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D E M A N D B E T T E R

**Consumer Demand Management:  
Strategies that Drive  
Merchandising Success**

**A DemandTec White Paper**

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## CDM: Strategies that Drive Merchandising Success

### Cherry Pickers or Jackpots

Big-box retailers don't gamble. They rely on systems that play to the strengths of efficient supplier and distribution networks. They deliver bulk-rate items to a generic customer base, which forces you and other competing retailers to gamble on pricing and promotions to try and keep pace.

These levers can't be left to chance. Promotions, Regular Pricing, Markdowns, Product Assortment, and Placement are important motivators of the shopping experience that can differentiate your store from your competitors in the minds of the consumer. To improve the odds, you need a suite of consumer demand applications as fail-safe as the Wal-Mart supply network to take the gamble out of your merchandising strategies.

Consumer Demand Management (CDM) is the only proven system to help you optimize the levers of demand with an understanding of consumer behavior at its lowest granularity. CDM finds your most valuable customers, defines their shopping "mission" or purpose for their visit, and helps you leverage everything within your power to relentlessly motivate them to increase their spend in your stores.

Why gamble when you can have a system that applies proven demand technology to solve some of your most difficult challenges? Here are the ways CDM turns the tables on traditional merchandising.



### Know the Cherry Pickers

**The gamble:** You promote baby food at a price that beats most of your competitors by 10 percent. You hope the extra traffic will lead to increased sales throughout the store. The problem is you don't know whether this strategy will attract valuable customers or simply lure cherry pickers into the store.

**The system:** CDM enables you to segment and rank your customers by analyzing all available forms of data: POS, market basket, loyalty, syndicated and panel data. Each provides valuable insights into consumer behavior; for example, POS data reveals a product-centric view of cross-category volume relationships between products, the relative effectiveness of promotions across products, and is an excellent starting source for quantifying cannibalization and dominant halo effects. Transaction-log (T-log) data

captures granular consumer-level information which is crucial for understanding traffic generation, identifying total store affinities, and generating anonymous segmentation insights based on basket profitability or contents. Loyalty data provides even further segmentation insights. Through these analyses, CDM helps you differentiate the buying behaviors unique to your valuable customer segments, and rank every item and category by their potential to help guide your customers' spend.

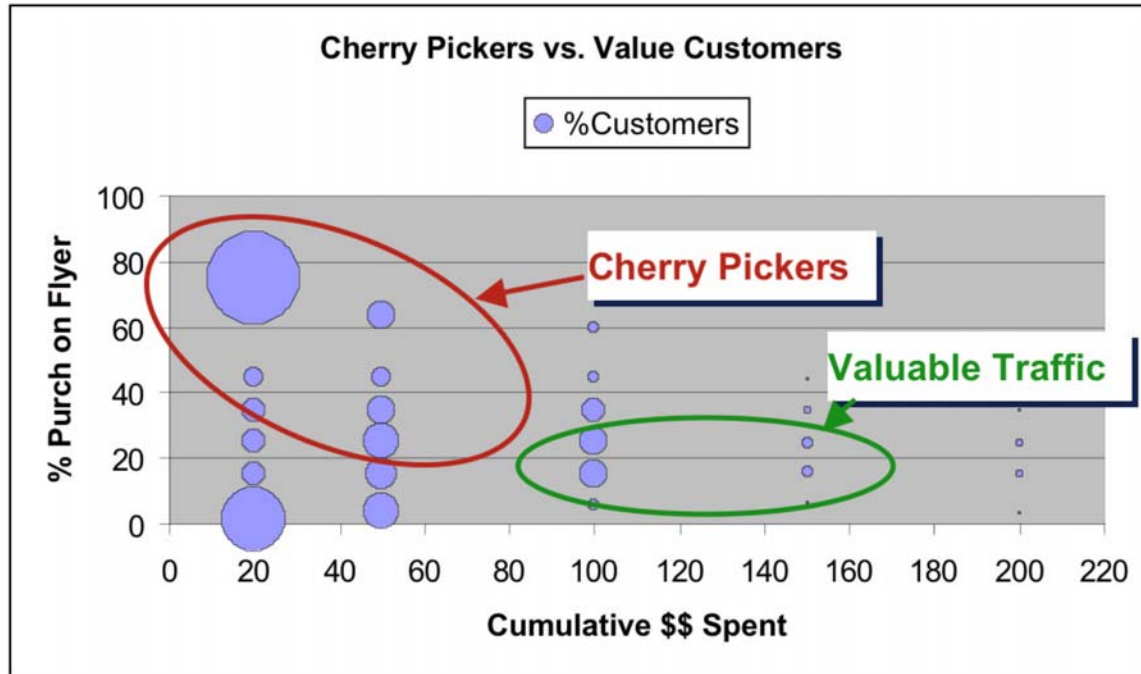


Figure 1: Cherry pickers may comprise your largest customer segment. The goal is to use market basket analysis to identify the mission of your more valuable customer segments, and execute merchandising strategies to increase their numbers and basket size.

Figure 1 illustrates the importance of being able to segment and rank your customers. Targeted analysis of the baskets of valued customers reveals what they typically purchase, and enables you to build strategies that reward and exploit the cross-category nature of their mission. It also helps you avoid falling prey to cherry pickers, which is not only inefficient, but may cause you to run out of stock for your valued customers.



## **Know the Market Baskets**

**The gamble:** You plan to reduce prices on hundreds of items based on market basket analysis conducted in a “representative” store in your chain. You hope this proxy data addresses the needs of your valuable customers, because analyzing market-basket data for every store traditionally is far too time-consuming. The problem is you don’t know if these items will increase high-potential traffic in any given store, or the chain as a whole. You don’t know if the promotion will lead to profitable market baskets, cannibalize other items, or erode regular shelf prices.

**The system:** CDM leverages massive mathematical modeling engines to systematically analyze terabytes of data and deliver unique and accurate elasticity and cross-elasticity relationships for every item in the store. This is the only way to determine cannibalization and halo effects associated with price changes on complements and adjacencies, and to distinguish true relationships from coincidence for the entire store. Vitamin sales may jump when the price of beer is lowered. Sales of cell phone accessories may languish when the price of printer toner rises. But which relationships are meaningful? Which items increase the likelihood of cherry picking? Which brands truly promote additional spend and encourage greater and more frequent patronage?

CDM leverages POS, T-log and loyalty data to accurately identify “driver” or “pull-thru” relationships. These affinities are extremely valuable for strategic pricing and promotional planning. For example, if CDM has found that video game software is a traffic builder for CD-RW disks, these items become candidates to be promoted or displayed together.

Let’s examine the process. In the following example, CDM is used to measure and rank market baskets, and identify what’s in the most profitable baskets: in this case premium juice, gourmet coffee, yogurt and deli turkey. Analysis of the baseline tells us premium juice leads in revenue at \$300,000. Analysis of historical merchandising response shows us the TPR lift, flyer lift and subsequent cannibalization effects in real dollars. Focusing on the pull-thru of premium juice, we see that promotion of this segment boosted sales of dry cereal, cookies, cola and other items for a total of \$110,000. In this example, further drill down on the premium juice segment will reveal that the Tropicana brand drives the most total store value when promoted.

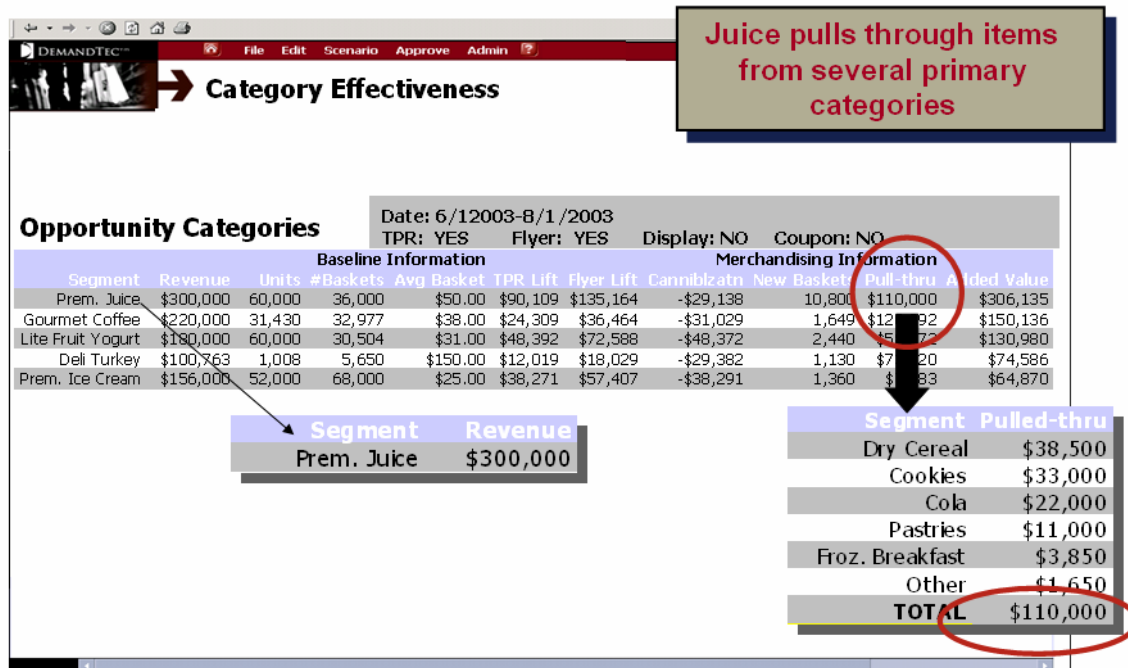


Figure 2: CDM is used to measure, rank and target profitable market baskets, enabling you to drill down and identify pull-thru items. Further drill down of the premium juice segment will reveal Tropicana brand drives the most total store value when it goes on sale.

Once the Tropicana brand has been identified as the key driver, CDM enables you to leverage this knowledge and create and test a variety of promotional scenarios in a virtual environment and compare their ability to grow market baskets. Next, you can compare your team’s baseline promotion forecast with a CDM optimized promotion that takes all rules, constraints, and volume adjustments of competitive and complementary items into account. Finally, these promotions can be executed, and results monitored and measured for market basket impact.

This process delivers merchandising recommendations that improve the number of valued customers, increase the number of items in their baskets, and raise the profitability of your various customer segments. Ultimately, market basket results are weighed with promotional allowances and activity costs to determine if net revenue and profits are meeting corporate expectations.



## Know the Financial Impact

**The gamble:** You've received a number of vendor offers for items that you are considering to include in your assortment and promotion plan. Your vendors claim to know your customers. The problem is you don't know if the brand-specific vendor recommendations will eat into category sales, and you have no way of determining total store impact.

**The system:** Market basket impact and total store impact should complement each other. If not, there are errors in the targeting. To arrive at total store impact, CDM factors in the additional purchases of promoted items and all complementary items (due to the promoted price and increased store traffic), less the reduced purchases of substitute items.

Figure 3 is a real-world example of how a category manager used CDM to increase the overall effectiveness (measured by total dollar value) of a promotion by more than 60 percent, while also increasing its overall efficiency (measured by the cost per incremental unit) by a factor of three.

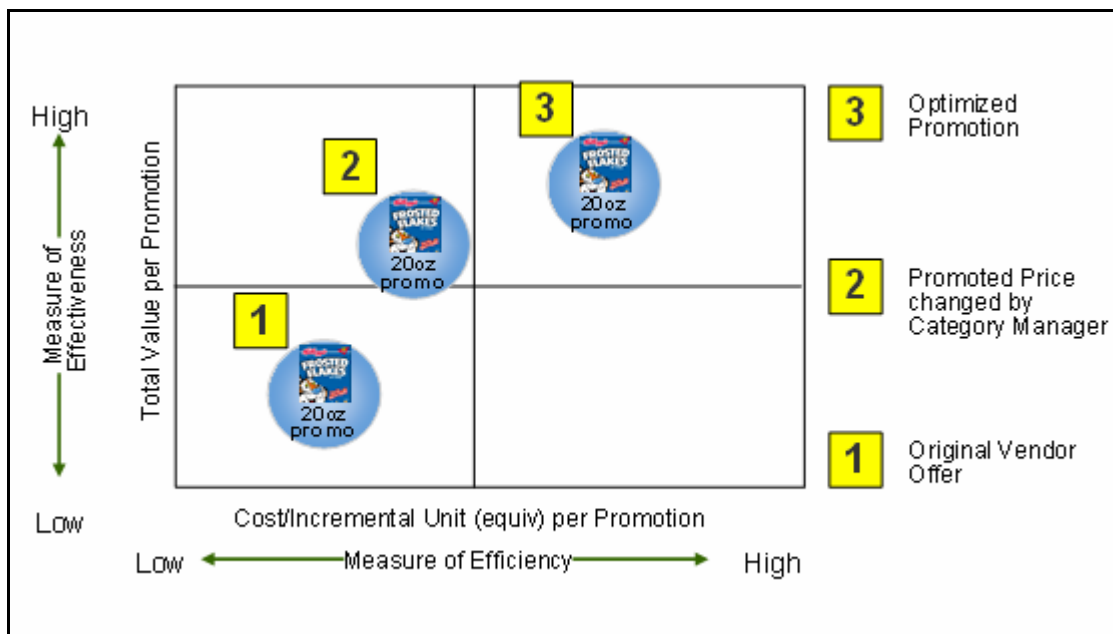


Figure 3: How CDM helped increase the effectiveness (total dollar value) and efficiency (cost per incremental unit) of a national brand cereal promotion over the original strategy of the category manager.

Knowing the total store impact of merchandising strategies is essential to improving the vendor relationship. It provides you with a fact-based analysis of how promotions and allowances will impact your valued customer segments and corporate financial metrics. This serves as a powerful tool to help you negotiate mutually-beneficial solutions with your vendors, which is increasingly important in light of recent Promodata research that predicts manufacturer allowances remaining flat this year.



### **Know the Strategies**

**The gamble:** Your category manager wants to revamp the entire category to emphasize the hottest new items. He hopes to cater to the adventurous crowd. The problem is you don't know the market basket impact, the activity and labor costs, and ultimately whether this bold move will hurt profits and alienate valuable customers. How can you get a holistic view of the impact?

**The system:** CDM integrates all of your data sources in a single repository, analyzes this data with proven consumer demand modeling techniques, and provides tools for forecasting user-defined scenarios. It enables you to test and evaluate the impact of price, assortment and display changes in a virtual environment well before the changes have been implemented. Moreover, a robust CDM solution delivers on the practical concerns of executing merchandising strategies, taking into account the complicated but necessary rules that govern your business. For example, all retail shelf signs must be properly assigned. Any overlap in rules of regular pricing and promotions must be reconciled. Finally, results of merchandising strategies must be continuously monitored and reported in a simplified manner to enable pricing teams to manage by exception. The last thing your managers want is a deluge of minutiae that distracts them from the more important role of strategizing and negotiating.

Now is the time for better strategizing and negotiating. News stories abound with retailers posting losses because competitive pressure prompted them to bet the farm on price reductions that ultimately cut deep into gross margin and failed to stimulate top-line growth. A key reason for failure is choosing the wrong items to promote and setting the wrong regular shelf prices.

However, there are clear signs of a silver lining in these reports. According to *Supermarket News*, nearly a third of U.S. retailers rank price optimization technology as their highest priority, up from only 10 percent in 2003. A recent Gartner/RIS survey of retailers shows as many as 60 percent plan to have price or promotion optimization software by 2005. Like scanner technology in the early 80s, the novelty of CDM is

quickly become the industry standard. There is little doubt the stiff competition of big-box retailers is driving this trend. There is even less doubt that holding on to the traditions of me too promotions and shelf prices are dangerous gambles. The science of CDM is a system that guarantees the “house always wins.” So if you are waiting to see if your competitors implement CDM before you do, you may want to ask yourself: is this something you really want to gamble on?

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