IBM Commerce
Thought Leadership White Paper

Consumer-centric merchandising

Leveraging customer, demand, and market intelligence to help drive profits and long-term customer loyalty

Defining consumer-centric merchandising

The era of product-centric retail management is giving way to one in which market leaders apply a more strategic, more targeted, more localized approach to communicating a value proposition to their customers. Top-performing retailers, realizing they cannot be everything to everybody, are now taking a more consumer-centric approach to merchandising, creating competitive advantages and differentiating themselves in the highly competitive retail industry. Consumer-centric merchandising is a way of planning and executing pricing, promotion, assortment and other plans, driven by a deeper understanding of customers, consumer demand and the competitive marketplace vying for attention and wallet share.

Consumer-centric merchandising is enabled by advanced science that taps into rich data sources and extracts insights that were previously unavailable to support merchandising decision-makers. It can enable better decisions in such critical areas as everyday pricing, promotion planning, merchandising support, timing and depth of markdowns and assortment.

It supports tailoring of merchandising to match demand variations across geographies and customer segments and in order to enable better forecasting.

For the leading retailers now putting it into practice, consumer-centric merchandising is also breaking down the walls between marketing and merchandising, creating synergies that drive exceptional, positive impact on price image and customer loyalty, sales volume and the bottom line.

New challenges in the retail industry

Recent industry trends have brought challenges that make it increasingly difficult for many retailers to achieve desired performance metrics.

Growth of “value” retailers

Perhaps chief among these is the sales erosion that retailers in traditional categories attribute to share growth by “value” channel retailers, such as discount mass merchants, dollar stores and even online stores. Pricing cues communicated by value-focused players affect almost the entire retail marketplace, establishing value comparisons in consumers’ minds that retailers with higher price points often struggle to counter. Communicating higher service levels, better assortments and other differentiators is difficult when fuel prices or other costs of living are on the rise.

Blurring of retail channels

The expansion into new merchandise categories by many retailers and formats compounds this challenge. Chain drug stores stock convenience foods and household goods; supermarkets display hard lines like garden furniture and feature “dollar aisles”; department stores offer consumer electronics and toys; convenience stores handle automotive supplies and over the counter (OTC) remedies; supercenters offer the above categories and more. Consumers are aware that for many basic needs, shopping is a multiple-choice proposition. Very often, impulse and location convenience are the deciding factors.

Proliferation of new formats and retailers

Compounding these effects is the over-storing of most retail markets and the growing acceptance of the online channel across customer segments. With the sheer proliferation of formats and expansion of chain retailers, shoppers have more choices than ever, and retailers feel greater pressure to maintain parity with competitors on price and selection. Savvy shoppers perceive this and understand that they can choose among many alternatives when it comes time to make a purchase.

Changing shopping behavior

These first three trends have created many new choices for consumers, leading to a fourth trend impacting retailers—a change in shopping behavior itself. Not only is the opportunity there to cross-shop, the willingness to do so has also increased. Consumers are less loyal and are routinely cross-shopping—buying groceries from a discount supermarket, a membership club and a specialty food store; or researching an electronics purchase in-store to determine the desired features, then buying online to obtain the best price. They spend more time comparing prices, but less time shopping in the store. Importantly, different groups of consumers display different shopping behaviors based on their enduring preferences, and at the same time, individual consumers display different behaviors based on their changing need states.

For these reasons, positioning a retailer in the "big middle" exposes it to competition from almost all sides almost all the time, without promoting strong loyalty bonds with the customers who account for the most profits. Yet many retailers still claim their target customer is "everyone who walks in the door." Retailers need to move beyond this one-size-fits-all approach to merchandising and marketing practices and adopt a more targeted and proactive approach, based upon more accurate and ongoing consumer, demand and market intelligence designed to enable them to segment, target and delight their customers. This is the essence of consumer-centric merchandising and the key to successful positioning.

Traditional merchandising vs. consumer-centric merchandising

The consumer-centric retail enterprise recognizes that it cannot be all things to all customers all of the time. Instead, it identifies its most desired groups of customers and the needs they can best serve and then designs its merchandising and marketing practices to target them. This need to focus more on the consumer is no more or less crucial for every day low price (EDLP) merchants than it is for full-service specialty retailers. Value retailer, boutique, or anywhere in between, retailers need consumer-centric merchandising to remain competitive.

In contrast, traditional merchandising methods rely heavily on data such as vendor costs, historical decisions (e.g., "what we did last year") and competitor decisions. This leads to relatively simple merchandise management practices such as standard assortments, cost-plus pricing, competitive price-matching and vendor-driven pricing and promotions. Particularly when reacting to competitive moves over time, these methods lack alignment between merchandising decisions and the retailer's corporate strategy. Considering the increasingly competitive retail environment described in the previous section, these methods are increasingly inadequate.

Consumer-centric merchandising transcends traditional merchandise management practice by re-centering the focus away from products and toward the consumer. Inputs such as costs, historical decisions and competitor actions remain valid but they alone no longer drive merchandising decisions. Instead, these inputs and other data sources such as loyalty card data, syndicated market data, consumer panel data and detailed market basket data from transaction logs, are merged and analyzed to create consumer, demand, and market intelligence. These insights become the drivers of new, consumer-centric merchandising decisions.

Customer, demand and market intelligence

Customer intelligence

Refers to a detailed understanding of a retailer's customers—in terms of who they are, what they do in that retailer's store and what they do outside the store. It includes an understanding of what they buy and why. Insights are based on market basket analysis of T-Log data, loyalty card data to analyze identified transactions over time, panel data and other sources. It permits segmentation of customers based on lifestyle, shopping behavior and value.

TRADITIONAL MERCHANDISING	CONSUMER-CENTRIC MERCHANDISING
Based largely on historical decisions, competitor decisions and vendor costs	Based on consumer, demand and market intelligence
Often reactive and disconnected from corporate strategy	Proactive, responsive and aligned with corporate strategy
Decisions are product-centric and focused on the "average" consumer	Decisions are targeted for specific customer segments

Figure 1: Traditional and consumer-centric merchandising compared

Retailers who identify their highest value or "best" customers can then study their common characteristics and seek ways to influence their behavior, as well as influence the behavior of customers in second- or third best segments to behave more like best customers. This may be accomplished through targeted incentives, pricing or other merchandising tactics. At the other end of the customer spectrum are so-called "worst" customers, who may buy only on deal and may even contribute negatively to the retailer's bottom line. A few so-called "cherry pickers" may be moved to a more profitable state, but in many instances they may be better left to the competition. The key to increasing the number of best customers and decreasing the number of worst customers is in designing merchandising plans that influence consumer behavior. Purchase behaviors are largely determined by key drivers such as everyday prices, promotions and assortments, among others. Tactics that generate favorable response from a lower value customer segment may have no effect or a negative effect on best customers, for example. Some modest price changes or promotions may cause no behavioral change whatsoever because they fall within the "imperceptible" range for that product or customer segment. The ability to understand, predict and influence consumer behavior of different segments requires a detailed understanding of consumer demand—the second driver of consumer-centric merchandising.

Demand intelligence

Provides detailed insights into what items and in what quantities consumers will buy under different circumstances—insights that are required to shape consumer demand. At a granular, store/SKU specific level, demand intelligence can enable volume, sales and profitability forecasting for almost all items, locations and customer groups, given price points, changes to the assortment, competitive activity, pricing rules in place, price image goals, seasonality and promotional activity, to name a few examples. When a merchant is able to augment the "art" of merchandising with science-based demand intelligence that incorporates all available drivers of consumer demand, he or she can more accurately predict and influence consumer response, driving profitability, as well as customer loyalty and price image improvement.

Market intelligence
Is focused on understanding the broader competitive market in which a retailer's customers are also shopping. It involves not only the market performance of the retailer and its competitors (e.g., volume market share), but also the merchandising activities of the competition as a basis for strategic decision making. The goal is to attain an understanding of how the business is performing, how competitors are performing, how competitors are making decisions and what should be done differently in order to compete more effectively against them.

Applying what is known from a retailer's own modeling of customer responses to competitor price and promotion data permits some "reverse engineering" and evaluation of the competitor's strategy for an item or category. Market intelligence may also support a retailer's decision on when to lead the competition in setting a low price or taking a markdown and when to follow, or even if to follow, at all. Consumer-centric merchandising permits the retailer to more accurately predict the outcome of its own pricing and promotion actions, and to learn when to anticipate a competitive response.

Figure 2: Consumer-centric merchandising brings together the customer, the market and demand

These three kinds of insights form the basis of consumer-centric merchandising decisions. Deriving these insights requires advanced statistics and analytical processing in order to rapidly analyze multiple data sources and provide insights and information to the merchants making decisions. Consumer-centric merchandising software is the interface that allows a merchant to make optimal pricing and other merchandising decisions driven by the consumer, demand and market intelligence.

Consumer-centric merchandising in action

Leading retailers are applying consumer-centric merchandising to more effectively support their strategic and operational goals including:

- **Creating more strategic store zones.** Group stores based on granular consumer, demand and market insights.
- **Defining consumer segments.** Augment current segmentation schemes with demand intelligence or create new segmentations by clustering transactions and identified customers into groups that can be targeted.
- **Evaluating customer impact.** Understand the effect that pricing, promotion, or other merchandising strategies are currently having on different customer segments.
- **Setting prices strategically.** Optimize base prices, promotions and markdowns with a detailed understanding of cannibalization and halo effects in order to achieve volume, sales, profitability and price image goals.
- **Cultivating best customers.** Define new, targeted pricing and merchandising strategies that incentivize and expand key segments. This may include optimizing prices and promotions to keep "best" customers; to influence second-tier segments to become "best" customers; or to discourage unprofitable cherry pickers.
- **Executing better promotions.** Refine promotional strategies based on targeted segments, local markets and category goals. Use product affinity data by segment, for example, to better understand what items should be promoted or merchandised together to drive sales and profitability.

- **Improving loyalty programs.** Refine the selection of items to be promoted using card programs and optimize prices based on segment preferences, product affinities, market basket analysis done over multiple trips, cherry-picking analysis and long-term assessments of lifetime customer value.
- **Improving price image.** Refine known-value item (image item) lists with advanced analytics that include price elasticity, cross-shopping behavior, market basket analysis and optimize pricing to manage price image by segment and geography.
- **Localizing assortments.** Tailor assortments based on target segments and local market preferences. Use loyalty analysis to understand the most important items to a customer segment and protect them in the assortment.
- **Optimizing assortments.** Use customer loyalty, panel and T-log data to build consumer decision trees and understand switching behavior. Use these insights to build more efficient assortments with less duplication and more variety.

Merging marketing with merchandising

The retailers that derive the most benefit from a consumer-centric merchandising approach are those that embrace the powerful synergies that now exist between retail marketing and merchandising functions. Where organizational silos and barriers exist, these synergies and capabilities will require, but also help facilitate, much greater cooperation. Consumer-centric merchandising adds predictive power to techniques already in established use and permits deep understanding of data required by merchants and marketers alike. Included among applications that forward-thinking retailers are now exploring and applying are:

- Leveraging existing segmentation for direct mail, online promotions, in-store promotions and even in-store pricing and assortment
- Adding new segmentation insights based on consumer demand for marketing programs
- Layering new value onto the loyalty program, such as: which items are best to promote on the card, how to motivate customers with point or reward schemes and linking the loyalty card to other in-store promotions
- Understanding the in-store effects of marketing programs outside the store (e.g., modeling online and offline media variables)

Today's competitive advantage becomes tomorrow's competitive necessity

Demand modeling, consumer analysis and market research technology has matured and broadened its perspective to enable a range of strategic, demand-driven applications designed to empower retailers by bringing them back into contact with their customers. Now, for the leading retailers putting it into practice, consumer-centric merchandising is the next leap forward, permitting a blending of marketing principles with merchandising pragmatism, with exceptional positive impact on store image and customer loyalty, sales volume and the bottom line.

Consumer-centric merchandising is helping merchants to finally understand and influence consumer behavior by blending science-based insights about price, promotion and assortment with the artful judgments of experienced merchants. It is helping to enable market-leading retailers to mine the true potential of the many rich data sources available to retailers, and to assemble a coherent picture that guides smarter decisions and supports more targeted, strategic, planning and execution.

Winning retailers are putting consumer-centric merchandising to work today. They see it as a key discipline for refining strategies, driving profitability and growth and strengthening long-term customer loyalty. Today, these retailers are achieving competitive advantage and are out-executing many of their peers. But this advantage will only last so long. The winning retailers of tomorrow will be internalizing consumer centric methods and using them to drive success, rapidly making consumer-centric merchandising a competitive necessity in the increasingly competitive retail industry.

About IBM Commerce

IBM Commerce enables clients to uncover and realize new, sometimes hidden, growth and efficiency opportunities by infusing intelligence and context into key processes across the commerce cycle. Our market leading products and services help organizations orient their entire business around the customer from procurement to supply management, to marketing, merchandising, eCommerce, payments and customer analytics. Differentiated by deep industry expertise and service capabilities, we help our clients create value as they engage with their customers, partners and suppliers. This is the power of IBM Commerce.

For more information

To learn more about IBM's Omni-Channel Merchandising solutions, please contact your IBM representative or IBM Business Partner, or visit the following website: **ibm.com**/merchandising.

IBM Corporation
Software Group
Route 100
Somers, NY 10589

Produced in the United States of America
May 2015

ZZW03159-USEN-02