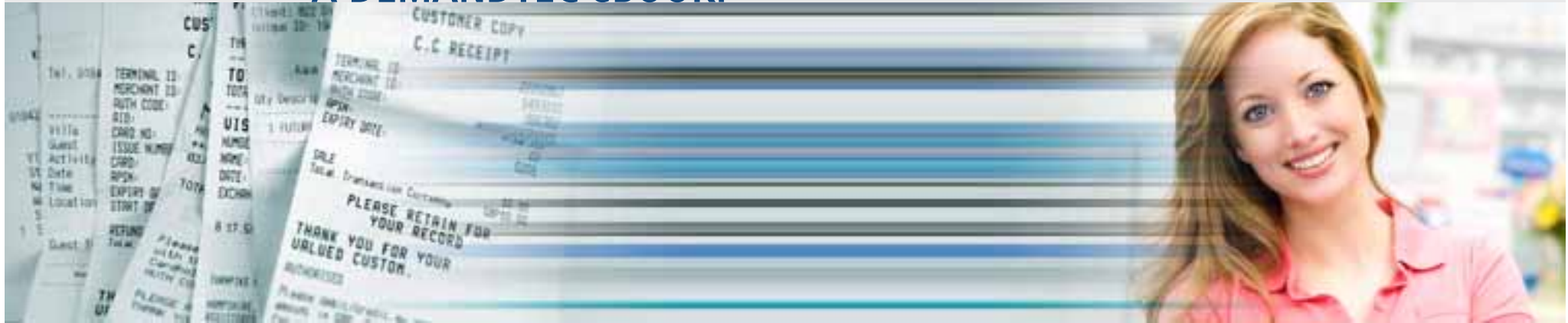**DemandTec**®

A DEMANDTEC eBOOK:

next GEN

OF MERCHANDISING & MARKETING

Customer Insights at the Point of Decision

nextGEN

OF MERCHANDISING & MARKETING

Customer Insights at the Point of Decision

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In the mass-market era, the customer became an abstraction – a mass market responding to mass methods.

RETAIL EVOLUTION AND CUSTOMER INTIMACY

The "good old days" of mom and pop retailing have faded to a pleasant, sepia-toned reminiscence.

In that magical time, early in the last century, understanding customers' needs seemed easy. Shop owner-operators knew their customers by name and their preferences by heart.

Merchandising wasn't very scientific, but it was personal and, in its way, intimate.

With the explosion of mass media and the economic expansion of the 1950s, mass retailing boomed also, to feed the surging demand of a culture oriented around consumption. Manufacturers could reach customers with a 30-second spot on three TV networks and a coupon in the Sunday paper. Retailers rolled larger and larger stores out across the landscape, pacing the expansion of suburbia and serving the hegemony of the national brands.

In the mass-market era the customer became an abstraction – a mass market responding to mass methods. For a brief, golden period, merchants could stack 'em high and watch 'em fly.

The growth of mass markets led over time to industry consolidation and the emergence of truly national and global retailers. By the 1980s and 1990s we were experiencing an explosion of consumer product choices and media outlets. Retail chains grew larger and more operationally intricate, even as cable television and the Internet caused audiences to splinter.

Retailers and manufacturers adapted by adding technologies to their arsenal. By the 1990s, retailers were hiring consultants to build econometric models representing consumer demand and provide advice on pricing, promotion and assortment to optimize their categories. By the turn of the century, these techniques were packaged into software tools designed to enable demand modeling, forecasting and optimization on a repeatable and scalable basis. Retailers reaped significant rewards from category-centric merchandising optimization, with the ability to better meet consumer demand and achieve their business objectives.

But, along the way, true intimacy with the customer had been lost. Even sophisticated demand analytics could only reveal a story about the average customer.

Today mass is past as are one-size-fits-all analytic models. The new era is all about segmentation.

In the next generation of retail, demand analytics and optimization intersect with customer segmentation in brave new ways. And retailers are prepared with next generation tools built to let them *operationalize* their segment strategies in both merchandising and marketing.

At DemandTec, we call that **nextGEN** *retailing.*

Operationalize segment strategies in both merchandising and marketing.

segmentation

THE MYTHICAL AVERAGE CUSTOMER MEETS SHOPPER MARKETING

Despite years of entrenched mass merchandising practices, all retail professionals know instinctively there's no such thing as the average customer. Each individual differs in his or her desires and preferences. In fact, they vary with every trip to the store.

Even in today's complex store environments, customers leave hints about themselves with every transaction. For decades, retail marketers have taken advantage of this data with customer segmentation programs that uncover behavioral traits of different groups of customers. These investments have resulted in better performance across their marketing programs. However, the category-centric optimization tools used by the merchants did not support insights and decisions at a segment level.

The Death of "Average" – What's Driving Retail Evolution?

MASS ERA RETAIL	NEXT GENERATION RETAIL
Mass markets	Segmented markets
Mass media	Targeted media
Prototype store	Clustered stores
Uniform assortments	Cluster-level assortments
Treat all customers the same	Focus on key customer segments
Share of market	Share of wallet
One optimized price	Segment-targeted prices

The opportunity to regain customer intimacy has always been with us. We just needed to find the right ways to marry the merchandising optimization techniques with customer segment strategies.

nextGEN retail

We can put individual faces back on our customers. We can get to know them personally again. We can learn to see what makes them different.

As retailers and manufacturers adopt new tools for understanding and managing customer data, we confront promising new opportunities. We can put individual faces back on our customers. We can get to know them personally again. We can learn to see what makes them different.

We can meet their needs and exceed their expectations.

In the next generation of retail, we understand which customers are most valuable to our long term success and what they find important.

This means we merchandise and go to market based on customer and segment insights as well as category and brand objectives.

Just knowing isn't enough. We need to take effective action on this new and improved understanding. Routinely. By embedding highly responsive practices into our operations every day.

nextGEN technology is ready to help us renew our intimacy with the customer, target our plans, and deliver competitive advantage.

competitive advantage

OPERATIONALIZE YOUR CUSTOMER SEGMENTS

For retailers, merging advanced customer segmentation with merchandising optimization capabilities can have a huge impact on the business. The shift from mass and average to targeted and differentiated has a profound effect in how retailers:

- Optimize merchandising and marketing together
- Plan assortments and understand image items by customer segment
- Tailor promotions to the right customers
- Set competitive, effective prices
- Collaborate with consumer products (CP) partners

In the next generation, all of these transition from an optimization process based on averages to a more finely-tuned process that detects and leverages the variability in demand among customer groups.

Optimize Merchandising and Marketing Together

Strategy	Planning & Execution	Measurement
Financial Customer Category	Customer	Customer Segment: ▪ Trips ▪ Total Spend ▪ Category Conversion
	Category	Category: ▪ Sales ▪ Profit ▪ Volume

Collaboration and Master Calendar

Retail strategy defines various goals in key areas: financial, customer and category. Plans flow from these objectives, informed by customer insights and our best understanding of demand.

To be effective, we must tune our planning and execution process to address both category objectives like sales and profit, as well as customer objectives like trips or loyalty.

The new breed of retail applications extends optimization science in exciting new ways:

- Customer segmentation becomes integral to the merchandising optimization process
- Customer insights are embedded at the point of decision
- Superior planning and collaboration are enabled with consumer products suppliers

In next generation retailing we combine segmentation and merchandising optimization and can act on subtle yet important segment differences. We know intuitively that young families with children have different purchase priorities than retired empty-nesters, to cite one clear-cut example. No amount of price cutting will motivate Golden Oldies to purchase more baby formula. That's easy to guess even without optimization tools.

But hundreds of more subtle, yet enduring, purchase preferences that define customer segments may be very difficult to identify without next generation tools that automatically sift the data for actionable differences. "Broadcast" merchandising methods overlook these differences, spreading finite resources too thinly, leading to results that may be good, but could be better.

Combining merchandising optimization with customer segmentation lets us identify and incorporate segment differences into our decisions.

If Golden Oldies are a strategically important segment in our stores, we need to identify and pursue merchandising and marketing programs that will be meaningful to them and elicit desired purchase behaviors.

Combining merchandising optimization technology with the discipline of customer segmentation lets us identify and incorporate a host of segment behavioral differences into our merchandising and marketing decisions. To operationalize our customer segment strategy, we need:

- Merchandising technology for assortment, pricing and promotion
- Optimization and segmentation combined and actionable for planners at the point of decision
- Active collaboration with CP partners

This integrated approach to merchandising activities defines next generation retailing.

If you delist a product, how much of that product's demand will shift to other products in your assortment, and how much will disappear from your store?

Plan Assortment and Understand Image Items by Customer Segment

The evolution of retail technology has led naturally to the application of optimization science to assortment planning decisions.

Of particular value are concepts of *transferable demand and incrementality*. An understanding of these two principles will help you understand how substitutable products are, and ultimately if you delist a product, how much of that product's demand will shift to other products in your assortment, and how much will disappear from your store.

Next generation retailing takes these concepts a step further, applying them at the customer level to understand how each segment behaves with respect to transferability and incrementality.

The implications may not be obvious.

Optimization science reveals that some strong-moving items add relatively little to category performance if the customer can easily replace them with other items if they were to be delisted. Other, slower moving items may be highly incremental – representing "plus" business that will be lost for good if the item is delisted.

The key opportunity here is to apply the transferability and incrementality analyses within each category by customer segment. We can then roll this up to an assortment plan that weighs the relative importance and contribution of each segment and the cumulative results of different assortment decisions.

TOP IMAGE ITEMS IN CEREAL ACROSS ALL SEGMENTS

- Top cereal image items across segments dominated by Kids and Family SKUs.
- We can quantify which are most valued overall.

Item "Strength"

| 5.23 | 4.26 | 3.82 | 3.65 | 3.30 | 3.29 | 3.04 | 2.92 | 2.84 | 2.80 | 2.78 | 2.71 | 2.67 |

TOP IMAGE ITEMS IN CEREAL FOR GOLDEN OLDIES SEGMENT

- Not surprisingly, Golden Oldies buy mostly Adult and Family cereal.
- We can identify which of these are their top Image Items.

Item "Strength"

| 4.69 | 4.60 | 3.52 | 3.36 | 3.32 | 3.28 | 3.26 | 3.07 | 3.01 | 2.81 | 2.72 | 2.66 | 2.39 |

It's no longer sufficient to optimize assortment only for a category. We need to understand the impact on specific segments, and protect or add items of particular importance to key segments.

This discipline applies equally well to gain an understanding of which items are image items for which segment. While some image items largely cut across the board, others are image items only for specific customer groups.

Our Golden Oldies segment, for example, may skew more strongly toward the purchase of certain unsweetened cereal brands, while the category overall may show much greater movement on kid-oriented pre-sweetened varieties. Here again, if we deem Golden Oldies to be an important strategic segment, our overall category assortment plan and pricing of key image items may require a degree of accommodation to their preferences that might not be revealed if the cereals were studied only at the category level.

But knowing isn't enough. Merchants need these insights embedded in the technology they use to help make decisions about assortment, price and promotion. In other words, if I'm using technology to help me make better decisions about what promotions to run, I want insight about how these promotions will impact various customer segments right on the same screen.

Tailor Promotions to the Right Customers

Next generation retailing applies segmentation and targeting principles throughout the promotion process. It adds value across the entire sequence of actions, from: managing deals; to optimizing promotion plans; to advertising execution; and measurement.

At each stage, the game changes when we consistently ask the question: "for which segments…?"

The next generation customer focus leads retailers to:

- Target promotions for specific segments
- Vary ad versions by segment
- Track and understand response by segment

Along the way we conserve finite promotional resources, and apply the effort and dollars where they will be most effective – toward the customer segments that care most about the category or the brand or are most valuable to the business. This capability naturally leads retailers to work more collaboratively with vendors on trade promotions.
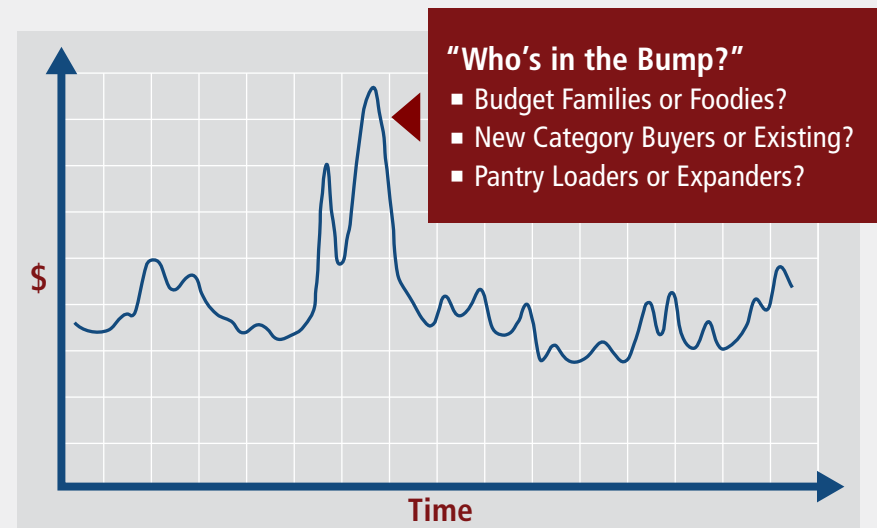

tailored promotions

Who's in the "bump" and to what merchandising levers do they respond?

Differentiating between customer segments reveals and *makes actionable* very profound and valuable insights about promotional performance.

Different segments respond differently to different promotions.

While this may seem intuitive, until the arrival of next generation retailing solutions we had very limited capability to act on this understanding. Promotion lift was calculated across the entire store and customer base, without understanding its behavioral elements.

But when you see a bump in sales the obvious question is *"who's in the bump?"* And who's not. Very often, 80% of the impact is accounted for by 20% of your customers.

"Who's in the Bump?"
- Budget Families or Foodies?
- New Category Buyers or Existing?
- Pantry Loaders or Expanders?

$ / Time

performance

Moreover, it is important to understand which promotional levers work for which customer segments and in which categories.

		COFFEE	DIAPERS	CEREAL
YOUNG FAMILIES	TPR		▲	▼
	Feature	▲	▼	▲
	Display		▲	▲
	Multiple	▼		
BUDGET FAMILIES	TPR	▼		
	Feature	▼		
	Display	▼		
	Multiple	▲	▲	▲
GOLDEN OLDIES	TPR			
	Feature			
	Display	▲		▲
	Multiple			

Young Families very sensitive to most promotion levers for most categories ←

Budget Families not as responsive to coffee promotions ←

Golden Oldies sensitive to display ←

In the example on this page, Golden Oldies show a strong promotional response when coffee is on display. In contrast, Budget Families are unmoved. But looking across the row, it's clear that Budget Families are generally more responsive to multiple pricing, although this leaves Golden Oldies generally cold. Next time around, if the goal is to grow coffee sales to Budget Families, we might try the "two-fer" lever, but we shouldn't expect much bump from the Golden Oldies.

Targeting promotions to specific customer segments will inevitably lead to an increase in versions of your flyers and other marketing deliverables. Would your system be able to handle a doubling or tripling of versions? Retailers need a buttoned-down system to keep a lid on this added complexity. Automating those capabilities with next generation solutions lets them support and execute promotional strategies by customer segment, category and geography.

response

Set Competitive, Effective Prices

Leading retailers have been benefiting from price optimization tools for a decade. Adding segmentation improves targeting and offers a substantial opportunity to improve decision-making accuracy throughout the pricing lifecycle – from base or everyday prices, to promotion prices, markdowns, pricing rules and price maintenance.

It begins with customer focus made possible by the application of next generation retail solutions:

- Identify price sensitive SKUs *by segment* across store
- Identify storewide image items *by segment*
- Identify price points that drive sales *by segment*

When we optimize pricing for target segments, we also seek an understanding of the unavoidable tradeoffs. What happens to other segments and the total business when you implement those prices?

So for example, if I decide to optimize prices for my most important segment—say Foodies—what happens to my overall forecast? It is quite possible that I can raise the price of an item for Foodies and improve performance for that group, but at the cost of a lower overall forecast. Depending on my goals, it may still be the right decision, but it is crucial that I have a detailed understanding of the impact of my decisions.

Needless to say, you can't do this forecasting in your head – you need next generation technology.

When we optimize pricing to target segments, we also anticipate the impact on other segments.

effective prices

By sharing data on a common platform, both parties can use the same online reporting capability to track and understand the impact on category growth, new customer attraction, or any meaningful behavioral impact on key customer segments.

Collaborate with your Consumer Products Partners

Trading partner collaboration is another area that is evolving rapidly. In next generation retailing, it goes well beyond after-the-fact reporting and data sharing to incorporate real-time collaboration on a common online platform.

Access to segment level performance data permits your CP partners to visualize what items should be put on deal, and which deals and promotions drive impact on the category.

From a customer standpoint, your CP partners can see and predict which promotions actually drive certain customer segments and who is responding to specific promotions. When CP partners work closely with retail category managers they'll have the insight to what the strategy is and which shopper segment is being moved by that merchandising or promotional action.

By sharing data on a common platform, both parties can use the same online reporting capability to track and understand the impact on category growth, new customer attraction, or any meaningful behavioral impact on key customer segments.

collaborate

DemandTec®

nextGEN: PUTTING IT ALL TOGETHER

In a varied and differentiated marketplace, where different customer segments display enduring behavioral differences, merchandising to an average shopper can no longer be expected to deliver superior performance.

Breakthrough results require new thinking and new approaches that recognize and reflect the differences that define customers.

nextGEN solutions from DemandTec let you operationalize your customer segmentation in these crucial areas:

- *Optimize merchandising and marketing together* – Tune the planning and execution process to be more responsive to the differences between customer segments.

- *Plan assortments and image items* – Optimize assortments for category growth, while keeping in mind specific needs of specific customer segments.

- *Tailor promotions* – Manage the end-to-end promotion process from collaborating with vendors through planning promotional activities, forecasting outcome, and executing on highly targeted and versioned campaigns.

- *Set competitive and effective prices* – Optimize prices across the product lifecycle with an eye on the impact of pricing decisions on various segments.

- *Collaborate with CP partners* – Share planning with CP partners across our collaborative DemandTec TradePoint Network™, using a common online platform that is secure and dependable and delivers access to powerful insights and forecasts.

At DemandTec, that's what we call nextGEN.

For more info on how you can get to the nextGEN, contact us at call 888.676.3626 or visit www.demandtec.com.

ABOUT DEMANDTEC

DemandTec *(NASDAQ: DMAN)* enables retailers and consumer products companies to optimize merchandising and marketing decisions, individually or collaboratively, to achieve their sales volume, revenue, and profitability objectives. DemandTec software services utilize DemandTec's science-based software platform to model and understand consumer behavior. DemandTec customers include more than 195 leading retailers and consumer products manufacturers such as Ahold USA, Best Buy, ConAgra Foods, Delhaize America, General Mills, H-E-B Grocery Co., Hormel Foods, Monoprix, PETCO, Safeway, Sara Lee, The Home Depot, Walmart and WH Smith. Connected via the DemandTec TradePoint Network™, DemandTec customers have collaborated online with over 2.3 million trade deals. For more information, please visit *www.demandtec.com*.

CONTACT US

DemandTec
1 Circle Star Way
San Carlos, CA 94070
USA

Inquiries:
Phone: +1.650.226.4600

Please visit www.demandtec.com

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