

View Point



Shrink Management

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Abstract

Shrink has become one of the most frequently discussed topics in retail circles recently. From products to mitigate theft to POS error reduction, there is significant interest in trying to tackle shrink through better use of technology. We believe shrink is a complex phenomenon with varying reasons based on the kind of product and clientele. We suggest an approach that ensures due diligence in identifying reasons that are the primary causes of shrink and only then proceeding to mitigate the same, thus ensuring maximum return on investment.

Shrink has always been present; however the true numbers are only now becoming apparent. A 2007 survey of retailers from 32 countries showed that global retail shrinkage (stock loss from crime or waste expressed as a percentage of retail sales) cost retailers \$98.6 billion, representing an annual 'tax' on honest consumers of \$287.70 per household in the U.S. and Europe.

If we contrast this to the fact that over the past decade the bulk of retailer investment has been toward supply chain efficiencies, it seems odd that shrink remains so high. We believe that this is because only now, with inventory systems in place, retailers are beginning to understand and report the correct shrink numbers.

Inventory Integrity

At a fundamental level shrink is an inventory integrity issue – the difference between the electronic or recorded inventory and the actual physical inventory. This issue primarily arises due to root causes such as receiving errors, counting errors, etc. besides theft and wastage (see figure 1). Example, if the receiving number is inflated, one later finds high shrink, which is virtual (or in one sense it is shrink due to supplier fraud).

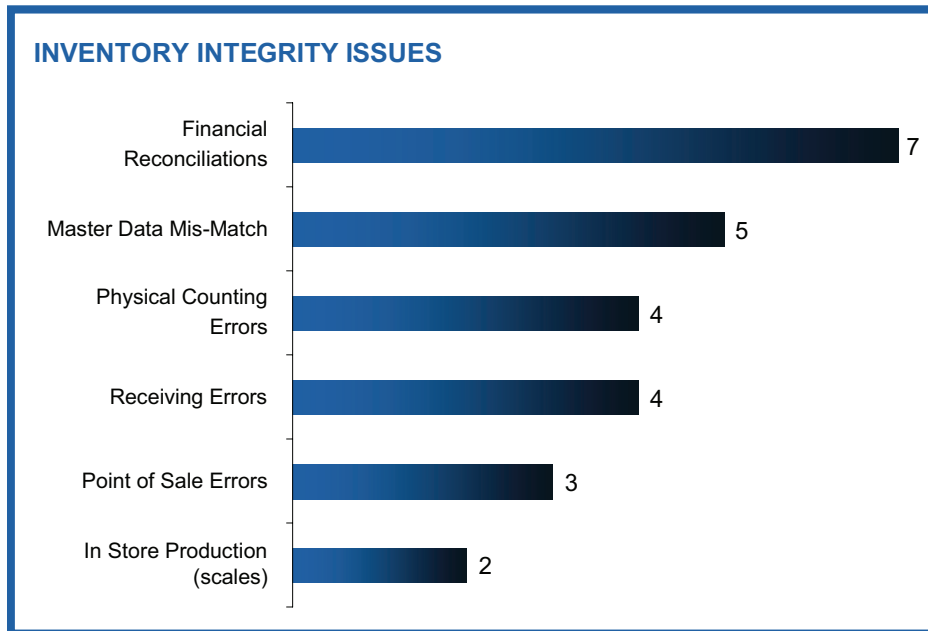


Figure 1 – Inventory Integrity Issues' Relative Impact (Source – Infosys experience and client surveys, 2006)

In our view, the approach to shrink analysis and remedy should therefore be

1. address inventory accuracy/ integrity issues
2. measure shrink accurately, across types of products, stores/ markets
3. conduct root cause analyses for shrink (causes would be theft or wastage, assuming others like pricing mistakes, accounting or counting errors, etc. have been taken care of in step 1 and 2)
4. plan remedial/ mitigation measures depending on type of product/ store or market

Based on Infosys experience, a phased plan to address issues seen in step 1, for example, could be: (See table 1).

Phase 1	Phase 2	Phase 3	Phase 4
If there are reconciliations due to invoicing errors in terms of costs do not let this reconciliation affect quantity count.	Keep the inventory system purely a system of record, disallow any calculations or logic in the system	Do shelf counts at wee hours, trailing stocking. And then count back room.	Let any reconciliation be a process between GL and numbers from stores. Physical inventory numbers are not to be affected by anything other than physical counts.
All inventory use and inventory creation processes to provide data at least 4 times a day.	Make adjustments to costs etc. at item level instead of dept. level wherever possible. In any case do not affect quantity.	Ensure all pending transactions are updated before freezing the inventory for a physical count.	Count item family group categories (e.g. soft family group) on half-yearly departmental
Scan out any returns or quality culling.	Initiate zero balance walks (and use smart count) along with aisle walks in the ordering process.	Introduce processes to support bucketing of inventory into custom returns, promotions inventory, sale	
If an item shows up in store but is not authorized, allow it in the inventory and flag for action.	Queuing and time stamped transactions to update inventory to ensure correct sequence and to avoid duplication.		
Exception reporting to replace human eyeballing to identify 'obvious errors'			

Table 1 – Phased approach to establishing Inventory Integrity

In case of a high level of confidence existing regarding inventory integrity, the analysis of shrink may begin directly from Shrink measurement, but then, the integrity risk remains.

Shrink Measurement, Analysis and Remedy

When measuring shrink, it is important to keep in mind that the metric is to be recorded over a significant duration of time. Given that shrink is the positive difference between an inventory record and a physical count, if the difference is not seen to be uniformly positive, but fluctuating between positive and negative across a series of counts, it is obviously incorrect to take a small period of time to measure shrink. Another aspect to be careful of is that, some chains have zero checks of warehouse items sent to stores, during receiving at stores. The logic for this practice is that any difference existing would not be benefiting any third party and hence why should the retailer count twice, once at the warehouse and then at the store. However, if reconciliations over a period of time are seen to be high, then that accuracy factor has to be addressed. Else, warehouse issues may get recorded as stores shrink throwing the causal analysis out of gear.

Root Cause Analysis

It is very essential to slice the shrink number so as to get to the correct cause. For example, we know that for pharmacy retailers like Boots (UK) etc., theft control systems and employee career shrink tracking had a significant impact on shrink. Given the high value density of items at a health, beauty and pharmacy retailer, this is to be expected, but that might not show us the same impact in another category of product. In our experience, grocers still find it most useful to combat shrink through accurately forecasting demand, reducing overall inventory levels, etc. indicating that wastage or in-store production yields may have a high contribution.

Remedial/ Mitigation Measures

Once the root causes have been identified, the remedy should be planned based on existing conditions on the ground, and feasibility. For example, if produce shrink is high due to prepping the product for display, the answer may lie in incoming quality control, factoring in shelf life in inventory planning, forecasting demand of produce, and factoring in-store uses of produce, for example, by the deli and salad bar.

An interim solution for perishable shrink may lie in the way markdown is handled. For example, a leading US grocery retailer authorizes meat department managers, enabled with handheld printers, to mark down products based on how fresh they “look”. This has helped the client save shrink to a large extent. Similarly, shrink also arises due to buying practices where buyers pick up “deals” from perishables vendors due to attractive prices, but fail to plan adequate promotions to drive sales. Improving buying discipline, in this case, leads to reduction in shrink.

Therefore, solutions to shrink may lie in warehouse processes, store processes, or enterprise practices. However, the route to take will depend on what is observed in the shrink analysis. If, for example, shrink is high in store A for a perishable item but not in store B, (and store B is similar to store A), then it might be store specific practices that are at the core of the problem. However, if store A is in a premium market while store B is not, product quality may be the issue. But if, for that product, shrink is high across the chain, buying practices, forecasting, markdown practices, etc. may be the issue. But if, for that product, shrink is high across the chain, buying practices, forecasting, markdown practices, etc. may be the issue.

To ensure quick wins it is essential that problems that have simple solutions but significant benefits are identified and remedies thereof planned for. Larger solutions at an enterprise level, such as perpetual inventory and store level demand forecasting, can be identified and planned for separately. A store level forecasting initiative is a comprehensive exercise and has costs that are justified by benefits other than simply shrink reduction. For example, a leading US based grocery retailer has seen a 75% reduction in out-of-stock after rolling out store level forecasting for dry groceries across the chain.

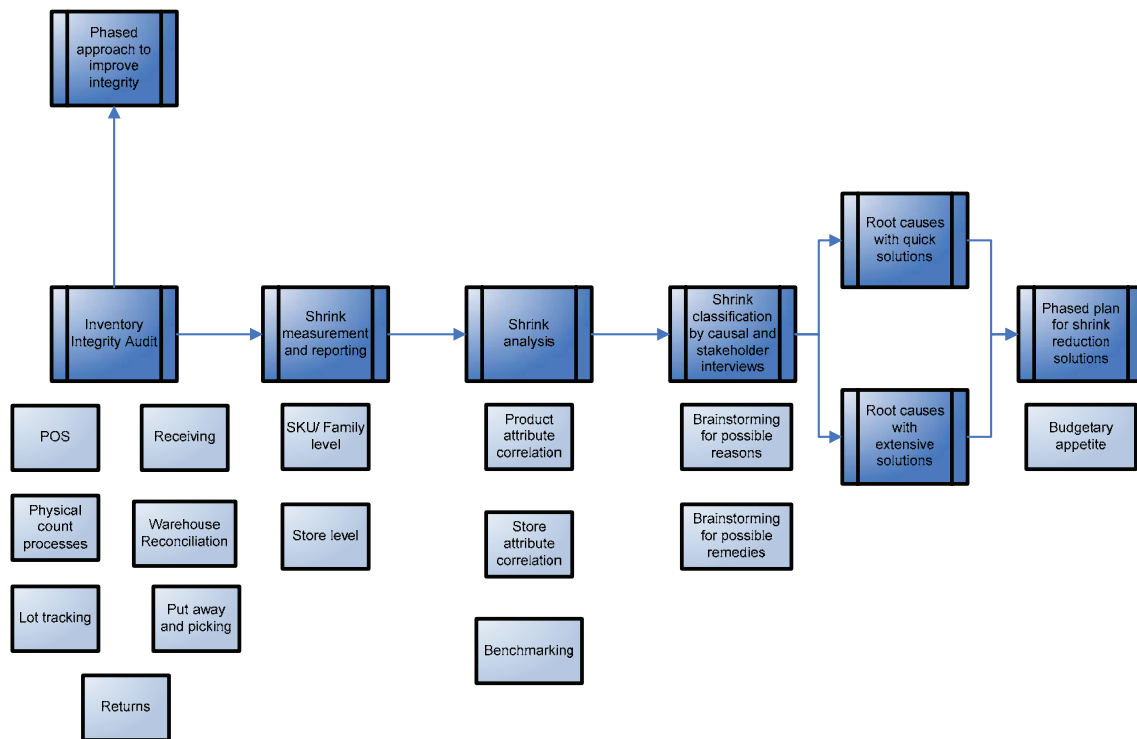


Figure 2 – Recommended structured approach to reducing shrink

To summarize, the effective way to reduce shrink lies in the adoption of a structured approach to shrink analysis and remedy (see Figure 2). The benefits of such an approach include easier top management buy-in and an ability to plan comprehensively. It is also possible that some shrink is allowed to continue if prevention costs are unpalatable, but then it would be based on a cost-benefit rationale and would be a business decision.

About the Author:

Subhashis Nath is a Principal Consultant with Infosys' Retail and CPG practice. He has extensive experience in marketing, customer relationship and consulting. He has provided strategic and process consulting services to European and US retailers in the areas of CRM, demand planning, merchandising and analytics. He can be reached at subhashis_nath@infosys.com.



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