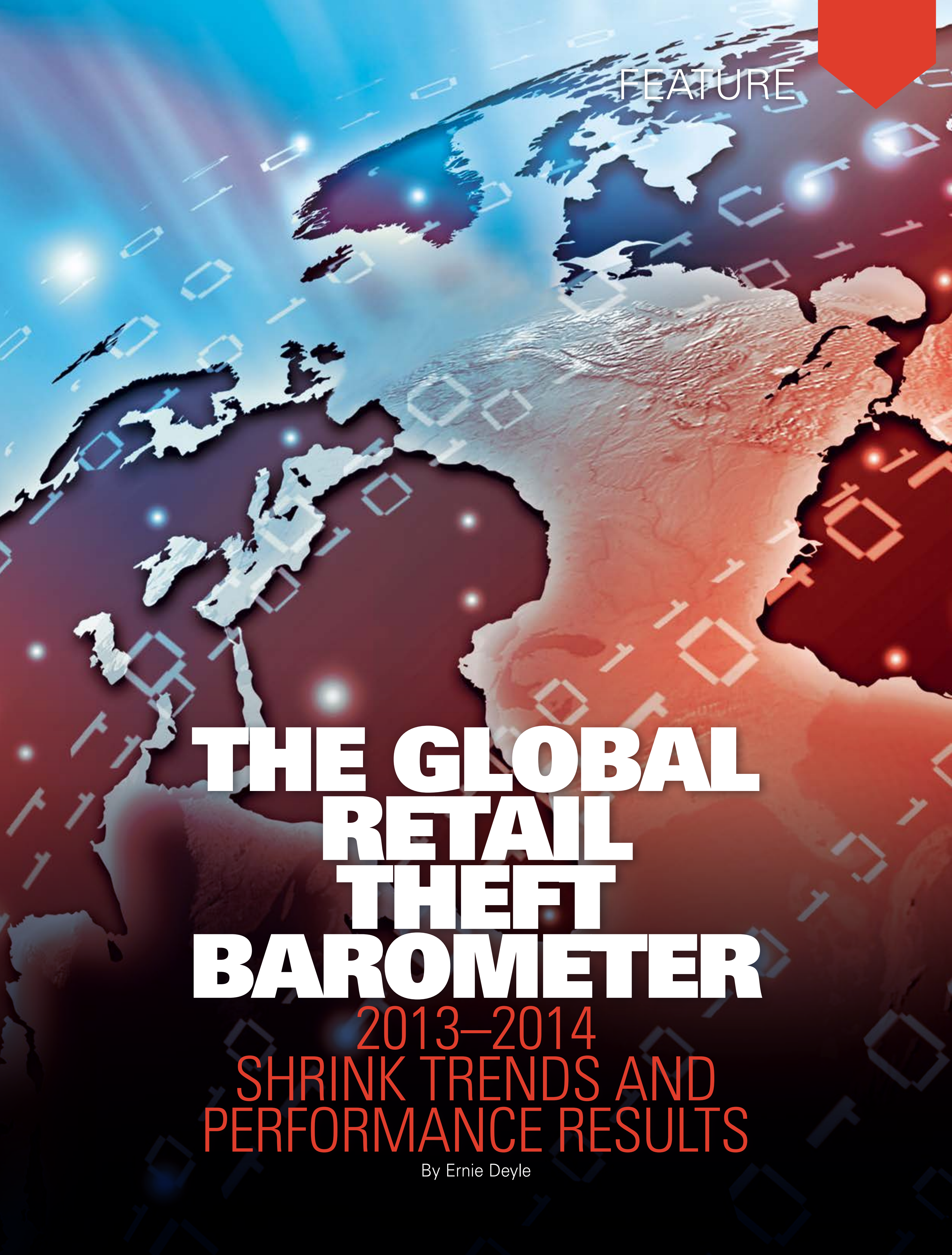


THE GLOBAL RETAIL THEFT BAROMETER

2013–2014 SHRINK TRENDS AND PERFORMANCE RESULTS

By Ernie Deyle

It probably comes as no surprise that shrink remains a significant operational challenge for retailers around the world. That's one top-line conclusion of the latest Global Retail Theft Barometer (GRTB), the first and only statistical research on global theft, which was undertaken by the author in 2014 with The Smart Cube, via an independent grant by Checkpoint Systems. This year's report provides an even more comprehensive view of global shrink trends.

The study was based upon in-depth phone and written survey interviews conducted in 24 countries among 222 retailers representing $744 billion in sales in 2013. As with last year, the findings are based upon a combination of online surveys completed by key retail decision makers in those countries, as well as personal, in-depth interviews with retail executives.

The performance results captured in this year's report are interesting in many ways, constituting elements of improvement and of concern. Globally, the business model governing retailers is in a transition phase on many fronts. As business evolves, retailers are asked to do more with less and be creative in how they deliver better value to consumers, along with driving performance for shareholders, while creating a culture where their associates can thrive.

Compositely, external theft continues to plague the industry in terms of traditional shoplifting-related activities and advanced organized retail crime (ORC) tactics. Now, more than ever, retailers must continually enhance product protection tactics to reduce exposure to this ever-growing cause of loss.

In 2013–2014 the US shrink rate decreased by 2 basis points to 1.48 percent of the region's sales. The total shrink stood at $42 billion. North America recorded the highest shrink rate in the world, as it has the highest concentration of retail stores and significantly lower retail loss prevention spend than other regions under consideration.

Summary of US Results

In 2013–2014 the US shrink rate decreased by 2 basis points to 1.48 percent of the region's sales. The total shrink stood at $42 billion. North America recorded the highest shrink rate in the world, as it has the highest concentration of retail stores and significantly lower retail loss prevention spend than other regions under consideration.

Shrink across Store Types. US discounters (2.78%), pharmacies/drugstores (2.16%), and supermarkets/grocery retailers (1.38%) witnessed the highest shrink rates owing to shoplifting, dishonest employee theft, and organized retail crime together with a low level of loss prevention spend. Almost all types of retail stores in the US were affected by dishonest employee theft and shoplifting. The lowest shrink rates were in department stores (1.11%), home improvement and gardening stores (1.10%), and apparel specialist retailers (0.84%).

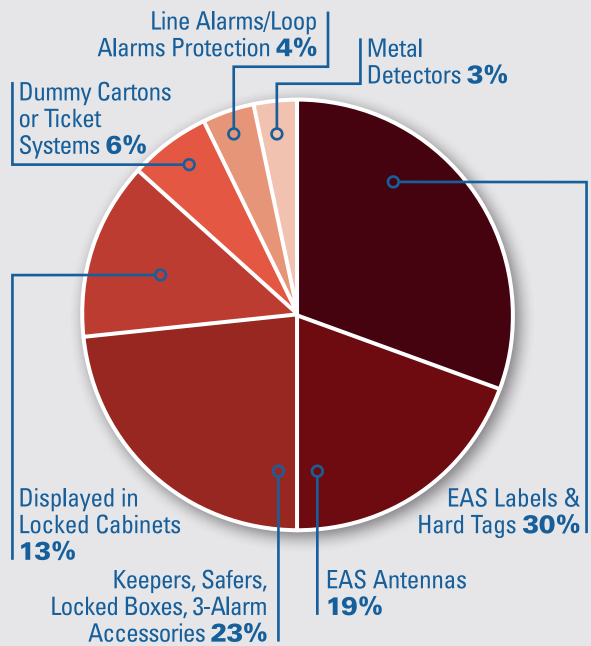
Shrink Sources. In 2013–2014 dishonest employee theft was the major reason for shrink in the US. The proportion of shrink attributed to dishonest employee theft increased to 42.9 percent. Dishonest and fraudulent employees were responsible for $18.01 billion (by value) of shrink. Key reasons of dishonest employee theft include the mismanagement of sales reducing activities (SRA) events, ineffective pre-employment screening, a diminishing focus on training and development of assistant and store managers, coupled with the lack of management stability within the store.

Shoplifting is the second-largest source of retail shrink in the US. In 2013–2014 it accounted for 37.4 percent ($15.70 billion) of shrink, up from 34 percent in the previous year.

2013-2014 Loss Prevention Solutions in Use by US Retailers

EAS antennas, labels, and hard tags are seen as the most popular and effective solutions for loss prevention for 49% of retailers.

Usage of keepers, safers, locked boxes, and 3-alarm accessories for high theft items are also widely used by 23% of retailers.



Flawed or lack of a sound product protection strategy, ease in selling stolen merchandise, deployment of fewer employees on the sales floor for servicing customers, and reduction in social stigma are the major reasons contributing to the growth of shoplifting in the US.

Finally, administrative and non-crime losses, including accounting mistakes, poor budgeting practices, pricing errors, and process failures specific to inbound and outbound inventory control accounted for 10.8 percent ($4.53 billion) of shrink, down from 26 percent in 2012.

Demographic Profile of Shoplifters. Adults in the 18–30 years age group constitute 42 percent of shoplifters in the US, followed by people falling in the 30–45 years bracket (25%). High involvement of the younger generation in shoplifting incidents is quite prevalent across the regions covered.

Furthermore, 32 percent of survey respondents (retailers) in the country claimed that 25–50 percent of shoplifters were male. An equal proportion (32%) of respondents expressed an inability to identify a shoplifters' demography, indicating the lack of a proper system to monitor and prevent in-store theft.

Dishonest employee theft and shoplifting—accounting for more than 75 percent—were the key reasons for shrink across retailers, except home improvement and gardening stores, where administrative losses accounted for most (45%) of the shrink. Supplier fraud accounted for the least shrink across retailers, moderately impacting non-grocery retailers (12%) and home improvement and gardening stores (15%).

Inventory Visibility. In 2013–2014 retail employees in the US spent 38.2 minutes daily of their eight-hour shifts counting inventory. Although the US average inventory counting time is higher than the global average of 37.8 minutes, survey respondents claim that retail staff members in the country still occasionally fail to locate products they believed were in stock. This resulted in low inventory visibility for retailers in the US, which affected North America's shrink rate.

The DIY home improvement, apparel, grocery, and mass merchant industries have the biggest challenges as far as what they face. Electronics would probably be next on the list. The more broad-based a company is with regard to its service offerings, the more asset protection challenges it has.

Cost of Retail Crime and Retail LP Spend. The cost of retail crime separates non-crime retail losses (losses caused by incorrect pricing and accounting mistakes) and accounts only for losses incurred due to crime (dishonest employees, shoplifting, and supplier fraud) and spend on loss prevention.

In 2013–2014 the cost of retail crimes in the US stood at $49.35 billion, accounting for 1.7 percent (up from 1.37% in 2012) of the total retail revenue. The increase in the cost of crime is primarily attributed to a surge in shoplifting and dishonest employee theft incidences in the country, along with lower loss prevention spending by US retailers than others abroad.

In 2013–2014 US retailers spent an average of 0.42 percent of retail sales, or $12.02 billion, on loss prevention. Although the country increased loss prevention spend over the previous year, it still lags behind most countries considered, as well as the global average of 0.80 percent. The lower loss prevention spend helps explain why the country has one of the world's highest retail shrink rates.

Loss Prevention Solutions. Key solutions deployed by US retailers to prevent loss of the most vulnerable product lines include fixtures designed to provide delayed access, electronic article surveillance (EAS) antennas, labels, and hard tags (49%), and locking and securing products in cabinets or shelves (13%). Keepers/safers, locked boxes, and product alarms were used to secure 23 percent of most-stolen items.

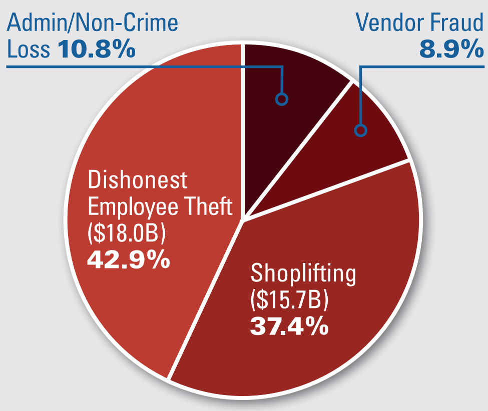
Other popular loss prevention solutions include three-alarm accessories (12%) and non-alarmed chains and cables (6%). Four percent of merchandise was not displayed in the store's selling area, but held in a

2013-2014
Sources of Retail Shrink in the US

Most US shrink comes from store employees

Potential Causes
- Easy access to merchandise
- Slow economic recovery

Retailer Options
- Visible source tagging—tamper resistant, visible circuit
- RFID inventory tracking—monitor back room activity
- Employee training and awareness—communicate shared responsibility, outcomes



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stockroom, and the customer bought a dummy carton or used a ticket system to purchase the item.

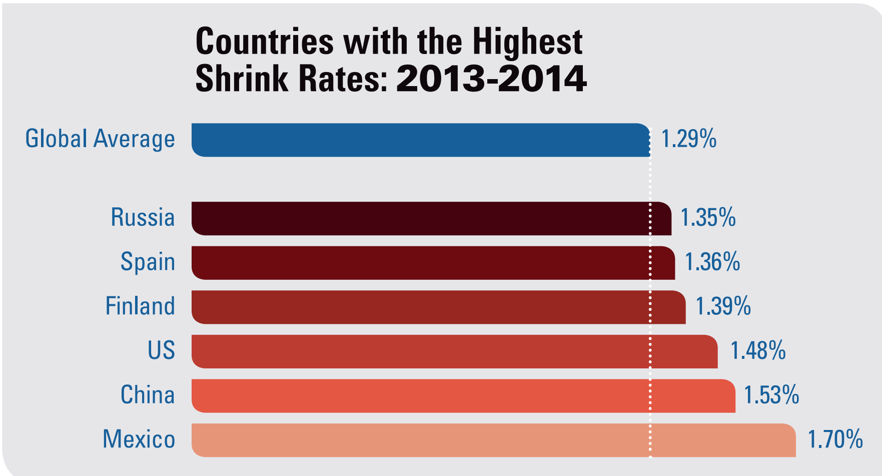
Apart from the aforementioned technological interventions, the respondents felt that imparting product knowledge and spreading awareness among the store staff to keep them motivated is highly beneficial. Regular training imparted to enhance customer service and staff interaction with customers can lead to lower shrink as well.

In the US source tagging continues to gain momentum with 50 percent of retailers source tagging or planning to increase the number of source-tagged SKUs. Retailers prioritize high-risk merchandise and source tag them either at the point of manufacture or at their distribution centers.

Most-Stolen Items. Shoplifters and dishonest employees in the US primarily targeted products that were easy to conceal and resell in the market, resulting in increased pilferage of accessories. In 2013 shoplifters preferred to steal fashion and mobile accessories over fashion clothing and mobile handsets, respectively. Other frequently pilfered products included power tools, wines, and cosmetic products.

Retailers believe more granular and in-depth analysis with respect to shrink contributors increases the probability of success in mitigating shrink. Retailers planning to deploy loss prevention solutions believe that it is important to assess the return-on-investment of each solution and the value they bring to the organization.

There is an overall perception that shrink is not well managed in the country and there is scope for improvement. Retailers believe that to eradicate it from the system, suppliers and retailers need to work collaboratively.



Q&A with Ernie Deyle

In late November *LP Magazine* hosted a webinar with Ernie Deyle to present the findings of the 2013–2014 Global Retail Theft Barometer. The archived webcast is available to readers by visiting the webinar page on the magazine website, LPportal.com, where you will find a registration form that will provide the link to the 60-minute presentation. The second half of the webcast was devoted to a live question-and-answer period where the author responded to listeners' questions. A portion of that Q&A follows.

One of the findings was that newly launched products were more likely to be targeted by shoplifters. Are there best practices around protecting them?

The short answer is collaboration and thinking outside the box. Using a personal example from my tenure in the chain drug sector, we put together a consortium called the ILRT. We were thinking outside the box and collaborating with suppliers in order to achieve some success or limit risk on opportunities and loss. Our organization collaborated with P&G, J&J, Pfizer, and GlaxoSmithKline to align and put in place a process where new items can be launched in collaboration with visual merchandising at each one of the companies to make sure that the packaging wasn't going to drive a theft pattern that was unusual and could result in loss that we couldn't defend ourselves against. In the past we were quite successful in working with our suppliers to help reduce the loss, because the POS system drove inventory movement and thus the replenishment system.

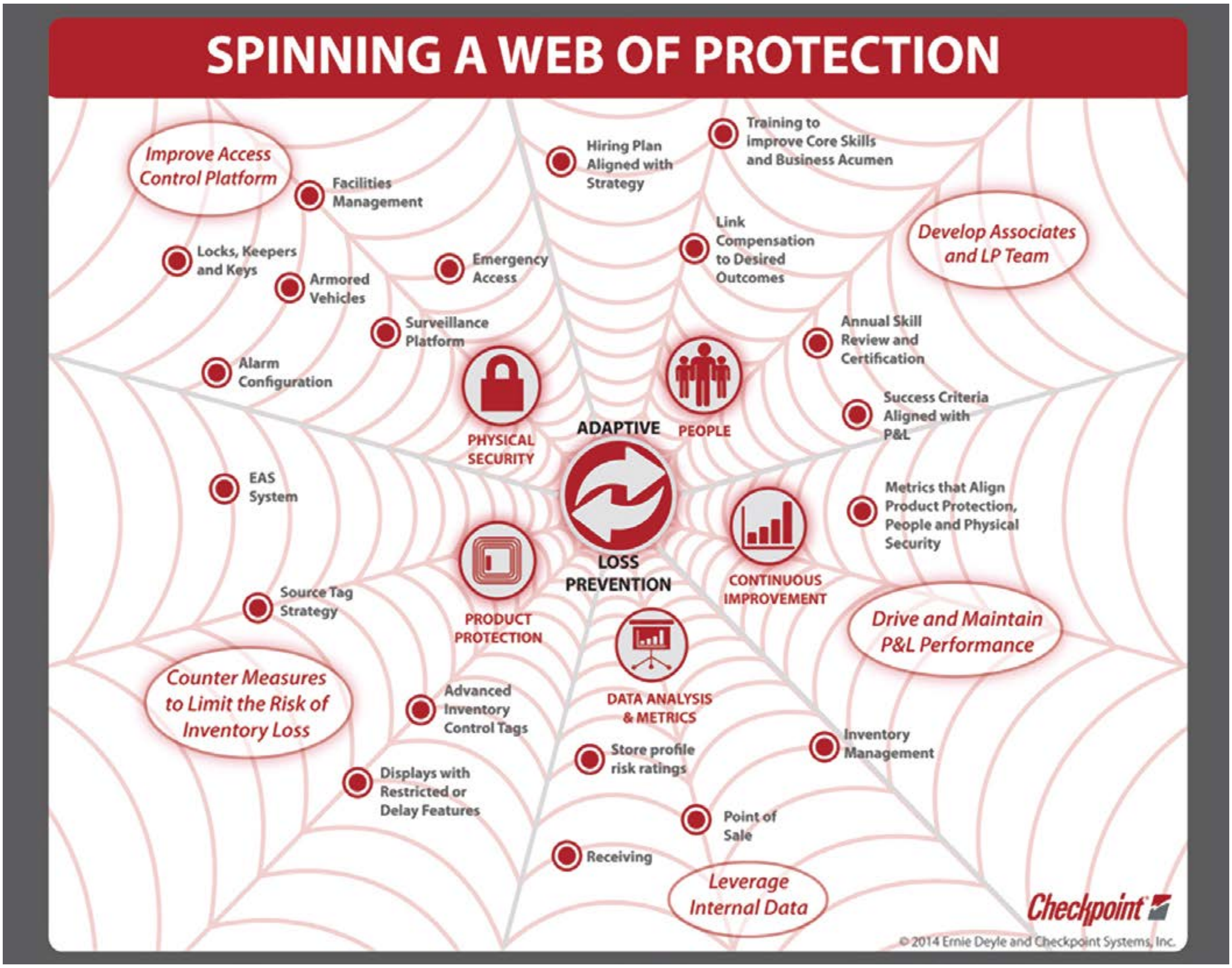
Today there are more factors at play, so collaboration with suppliers is more important. In fact, we're now seeing retailers and suppliers work collaboratively on initial packaging to help protect products before they even reach the store. This collaboration provides a platform for both the retailer and the supplier to determine the balance between the two core elements of product protection, which are presentation and protection.

You mentioned that retailer/supplier collaboration will help increase strength during peak season. Can you provide other examples of how retailers have worked with suppliers?

It goes back to the collaboration element of the equation and the core four attributes of product protection that must be considered. These attributes vary in who has initial accountability, but, big picture, these attributes include, but are not limited to the following:

- Performance—Financial expectations have been determined/pro-forma with sales, margin, promotions, and loss measurement criteria defined.
- Packaging—Item design, visual merchandising, and item risk assessment.
- Placement—Item maturity, both primary and alternative location, and governance.
- Protection—Define the product protection variants within a risk mitigation matrix.

This is based on the type of item and the item's age in the market place, meaning a new item versus one that has established patterns of behavior specific to sales and loss. That said, seasonality also plays a major role in protection strategies. The tactical approach will change or evolve depending on the variables just mentioned. New item launches vary by item type and retail vertical. For example, consider a grocer introducing a new salsa or a specialty



electronics retailer launching a new mobile device. While these two launches are dramatically different, each loss prevention executive using the four attributes will apply the same principles to their specific need.

Looking at the better performing countries, what would you say are the more effective strategies they use?

The one big difference between countries is the use of technology. The US tends to be on the forefront of the technology in general, but there are different nuances in retail technology use when comparing the US and the UK, for example. We may be a little further bit behind the UK and Japan, for example, in the use of retail theft technology, such as visible source tagging and EAS infrastructure. For instance, many grocery retailers in Europe have EAS pedestals at each checkout, as opposed to the exit door, and have extended asset protection programs to mobile checkout and self-checkout. So that would be one of the first, most obvious and logical places where I would go. And culturally, it may be less acceptable to steal in some other countries as well.

Is there a particular type of retailer that has suffered more on stock loss, for example food or fashion?

The DIY home improvement, apparel, grocery, and mass merchant industries have the biggest challenges as far as what they face. Electronics would probably be next on the list. The more broad-based a company is with regard to its service offerings, the more asset protection challenges it has.

Let me expand on that. When retailers add product categories outside of their core competency, it's more difficult to manage that category, both operationally and financially. Moreover, these decisions are often made in a vacuum. Thus, in some cases, a decision was made not fully comprehending the risk associated with this new offering, both in terms of the expected outcomes and the reality of the actual results. More often than not, this will have a domino effect on other core business offerings as attention is diverted to manage the new offering. And the ripple effect of these decisions can be significant.

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Looking at the better-performing countries, were you able to pick out particular effective strategies that were being used in those countries?

It boils down to the management team and how they approach the business from a day-to-day perspective. Retailers in some countries tend to think further out and proactively manage their business from loss prevention in-store to the entire value chain. They're monitoring shrink outside the store, such as vendor fraud and diversion. They also have a tendency to be more informed about the upcoming behavioral trends so they can limit their loss exposure. So, it's not just about the technology tools, but it's also about the organization and the acumen of the people who are executing on those tools that actually make the difference.

Do you believe that US retailers may be underreporting the external theft category due to not having a grasp on ORC activities?

The short answer is we miss a lot of the cases because we don't see them. It's transparent to us as retailers, but we only know about it after the fact. And sadly after the fact it's getting bucketed or categorized improperly, so we don't have a true accounting or measurement of said loss. It's anecdotal at best. So, that's an opportunity for everybody in retail—be it apparel, jewelry, hard goods, or grocery—to be more focused on what is the root cause and analysis of external loss.

We must remain vigilant on all fronts. We must keep our heads on a swivel so to speak. We must continue to raise awareness within our own organization as well as our competitors. As LP officers, we must maintain a degree of communication with our peers, with law enforcement, and with those businesses that are collateral ORC touch points, including low-budget hotels, rental car agencies, and those Internet channels that assist in the moving of merchandise through alternative channels. We're also seeing retailers and manufacturers collaborate on tamper-resistant labels that are difficult to remove and, if removed, make products unattractive for resale.

What are your thoughts on Omni-channel and how that's changing the landscape of retail?

With Omni-channel online orders are now flowing through the stores, and stores are not always compensated for fulfilling those orders. If the orders create more work with less reward, internal shrink is a potential result. The other thing we are seeing is that store operations are getting over-burdened with order fulfillment and store-to-store transfers, regardless of how they are compensated. This takes time away from loss prevention and sales activities.

Was there any correlation between the number of times inventory is undertaken within a company and internal shrink?

Most retailers count inventory at least once a year. If you're doing it the right way, if you take your entire company and you do the average window from the last physical to the current physical, you should be averaging right around 10.8 months per inventory window, because you do need to. If you're doing it once a year, you do need to have some supplemental counts to project what your budget is going to look like for next year as well as have the ability to take care of that store that had a count misstep that you need to recalculate, or a significant case from an internal loss or external loss standpoint that you need to re-index so you get an accurate count moving forward.

As more retailers adopt RFID technology, cycle counts are happening much more frequently—once or twice a week. When properly designed, the planned cycle counts can provide valuable insight as to trends, forecast corrections, and ultimately performance. In some retail verticals, RFID technology and counts can be a significant tactical tool to drive performance and, more importantly, maintain the results achieved once improvements have been realized financially.

The side benefit is that retailers are not only getting inventory and shelf replenishment under control, but loss prevention as well, since they can automatically compare what leaves the store against what actually gets sold. This also impacts internal shrink, since if inventory is being tightly managed, employees know that missing items are more likely to be noticed. ■

ERNIE DEYLE currently manages the business consulting practice for Sysrepublic. He has served in a variety of roles including COO and vice president of loss prevention for consulting firms Cap Gemini and Arthur Andersen as well as Kroger and CVS Caremark. Deyle's thirty-plus years in retail loss prevention and business risk mitigation has made him a leading expert in performance improvement programs that impact the corporate bottom line. He can be reached at ebdeyle@mac.com.