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Five pitfalls to avoid when creating clusters

Nov. 9 2009
By Doug Erickson and Winston Weber

It's a shopper's market. Today, consumers have an array of options when it comes to shopping and no longer have to rely on their neighborhood stores. Leading retailers are taking a closer look at their merchandising strategies to precisely cluster their stores in order to meet localized demand and ensure the right products are in the right place, in the right quantities, at the right time. However, in order to cluster stores efficiently, it's important to steer clear of five common pitfalls that can sabotage any retailer's move toward customer-centricity.

1. Don't confuse store groupings with cluster strategies

It's critical to know the difference between store groupings and store clusters in order to create an efficient centralized merchandising and assortment strategy. Many often confuse the strategies for one concept. Historically, retailers have grouped their stores based on top-down constraints such as store size, total store sales volume or supply chain requirements to ensure the chain is operating efficiently. However, to create an all-encompassing strategy, it's imperative to take a deeper dive to understand your customers through store-level and category-level clustering, while still factoring in key operational constraints.

To achieve operational and supply chain efficiencies, retailers can analyze every store within a network and assign each store to a group based on common top-down attributes such as sales volume or store size. However, to develop an effective customer-centric assortment and merchandising strategy based on consumer behavior, retailers need to create category-specific clusters. This enables retailers to create different strategies within the same store to ensure each category operates to its full potential. For example, a category such as ready-to-eat meals may be heavily influenced by the ethnic make-up of a store's shoppers, while the beer, wine and spirits category in the same store may be influenced predominantly by the shopper's income level and education.

2. Don't forget to consider category performance

When forming clusters, many retailers often make the mistake of basing their decisions solely on top-down grouping methodologies. This typically includes basing groups on such physical characteristics as store size, dollar volume or the demographic profiles of each store's neighborhood. For example, a retailer may create a group for all stores larger than 50,000 sq. ft. and another group for all stores smaller than 30,000 sq. ft. Another common approach would be to form groupings based on the amount of sales each store generates per week.

While the top-down constraints are all important factors to consider when grouping stores, relying on these methods alone will not produce an effective strategy. Retailers must begin the process by analyzing category performance to identify any similar trends and patterns across its chain. For instance, a store with less than 30,000 sq. ft. may have a dynamic category that sells the same mix of products at the same ratios and frequencies as a larger store. Since the category performs similarly in both stores, it would make the most sense to merchandise them similarly as well.

Once the store-level clusters are determined, performing a deeper, category-level analysis of how each category performs in each store is necessary to achieve true customer-centricity. Retailers can do so by implementing a customer-centric cluster planning solution that clusters stores using a "bottom-up" approach to analyze individual category performance patterns based on actual consumer buying behaviors. Once complete, the solution then allows the retailer to factor in top-down group constraints to ensure the clustering strategies can be effectively implemented in store. This level of analysis enables retailers to capitalize on all opportunities.

3. Don't exclude vendor partners from your clustering process

Manufacturers play a significant role in the clustering process by providing retailers with valued, strategic category expertise and cross-retailer insight. Collaborating with strategic partners ensures that your category clusters are based on the best available internal and external inputs and category knowledge.

However, issues can surface quickly if multiple manufacturers offer this service without following a consistent methodology defined by the retailer. For example, one soft drink vendor may provide a cluster plan based on pack size, while another may create a plan based on sales volume for the same category. When the same data and clustering processes are not used, the vendors' plans can become inconsistent with the retailer's strategy, causing confusion when the retailer tries to compare the two plans side-by-side.

When developing a clustering strategy, analyze the data first and then determine which attributes are best suited to define clusters. Rarely will the same attribute, such as pack size, apply to all categories. Once the retailer establishes a clustering methodology for each category, it is critical that each vendor partner follows that approach when providing cluster recommendations for their category. At the end of the day, if a cluster strategy is not operational, neither the retailer nor its shoppers will benefit.

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4. Don't worry about every category ... prioritize for clustering

The thought of clustering at the category level overwhelms many retailers. There is a misconception that they must analyze the performance of every category in every store in order to create a successful strategy. This is not the case. Typically, 20% of a retailer's categories generate 80% of its revenue. In order to maximize the benefits of category-level clustering, retailers must focus specifically on strategic categories that significantly impact business. A good starting point is to decipher which categories are dynamic, variable or basic. For a grocery retailer, categories such as fresh produce are dynamic and benefit greatly from localized assortments. On the other hand, categories such as batteries are basic and don't vary much on a store-by-store basis.

5. Don't aspire to be in a certain cluster

Lastly, when designating names to each store cluster across the chain, it is important not to use a numeric or alphabetical approach. Store managers tend to interpret this as a ranking, which often leads them aspiring to be in store cluster 1 or A. This can wreak havoc on the entire strategy. Clusters are formed so stores can efficiently meet localized demand and each store must work to serve its clientele. The best way to avoid this pitfall is by providing generic names such as colors or objects.

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