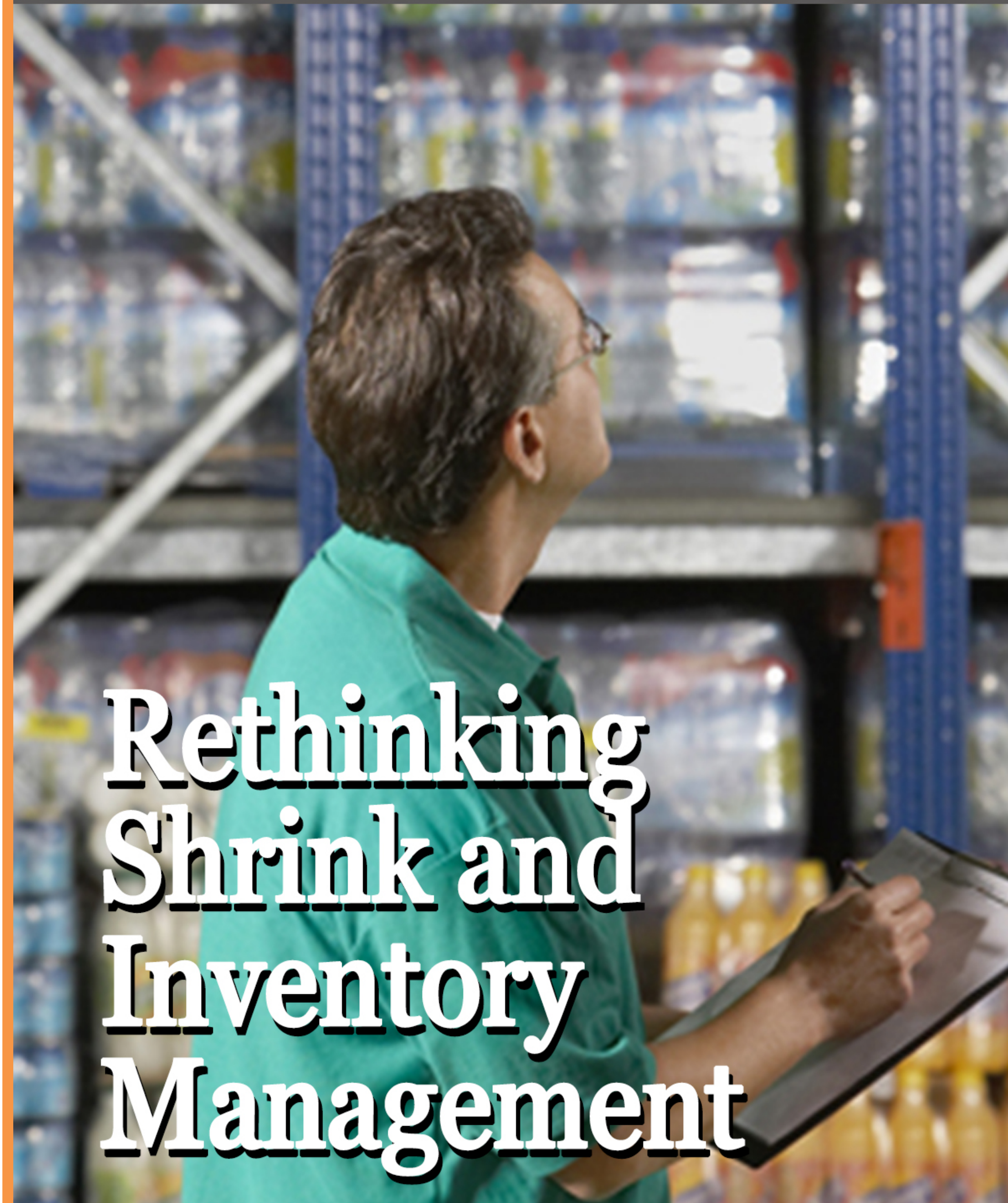
LPM SPECIAL REPORT



Rethinking Shrink and Inventory Management

In the retail environment, the term “shrink” or “shrinkage” has traditionally referred to the difference between the amount of merchandise (or inventory) that the company owns on its books, and the results of a physical count of the merchandise. Shrink can come in many forms and can impact a business in many different ways. The primary causes of shrink can include operational errors, internal issues, and external losses.

- Operational errors can involve paperwork issues and other operational missteps. These incidents typically occur when processing a transaction, receiving merchandise, shipping merchandise, or taking inventory.
- External losses can involve theft by customers (primarily shoplifting), issues involving vendors, or other incidents that pertain to those not working for the company.
- Internal losses are the result of incidents that involve store associates and other company employees who take advantage of opportunities to steal from the company.

In addition to theft issues, damage, waste and spoilage can directly contribute to a company’s losses.

When merchandise is stolen or otherwise unaccounted for, it affects the company in terms of the missing product, but it also skews our inventories in other ways. This not only impacts current sales, but also affects product replenishment and future sales as well. Shrinkage and loss can have a significant impact on the bottom line and a direct influence on the health of the company. Every year, shrink issues cost retail businesses tens of billions of dollars. This is a real and growing problem.

Managing shrink is a critical aspect of inventory control, which involves the management of the supply, accessibility, storage, and delivery of the company’s goods. As a result, shrink management strategies require a multifaceted, broad-based approach in order to successfully manage the process.

Shrink Visibility

A variety of technologies are available to help retailers manage inventory and address retail shrink:

- POS analytics that can help track sales processes and productivity.
- Video surveillance to maintain safety and security, and provide context and evidence for retail shrink events.
- Electronic article surveillance to deter and detect shoplifting.
- RFID-based inventory visibility solutions to enhance the speed and accuracy of store operations.

Each solution is valuable in its own right—but together they deliver a new level of business intelligence. The integration of item-level RFID information and loss prevention data creates a real-time understanding of what, when, and how specific items go missing. This understanding may be referred to as shrink visibility, which gives retailers a complete picture of loss events—at the SKU level and in full context—at the moment they occur. Shrink visibility improves loss prevention effectiveness, and simultaneously corrects errors and gaps in inventory visibility. By integrating multiple store technologies and databases, shrink visibility delivers a more intelligible, accountable, and ultimately more profitable retail environment.

For example, consider how shrink visibility could help a big-box electronics store address the systematic theft—with possible insider assistance—of high-value consumer electronics. Using item-level RFID information to augment alerts from its EAS-based LP system, the retailer can set its loss prevention platform to alert staff whenever the number of tablet computers leaving the store crosses an hourly threshold. By setting alarms to trigger video captures of POS scans and store exits, the store can know when, where, how often, and in whose hands every item is leaving, so the LP team can dig into root causes of losses instead of chasing after symptoms—and even use images of thefts in progress for use as evidence at trial.

Controlling Retail Shrink at Every Checkpoint

Capturing quality data in real time enables predictive-analytics-based strategy and response—at the exit, at checkout, in receiving, and on the selling floor.

At Receiving. Automated processes up and down retail supply chains are accelerating purchasing cycles, reducing receiving delays and costs, and helping to distinguish in-store from supply-chain retail shrink. Small process adjustments—like integrating SKU-level information into advanced shipping notices, for example—can automate accuracy checks on receipts and accelerate vendor recourse for any discrepancies. More sweeping changes such as vendor-managed inventory agreements offer even greater savings, but require high-quality information about the source and scale of any loss.

On the Selling Floor. Addressing retail shrink on the sales floor—especially in high-risk areas with limited staff visibility—is a persistent challenge for loss prevention. Thieves use quiet corners of stores, areas with tall shelves, and fitting rooms to remove EAS tags and labels, conceal items, and stage merchandise for later theft. Staff video surveillance and public-view monitors improve visibility and deterrence, but can't offer SKU-level information about item movement that LP staff need to anticipate and intercept a theft or staging event.

RFID-enabled item-level tracking in critical zones—high-margin "boutiques," consumer electronics and media, and secluded areas like fitting rooms—gives loss prevention a powerful tool to analyze the process by which organized retail crime gangs stage merchandise within the store for later concealment and removal. For example, movement of ten identical SKUs of high-end jeans from a designer's boutique to a fitting room or the sporting goods department is a tip-off to the LP team that an organized retail crime event may be in progress.

At Checkout. Many forms of retail fraud depend on collaboration between an "outside" thief and an employee staffing a POS terminal; it's one reason front-of-store video surveillance often covers checkout stations as well as store exits. But video alone can't detect paperwork-based crimes. Detection of sweethearting and related crimes requires integration of information across item-level tracking, POS, and possibly video systems. Comparison of item-level and POS data can detect the crime; real-time solutions that allow hard-tag detachment only after items have been scanned can prevent it; and video-capture integration can identify the outside thief as well as the corrupt or compromised employee.

At the Exit. Adding RFID capability to EAS exit pedestals can produce dramatic improvements. RFID tags can detect individual items leaving the store without proper transactions, and trigger video captures to deter future losses and collect evidence against suspected thieves.

Improvements in inventory visibility are equally dramatic. Item-level data from merchandise leaving the store, correlated with tag or barcode reads from POS terminals in the immediately preceding time period, reliably measures total decrement from inventory-on-hand. Basing replenishment on total lift instead of sales keeps planned levels of inventory on the floor and avoids out-of-stock conditions due to undetected retail shrink. Exit reads uncorrelated with preceding POS reads reflect actual retail shrink—errors and theft. And because this is an actual measurement rather than a plug number, the information isn't obscured by other kinds of inventory distortion. Data from RFID tags on returned goods can be checked against POS data, reducing opportunities for merchandise substitution and other forms of return fraud.

Can a Retail Buyer Help Reduce Shrink?

While the perception of shrinkage among the loss prevention industry has evolved from thinking about loss strictly in terms of theft to the consideration of all causes of inventory discrepancy, this change in approach hasn't necessarily diffused into all of the other teams in a retail organization. Retail buyers are a prime example of a team that can help reduce shrink.

In 2015, the Retail Industry Leaders Association's (RILA) Asset Protection Leaders Council commissioned a study to look at the relationship between retail buyers and the asset protection function. The study was performed and authored by Nicole DeHoratius, adjunct professor of operations management at the University of Chicago's Booth School of Business, and Dragana Pajovic, PhD student at the University of Chicago's Booth School of Business. Checkpoint and Ernst & Young underwrote the research.

Of the buyers surveyed in the study, only 32 percent "viewed the asset protection team as a partner in efforts to drive sales." Further, "when asked whether asset protection was a factor they regularly took into account, less than 10 percent of [buyers] surveyed identified it as a key driver for their category performance. The categories where asset protection was mentioned repeatedly included electronics, cosmetics, and fashion accessories. Most other buyers considered asset protection to be an activity delegated to other parts of their organization over which they had little control or influence."

Buyers are often seen as the CEO of their product category. They oversee decisions within their category over which products to offer, how those products are packaged, how new items are set up and rolled out, and product pricing, promotions, and planogram design.

But the scope of these responsibilities is multiplied to staggering proportions when one considers that a typical buyer in the survey managed 13,000 SKUs and 34 different vendor relationships. "Not surprisingly," say the study authors, "our interviews revealed that buyers are essentially pushed to their limits in just trying to fulfill the requirements of their existing role."

Given such herculean workloads, is there any room for a closer relationship between buyers and loss prevention? Of course, any initiative towards reevaluating that relationship should respect the workload pressure that buyers are already under. But there can be significant overlap between the goals, outcomes, and methods of buyers and LP.

Just as product designers must consider supply-chain constraints in their design decisions, buyers' choices have consequences reaching far beyond simply considering what assortment of products will best match their customers' preferences. The loss prevention objective would be well served by advocating for buyers to consider full supply chain and operational execution in their choices, in addition to LP goals.

For example, while conventional wisdom may view an increase in the variety of products on offer as an unambiguous positive, variety can actually reduce sales. Too much variety among a single product category can cause a customer to decide to make no purchase rather than decide among myriad similar alternatives. Variety can also cause chaos in inventory management processes like stocking and counting. A group of products whose packaging lacks clear visual differentiation can confuse both customers and stockers, leading to errors, wasted time, and frustration. "Research shows that lowering the level of product variety can result in lower levels of stock discrepancy; however, few buyers are aware of this link."

The study authors identify five key ways in which buyers can help reduce shrink:

- **Manage Vendor Relationships—**Since buyers are the primary company representatives who interact with vendors, if LP wants to change something like product packaging, buyers are invaluable, necessary intermediaries. Buyers may also be the first to hear of widespread issues in a particular product category or product line, and could tip off LP to a problem before it gains traction.
- **Product Selection—**When selecting products, buyers can identify those items that might need additional security tagging and can work with vendors to ensure these items are delivered as desired.
- **Merchandising Decisions—**Buyers can select items to minimize the chance of discrepancies. And their decisions about the location of product placement can have significant impact on theft and operational losses.
- **New Product Introduction and Resets—** Introducing products correctly means that all the data used to make management decisions about those products are accurate from the beginning.
- **Determine Product Flow—**Since buyers often are responsible for deciding how products move through the supply chain and how they are delivered, they can directly influence loss caused by complexity and mistakes.

Based on the results of this study, there exists a clear need—and opportunity—across the retail industry to have buyers and loss prevention teams work more together closely and better understand their mutually entwined goals. Winning over buyers' hearts and minds would benefit the buyers, the loss prevention department, and the company as a whole.

Rethinking Loss Prevention and Shrink Management

The pace of change in the retail industry has accelerated dramatically over the past few years. The move to online shopping, emergence of mobile retail, and use of social media as part of the "daily fabric of shopping"—three of the disruptive forces highlighted in PwC's *Total Retail 2015: Retailers and the Age of Disruption* published in February 2015—are among the factors making it more difficult to prevent, detect, and manage loss and shrink.

Most retailers have adopted omni-channel strategies to meet consumers' demand to browse or buy whenever and wherever they choose. But enabling everything from mobile POS to in-store pickup of online purchases has made inventory management and product logistics far more difficult. The complex new retail environment is increasing a variety of risks, including the risks of internal and external theft, paperwork and operational errors, system issues, and vendor fraud.

The retail industry is struggling to manage the emerging risks it faces. As the industry transitions from bricks and mortar to "bricks and clicks," the capabilities of existing systems are being stretched thin, and many retailers have not fully integrated the new technology required to manage loss and shrink effectively in an omni-channel world.

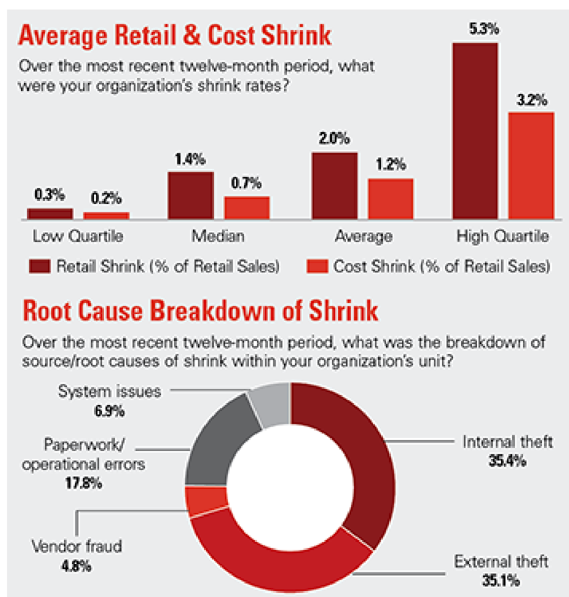
To better understand the current state and emerging challenges of the retail industry, in the summer of 2015 PwC conducted an online survey of loss prevention professionals within US-based retail organizations, including big-box stores, specialty retailers, department stores, grocery chains, and drug stores. The survey results, highlighted here, suggest a need for many retailers to rethink their LP strategies, organizations, and practices. Among other things, retailers must embrace formal root-cause analysis and the use of data analytics to remain competitive in a dynamic, increasingly risky environment.

LP professionals were asked to report on their organizations' shrink rates over the most recent twelve-month period. Among survey respondents, the average retail shrink rate was 2 percent, and the average cost shrink rate was 1.2 percent.

Sources of Shrink and Loss

According to survey respondents, internal and external theft are by far the main sources of shrink, accounting for 36.4 percent and 35.1 percent of the total, respectively. These results represent a significant shift in the industry. In the past, most retailers have reported that internal theft was significantly higher than external theft, due to employees' access to cash registers, alarms, and inventory.

What accounts for the shift in the sources of shrink? Organized retail crime, facilitated by social networking, is likely the main driver of the relative increase in external theft. The emergence of omni-channel retail, which makes it more necessary to gain an enterprise-wide view of inventory and to accurately track and manage inventory, is more likely the main factor driving internal theft, paperwork and operational errors, and system issues. (Organized retail crime likely also plays a role in driving shrink related to system issues, paperwork and operational errors, and vendor fraud.)



Another surprising finding is the significant percentage of shrink that is due to paperwork and operational errors (17.8 percent) and system issues (6.9 percent). Typically, the industry doesn't break out system issues as a potential root cause of shrink; rather, these issues are integrated into the category of paperwork and operational errors. But in the authors' view, they deserve a separate category because the emergence of omni-channel has made systems themselves a significant issue in loss prevention. System errors are exacerbated by dynamic omni-channel customer fulfillment and reverse flow (returns) logistics.

The relative amount of shrink attributed to system issues by survey respondents (6.9 percent) may be artificially low due to confusing operational errors with system errors—including errors that result when transitioning from manual to computerized processes, or integrating new systems as part of implementing an omni-channel strategy.

Identifying and Addressing Root Causes of Shrink

The vast majority of survey respondents (78 percent) use internal experts and historically reliable procedures to identify sources of shrink. More than half (59 percent) have developed a structured root cause analysis protocol that they use consistently, and the same percentage report using data analytics and end-to-end root cause analysis as their primary tool to identify shrink.

When asked how they address the root causes of shrink, the vast majority of respondents (83 percent) said they leverage historical best practices and activities that work consistently. Almost nine in ten (87 percent) use historical best practices and targeted awareness programs and leverage key indicators of shrink to address root causes and find solutions. Just over two-thirds of respondents (65 percent) said they go one step further, leveraging data trends and predictive analytics to identify the root causes of shrink, and another 16 percent plan to adopt this strategy in the next 18 months.

Implementing an Effective Root-Cause Analysis

The survey results suggest that retailers understand the importance of using root-cause analysis to identify and manage shrink in a complex retail environment. But based on the authors' observations, not all retail organizations conduct thorough, effective root-cause analyses. Doing so requires the following key steps:

- Use cross-functional teams to develop hypotheses and analyze results.
- Leverage data analytics and systems-process mapping to test hypotheses.
- Develop a shrink-reduction strategy and corresponding mediation plan based on results.
- Identify and decompose shrink drivers and quantify their impact over time.
- Develop dashboards and diagnostic tools to monitor and track root causes of shrink over time.

Collecting and Analyzing Data

How retailers collect and analyze data is the most important area of this survey. Leveraging data and analytics more effectively is the most critical step that LP professionals can take to address the current and emerging risks they face

Analyzing data is essential to identifying risks early, when they can be addressed more effectively. For example, one major US retailer was able to reduce shrink by more than 70 percent over six years, from more than $950 million to less than $250 million, by focusing on high-risk stores and leveraging data analytics to identify potential losses and prioritize risks earlier in the risk cycle.

Analytics can also help to optimize scarce resources. For instance, predictive analytics can be used to reallocate LP personnel to stores whose risks are increasing, to proactively address and mitigate the risks before they become a major problem that impacts profitability.

Data Collection. Almost all of the LP professionals surveyed (93 percent) indicate that their organizations collect key performance indicators (KPIs) and metrics that historically have had the greatest impact on operational excellence. Six in ten (60 percent) collect metrics on a more frequent basis, and they use trend data to determine how to deploy resources—an approach that's much needed to optimize the use of reduced levels of staff.

Only 24 percent of survey respondents use real-time KPIs with advanced algorithms and predictive indicators programmed to recognize patterns (for example, those related to cash and inventory levels), but 34 percent plan to begin doing so within the next 18 months. The use of real-time KPIs can help retailers to identify and address risks earlier in the risk cycle, mitigating their potential impact.

Analytical Tools and Resources. Nine in ten of the LP professionals surveyed (90 percent) still use a traditional tool—Microsoft Excel (pivot tables and formulas)—to analyze data, and 72 percent use analytics tools such as SAS and SPSS. Only one-third (34 percent) leverage sophisticated business information tools such as Tableau and QlikView to analyze data, although an additional 17 percent indicated they plan to adopt such tools in the next 18 months. And less than half of respondents (48 percent) use LP technology dynamically across the organization to define, detect, predict, and prevent shrink, although another 38 percent plan to begin doing so in the next 18 months. This result indicates that retailers are waking up to the need for rapid prediction and detection of shrink in a dynamic omni-channel environment.

Retailers that are ahead of the curve, using sophisticated, dynamic tools to manage loss and shrink, have an opportunity to leap ahead of competitors that continue to use traditional approaches to data analysis. That said, even the most sophisticated analytical tools will not be effective without the knowledge and resources required to understand the tools and use them effectively to perform sophisticated analytics. This is a lesson that some retailers have learned the hard way as they failed to realize the benefits of the powerful tools they purchased.

An Expanding LP Mandate

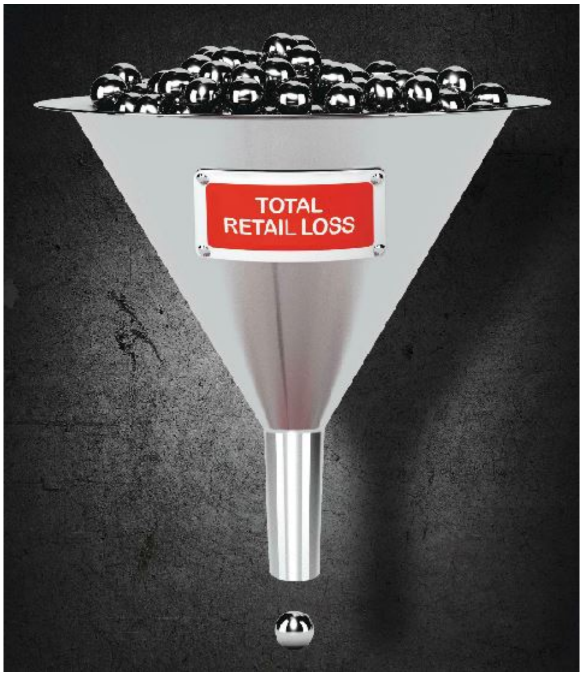
As the roster of retail risks has expanded, so has the mandate of LP professionals. Large percentages of survey respondents report that their LP organizations are involved in mitigating risks and losses for a variety of areas, including areas not typically addressed by LP professionals, such as supply chain (74 percent) and business continuity planning (81 percent).

The results of PwC's retail industry survey highlight the need for retailers to reassess their LP strategies and capabilities to ensure they can remain competitive, much less move ahead. As discussed, retailers must deploy effective root-cause analyses and leverage data analytics and technology tools to identify and manage shrink and loss and to deploy scarce resources effectively in a complex, dynamic environment.

To better manage loss and shrink, many organizations are building advanced data analytics and other LP capabilities in-house or leveraging external organizations to augment their internal resources. Whatever approach they choose, retailers that recognize and address the evolving risks and challenges of the new retail environment will be better positioned for success.

Beyond Shrinkage: Introducing Total Retail Loss

A major report published by the Retail Industry Leaders Association (RILA) puts forward a dramatically different way of thinking about the problem of retail loss and how it might be defined and measured in the future.



The Situation

There is little consensus on what constitutes "loss" within the retail world nor how it should be measured. The terms "shrinkage" and "shortage" have been loosely applied to encapsulate some of the areas that generate loss, but they are not terms enjoying a clear and agreed-upon definition across the sector. Equally, measuring losses at retail prices is probably the most common method adopted to capture the scale of the problem, but again, it is not without its critics. While the term "shrinkage" has been used for probably the last hundred years of retailing, there continues to be wide variance on what is included and excluded when this term is used, with some retailers using it to describe only those losses captured through identified discrepancies in inventory counts, while others add in additional types of loss recognized through other forms of recording practices.

The inclusion or exclusion of losses associated with the retailing of items such as food adds further ambiguity. Should products that have been recorded as going out of date be included as shrinkage? What about those items that have been reduced in price to encourage a sale due to oversupply or a change in consumer demand, or products that have been damaged in the supply chain? Even more variability exists when the losses associated with what are sometimes called "process failures" are considered. Should those losses that are generated by mistakes within the business be included in the overall shrinkage figure, such as product set-up errors, non-scanning at the till by members of staff, the reduction in sales caused by products being out of stock, or shelves not being replenished accurately?

In addition, there is increasingly a tranche of losses that can be associated with discrete and purposeful decisions made by retail organizations as part of pledges and guarantees to consumers, such as price matching, compensation for poor service, and guarantees of product availability. Should these be included in a definition of retail loss? Finally, the growing breadth and complexity of the retail landscape is putting stress on the applicability of traditional shrinkage definitions. How might losses associated with online and so-called omni-channel retailing be measured and understood?

Researching Total Retail Loss

It is within this context that both RILA and the ECR Community Shrinkage and On-shelf Availability Group decided to support a research project not only to explore how retailers currently view the problem of loss, but also to work toward developing a new definition and typology that might better capture how losses are impacting their businesses. The research used a number of different methodologies—an extensive literature review; a questionnaire to a group of large European retailers; 100 face-to-face interviews with senior directors in ten of the largest retailers in the United States, representing 27 percent of the total retail market; and a series of workshops and focus groups with loss prevention representatives from a range of European retailers and manufacturers.

The Limitations of "Shrinkage"

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. 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, while others only seem to use it to refer to variance in the value of expected and actual inventory.

The review of the existing literature on how shrinkage is defined and understood can be summarized as follows:

- There is no agreed definition of what constitutes shrinkage.
- Most published estimates of shrinkage are based primarily on measures of unknown loss where the root cause is unidentifiable.
- The focus of most definitions of shrinkage typically relate only to the loss of merchandise.
- In most surveys the measurement of shrinkage is requested at store level—the retail supply chain rarely features.
- There is relatively little consensus on how shrinkage should be measured although most surveys collect information at retail prices.
- Expressing shrinkage as a percentage of total sales is the most commonly used method to illustrate the scale of the problem.
- The categorization of shrinkage is confusing and often relies on catchall phrases that lack firm definitions or seem incapable of capturing the various types of risks associated with an increasingly complex retail environment.
- The terms "retail crime" and "shrinkage" are sometimes used interchangeably with the former including the costs of responding to losses, while the latter may or may not be based on known and unknown losses.

Developing Total Retail Loss

Among the difficulties of benchmarking any retail business using the indicator of shrinkage are the problems associated with understanding what categories of retail loss are included or excluded, particularly under the rather catchall terms of administrative error/process failures. Some companies taking part in this research adopted very strict criteria—shrinkage is only the value of their unknown losses based on the difference between expected and actual stock number/values, with anything else being regarded as known and therefore not included in the calculation. Other companies were much more inclusive, incorporating a number of other types of loss ranging from damages, wastage, spoilage, and price markdowns to the costs of burglaries, robberies, and even predicted losses from organized retail crime (ORC).

Some of the respondents, however, were increasingly concerned about the continuing applicability of the term "shrinkage" in a modern retail context. One respondent said, "Listen, I think the word has become obsolete because loss prevention has evolved into asset protection, and now it's asset profit and protection, and God knows where it's going to be three years from now. The names have changed, the roles have changed, the roles have gotten significantly wider, but we still hang on to this word that we've been using that describes something that we did a hundred years ago."

Part of this definitional variance seemed to be based on how respondents interpreted the difference between what could be regarded as a loss compared with a cost, the latter being viewed as everyday planned and necessary expenditure in order for the business to achieve its goal of making a profit.

However, a considerable number of respondents made a key distinction between the value of the outcome and how this differentiated costs from losses: "Costs—they bring value to the business, they are incurred because there is a perceived positive purpose in having them, they are part of the revenue generation process, and without them profits would be negatively impacted. Losses are things, which if they didn't happen there would be no negative impact upon profitability; they do not offer any real value to the business and simply act as a drain on profitability."

It was also instructive to hear how some respondents adopted a process of normalizing what some considered to be losses into costs: "We plan a lot of those costs [possible types of losses], so when we're looking at it from a planning perspective, we have that built in. Anything that we can account for and process and know what it is, we take more so as a cost rather than a loss, when we're defining it."

Another respondent talked about how the planning and budgeting process enabled many losses to be redefined as costs: "If it goes above budget, then it becomes a loss; otherwise, it's a cost." Interestingly, one respondent reflected on the dangers of this approach of "hard baking" losses into costs: "People always viewed [workers' compensation] as a cost of doing business, but I think we've been incredibly innovative, and we've shown that, no, you can really change the way we do things. … When you view it as a cost to doing business, that's when you lose innovation and when you lose really looking at how do you prevent [it]. We've done some incredibly strategic things around here in that area. In particular, I can just remember the conversations when we were doing it—it was like, a lot of people thought don't mess with that. That's just going to be what it's going to be; it's just going to gradually increase every year."

This is a good example of how labeling something as a cost can begin to drive particular behaviors. And this can be particularly the case when a budget or target is set for a given cost/loss. It is also worth noting that many respondents adopted a much more accepting tone when types of expenditure were described as the cost of doing business—a reassuringly benign phrase, which seemed to absolve them of taking responsibility for the consequences: "We try and convert as much of [these losses] to costs. It's then not on my agenda anymore—I deal with shrink."

Defining Total Retail Loss

From the interviews with senior US retail executives and feedback from the roundtables held in Europe, the following definitions of costs and losses were developed:

- *Costs*—Expenditure on activities and investments that are considered to make some form of recognizable contribution to generating current or future retail income.
- *Losses*—Events and outcomes that negatively impact retail profitability and make no positive, identifiable, and intrinsic contribution to generating income.

Using these definitions, various types of events and activities can begin to be categorized accordingly. For example, incidents of customer theft can clearly be seen to be a loss—the event and outcome play no intrinsic role in generating retail profits. It makes no identifiable contribution whatsoever, and were it not to happen, the business would only benefit. Alternatively, incidents of customer compensation, such as providing a disgruntled shopper with a discounted price, can be seen to be a cost. In this case, the business is incurring the cost because it believes that by compensating the aggrieved consumer they are more likely to shop with them again in the future. The policy of compensating is regarded as an investment in future profit generation and is therefore categorized as a cost and not a loss. (That's not to say it shouldn't be recorded and monitored for review.)

Another example of a potential loss is workers' compensation, where a retailer will cover the legal, medical, and other costs associated with an accident at work, such as a member of staff being hurt falling off a ladder. There is no intrinsic value to the business of a member of staff incurring an injury while at work. If it had not happened, the business could only benefit through not having to pay out for the consequences of the event. It is therefore a loss, and while a number of respondents to this research argued that it is a predictable and recognizable problem that can and is budgeted for, it still remains an event that ideally the retailer would prefer not to happen as it impacts negatively on overall profitability.

In contrast, expenditure on, for instance, loss prevention activities and approaches, such as employing security guards or installing tagging systems, can be seen as a cost. The retail organization has committed to this expenditure because it feels there will be some form of payback from the investment—hopefully lower or acceptable levels of loss that in turn will boost profits.

What these examples focus on is not whether an activity or event can be controlled or not, or where the incurred cost was planned or unplanned, but on its fundamental role in generating current or future retail income. When a clearly identifiable link can be made between an activity and the generation of retail income, then it should be regarded as a cost, whereas all those activities and events where no link can be found should be viewed as losses.

Categorizing Total Retail Loss

There is little point developing a typology made up of a series of categories that are either impossible or implausibly difficult to measure or once measured offer little benefit to the business undertaking the exercise. It is also worth noting that while use of the term "total retail loss" might better capture the range of losses occurring across the retail landscape, the associated typology does not necessarily encompass every form of loss that 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. For instance, there are a number of potential losses not included such as those associated with brand reputation, lost sales associated with counterfeit goods and the grey market, and 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 and measured, as yet they remain, for most retailers, highly problematic to calculate with any degree of confidence. No doubt in the future the scope and range of total retail loss will change to accommodate new forms of loss, and this is to be welcomed. Like retail itself, the world of loss prevention needs to continually adapt to meet the demands of a highly dynamic sector of the global economy.

In this document, it is not possible to go into great detail describing the various elements of the proposed typology. A fuller, more detailed description is available in the full RILA report. But as can be seen in the diagram, the typology is firstly organized around a series of centers of loss—the store, the supply chain, e-commerce, and corporate. The losses in stores and the supply chain are then separated into those that are known and unknown, with the latter being the category that most closely resembles many of the current definitions of shrinkage. All losses are then broken down into two types: malicious and non-malicious. The former brings together types of loss associated with criminal activity, while the latter focuses on losses often regarded as process or administrative in nature.

The typology then goes on to propose thirty-one types of known loss covering a wide range of losses across the retail enterprise and incorporating events and outcomes beyond just the loss of merchandise. There are of course a multitude of root causes that make up each of the proposed core categories of loss. These will vary depending upon the retailer, but it is hoped that those selected provide sufficient macro-analytical capacity to provide value when it comes to understanding the broad landscape of loss within a business.

The purpose of the typology at this stage is not to offer micro-level identification of all causes of loss but more to act as an organizational tool to compare the distribution of core categories of loss across a business, which in turn could then stimulate deeper analysis of any given category warranting further investigation. This list of known causes is still a work in progress, and it is hoped that future research and application of the proposed typology will enable it to be further fine-tuned and amended to ensure it has as high a degree of applicability across as many types of retailing as possible.

It is important to note that the typology design enables the value of retail losses to be calculated and not necessarily the number of events. Where an associated value cannot be calculated or there is no loss of value associated with an incident, this should not be included. For instance, if a shoplifter is apprehended leaving a retail store and the goods they were attempting to steal are successfully recovered and can be sold at full value at a later date, there is no financial loss associated with this incident. While the retailer may still want to record the fact that an attempted theft took place and was successfully dealt with, it would not be recorded in the total retail loss typology. In this respect, the typology is recording the value of retail losses and not their prevalence.

Total Retail Loss: Helping Your Business Make Good Choices

It is clear that the proposed total retail loss typology is a radical departure from how most retail companies have understood and defined the problems of loss within their companies—moving away from a definition focused primarily on unknown stock loss, mainly in physical retail stores, to one that encompasses a broader range of risks across a wider spectrum of locations. While there is a simple elegance about the approach adopted in the past, based on the traditional four buckets of loss (internal theft, external theft, administrative errors, and vendor frauds), it is increasingly recognized that these rather broad-brush and often ambiguously defined categories are no longer capable of accurately capturing the complex risk picture now found in modern retailing.

As increasingly rich veins of retail data become available, it is becoming more apparent that most retail losses are a product of business choices—the scale of many losses are directly related to decisions made about how a retailer wants to operate. For example, introducing customer self-scan checkouts is a choice. It has some clear benefits associated with it, such as lower staffing costs, but it also has some clear risks, such as increased levels of loss associated with non-scanning or missed scanning of product. Deciding on the overall value of these retail choices requires high-quality data on both sales and all possible losses, and they must be viewed together rather than in isolation. The interplay between sales and losses needs to be viewed in the round and not as a series of cross-functional trade-offs where losses and profits are allocated separately, inevitably driving behaviors that do not benefit the business as a whole.

Within this context, the proposed total retail loss typology can bring value. By identifying as many of the manageably measurable categories of loss across the entire retail business as possible, it will enable greater transparency to be achieved and better avoid the shifting of losses/costs between one category and the next, depending on whose interest it best serves. By agreeing what should and should not be defined as a loss, the proposed typology will help to inform decisions that are in the interest of the business as a whole and not just certain stakeholders.

Helping to Develop the Role of Loss Prevention in the Future

The total retail loss typology combines data from across a wide range of business functions. It has the potential to offer a unique macro overview of how all forms of loss are affecting a business and from there provide an opportunity to reflect on how an organization's resources are being allocated. In many respects, it could provide current and future loss prevention practitioners with an even greater opportunity to make a significant and lasting contribution to maintaining and improving the overall profitability of their businesses. As levels of what might be described as traditional shrinkage begin to reach levels where it increasingly becomes either uneconomic to reduce further (because the required investment is not justifiable based upon the likely return to the business) or positively counter-productive to reduce (because of the negative impact required interventions will have on sales and profits), then it makes sense for loss prevention practitioners to use their resources and established skills to better effect on other problems faced by the business. After all, the goal of loss prevention is not necessarily to reduce losses to zero—this could easily be achieved by a series of draconian measures that would likely induce bankruptcy in most retail companies. The goal is to achieve a level of loss that, based on the operational choices made by the business, optimizes the profitability of the organization.

Dealing with unknown loss, which is what most loss prevention practitioners typically focus on (given they have responsibility for shrinkage), is probably one of the hardest challenges faced by a management team in retailing, requiring them to develop a high level of analytical and problem-solving capability. Trying to solve problems where the cause is typically unknown is at the hard end of the management spectrum—it requires creative thinking, imaginative use of data, and considerable experience. Imagine if these capabilities were put to use on the broader range of known problems encapsulated in the total retail loss typology. The impact could be profound. This is not to say that a loss prevention team should not continue to ensure that unknown losses (as defined in this document) remain at an acceptable level for their business and try and convert as much of them as possible to known losses. But the typology could provide them with an opportunity not only to become the agents of change for the better management of loss throughout the business, but also to take on new challenges that use their considerable established skill set. As one respondent to this research said, "I don't own 'damage.' I could really make a difference [to it]. It would be a walk in the park compared with dealing with ORC!"

In effect, the loss prevention team of the future could become the drivers of a total retail loss group, marshaling data on losses across the business, coaching and encouraging other retail functions to better manage the problem, and using their problem-solving skills to help the business sell more through managing losses more effectively. It would enable the loss prevention team to reimagine their role within the business, providing them with an opportunity to remain a relevant, agile, and highly valued function in a rapidly changing retail landscape.

Total Retail Loss: Next Steps

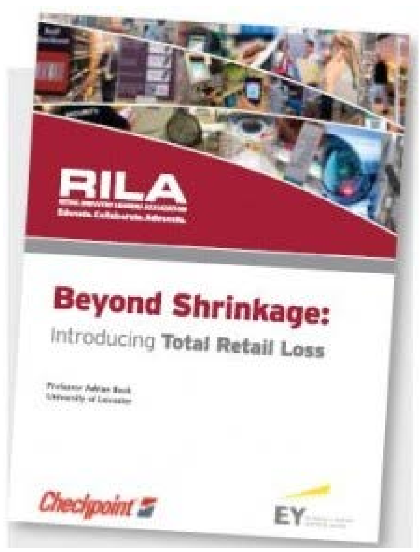
Moving from something as established as "shrinkage" as a core measure of how loss is generally understood to one described in this report is never going to be easy. Roles, functions, surveys, indeed an entire industry has evolved using this word to describe retail loss.

The current research set out not only to better understand how modern retailing is thinking about the issue of loss—how it is defined and measured—but also to begin to put together a more comprehensive typology that it is hoped will add value in the future.

Through enabling businesses to view the big picture of loss, across their entire retail landscape, the typology potentially offers an analytical tool that can be used to better understand how losses are impacting business profitability and how current resources are being allocated.

Through a process of engagement, further testing, and refinement, it is hoped that the total retail loss typology will begin to add value to retail companies, enabling them to better understand how all forms of loss impact their capacity to make customers happy and their businesses profitable.

For a free copy of the report, go to the Asset Protection tab at RILA.org. For questions about the report findings, contact Professor Beck at bna@ leicester.ac.uk. ■



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