Merchandise Forecasting and Budgeting

The Process of Merchandise Planning

Customers visiting a retail shop, very often, know what they wish to purchase; they may however, be unaware of the specific size, variant or type of product that is best suited for their needs. After an initial assessment of the products available, they may arrive at a decision in terms of the specific product that they wish to purchase. It is at this stage that the merchandise that the retailer has on offer in the store plays a critical role in determining whether the purchase is made or the customer takes his search for the products elsewhere.

We understood the function of buying and merchandising varies from organization to organization, depending on the size of the organization, the region that it operates in, the products sold etc. The significance of this function stems from the fact that the product is an integral part of the retail function. The products to be retailed in the stores have an impact on all other functions and therefore this function, immaterial of the size of the organization, can never work in isolation.

The Concept of Merchandise Planning:

The retailer’s reason for existence or his vision and missions for being largely dictates the business strategy adopted. A part of this strategy is also the retail model that he chooses to operates in, which in turn determines the type of product, the price etc., that is retailed in the store. Therefore while the retailer’s business mission dictates merchandise planning the starting point of merchandise planning is in analysis. Merchandise planning can therefore, be defined as the planning and control of the merchandise inventory of the retail firm, in a manner which balances the expectations of the target customers and the strategy of the firm.
Merchandise planning is beneficial to the customer and to the retailer. It benefits the retailer as it enhances the possibility of the right assortment of goods, with the adequate amount of depth, to be available at the stores where it is needed. The process of merchandise planning further enhances the possibility of increased stock turns, thereby releasing important working capital. From the point of view of the customer, it is beneficial as it increases the choice available to him and reduces the possibility of facing a situation when the store is out of stock of the merchandise needed.

**Determining the Merchandise Requirements**

Planning is essential to provide direction and serve as a basis of control for any merchandise department. In order to be able to provide the right goods to the consumer at the right place and time, one needs to plan a course of action.

Planning in merchandising is at two levels:

1) The creation of the Merchandise Budget, and
2) The Assortment Plan

There are two methods of developing a merchandise plan. They are top down planning and bottom up planning. In top down planning, the top management works on the sales plan and this is passed down to the merchandising team. On the other hand, in bottom up planning, individual department managers work on the estimated sales projections. These are then added up to arrive at the total sales figures.

After the sales forecasting exercise has been completed, inventory levels need to be planned. The merchandise budget is the first stage in the planning of merchandise. It is a financial plan, which gives an indication of how much to invest in product inventories, stated in monetary terms.

The Merchandise Budget usually comprises of five parts:
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1) The sales plan, i.e. how much of each product needs to be sold this may be department wise, division or store wise.

2) The stock support plan which tells us how much inventory or stock is needed to achieve those sales.

3) The planned reductions, which may need to be made in case the product does not sell.

4) The planned purchase levels i.e. the quantity of each product that needs to be procured from the market.

5) The gross margins (the difference between sales and most of goods sold that the department, division or store contributes to the overall profitability of the company).

The Assortment Plan on the other hand, details the merchandise that will be sold in each product category i.e. the complex mix of products that will be made available to the consumer. This is the next stage after having determined the money available for the inventory. At this stage, it is also necessary to be clear about some of the constructs commonly used in merchandising parlance.

**The Merchandise Hierarchy:**

Every retail organization has a merchandise hierarchy which is an indicator of the manner in which product classification is done. It is in a logical manner depending on the manner in which the customers are likely to buy the products. Let us take the example of a supermarket to understand the concept of merchandise hierarchy.

The first level of identification is the store itself. Depending on the product needed by the customer, he would decide on the store that he wishes to visit. After entering the store the customer looks for a particular product – the first point of demarcation here is the category or the department from where the product is likely to be available. Let us assume here, that the customer wishes to buy a shampoo and groceries. Typically, within a supermarket the classification of merchandise would be:
1) Fresh groceries
2) Ready to eat – snacks, biscuits etc
3) Additives / Masalas / Pickles
4) Personal hygiene products
5) Cooking aids – like ready pastes etc
6) Necessities like dal, sugar, salt, oil, atta, etc
7) Soft drinks / juices and the list continues

This would be the fist level of merchandise hierarchy. The next level of classification would be the various categories of products that the retailer offers in every department. For example in ready to eat, the product offered could include biscuits, chips, wafers, branded snacks like Haldiram’s etc. This is classification at the category level – the next level in the merchandise hierarchy. Many retail organizations refer to this classifications refer to this classification as merchandise class.

Now, within chips and wafers the products could be salted wafers, branded wafers, wafers in different flavors etc. This is the next level which is termed as the sub category. Typically at this level, merchandise is separated on the basis of the features that it has. Organizations, which refer to the earlier level of classification as class would refer to this level of merchandise hierarchy as the sub class.

The next level of classification could be on the basis of style / pack size and / or price point. Pack size would be the size in which the products retailed – 100 gms, half kg, one kg etc. Price point obviously refers to the price that the retailer has fixed for the product. The final level will be that of the end Stock Keeping unit or SKU. The SKU is the basic level of identification of merchandise and helps the buyer understand the complete break up of the quantities needed in each and every product that needs to be purchased. Product planning has to be done for the complete merchandise hierarchy.
Profit Improvement through Merchandise Planning

The primary objective of merchandise planning is profit improvement. As the buyer plans the buying for each department, a better overview of the profitability is available for the retail organization that it will be able to achieve. As the function of merchandising deals with the actual procurement of products for the retailer, it has implications on other areas of the business.

The entire process of merchandise planning helps the buyer arrive at the quantities of the products that need to be bought. It therefore has the following implications on other departments:

**Finance:** At the end of the merchandise planning process, when the Purchase Order (PO) is raised on a particular supplier; the finance department needs to be informed about it as they are finally the ones who will be making the payments. Finance will also look into the evaluation of the profitability off the merchandise purchased by the buyer.

**Marketing:** The marketing department needs to be aware of the products that are being purchased as they may want to create campaigns for advertising the products or for sales promotions.

**Warehousing and Logistics:**

In many retail organizations, these functions may be handled by one department. When orders are placed for new merchandise this department needs to know as it is the one that will actually receive the products and do the physical verification of the same. The quantities mentioned in the Purchase Order need to be tallied with the accounts department and the quantities actually received. Any discrepancies have to be informed to the accounts department and to the merchandiser who has placed the order. This department also needs to know the dispatch details of various products that are received i.e. it needs to know the quantities, sizes, colors, etc of products to be sent to various stores.
Store Operations:

The information on the merchandise being purchased needs to be communicated to the retail stores. In case the product is a new product, the features also need to be communicated. Information on merchandise to be received in the stores also helps in space planning in the retail store. In case the store has the authority to make purchases at a local level, it would help by ensuring that duplication of products does not happen.

The process of Merchandise Planning:

Planning can be multi dimensional. The first dimension to be considered is the time span or the time hierarchy. This could start with the forecast for the year and then go down to the season, quarter, month, week and at times, even at transactional level. The second level of planning would be at the location level, where the plan would first be created for all existing and new stores, then perhaps at the regional level, and then it would move towards clustering of similar stores. This would be followed by planning for individual stores. Similarly the third dimension of planning would be at the merchandise hierarchy level; starting with the overall department level and then finally, coming down to the Stock Keeping Unit Level.

Factors Affecting the Retail Pricing Strategy

Retail Pricing

The Malls or large departmental stores have reached even Tier 3 cities. The competition is increasing in FMCG and pricing has become a critical factor between Malls and large stores. So pricing of the goods displayed must be done in accordance with a strategy so that foot falls does not decrease and the stocks are sold out.
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The pricing strategy adopted by a retailer can be cost oriented, demand or competition oriented pricing.

In Cost oriented pricing a basic markup is added to the cost of the merchandise to arrive at the price. Here, retail price is considered to be a function of cost markup.

Thus, Retail Price = Cost + markup

If this formula is rearranged, we get

Cost = Retail Price – Markup and,

Mark up = Retail Price – Cost

The difference between the selling price and the cost is considered as markup and should cover for operating expenses and transportation etc. Mark up percentages may be calculated on the retail price or on the cost. They are calculated as under:

Markup% (at retail) = (Retail Selling Price – Merchandise cost) / Retail Selling Price

Markup% (at cost) = (Retail Selling Price – Merchandise Cost) / Merchandise Cost

For the seasonable products like fruits and vegetables the pricing factor evolved is on daily basis. The same logic applies to some Agro Products but the pricing evolution may be on a weekly basis.

Demand oriented pricing focuses on the quantities that the customers would buy at various prices. Sometimes, a high priced product is perceived as being of low quality.

When the prices adopted by the competitors play a key role in determining the price of the product, it is said that Competition oriented pricing is being followed. Here, the retailer may price the product on par with the competition above the competitor’s price or below the price.
The main objective of employing a price skimming strategy is, to benefit from high short term profits (due to the newness of the product) and from effective market segmentation. Such a strategy for pricing of products works well when the products are considered to be prestige goods or luxury items.

This aims to capture a large share by charging low prices. The low prices charged increase purchases and can discourage competitors from entering the market, as the profit margins per item are low. Retailers who wish to enter a new market or build on a relatively small market share often use this strategy. New buyers will be attracted or existing buyers will buy more of the product as a result of low price.

Companies attempting to enter new or international markets for their products may use different pricing strategies. A low cost variety of a product may be offered at a very low price to gain recognition and acceptance by consumers. Once acceptance has been achieved, more expensive models can be made available at higher prices.

Growth in retail at one point in time was possible through the opening of new stores and simply getting the product to the stores. However, with the scale of competition, the focus is now on making store space and product mix work as hard as possible to maximize returns from every square foot and every promotion. Budgets are constantly tightened and decisions at each level need evaluation. The retailer today has little choice but to ensure that every product in the store is on sale at a price that grows profits, preserves market share and builds customer loyalty.

Price is an integral element of the retail marketing mix. It is the factor, which is the source of revenue for the retailer. The price of the merchandiser also communicates the image of the retail store to the customers. The primary factor that is to be considered while arriving at the pricing strategy is the business model that the retailer has chosen to follow. The decisions on the pricing of the products will have to follow which the retailer has chosen to be the market place.
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The next factor to be taken into consideration is the demand for the product. In some cases, the price of the product is linked to the quality. This is generally in case of products like electronics where a high priced product is perceived to be of good quality. On the other hand, for products like designer clothing a certain section of the population may be willing to pay a premium price.

Retailers who want to create a prestige image may opt for a higher pricing policy while a retailer who wants to penetrate the market may decide to offer a value for money proposition.

Competition for the product and the competitor’s price for a similar product in the market also need to be taken into consideration. In case the product is unique and does not have any competition it can command a premium price, on the other hand, in case there is a fair amount of similar products in the market, the prices of such products need to be taken into consideration before fixing the price.

Retail Pricing and Evaluating Merchandise Performance

Growth in retail at one point in time was possible through the opening of new stores and simply getting the product to the stores. However, with the scale of competition, the focus is now on making store space and product mix work as hard as possible to maximize returns from every square foot and every promotion. Budgets are constantly tightened and decisions at each level need constant analysis and evaluation. The retailer today has little choice but to ensure that every product in the store is on sale at a price that grows profits, preserves market share and builds customer loyalty.

Arriving at the right price for a product or service is one of the most difficult tasks of marketing. Various factors need to be considered and it calls for balancing act on the part of the person responsible for fixing the price. Price is the value placed on what is exchanged. It is the point at which the exchange between the buyer and seller takes place, where supply and demand are equal. Pricing is an integral part of the retail strategy and again cannot work in isolation. Costs and operating expenses also need to be considered while establishing the retail price.
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We start with the concept of retail price and the factors affecting it. The elements of retail price are then examined. Developing a pricing strategy and the adjustments that can be made to retail price are studied. The subsequent paragraphs examine the methods that can be employed for measuring merchandise performance.

The concept of Price:

Price is an integral element of the retail marketing mix. It is the factor, which is the source of revenue for the retailer. The price of the merchandiser also communicates the image of the retail store to the customers. Various factors like the target market, store policies, competition and economic conditions need to be taken into consideration arriving at the price of a product.

The primary factor that is to be considered while arriving at the pricing strategy is the business model that the retailer has chosen to follow. The decisions on the pricing of the products will have to follow which the retailer has chosen to be the market place, or example followed by an up market department store.

The next factor to be taken into consideration is the demand for the product and the target market. Who is this product meant for and what is the value proposition for the consumer? In some cases, the price of the product is linked to the quality. This is generally in case of products like electronics where a high priced product is perceived to be of good quality. On the other hand, for products like designer clothing a certain section of the population may be willing to pay a premium price. Hence it is very essential that the buyer is clear about the target market for the product and the value proposition that they would look for.

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**Retail Price Strategies**

Before detailing the development of pricing strategy, it is necessary to discuss the factors that affect price decision making. Consumers, govt., manufacturer and wholesaler and competitors each have an impact on the pricing strategy of retailer.

**The Consumer and Retailer Pricing**

A retailer must understand the relationship between price and consumer purchases and perception's. Two economic principles explain this relationship the law of demand and the price elasticity of demand. The law of demand states that consumers purchase more units at low prices than at high prices. The price elasticity of demand relates to the sensitivity of the buyers to price changes in term of the quantities they will purchases, if relatively small changes in price have little impact on the number of unit purchased, demand is considered to be inelastic. Unitary elasticity occurs in the cases where changes in price directly offset changes in quantity.

The importance of price varies by market segment, on the basis of a classic study; consumer can be divided into four categories, depending upon their shopping orientations.

1. **Economic**

   Primarily interested in shopping for values and extremely sensitive to price, quality and merchandise assortment.

2. **Personalizing**

   Shops where he or she is known, strong personnel attachment with store personnel and the store itself.

3. **Ethical**
Willing to sacrifice lower prices and better assortment of goods in larger stores or chains to help the smaller stores stay in business.

4. Apathetic

Shops only because he or she must want to finish as quickly as possible, and place emphasis on convenience.

The Government and Retail Pricing

When examining the impact of government upon planning a pricing strategy, it must be remembered that three levels of govt. Exist central, state and local. Although many of the key laws are central, these laws apply only to interstate commerce. Therefore a retailer who operates exclusively within the boundaries of one state may be restricted by central legislature. Legislation focuses on six major areas, horizontal price fixing, vertical price fixing, price determination, minimum price levels, unit pricing and price advertising.

Manufacturers, Wholesalers and other Suppliers and Retail Pricing

Manufacturers, wholesalers and other suppliers have an impact on the retailers pricing strategy. In cases where suppliers are unknown or product are new, retailer seek price guarantee to ensure that inventory values and profits will be maintained. Price guarantee protect retailer against poise decision. For examples, a new manufacturer sell a retailer against poise decision. For examples, a new manufacturer sell a retailer radio's that have a final selling price of Rs. 800. The manufacturer pays him the difference. Should the retailer have to sell the radio at 25% ? The relative power of retailer and his supplier determines whether or not a guarantee is provided.

There are often conflicts between manufacturer and retailers in the setting final prices. Manufacturer and retailer would each like to control the final selling price of merchandise. The manufacturer wants to achieve and retain a certain image and to allow all retailers, even those who are inefficient, to make profits; in
contrast, the retailer would rather set prices based upon his or her store image, objective and so on.

**Competition and Retail Pricing**

The degree of control a firm has over prices depends upon the competitive environment in which it operates. In a market pricing situation, there is a lot of competition, and consumers can seek out the lowest price. Retailers price similarly to each other and have little control over price. Supermarket, fast-food retailers, and gas stations are all in highly competitive industries and sell similar products or services. Therefore, in this area, retailers utilize market pricing demand for a retailer in one of this area is weak enough so that a number of customers will switch to competitors if prices are raised.

Under administered pricing, retailers attempt to create store loyalties on the basis of a distinctive retailing mix. If strong differentiation is possible, the retailer can have control over the prices it charges. This occurs because consumers consider image, assortment, personal service, and so on more important than price and will pay a high price for the products when shopping at status stores do not offer a good image, a good assortment, personal service and so on. Department stores, discount stores, and restaurants and retailer that are able to create distinctive offering and have some control over the prices.

The key to the impact of the competitive environment on prices is the ability of retailers to differentiate itself from competitors. Weak differentiations yield market pricing, strong differentiation results in administered pricing. Because most price strategies can be easily copied in a short time, the reaction of competitors is predictable if the leading firm is successful. Accordingly, a retailer may have to view price strategy from short run as well as long run.

**Retailing in the Future**

Many environment changes will occur in the future, and these will have a impact on retailing. A far-sighted retailer must study demographic, life style, consumerism, technological and institutional trends adapt the retail mix to these
trends. Demographic trends are growth in the number of house holds (due to increase in one person house hold) suburban communities the number of working woman, and the number of higher income families.

Life style changes will include different and expanding roles for woman and increased consumer sophistication and confidence. Some consumers will experience a poverty of time and will seek convenience in shopping. The other consumer will have greater amount of leisure time and will purchase more entertainment and recreation products.

Consumerism (organized reaction to harmful business practices) will continues to grow in importance, consumer group and govt. Agencies will expand their actions and participation many retails have already implementer volunteer plans to aid consumers. The major technological changes will be concentrated in electronic banking (cashless transaction and nation credit cards) computerization (computerized checkout and electronic point of sale systems) Retail institutions changes will occur because of the evolutionary nature of the retail life cycle and rising costs. Retailers must be aware of the retailer life cycle and react according to the stages in shish they are operating (innovative, accelerated development, maturity and decline) four institutional type (the super store, risk minimization, rationalized retailing and positioned retailing) will become more prominent in the future.

**Elements of Retail Price:**

In order to arrive at the retail price, one needs to first consider the elements that go into the making of the price. The first element to be considered is the Cost of Goods, which s the cost of the merchandise and various there expenses, which are involved in the movement of the goods from the manufacturer to the actual store. These expenses may be Fixed or variable.

**Fixed Costs:**
Fixed costs sometimes referred to as overhead, are expenses that don’t vary according to production amounts – such as rent or office space (and storage space if you store inventory), office equipment (telephones, faxes, computers etc) insurance, utilities etc.

**Variable costs:**

Variable costs are expenses that do vary with the amount of service provided or goods produced. They include cost such as hourly pay for a contractor on a specific project, raw material etc. Some available costs don’t depend specifically on the number of product but are still variable such as advertising or promotion expenses.

The cost of a product is the total of the fixed and variable expenses to manufacturer or offers your product or service. Price on the other hand is the selling price per unit customers pay or your product or service.

The price of a product may be seen as financial expression of the value of that product. For a consumer price is the monetary expression of the value to be enjoyed / benefits of purchasing product, as compared with other available items. For consumers the price of a product is the most obvious indicator of cost hence the need to get product pricing right.

**Determining the Pricing Objectives and Strategies**

**Price Stabilization Objective:**

Frequent changes in the prices of product will harm the long-term interests of the companies. Hence, they aim at stabilization of prices. They do not exploit a short supply position to earn the maximum. During the periods of good business, they try to keep prices from rising and during the periods of depression, they keep prices from falling too low. Thus, they take a long-term view in achieving price stability.
Meet or Follow Competition Objective:

Pricing is often done to meet or even prevent competition. If a company is a price leader, it is better to follow it to ward off the possibility of competition.

Market Share Objective:

A company may either have the objective of maintaining the present market share or increase its share depending upon its stature. Particularly, big business houses adopt such pricing that it enables them to retain their market share. If they raise their market share, they may draw the attention of the government and if they shed their share, they may lose revenues. Contrary to this, small business houses are found interested in raising their share in the market so as to reap the benefit of large-scale production. In few cases, firms may sell the products even at a lower cost to capture the market. However, such practice may lead to financial crisis. As a matter of fact, this is an objective to be adopted by new firms cautiously.

Profit Maximization Objective:

Profit maximization does not mean profiteering. There is nothing wrong in this policy if practiced over the long run. As a matter of fact, many of the enterprises strive to maximize their profits. Maximization of profits should be on the total output and not on a single item. In such case, consumers do not get dissatisfied since a particular group is not called for paying a high price. While adopting this pricing objective, the marketers should attempt to project their image in the market through sales promotion techniques. The marketers should watch the reactions of the consumers. Profit maximization through price hikes should be sparingly used.

Cash Flow Objective:

One of the important objectives of pricing is to recover invested funds within a stipulated period. Most of the time you will find different prices for the cash and credit transactions. Generally, you find lower prices for the cash sales and high
prices for the credit sales. But this pricing objective could be implemented with good results only when the firm has monopoly in the market.

**Product Line Promotion Objective:**

Product line means a group of products that are related either because they satisfy similar needs of different market segments or because they satisfy different but related needs of a given market segment. While framing the product line, the marketer may also include such goods, which are not popular. The intention of the marketer is to push through all the goods without any discrimination. Thus, the ultimate objective is to increase the overall demand of the goods. In this pricing objective, equal prices are adopted for the entire product line.

**Survival Objective:**

Perpetual existence of the business over a period is the indication of the sound financial position of the enterprise. All organizations will have to meet expected and unexpected, initial and external economic losses. These enterprises have to pool up the resources to meet all the contingencies through appropriate pricing strategies. Price is used to increase sale volume to level up the ups and downs that come to the organization.

**Objectives of Pricing Strategy**

1. **Maximize Profits**

Maximize your profits by balancing the price of your goods with anticipated demand. Chart the demand for your products at various price points. Select prices at which your supply and demand intersect. Consider your overall profit at various supply levels and increase or decrease your supply based on revenue projections.
Enhance Promotions

Price your goods to enhance a marketing campaign. You can lower prices through coupons, special offers and discounts. These promotions encourage customers to purchase more products, try a new product or change brands. Common pricing strategies include bulk discounts, seasonal promotions and customer-loyalty discounts. Price discounts help increase sales to price-sensitive consumers and increase the value proposition of your products or services.

Cost Recovery

Recover the cost of your product investment. Heavily discount your products to move older goods when changing product designs or when terminating a product. Lowering your prices may not result in profits, but you can decrease your storage overhead and make distribution channels available for new products or services. Price your products for maximum sales speed, but try to cover materials, labor and manufacturing costs. You can also use a cost recovery pricing strategy if your company needs rapid cash flow returns.

Competitive Leadership

Create a price strategy to establish your company’s leadership position in the market. Selling products below cost can be a short-term measure to reduce your competition, increase your market share and penetrate a tough market. You can also establish your product as the luxury leader by pricing your products at a premium. Match your pricing strategy to your market leadership objective for maximum impact.

Distinguish Products

Set your prices to distinguish items in multiple product lines. Use price to establish quality differences and prestige perception. Pricing differences can also distinguish your products from your competitors. Higher prices tend to denote higher quality or more desirable products, while lower prices can denote an economical product selection.