

Monte Carlo Simulation and Risk Analysis for Grocery Store Revenue

By Team 4: Sri Lakshmi Mallipudi | Velangini Roja Karanam | Ami Shah | Justin Le | Karan Savaliya | Munkhjin Batjargal

Introduction:

Understanding customer spending patterns is essential for effective business management in the retail industry, particularly in grocery stores. This report presents a Monte Carlo simulation and risk analysis model to analyze customer spending and the fluctuation in daily revenue for a grocery store across four product categories: fresh baked goods, meat and dairy, produce, and frozen food.

Methodology:

The Monte Carlo simulation technique was employed to simulate customer spending behavior across various product categories, utilizing the following dataset:

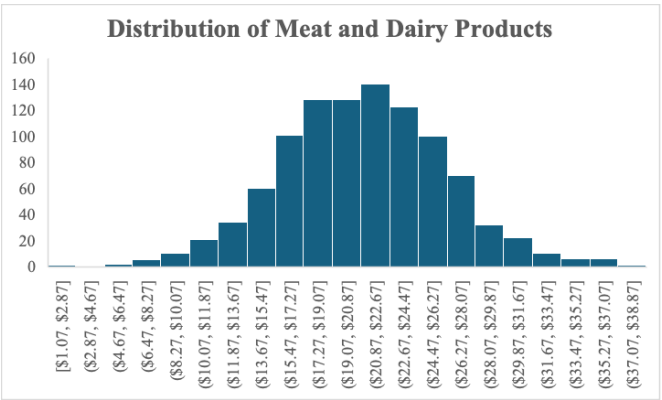
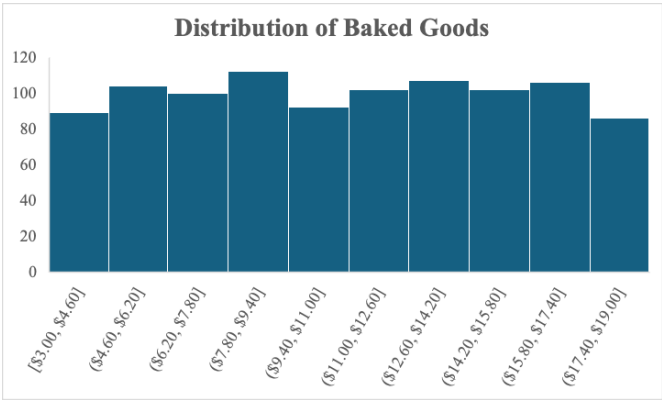
Daily Customers Simulation

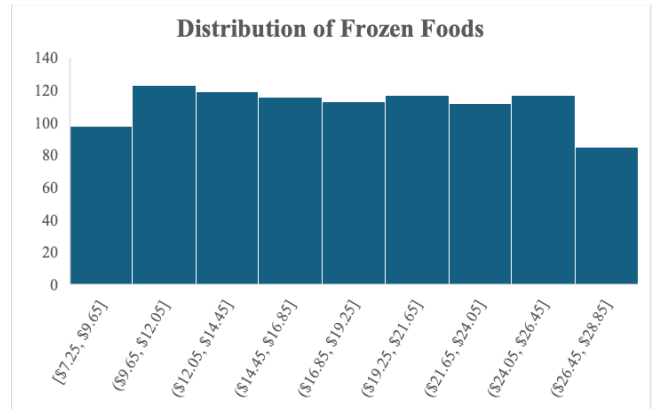
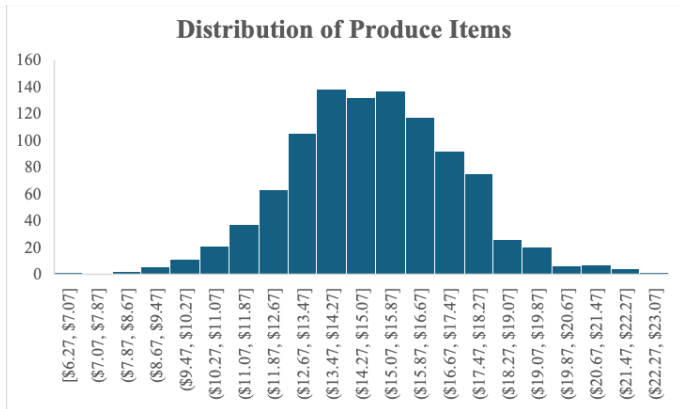
Using a uniform distribution between 180 and 260, we simulated the number of daily customers, with an average of 220 customers per day.

Customer Spending Simulation

Modeled customer spending for each category as follows:

- Baked Goods:** 30% of shoppers purchase baked goods items, with spending following a uniform distribution between \$3 and \$19.
- Meat and Dairy:** 70% of shoppers purchase from this category, with spending following a normal distribution with a mean of \$21 and a standard deviation of \$5.27.
- Produce:** 80% of shoppers spend an average of \$15, with spending following a normal distribution with a standard deviation of \$2.31.
- Frozen Food:** 65% of shoppers purchase items from this category, with spending following a uniform distribution between \$7.25 and \$28.50.

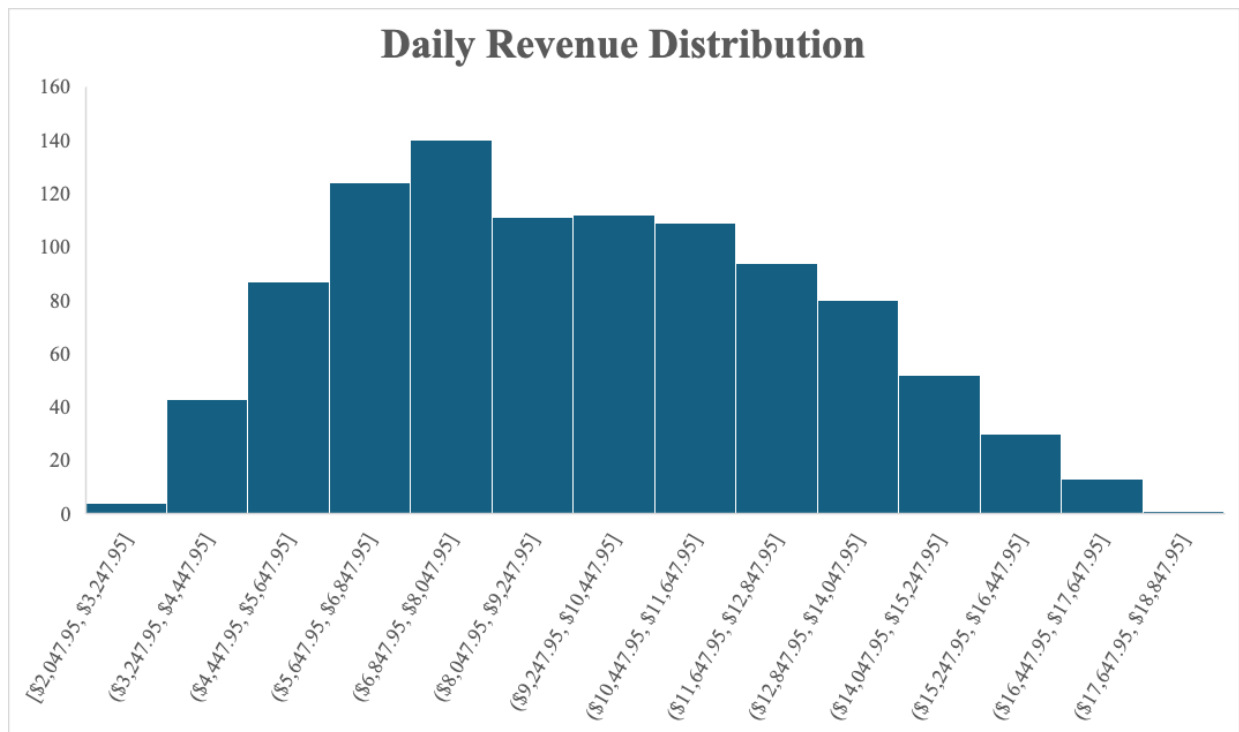




The simulation was iterated 1000 times with random seed 10 to explore the daily revenue variability thoroughly. This approach allowed for the creation of diverse scenarios reflecting customer spending patterns across the specified product categories.

Daily Revenue Calculation

Daily revenue was derived by multiplying the proportion of customers for each category with their corresponding spending and then summing up these values across all categories. The resulting distribution of daily revenue is outlined below:



Simulation Results

Our simulation model yielded an average daily revenue of \$9,395.74, with a standard deviation of \$3,297.13. The maximum daily revenue observed was \$18,020.21, while the minimum daily revenue recorded was \$2,047.95.

The Monte Carlo simulation revealed that approximately 48% of simulations resulted in revenue below the average. This indicates a significant risk associated with daily revenue fluctuations, potentially impacting financial targets and operational expenses. Recognizing and mitigating this risk is imperative for sustaining profitability and ensuring the continuity of business operations.

Risk Analysis:

Sensitivity Analysis

We conducted a sensitivity analysis to evaluate the change in daily revenue for every 10% increase or decrease in the proportion of customers for each product category. This analysis underscores the varying degrees of influence that each product category exerts on daily revenue. Here's a breakdown of the sensitivity analysis results:

- **Baked Goods:** A 10% increase in the proportion of customers purchasing baked goods results in a **2.68%** change in daily revenue.
- **Meat and Dairy:** A 10% increase in the proportion of customers purchasing meat and dairy products results in a **5.04%** change in daily revenue.
- **Produce:** A 10% increase in the proportion of customers purchasing produce results in a **3.57%** change in daily revenue.
- **Frozen Food:** A 10% increase in the proportion of customers purchasing frozen foods results in a **4.33%** change in daily revenue.

Based on the above, Meat and dairy products emerge as the most influential category, with even a modest increase in customer purchases resulting in a substantial boost to revenue. While baked goods, produce, and frozen food contribute to revenue growth, their impact is comparatively moderate.

Scenario Analysis

We conducted a scenario analysis to understand further the potential outcomes and implications of different customer spending scenarios. This analysis involved adjusting the proportions of customers for each product category to create three distinct scenarios: best case, most likely, and worst case.

- **Best-case scenario:** This scenario assumes higher proportions of customers for each category, maximizing customer engagement and spending. It represents an optimistic outlook with the highest potential revenue.
- **Most Likely Scenario:** This scenario maintains the current proportions of customers, reflecting average or typical spending patterns. Serves as a baseline for comparison with other scenarios.
- **Worst-case Scenario:** This scenario assumes lower proportions of customers for each category, minimizing customer engagement and spending. It represents a pessimistic outlook with the lowest potential revenue.

By exploring these scenarios, the grocery store manager can gain valuable insights into potential outcomes and prepare appropriate strategies to address different situations. This analysis enables proactive decision-making and risk management, ensuring the business is well-equipped to navigate various market conditions and optimize revenue generation.

Scenario Summary

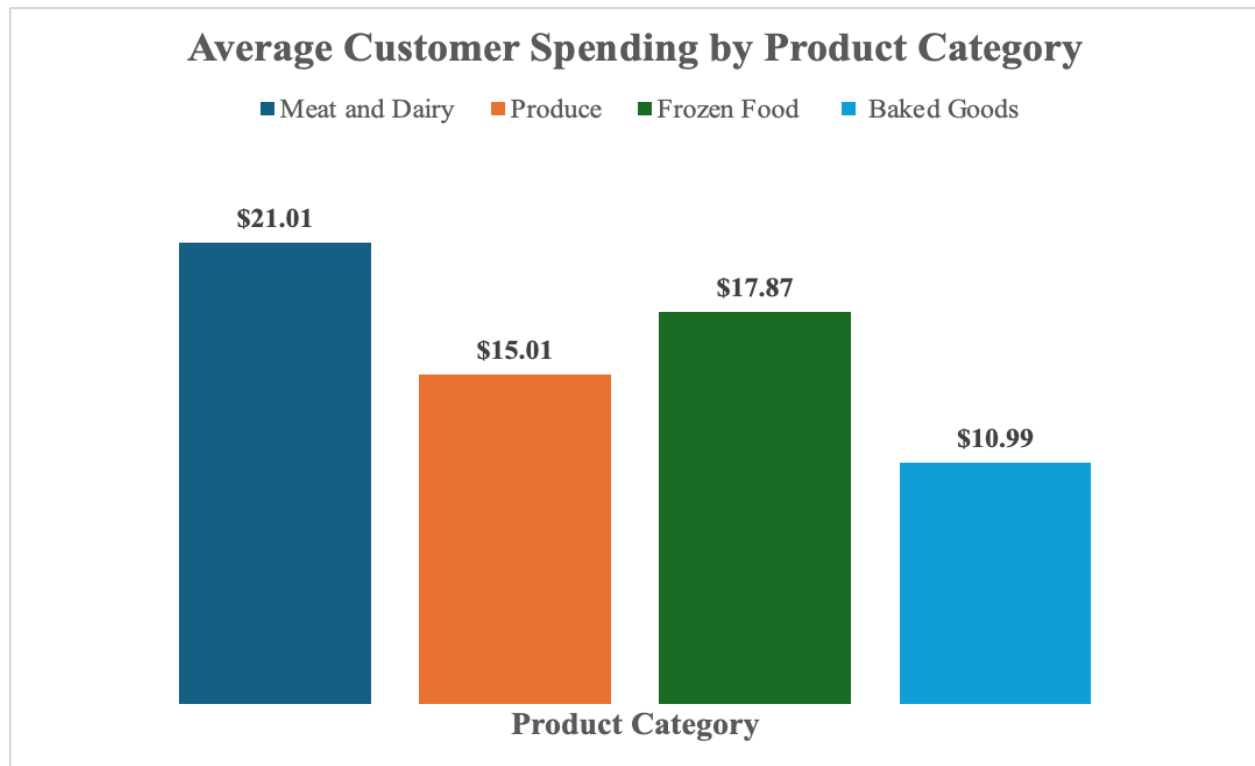
The scenario summary presents a comprehensive overview of each scenario's average, standard deviation, maximum, and minimum revenue values. This summary enables a clear comparison of the potential outcomes across different scenarios.

Scenario Summary				
	Current Values:	Best Case	Most Likely	Worst Case
Changing Cells:				
Baked Goods (%)	30%	50%	30%	10%
Meat and Dairy (%)	70%	90%	70%	50%
Produce (%)	80%	100%	80%	60%
Frozen Food (%)	65%	85%	65%	45%
Result Cells:				
Average Revenue	\$9,395.74	\$12,330.68	\$9,395.74	\$6,460.80
Standard Deviation	\$3,297.13	\$4,382.49	\$3,297.13	\$2,211.86
Maximum Revenue	\$18,020.21	\$23,670.53	\$18,020.21	\$12,369.89
Minimum Revenue	\$2,047.95	\$2,681.19	\$2,047.95	\$1,414.71

- **Best Case Scenario:** Higher proportions of customers for each category lead to increased average revenue of \$12,330.68. However, this scenario also comes with higher variability, as indicated by the larger standard deviation and maximum revenue.
- **Most Likely Scenario:** Maintaining current proportions of customers results in average revenue consistent with the baseline at \$9,395.74. This scenario provides insight into the expected revenue under typical customer spending patterns.
- **Worst-Case Scenario:** Lower proportions of customers for each category lead to decreased average revenue of \$6,460.80. Despite having a more pessimistic outlook, this scenario demonstrates lower variability than the best-case scenario.

Key Insights:

Analysis of customer spending by product categories reveals that meat and dairy products command the highest average spending per customer, followed by frozen food, produce, and baked goods. Understanding these spending patterns equips the grocery store manager with valuable insights for strategic decision-making in product placement, pricing strategies, and inventory management. By leveraging this understanding, the manager can optimize revenue generation and enhance customer satisfaction by aligning offerings with consumer preferences and behavior.



Future Analysis:

To deepen our understanding of customer behavior and optimize business strategies, further analysis should explore the factors driving higher spending in the Meat and Dairy category. Exploring aspects such as product quality, brand perception, and customer demographics can provide valuable insights into consumer preferences and behaviors. Additionally, tracking spending trends over time will enable identifying evolving customer preferences and market dynamics. This information serves as a foundation for future strategic initiatives, allowing the grocery store to adapt proactively to changing consumer behavior and maintain a competitive edge in the market.

Conclusion:

Integrating Monte Carlo simulation and risk assessment has provided valuable insights into the daily revenue fluctuations and the revenue sensitivity to changes in customer spending patterns. By acknowledging the probabilistic nature of customer behavior and product category spending, the grocery store manager is empowered to make informed decisions to optimize revenue and manage risks effectively.

Recommendations:

Based on the analysis, the grocery store manager should prioritize the following strategies to maximize overall revenue and profitability.

- Conduct targeted promotions or discounts on high-margin items within the Meat & Dairy category to encourage increased spending.
- Enhance product placement, freshness, and variety of produce and frozen food items to attract customers and encourage higher spending.

- Explore partnerships with local bakeries or introduce specialty baked goods to elevate the appeal of this category and potentially increase average spending.
- Continuously monitor customer preferences and adjust the assortment of products within each category based on demand, seasonality, and trends.
- Implement promotional pricing or bundling strategies to stimulate sales and increase customer spending, particularly for high-margin products or slow-moving inventory.
- Continuous refinement and enhancement of the Monte Carlo simulation model to incorporate updated data and improve accuracy in revenue forecasting.