

Cross-Functional Collaboration: How Retailers Can Uncover Hidden Profit

How the lack of cross-functional collaboration in retail enterprises causes inefficiency and a suboptimal customer store experience, and how a billion dollar retailer can uncover millions in hidden profit

by Tim Lynch



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Executive Summary

Mid-sized and large retailers can add millions of dollars to their bottom line by improving communication and collaboration among functional areas such as merchandising, marketing, loss prevention, supply chain, and regional and store operations. Although retailers have implemented numerous applications that enable improved efficiency in one functional area, these “siloed” applications don’t do as well at improving efficiencies and collaboration among two or more functional areas.

A billion dollar retailer could drive a positive impact of millions of dollars by:

- Improving planogram compliance by 20 percent – it could generate \$10 million in additional sales
- Ensuring consistent in-store execution of marketing strategy – it could generate \$50 million in incremental sales
- Reducing employee turnover through better labor scheduling – it could save up to \$3 million
- Reducing shrink through improved loss prevention – it could save up to \$5 million
- Improving efficiency of managers in the field – it could save up to \$0.6 million, either through head count reduction or improved morale and reduced employee turnover/training costs
- Automating labor scheduling and time and attendance processes – it could save \$6.5 million in lost employee productivity due to inefficient processes
- Improving performance of vendor operations – it could save \$900,000 in overpayments to third parties
- Improving supply chain effectiveness and reducing out of stocks – it could increase sales by \$37 million

The lack of a robust collaboration process across the retail enterprise has a negative impact on each functional area and ultimately ripples down to the customer. By implementing systems that break down the walls between previously isolated departments and improve visibility, streamline communication, and align work with strategy, retailers can improve profitability by increasing inventory turns, reducing employee turnover, controlling costs, and increasing sales.

Chapter One: Siloed Exclusivity, the Negative Impact of Forced Efficiency

Large enterprises that suffer from an inability to communicate and collaborate across interrelated functional areas are like big, slow dinosaurs – by the time the tail is bitten, it may be too late for the brain to process the sensory input and tell the body how to react.

Over the past three decades, retailers have been forced to respond to occasional negative economic cycles and increased competition. The responses of mid-sized and large retailers were often to reduce the size of their workforce, which forced them to become more efficient. They achieved these efficiencies by:

- a. Taking the slack out of the workforce
- b. Eliminating the “poor performers”
- c. Implementing technology to improve productivity
- d. Having employees (especially ones exempt from overtime) work more hours

Unfortunately, the unintended consequence of the above is “Siloed Exclusivity.” When fewer people are doing more, they have little or no time to collaborate with other functional areas. And, while many of the applications that retailers have implemented in the last decade enabled improved efficiency in one functional area, these “siloed” applications didn’t do as well at improving efficiencies and collaboration among two or more functional areas. Of all the consequential effects of these increased efficiencies, the intensified silo effect has the most significant and far reaching negative impact on the business.

While the structure of mid-sized to large retailers varies, most retail chains with more than 100 stores have a centralized structure that includes a senior leadership group consisting of a CEO, CFO, Vice President and General Counsel, and other executives. The senior executives lead key functional areas such as merchandising, marketing, Human Resources (HR), operations, supply chain, Information Technology (IT), real estate, and finance. Some retailers may have an additional business unit responsible for private label (also called store label) management. The senior executives define corporate goals and business targets, which are then communicated down the chain to regional executives and managers and ultimately to the stores themselves. See below for an example of an organizational chart of the key function areas responsible in a traditional brick-and-mortar retailer.

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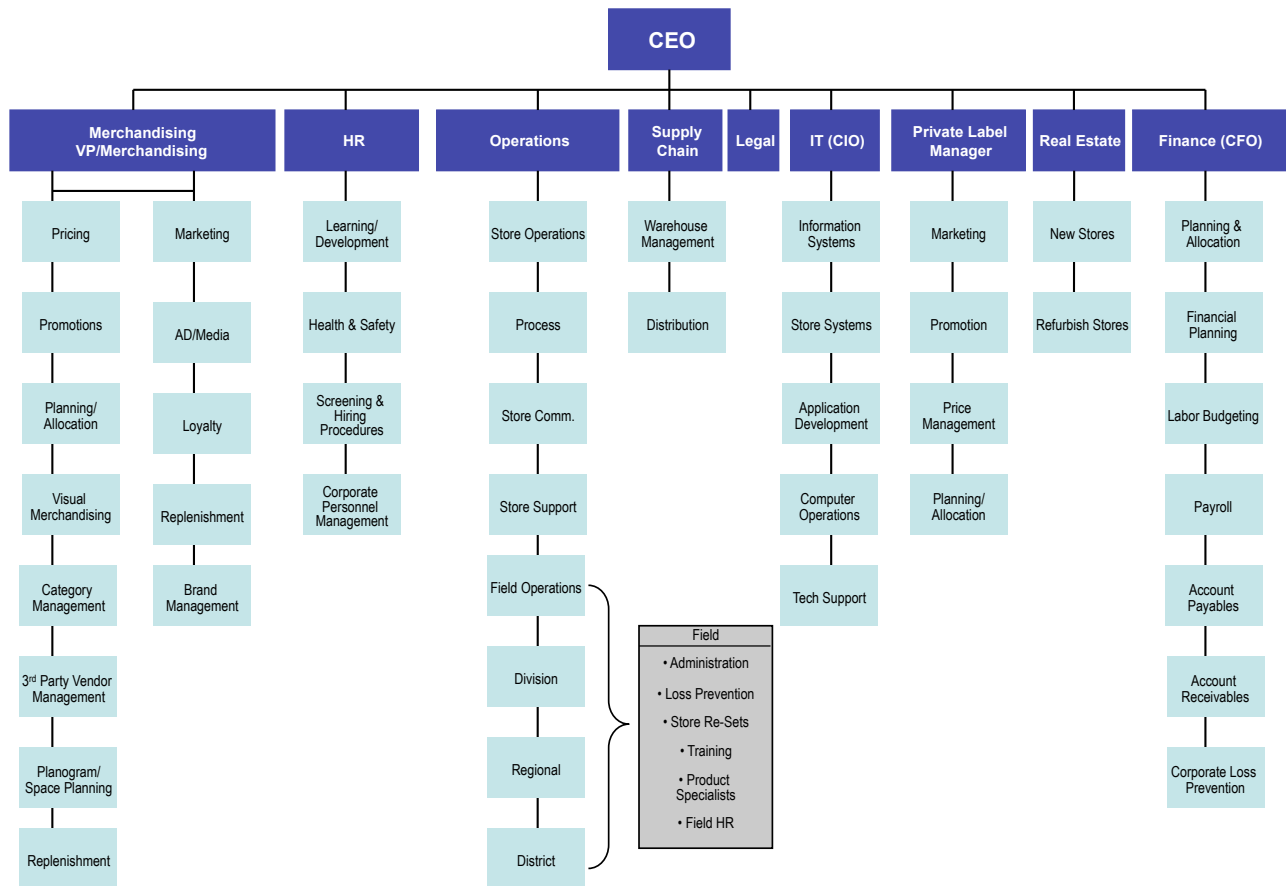


Figure 1.1: Organizational Chart of Retail Functions

Siloed Exclusivity and the Communication Gap

Large, geographically dispersed retailers suffering from siloed exclusivity tend to struggle with cross-functional communication in several ways:

- 1) A lack of communication among their various functional areas
- 2) Information overload caused by duplicate and incorrect communication, the latter requiring follow-up corrective messages
- 3) Lack of structured two-way communication for functional areas to communicate and aggregate data on what's going right and what's going wrong.

“The lack of a robust collaboration process across the retail enterprise has a negative impact on each functional area, and ultimately ripples down to the customer.”

All functional areas can benefit from succinct communication within their department and among other departments. When that exists, everyone is on the same bus and knows exactly what to do. When it does not exist, the result is fractured planning and communication, which results in inconsistent execution of the retail strategy, reduced customer service, and lower sales and profitability.

The Impact of Siloed Exclusivity on Labor

The lack of cross-functional collaboration also has a significant impact on labor and ultimately, store conditions and customer service. All retailers have seen examples of this. On any particular week, and with little warning, a store may be asked to implement several different initiatives that originate from different functional areas and may not be coordinated. These initiatives may include a new customer service program (requiring associate training), a major center store re-set, and a “three day” sale of a specific product line.

While the increased revenue from the sale may help cover some of the additional labor required to complete all the work, the other initiatives will not realize immediate benefits. The store director discovers that to complete all this last-minute work, she needs more employees, and to do that, she'll have to go over her labor budget for that week. She could decide to miss the budget this week and make it up later in the quarter, except she does not have enough time to call the extra workers and get them into the store. As a result, she must choose between deploying her resources to complete the initiatives or meeting her other obligations such as customer service, store conditions, and sanitation. This dilemma could have been avoided with a collaboration process among the various functional areas that is robust – consisting of authentic dialog about processes and next steps for future improvement.

The lack of a robust collaboration process across the retail enterprise has a negative impact on each functional area and ultimately ripples down to the customer. The next few sections of this report will take a closer look at the key functional areas in a geographically dispersed retailer, the impact of the lack of cross-functional collaboration, and most importantly, the potential positive impact of millions of dollars to the bottom line of a billion dollar retailer by eliminating siloed exclusivity.

Chapter Two: Communication and Process Gaps in Key Retail Functional Areas

Merchandising

Retail merchandising involves the planning and execution of strategies and tactics to maximize sales to the consumer. It includes but is not limited to product assortment, display, pricing, marketing, and advertising. At the in-store level, merchandising refers to the variety of products available for sale and how those products are displayed in the stores to stimulate interest and entice a customer to make a purchase. The merchandising group has five primary objectives:

- 1) Product
- 2) Price
- 3) Placement
- 4) Promotion
- 5) Presentation

The first three for the most part occur within merchandising (i.e., within their own silos). The fourth, Promotion, is done in conjunction with marketing, and in most organizations the lines between these two are virtually transparent. The fifth objective, Presentation, requires significant and sufficient collaboration with other functions.

Business units that play an important role in the overall merchandising team include the Promotions and Visual Merchandising teams. The Promotions function is responsible for increasing sales through a variety of techniques such as cross-selling, seasonal, holiday, and pricing campaigns. Visual Merchandising is responsible for designing standard merchandising layouts, commonly called planograms, for stores, displays, and signage. Depending on the retailer, these planograms may change often to support promotions as well as other activities such as store re-sets (changes in the overall appearance of a department or entire store).

To accomplish the Presentation objective, the merchants need to collaborate among themselves and with other areas such as finance, supply chain, and marketing to ensure they are aligned prior to communicating with the stores (not everyone can have end cap No. 1). This process is not always straightforward and it is getting even more complex as retailers move to a strategy of creating store-specific planograms to cater to a local audience and maximize sales.

Merchants spend a lot of time creating, refreshing, and sharing spreadsheets and having regular update meetings. But the spreadsheets are not updated in real time and are out of date almost as soon as the “Print” or “Send” button is pressed. Due to the lack of timely data that’s accessible across the organization, retailers struggle to keep tabs on who has done what, and in the case of delays, respond proactively.

Another major challenge is in-store execution. The operations team is usually capable, but many times poor communication causes poor execution. In a 500 store chain, vague, incomplete, or confusing communication can be misinterpreted in 500 different ways. If the merchant’s contract with the vendor includes an obligation on

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Annual Sales increase \$10 million

the part of the retailer to perform, there is little room for misinterpretation.

A recent independent report from Forrester Research, Inc. notes: “Increased planogram variety increases the complexity of store tasks and reduces the probability that tasks will be executed exactly as planned. This in turn leads to increases in stock-outs and, because inventory is wrongly located and therefore not selling through, to falling inventory turns. One of Forrester’s interviewees expressed the opinion that a 10 percent increase in store planogram or floor set compliance can reduce incidence of out-of-stock by as much as 10 basis points — from 8% to 7%, for example.”¹

Numerous retailers have increased planogram compliance in their stores by implementing task management applications, with many reporting increases from compliance levels of about 60 percent to 95 percent or higher. But assuming just a modest increase in planogram compliance from 60 percent to 72 percent (a 20 percent improvement) would mean a reduction in out-of-stock by 20 basis points. If just one out of two of those now in-stock products were purchased, that would drive a sales increase of 1 percent. The positive impact to the bottom line for a \$1 billion dollar retailer: **\$10 million more in annual sales.**

Marketing

The ability to drive the business initially rests on the shoulders of the marketing team. It’s the message and how that message is delivered that gets the customers into the stores. Of course, that message has to be supported by the entire organization. Whether the organization determines that the company will “drive” the business with price, promotion, customer service, or “all of the above,” the marketing team has to drive the plan.

The marketing team, in collaboration with other functional areas, works closely to develop a succinct and strategic marketing plan. Once the marketing plan is complete, it is executed through various communication channels (TV, newspapers, radio, the Web, and more recently, text messages and social media sites) and communicated to the store operations group. The store operations group, which includes regional and store managers and associates, is responsible for execution.

“The marketing plan needs to be executed consistently by all of the retail units. It is imperative that this message is disseminated concisely and with a process that facilitates constructive, timely feedback.”

The marketing plan needs to be executed consistently by all of the retail units. It is imperative that this message is disseminated concisely and with a process that facilitates constructive, timely feedback. If the communication of the plan to operations is not clear and concise, the interpretation can be as varied as the number of units in the organization. Unfortunately for many store operations groups, communication of these plans is not clear and concise. It is instead clouded by duplication, incorrect information, and vague instructions that are open to interpretation (for a more detailed discussion of the causes and impact of corporate-to-store communication problems, see the section on “Store Management and Employees” later in this paper). The result of suboptimal communication is inconsistent execution of the marketing plan, as well as the overall retail strategy.

¹ “Filling the Store Labor Productivity Gap,” by George Lawrie, Forrester Research, April 23, 2009.



Annual Sales increase \$50 million

Numerous retailers, including ones in the home improvement, apparel, books, and general merchandise categories have conducted pilot studies where they implemented task management solutions in a few stores and compared the uplift in sales to a control group of similar stores. These studies found that a task management application could greatly improve in-store compliance of marketing initiatives by streamlining communication, prioritizing tasks, and providing a closed loop channel for two-way feedback to drive operational improvement. The application also enabled store managers to spend less time in the office and more time on the sales floor helping customers and coaching employees. The result was an average increase of sales of 5 percent in the pilot stores. The impact to a billion dollar retailer of that 5 percent boost: **a \$50 million increase in annual sales.**

Human Resources

Over the past two decades, forward thinking companies have elevated the strategic importance of the Human Resources (HR) function within their organizations. They have realized that the HR role should be more than that of a “Policy & Benefits” administrator. Leading companies ensure that HR is a strategic partner in most everything they do. From recruiting and training to labor relations, succession planning, and up to executive coaching, HR is integrally involved.

High retail workforce turnover rates continue to challenge the entire industry, not only for part-time or seasonal workers but full-time employees as well. Employee turnover at every level is excessive. The average executive tenure is less than three years, and it’s not unheard of for some stores to experience 50 percent annual turnover or higher. If a store employee becomes disillusioned, there is often little to prevent them from quitting and going down the street to find another job. The causes of poor employee morale include:

- Labor schedules that do not match employee proficiencies and preferences
- Excessive workloads – too much to do
- Vague and incomplete instructions that make it difficult to complete tasks
- Lack of schedule rotation – same employees get the worst shifts
- Schedules posted too late for employees to make plans for their personal lives
- Low pay

While retailers may not have the luxury to increase pay levels, leading edge companies have addressed the other problems by implementing advanced workforce management applications like labor scheduling, task management, and time and attendance that streamline communication and processes while considering employee proficiencies and preferences. Systems that address both the needs of the business and employees enable a balanced work environment and promote higher employee morale, leading to reduced employee turnover.

Consider a billion dollar retailer with 5,000 employees and 30 percent workforce turnover rate. That means every year, the retailer has to re-train 1,500 employees, managers, and executives. Two different studies have found that when all the factors



Bottom Line = \$3.4 Million saved

“With fewer resources devoted to loss prevention, it’s no surprise that U.S. retail shrinkage averaged 1.51 percent of retail sales in 2008, a significant increase from 1.44 percent in 2007. Total merchandise losses increased to \$36.3 billion, up from \$34.8 billion in 2007.”

involved in replacing just one employee – time to recruit and train a replacement, cost of having another employee fill in (overtime), administrative costs, cost of severance and benefits continuation for eligible employees, cost of training investment in ex-employee, and so on -- the calculations can easily reach 150 percent of the employee’s annual compensation.² That means that at a modest blended salary of just \$15,000 per employee (including associates, managers, and executives), the total cost to a retailer that must replace 1,500 employees annually is \$33.7 million. If that same retailer could reduce employee turnover by just 10 percent (150 employees) by improving morale through better scheduling and streamlined communication, it would have a positive impact of **\$3.4 million on the bottom line.**

Loss Prevention

The Loss Prevention (LP) systems of many organizations have become much more sophisticated over the last decade. This has been promoted by the advance of various types of software and hardware. Because of the significant investments in these systems, LP vendors have been required to provide solid ROI results. This requirement has provided for an extremely enhanced collaboration between LP and finance systems.

However, despite investments in LP systems, gaps can occur at the store-level execution level. During poor economic times, retailers make deep spending cuts across the board, and loss prevention professionals are not immune. With fewer resources devoted to loss prevention, it’s no surprise that U.S. retail shrinkage averaged 1.51 percent of retail sales in 2008, a significant increase from 1.44 percent in 2007. Total merchandise losses increased to \$36.3 billion, up from \$34.8 billion in 2007.³

Forward-looking retailers are reducing their retail shrink rates by implementing task management and compliance monitoring software solutions to drive increased efficiency in their LP personnel so that they can cover more ground while still providing effective shrinkage control. At a presentation on Store and Operations Innovation at a retail technology conference in 2009, executives for a \$2.8 billion grocery noted the following benefits from implementing a task management and storewalk/compliance system to enable streamlined communication, real-time visibility into LP compliance, and best-practice response to Key Performance Indicators (KPIs)⁴:

- Product recall compliance reduced from weeks to 3 hours
- Email reduced by two-thirds, giving back store managers 5 more hours on sales floor
- \$14 million reduction in annual shrink

It is difficult to quantify the cost savings or sales increases from giving store managers five more hours on the sales floor – though that increase in time would allow more time for helping customers, coaching associates, and performing other duties. But given the positive impact on the bottom line of \$14 million for a \$2.8 billion

² “Cost of Employee Turnover,” by William Bliss, Bliss & Associates Inc., Wayne, NJ. “Breaking the Cycle of Failure in Services,” by Leonard A. Schlesinger and James L. Heskett (1991-04-15). MIT Sloan Management Review

³ “The 2008 National Retail Security Survey,” conducted by the University of Florida.

⁴ “Store and Operations Innovation,” RIS News Retail Technology Conference, April 2009.



Shrink Reduced by \$5 million

“The multitude of reports and metrics and their static nature can actually inhibit managers and vice presidents from identifying important trends and responding rapidly using best practice.”

retailer, **the equivalent for a billion dollar retailer would be \$5 million in reduced shrink.**

Regional Vice Presidents and Managers in the Field

Large retailers typically organize their stores geographically, by district, region, and division. Each division’s reporting structure typically looks like a pyramid: many store managers report to a smaller number of district managers, who report to an even smaller number of regional vice presidents (VPs), and so on.

District managers usually have the highest direct impact on store managers and associates. They inspect stores, coach their reports, and identify and solve problems. The roles of the vice presidents and senior vice presidents are usually more strategic. They are given goals and objectives by corporate and work with their direct reports to determine how to execute and deliver within their specific territory.

But whether the role is tactical or strategic, one thing all of these managers and VPs have in common is they receive a huge number of reports, including sales, expense, profit and loss, shrink (how much product is lost, stolen, or damaged), store performance comparison, inventory, employee turnover, and customer service surveys.

The multitude of reports and metrics and their static nature can actually inhibit managers and vice presidents from identifying important trends and responding rapidly using best practices, due to the following reasons:

Too much information. In many retail organizations, managers receive the exact same reports. This forces managers to take too much time reading through pages and pages to find the information specific to their area.

No best practice response. Reports tell you what happened, not what is happening and what to do about it. Management up and down the chain has to rely on their own experience to determine the most important thing to address and how to respond. This results in inconsistency throughout the organization.

Too late. MIS reports may not allow a regional manager to respond in time to correct a problem or respond to an opportunity.

District managers typically spend a lot of time on the road, visiting stores (usually from 8 to 16, though this can vary). But each district manager has his or her own style and personality. District managers may focus more of their time on one department during a store visit because they have more experience in that area. This inconsistency opens up the possibility that problems in other departments are missed – and will not be addressed until the next visit, if at all.

Another gap in the store visit process is the inefficiency for field and home office management in filling in and processing paper-based forms and checklists. This

information is either faxed back to an office or manually entered after the store visit is over and emailed to an office. Once received, it is re-entered into a report, a process that can take days or weeks. The lag time in this process prevents the company from quickly identifying and responding to problems and trends.

Finally, district managers often don't know what they're going to find at a store until they walk through its front doors. They have to do a walk-through of the entire floor before they can determine where to focus. That time could be better spent solving problems.

Published case studies and confidential pilot studies by retailers in a variety of categories have found that by implementing an integrated task management, KPI, and compliance audit solution, companies can free up an average of 7-12 hours per week for managers in the field. Instead of having to read endless reports in an office, mobile managers can monitor real-time KPIs and assign corrective using smart phones while on the road or sales floor.

An average time saving of 10 hours per week would free up a total of 15,000 hours annually for a billion dollar retailer with 30 regional, district, LP, and human resource managers in the field (this figure assumes two weeks of vacation per manager). If each manager works 50 hours per week, that means an overall time savings that is the equivalent of six of those managers. At a blended cost of \$100,000 per annual manager salary, the increased efficiency translates to a savings of **\$0.6 million per year** were the retailer to re-align its field manager structure.

If the organizational structure is preserved, that would give back each manager 10 hours per week to either provide better leadership or get home earlier. If the reduction in stress and ability to spend more time with the family were to result in four managers not leaving the company per year, that would translate to a savings of \$600,000 in managerial replacement costs (assuming the 150 percent replacement cost rule of thumb and blended salary cited earlier). Either way, the savings to the retailer would be about the same.



Efficiency Increased by \$0.6 million

“The store is where the strategies developed by the various functional areas in corporate must be executed as expected. Even the most brilliant merchandising strategy or exciting new product launch will fail if store-level execution is poor.”

Store Management and Employees

When it comes to brick-and-mortar retailing, the success of a retailer depends on what the customer experiences in a store. The store is where the strategies developed by the various functional areas in corporate must be executed as expected. If customers encounter dirty stores with bad customer service and can't find the products they want, chances are they will not return.

The store manager and assistant managers are responsible for the store's performance. They hire, schedule, motivate, and develop store employees (often called associates), many of whom are young and inexperienced. The store managers must ensure stores are clean, well-stocked, and operating efficiently while supervising (and sometimes performing) corporate-driven tasks such as promotion setups, new product introductions, and store re-sets.



Save \$645 per employee

“In fiscal year 2007, the U.S. Department of Labor’s Wage and Hour division collected more than \$220 million in back wages at an average rate of \$645 per employee.”

“Many retailers still rely on an inefficient combination of manual time cards, faxes, email, and spreadsheets to calculate payroll. This process is rife with opportunities for error (again exposing the retailer to fines or lawsuits such as when overtime is not calculated correctly).”

Previous sections of this white paper have discussed how concise, prioritized information combined with the ability to respond to real-time KPIs using best practices can help drive an average annual sales increase of 5 percent. Another major opportunity to uncover profit is in scheduling, payroll, and time and attendance. Many retailers’ scheduling process consists of sending out spreadsheet templates on a regular basis to the stores and leaving it to managers to complete them. It’s not uncommon for managers to create the schedule using a combination of Excel, sticky notes on bulletin boards, and notebooks as they juggle their various employee proficiencies, preferences, and availabilities. If mistakes are made (e.g., an employee cannot work a shift due to other obligations such as child care), the manager has to scramble to find a replacement, or go short on the shift. The inefficient process again takes time away from managers to walk the sales floor and can have a negative impact on customer service (e.g., longer checkout lines, lack of associates to help customers).

Manual tools such as spreadsheets also lack integration with other key data such as customer traffic patterns and, in the case of commissioned associates, sales performance. Yes, store managers may have a general idea of who their best sales people are. But without data to back that up, managers can’t be sure. And without a system to institutionalize the scheduling of the best sales people to work when stores are busiest, the retail enterprise has to rely on each store manager to make sure their best people are on the sales floor at the right time. By automating the process of generating labor schedules that take into account store sales patterns and then deploying commissioned sales people at the right hours, the positive impact on sales is obvious.

Managers must also be keenly aware of all relevant federal laws and, in the case of organized labor, union rules. Failure to comply with labor regulations such as minor work laws and union rules can result in million dollar fines and lawsuits. Another area retailers expose themselves to lawsuits is when they do not correctly calculate pay based on regular or overtime hours.

In fiscal year 2007, the U.S. Department of Labor’s Wage and Hour division collected more than \$220 million in back wages at an average rate of \$645 per employee.⁵ These employees included low- and mid-level managers. When retailers rely solely on store managers who use manual tools to comply with complex labor laws and union rules when scheduling employees, they expose themselves to significant fines and lawsuits. Similarly, when they rely on manual calculations and punch cards to calculate employee pay, they risk back wage lawsuits. **At an average of \$645 per employee, just one lawsuit in a year could cost a retailer with 5,000 employees \$3,229,000.** And that’s just for non-compliance with labor laws. It doesn’t include the risk of class-action lawsuits by a workforce that is unionized.

One could argue that the retailer would have had to pay its employees the \$3,229,000 either way. But that argument doesn’t consider the cost of Directors

⁵ U.S. Department of Labor press release, 2007.
Online at: <http://www.dol.gov/opa/media/press/esa/archive/ESA20071952.htm>



\$12.8 million savings in administrative and management time

and Officers liability insurance, interest, negative brand impact, and legal fees for the retailer. Wage class-action lawsuits can take years to settle. Assuming a modest annual salary of \$75,000 for just one attorney dedicated to fighting a class action lawsuit over a 5 year period, the cost to the retailer (not including insurance and interest) is a conservative estimate of \$375,000.

Another opportunity for retailers to increase efficiency and reduce costs is in payroll calculation and labor forecasting processes. Many retailers still rely on an inefficient combination of manual time cards, faxes, email, and spreadsheets to calculate payroll. This process is rife with opportunities for error (again exposing the retailer to fines or lawsuits such as when overtime is not calculated correctly).

One major supermarket operator that switched from a manual payroll process to an automated one based on time and attendance software integrated with its payroll system did a study on the cost savings from the new system. The grocery chain had more than \$30 billion in annual sales. Multiple people at every regional and banner office had to manually input data into spreadsheets that the stores had faxed or emailed. The manual nature of the process also introduced the possibility of data entry error, which required additional employee hours devoted to proof reading and error reconciliation. By switching to an automated labor scheduling and time and attendance solution, the company identified **savings of \$12.8 million a year just in administration and management time** in its daily sales and labor reporting, weekly store forecast, and scheduling to customer demand processes. **This doesn't include the savings on the IT side due to the simplified management of one common platform.** The equivalent savings for a \$1 billion retailer: **almost \$427,000 per year.**

Another significant area for retailers to uncover profit is in the area of labor scheduling and time and attendance. In a recent survey conducted by AMR Research with 108 respondents, retailers identified the following problems⁶:

- 2.5 percent – the average increase in total budgeted labor costs due to over-payment of wages due to “time rounding,” “buddy punching,” poor scheduling practices, and the lack of an effective time and attendance system
- 3.5 percent reduction in payroll costs over 12 months because of the utilization of an automated scheduling system

By implementing automated labor scheduling and effective time and attendance systems, retailers said they could reduce their payroll by a total of 6 percent. Assuming that a billion dollar retailer spent 10 percent of its sales on payroll (\$100 million), reducing payroll by 6 percent would have a positive impact of \$6 million to the bottom line. The positive impact in reduced legal fees and improved labor scheduling and time and attendance expenses is a total of about \$6.5 million. This figure does not include the cost of reimbursing workers for back pay or fines.

⁶ “Workforce Management: Critical for Mitigating Labor Compliance Risks and Controlling Costs in a Retail Environment,” by Karen Carter and Janet Sherlock, AMR Research, July 2009.

“Lack of visibility into the labor hours actually required by vendors to complete tasks can result in millions of dollars of over-billing throughout the retail chain.”



Save \$0.9 million

“Gaps still exist that prevent retailers from solving longtime problems such as out-of-stocks, a problem the industry has struggled with for years, and excess costs.”

Vendors

Communication between the retailer and the vendor community is much more complex than within the retailer, primarily due to two dynamics. First and most obvious is that third-party vendors are external to the retail organization. Vendors would like their relationship with the retailer to be seamless. Although communication with their principle contact within the retailer is often excellent, collaboration among other functional areas can be difficult. The second dynamic is that because they are external to the retailer, they use different “systems,” which further limits their communication ability.

While the vendor and his/her key contact at the retailer may have a robust and seamless relationship with excellent communication, the challenge quickly heightens once their conversations stop. In most cases, the vendor and the contact at the retailer agree on communication to the various functional areas (e.g., operations, marketing, and supply chain). The vendor is completely reliant on the retailer contact to disseminate that information completely and consistently. And while the contact has the best of intentions in delivering that message as agreed upon, that’s not what always happens.

Too many obstacles are in place, in the form of siloed functional areas, to make this flawless without the proper tools. The best software tools provide for a platform that can be accessed by both the vendor and the retailer to share words, pictures, and diagrams. Most importantly, the platform should support two-way communication that can be quickly aggregated for a meaningful and strategic response.

Finally, there are the vendors who come into stores to do things like repairing signs and equipment. They check in, and then most of the time busy store managers don’t see them again. Lack of visibility into the labor hours actually required by vendors to complete tasks can result in millions of dollars of over-billing throughout the retail chain. Further hampering the retailer’s attempt to monitor vendor efficiency is a lack of visibility into time taken by various vendor employees to complete tasks and inability to benchmark them to industry standards.

One major DIY retailer in North America solved these challenges by implementing a Vendor Performance Management system on mobile devices. The handheld devices were given to employees of the retailer’s third-party merchandising services providers. The system enabled the retailer to send tasks to vendor employees, monitor status completion, and benchmark performance levels. The retailer quickly found that the average time to complete various tasks such as setting up promotional displays and provide product training was less than had been previously reported. In one year, the retailer reduced its merchandising services spend by \$70 million. **The equivalent savings for a \$1 billion retailer: about \$0.9 million.**

Supply Chain

The supply chain function is responsible for managing the warehouse, logistics, distribution, replenishment, and delivery requirements of the stores. Over the past three

decades, the supply chain function in retail has become much more efficient thanks in great part to the advent of the sophisticated integration of technologies such as bar codes, wired and wireless networks, and more recently, RFID (with mixed results). These technologies, when combined with applications such as transportation and warehouse management systems, have enabled retailers to dramatically increase their efficiency. However, gaps still exist that prevent retailers from solving longtime problems such as out-of-stocks, a problem the industry has struggled with for years, and excess costs:

Deliveries are not synchronized with store labor. One problem is the effect of sub-optimal communication among merchandising, supply chain, and store operations. Starting in corporate, merchandising spends significant time and money planning product assortments, new product introductions, and category refreshes. A variety of business intelligence systems are used to determine the best mix of products to carry in the stores. But due to the extended and global nature of supply chains today, a variety of events can cause delays: weather, port lockouts, manufacturing problems, and more. The supply chain then has to either ship the product late to stores or incur higher transportation costs due to expedited freight charges.

“Unexpected spikes or drops in consumer demand of certain products will always happen. The increasingly extended nature of supply chains makes it that much harder to respond in a timely fashion.”

For this reason, supply chain and stores need better upstream visibility into when products are going to arrive in their distribution centers and store loading docks. When product hits the distribution center, supply chain generally does a good job of getting it to the stores, but many times on a last minute basis. This gap results in a ripple effect that causes misalignment between supply chain and store labor. When stores find out about incoming product at the last minute, they may not have enough employees in the store to unload product and re-stock shelves. Then, one of two things happens: stock-outs or reduced customer service because overloaded employees are too busy unloading trucks and stocking shelves to help customers.

Supply chains send what they have, not what stores need. Due to the global economy, supply chains are more extended than ever. Despite the efforts of suppliers, logistics providers, distributors, and retailers to integrate their systems, reduce inefficiencies, and improve visibility, lag times still exist. Unexpected spikes or drops in consumer demand of certain products will always happen. The increasingly extended nature of supply chains makes it that much harder to respond in a timely fashion. When faced by product shortfalls, the distribution manager in the supply chain function has to ration out high demand products and ship to the stores what is available. If the stores run out of surprise best sellers, sales are lost. Similarly, in the case of slow sellers, those are sent to the stores too, with the assumption that price discounts will take care of the remaining inventory. Profit margins are reduced.

Supply chain does not work optimally for promotions. Most consumers have experienced at one time or another when they go into a store to buy a promoted item, only to find that it is out of stock. Meanwhile, another store of the same retail chain just a few miles away may have the exact same item on the store floor. This is a big problem for retailers, and a multitude of technologies including RFID have been

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\$37 million in increased sales

implemented in an attempt to solve it. Although there are many aspects of store-level RFID technology that could solve this problem (instant alerts to stock-outs without the need to scan a product), the technology has not yet been widely embraced. Until stores can get accurate real-time inventory level data, retail supply chains will continue to face the daunting problem of responding immediately to varying store-level inventory levels on a cost-effective basis. This problem is even more difficult to solve for large, hard to move products such as furniture. The cost of disassembling product, shipping it to another store, and reassembling it may be more expensive than the margin on the sale.

Localized assortments? Not so fast. Numerous articles and analyst reports indicate that the Holy Grail for retailers is to localize their product assortments and cater to their customers’ needs on a neighborhood by neighborhood basis. But given all the problems in cross-functional collaboration among the various functions of a large retail chain, most retailers are not yet ready. What is the use of spending time to plan an elaborate localized assortment strategy if the retailer cannot be sure that its supply chain and stores will execute?

Retailers define out-of-stocks much more narrowly than consumers do. Retailers measure them by empty spots on a shelf, but consumers include multiple factors, including the inability to find a product (even if it’s in the store), get help retrieving a product (from a locked compartment or a high shelf), or get product information from a store assistant, according to a recent study by the IHL Group.⁷ Store managers and associates cannot provide good customer service if they are doing paperwork in an office or in the back unloading a truck. Store labor schedules have to be aligned with all the activities – daily, fixed, and ad hoc -- that have to take place in a store. Until they are, out-of-stocks as perceived by the customer will always be a problem.

Retail out-of-stock rates average 8 percent throughout the industry and are nearly double that for promotional items. But as this white paper has shown, the problem is not just an issue of inventory control – out-of-stocks are caused by problems throughout all the functional areas of a retail chain, including merchandising, marketing, store operations, workforce management/labor scheduling, and more. As noted in the IHL Group study, “A retailer that invested in completely fixing its out-of-stock problem would gain a solid competitive edge. The average retailer could increase same store sales 3.7 percent by converting all perceived out-of-stocks into transactions.” For a billion dollar retailer, that’s a **positive impact of \$37 million in increased sales.**

Information Technology

Over the past two decades, the role of the Information Technology (IT) function at progressive retailers has evolved. A well run, progressive, IT-savvy organization has two compelling characteristics. First, the “business” drives the strategy and the organization. Second, IT services the “business.” Of course, in an ideal situation, the CIO and rest of the IT department do not merely take orders and comply with direc-

⁷ “How Much Are Out-of-Stocks Costing You? Much More Than You Might Think,” by Greg Buzek, President, IHL Group, April 2008.

tives. Progressive CIOs understand the priorities of their line of business colleagues, anticipate, and align their resources to enable the company to reach its goals.

Unfortunately, not all retailers are progressive. A typical dynamic that exists in less progressive companies is that IT drives the business. The problem in this scenario is IT people tend to make decisions around hardware and software solutions or, at the very least, they have heavy influence over those decisions. This accommodates in theory the purchase of high quality products with low maintenance and enhancement costs, but there may be better solutions to fit the needs of the users (“the business”) and their customers. This is why the business and IT need robust collaboration in those discussions and a realization that ultimately, the business has to have the proper tools in their toolbox to get the job done. The business is better equipped to determine which tool is the best fit for the organization. IT decisions are not easily reversible and may have long term effects.

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Each year, a retail CIO typically can devote about 30 to 35 percent of the IT budget to new initiatives. The rest of the budget is required to maintain and upgrade existing systems. This white paper has identified how retailers can have a positive impact of about 11 percent of annual sales on their bottom line by implementing systems that break down the walls between previously isolated departments and improve visibility, streamline communication, align work with strategy, and foster robust collaboration. These retail execution and workforce management systems are available today.

Furthermore, today’s Web-based solutions can be implemented much more easily and rapidly than the enterprise solutions of 10 years ago – three or four months instead of years. Retail executives should take a close look at Retail Execution Management software platforms. They streamline operations throughout the company, align store labor and activity to corporate goals, increase the ability to quickly identify important trends, and improve execution of retail strategy. In short, transform an organization suffering from the siloed exclusivity effect from one that resembles a dim-witted, slow-moving dinosaur to one that resembles a shark – able to use its keen senses to quickly detect opportunities and seize them.

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(Editor’s note: Part 2 of this series will look at four key processes in retailing – new product introductions, promotions, price changes, and product withdrawal – and the opportunities for retailers to increase efficiency and improve execution.)