"Shift-to-Early"

How lifecycle pricing pays dividends for softlines retailers

IBM

Introduction

Softlines retailers face a specific set of challenges when it comes to maximizing sell-through and profit margins. While the trend-spotting, product design, and buying processes have long been considered art forms by expert practitioners in softlines retailing, current business pressures suggest a more empirical approach may be required.

Lifecycle Pricing – taking a systematic, science-based process – can offer substantial benefits by helping minimize steep clearance markdowns and helping to shift a greater proportion of sales toward mid-season promotions. It can also support shifting a greater proportion of seasonal sales toward full margin and away from mid-season promotions. When implemented on a geography-specific, cluster-specific, or even store-specific basis, the dividends can be even richer.

Lifecycle Pricing practice has become increasingly adopted – even essential – due in part to the availability of solutions that make it more practical and accessible for contemporary retailers. Leaders recognize the opportunity to apply empirical, scientific processes in order to better realize the value from their traditional areas of expertise – design, creativity, and trend-spotting.

This paper examines the present challenges and offers a realistic set of practices that can significantly reduce forecasting uncertainty, help enable better pricing decisions and improve profitability. Softlines merchants have a four-level opportunity to improve outcomes through an approach we call "Shift-to-Early." Lifecycle Pricing tools can help you:

1. Sell a larger proportion of goods at full margin by keeping more of the right items at full price longer into the season

2. Detect and promote slow-moving or over-inventoried items earlier in the season, and identify items that can be promoted to stimulate demand across the department, leaving fewer markdowns to follow

3. Improve depth and timing of markdowns for merchandise that remains

4. Tailor forecasting, promotion and markdown tactics on a localized basis to achieve better overall performance

The next sections will look in more detail at some of the characteristics that define the softlines business, with an eye toward its distinct opportunities. Later this paper will address how applying lifecycle pricing tools can help make the Shift-to-Early achievable.

Softlines defining traits

Softlines – generally defined as apparel, fashion and home goods - is a set of merchandise with its own rhythms, own timing, own challenges. A large proportion of softlines merchandise is expected to be on the shop floor for one season only, and virtually everything about the forecasting, ordering, merchandising, pricing, promoting and in-store practices is geared to that reality. Contrast that with fast-moving consumer goods categories, whose assortments may be dominated by staple items which may be regarded as perennial.

In the softlines world, merchandise from multiple sources must arrive in sync for each season, even though lead times may vary. Seasons wind down rapidly – often as quickly as 12 weeks, allowing little time for mid-course adjustments. Traditionally many items in the assortment are sourced from overseas factories due to cost-of-goods considerations, but the savings may come at the price of very early commitments – some orders must be confirmed months in advance.

Brief seasons and long lead times also mean there is little expectation of reordering for many fashion items. With the possible exception of replenishment of wardrobe basics, some branded merchandise, and some staple household items, merchants must play out the hands they deal themselves, each and every season.

Needed: An improved demand forecast

The requirement to lock in style choices and factory orders early on, can create inherent challenge areas and confusion for merchants. An improved demand forecasting mechanism could bring enormous advantages in the face of several notable trends:

- **Fast fashion.** The apparel industry has been a marked trend toward more "disposable", lower cost garments. In the past decade or so, so called "fast fashion" has been driven by notable retailers in Europe and North America such as Zara, Topshop, H&M, and American Apparel. Tactics may include: more frequent, smaller order quantities from foreign factories; local production in own factories or by local cottage vendors. The intent is to create a more nimble, shorter supply chain that can respond to fashion trends more quickly.

- **Rapid fire seasonality.** Seasonal collections are now specified beyond the traditional spring/summer and fall/winter. The trend has been toward more and shorter seasons – 8 to 12 weeks is not uncommon. Brief seasonal events, like back-to-school and Halloween also add to the challenge. Marketplace and competitive trends drive this for virtually all retailers, not just the fast-fashion proponents. The result is to require more decision cycles per year – for orders, prices, promotions and markdowns.

- **Long supply lines.** Despite the emphasis on speed, cost of goods remains paramount. Many softlines retailers must rely on traditional manufacturing cycles and overseas sourcing. This can require 12-18 months design-to-delivery lead times, a precarious factor when shipping into a 12 week selling season. No reordering may be possible if the forecast is off the mark. Retailers who do not manufacture or source all of their merchandise locally must contend with this. Many retailers employ a mix of local and overseas sources, which can cause lead times for a targeted season to vary widely, an impact felt by nearly all softlines merchants to a greater or lesser degree.

These realities squeeze the merchandising decision maker between conflicting objectives – find the lowest cost of goods, but also the fastest times to market. Reliance on instinct and experience helps with this challenge, but empirical, rapid forecasting tools hold the potential to help even more. Figure 1 illustrates how long leads and short seasons make for added pressure on price and sales performance.

Softlines: Time to Market vs Short Seasons = Pressure on Sales & Price

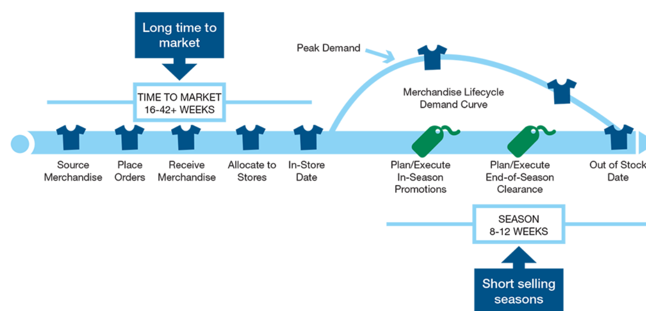

Figure 1: In softlines, merchants must pit time-to-market objectives against the need to hit narrower seasonal windows with precision forecasts, and proper pricing.

Merchants must play out the hands they deal themselves, each and every season.

Further challenges

Aside from the above mentioned realities testing softlines merchants, the challenges go further still:

- **Cost pressures.** With first world economies under recessionary pressure, retailers currently face tremendous, continuous customer demand for high quality merchandise at lower costs. They face a simultaneous upward pressure on manufacturing costs as standards of living increase, in some parts of the world, where many factories are located. The response by many has been to source more merchandise overseas in China, India, Southeast Asia, and other regions where labor costs are lower. However, this can add to lead times.

- **Commodity prices.** Costs of goods are further challenged by swings in commodity prices, due to economic and/or environmental issues. Cotton is an agricultural commodity and can be subject to supply interruptions due to bad weather, such as the 2010 flooding crisis in Pakistan that affected world markets. Shortage-caused price increases and availability uncertainty can toss traditional merchandising plans out the window, leaving the merchant with very limited options for response.

- **General complexity.** This is added by retailers' geographic and channel expansion. Many are omni-channel, selling through stores, online, catalogs, franchises and concessions (leased departments or boutiques) in larger retail stores. Aligning prices across all these points of contact is an ongoing challenge. Efforts to deliver locally relevant assortments and prices can add to the difficulty.

- **Seasonal variation.** Also, unlike the situation in fast-moving consumer goods, softlines retailers are seldom selling the same items season to season, year to year. This means demand forecast methods that are well proven in Fast Moving Consumer Goods (FMCG) are not entirely appropriate. At best, they will be directionally correct. Rarely will there be long-term baselines upon which to base forecasts. This is true except for a few wardrobe basics, certain styles of branded merchandise, or home textiles. As a result, merchants have a tendency to over-order to cover the season, which often leads to more markdowns than they would like at the end of the season.

- **Customer conditioning.** As a matter of considerable vexation to virtually all retailers, customers are becoming conditioned to anticipate heavy end-of-season markdowns. They shop the sales routinely, which is becoming easier to accomplish when seasons are shorter and more frequent. So merchandise gets bought at the beginning of the season, but then there is a lull in trading, as customers wait for the expected end-of-season clearance.

For many merchants, these factors mean in-season pricing decisions are like a game of "chicken." They lack a source of insight to help with crucial timing choices. Some parts of the assortment should be promoted earlier, others should be delayed. And decisions may vary across geographic markets, store clusters, and even individual stores. The old rule of thumb is less and less sufficient.

Time factors

A useful way to look at the softlines merchandise planning challenge is that it depends greatly upon timing. This paper has already addressed several key time factors in the preceding sections:

- **Fashion pace.** The speed to introduce new fashion items keeps getting faster.

- **Time to market.** Time to market is still a strongly influential factor on the merchandising decision process, especially when items are sourced from distant markets in order to keep prices competitive.

- **Shorter, more frequent seasons.** The duration of seasons is shorter than ever, which means merchants must hit narrower windows, more times per year, with narrower margins for error.

Those considerations alone constitute a solid basis for the conclusion that softlines retailers need to acquire improved merchandising lifecycle practices and the tools to support them. However the critical time factors do not stop there. The faster pace of today's softlines retail business also brings new intensity around two other factors:

- **Time to analyze.** The time required to analyze product movement situations and make confident decisions that can be acted upon during the selling season, while there is still time to influence performance outcomes. This is best enabled by automated analytics tools that can deliver insights on the fly as each selling season develops.

- **Right timing.** Improving the timing of key in-season decisions, such as which items to promote early in the season, in which geographies or stores, as well as determining the optimal times to take markdowns. Earlier analytics are a pre-requisite for this; the ability to rapidly re-forecast demand at the style and item level is the key enabler.

Softlines buying and merchandising teams regularly contend with an elongated time to design, develop, produce and ship the merchandise for a given season. Once the goods hit the back door, decision moments then come suddenly.
With selling cycles typically around 12 weeks, rapid decisions are needed on what is selling, what to promote, and what to mark down.

The good news is since we can anticipate that these decisions are coming, we can put a plan and methodology in place to confront and master them at the right moments in the seasonal lifecycle.

"Shift to Early" lets softlines retailers manage pricing across the merchandise.

Impact on price and promotions

These challenges have significant impact on price decisions for the softlines merchant. In even the best-case scenarios, some merchandise will sell faster or slower than expected within a defined season. Retailers are well aware that managing forecasting on virtually all these factors, using classical methods based upon professional instance and experience cannot achieve perfection.

Today's retailers also understand they cannot rely solely on drastic end-of-season markdowns and clearances to "paper over" their planning inaccuracies.

How can merchants best decide which styles should be promoted in season? At what level of discount? Should these choices vary by geography? By store? How soon should they pull the trigger?

A reliable, pragmatic process for adjusting item forecasts soon after the season begins could bring tremendous advantages to this decision making process. It would allow softlines merchants to identify and promote underperformers earlier in the season while standing firm on other item prices.
The ultimate, desired result would be far fewer "slash and burn" markdowns at the end of the season.

The cumulative benefit of these improved lifecycle pricing practices would be stronger margins and higher sell-through. A secondary positive consequence would be the signal it sends to customers about the value proposition.

To accomplish these highly desirable goals, retailers must have reliable, automated tools to help them make several sets of decisions within each +/-12-week sales cycle. Otherwise there is insufficient time to take these decisions.

Define a solution strategy

By recognizing the desirability of better forecasts, automated analytics, earlier promotion decisions and fewer, later markdowns, softlines retailers may define a number of relevant, achievable strategic goals for lifecycle pricing. These include:

- Mitigating the need to rely solely upon the same season last year or prior season forecasts that we know must be imperfect because so many causal factors have changed and the merchandise is different.
- Getting an early, more accurate read of merchandise performance within the first four weeks of the season, by style and item and across the portfolio of retail locations.
- Taking advantage of the capability to make adjustments in-season, including carefully selected promotions identified in the first few weeks.
- Making subsequent price and other adjustments for the duration of the selling season.
- Significantly reducing markdown exposure at the end-of-season by executing the above listed actions.
- Optimizing the depth and timing of markdowns at store, market or cluster level. Here the goal, of course, is fewer, later, and less deep markdowns, while still selling through.

Case example:

Softlines retailer responds

Last year, in an earnings call a major specialty apparel chain reported its 4th quarter profit had dropped by nearly 50 percent due to excess markdowns at end-of-season.

Worryingly, its gross margins had narrowed by almost 10 percentage points compared to the previous year.

The CEO indicates this firm is now shifting focus toward what he calls "higher quality revenues" (i.e., more full-price sales) as a strategy to prevent this from re-occurring.

In the next section, this paper will discuss how problems like this could potentially have been avoided using lifecyle pricing tools that enable a shift to earlier, corrective decisions, beginning with improved forecasting. Promotion decisions can be made earlier in the season on only the most underperforming items, and at more modest discounts. The result is more full-margin sales early, and fewer margin-robbing clearance.

A better way - "Shift to Early"

A superior business approach for softlines merchants can bring benefits at three crucial stages of the selling season. Figure 2 illustrates how full-price sales, fuller margins and fewer markdowns can be enabled using lifecycle pricing solutions.

Shifting to a Lifecycle Price Management Approach

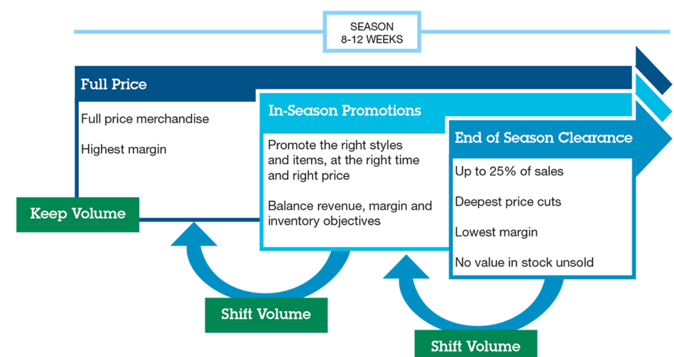

Figure 2: The "Shift to Early" means maximizing the full-price volume to support margins, while promoting the right items in season at the right times, and minimizing end-of-season clearances.

Retailers know they cannot manage forecasting with perfection using classical methods based upon professional instinct and experience.

"Shift to Early" means adopting a lifecycle price management approach, which leverages the advanced science and automated analytics in the IBM DemandTec solution designed to keep more full-margin sales while significantly reducing drastic markdowns. It is summarized by the following three principles:

- **Keep the early volume**. Identify which styles and items you can keep at full price. This permits highest proportion of full-price, full margin sales. Locking in early profits tends to reduce the pressure to pull the trigger later in season.
- **Shift in-season promotions**. Analyze item movement in the first few weeks of the season to identify items that will continue to sell well at full price. Promote a smaller subset of styles and items at the right times and without taking excessive discounts. This allows for a better balance of revenue, margin and inventory objectives.
- **Shift end-of-season clearances.** These commonly represent up to 25 percent of gross sales and are subject to the deepest price cuts. Since they capture the lowest margins they can have a negative effect on net profits. On the other hand, no value is received from stock left unsold. Where possible, shift more of these items earlier to mid-season promotions to sell through earlier at somewhat better margins. Delay final markdowns where possible to significantly reduce margin impact and unsold merchandise.

"Shift to Early" lets softlines retailers manage pricing across the merchandise lifecycle. It can be effective at increasing full price sales, and helping enable merchants to promote the right styles at the right time within the selling season. Precise markdown depth and timing can contribute to improved overall gross margins.

Lifecycle pricing benefits

IBM DemandTec Lifecycle Price Management for Softlines helps enable retailers to increase their revenue and maximize margins by planning, optimizing and executing better in-season and clearance pricing decisions. The benefits are significant:

- Help maximize volume, revenue and profit by managing pricing across the merchandise lifecycle.
- Improvements in gross margin can reach 7-10 percent.
- Increase sell-through rates with pricing decisions based on true customer demand, tailored by merchandise grouping, style, store, etc.
- Improve inventory productivity and reduce the levels of excess end-of-season inventory that traditionally have forced deep markdowns
- Operational efficiency gains, by automating and streamlining the weekly markdown pricing process

When implemented on a geography-specific, cluster-specific, or even store-specific basis, the dividends of lifecycle pricing can be even richer.

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