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Leveraging In-store Systems for Competitive Advantage

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Executive Summary

Retailers are competing in a race for survival, and how they leverage their in-store systems will separate the winners from the losers. Some see this as a competition for sales growth and market share, but it's really about establishing more compelling value propositions—value propositions that differentiate them from their competition in ways that create a more compelling retail destination for their shoppers.

This race will be a little easier for operators running new store formats. For them, most of the creative work is already done, and the focus is on delivering the value. This is where supercenters are today.

The race is more challenging, however, for companies operating in mature retail segments because they need to enhance the way they add value to their shoppers. This means simultaneously:

- ✓ Identifying the new ways to add meaningful value.
- ✓ Modifying their marketing, merchandising and operations to effectively deliver that value.

The chances for success are improved when the retailer is able to mobilize all the available resources toward this goal. The good news is that there is a powerful new way to do this—through a strategic partnership between a retailer and their store systems supplier.

Objective

This white paper explores how retailer/store systems supplier partnerships can drive continuous value improvement and build a sustainable competitive advantage for the retailer.

What's the Situation?

The world has changed considerably in the last few years for retailers, and the "stress lines" are showing up across the industry.

I. Pressure on Margins – Increased competition puts greater pressure on margins. While this isn't particularly new—especially during a slow economy—two things make today's situation a little different.

- ✓ ***Industry consolidation***, which is happening in most sectors of retailing, usually leads to fewer competitors and to an eventual return to more normal profit margins. But that's not what's happening this time around. Instead, the larger retailers are actually increasing competitive pressure by leveraging their advantages of size to become more sophisticated marketers and continuously drive down costs. In the near term, this suggests that there is no reason to expect that margins will return to traditional levels, and successful retailers must adapt to this new reality.

- ✓ ***New, cross-channel competition*** creates competition from sources where it never existed before. Notwithstanding the failure of many B2C propositions, Internet shopping is having an impact here. Brick-and-mortar retailers are also filling "white space" with products that are non-traditional for their businesses. Ikea's specialty food department and Costco's current emphasis on apparel are just two examples. This highlights the need to defend against loss of business to this new competition.

II. Technology Benefits Have Been Elusive – Not long ago, senior retailer managers were "open to buy" the general competitive advantage that technology offered. Now, most are more focused on understanding and capturing return on investment. This more hard-nosed business approach has been driven, in part, by the unrealized promise of e-commerce, whether it is in the anemic demand for B2C offers, or the still largely unrealized value from B2B initiatives such as electronic marketplaces.

III. Retail Data Continues to Be a Challenge – It's easy enough to assert that retailers can run their businesses better with timely access to accurate retail sales data. While this sounds appealing, the realization has been frustrated by disparate systems and the practical realities of achieving adequate discipline at retail. As a result, senior retail managers responsible for setting capital budgets are more skeptical today about the returns they'll see from this type of investment – and they require proof of the benefits before they invest.

In this environment, retailers will need to win increased business by responding more quickly and effectively to the changing needs of their shoppers if they are going to insulate themselves from the pressures of increased price competition and survive.

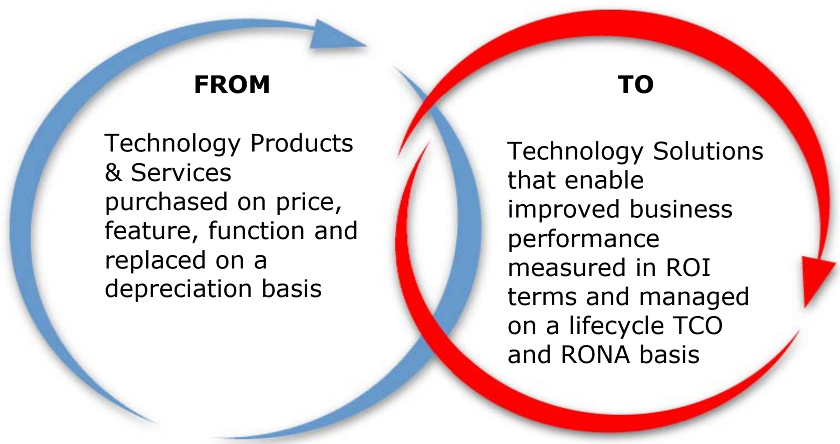
Why the Partnership with Store Systems Suppliers?

Today's challenges demand "outside-the-box" thinking, and a partnership with your store systems supplier can produce real improvement in performance and return on investment. A key driver of improved and differentiated performance requires effectively harnessing the power of technology at the store.

Objective	Benefits
• Reduce the number of vendor relationships an support paths	Decrease Total Cost of Ownership
• Maximize uptime, minimize maintenance costs	Increase Return on Investment
• Attract more customers and increase customer loyalty	Increase Productivity

A New Way of Thinking – Releasing the full power of this partnership requires establishing a longer-term relationship between retailers and their store systems suppliers. This starts with changing the way the retailer approaches the purchase decision for in-store technology, i.e., shifting from a transaction-by-transaction basis with a focus on minimizing purchase cost, to a longer-term relationship that considers all of the costs and benefits related to the total useful life of the system. This creates a partnership perspective that will be more aligned with overall retail performance.

For retailers to successfully meet today's demands, the traditional model for store systems technology investment has to change:



Foundation Concepts –At the core of this new relationship are two concepts that provide the framework for the partnership.

- ✓ ***Lifecycle Solutions*** – This concept expands the scope of the discussion to consider all the costs and benefits—hard and soft—impacted over the life of the store system and on to the next generation system. If the system, for example, allows the retailer to reduce training costs for cashiers and/or to increase labor productivity, it's important to include these positive benefits over the life of the system in order to accurately capture the impact on overall business performance. Some important considerations include:

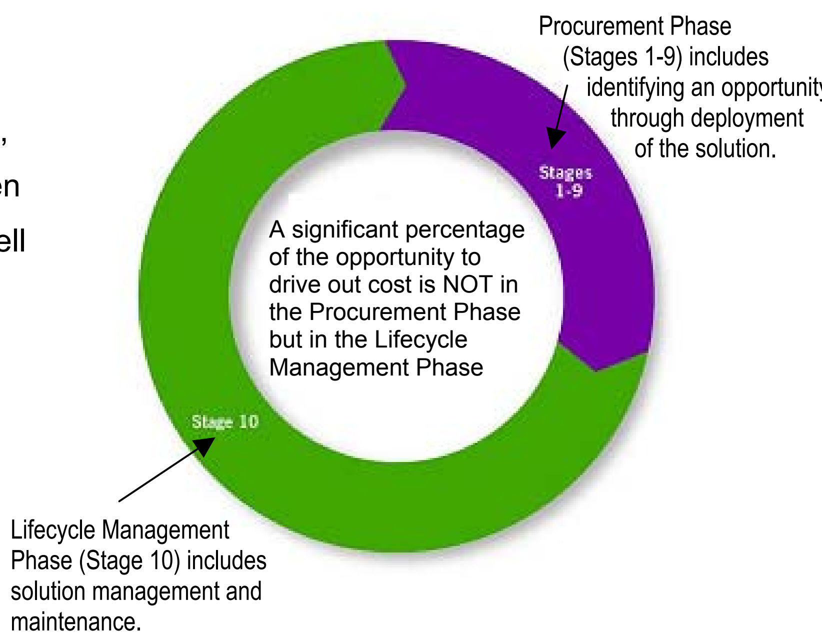
- Installation costs, including the direct cost of installation as well as the cost for the retailer's staff assignable to installation and the opportunity costs associated with rolling out the installation of new equipment more slowly than would be optimal.

- Maintenance and support costs, including the direct costs – which can be substantial – particularly towards the end of the useful life of the system, as well as the impact that maintenance-related problems have at store level. This is where the retailer realizes significant value from the store systems supplier's capabilities. For example:

    - Intelligent help desks and call management systems support joint development of a knowledge pool that drives quicker, lower cost and more effective responses.

    - An asset management system reduces short-term capital needs by effectively tracking, monitoring and facilitating redeployment of store systems assets instead of purchasing new ones.

A lifecycle solutions approach recognizes all these costs and makes it easier to see the real, total cost comparisons between different system options, as well as to exploit their advantages.



- ✓ ***Return on Investment*** – While most retailers still manage their businesses on gross profit margins, Wall Street and the investment community is more focused on return on investment—a measure of how well a retailer is using its financial resources.

  There are a number of different ways to measure return on investment (ROI), e.g., payback, return on invested assets, net present value. All these approaches can provide easy-to-understand ROI benefit statements that give management an estimate of what they get for each dollar invested.

  To get the full value from ROI, *a retailer needs to clearly recognize that a major new store system will impact just about every part of their business.* To accurately build this into the ROI analysis, the store system supplier should be able to provide a robust ROI model as well as the analytical capability to apply it objectively. This is a resource that is critical to the evaluation and decision process and can be used by the retailer to great advantage.

  For a retailer to get the full value from the ROI benefit statements, it's necessary to ensure that these statements are tailored specifically to the retailer's business and that they capture their actual numbers.

  - Tailoring the benefit statement involves analyzing the impact at a level of detail that captures the unique aspect of the retailer's business, e.g., exactly how the retailer handles paper coupons.

  - Capturing the retailer's cost requires gathering enough specific information on wage rates, productivity level, and schedule procedures to accurately estimate the impact.

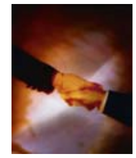
Both of these criteria can be met through an open dialog process between the retailer and the store systems supplier's ROI-trained personnel. Of course, in the end, this process must lead to auditable and secure results to give the retailer complete confidence in the process.

Return on investment helps tie the retailer's investment decision to overall strategy, and this can be particularly important at a time when retailers are able to make only limited investments and need to be sure that they're spending scarce dollars where they will produce the best return.

Gaining by Sharing—A key reason for embracing the partnership model is that it helps drive profitable growth through more open sharing of:

- ✓ ***"Business goals,"*** with:
  - ➢ Retailers explaining their strategies to build customer value. The key here is to get at specific tactics that will be used.
  - ➢ Store systems suppliers sharing the ways in which they're striving to build their own businesses by providing unique value to their retail customers.
- ✓ ***"Knowledge of operating costs"*** so that it's possible for each side to have a framework to look for ways to help each other reduce their direct costs and establish cost-reduction goals. In a true partnering relationship, the costs of the store systems supplier should be completely transparent to the retailer, giving them more knowledge and control over their costs.
- ✓ ***"Assets"*** so that both partners can leverage their growth plans against some of their partners' assets as well as their own. Sharing assets, both hard goods and intellectual, is an important economic advantage of the partnership

since it gives each side a way to support growth without making the full investment in the assets necessary to support that growth.



Successful Retailers Are Partnering – While the idea of partnerships between companies that have traditionally dealt with each other on a transaction basis is still relatively new, some retailers are already experienced in these relationships. This practice has been well established between consumer packaged goods manufacturers and their retail customers for the last five or six years and has produced some strong results.

The success of this type of inter-company partnership has been documented in a number of different businesses, so they're much more than just concepts. The 2001 AMR report, *Beyond CPR: Retail Collaboration Comes of Age,* reported that these partnerships produce:

- ✓ 2-4% improvements in retail in-stock position
- ✓ 10-40% lower inventory levels
- ✓ 5-20% sales improvements
- ✓ 3-4% reduction in logistics costs

Since partnerships already exist between retailers and certain of their product suppliers, successful retailers will be readily disposed to securing additional competitive advantage through partnership with their store systems supplier.

What's the Goal of the Partnership?

Retail value creation requires developing a strategy that simultaneously focuses on:

- ✓ Relentlessly driving down costs so the retailer can be successful in a lower-margin environment.

- ✓ Continuously introducing service enhancements that deliver increased and differentiated value that appeals to a retailer's target shoppers.

Relentlessly Driving Down Costs – While it's typical for retailers to look first to store labor for major opportunities for cost reduction, the partnership focuses on total costs of ownership that impact the retailer's overall business performance. Rather than arbitrarily targeting a single line on the P & L statement for cost reduction, the partnership examines the processes the retailer uses to deliver value to shoppers and then strives to give the retailer a means to execute these processes more efficiently and cost effectively.

The cost categories that can be addressed under this approach include:

- ✓ ***Store Systems*** – This is the logical place to begin the discussion. These costs can be examined from the standpoint of lifecycle management and the total cost of ownership. In this case:
  - ➢ The retailer brings an understanding of the features and benefits needed to successfully execute their go-to-market strategy, as well as knowledge of the options available in the market.
  - ➢ The store systems supplier brings the ability to modify their systems solution to serve the retailer's specific needs and eliminate unnecessary functionality and the related cost that is not required.

Cost Displacement	removing a cost by replacing it with a lower one.
Cost Avoidance	investing in processes to anticipate costs, which will be greater than the needed investment.
Performance Improvements	buying technology and services that will improve performance of key business processes.

The result is that the retailer only pays for what they need, and, in some instances, this is a significantly lower cost option.

- ✓ ***Store Personnel Costs*** – This is the next logical focus with the goal of enhancing staff productivity. Here:

  - The retailer has access to labor productivity benchmark results which help focus on opportunities to reduce labor costs as a percentage of sales.

  - The store systems supplier provides insights into the ways other retail customers have changed equipment and processes to increase productivity/reduce costs.

  - Freeing up the time of store personnel so they can devote more attention to interacting with customers in ways that help enhance the shopping experience and create more value.

  Combined, these knowledge and experience resources are mobilized against the goal of store labor cost reduction in a way that could not have been brought together as cost effectively without the partnership.

- ✓ ***Operational Costs*** – The partnership can address ongoing operational costs such as markdown and shrink. These provide some of the greatest opportunities for cost savings, particularly if the retailer hasn't previously made a concerted effort to control these costs. In this case:

  - The retailer brings their cost experience and the current problems they are encountering, as well as a clear notion of what it will be worth to reduce these costs.

- The store systems supplier brings experience across retailers from a range of different sectors and an understanding of how other types of retailers have creatively controlled these costs. Some retailers, for example, are successfully using cashier monitoring to control shrink.

With the right partnership in place, the retailer can easily access this experience base.

Continuously Focusing on Customer Needs –While cost reduction is key to keeping most retailers in the game, it's the ability to identify and deliver differentiated value against important unmet customer needs that allows retailers to get the big wins. Two things must be done here to make it work on a continuous basis.

- ✓ ***Monitoring and getting meaningful feedback on the needs of the retailer's target consumers*** – This requires good monitoring against performance standards, e.g., in-stock position and wait time, and provides a mechanism for feedback.

  - Retailers can reach out—and some already have—in a highly focused way to better understand the unmet needs of their shoppers. Ideally, the process is driven, in part, by input from the store systems supplier.

  - The store systems supplier can bring an overview of what they are learning about how shoppers want to relate to the retail store, e.g., how important it is for the shopper to know that a particular item is in stock prior to making a trip to the store.

- ✓ ***Cost-effectively deploying new service enhancements*** – Here the partnership with store systems suppliers can pay strong dividends because practical solutions can be brought to the retailer with little extra effort.

- Retailers can provide the "lab" to validate the value-added contribution of the new enhancement and are typically very interested in ensuring that it works.

- Store systems suppliers provide the analytical discipline to ensure that the evaluation is executed in a way that yields meaningful results.

Improvements in service levels at key "touch points" with shoppers, such as price-checking/verification and the tendering part of the checkout process, reduce shopper wait time which encourages more frequent repeat visits.

This aspect of the partnership brings together capability and talent that would otherwise be very difficult to mobilize against this critical element of the decision-making process.

Key Steps in the Partnering Process

There are four steps in the successful retailer/store systems supplier partnership.

Store Systems Supplier Partnership Checklist

To help ensure that the store system supplier will be a good partner, a retailer should ask:

1. Do they have a clear vision of the joint benefits of collaboration?
2. Can they tailor their in-store system offer to satisfy the retailer's unique needs?
3. Are lifestyle solution capabilities in place?
4. Do they have a comprehensive and objective ROI analysis capability?
5. Are you comfortable trusting this supplier to be a good long-term partner?

Get strong positive answers on all five points before proceeding.

Step 1: Validating Interest – The first step is to validate strategic interest in forming a new, longer-term relationship. The partnership requires commitment on both sides to change processes and behavior. This takes support from senior management.

Each side needs to assess whether the synergy that can come out of the partnership is worth the effort and the risk of trying something new.

- ✓ The retailer wants to confirm their supplier's commitment to this innovative business model and their confidence in partnering with their store systems supplier.

- ✓ The store systems supplier wants to confirm that the retailer's culture and commitment to the partnership are strong enough to justify the additional effort required to support this unique type of customer relationship.

The best way to validate interest is through a top-to-top meeting where both sides have the opportunity to agree upon the vision of success for the partnership and the rules governing it.

- ✓ The vision for success will include a description of how the partnership improves the retailer's performance, including an estimate of specific cost savings and revenue gains. It should also clearly outline what will make this partnership a "win" for the store systems supplier and how that win is compatible with the retailer's interest.

- ✓ The charter for the partnership documents the principles of the partnership agreement, including—in general terms—how each partner will relate to each other as well as the conditions that will support continuation of the partnership.

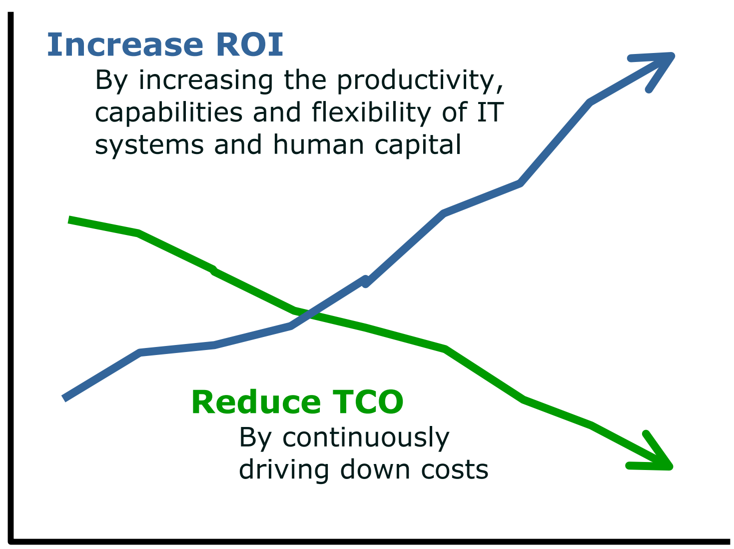
This top-to-top session can be driven by the party who is the primary advocate for the partnership, but the agenda and content of the meeting should be agreed upon at the working level in advance of the meeting.

Step 2: Establishing Immediate Objectives – Once this mutual agreement moves forward with the new relationship, the next step is to establish immediate objectives for partnership activity. Ideally, these objectives can be drawn from the retailer's overall strategy for creating value. If a strategy isn't available, some additional work will need to be done to be sure that the partnership objectives are at least consistent with where senior retail management is taking their business.

The process of establishing objectives should be carried out at the working level, but it's important that senior management understands and endorses the objectives.

Step 3: Building the Performance Improvement Plan – The next step is to jointly build a plan that will deliver the performance improvement against the immediate objectives. Here is where the joint development of individual ROI benefit statements and the overall ROI, adjusted for various levels of uncertainty, can play a major role in supporting and adding a structure to the planning process. This will have two components.

- ✓ ***The cost-reduction component*** focuses on identifying specific opportunities to reduce complexity and streamline work processes to reduce costs. This component begins with a review of the store systems requirements and identification of areas where savings can be achieved by eliminating unnecessary functionality. It then focuses on lifecycle total costs of ownership.



- ✓ ***The shopper-service enhancement component*** starts with gathering specific input from the retailer's shoppers on their under-served/unmet needs. Once the partnership understands the "opportunity gap" from a customer point-of-view, the focus shifts to identifying the best ways to deliver the differentiated value. This includes:

- Finding the best solution.
- Determining the best way to explain it to maximize perceived value for the customer.
- Testing that the solution delivers the intended value.

Step 4: Monitoring/Evaluating the Partnership Contribution – There are two elements to this final step in the partnership process. One relates to conducting a post-installation audit that compares the actual results with the expectations imbedded in the plan. This involves fieldwork in each of the areas where ROI benefit statements have been created and determining the actual impact of the changes. This data is then processed through the ROI tool to create the competitive benchmarks.

The other involves developing a balanced scorecard to help access the overall performance of the partnership and to identify opportunities for improvement. Experience in other partnerships has shown that this is a very useful management tool.

Conclusion

In the past, it was not always essential for a retailer to focus strategically on driving continuous value improvement for their shoppers. And, as a result, some are not prepared to do it. It requires both a clear definition of how to create value as well as an understanding of the opportunities to enhance it. To remain competitive, today's retailer must respond to changing shopper needs with an ongoing focus on differentiated value improvement.

As more retailers embrace this new reality, they must find ways to mobilize all of the available resources to make this effort cost effective. A great way to help make this happen is through a partnership with their store systems supplier, i.e., a relationship that creates a mutually beneficial, more cost-effective response to their shoppers' needs. Retailers open to "big ideas" will win the race for survival by exploring and taking advantage of store system supplier partnerships.

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