Strategies to Mitigate Shrink in a Boundary-less Retail World

Shrink is a constant, multi-faceted challenge that retailers must overcome to grow and prosper amid continuous omni-channel expansion.

Executive Summary

In the U.S. retail industry, where average net margins are just 3%, nearly $50 billion annually is estimated to be lost to shrink — or nearly 1% of the industry’s $5 trillion in annual sales. Theft, fraud and inefficient operations are all significant problems that erode the margins that retailers work so hard to increase or, at the very least, preserve. Combine unrelenting margin pressures with ongoing consumer price consciousness, and the ability to control shrink can make or break a retailer’s bottom line.

Over the last 50 years, the evolution of loss prevention (LP) has been quite extraordinary. As the retail landscape has changed, so has the problem of shrink. During the 1960s, when retailing comprised mostly independent small stores, shrink was not a significant concern. The reason: simple store formats, supply chains, limited assortments and smaller staffs. With the advent of regional and national chains, it is now difficult to scrutinize all corners of the larger store formats. Furthermore, the need for a larger workforce and complex supply chains has opened new doors to shrink (see Figure 1, next page).

Retailers have responded to these challenges by creating an organized LP department that works with divisions across the enterprise to slow the growth of shrink from both internal and external sources.

Amid today’s growing movement toward omni-channel retailing, retailers face more complex challenges than ever before. Margins are under attack on many fronts: losses attributed to shoplifting and internal theft are compounded by online fraud, organized crime and sophisticated supply chains (i.e., geographical sourcing, multiple touchpoints, access to products by outside resources and availability of products at multiple nodes).

We believe that retail LP departments are at a tipping point once again; the tools that had worked incredibly well in the past are not enough. To remain ahead of the curve, LP teams must shift their focus from traditional strategies, such as policing and basic reporting, to IP videos and predictive analytics.

This whitepaper describes how the LP function has evolved over time, the new challenges retailers face in controlling it and, from our point of view, ways to overcome these challenges.
Loss Prevention: A Constant Struggle to Protect Profits

The history of LP strategies is as follows:

- **Pre-20th century**: Shrink has grown, along with the evolution of the retail industry. Policing and detection units by retailers to prevent shoplifting date back to 18th century London, when the city pioneered the use of a dedicated police division, “The Bow Street Runners,” for swift investigation at crime scenes.

- **Emergence of dedicated LP departments**: Retailers continued to use rudimentary LP methods until the 1960s, when the first formal departments were formed. Most of these were staffed by former law enforcement officers who did not have retail experience. These LP departments were managed at the individual store level and had very little or no communication with upper management. Stores utilized tactics such as plainclothes detectives, shoplifting focus towers and basic daily till reconciliation.

- **Retail growth begets additional shrink, new tactics**: As retailers grew larger in size and revenue, dollars lost to shrink also increased, and retailers began to invest in more sophisticated tools and effective strategies. EAS, CCTV and interdepartmental collaboration replaced ceiling mirrors and shoplifting watchtowers within stores. Laws were enacted in the U.S. in the 1970s that allowed merchants to recover penalties from shoplifters that fueled the expansion of LP departments.

One of the main themes that reshaped LP departments in the late 1980s and 1990s was their organizational structure and propensity to collaborate with other departments to reduce shrink. Driven by the need to support a positive ROI, LP shared many goals with other departments and divisions and took the new form of asset protection (AP), which extended the scope of responsibility outside the four walls of the store and into the warehouse. This led to the introduction of distribution center (DC) audits, truck seal programs, vendor compliance audits and increased focus on production planning and overall retail operations (see Figure 2, next page).

By the start of the 21st century, most AP departments had embraced technology to uncover wrongdoing within the organization. Through the emergence of exception-based reporting,
enterprise shrink reporting and refined case management software, productivity increased dramatically.

With the evolution of LP techniques such as exception-based reporting and EAS tags, retailers have been able to reduce shrink as a percent of sales; however, the actual dollar loss due to shrink continues to grow.

Challenges and Opportunities
Growing shrink concerns have placed LP initiatives high on the agenda of many retailers. Companies are keen to invest in effective and proven LP methods, as well as collaborate with technology companies and specialists to find loss management solutions that diminish continuing shrink problems. We believe forward-looking retailers will differentiate themselves by exploring new methods to control shrink. Figure 3 (next page) illustrates five key themes that we contend will shape the future of shrink management.

Loss Prevention Beyond Boundaries
Seven in 10 retailers report shoplifters stealing merchandise and returning it for store credit.

Over the last decade, thanks to the Internet, organized retail crime (ORC) has achieved new heights. Online forums and social media platforms provide an easy means of exposing loopholes in retailers’ systems or to sell stolen merchandise. In order to stem the tide against ORC, retailers found an unlikely accomplice – their competitors. Retailers created local collaborations and started sharing intelligence with their competitors, as well as with law enforcement officials.

Today, most interactions are ad hoc and occur via phone calls and e-mails. While the spirit of cooperation provides a reasonable starting point, retailers need to find ways to make collaboration easier, more timely and more effective. Reduction of ORC benefits the entire community; as such, retailers and law enforcement agencies need to work together to create a common communication platform on which mutual alerts are dispatched and best practices are devised and shared.

Data Convergence and Advanced Analytics
Over the next year, 43% of retailers plan to implement real-time theft analysis capabilities. Limited resources and tools to mine enormous amounts of structured and unstructured data continue to undermine the effectiveness of LP teams. Retailers must consider investing in technologies that collate data from applications across the enterprise to assemble a complete picture of shrink.

Advanced data analytics and predictive modeling introduce an enormous change to the way LP organizations operate. Retailers have historically focused on known and verifiable past shrink to plan for the future; however, the next decade
will usher in a new era in which retailers will be able to analyze real-time data and predict shrink. Imagine waiting a couple of weeks rather than months to verify whether your shrink strategies are working. Analytics has the potential to be a game-changer in shrink management.

With increasing numbers of consumers active on social networks and online forums, retailers can apply big data analytics to better understand behavior patterns and develop short- and long-term LP strategies. Criminals who frequent these forums are actively seeking and providing aid to help shoplifters. Big data reports can point out products that are being stolen, mechanisms used to steal them and, in some cases, the individual who allegedly perpetrated the crime. Instead of looking at each source independently, retailers should start analyzing a variety of feeds as one large, interconnected pool to generate actionable insights. For example, retailers can start by analyzing transaction logs, videos and stills from CCTV and workforce management applications in tandem to identify employee fraud.

**Video Analytics**

*Within the next two years, 23% of retailers plan to use CCTV video surveillance integrated with video intelligence software.*

Video surveillance has incrementally improved over the better part of the last two decades, moving from analog, to compressed analog, to digital, to a distributed digital version. Video analytics can help with effective monitoring of shrink-prone areas of the store. By monitoring activities such as cash movement, retailers can use video analytics to reduce shrink resulting from employee collusion.

Advancements in visual analytics have enabled automated tagging of certain events, such as returns processing with no customer present. These features accelerate the discovery of relevant events that allow shrink management teams to be more targeted in their investigations, saving hours spent reviewing random video footage.

Facial recognition systems have existed since the turn of the century, but until recently, they have not been widely deployed. Government agencies were early adopters, targeting fugitives, terrorists and spies. Retailers have had their eyes on the technology for some time, but the price point was simply too high to justify. Now that detection algorithms have been refined to improve identi-
ification accuracy, and solutions have declined in price, facial recognition technologies are more appealing to certain retail segments.

The big advantage of CCTV, IP cameras and video analytics is cross-departmental use. Video analytics and improved video resolution will allow departments such as store operations, risk management, HR, legal and marketing to make decisions based on a whole new set of data that was previously unavailable. They will have insight into demographics, customer service, training, foot traffic, abandonment, conversion, dwell time, line queueing and merchandising. With remote capabilities built into these solutions, associates in all departments can easily access the analytics data. With increasing reliability and advancement, retailers will soon be able to start using video analytics in some capacity in their fight against shrink.

Omni-channel and Mobility Focus

31% of retailers’ IT budgets by 2016 will be spent on omni-channel capabilities. Online fraud is easier to commit but more daunting to detect compared with traditional methods of theft that occur within the four walls of a store. Given the omni-channel nature of retail, these types of fraud will increase in frequency and impact. In one recent example, a retailer viewed a markdown loophole on its Web site that was exploited by a single individual for thousands of dollars across the chain.

RFID Tagging

American Apparel has reduced shrink by an average of 55% at RFID-enabled stores. Some locations curtailed shrink by as much as 75%. RFID technology has promised improved product tracking for some time, but store adoption of RFID has been hampered by high front-end costs. In the near future, RFID is expected to make a major impact in two key ways: as a replacement for EAS tags and as a means to secure supply chains.

RFID usage is limited to high-value products, and we expect this trend to continue. However, the threshold of “high value” will begin to decline as the adoption and availability of RFID tags increase and manufacturing costs are reduced (see Figure 4, next page). Today, EAS is still the most prevalent theft deterrent tag used in retail; however, with a reduction in costs, RFID tags are set to replace EAS tags as a more effective way to secure both merchandise and the supply chain.

Retailers have contended with porous supply chains and limited access to accurate data for a long time. Most of the analytics that can help retailers fight shrink require clean, consistent and accurate data; RFID solves that problem by automatically logging all the required data from systems of record, which can then be mined in real-time for analytical insights. According to a study conducted by VILRI, item-level RFID tagging is proving to deliver product inventory data that is up to 99.5% accurate.
While RFID will not prevent internal and external theft, it will provide valuable, actionable insights regarding a store’s physical inventory. This will enable merchants and planners to take corrective steps to ensure sales are not lost.

**Looking Ahead**

Shrink is a multi-dimensional threat for retailers across the globe. As long as retailing exists, losses associated with shrink will continue to impact retailing’s financial performance. Digital transformation and the emergence of omni-channel strategies will stretch LP teams and their ability to control shrinkage throughout the enterprise. While new technologies continue to evolve to combat shrink, there is no one-size-fits-all solution.

Based on our experience, we believe the following recommendations can help retailers improve their loss prevention programs:

- Develop a holistic loss prevention strategy that complements enterprise initiatives.
- Assess the existing loss prevention infrastructure and conduct cost-benefit analyses of outdated technologies, such as EAS tags and analog CCTV.
- Expand LP responsibilities beyond the four walls of the store to include online, mobile and other selling channels.
- Create a community forum for retailers to collaborate and counter ORC.
- Use big data and predictive analytics to provide near-real-time actionable insights.
Footnotes


References


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