Process and Software Issues for Retail Merchandising Organizations
A Research Study

Differentiation and Focus are the Key Needs of Merchandising Service Organizations

Software Problems Will Continue Until Organizations Focus on a Limited Number of High-Value Activities

Profit Margins Must Be High Enough to "Afford to Do the Software Right"

by Tom Ingram, PMP

Study Purpose: With assistance from NARMS, (the National Association for Retail Marketing Services), we set out to study two questions:

1. **Why is it so hard to get software right for Merchandising Organizations?**
2. **What can be done about it?**

Who should read this report? This report is directed primarily to owners and managers of Merchandising Service Organizations (MSOs) who perform services for a fee (not to manufacturers or retailers with in-house merchandising organizations.)

Key Finding #1:
Differentiation and Focus are the Key Needs of Merchandising Service Organizations

In reviewing web sites and NARMS profiles of 68 merchandising organizations for this study, I was struck by how undifferentiated the companies are. A chief complaint of many organizations is "head-to-head price competition", resulting in commodity, low margin work. This is the natural result of buyers seeing no difference between competitors (other than price.)

Happily, a number of organizations reported that they had found ways to differentiate themselves, add value, become a partner to their clients and earn a much better than average profit margin. Techniques ranged from focus on a sole category within a single retailer to an extreme emphasis on immediate and effective reporting on the results of retail projects. It was interesting to me that "we have national coverage", "we have local market knowledge," or "we provide 98%+ completion" were not sufficient points of differentiation.

Those that rely on these points of differentiation alone do not seem to rise high enough in the customers' eyes to consistently earn higher margins.

Key Finding #2:
Software Problems Will Continue Until Organizations Focus on a Limited Number of High-Value Activities

You may ask, "What does all this have to do with software and processes?" Please refer to Figure 1: "Understanding the

Complexity." Most merchandising organizations deal with multiple retailers and multiple manufacturers. They also do several different types of projects, as shown in Figure 1. Let's assume that a merchandising organization deals with nine different retailers, nine different manufacturers and provides nine different types of projects. The total number of little cubes inside of the big cube, in this case, equals 729. This represents 729 different combinations that their software must support!

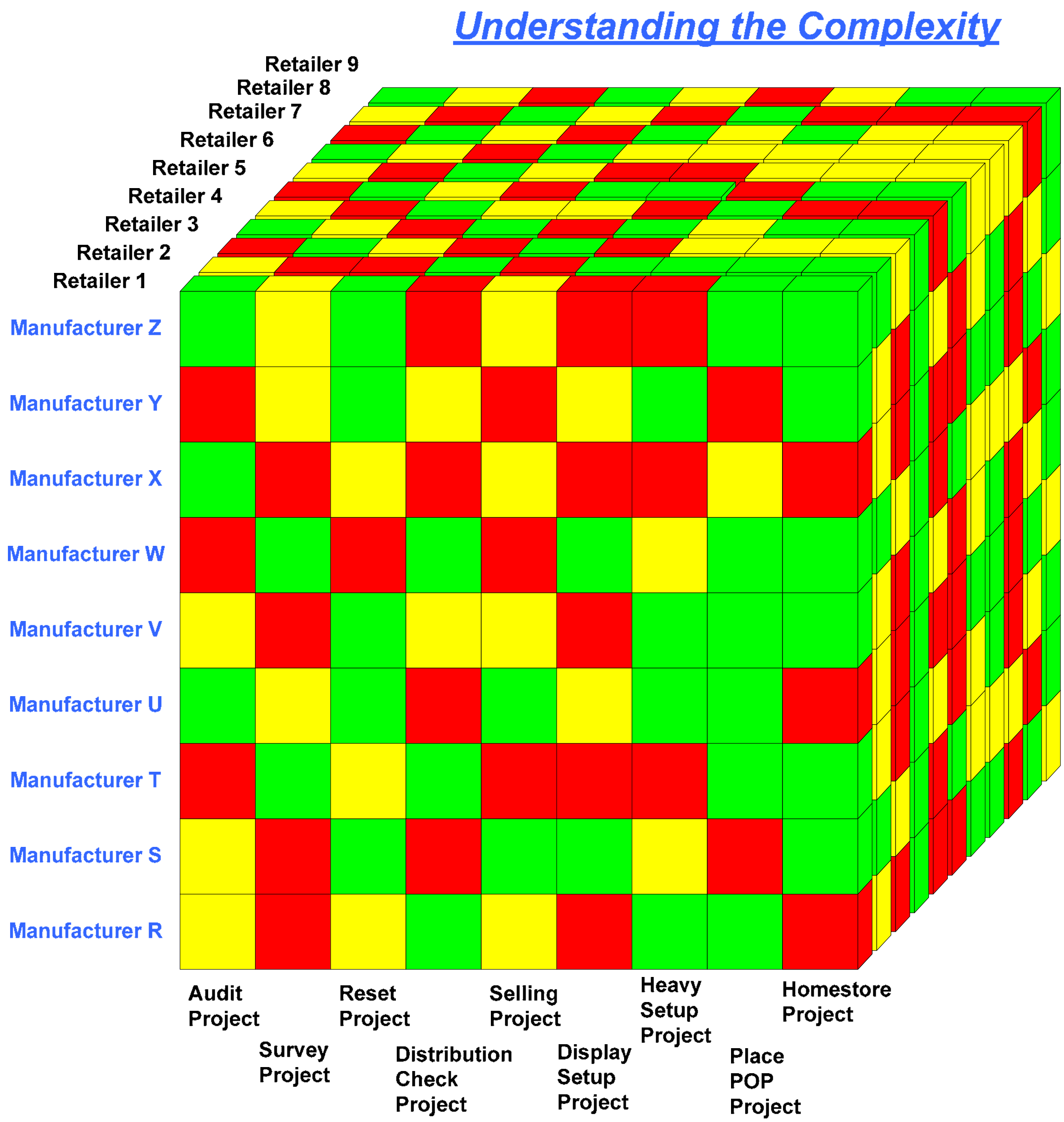

Figure 1: Understanding the Complexity

Key Finding #3:
Profit Margins Must Be High Enough to "Afford to Do the Software Right"

Notice the red, green and yellow blocks in Figure 1. These represent the profitability of the various combinations of work, retailer and manufacturer. The first step is that the organization needs to understand its costs (not just direct costs, but overhead and extraordinary costs as well.) The idea is that the green blocks are the combinations that provide enough profit margin to afford software which will allow the work to be done in a quality / minimum labor / minimum cost fashion.

By focusing only on the profitable business, you reduce the combinations that your software has to support from 729 to approximately 240.

"But we never turn down any business. We take any piece of work we can close." I'm sorry to say this, but if this is your company philosophy, you are going to be in a difficult spot.

Key Finding #4:
The Most Often Repeated Mistake is Trying to Have Your Software Be "All Things to All People"

By taking all the work you can close, you are asking your software and your computer people to react to an ever changing set of needs. They never get the time or the money to solve one situation effectively before they must move on to handling another crisis or problem.

This results in a downward spiral of poor results on projects, loss of confidence from customers, more price competition and low morale among your people.

Key Finding #5:
You Need to Understand How Much Software Really Costs

See Figure 2: Retail Merchandising Software Master Modules. This is the ***short version*** of how we explain the magnitude of complexity that retail merchandising software must handle. Note that not every merchandising organization will require every module of software, but most organizations will need to deal with a lot of complexity, processes and software in order to be competitive.

Our ***master system design chart*** identifies 80 separate major functions for retail merchandising software. You will probably be surprised to know that each of these functions will cost $10,000-$20,000 to program, test and implement. **Even if your organization only needs 50% of these major functions, your software will still cost $400,000-$800,000.**

(Note that these costs are for design, development, test, installation, training, shake down and modification until it is working smoothly. Some will argue that software does not cost this much, but we must remember all of the wasted time and lost revenue because software does not do what is needed. Many organizations will lose more than $100,000 in labor and opportunity costs over the next year due to ineffective software.)

Expect to Spend 3.4% to 4.2% of Revenues on Software and IT. This will probably be your largest single item of fixed cost. The merchandising services industry is so new that I have not been able to find information showing what percentage of revenues are being spent on IT. A study published in the August, 2003 edition of *The Controller's Report*, page 21, does provide some useful information from similar industries.

- The financial services industries and professional services industries are very similar to MSO organizations because their primary costs come from labor rather than inventory, products, buildings, etc.

- Their average and median expenditures range from 3.4% to 4.2 % of revenues. This is not perfect information, but it is consistent with my experience with services organizations over the last 25 years.
- The risk is that some MSOs are spending too little on IT. Software and IT are clearly critical competitive issues for MSOs. If one MSO is spending 1% of revenues on software and IT, how will they compete with a someone else who is spending 4% of revenues?

Key Finding #6: You Must Spend Your Software Dollars Well. How to Beat the 70% Failure Rate for Large Software Projects

Unfortunately, even if you do spend the necessary money, you will be unhappy with the outcome about 70% of the time. In 1998 I authored a book titled *How to Turn Computer Problems into Competitive Advantage* (published by the Project Management Institute.) A total of eight different studies have shown that large computer projects in the United States are completed on time, on budget and as promised only about 30% of the time.

Software Horror Stories: The Consumer Package Goods / Retail Merchandising industries are no exception. Our web site has summaries of 18 different horror stories. These Horror Stories should help you understand how easy it is for things to go wrong. See http://www.tomingraminc.com/CPGIndustrySoftwareHorrorStories.pdf

CIO Turnover: You may be aware that, in the United States, the average job tenure of a CIO (Chief Information Officer) is 19 months. Clearly, corporate America is having trouble finding people who can consistently deliver software projects on time, on budget and as promised.

What do I do about all these problems with software? By understanding some of the root issues we've discussed here, you are off to a good start. We offer two courses to help you take the next steps. See http://www.tomingraminc.com/OnTimeOnBudgetHappyCustomer.htm for details.

Key Finding #7: The Coming Shakeout: Get Very Big and Very Efficient, or Get Very Specialized and Add Very High Value

In 1980, Michael Porter, a now famous Harvard professor, published an landmark book called *Competitive Strategy*. In this book he forecast exactly what is happening to the merchandising services industry. He predicted that a new industry such as merchandising services would go through a rapid growth period and then a rapid consolidation.

He predicted that, in the end, only a very few large competitors would be left. They would compete on a very large scale and would be very lean, efficient and cost competitive. The only other companies that will survive will be specialized in niches where they can add very high value, can make a decent profit margin and can avoid brutal price competition.

Porter is famous because his predictions have come true in dozens of industries, and this type of shakeout is inevitable for the merchandising services industry. I will only add that in my 25 years of software and consulting related work, I have seen numerous firms find high value niches and prosper. I have never personally seen a successful case of growing a business to large economies of scale – but I have seen numerous failed attempts.

Can I Buy Package Software for Retail Merchandising? The short answer is "not really". Of all the companies interviewed for this study, only one purchased a software package to manage retail merchandising work. That company is a very large manufacturer who spent a lot of money, and still had to have the package modified substantially. In the interviews, we discussed some packages that people had looked at, but everyone else chose to develop their own software.

What About Sharing the Cost of Software with Other, Non-Competing Organizations? This might be possible, but I have my doubts. I know of one attempt so far to do this among the MSO community, and I afraid that the effort isn't working out as expected.

Referring back to figure 1, remember that each combination of manufacturer, retailer and project type creates unique requirements for the merchandising management software. If three or four MSOs band together to create software that they can all use, we are back to the problem of the software "trying to be all things to all people."

While I believe there are a few successful precedents in other industries for this type of cooperation, I believe the failures are far more numerous.

Basis for this Research Study: We conducted 18 in-depth telephone interviews based on a 12-page questionnaire. This included CEOs and operating managers from 15 MSOs and three manufacturers. Added to the study are observations from multiple years of consulting work for one of the three largest retail services organizations in the United States. Study observations include general analysis of available websites, public information and NARMS member profiles for 249 MSO members of NARMS. We also conducted a moderate-depth review of 68 MSOs prior to selecting approximately 50 organizations to request an interview from. Approximately 33% of those contacted ultimately participated in the phone survey interview with us.

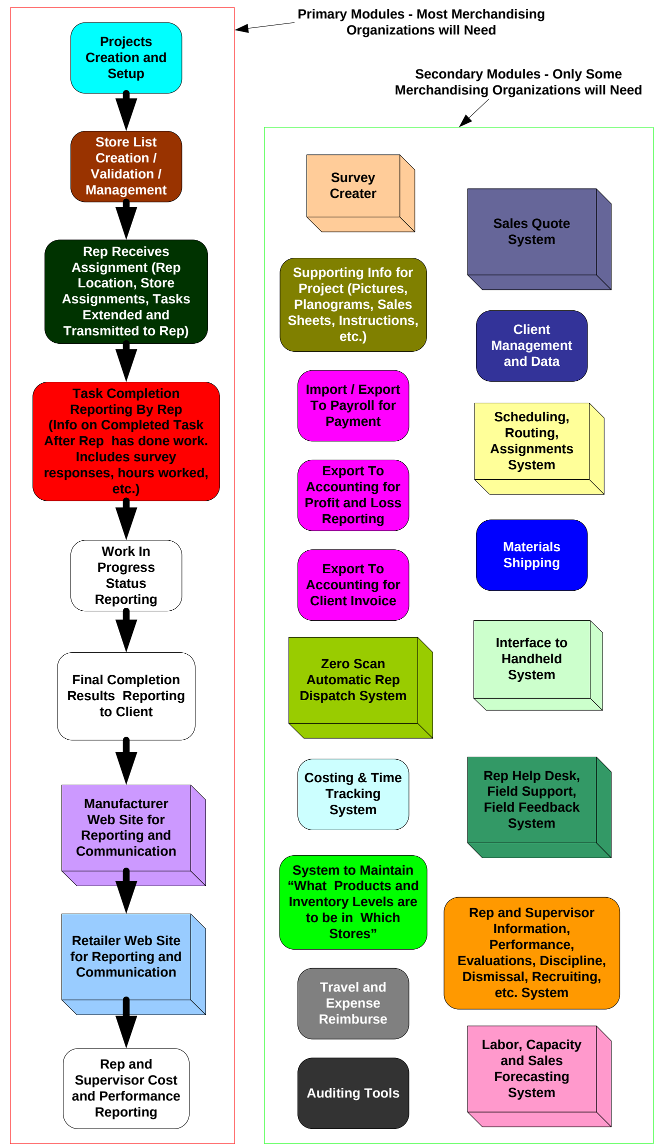

Figure 2: Retail Merchandising Software Master Modules

Cautions and Limitations on the Findings: This study actually was stopped prior to completion, so the research sample size is far short of the size needed for rigorous statistical analysis or statistically significant findings. The findings of this report should be viewed as the informed opinion of an expert at implementing computer software, supplemented by the research basis described above. No representation is made by Tom Ingram and Associates, Inc. as to statistical accuracy, significance or applicability of the findings to a particular situation. This report is intentionally kept short for ease of reading, and is not intended to provide rigorous detail or explanation.

Summary: Let's look at the answers to the two key questions of this study:

1. **Why is it so hard to get software right for Merchandising Organizations?** The key reasons are:
   - Due to lack of differentiation and fierce price competition, Merchandising organizations are frequently not earning enough profit margin to afford to do their software right.
   - Merchandising organizations are often asking their software to "be all things to all people" by accepting any type of work that they can close. Unless the organization gets focused on doing fewer, high-value projects, in higher margin niches, it will continue to suffer a downward spiral of poor project results, unhappy customers, increasing price competition and less than happy employees.

2. **What can be done about it?**
   - Software is a "pay now or pay later" tool, and business owners need to truly understand the costs of doing software effectively. Most of us have learned that doing software badly results in wasted labor, lost revenues, unhappy customers and unhappy employees.
   - Tools, training and tips to help you get your software right the first time can be found on our web site at www.tomingraminc.com , or feel free to call me.
   - Understand that software is a big part of your business strategy. You will probably be forced to either grow to become very large, or become specialized at doing just a few things very well. It is important that you focus your business on a few, very important things, then insist that your software does those things very well.

Special thanks to Dan Borschke, executive director, and all the NARMS members that helped with this research!

Need further information?

Call us if you have questions or would like more information. This case is written as a teaching tool and is not intended to fully describe exact details or dialog.

Email us at tom@tomingraminc.com for details or contact us at 972-394-5736.