Fundamentals of Merchandise Financial Planning

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Simply put, Merchandise Financial Planning (MFP) is the discipline of anticipating customer demand, then planning your inventory needs to meet that demand while satisfying company's financial objectives to maximize profit. Practically speaking, MFP is about determining how much money to put in each Buyers' wallet to maximize your inventory profitability.

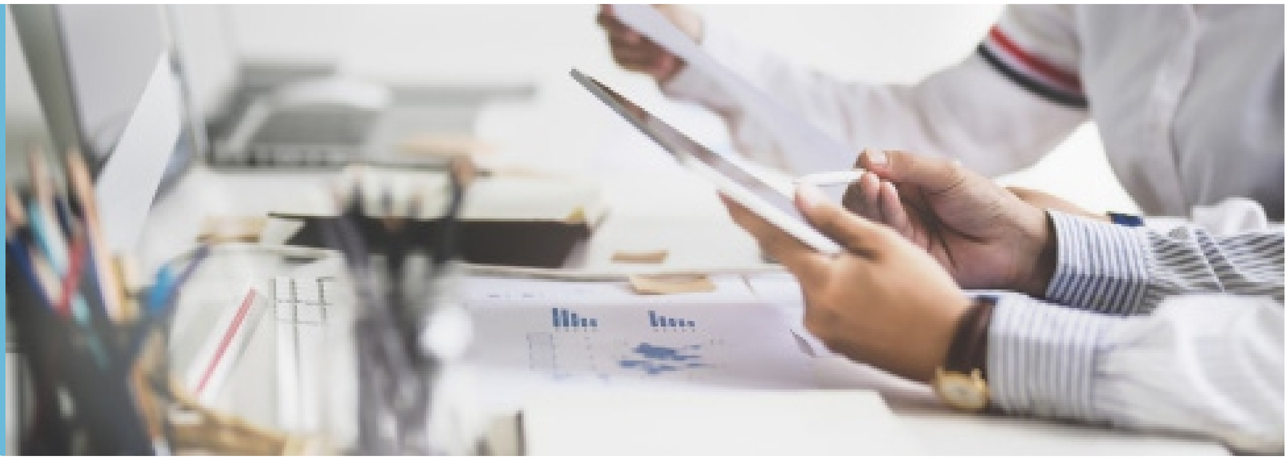
In order to determine your inventory needs, you first need to determine the likely demand (ie the sales plan) for your product categories. You want to be sure you are buying just the right amount of inventory to meet your customer demand. Too much inventory results in margin eroding markdowns, and too little inventory results in lost sales opportunities.

Once you know how much merchandise you are likely to sell, you can then determine the inventory you will need to meet that demand.

It sounds simple, but the complexity lies in the multiplicity of factors. The more varied your business, the more complex your plans.

Inside, you'll learn:

- *The planning workflow from Sales Planning to Inventory and Receipt Planning which results in your Open-to-Buys*
- *Considerations for different planning roles within your organization and how to preserve your critical plan versions*
- *Put in place Buying and Planning processes to anticipate change with speed and agility*



Sales Planning

First, you will likely need individual sales plans by each product category. For example, winter jackets will likely sell more in winter months, in colder climate locations, than summer.

All of the merchandise categories you carry have seasonality, different selling patterns across time and sales channels. You need to develop a sales plan for each product category across time, week/month/quarter/season for your various sales channels, brick & mortar stores, eCommerce, Catalog, Wholesale, or by customer (but customer centric planning is another topic we'll have to pickup another time).

While you are developing your product category sales plan, other planners are simultaneously developing theirs for their categories.

Second, all the sales plans from each of the product categories need to be consolidated to give managers visibility at the total levels, such as department, division or company.

Concurrently, you will have managers who are developing their own sales plans at higher levels, for example women's or total company level. This is typically known as the strategic plan or top plan. At some point, the manager will meet with each of the category planners and merchants to determine the plan targets everyone can agree on.

Consider the **data source** when planning your **sales projections**.

1. How reliant are you on your history? To what degree is history relevant for this product category? Think about the difference between basic vs fashion product categories.

2. Are you using forecasting? If so, which algorithm works better for this particular category? Remember that even for the same product category, it may require different forecasting methods due to differences in seasonality.

3. What outliers do you need to account for? For example: shift in calendar due to Easter that impacts the specific week's sale; or non-comp stores due to closure for part of the year; history might be useless for your e-comm if you didn't have it last year; or drastic macro changes such as a pandemic that affected overall sales trend, etc. All of these must be considered and adjusted accordingly in your planning process.

Inventory and your Open-to-Buy

To satisfy the and meet the demands of the sales plan, you need to develop the corresponding Inventory and Receipts plans.

This is often referred to as a Balance Set. It is a perpetual tracking of the In's and Out's of your inventory.

Here is an example of a Balance Set:

End of Period (EOP) Inventory = Beginning of Period (BOP) inventory
+ Receipts
- Sales
- Markdowns
- Adjustments[1]

It is often referred to as perpetual inventory because the balance set is used to track your inventory flow across time, week, month, quarter, etc.

The End of Period (EOP) inventory for the current period is equal to the Beginning of period (BOP) inventory at the beginning of next period and so on.

Below is an example to illustrate:

	Month 1	Month 2	Month 3
BOP	150	154	158
+ Receipts	40	45	50
- Sales	30	35	40
- Markdowns	5	6	8
- Adjustments*	1	0	1
= EOP	154	158	159

1 Examples of inventory adjustments might include Shrink, Return to Vendor (RTV), Marked Out of Stock (MOS), etc.

Did you notice Receipts in that formula? The receipt is also known as your Open-to-Buy (OTB) for the given period. That's how much buyers will have in their wallets for that period's Retail purchases/buy. Ideally, you want your inventory to arrive just as the customer is ready to buy. In other word, your receipt curve should precede your sales curve just enough to get your inventory in to the customers' hands. This is usually referred to as lead time. The longer your inventory sits in your stores or your distribution centers (DCs), the higher your carrying cost.

Of course, in reality, this is much harder to accomplish. For example, think of the holiday inventory build up. You have to get inventory in much earlier than normal due to the sheer amount of inventory you need to meet the increase demand of holiday sales. Other factors such as where the inventory is coming from, domestic vs import will also impact your lead time. Imports will take longer to get to you. Another example is the frequency of your shipments. Deliveries to stores daily vs weekly impacts your sales and capacity planning.

It's important to understand the lead times for the product category you are planning. If you plan your lead times too long, your inventory will sit unproductive in your warehouses or worse in stores. If you don't give yourself enough lead time, you risk not getting that inventory in time for your expected sales launch. An empty store void of products is every merchant's nightmare.

Other Planning Metrics

To determine the effectiveness of your MFP, there are a number of key performance metrics you will employ to help you evaluate the business.

Here is a list of some of the commonly used inventory performance metrics:

Inventory Metrics	**Description**
Sell Thru %	Sell through percent is the amount of inventory you have against what you sold over a specified period of time
Stock to Sales Ratio	This ratio establishes the relationship between your sales and its inventory
Turn	# of times a year or season that you're selling and replacing your average inventory
Weeks of Supply (WOS)	# of weeks it would take to sell out of your current inventory at the current rate of sale

Of course, MFP isn't MFP without considering cost and gross margin. In other word, the profitability metrics of the business must be planned alongside the above-mentioned metrics. For a more detailed understanding of all of the planning metrics and associated formulas, consult our retail math training resources.

In addition to these MFP essentials, there are a number of other key elements of the planning process above and beyond the capabilities of spreadsheets you will need to consider.

Plan Versions and Roles

We have already covered the "bottom level category plan" vs "the top-level strategic plan" versions. These versions are carried out by different planning roles.

Individual planners are responsible for specific product categories sometimes called the "bottom-up" plans. Managers, Directors and/or VP of Planning can sometimes opt for separate versions of "top" plan or "strategic" plan carried out at higher product levels such as Department, Division or Company. Therefore, the Planner or Manager roles in planning along with the plan versions (bottom level or strategic level), provide separate planning scenarios for teams to collaborate, revise and finalize their planning for final submissions and approvals.

These revisions and approvals often need to be maintained or preserved. For example, your original merchandise plan version (OMP), the one you communicated to the Finance Department, might be a version you'll want to save. That's the version you've ultimately committed to your CEO or Wall Street so you'll likely want reference it to make sure you're on target throughout the year. You might also have another revised version (RMP) from that original plan, often referred to as the stretch plan for your internal team to use. It's more aggressive and gives you some leg room to make sure you can make your official plan even if some things come up short. And of course, you always have a working plan (PLN) version that you are consistently monitoring and adjusting.

Preseason and Inseason

Several months before your fiscal year starts, you will already be working on the upcoming year's merchandise financial plans. This is commonly known as preseason planning. It is an important part of the planning process and obligates everyone to the upcoming year's deliverables. Pre-Season plans are the established budget for the upcoming year.

As the year starts, your merchandise financial plans now move into in-season mode. In-Season plans are a combination of actual sales activity for time periods passed or elapsed and a re-forecast or re-plan for forward looking time horizons.

Typically, the switch over from preseason to In-season is marked by some form of approval process. It is usually during this approval process the working plans are reviewed, approved and moved into an OMP version.

Agility to Re-Plan

As you can see, in all of these cases, there is massive movement of data and calculations. Whether it's locking down plan versions, or updating in-season plans with actual sales and re-planning, or consolidating multiple categories of plans for company summaries and visibility, or adjusting to changing market conditions and making sure the changes are spread down to corresponding plans quickly.

Agility is the key to gaining the competitive edge, to move quicker, faster, and do more with less all the while keeping your eyes on the profitability prize. That's merchandise financial planning.

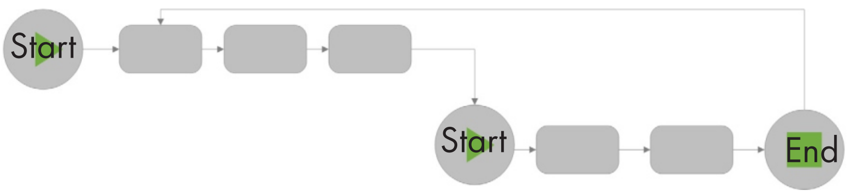
Concurrency to Accelerate

When I started in this industry more than three decades ago, the wisdom of the day was to do your preseason MFP first, before all else. Once that's approved and locked down, the team can then take the MFPs down to product plans by location and ultimately explode down to assortment plans.

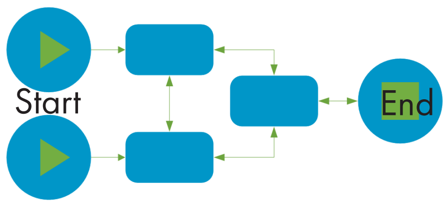
Of course, the reality was this linear process was never achievable in its entirety. MFPs took too long to complete, and the approval process took even longer since it involved multiple stakeholders. The process to change plans was too cumbersome and time consuming. By the time MFP is finalized and approved, it was often already in season.

Buyers in the meantime had to go to market and make purchasing decisions often without the finalized MFP #s. Changes or differences in buying was too tedious to consolidate in MFP so these variances in buys were often adjusted manually and after the fact. This contributed to the disconnect often witnessed between planning and buying.

Linear, Sequential workflow



Concurrent workflow



Today, our speed to market has increased exponentially as has the complexity of the merchandising and supply chain. Planning and buying teams are making thousands of decisions at breakneck speeds. Real time insight and planning tools are critical to everyone on the team. This is why AP can not be an extension of the MFP tool. MFP and AP need to cater to different needs.

As planners constructs MFP, buyers can simultaneously build their assortment plans. MFP and AP are two very different planning tools and must be built to the unique user profiles of each. Planners require data intensive analytically driven tools that is so ubiquitously characteristic of MFP as we know it. Buyers need the visually impactful and intuitive tools that let's them create beautiful assortments that will engage all of their customers.

Having specialized tools tailored to the unique user profiles of each allows both teams to work in their respective functional areas and collaborate real time. One function should not have to wait for the other to be done before they can start on their work. Technology is your enabler to facilitate the two functions and seamlessly connect both to help identify variances to call to attention - to ensure the financial plans are always in sync with the buys. Specialized, purpose-built concurrent tools integrated in real time is the key to accelerate the pace of team decision making for your competitive edge.

OPEN TO BUY

Inventory is your biggest cost, and opportunity. Merchandise Financial Planning gives your team the ability to create strategic financial roadmap to drive profitability and maximize inventory turns.

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