RETAIL'S DIGITAL JOURNEY

HOW WINNING RETAILERS ARE CONTROLLING SHRINK AND THRIVING

IHL GROUP

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Agilence

Cutting-edge loss prevention teams are expanding their purview beyond traditional theft and fraud to tackle retail loss in all its forms - in the store, online in e-commerce sites, in the supply chain, and at the corporate office. With Agilence, businesses easily pinpoint concerns about preventable loss cases and quickly prescribe appropriate solutions. Agilence's prebuilt reports and dashboards; predictive analytics; self-service analysis, automated alerts; and prescriptive resolution plans ensure timely detection, communication, and action. Retailers have saved millions of dollars by optimizing operations and preventing loss using Agilence. Many have also improved employee and customer safety, identified training opportunities, improved customer experiences, increased promotional success, and eliminated productivity gaps. By empowering retailers with easily digestible analytics, Agilence provides actionable insights with tangible business value.

The New State of Retail DISRUPTIVE CHANGES ARE HERE TO STAY

After multiple years of disruption, Covid-19 and its variants have changed how consumers shop forever. The pandemic has altered not only what we buy, but how we buy it. Purchases both large and small are now frequently made online and remote working has turned the home improvement market into a new growth area.

There's been another big change during this period as well. Nearly 4 million laborers began working in warehouse and delivery jobs, joining companies like UberEATS, DoorDash, Amazon, and Postmates. This unexpected shift has created a massive labor shortage for front-end retail positions.

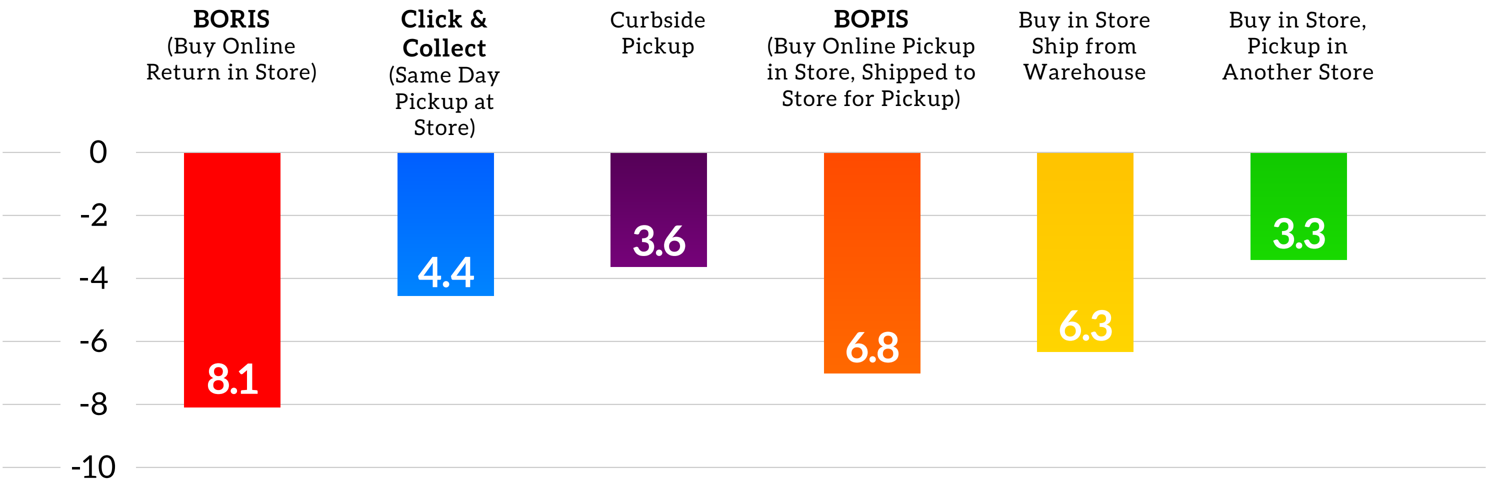
Whether it is Buy-Online-Pickup-In-Store (BOPIS), delivery or ship from a warehouse, when compared to traditional in-store purchases, digital journeys can incur a significant margin loss. This is due to the additional costs of fulfillment, whether it be packing, shipping, or storage. On average, retailers lose 3-8 margin points when consumers leverage one of these digital journeys to complete a purchase.

Moving into 2022, less than 30% of retailers say they have adequately invested in systems and process that optimize these newly formed digital journeys. In IHL's latest research, 37% of retailers say they have optimized Ship from Warehouse, while only 16% have optimized BOPIS, 26% Ship from Store, and 27% Local Delivery.

AVERAGE MARGIN POINT LOSS

From Traditional Store Visit When Not Optimized

Source: IHL Group



Early in the pandemic, the experience around these new journeys was poor, likely because they came together quickly and were often put into operation before being thoroughly understood. Contributing factors like competition for pickup and delivery spots, large numbers of out-of-stocks, and on-the-fly substitutions made it unlikely consumers would find these new digital-heavy journeys desirable post-pandemic. In fact, IHL estimated only 45% would remain. Unfortunately, the COVID-19 pandemic has not subsided, and its persistence will continue to affect all aspects of consumer lifestyles for the foreseeable future.

While consumers rushed back to stores after lockdowns lifted, over 79% of their household budgets designated for online shopping have remained after stores reopened. Meaning, consumers aren't choosing to shop primarily one way or the other - online or in-store. The answer for today's empowered consumers is simple: they want both. Both are here to stay, and retailers must invest in technologies to make all these journeys more profitable long term.

Some retailers are increasingly charging fees, either as a membership or per transaction, for pickup and delivery to get closer to acceptable margins on these transactions. But fees alone are not enough to preserve profitability. To become sustainably profitable, retailers must rectify the areas of margin erosion within these transactions.

Further, losses are not just limited to the new journeys. Retailers continue to suffer major losses due to traditional causes of shrink including theft, fraud, and administrative errors. This can be shrink caused by consumers or employees. As inflation outstrips wage growth, internal employee theft is on the rise. Finally, adding on top of these is the meteoric rise of organized retail crime. Retailers are facing record losses.

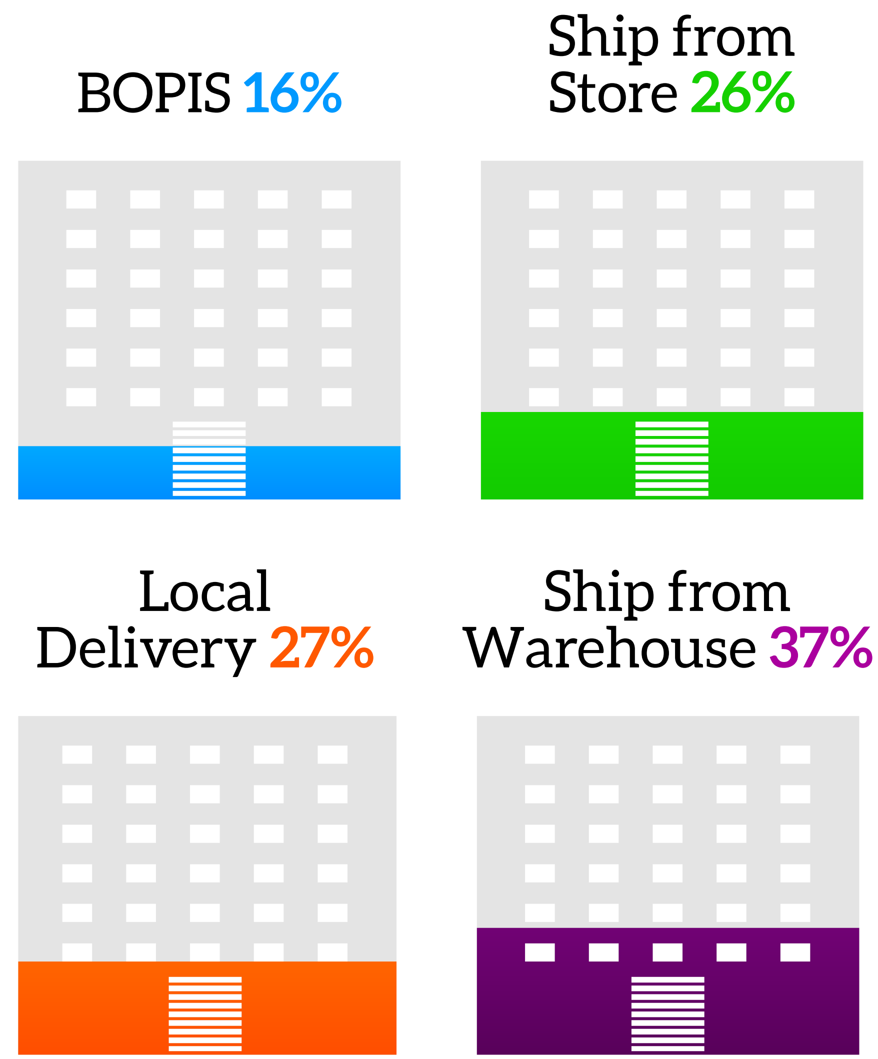
The return of store sales growth in 2021 has hidden many of these challenges. Traditionally, sales growth creates an increase in profitability. For instance, if sales growth increases 10%, profitability generally goes up 12-15% as fixed costs are already covered and only variable costs remain. Thus, more of the sale contributes to the bottom line. But that hasn't been the case since the pandemic. Some of the fastest growing retailers have seen sales rise 10% in the past year, but their profitability is only up 6-7% due to margin loss and shrink. Extrapolate this issue to a $5.5 trillion economy and the new retail landscape is showing total margin losses around $165 billion, much of which can be attributed to shrink, inefficient processes, and out-of-date technology.

Once again, because this has been overlooked in the comparisons from the reopening of the economy in the past year, retailers will face a major reckoning once that sales growth slows. To attack these problems, it is absolutely crucial for retailers to significantly invest in technologies along with process improvements and increased security.

DIGITAL JOURNEYS NOT OPTIMIZED IN 2021-2022

Percent of Retailers Who Have Optimized Digital Journeys for Profitability Today

Source: IHL Group



The Value of Optimization & Automation

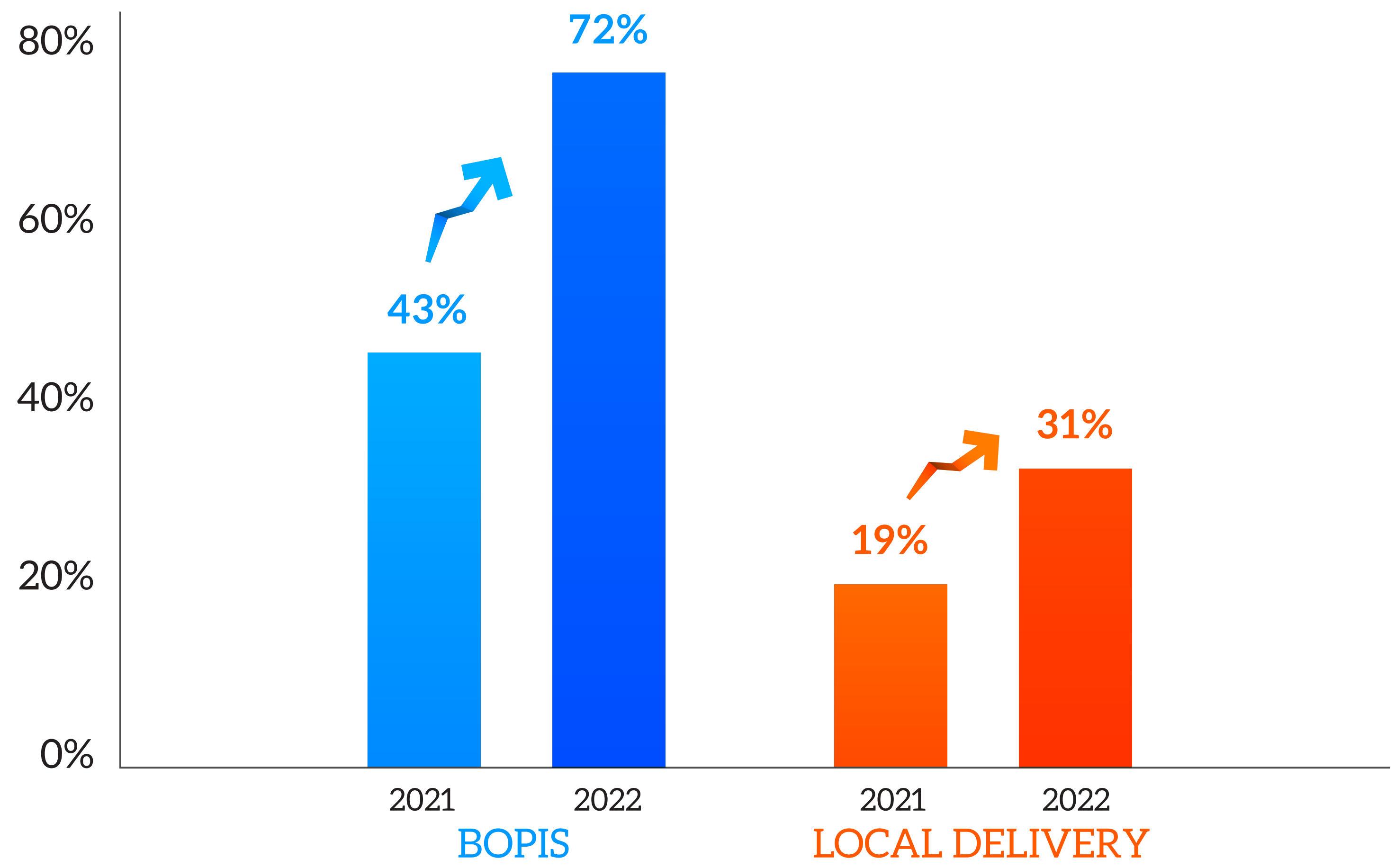
How much better financially do retailers perform when their digital journeys are optimized? Let's look at the most recent data. Retailers that optimized their BOPIS processes and systems by the end of 2021, experienced profitability at growth rates 43% higher than those that were not optimized. Further, for 2022, their expectations for profitability are 72% higher than those who haven't perfected their BOPIS offerings. For Local Delivery, those who have optimized that channel have already seen 19% higher profitability in 2021 and expect 31% higher in 2022.

It is important to note that even the most efficient of today's retailers have not yet cracked the full equation of making their digital journeys as profitable as traditional walk-in customers. Retailers can recapture up to 80% of the margin loss through optimization of the process alone. The addition of a fee (if consumers will accept) does then make the equation positive. The most critical component, however, is that as retail sales growth drops from double digits to single digits in 2022, optimized retailers will remain profitable. Without optimization many retailers will be facing losses when in-store growth abates.

Optimization should not just be limited to systems. It should also include optimizing processes and scarce labor resources as well. A good rule of thumb is "automate what can be automated" and leverage labor where it adds the most value and contributes to the greatest margin increase. In doing so, it not only brings them profitability today but positions these retailers competitively for the future.

OPTIMIZATION PAYS FOR YEARS TO COME
Higher Profitability Growth Expected for 2021 & 2022
For Retailers Who Optimized Their Digital Journeys

Source: IHL Group



Analytics Are Essential to Reducing Loss for Retailers

The initial challenge retailers face when it comes to stopping margin erosion is figuring out how to begin. Retail companies are often data rich but decision poor, storing massive amounts of information about their stores, employees, and inventory but lacking the ability to interpret their data and transform it into actionable insights.

The first step retailers must take is to deploy the appropriate analytical tools that help their loss prevention and operations teams dig into their sales and operational data to identify actionable opportunities for improvement. Some issues become obvious with top level analytics, but the big changes often require taking the analysis to deeper levels. This is particularly true when the margin loss is hidden amongst the numerous transactions, stores, customers, and employees that interact with the company daily. Most retailers, including the largest and fastest growing, struggle to identify and interpret patterns without the help of robust analytics-based tools.

The use of advanced analytics, including forecasting and machine learning, can assist loss prevention and operations teams in quickly identifying deficiencies among systems, processes, and people that are causing the greatest margin leaks.

It's not always the most obvious issues that provide the biggest returns either. When determining where to act first, using data to investigate where loss is compounding over time often leads retailers to uncover even bigger opportunities for improvement.

For example, margin losses for BOPIS or Click and Collect may initially appear to be related to labor performance or understaffing. But digging deeper could show that the heart of the issue is inaccurate inventory counts. Fixing the inaccuracies not only improves the margins for BOPIS or Click and Collect, but the labor utilization metrics also improve. But the analysis shouldn't end there. Inventory inaccuracies should be investigated too. The root causes of these losses could be attributed to several identifiable issues, such as customer theft, misplaced or mislabeled products, inventory locked up, vendor fraud, or employee theft. Without a detailed analysis, these losses may remain hidden and will continue to negatively affect the business.

In 2021, North America saw retail losses of

$165 Billion

Source: IHL Group

due to shrink & insufficient digital journeys.

Not All Retail Analytics Tools are Created Equal

When selecting an analytics tool, retailers are often tempted to use homegrown solutions or try to retrofit existing corporate business intelligence tools. The difficulty in taking this approach is that neither option was designed specifically for retail or loss prevention, which means reinventing KPIs, reports, and alerts that may or may not have been based on best practices. The time and resources needed to tweak and perfect these tools into solutions that meet the specific needs of retailers is not insignificant either, meaning the return on investment may not be noticeable for a much longer period of time. This is why selecting an analytic tool designed specifically for reducing retail shrink across all channels can provide a huge jump start toward optimizing and automating.

These tools are often designed specifically for retailers while allowing customizations and integrations to all your mission-critical data for a comprehensive view of your operations. Using tools designed by domain experts also makes it possible to jump-start the analysis. After all, 95% of the issues one retailer faces are faced by others, whether they are analyzing shrink, operations, or sales-increasing opportunities. Leveraging the right analytics tool gives your company the benefit of learning from your peers and the ability to focus your scarce resources on the specific issues.

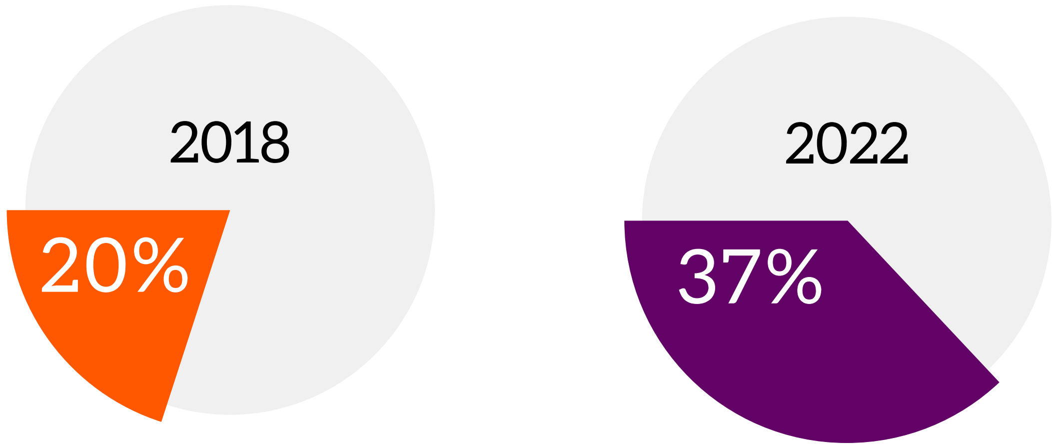
Where Retailers of the Future are Spending

The COVID-19 pandemic ushered in a once-in-a-generation increase in the percentage of revenue that retailers spend on IT. On average, we have seen IT spend as a factor of revenue increase 40-50%, depending on the sector.

There is, however, a significant disparity in how different classes of retailers spend their IT budget and the level in which they are investing. Just a few years ago, retailers estimated that 80% of their spend was used to "keep the lights on" for existing systems and roughly 20% was available for new technology and innovation. In IHL's latest research, the percentage for innovation doubles to 40% for General Merchandise Stores (Department Stores and Specialty Stores) and Hospitality (Restaurants, Lodging, Entertainment) companies. Overall, retailers report that only 63% of their budget is spent maintaining and integrating existing systems and 37% is now being spent on new systems and innovation. For winning retailers (retailers with sales growth of 10% or more), only 53% is being spent on existing systems for 2022 and 47% is available for innovation. This means that not only are winning retailers spending more on IT, but they are also spending considerably more on innovative IT spend and transforming their operations to align with both current and future shopping habits.

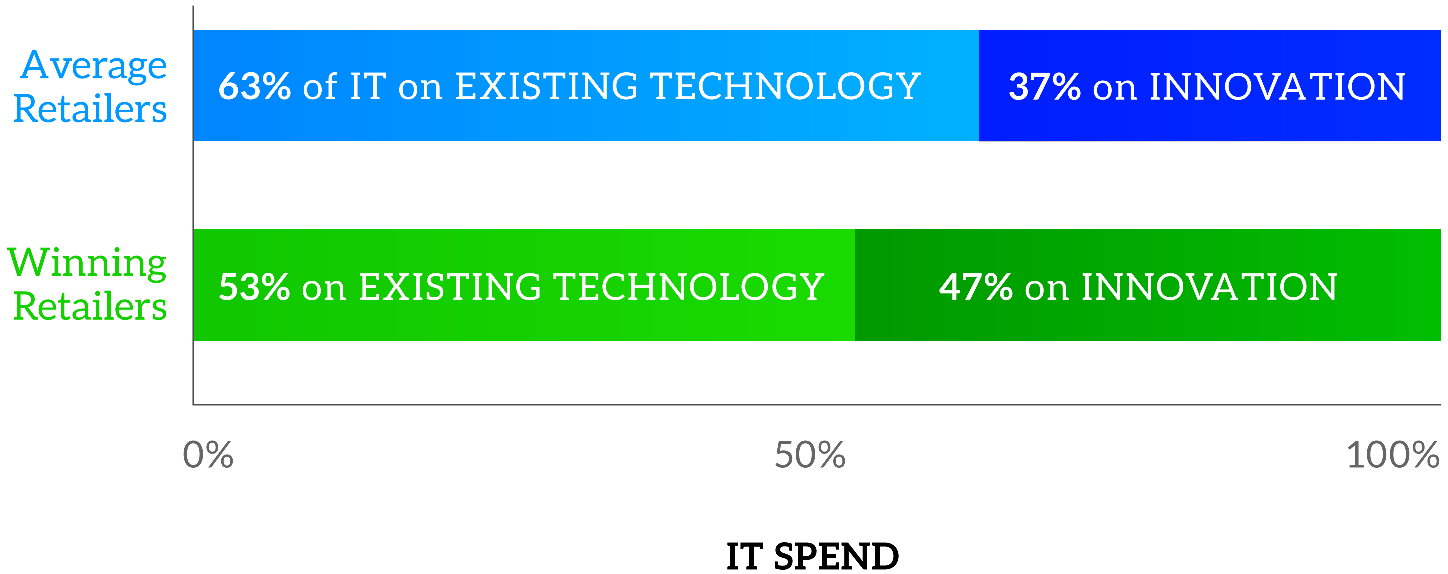
HIGHER IT SPEND FOR INNOVATION

Source: IHL Group



WINNING RETAILERS SPEND SIGNIFICANTLY LESS ON EXISTING TECH Those With Sales Growth > 10%

Source: IHL Group



Nowhere is this difference more apparent than the comparison of winning retailers to below-average retailers (flat or declining sales). Winning retailers are investing in ways to ensure their digital journeys are profitable whereas below-average retailers are spending their IT on opening new stores (at a rate 2x that of winning retailers). But the winning retailers are heavily investing in making certain all digital journeys are profitable. In other words, below-average retailers are spending considerably more of their IT spend on basic infrastructure for new stores, while winning retailers continue to build a firmer foundation from which to expand and grow their business.

Winning retailers are heavily investing in all technologies that are making the most of limited labor, reducing losses, and optimizing digital journeys for profitability. In fact, they are growing their spend in BOPIS/Click and Collect-specific spend at a rate 110% higher than below-average retailers. When it comes to Local Delivery, the winners are growing IT spend at a level 58% higher than the below average performers in their sector. They are leveraging analytics to find both the visible and hidden areas of loss and attacking those areas with process and technology updates. They are focused on using data insights to optimize, reduce non-sales activity, increase efficiency, uncover upsell and cross sell opportunities, and maximize the labor force. They rely on their analytics to monitor the data and deliver alerts in a timely fashion when something is wrong or out of the ordinary.

The bottom line is that winning retailers are ahead of their competitors when it comes to using technology and analytics to reduce shrink and improve margins. They are embracing the fact that the labor shortage is not going away and digital journeys are here to stay. As such they are adapting their businesses to be more future proof.

WINNERS SPEND MUCH MORE ON OPTIMIZATION

Than Below Average Retailers

Source: IHL Group

BOPIS **110%** Higher Spend

Local Delivery **58%** Higher Spend

Conclusion

We have seen a once in a lifetime reset in retail because of COVID-19. This reset has changed the way consumers shop as well as how retailers do business. Labor shortages plaguing retailers are likely here to stay, as is the shift in customer journeys to a more digital focus. Smart retailers have already made the pivot and are investing in systems that will help them adapt to these changes and innovate for the future. They are leveraging advanced analytics to search for both obvious and well-hidden leaks in profit margins.

These insights and the ability to act on them are key to succeeding in the new retail landscape. Many retailers will struggle to remain profitable if they do not make investments to optimize their new digital customer journeys.

Winning retailers will allow empowered consumers to shop where they want, how they want, and when they want while remaining profitable. It will take bold investments, strong insights, and forward-thinking leadership to succeed in this new era of retail.

> “The data is clear, below-average retailers are spending their IT on opening new stores (at a rate 2x that of winning retailers), but the winning retailers are heavily investing in making certain all digital journeys are profitable.”
>
> *– Greg Buzek, President IHL Group*