IS YOUR MARKDOWN OPTIMIZATION STRATEGY LEAVING MONEY ON THE TABLE?
PURPOSE-DRIVEN, RESILIENT & ADAPTABLE

with Business 4.0™
Introduction

Fashion inventory is not like wine and cheese that get better with age; it is a serious issue for retailers and COVID-19 has only exaggerated it. Fashion and apparel retailers are sitting on tens of billions of dollars of unsold merchandise across stores, distribution centers, warehouses, and even shipping containers due to COVID-19 lockdown.

Already, more than a fifth of the UK’s fashion expenditure ($13.5 billion) is poised to go up in smoke\(^1\). In the United States, clothing and footwear sales could plummet by $19.4 billion\(^2\). Gap Inc. pegs coronavirus losses at $100 million and counting\(^3\), and Ralph Lauren estimates a $70 million loss in sales since the outbreak of the pandemic\(^4\).

---


Irrespective of how the fashion industry reacts to its inventory problems in the long term, one thing is certain—the growing acceptance that less should be produced. Customers are demanding it; the environment demands it even more. The surge in the clothing rental market is a pointer to the increased sensitivity towards sustainability.

A fashion industry that is more responsible and sustainable will likely drive an entirely new set of scenarios: buying quantities will likely reduce, traditional fashion seasons may be redefined, customers may have to pay more, and sale events/markdowns may not be as widespread.

However, in today’s context, over-stock and sale events are a harsh reality facing retailers that will be further exacerbated by COVID-19. With markdown budgets likely to be significantly higher this year, markdown decisions will be a major focal point for 2020.

Regardless of whether fashion retailers use a markdown pricing strategy, promotions or a combination of both, as their strategy to solve their overstock, one thing is certain: those retailers that choose Excel and intuition are leaving millions on the table. With the stakes so high, getting markdowns right is critical.

Leading fashion retailers are already leveraging the data they have, capturing better data, investing in their pricing capabilities (tools, data, people, skills, and processes), and reaping the rewards.
Traditional approaches to markdowns in retail often focus on assignment of broad markdown discounts to a wide range of stock across different channels. The range of discounts are often set in line with past events (“We went to 50% off on average last time, and that worked well”) or a set of business rules that framed the markdown events of the past (“We always discount 35% at first”).

Such rule-based approaches, whether explicit or implicit, traditionally are supplemented by internal merchandiser judgments about the quality of their stock and some basic financial modelling based on stock positions. In scenarios where retailers are hard pressed for time and in the absence of sophisticated tools, algorithms, and data, these approaches have served well.

Old approaches of assigning blanket discounts to groups of products fall short. Such approaches do not assess and take into account the SKU elasticity, the possible future demand response, the granular stock position, or the impact of cannibalization on other items. On the contrary, AI-led markdown strategies leverage sophisticated forecasting techniques, elasticity estimation, optimization science, and a granularity of decision making that the old combination of human intuition and Excel cannot compete with. Combining these powerful techniques to select the optimal discount to realize a stated strategy is where merchandisers can gain real tangible value. Coupling the markdown engine with ‘what-if’ modelling functionality further enhances the flexibility and gives end users the ability to quantify the impact of key decisions, preventing the cardinal error of over-discounting.
Understanding the right discount for the right product at the right time through the right channel avoids costly broad-brush markdown discounting and can save millions in margins for the retailer over a relatively short period.

Key decisions that can be enhanced with data science:

• Select what product needs to be included in the markdown event based on scientific assessment of elasticity, stock, and demand projections for every SKU or line. Exclude products that will sell through anyway regardless of markdown and save margin dollars.

• Calculate optimal discounts across all your key SKUs and lines to avoid over discounting. i.e. Get the discount right—for the product, channel, store, stock on hand for each product.

• Explicitly let your strategy drive the discount profile across your stock—no broad-brush rules of thumb or copycatting from last year. If you are targeting a given margin performance, or targeting a sell through percentage, then use optimization science to blend the right profile of discounts relative to stock positions, elasticity, and predicted demand responses at the most granular level.

• Forecast the commercial outcomes to know what to expect, and which products and product areas will require more markdown spend based on real-time demand forecasting and discounting sensitivities.

• Monitor markdown performance in near real-time to closely understand performance and use automation to allow speedy and accurate course corrections where needed.

A science-based approach that is granular, demand forecast driven, utilizing optimization science and the ability to quickly adapt to demand patterns is the cornerstone of how modern markdown events should be planned.

AI and ML techniques are now being utilized to make this type of powerful approach a reality. Sophisticated modelling and a greater understanding of demand patterns across seasons help drive more accurate demand predictions at the most granular levels driving stronger business outcomes. It also means customer behaviors across channels can be taken into account, and markdown discounts can be optimized across these channels to maximize the retailers return from the events. This means as a retailer you can more efficiently manage the product life cycle of your product leading to stronger margins and less stock hangover from season to season.
The reasons to embark on markdown optimization are clear—the ROI and speed to benefit alone make a compelling case. Our top tips:

1. **Be relentless**: Diligently drive the use of insights at each stage of the markdown planning process. Review historical data to understand product performance, uplifts, tactics, etc. and use this knowledge to drive future effectiveness. Help it shape your future buys too!

2. **Go granular**: Granularity in decision making is the key for markdown optimization. Recommendations and forecasts must be made at the lowest level by taking into consideration various factors such as margin, stock, elasticities, customer behaviors, zoning, and channel. This is why Excel is no longer enough.

3. **Forecast and re-forecast**: Model various scenarios including ‘what-ifs’ to realize the best outcomes based on the strategic goals. However, doing this once isn’t enough. Flexible, adaptable forecasting engines that harness near real-time data are critical for capturing the latest customer demand patterns.

4. **Make integrated decisions**: Markdown systems that integrate price, promotions, and markdowns ensure more accurate stock forecasting and help drive stronger decisions.

5. **Use flexible discounts**: Flexible discounting levels for different products and ‘upto’ events drive greater variety of deals and better margin performance. Don’t commit to fixed markdowns.
6. Choose carefully: Be cautious in deciding on which stock should be marked down in order to avoid deep discounting. Intelligent allocation of stock for markdown events, supported by forecasting and stock analysis, is critical to ensure margin performance.

7. Be proactive: Customers generally make up their minds early on merchandise. Early stock management insights and decisions will enable in-season proactive course corrections, better forecasting, and better strategies. Consider markdowns as you go or proactively manage the pricing levels of stock across the season to nudge you to a more favourable stock position by the time markdown events happen.

8. Continually monitor your markdown performance: Automated performance monitoring and near real time re-forecasting can help decision makers understand the very latest customer responses to your Markdown event and respond with high levels of agility. Automated course correction utilizing revised forecasting can help mitigate any surprises and maximize performance.
Conclusion

Retailers are adapting and evolving like never before. Decisions made by merchandisers have always been at the heart of a retailer’s success; in the post COVID-19 era, the pressure to get these decisions correct and survive 2020 is tremendous. Blending leading edge data science and AI techniques with the merchandiser’s contextual knowledge to manage the pressing issues will help retailers win.

The benefits of leveraging automation, cognitive intelligence, and machine learning in fashion are proven—improved margins, enhanced stock management efficiencies, and reduced effort and time on planning, freeing up merchandiser time to make better decisions elsewhere. In a post-lockdown world, utilizing optimization science and leading-edge forecasting techniques is table stakes for modern retailers.

The importance of margin efficient stock management is greater than ever before, and how retailers work through this will be critical to success.

Chris Arnold
Leading Consulting Partner,
Retail Strategic Initiatives

Chris has broad and deep consulting skills on price, promotions, and markdowns, and has been instrumental in helping businesses drive millions in incremental sales and margins to meet their strategic goals. He is passionate about leveraging data science and latest techniques to enhance pricing capabilities, and has over 15 years of experience on pricing initiatives for leading retailers.
About TCS Retail

TCS Retail partners with over 100 global retailers, driving their growth and digital transformation journey. We are solving their toughest challenges by harnessing our deep consulting and technology expertise, amplified by strategic investments in products and platforms and research partnerships with top universities; a co-innovation ecosystem of over 3,000 startups; and Nucleus, our in-house innovation lab.

Retailers worldwide are adopting the TCS Algo Retail™ framework, a playbook for integrating data and algorithms across the retail value chain, thereby unlocking exponential value. TCS’ portfolio of innovative products and platforms include the AI-powered retail optimization suite TCS Optumera™ and the unified commerce platform TCS OmniStore™ that are powering the future of retail. Our solutions and offerings leverage the combinatorial power of new-age technologies to make businesses intelligent, responsive, and agile. With a global team of 40,000 associates, we are powering growth and transformation among leading retailers worldwide.

Contact

For more information on TCS’ retail solutions and services, please visit http://on.tcs.com/TCS-Retail

Email: marketing.retail@tcs.com

About Tata Consultancy Services Ltd (TCS)

Tata Consultancy Services is an IT services, consulting and business solutions organization that delivers real results to global business, ensuring a level of certainty no other firm can match. TCS offers a consulting-led, integrated portfolio of IT and IT-enabled, infrastructure, engineering and assurance services. This is delivered through its unique Global Network Delivery Model™, recognized as the benchmark of excellence in software development. A part of the Tata Group, India’s largest industrial conglomerate, TCS has a global footprint and is listed on the National Stock Exchange and Bombay Stock Exchange in India.

For more information, visit us at www.tcs.com

All content/information present here is the exclusive property of Tata Consultancy Services Limited (TCS). The content/information contained here is correct at the time of publishing. No material from here may be copied, modified, reproduced, republished, uploaded, transmitted, posted or distributed in any form without prior written permission from TCS. Unauthorized use of the content/information appearing here may violate copyright, trademark and other applicable laws, and could result in criminal or civil penalties.

Copyright © 2020 Tata Consultancy Services Limited