Merchandise Plan

6. Gross Margin
   - Gross margin is the difference between the selling price and the cost of the product

7. Cost of Goods Sold (COGS)
   - BOM Inventory + Purchases – EOM Inventory
   - **At Cost**
     - **Need to convert the BOM, Purchase and EOM into cost price using the mark up percentage**
     - **And the mark up dollar**

Develop The Merchandise Plan

Let BOM Inventory + Purchases – EOM Inventory = Z

Percentage mark up = 35%

COGS = Z – (Z x 0.35)

Where,

Markup dollar

- Selling price – Cost Price

$$Markup\ percent = \frac{Markup\ dollars}{Retail\ Price}$$

Develop the Merchandise Plan

- Once sales projections, stock reductions and stock levels have been established, you can calculate your planned purchases.

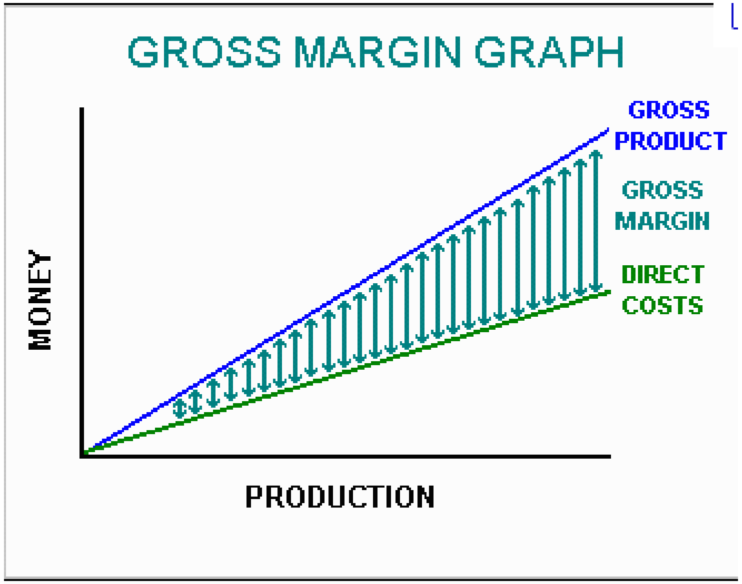
  <u>EOM + Sales + Reductions – BOM</u>

- Planned purchase figure is also the buyer’s first "open-to-buy" estimate
- Planned purchase figures are used by buyers to do assortment planning on products to purchase

Develop The Merchandise Plan

8. Planned Gross Margin (%)

$$Planned\ Gross\ Margin = \frac{Period\ Sales - COGS}{Period\ Sales}$$



Develop The Merchandise Plan

- Gross Margin Return on Inventory Investment (GMROII)
  - combines the effect of both profits and turnover
- GMROII = Gross margin ($) / Avg. Inventory Investment at Cost

  = 187%

- The minimum standard for GMROII in most retail operation is 200%. Anything less is considered to be unprofitable

Year 2013 (Planned)

	Year	Feb	Mar	Apr	May	Jun	Jul	Season Total
Beginning Of Month (B.O.M) inventory	2013	$50,000	$105,000	$60,000	$40,000	$70,000	$120,000	$445,000
Planned Sales	2013	$70,000	$60,000	$40,000	$35,000	$80,000	$65,000	$350,000
Planned Purchases	2013	$132,000	$21,000	$24,000	$68,500	$138,000	$49,000	$432,500
Planned Employee discount	2013	$3,500	$3,000	$2,000	$1,750	$4,000	$3,250	5%
Planned Shrinkage	2013	$3,500	$3,000	$2,000	$1,750	$4,000	$3,250	5%
End Of Month (E.O.M) inventory	2013	$105,000	$60,000	$40,000	$70,000	$120,000	$97,500	$492,500
Planned Stock-to-Sales Ratio	2013	1.5	1.0	1.0	2.0	1.5	1.5	
C.O.G.S	2013	$50,050	$42,900	$28,600	$25,025	$57,200	$46,475	$250,250
Planned Gross Margin (Percentage)	2013	29%	29%	29%	29%	29%	29%	29%
Planned Gross Margin (Dollars)	2013	$19,950	$17,100	$11,400	$9,975	$22,800	$18,525	$99,750

Average Inventory at retail price	2013	$82,083
Average Inventory at Cost	2013	$53,354.17

Stock Turn Rate	2013	4.3
GMROII	2013	187%

Assume that there is a 35% markup on all good	0.35

Suggested Solution

To increase the GMROII, we can

- Reduce the EOM
    - Do not hold so much stock unnecessarily
    - Decrease the S.S ratio
- Reduce the purchase
- Reduce the mark down
    - Balance between markdown and customer volume
- Higher mark-ups
    - balance mark-ups with the volume of sale
    - In today's problem, if we increase the markup to 45%, the GMROII will be **306%**.

Suggested Solution

To achieve those mentioned earlier, we can:

- Keep less stock of merchandise that have lower markups
- Source for a more competitive source that provide the same merchandise. This will increase your profit margin.
- Begin with a higher original mark-ups so that the first markdowns can be meaningful without killing the gross margin
- Reduce the reductions

Year 2013 (Planned with reduction in S.S Ratio)

	Year	Feb	Mar	Apr	May	Jun	Jul	Season Total
Beginning Of Month (B.O.M) inventory	2013	$50,000	$70,000	$60,000	$20,000	$70,000	$80,000	$350,000
Planned Sales	2013	$70,000	$60,000	$40,000	$35,000	$80,000	$65,000	$350,000
Planned Purchases	2013	$97,000	$56,000	$4,000	$88,500	$98,000	$56,500	$400,000
Planned Employee discount	2013	$3,500	$3,000	$2,000	$1,750	$4,000	$3,250	5%
Planned Shrinkage	2013	$3,500	$3,000	$2,000	$1,750	$4,000	$3,250	5%
End Of Month (E.O.M) inventory	2013	$70,000	$60,000	$20,000	$70,000	$80,000	$65,000	$365,000
Planned Stock-to-Sales Ratio	2013	1.0	1.0	0.5	2.0	1.0	1.0	
C.O.G.S	2013	$50,050	$42,900	$28,600	$25,025	$57,200	$46,475	$250,250
Planned Gross Margin (Percentage)	2013	29%	29%	29%	29%	29%	29%	29%
Planned Gross Margin (Dollars)	2013	$19,950	$17,100	$11,400	$9,975	$22,800	$18,525	$99,750

Average Inventory at retail price	2013	$60,833
Average Inventory at Cost	2013	$39,541.67

Stock Turn Rate	2013	5.8
GMROII	2013	252%

Assume that there is a 35% markup on all good	0.35

Learning Outcome

- Explain Merchandising Strategy
- Apply Merchandise Planning Process
- Evaluate Merchandise Plan Performance