Beyond SHRINK

A **NEW FRAMEWORK** EMERGES TO **CHANGE** HOW RETAILERS **THINK ABOUT** AND **MEASURE LOSS**. > By Mike Troy

Achieving success in the retail business has long been a straightforward proposition that involved driving top-line growth through new stores and improving selling space productivity as a means to leverage expenses over a larger base of sales to improve profits. The formula, while tried and true, doesn't work so well in an environment of tepid consumer spending and food deflation coupled with an abundance of selling space that inhibits the return on investment of new stores while expense pressures mount related to satisfying consumers' digital desires.

Faced with this scenario, retailers continue to scour their supply chains for efficiency gains while increasing efforts to curtail shrink-related losses that destroy margins. The former typically involves process-driven and readily measurable approaches related to the importation, distribution and replenishment of goods along with the optimization of in-store processes.

When it comes to shrinkage, efforts to improve profitability become more challenging. For starters, the terminology used to describe sources of loss vary from retailer to retailer, and even those who have figured out what to call it have differing views on the type of losses that comprise shrink and how to calculate them. This inability to accurately define and measure shrink has hindered efforts to manage and reduce it.

The new Total Retail Loss typology segments sources of retail loss into 33 areas so retailers can better define, measure and consequently manage all type of profit-sapping losses.

"We find ourselves in a position where for the first time as an industry when we are talking about Total Retail Loss we are talking about the same thing."

—LISA LaBRUNO, *RILA*

The situation is about to change thanks to a landmark study released in the fall of 2016 titled, "Beyond Shrinkage: Introducing Total Retail Loss." The 54-page report published by the Retail Industry Leaders Association (RILA) gives the industry a new way to think about an operational challenge that increases costs and erodes profitability at numerous points throughout the enterprise. The culmination of a two-year process, the report attempts to introduce a common vernacular, or typology, as a means to drive improvement. The research was commissioned by RILA's Asset Protection Leaders Council (APLC) and executed by Professor Adrian Beck from the University of Leicester in the United Kingdom, and involved interviews with 100 senior retail executives whose companies' combined annual sales totaled more than $859 billion.

COMMON LANGUAGE

"We find ourselves in a position where for the first time as an industry when we are talking about Total Retail Loss we are talking about the same thing," says Lisa LaBruno, RILA's senior vice president of retail operations.

Currently, there is no consensus on how to define and measure losses in retail, according to LaBruno. The term "shrinkage" is long-standing and widely used, but study found that its definition and use varies considerably across the industry. Therefore, the report develops a definition of Total Retail Loss that is manageably measurable, meaningful, and applicable to a broad range of retail environments.

"The impetus for this report was a conversation at a meeting of our Asset Protection Leaders Council meeting, a group comprised of the top AP executives from our member companies, where we were talking about shrink and the need for a more global view of things. Fast-forward two years and we have this comprehensive research report that resulted from the AP Leaders Council coming together to identify common and compelling challenges and how we solve them," LaBruno says.

The key outcome from the research is a first-ever typology for Total Retail Loss that categorizes retail costs and retail losses; establishes an organizational framework for measuring loss and its impact on the business, whether it be in-store, along the supply chain, or in the corporate office; and assigns a measurable value to different categories of loss.

DEFINING THE CHALLENGE

Consensus is actually very hard to find on what the term "shrinkage" means and what should be included and excluded when it is being calculated, Beck noted in the report. Some regard it as a catchall for a wide range of losses suffered by retailers, including both crime-related events such as staff and customer theft, and errors incurred as part of the process of retailing, such as incorrect pricing, changes in price, damaged products and food items going out of date. Others seem to use only it to refer to variance in the value of expected and actual inventory.

While definitions of shrinkage varied, typically it would be broken down into four main areas of loss: employee/internal theft; customer/external theft; administrative/paperwork error; and vendor/supplier fraud. According Beck's report, these categories, and the associated guesstimates of their significance, have dominated the reporting of shrinkage for decades. While internal and external theft can be readily understood, administrative errors and vendor fraud are more difficult to categorize.

Beck's report takes the ambiguity of shrinkage and puts a much finer point on the issue with the Total Retail Loss typology and new thinking around how to measure areas of loss. For starters, Beck categorizes sources of loss into the four main areas of stores, retail supply chain, e-commerce and corporate. Then under each of those areas, sources of loss are further categorized as known and unknown, and malicious and non-malicious. The result is 33 potential sources of loss, as opposed to the four large categories previously relied upon.

BRINGING CLARITY

The new way of thinking about loss might seem to add complexity to the issue, but LaBruno contends more finely segmenting and clearly defining sources of loss brings much needed clarity to the issue. Doing so will aid in management of the challenge by giving the industry standards against which to benchmark and allowing organizations to overcome internal issues, LaBruno says.

"There is not a singular organizational function that is responsible for most of these loss areas. So in addition to this report allowing for greater synergy across retailers, it provides insights cross-functionally within a within a single organization and makes the organization smarter," LaBruno says.

One retailer quickly becoming smarter as a result of the research is Walgreens. Tim Gorman serves as Walgreens' divisional vice president of asset protection solutions and also chairs RILA's Asset Protection Leaders Council.

"The report offers compelling reasons for retailers to consider adopting the total retail loss typology and is intended to serve as a resource for asset protection executives across the industry," according to Gorman.

Gorman is a vocal proponent of the Total Retail Loss way of viewing the business challenge, and in October participated in a webinar with RILA to discuss the topic shortly after Beck's report was released. He, LaBruno and Beck are eager to see the report and its findings gain broad acceptance and are encouraging retailers to experiment with the typology by populating the 33 newly defined categories of loss with available data. RILA is also in the preliminary

stages of working with a group of retailers to undertake a benchmarking exercise to understand how the typology can be used to understand industry trends.

REFINEMENT OVER TIME

Over time, there is an expectation that through retailer engagement and testing the Total Retail Loss Typology can be further refined, since Beck acknowledges the new framework doesn't encompass every form of loss a retailer could conceivably experience.

"The word 'Total' is being used in this context to represent a much broader and more detailed interpretation of what can be regarded as a retail loss, rather than necessarily claiming to be a reflection of the 'entirety' of events and activities that could constitute a loss," according to Beck.

For example, there are a number of potential losses not considered, such as those associated with brand reputation, lost sales associated with counterfeit goods and the gray market, as well as lost sales that may arise from stolen product being sold on internet auction sites.

"While some of these types of losses are beginning to be better understood, becoming more visible and measurable, as yet they remain, for most retailers, highly problematic to calculate with any degree of confidence," according to Beck. "No doubt in the future the scope and range of 'Total Retail Loss' will change to accommodate new forms of manageably measurable and meaningful losses, and this is to be welcomed." **RL**

THE ORGANIZED CRIME THREAT

It's not like the retail business isn't already hard enough between intense competition, constant expense pressures and shifting consumer behaviors. Retailers are also coping with increased losses from organized retail criminals who are increasingly brazen, well-versed in changes to shoplifting laws, and have discovered that the anonymous internet is an effective way to resell stolen goods.

Organized retail crime has become a big enough problem for a long enough period of time that the National Retail Federation is now on the 12th iteration of its annual Organized Retail Crime (ORC) survey. The trade group recently surveyed 59 retail executives, and for the first time each of the survey participants said their company had been victimized by ORC.

"The criminal mind and creativity never stop: as one vulnerability is resolved, criminals find another way of stealing from and defrauding retailers," according to Bob Moraca, NRF's vice president of loss prevention. "Clearly, combating organized retail crime is a full-time job, and it is a constant battle industry-wide for retailers large and small to stay one step ahead of these savvy criminals."

A total of 83 percent of those surveyed said ORC had increased during the past 12 months, and the impact is huge. NRF said the median impact of ORC per $1 billion in retail sales increased to $200,000 from $194,000 the prior year. The growth is due to a number of factors, including:

➤ The decriminalization of shoplifting. Many states have increased the threshold at which theft is consider a felony, with the limit increased to $2,500 in Texas, $2,000 in Colorado and South Carolina and $1,500 in Georgia. Savvy thieves aware of the revised limits make sure they stay under the new amounts to face limited consequences if apprehended.

➤ Flea markets are out and digital methods are in when it comes to fencing stolen goods. Those surveyed reported continuing declines in identifying stolen merchandise at physical locations, while "e-fencing" is on the rise. Nearly 60 percent of those surveyed have identified stolen merchandise on online auction sites.

➤ The popularity of gift cards has created a huge, and somewhat self-imposed, problem. Retailers with liberal return policies who provide gift card refunds when goods are returned without a receipt are finding their gift cards for resale on the internet with increased frequency. Gift cards purchased with stolen credit cards are also showing up on the internet.

➤ Cargo theft is a growing problem. Nearly 45 percent of respondents indicated they have been victimized, most often when merchandise is in transit from a distribution center or manufacturer.

➤ Law enforcement has bigger fish to fry. More than half of survey respondents said they have not seen any additional support from law enforcement, the highest level in the survey's 12 year history.

Although a growing problem, the good news is the issue of ORC is getting more attention from the retail C-suite, according to survey respondents, some of whom indicated their organizations are allocating greater resources to prevention and implementing new return policies. However, to truly combat the ORC plague, more than three-fourths of those surveyed contend a federal law is needed. The resulting uniformity, along with stiffer penalties, would resolve jurisdictional issues in what has increasingly become an interstate crime, according to NRF.