Preparing for the Upturn

Four Initiatives to Help Retailers Get Ready for the Economic Recovery
Until the second half of 2008 market conditions allowed retailers to focus on growth and expansion. Since then, the picture looks very different. Many retailers have faced declining or stagnating sales, increasing margin pressures and a lack of available capital.

Most retailers have now put in place initiatives aimed at short-term survival and mid-term stability. Tomorrow's winners, however, will shift their focus to longer-term prosperity.

Capgemini Consulting recommends four initiatives designed to help retailers prepare for the economic upturn.
Facing the Challenge of Changing Times

The years just prior to 2008 may rightly be considered the “good old days” for many retailers. During that time, the retail industry experienced a period of significant and sustained growth. Average revenue grew by close to 9% from 2003 to 2007 for many of the world’s leading retailers, with a steady increase in gross margin.\(^1\)

The positive climate allowed retailers to focus on expansion of both their physical and online channels. For example, in the U.S., specialty retailers opened almost 25,000 stores between 2000 and 2007.\(^2\) The percentage of online sales grew by as much as 50% annually in some geographies.\(^3\)

The second half of 2008, however, proved to be a turning point for many retailers. They were increasingly impacted by various pressures such as lower consumer spending, fluctuating upstream commodity costs and lack of available short-term and long-term capital. With companies being forced into restructuring or in some cases liquidating completely, these pressures of the economic downturn have taken their toll on the retail market.

How Retailers Should Respond

The retailers that have survived thus far were able to quickly address activities pertaining to the short and medium term, such as de-prioritisation of capital projects, optimising accounts receivables/accounts payable terms, and securing long-term and short-term credit.

With balance sheets being sufficiently stable, the next challenge has been to optimise operational expenditures. This entailed, and in many cases still entails, going through various cost-cutting initiatives across functions. Whether it be spend in IT, marketing, logistics or other areas, the key has been to slash costs in the short term without damaging the long term. These measures have been primarily about stability, however, and have offered limited scope for future differentiation and competitive advantage.

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1 Capgemini analysis
3 Capgemini-IMRG Online Sales Index, 2007-2008
3. Store Workforce Management:
Best-practice workforce management, supported by best-practice resource management, can significantly improve employee productivity, enabling retailers to run stores more efficiently, thereby freeing up the time needed to invest in customer service for competitive advantage and growth.

4. Head-Office Outsourcing:
Outsourcing elements of the head-office and field functions can help retailers focus on strategic cost alignment while also freeing management attention to focus on the core business.

Let’s look more closely at each of these initiatives.
1 Customer-Centric Proposition Differentiation

There’s no question that consumers today have become more demanding and increasingly expect a customised offer from retailers. However, store formats and assortments are often misaligned with local demographics, which combined with limited space in stores, impedes attempts at customisation. This is largely due to the fact that retailers address store assortment differentiation based on store size or format, commonly without taking into account the local characteristics of the customer base. When allocation is based on store size, typically the entire assortment goes to the larger stores, and smaller assortment subsets go to the smaller stores. As a result, all stores tend to get all categories in the same proportions with little or no emphasis on where the store is located and the needs of the local customer base or nearby competition.

Likewise, allocation based on format rarely considers the demographics of the customer base. For some retailers, format is synonymous with size, while others will adjust categories – for example, more impulse products will be included in a convenience store – while not taking into account the demographics of the area in which the particular store is situated.

These approaches can lead to compromised availability, dissatisfied customers, wastage and excessive stockholding.

In comparison, when allocation is based on the local customer, store categories and assortments within categories are designed around the profile of the customer groups who typically visit that store.

A customer-centric approach to store differentiation can be piloted and implemented rapidly as long as a retailer collects or acquires a certain level of customer data. A combination of customer parameters can be analysed and modelled to determine the required store differentiation. Those parameters include demographics such as average income levels, ethnicity, age and family situation, as well as geographical factors like climate and local products. Store location – such as city, countryside, tourist area, high traffic – and regional preferences also should be taken into account. For example, in the Netherlands, Heineken is the main brewer in the West and Grolsch in the East, so Dutch grocery retailers can take advantage of this by tailoring their East and West assortments accordingly.

Capgemini recommends that retailers take a clustering approach to store segmentation, factoring in these types of customer parameters. This approach incorporates two stages:

**Stage 1: Customer segmentation.** This analysis is typically based on loyalty card data (to indicate behaviour and purchasing power) combined with demographic information by postal code. Customer purchasing and demographic characteristics are analysed to see what kinds of behaviours/attributes are exhibited and in what numbers.

**Stage 2: Store clustering.** In this stage stores are clustered with a machine-learning algorithm that uses a combination of information about the attributes of the customers (from stage 1), sales volumes by product line and location characteristics. Clusters are named (for example, “affluent suburban,” “all-purpose central”), and this analysis is then applied to the full store base. From this analysis, a retailer can look at a small number of store groupings that represent the diversity in the chain.

In our experience, retailers can realise financial benefits from a clustering approach that include increased sales through optimisation of the product portfolio in each store and less cash tied up in inventory as a result of more targeted stockholding. We have seen retailers achieve sales increases of up to 15% on a category level as a result of this approach.

**Case Study: Benefiting From Customer-Centric Assortment Planning**

Capgemini worked with a U.S.-based personal care retailer to implement a customer-centric approach to assortment planning designed to help the company better address changing consumer behaviour. In the past, assortment planning decisions had been made based on the average store performance or on simple store segmentations reflecting variables like sales velocity or store size. All the stores were treated as a homogenous mix and received the same assortments.

Using Capgemini’s Integrated Planning and Execution solution, stores were “clustered” into a small number of groupings with similar customer purchasing preferences and product affinity for specific assortment categories. Each group contained stores with similar buying patterns, competitive situations and demographics.

This clustering captured the diversity in the marketplace and also allowed the retailer to leverage resources (including successful promotional programs) to “same-as” stores. The resulting assortment plans per cluster were then applied to processes such as space allocation, with space adjusted based on customer buying preferences to optimise product presentation and space productivity.

The benefits of this approach include:

- **Increased sales:** Customers find more of what they want to buy and the stores experience lower out-of-stocks, helping to build customer loyalty.
- **Lower inventory costs:** The stores carry less inventory of products that are not selling and more of what customers are buying.
- **Improved in-store experience:** Products preferred by the customer are more prominently displayed and are present in higher inventory quantities.
2 Dynamic Pricing

For most retailers, product pricing is fixed throughout channels and geographies. Any variation usually occurs at the end of the product lifecycle through markdowns and in promotions that are often driven by suppliers. This can result in lost unit sales when customers perceive that the price is too high and in lost unit margin when customers would have paid more for a product.

Few retailers have strongly progressed pricing strategies beyond the traditional model, yet there is a significant rationale to investigate dynamic pricing alternatives, given the direct flow to the bottom line.

Dynamic product pricing is managed to maximise unit sales and unit margin on four dimensions:

- **Channel**: pricing differently based on the customer needs of that channel
- **Per format**: same channel, same customer, different buying need
- **Time (real-time)**: pricing products depending on weather/time of day or depending on product lifecycle (turnover rate in fashion or during promotion period)
- **Customer**: for example, pricing differently among different demographics

Capgemini Consulting believes that retailers need to respond to increased price sensitivity on the part of customers through dynamic pricing. In our experience, implementing a customer-centric approach based on rational data-driven analysis can help drive sales.

For one thing, this type of strategy considers key demand drivers such as price elasticity, seasonality, cross-elasticity, and targeted price elasticity models at the item and store levels. It also recommends the minimum relative price gap needed to compete effectively for each store or key item, and it provides what-if decision support to simulate options prior to executing the strategy.

Using customer-centric pricing and promotions enables a retailer to more accurately:

- Arrive at the most competitive everyday pricing and promotions
- Consider the impact of various promotional pricing strategies
- Calculate what uplifts to expect from different promotional and markdown strategies
- Plan for the inventory effect of promotional and markdown pricing strategies
- Determine the best timing, depth and location for markdowns

This approach can result in financial benefits such as increased revenue and margin by offering the right products at the right prices, and reduced wastage and stockholding by optimising pricing to ensure sales. In our experience, this can in some cases help increase sales by over 5% and margin by 2% to 10% per category.

In one example, Capgemini worked with a UK supermarket chain to implement a customer-centric pricing and promotions optimisation programme, which provided a clear understanding of how differential markdowns could be applied in practice within the business. The programme identified savings of up to 20% of the markdown budget for in-scope departments.
For most retailers, labour represents the largest variable expense, so any cost savings in this category are particularly valuable to the overall health of the business. In the current retail environment, it is particularly important to understand the specific labour needs of every store in order to maximise the efficiency of the store-level workforce.

Most retailers face a range of workforce challenges, including high employee turnover, lack of an automated labour scheduling structure, decentralised task management systems and lack of integration between time and attendance management. Workforce management tools can address these issues and provide retailers with the opportunity to improve employee productivity and customer satisfaction while increasing sales. However, these tools need to be supplemented with the right organisational structure and communication.

In particular, retailers can reap benefits by focusing on the task management and scheduling elements of a workforce optimisation programme to ensure that staff efficiency improves within stores. In addition, retailers need to move from a fragmented manner of communication to a systemised task management gatekeeper, which can result in more effective store performance by helping to prioritise the store workload.

Potential financial benefits from improved workforce management can be significant. For instance, some retailers have realised savings of 3% to 7% on salaries in stores through the management of off-peak resource spend and aligning to on-peak resource needs. Additionally, they achieved an improved shopping experience (and thus improved conversion).

In one example, Capgemini worked with a chain of French-based beauty product stores to optimise scheduling and task management. The new system helps to ensure that the right employees are scheduled at the right time to meet customer demand, thereby avoiding unnecessary overtime. The system has also optimised the non-selling tasks so they are scheduled when traffic is lower. The result: productivity has increased by 7%.
Head-office resource costs are also a significant proportion of operational expenses for most retailers. While these are essential functions, they are not all differentiating or core to the business. This has caused some retailers to look to third-party specialists to take over these functions, thereby helping them focus on value-adding activities. In particular, infrastructure outsourcing is favoured by retailers to achieve cost reduction and modernise platforms in the current economic climate.

As outsourcing takes hold in the retail industry, companies are moving beyond traditional applications such as payroll and finance to more strategic activities such as CRM. Some retailers are even outsourcing activities such as sourcing and logistics services.

Cost savings, stemming primarily from lower labour expenses, is the primary reason retailers turn to outsourcing, and those savings can be substantial. According to Outsourcing Journal, companies that outsourced achieved cost savings of more than 30%.

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Operational Excellence Through
Shared Services

In addition to head-office outsourcing, retailers are also turning to shared-services centres to improve operational excellence, while increasing automation. For example, Capgemini helped a large multi-brand fashion retailer create a shared-services centre, which included the transformation of the company’s information systems and operating processes like finance, supply chain, business intelligence and merchandise planning. The new model will enable the retailer to focus on serving its customers’ needs and expectations better.

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Besides generating significant cost savings, outsourcing also allows retailers to leverage the technology and process expertise of third-party specialists and can help bridge the gaps or lack of expertise within a company’s own departments. For example, a leading apparel retailer in the UK has signed an agreement with Capgemini to outsource its IT function, enabling anticipated cost savings of £9 million ($19 million, €13 million) over the six-year contract.

Less tangible benefits can also be realised. In particular, outsourcing enables retailers to focus on their core competencies and on enhancing business value in key areas of differentiation. In one study, 83% of global respondents said outsourcing helped their organisation focus on core competencies and 82% of them said service quality improved.5

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The retailers that will truly benefit from this dynamic period of uncertainty will be those that resist the myopic quarter-to-quarter management of targets and instead look over and beyond the horizon. Differentiation is never easy, but Capgemini Consulting believes that the four initiatives outlined in this paper can position your retail organisation for success when the economy picks up again. The game has started to shift from surviving today to winning tomorrow. That requires a different mindset and a different set of supporting tools and techniques.

Since the second half of 2008 the retail landscape has changed from one focused on growth to one focused on survival and increasingly to one that slowly but surely is preparing for an upturn of fortunes. In that time, the primary emphasis has shifted from growth to cash management, through to cost management and now increasingly to positioning for future success.

If you’re reading this as a retail executive today then you have probably helped ensure your company’s short-term survival. How about your medium-term stability? Has your organisation kept an eye on cash management while sustainably driving down operational costs and not forgetting about the top line? Assuming the economic climate doesn’t get any worse, that should put you in reasonable stead.

Conclusion: Setting Yourself Up for Success

“The game has started to shift from surviving today to winning tomorrow. That requires a different mindset and a different set of supporting tools and techniques.”
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Capgemini provides its clients with insights and capabilities that boost their freedom to achieve superior results through a unique way of working, the Collaborative Business Experience™.

The Group relies on its global delivery model called Rightshore®, which aims to get the right balance of the best talent from multiple locations, working as one team to create and deliver the optimum solution for clients. Present in more than 30 countries, Capgemini reported 2008 global revenues of EUR 8.7 billion and employs over 90,000 people worldwide.

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About Capgemini’s Consumer Products and Retail Insights Group
The consumer products and retail insights group carries out research and produces thought leadership and guidance on global issues affecting the industry.

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