To Fund SMAC, Examine SG&A

Social, mobile, analytics and cloud are remaking retail. Here’s how to reduce SG&A to underwrite your SMAC investments.
Executive Summary

In tandem with online retailing’s skyrocketing growth, the SMAC Stack™ (social, mobile, analytics and cloud technologies) has disrupted business for traditional retailers. Yet the one-two punch also offers important opportunities for retailers to strengthen their market position by leveraging new technologies. SMAC investments today have progressed far beyond “nice to have” and are now a mandate.

This white paper examines retail organizations’ revenue growth and provides practical guidance for traditional retailers to fund SMAC investments and win in the modern digital economy.

Key takeaways include:

- **Traditional retailers that embrace SMAC and e-commerce are emerging as market leaders.** Tesco, Home Depot and Macy’s are among the traditional retailers investing in innovative technologies and successfully building out their SMAC architectures.

- **Funding SMAC projects is the key issue.** Traditional retail revenue growth has stalled, and net margins remain stubbornly – and dangerously – low, trailing into the single digits.

- **Reducing SG&A expenses can generate significant savings.** To offset the investment in front-office SMAC technologies, retailers need to reduce back-office costs aggressively and implement virtualization.

- **Stepped-up use of business process services (BPS) represents an important opportunity to lower SG&A costs** and help fund SMAC investments.

Growing online retailer market share is here to stay; in fact, the surge is the result of SMAC’s creative destruction. Time is of the essence; as our analysis shows, margins cannot fall any further.
TO FUND SMAC, EXAMINE SG&A
Change Isn’t Coming; It’s Here
The SMAC transformation in retail is happening more quickly than any change the industry has ever experienced. By 2020, 100 billion computing devices will be connected to the Web, and corporations will be managing data volumes that are 50 times what they are today.

SMAC’s numbers are big — and getting much bigger. By 2016, consumers will have signed up for 4.9 billion social network accounts. Mobile shipments will reach nearly 1.9 billion, with tablets not far behind at 304 million. The big data market will skyrocket to $48 billion, up from $5.4 billion in 2012. The cloud market will top $207 billion.

E-commerce’s projected growth is equally powerful. Fueling this growth are traditional stores’ investments in Web businesses to support omnichannel strategies, the rapid pace of mobile device adoption, and consumers’ increased comfort with purchasing online.

SMAC is transformational for retailers because it is highly disruptive, and because the stakes are high: Retailers unable to keep pace with SMAC’s inexorable changes have perished or been bloodied. Think Borders, Blockbuster, AOL and Rand McNally. (For more on this topic, see our white paper, “Code Rules: A Playbook for Managing at the Crossroads.”)

But as SMAC reshapes the industry, it also represents an enormous opportunity for retailers. Companies that have embraced its changes — think Amazon, Apple and Garmin — have emerged as market leaders.

How Leading Retailers Win with SMAC
SMAC’s creative disruption is well underway (see Figure 1). In response, some traditional retailers have moved quickly — and successfully — to invest in innovative technologies such as Wi-Fi hotspots, smart shelves, sophisticated point-of-sale systems

Catching the Fifth Wave of Corporate IT

Figure 1
and virtual stores. An example is UK-based retailer Tesco. The world’s third-largest retailer predicted its 2013 technology spend would total $750 million, up threefold in three years. Its innovations have earned Tesco some impressive advances. To gain market share in Korea, where it has fewer stores than its competitors, Tesco opted to bring its grocery services to customers by launching Homeplus virtual stores in Seoul subway stations. Lifelike replicas of Tesco’s supermarket shelves cover the stations’ walls, and commuters use their smartphones to scan the products’ Quick Response (QR) codes and place grocery orders that are then delivered to their homes.

In the first three months, 10,000 commuters shopped the virtual supermarkets, according to Tesco, and online sales spiked 130%. Tesco eventually expanded Homeplus to bus stops, and it now operates 22 virtual Homeplus stores. Koreans have downloaded the Homeplus app more than one million times.

The Home Depot, Inc. plans $300 million worth of e-retail, warehouse and supply chain investments in 2014. The home improvement giant was an early mover in the mobile marketplace, launching a mobile site in 2010 that lets shoppers access real-time inventory, pricing and aisle location. That same year, it plowed $64 million into wireless handheld devices for associates at its big-box stores to better assist customers and speed checkout.

Robust SMAC strategies need to cover both an optimal integrated online presence and the brick-and-mortar side of the business.

Retailers are developing the technology talent that drives e-commerce growth. When Macy’s consolidated its operations in New York in 2009, it continued to invest in its digital team, which stayed in Silicon Valley. The team forms the heart of Macy’s e-commerce initiatives and has helped the retailer boost traffic and improve conversion rates, spurring online sales growth of 41% in 2012 compared with 2011.

With its ambitious global e-commerce strategy, Walmart has given the industry notice that it plans to continue its aggressive digital expansion and take on the online powerhouses. Through its Walmart Labs unit, the world’s largest retailer purchased predictive analytics firm Inkiru and signaled its intention to beef up its customer experience and site personalization. It has also acquired OneOps and Tasty Labs to bolster its cloud and social capabilities.

Retailers’ Progress on Growing Revenues: What the Data Reveals

For traditional retailers, funding SMAC transformation is the key issue. Indeed, revenue growth has stalled since retailing’s rebound following the 2008-2009 recession, net margins remain dangerously low, and SG&A has improved only slightly (see Figures 2, 3 and 4, next page).

Why the slowdown? Traditional retailers are focused on revenue growth while holding down costs and developing omnichannel capabilities. They have advanced their digital strategies, and nearly all have built an online presence. But their lackluster growth – particularly in comparison with online competitors’ explosive growth – indicates that more work is required to fill out their SMAC strategies.
Retail's Rebound and Ensuing Flat Line

Source: Company SEC Filings and Capital IQ
Figure 2

Retailing's Razor-thin Margins

Source: Company SEC Filings and Capital IQ
Figure 3

Retailing’s Relatively High SG&A Expense as a Percentage of Revenue

Source: Company SEC Filings and Capital IQ
Figure 4
The solution is to develop and move forward with parallel strategies that address the top and bottom lines. On the top line, efforts to incorporate SMAC technologies have been insufficient. Robust SMAC strategies need to cover both an optimal integrated online presence and the brick-and-mortar side of the business.

Opportunities to Reduce SG&A Expenses

To free up more corporate dollars for SMAC investment, it’s critical for retailers to address SG&A expenses. Not only do these expenses account for 24% of top retailers’ revenues, but SG&A reductions also provide significant savings. Given the industry’s low margins, each dollar of new revenue brings only pennies of incremental profit, while one dollar in G&A cost reduction brings a full incremental dollar increase to pre-tax profit.

To reduce SG&A, retailers must offset the cost burden of their stores’ front offices with aggressive cost-cutting and virtualization of the back office. New savings can come through automation and third-party partnerships that allow retailers to focus on the front office.

Stepped-up use of BPS represents an important opportunity for traditional retailers to lower their SG&A costs and fund their SMAC investments.

How do retailers begin to identify SG&A expenses to reduce? A disciplined approach is essential that starts with assessing and benchmarking all G&A functions.

- How many resources are performing each process, and how does this compare with industry competitors? Are resources centralized or decentralized?
- Are the processes manual or automated, and are they documented? To what degree has sourcing been used? Are best practices utilized?
- What systems are used, and are redundant systems performing the same process? Are systems integrated? Are the current systems meeting business needs? Do the systems support mobility and provide actionable market insights?

Quick Take

Analysis of the G&A Sourcing Landscape

In early 2014, we conducted primary research to understand the sourcing landscape in the retailing industry, based on data available in the public domain for the top 30 retailers across key categories, such as general merchandisers, grocery/supermarkets, apparel, specialty, etc.

Further, we identified and analyzed the processes and functions outsourced by these companies. We looked for any evidence of G&A outsourcing, including IT, HR, finance, call centers and procurement, and we excluded outsourcing outside of G&A, such as private label manufacturing.
A large, global general merchandise retailer was looking for ways to improve and standardize its processes, while also reducing the cost of vendor onboarding.

**Solution**
We have partnered with this retailer to:

- Establish an offshore, shared-service operation to perform supplier onboarding and handle the supplier calls.
- Reengineer the process to increase productivity and improve visibility into the process.
- Document the operating procedures for the newly reengineered process.
- Implement a SMAC-based call management system (CMS) for call management and tracking. The CMS enables the capture of data for every call, which in turn allows for calls to be categorized or analyzed to support ongoing and continuous improvement efforts.

**Benefits**
The results of this engagement exceeded the client’s expectations.

- Go-live at the offshore center within seven weeks of contract-signing vs. the three to four months often required for offshore sourcing.
- Over 50% cost reduction via offshore cost (labor) arbitrage and productivity gains.
- Over 25% improvement in labor productivity resulting from process reengineering.
- Improved tracking of supplier onboarding applications to provide visibility into the onboarding cycle time for each supplier and in aggregate.
Once the functions are assessed and benchmarked, an important next step is developing plans to reduce costs and virtualize the back office through standardization, systems rationalization, increased automation, shared services and sourcing. According to McKinsey, retailers are removing or redeploying up to 30% of costs in store operations and corporate support functions by applying lean techniques and accelerating offshoring.15

We evaluated the 30 largest U.S. retailers and found that although 50% have embraced BPS, most limit it to single-process areas in departments such as human resources and finance (see methodology, page 7). Stepped-up use of BPS represents an important opportunity for traditional retailers to lower their SG&A costs and help fund their SMAC investments. Finance and accounting is a key target. Approximately 60% of F&A headcount is related to transaction processing. Retailers can generate significant savings by wringing inefficiencies from accounts payables, accounts receivables, fixed assets, general accounting and payroll, with little impact to customers.

In addition to transaction processing, much financial planning and analysis (FP&A) work can be sourced and performed offshore, such as monthly variance analysis, standard reporting, ad hoc financial analysis and ad hoc reporting.

Many business process support functions beyond finance can also be sourced. For example, centralizing store support and facilities maintenance support reduces costs and improves effectiveness in the following areas:

- Enhanced problem-solving for stores frees associates to spend more time with customers.
- Better analytics and trend analysis (e.g., any deviations on average spend per incident for electrician/plumber), maintenance of vendor scorecards, and support for chargeback processes.
- Faster, more reliable implementation of new in-store technologies, such as POS, pricing updates and analytics.

Another example of an increasingly sourced business process is vendor/partner onboarding and compliance checks. Because noncompliance by a single small vendor can result in negative publicity, the two functions are becoming important to risk mitigation. Sourcing these tasks to an experienced partner provides process standardization and focused, dedicated teams.

**Looking Forward**

With the development and implementation of a transformation roadmap, your organization can make the adjustments to reduce and virtualize back-office costs and emerge a stronger, more efficient business. These savings can then be used to help offset some of the investment required to utilize SMAC technologies to drive sales and customer experience. (See SMAC: The New Enterprise IT Model for further information on how to think about and approach SMAC.)

To get started, we recommend the following:

2. Assess each process against best practices regarding standardization, rationalization, shared services, automation and sourcing.
3. Develop a future-state vision and prioritized transformation roadmap to get there.
Footnotes

1 “Creative destruction” — coined by Joseph Schumpeter in 1942 — refers to the incessant product and process innovation mechanism by which new production units replace outdated ones.

2 IEEE Computer Society Journals.


10 “Home Depot Bridges the Gap between In-Store and Mobile Experience,” Google Think Insights, October 2012.


About the Authors

Roger Lvin is an Associate Vice-President within Cognizant’s Business Process Services Group, where he leads a diverse set of businesses, including retail, consumer goods, travel and hospitality, man-log and technology. A long-term veteran of the outsourcing industry, Roger helps CFOs transform their back-office and middle-office operations for optimal performance and seamless customer experience. Roger is a cum laude graduate of Brandeis University, with degrees in computer science and history. He can be reached at Roger.Lvin@cognizant.com | LinkedIn: www.linkedin.com/pub/roger-lvin/2/544/902.

Paul Nowacki, CFA, is a leader of finance and accounting transformation and outsourcing services within Cognizant’s Business Process Services Group. In this role, Paul helps clients assess and optimize their F&A operations, serves as a thought leader in F&A, and helps identify market trends and shape new offerings. He is a frequent conference and webinar speaker and author of numerous articles and whitepapers on various finance and accounting topics. By combining his industry experience in IT and finance leadership roles with a background in transformational consulting, Paul looks holistically at finance and accounting organizations and blends process and systems with organizational design perspectives. He has a B.S. in Quantitative Business Analysis from Indiana University and an M.B.A. from the Lerner Business School with a concentration in operations research. Paul also holds the Chartered Financial Analyst professional designation. He can be reached at Paul.Nowacki@cognizant.com | LinkedIn: https://www.linkedin.com/in/nowacki.

Justin Jesudas is a Senior Manager with Cognizant Research Center, where he provides insights into market and industry trends. Justin has more than 12 years of experience in market research, strategy analysis and competitive intelligence. He holds a master’s in public administration. He can be reached at Justin.Jesudas@cognizant.com | LinkedIn: http://in.linkedin.com/in/justinjesudas.
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