

How Do You Climb a Mountain? One Step at a Time

Michaels Stores is the leading player in the flourishing arts and crafts segment of the retail industry. Its 2004 sales (\$3.4 billion) represents approximately 11 percent of that market.

The customer base is overwhelmingly female (90 percent), young (half the customers are 35-54, another 24 percent are under 35), and affluent (45 percent have household incomes of at least \$60,000; 20 percent have household incomes above \$100,000). They are also loyal. The typical Michaels customer shops in the stores twice monthly, and “core” customers shop three times a month.

Out of the Dark Ages

Michaels has 872 stores in the United States and Canada, each with an average of 18,500 sq. ft. of floor space. Each store averages about \$4 million in annual sales and carries approximately 40,000 sku’s. That’s a lot of glue, ribbon and dried flowers to keep track of, and the inventory challenge was a major consideration in setting up the recent systems improvements.

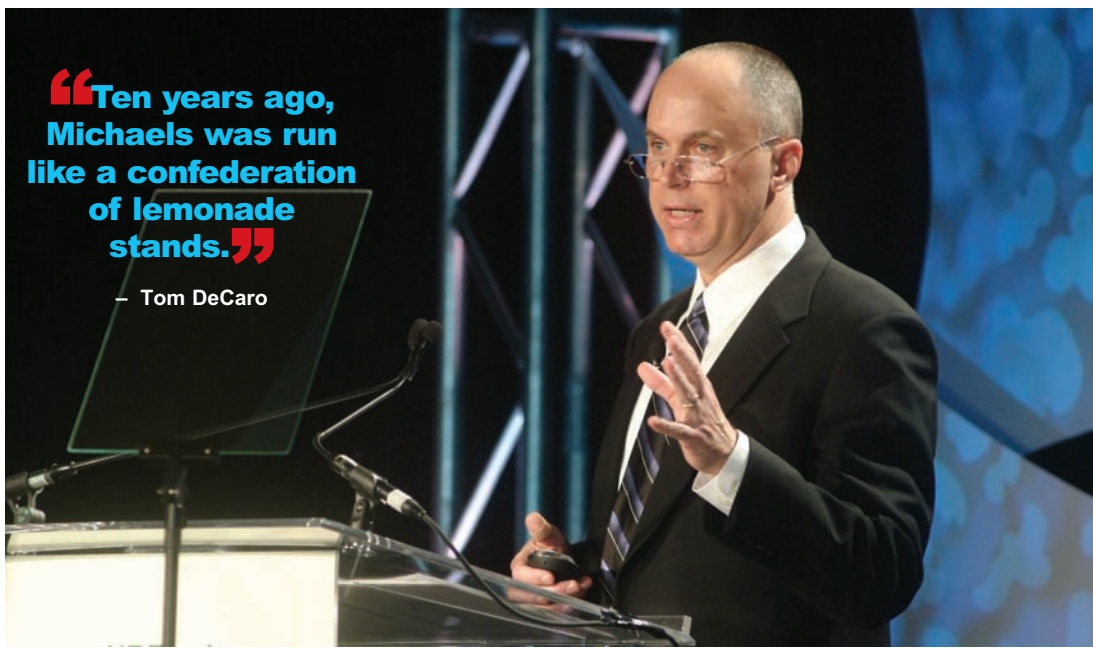
To hear executive vice president of supply chain Tom DeCaro tell it, there was plenty to improve. Ten years ago, Michaels Stores was in what he calls the Dark Ages. “It wasn’t run like a chain-store organization,” he said. “It was run like a confederation of lemonade stands. There were no POS cash registers. Each store ordered what, and how much, it wanted. The individual stores were even paying vendors on their own.”

Even then, Michaels wasn’t a tiny operation: In 1995, it had more than 500 stores and annual sales of \$1.3 billion. Its strength was that it was a large, well-known chain. Its weakness was that it had no systems in place to manage a business that size. There was no sales information. There was no centralized inventory data. Vendor relationships were a mess, not least because the vendors couldn’t get paid on time.

The distribution system was also a mess. There was erratic ordering, there was a lot of out-of-stock inventory, and there was a lot of dead inventory. The company, not surprisingly, was in poor financial condition.

Step-by-step plan

Michael Rouleau was brought in as president and CEO in 1996, and he articulated a clear, straightforward vision: Michaels would be a world-class arts and crafts retailer. It would get its act together in an ordered sequence of steps, beginning with the stores and working backward. Michaels would simplify store operations so that associates could spend more time with customers. To do that, it was necessary to keep the stores stocked properly. To do that, the distribution centers had to work effectively, which meant the distribution centers needed a reliable flow of stock to distribute. Finally, the company would take centralized control of its inventory.



These things the company proceeded to do, one step at a time. It began by installing POS cash registers in the stores, so they would know what they were selling. A year later Michaels put in a store order system using RFID and bar codes. Then came JDA space planning software, which showed all the stores how to present their merchandise, and an enhanced store order system that gave sales history and enabled the stores to order more intelligently.

Central systems

In 1997, Michaels implemented a Retek system to serve as a central repository of merchandise sales information. (The system could also manage inventory and track purchase orders, but Michaels wasn't ready for that yet.) Then it was time to open new distribution centers in Texas and California.

More important than the physical distribution centers, however, was the 1998 installation of a warehouse management system from Red Prairie. "For the first time, we had a consistent system across the network," DeCaro said. To help keep track of what was moving in and out of the DCs, Michaels installed JDA's Advanced Warehouse Replenishment by E3.

With a stable distribution system in place (Michaels opened another DC, in Hazelton, Pa., in 2002), it was time to get control over what the stores were ordering. In 2000, DeCaro and his teams had a planogram control function built into the Retek system. This generated a profile of appropriate planograms for each store; from here on, only items on an approved planogram could be ordered.

Vendors

Now it was time to standardize relations with the vendors. In 2000, Michaels teams created a manual to inform the vendors of what they needed in terms of UPCs and carton labeling. Since then, it has trained some 3,000 vendor associates and established a website for vendors. Initially intended to make vendor requirements available online, it is now used to share projections, sales and inventory data.

Having all these pieces in place enabled the chain to take on another important project: This kind of merchandise has an intense but short sales season; once the season is over, all you can do is mark it down and clear it out. Because of the liability represented by this fact of retail life, the stores were no longer allowed to buy seasonal merchandise on their own.

Top of the mountain: inventory

Non-seasonal merchandise — most of the total inventory — was still being purchased by individual store associates on an as-needed basis. This meant that the company couldn't forecast its requirements and couldn't correlate inventory to sales. What was needed was an accurate perpetual inventory system — which, like everything else, Michaels approached in stages. In 1999, it set up a team to identify every item that would be maintained by the system; in 2000, it performed the first in-store inventory pilot program.

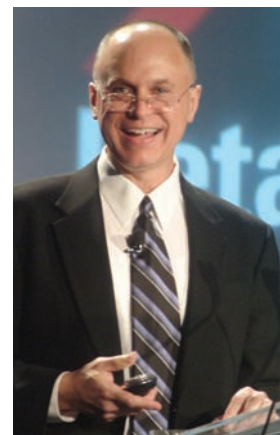
DeCaro and his teams spent 2001 expanding and enhancing the planned system. The rollout began in 2002, and by the following year all the stores had been inventoried. "Now," DeCaro said, "we knew what we owned, store by store — and it was really ugly. In-stock average was 81 percent, way below where it should have been."

By then, however, the end was in sight. A good thing, too, because the next chore was setting up an auto-replenishment system, which meant keeping track of 32 million sku/store combinations. "It was," DeCaro said, "one of the largest auto-replenishment implementations ever attempted."

In 2002, it piloted JDA's Store Replenishment by E3 in five stores. In 2003, Michaels began to roll out auto-replenishment to the chain. In June 2004, the last store went on the system, and Michaels tied the two JDA systems together earlier this year. Along the way, in-stocks have grown to better than 95 percent, while total inventory has declined by 12 percent.

Fruits of success

"It was a good plan," DeCaro said, "well thought out, and based on a vision and a strategy. It had a significant and immediate positive impact on the business." In 1998, Michaels Stores generated \$6 million in cash flow from operations; in 2004, it generated \$427 million. Much of this is attributable to growth, but much of it also is due, he said, to the rigorous, systematic way the company has brought its operations under control.



In-stocks now exceed 95 percent, while total inventory has declined by 12 percent.



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