

View Point



Preparing Retail IT for a Flatter World

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Abstract

The rules of retail are changing. As growth in their traditional markets turns sluggish, retailers are looking to expand into newer geographies that offer better opportunities. Technology can be an effective enabler in this strategy, helping drive revenue across countries.

To realize the promise of a global marketplace in the flattening world, retailers need to align their IT organization with business requirements. However, saddled as they are with monolithic, fragmented and inflexible legacy systems, this is easier said than done.

Retailers must assess their platform to ascertain whether the:

- Legacy set-up has the flexibility to meet the challenges of the flattening world
- Retail operation has a dynamic and enabling delivery model
- Organization contains elements of centralization and decentralization

Only then can they create a more agile and efficient organization that is geared for global competition. This paper examines the challenges retailers face in fashioning an IT set-up for a flattening world.

Introduction

The flattening world is creating several opportunities for retailers aiming for a successful global footprint. The emerging economies have opened up new areas of expansion for retail giants by offering them developing markets. Penetrating these markets and establishing a customer base can help retailers propel growth and increase revenue. Doing so is critical since growth has been plateauing in their traditional markets.

Let us consider the dominant retailers in Europe – Tesco, Albert Heijn, Metro, Dansk, Coop, Migros and Carrefour. They sell everything from grocery and fruit to apparel, home furnishing, electronics, financial services, and even their own-brand word processor and presentation software.

It is interesting to note that while these retailers are leading names, they reign supreme in national markets, not international ones. The domestic revenues of UK's Tesco, a global retailer, outweigh its international proceeds by four times. Carrefour, which has a presence in 20 countries, earns a sizeable 48% of its revenue from its home, France.

The fact that markets that form a large chunk of business are plateauing is a cause for serious concern for such retailers. UK's retail market is forecast to grow at less than 3% per annum for the next fifteen years. In contrast, it is estimated that Russia's retail market will grow at more than 7.5% annually, reaching three times its current size in the next fifteen years. China's retail sales grew more than 11% annually last year. Even the recently opened-up Indian market is growing at more than 7% per annum.

Thus, developing economies that were sourcing hubs for cheap goods are now emerging as retail destinations of the future. With this perspective, many retailers have started setting up operations in China, India, Central Europe and Latin America. While some have followed the acquisition route, others have taken an organic approach. In short, what we are seeing is a 'flattening' of the retail industry.

Even as this new order offers retailers myriad opportunities, it poses great challenges. The new markets will make several demands on retailers such as compliance with different regulations across geographies, understanding local tastes and preferences, setting up robust supply chains and distribution networks within their infrastructure constraints, et al.

IT can be a great enabler when meeting these challenges, allowing retailers to take on the competition and capture new markets. In order to deliver in the flattening world, retailers must leverage IT and develop cutting-edge solutions. However, very few retailers are asking how they can proactively shape their IT landscape for the impending flat world.

Over the years, the use of technology has been pivotal in helping retailers lower costs, improve service, satisfy fickle customers, and create profits in a hyper-competitive industry with minuscule margins. Be it ringing in millions of transactions, running proprietary algorithms for efficient replenishment schedules, or fulfilling millions of online orders, IT is at the core of retailers' operations and a key driver of business performance.

As retailers prepare for the global market, IT's role only increases. No longer is IT a mere tool to automate business processes. It also becomes a vehicle for the retailers to transport their best practices and processes to new markets. IT provides the platform and operations model on which retailers will be building their presence in the new theaters of operation.

However, Infosys' view is that in many cases, the retailers' IT organization and platform are not ready to take on this increasingly important role. Their IT solution may actually be part of the problem, leaving retailers ill-equipped to meet business needs. This could be due to one or more of the following challenges:

- Inflexible and expensive legacy platform
- High-cost service delivery model out of tune with the lower price levels of new markets
- Fragmented IT organization not aligned to new business realities

The benefits retailers can expect to realize from their IT organization will depend on the extent to which they transform their IT architecture. This is a key factor in gaining and sustaining the competitive advantage. Let us examine each of these challenges in greater detail to understand the road ahead for retailers.

Inflexible and expensive legacy platform to package-based architecture

Core business processes in most retail organizations run on legacy platforms. These systems have limited flexibility and scalability, depriving retailers of the much-needed agility essential to seizing opportunities and gaining business advantage.

The legacy application can have some of the following drawbacks. It can be:

Monolithic Makes it challenging for a retailer to introduce agility in operations. For example, a client had built separate applications for point of sales, merchandising and inventory functions, which made it cumbersome to introduce pricing and promotion functionalities in response to competition

Fragmented A fragmented set-up can make it difficult for a retailer to take concerted action when needed. For example, a retail client has more than 40 mainframe applications to manage deals with suppliers, making it difficult to obtain a consolidated view of the business

Inflexible An inflexible platform is a relatively common problem, impacting business significantly. For example, a retailer can keep only one price data against one item, preventing him from using pricing as an effective strategy to drive business performance

As retailers expand their business to newer areas in the flattening world, legacy platforms, which are not adaptable for multi-country deployment, create further challenges. This is due to the following reasons:

- Legacy platforms are difficult to replicate in new geographies. Moreover, configuring them in accordance with varied rules and processes is a demanding task. The 'spaghetti' nature of the applications and the scarcity of skill-sets needed to maintain aging systems increase the cost of supporting and enhancing legacy applications when meeting the new requirements
- Winning the retail game in emerging economies will require retailers to introduce new products and promotions and change their pricing approach at a faster pace. This is a must to keep pace with the market tactics of aggressive and ambitious local players. The lack of flexibility and scalability inherent to this technology can be a significant disadvantage, especially when the local players have new IT platforms, having skipped a generation or two in technology evolution. The changing reality of today's retail environment calls for a nimble solution to help the bottom line

Transforming legacy systems is becoming an urgent priority to take on these challenges. However, we have to recognize that some key business processes and practices that can help differentiate the retailer in the new markets are embedded in legacy applications. This makes it difficult to discard the legacy applications right away.

How do retailers address this dilemma? In our view, retailers need to follow a systematic approach to address the legacy challenge:

- Retailers need to assess their current application portfolio to determine if it is flexible enough to support a multi-country business. If the platform is pre-dominantly legacy, the answer in many cases is likely to be in the negative
- As a next step, retailers must evaluate the package products option. Today's leading packages support most processes a retailer needs. While retailers have some problems regarding the ease of customising these applications, we believe packages are a better option than building be-spoke applications
- Companies may want to continue with their legacy applications for a limited set of business functions. This may be required when the legacy applications contain proprietary algorithms or support processes and practices that provide a unique competitive advantage. In such cases, retailers can look at wrapper technologies that allow them to host mainframe technologies on industry standard platforms such as Unix, Linux or Microsoft. However, wrapper technologies have some disadvantages – they are likely to be a short-term solution and do not address the 'skill-set scarcity' and 'spaghetti technology' issues. Retailers may therefore need to rewrite legacy applications using a modern language such as .NET

Re-writing an application or implementing a package can be a daunting challenge not only for the IT department but for the business as a whole. This is especially true as the traditional high-cost IT service delivery model for the IT platform requires significant investment. It is important to note that retailers need to spend this money before they have opened their first international store.

In the retail industry, opening a store can involve an investment of nearly £10 million and it will be some time before the outlet generates a secure revenue stream. Thus, building an IT platform which requires an investment that is several times higher in magnitude and does not assure certain revenues raises significant business case challenges. In such situations, retail CIOs need to consider leveraging the Global Delivery Model to minimize cost, ensure flexible IT services and improve delivery predictability.

High-cost service delivery model to Global Delivery Model

The Global Delivery Model (GDM) is a proven method to harness resources and lower costs. In the past few years, although many retailers in Europe have been adopting the model for their IT operations, the adoption has been low when compared to counterparts in the banking and telecom industries. Our research shows that at least 8 of UK's top 10 retailers – including Tesco, Sainsbury's, Somerfield, Boots and Dixons – have moved some of their IT activities to low-cost locations in India, South America, China, South Africa, etc.

When executed effectively in line with business needs, the GDM can deliver significant business value. Our estimate is that on adopting the GDM, a retailer can reduce IT costs on a sustainable basis by more than 30% over 18-24 months.

The GDM assumes greater importance when retailers try to expand their operations outside their home countries. This is because:

- Price levels in emerging economies are significantly lower than in the home country. This is true even in the relatively proximate Central European market where the average price level is typically less than 80% to 85% of Western European retail price levels. Such levels cannot sustain the cost of an IT operation based in a developed economy with its high wage bills and often inflexible labour practices
- As described earlier, a retailer may need to invest in building a new IT platform even before a revenue stream is secured when entering new markets. If the retailer fails to use the GDM, he may need to build a completely new IT platform, thus increasing costs by 30% to 40%
- Retailers often have a narrow window of twelve to eighteen months between deciding to enter a market and opening their first store. Thus, they must customize, build, test, and have their IT systems up and running in a very short time. Instead, the GDM allows retailers to leverage the deep resource pool available in countries such as India – and to some extent China – to ramp up teams rapidly and dismantle them as soon as the job is done. For example, recently Infosys ramped up a team of more than a hundred skilled technical consultants in less than 6 weeks to integrate and validate IT solutions for a retailer planning to enter a new geography. Without leveraging the GDM, this would not only have been expensive but also difficult.

Adopting the GDM is easier than most companies think. At Infosys, we work actively to ensure that clients can start using the model easily and with minimum disruption. The key to this is having a thin but competent and culturally aligned layer of skilled resources at the retailers' site with whom the retailer interfaces. These resources manage the team based outside to meet the retailers' business requirements.

Fragmented IT organization to new business reality-aligned organization

As European retailers globalize their business and transform their IT landscape, they need to assess if their current IT structure and governance mechanisms will be adequate to meet new realities.

Many retailers who have taken the inorganic approach to expanding their international business have a de-centralized IT organization distributed across countries. Such a structure, while offering a degree of flexibility for business growth, also raises several challenges, such as:

- A decentralized structure makes it difficult to:
 - Enforce a consistent IT platform and architecture across all businesses
 - Ensure that the best practices are transported to the new countries
- Even if companies are able to use common applications across countries, the applications drift away from each other over time, leading to each country having almost unique applications
- Decentralization makes the cost of support and maintenance significant. Moreover, introducing new business functionalities becomes expensive and time-consuming

However, total centralization is not an answer. In our view, the answer to the problem lies somewhere in the middle and retailers need a combination of the two. The following activities will benefit from centralization:

- Operations that require consistency and integration such as IT platform architecture
- Maintaining and enhancing the IT platform
- Benefits from economy of scale, e.g., application support, software and hardware purchase

Activities that require significant business engagement or engagement with local suppliers are often best carried out in the specific geography. These include managing the following:

- Business relationships
- Local IT infrastructure
- Country-specific requirements

While retailers can follow the principles mentioned above, rewiring the IT system for a more globalized business will depend on the route the organization has taken to grow its international presence, i.e., whether it has opted for organic growth as opposed to mergers and acquisitions. The latter involves the integration of varied systems and processes in the organization design and may make centralization an onerous undertaking. The IT landscape will also depend on the organization's culture. A more consensus-driven set-up and values can enable GDM adoption.

Conclusion

Transforming the IT environment to reflect the requirements of the flattening world will affect all aspects of business. Therefore, while transformation is technology-driven, it must take into account business needs and goals if it is to help retailers convert opportunities into realities.

Retail CIOs need to address the challenges of the flattening world to build an IT organization which does not have legacy issues, has a dynamic and enabling delivery model, and contains elements of centralization and decentralization. Now is an exciting time for retail CIOs. The architecture and organization they establish will enable their business to pull ahead in the flat world. As Thomas Friedman remarks in his now-celebrated book, 'The World is Flat': "The playing fields are being levelled and rules are being written anew." How CIOs use this opportunity to transform their IT architecture and organization will determine the success of their business.

About the Author

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