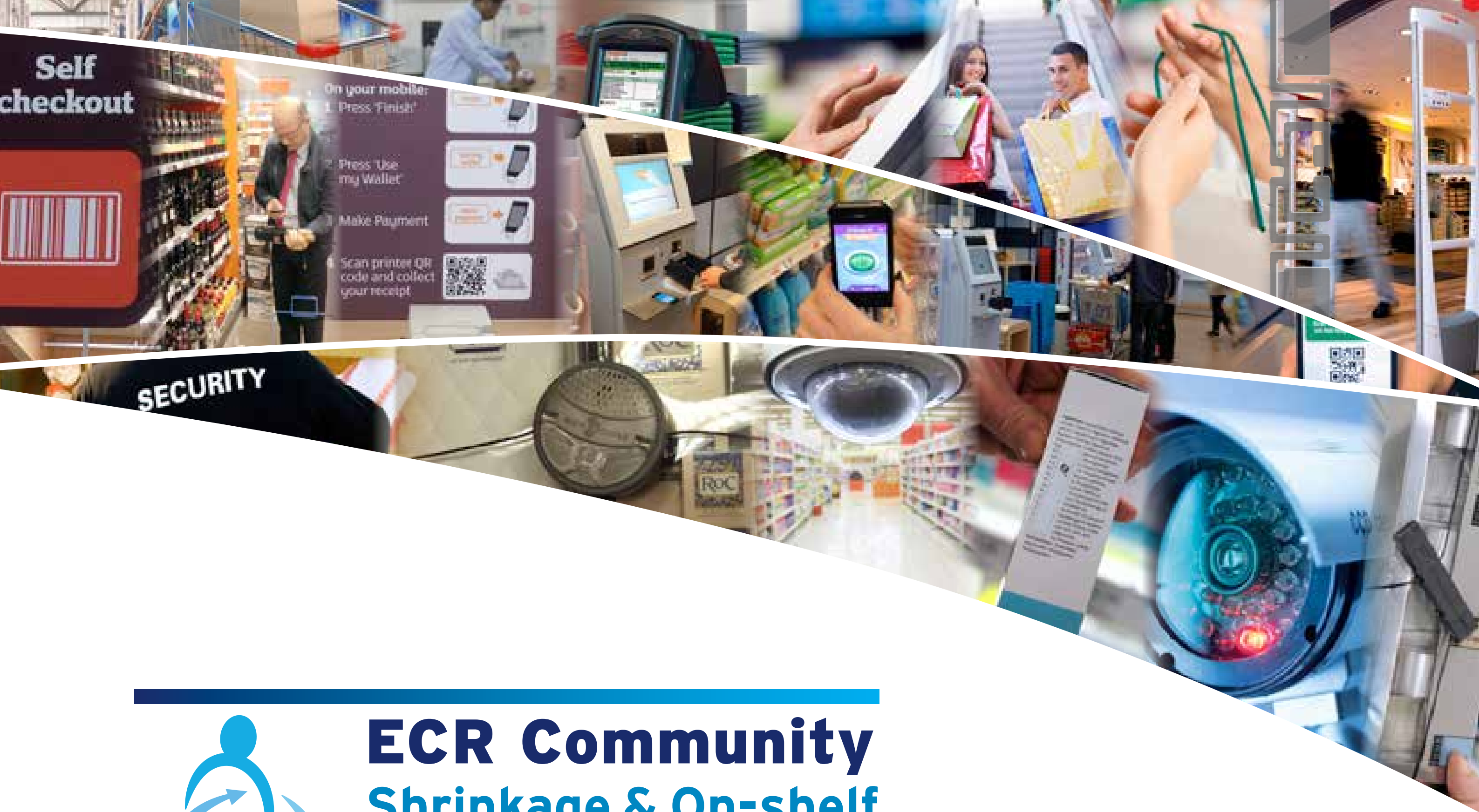


ECR Community
Shrinkage & On-shelf
Availability Group

An Overview of **Total Retail Loss**

Professor Adrian Beck
University of Leicester

Checkpoint
RILA
RETAIL INDUSTRY LEADERS ASSOCIATION
Educate.Collaborate.Advocate.
OLIVER WYMAN

Disclaimer

About the Author

Professor Adrian Beck works in the Department of Criminology at the University of Leicester, UK. Over the last 27 years, his research work has focused on helping retailers better understand the impact of loss upon their business and how it can be more effectively managed. He is currently an academic advisor to the ECR Community Shrinkage and On-shelf Availability Group.

He is extremely grateful to all those retailers who agreed to take part in this research – their time and patience was very much appreciated. Particular thanks are also due to Walter Palmer and Colin Peacock for providing extensive feedback on early drafts of this report.

To contact the author: beckbrc@gmail.com

ECR Community Shrinkage and On-shelf Availability Group

The Group is part of the ECR Community, a voluntary and collaborative retailer-manufacturer platform with a mission to 'fulfil consumer wishes better, faster and at less cost'. Over the last 18 years, the Group has acted as an independent think tank focused on creating imaginative news ways to better manage the problems of loss and on-shelf availability across the retail industry. Championing the idea of Sell More and Lose Less, the group is open to any retailer and manufacturer to join.

For further information: http://ecr-shrink-group.com

Retail Industry Leaders Association (RILA)

RILA is the largest retail trade association in the US, representing some of the most important retail brands in the world. It promotes consumer choice and economic freedom through public policy and industry operational excellence. By enabling collaboration, providing opportunities for the sharing of better practices, and proactively advocating on behalf of the industry, RILA plays a vital role in ensuring the retail sector remains one of the most important and successful parts of the US economy.

For further information: www.rila.org

For a copy of the ful report visit: https://www.rila.org/protection/resources/BeyondShrinkageReport/Pages/default.aspx

Background and Context

There is little consensus on what constitutes 'loss' within the retail world nor how it should be measured. The terms 'shrinkage' and 'shortage' have been loosely applied to encapsulate some of the areas that generate loss but they do not enjoy a clear and agreed upon definition across the sector. Equally, measuring losses at retail prices is probably the most common method adopted to capture the scale of the problem, but again, it is not without its critics. It can also be an unreliable indicator of risk, frequently not taking account of the profit margin associated with a particular product or indeed allowing for variations in how products are valued at any given time. Moreover, while the term 'shrinkage' has been used for probably the last 100 years of retailing, there continues to be wide variance on what is included and excluded when this term is used, with some retailers using it to describe only those losses captured through identified discrepancies in inventory counts, while others add in additional types of loss recognised through other forms of recording practices such as products going out of date, markdowns, damaged products, and product set up errors to name but a few. It is also clear that the growing breadth and complexity of the retail landscape is putting stress upon the applicability of traditional shrinkage definitions – how might losses associated with on line and so called Omni-channel retailing be measured and understood? In summary, the key challenges are:

- There is no agreed definition of what constitutes 'shrinkage'.
- Most published estimates of shrinkage are based primarily upon measures of unknown loss where the cause is unidentifiable.
- The focus of most definitions of shrinkage typically relate only to the loss of merchandise.
- In most surveys the measurement of shrinkage is requested at store level – the 'retail supply chain' rarely features.
- There is little consensus on how shrinkage should be measured although most surveys collect information at retail prices.
- The categorisation of shrinkage is confusing and often relies upon catch all phrases that lack firm definitions or seem incapable of capturing the various types of risks associated with an increasingly complex retail environment.
- The terms 'retail crime' and 'shrinkage' are sometimes used interchangeably with the former including the costs of responding to losses, while the latter may or may not be based upon known and unknown losses.

The purpose of this research was to develop a definition and typology of **Total Retail Loss** as means to better understand and measure the current and emerging retail risk landscape.

Research Methodology

The project utilised the following research methods:

- Questionnaire sent to a selection of European retailers soliciting feedback on how they currently measure and understand a range of retail losses.
- One hundred interviews with senior directors representing functions in some of the largest retailers in the US (27% of the total market). This included: Loss Prevention; Internal Audit, Accounting/Finance, Supply Chain; Risk Management; Store Operations; Merchandising; Omni Channel; Product Development; Stock Controllers; Analytics; Information Services; Organized Retail Crime; and Safety.
- Four focus groups with loss prevention representatives from a range of European retailers and manufacturers. These sessions lasted on average two hours with the number of representatives ranging between 15 and 40.

Introducing Total Retail Loss

Defining Total Retail Loss

The research developed the following definition of costs compared with losses:

Costs: *Expenditure on activities and investments that are considered to make some form of recognisable contribution to generating current or future retail income.*

Losses: *Events and outcomes that negatively impact retail profitability and make no positive, identifiable and intrinsic contribution to generating income.*

Using these definitions, various types of events and activities can be categorised, for example, incidents of customer theft can be seen to be a loss – the event and outcome plays no intrinsic role in generating retail profits – it makes no identifiable contribution whatsoever and were it not to happen, the business would only benefit. Alternatively, incidents of customer compensation, such as providing a disgruntled shopper with a discounted price, can be seen to be a cost. In this case, the business is incurring the cost because it believes that by compensating the aggrieved consumer they are more likely to shop with them again in the future – the policy of compensating is regarded as an investment in future profit generation and is therefore categorised as a cost and not a loss.

What these definitions focus upon is not whether an activity or event can be controlled or not, or where the incurred cost was planned or unplanned, but upon its fundamental role in generating current or future retail income. Where a clearly identifiable link can be made between an activity and the generation of retail income then it should be regarded as a cost, whereas all those activities and events where no link can be found should be viewed as a loss.

Margin Eroders – A Cost and Not a Loss

Margin Eroders are events or activities that while potentially undermining overall profitability can still be regarded as playing a role in generating value. Examples include: product markdowns, customer guarantees, staff discounts, price matching guarantees, customer compensation, and food donations. These are 'choices' made by the business and as such can be regarded as investments – product markdowns improve the prospects of some value being received for the item; price matching, customer guarantees and compensation schemes are an investment in goodwill to try and ensure that recipients continue to be customers in the future. As such, they are not included within Total Retail Loss although is it recommended that they are monitored and measured elsewhere to understand their impact across the business.

Developing a Total Retail Loss Typology

The term 'Total Retail Loss' is being used to better capture the range of losses occurring across the retail landscape, although it should be noted that the associated typology does not necessarily encompass every form of loss that a retailer could conceivably experience.

The Typology is focussed upon capturing the 'value' of retail losses and not the number (prevalence) of events – where a 'value' cannot be calculated or there is no loss of value associated with an incident, then this should not be included. It is important to note that the Typology moves beyond the just the loss of **Assets** (stock and other physical objects valued mainly at **Cost Price**) and includes the loss of **Cash** and **Margin**.

Locating Total Retail Loss

When losses are predominantly/exclusively focused upon the loss of stock, as is the case with existing definitions of shrinkage, then the location is largely determined by where the stock can be counted – usually the physical store. However, when the definition of loss is broadened to consider all events and outcomes that negatively impact retail profitability and make no positive, identifiable and intrinsic contribution to generating income, the range of possible 'locations' inevitably increases beyond just the store. It is therefore proposed to group losses under four 'centres' of loss: (see Figure 1):

Stores: Losses that occur in the physical buildings owned or rented by a retailer where customers can purchase products and where E-commerce activities may be undertaken such as shipping of product, customer pickups and returns.

Retail Supply Chain: Losses occurring across the entire process of manufacture, transportation and storage of products for which the retailer has ownership and liability. This includes where appropriate, E-commerce activities such as managing fulfilment centres, shipping of product to customers and dealing with returns.

E-Commerce: Specific losses related to the provision of goods and services provided through some form of on-line/Internet-based interface, enabling customers to purchase goods/services without necessarily visiting a physical store.

Corporate: A category of losses which are typically related to the broader activities of the business, beyond those necessarily occurring in stores, the retail supply chain or E-commerce, or where the overall loss is not allocated directly to these centres.

Known and Unknown Losses

The Typology recognises that there are two types of losses incurred by retailers – those where the cause is **unknown** and those where the cause is **known**, with a reasonable degree of certainty. Most existing measurements of shrinkage are based upon the difference between the value of expected and actual inventory levels in retail stores, which generates an unknown loss number – the collection process rarely if ever generates data that might give a sense of how losses occurred.

There are then losses where the cause of the loss is known, sometimes with a high degree of certainty and at other times with a lower level of confidence. For instance, a product that has gone beyond its sell by date and must be thrown away is often recorded by a retailer – the value of the items discarded is known, as is the cause. Where retailers have recognisable policies and practices in place to record these types of loss, then they should be included under the appropriate known loss category.

Known Losses: Malicious and Non-malicious

The typology subdivides known retail losses into two groups: malicious and non-malicious forms of loss. 'Malicious' refers to those activities that are carried out to intentionally divest an organisation of goods, cash, services and ultimately profit, while 'non-malicious' relates to events that occur within and between organisations that unintentionally cause loss. Malicious losses typically happen when existing systems have been found to be vulnerable – sometimes by accident, often by 'probing' – and are duly 'defeated' by the offender. As such, remedial action to deal with some types of malicious activity will have a 'half-life' where their effectiveness deteriorates over time as offenders find new ways to overcome them. On the other hand, non-malicious loss is usually less dynamic and therefore more responsive to lasting ameliorative actions.

Categorises of Total Retail Loss

Total Retail Loss draws a distinction between the categories of loss that can be **Measured**, and measured in a way that is **Manageable** for a modern retail business, and those that cannot. In addition, it must be **Meaningful** for the business to monitor a particular category of loss. As can be seen (Figure 1), 31 types of known loss are included in the Total Retail Loss Typology covering a wide range of losses across the retail enterprise, beyond just the loss of merchandise (for a description and definition of each category see the [full report]).

The Potential of Total Retail Loss

The proposed Total Retail Loss Typology is a radical departure from how most retail companies have understood and defined the problem of loss within their companies – moving away from a definition focused primarily on unknown stock loss, mainly in physical retail stores, to one which encompasses a broader range of risks across a wider spectrum of locations. The Typology has the potential to benefit retail organisations in the following ways.

Better Managing Retail Complexity

The retail landscape in which the term 'shrinkage' was first used has been transformed by wave after wave of innovation and change. From the rise of consumer choice right through to the widespread adoption of open display and increased merchandising, the risk profile has changed immeasurably. Simply relying upon 'shrinkage' to reflect and properly convey the scale, nature and impact of retail losses is no longer appropriate, particularly as the retail environment becomes more dynamic and fast changing.

Generating Greater Transparency and Accountability

The ambiguous nature of shrinkage and general lack of transparency in terms of understanding its root causes can generate a lack of accountability, particularly within retail stores. Store managers, understandably, question the reliability of the number, especially where there is a pervasive sense that the supply chain may be foisting losses upon stores, caused by its own inefficiencies. Equally, losses can be moved between different categories depending upon the performance measures in place – 'wastage' can become 'shrinkage' if the former is identified as a key performance indicator. By measuring a broader range of categories of loss, it becomes much more difficult to play this game – most losses will be measured somewhere, improving transparency and accountability throughout the organisation.

Creating Opportunities – Unlocking Baked-in Losses

There is a general lack of prioritisation and urgency associated with categories of 'loss' that are already measured and/or a budget has been allocated to cover. They are often viewed as a 'cost' and therefore not requiring any remedial action – in effect the process of capturing the loss or in some way planning for it through budget allocation renders them immune from generating concern. By adopting a more systematic approach to agreeing what is a retail 'loss' and bringing these together under a single typology, opportunities may then arise to begin to minimise their overall impact upon the business and realise new profit enhancing opportunities.

Maximising the Potential of the Loss Prevention Team

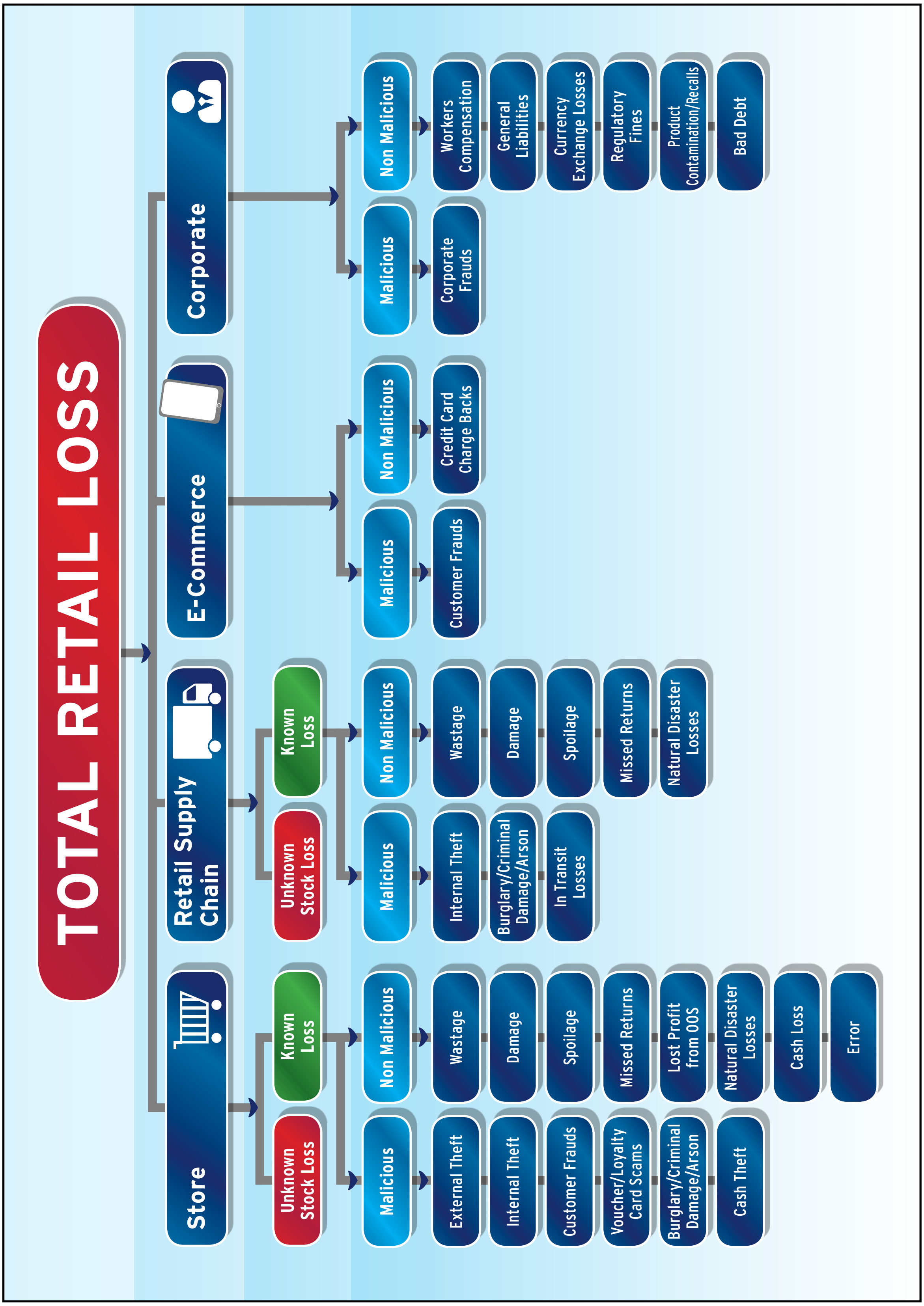
Dealing with unknown loss, which is what most loss prevention practitioners typically focus upon, is probably one of the hardest challenges faced by a management team in retailing. Trying to solve problems where the cause is typically unknown is at the hard end of the management spectrum – it requires creative thinking, imaginative use of data and considerable experience. Imagine if these capabilities were used on the broader range of *known* problems in the Total Retail Loss Typology – the impact could be profound.

Making Good Business Choices

By generating a broader, more detailed understanding of how losses are impacting across a retail organisation, it may be possible to take a more strategic approach to the allocation and use of existing resources. Certainly, at a macro analytical level, the Total Retail Loss Typology offers value in helping the business respond not only to existing loss-related challenges, but also reviewing the implication of any future business decisions.

Levels of retail loss are a function of choices made by the organisation, for example, introducing customer self-scan checkouts is a choice – it has some clear benefits associated with it, such as lower staffing costs, but it also has some very clear risks associated with it as well, such as increased levels of loss associated with non/mis-scanning of product. Deciding on the overall value of these retail choices requires high quality data on both sales and all possible **losses.** They need to be viewed in the round and not as a series of cross functional trade-offs where 'losses' and 'profits' are allocated separately, driving behaviours which are unlikely to benefit the business as a whole. The Total Retail Loss Typology can play a key role in enabling this more holistic review of business choices to be undertaken.

Figure 1: The Total Retail Loss Typology



ECR Community
Boulevard du Jubilé 71, bt3
1080 Bruxelles
Belgium
http://ecr-shrink-group.com