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Reinventing Retail  
*A New Path to  
Profitable Growth*



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**Contact Information**

**Beirut**

**Gabriel Chahine**

Partner  
+961-1-985-655  
gabriel.chahine@booz.com

**Chicago**

**Vinay Couto**

Partner  
+1-312-578-4617  
vinay.couto@booz.com

**Namit Kapoor**

Principal  
+1-312-578-4502  
namit.kapoor@booz.com

**Paul Leinwand**

Partner  
+1-312-578-4573  
paul.leinwand@booz.com

**Anu Sharma**

Senior Associate  
+1-312-578-4553  
anubhuti.sharma@booz.com

**DC**

**Matt Mani**

Principal  
+1-703-905-4070  
matt.mani@booz.com

**Florham Park, NJ**

**Thomas Ripsam**

Partner  
+1-973-410-7603  
thomas.ripsam@booz.com

**London**

**Simon Harper**

Partner  
+44-20-7393-3434  
simon.harper@booz.com

**New York**

**Richard Kauffeld**

Partner  
+1-212-551-6582  
richard.kauffeld@booz.com

**San Francisco**

**Nick Hodson**

Partner  
+1-415-627-3330  
nicholas.hodson@booz.com

**Karla Martin**

Partner  
+1-415-263-3712  
karla.martin@booz.com

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## EXECUTIVE SUMMARY

*Coming out of one of the worst downturns in history, many retailers have become skilled at cutting costs fast, whether by shrinking store footprints, limiting SKUs, tightening up supply chains, or cutting store labor. But to achieve lasting advantage in an increasingly demanding industry, retailers need to step up their game and create operating models that maximize efficiency and effectiveness on a sustainable basis. Greater efficiency will make room for the kind of investment that builds lasting competitive advantages, while improved effectiveness will help retailers meet their strategic goals. To create an efficient and effective model, retailers should focus on six distinct improvement levers and develop the organizational, process, and people capabilities to sustain the changes. By transforming their businesses now, retailers will come into the next wave of growth poised to succeed.*

## KEY HIGHLIGHTS

- Retailers that use knee jerk “cut and grow” tactics, merely reacting to business cycles, will struggle to succeed long term.
- Retailers should take a capabilities-driven approach to building a more efficient and effective operating model. Each retailer will need to deploy those capabilities within the context of its strategy, size, physical versus online footprint, and complexity of operations.
- A more effective and efficient operating model frees up capacity to invest, improves agility and flexibility to respond to customer and competitor dynamics, and lowers cost structure.
- Retailers should focus on six primary improvement levers, systematically approach each one, and build the team, culture, processes, and operational capabilities needed to sustain the improvements.

# THE NEW RETAIL IMPERATIVE

The retail industry has undergone a painful period of cost reductions and contraction. Retailers, already accustomed to operating with low margins, in recent years have had to reduce store count, head count, store square footage, inventory and selection, supplier networks, and expansion plans.

Retailers that have managed to survive the shakeout can look ahead with a sense of optimism. Yet overall operating conditions will remain challenging. Customers are more demanding than ever, and competition has intensified due in part to globalization. Customers have now grown accustomed to certain regular price reductions and will expect similar discounts going forward. Additionally, customers’ reliance on the Internet will only increase, placing an even greater emphasis on price, selection, and the integration of the in-store and online shopping experience. Meanwhile, evolving technologies, especially in e-commerce, add operational complexity and allow new competitors to encroach, while also vastly expanding retailers’ potential reach.

To achieve lasting advantage in this environment, retailers will need to step up their game and operate more effectively and efficiently than they do today. They can do this by focusing on six primary levers while building the necessary capabilities to sustain performance (*see Exhibit 1*).

The payoff can be sizable. We have seen retailers lower their cost structure by as much as 30 percent while improving flexibility, agility, labor productivity, and the efficiency of their existing investments.

Retailers must look for improvements within the context of a clearly defined value proposition, target markets and customers, business model, formats, banner, and product and service choices. A retailer’s inherent cost structure, complexity of operations, and differentiated capabilities will logically flow from these choices, and the operating model must also be designed to fully support it.

The six levers address elements of a retail business that require significant investments or are labor intensive. Properly applying each one will have cascading implications for the organizational structure, business processes and technology, and talent. The difference between achieving basic or best practice improvements can dramatically affect both spend and competitiveness.

The relative importance of particular levers to individual retailers will vary based on their size, physical versus online footprint, and complexity of operations. For example, physical store footprint improvements will matter little to primarily online retailers, while expanding shared services or outsourcing may have less value for a local or regional retail chain.

**Lever 1: Footprint, Scale, and SKU Rationalization**

A complex footprint and an assortment that is not tailored to the retailer's value proposition or shoppers' needs in a given geography can drain capital

and increase operating expenses. This is true even in a franchise model in which the franchisee incurs more of the capital costs and operating expense. Retailers can simplify and better tailor physical footprint and assortment through various means.

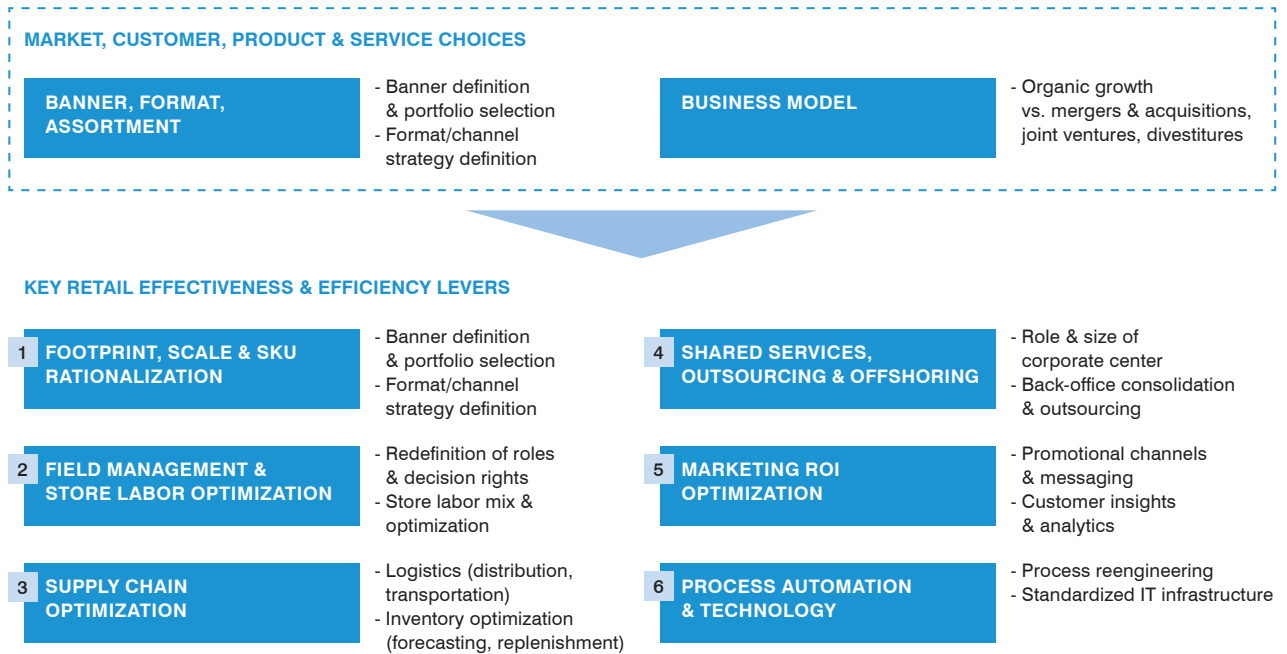
First, bigger—more square footage and larger assortments—isn't always better. Smaller formats with assortments that are more tailored to regional and local shopper demographics and needs can both simplify the shopping experience and reduce inventory carrying costs. Retailers must continuously reevaluate their footprint based on

store profitability, growth potential, and geographic reach.

Second, retailers should integrate their physical stores with their “endless aisle” offerings online. Forrester expects nearly half of all U.S. retail sales in 2010 to be online or Web-influenced. Third, retailers should develop the capability to better understand shopper needs and shopping patterns—at the geographic and demographic levels—to better tailor the assortment.

To sustain effectiveness and efficiency improvements, retailers need to become smarter about format choices, space allocation, footprint, categories,

*Exhibit 1  
Primary Levers for Improving Retail Operations*



Source: Booz & Company

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and assortment. They also need to place more emphasis on shopper economics and value rather than focusing exclusively on unit volume.

## **Lever 2: Field Management and Store Labor Optimization**

Labor is one of the largest cost categories for most retailers, and it must be managed skillfully to optimize the marginal profit per labor hour. Retailers can address this issue at two levels: field management and store labor.

*Field management:* The traditional hierarchical retail management structure is under pressure. First, the model is costly and hard to flex in lean times. Second, as markets become increasingly competitive, field managers need more autonomy and decision rights at the store level. Leading retailers have begun delegating decision rights for local marketing initiatives and revising incentives to provide managers with more latitude to optimize profits, within certain guidelines, at the local market level.

Some retailers are also turning to social media and manager peer groups to build real-time coaching and support networks between experienced store managers and those with less experience. Senior managers use these peer networks to facilitate daily management interaction with all stores in a region, rather than

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### **Sharing Data, Boosting Sales**

Migros Türk Ticaret, one of Turkey's largest supermarket chains, worked with Unilever to use consumer response and store layout data to increase sales of hair conditioner. As a result of a jointly conducted in-store survey, Migros and Unilever tweaked their sales program, increased price promotions, and reallocated shelf space. This campaign led to a 25 percent increase in Migros's overall conditioner revenue, and the chain's sales of Unilever conditioner grew by 36 percent.

U.K. health and beauty retailer Boots, working with a leading supplier of hair accessories, designed an intuitive, color-coded product display system. This cut setup times from 60 minutes to about 15 and reduced overall store rebuilds from eight weeks to two. This faster path to installing and changing promotional campaigns helped Boots increase sales of hair accessories by double digits in the first year alone.

relying on visiting, say, 10 stores a week individually. This approach may ultimately give senior managers improved visibility into day-to-day store operations and a broader span of control, which translates to equivalent oversight with fewer senior managers for the retailer. Meanwhile, less experienced managers benefit from the oversight, coaching, and support they receive—all of which will help them develop into future leaders themselves.

*Store labor:* Retailers have successfully optimized store labor hours to match customer traffic. Now they are scrutinizing the impact of each store's activity on revenue and profitability and are uncovering significant opportunities to improve efficiency and effectiveness at the store level through changes in head count, automation, and processes. For example, a leading convenience store chain eliminated the role of beauty products specialist supervisor after determining that this position had a negligible impact on sales. The Boots drugstore chain in the U.K. reduced labor hours by nearly 15 percent by implementing a centrally monitored, wireless inventory management system that reduced time spent counting and moving inventory from the stockroom to the retail floor. This also created an opportunity to ship store-ready pallets, further cutting the labor associated with store setups.

Similarly, Britain's Metro Cash & Carry dramatically reduced overtime and overlap hours by replacing its manual, store-by-store approach to staff scheduling with a centralized, Web-based scheduling system that helps to optimize store coverage by redeploying staff in real time based on traffic patterns.

### **Lever 3: Supply Chain Optimization**

Retailers have long sought to shorten the time needed to take goods from design to supplier to shelf, and that trend has only accelerated in recent years. Nimble retailers are driving awareness of market trends and sales data throughout the supply chain, helping them meet customer demand faster, reduce working capital tied up in inventory, and avoid markdowns on unsold inventory. For example, specialty apparel retailers Zara and H&M have shortened the time it takes to go from design to store shelf to four or five weeks, far below the industry average of 25 to 50 weeks.

Some retailers have begun to experiment with greater collaboration with suppliers to improve revenue capture and margins. The most obvious opportunities are in inventory management and retail execution. By sharing shopper insights with suppliers, retailers can help suppliers more accurately forecast SKU demand at the local level and synchronize cam-

paigns tied to those forecasts. Better assortments mean more store traffic, increased sales, and lower warehousing costs. Moreover, providing suppliers with real-time visibility into inventory can prevent stockouts.

While collaboration can help boost revenues and margins, large retailers should continue looking for ways to use their size, relative to other retailers working with the same suppliers, to get favorable pricing and a larger share of trade spend. Retailers looking to reduce SKUs can create competition for shelf space, while those with private-label experience can apply their own insight into manufacturing cost structures to negotiate better terms with suppliers.

### **Lever 4: Shared Services, Outsourcing, and Offshoring**

Shared services and outsourcing have long been powerful levers to reduce and variabilize costs and establish consistency and quality. For example, many retailers have implemented shared services and outsourced models to support customer service call centers. But they could apply that model much more broadly. A rigorous assessment of truly core capabilities—those that are essential for competitive advantage and/or brand differentiation—can also shine the spotlight on non-core functions that may be candidates for shared services or outsourcing. These include functions

in the corporate center (finance, human resources, legal) and even operational functions such as marketing analytics, market research, and customer loyalty program support.

For example, Target initially established its offshore operation in India in 2004 primarily to deliver IT services. Since then, it has expanded its India operations to support loss prevention, brand management, analytics, and store support for operational issues. In addition to lowering cost, the offshore operation provides this broad range of support services faster across a large store footprint, and identifies best practices that it can then share globally.

The retail outsourcing and offshoring market has matured in the last five years as pioneers such as Target and Tesco have blazed a trail. Retailers must confront their fears and apply a fact-based approach to fully explore what can be shared, outsourced, or offshored. Customer loyalty, logistics, warehousing, quality assurance and control, project management, training, and store and marketing support are all viable candidates. Success requires the right team, governance structure and supporting processes, and vendor

management capabilities. Much can be learned from other industries, such as consumer packaged goods, technology, and financial services, in which companies have implemented highly mature models over many years of successful shared services, outsourcing, and offshoring implementations.

#### **Lever 5: Marketing ROI Optimization**

Although marketing budgets will rebound with the economic cycle, retailers are still eager to improve marketing efficiency and to correlate marketing spend more directly with increases in customer interactions, sales, and profitability. Developing a robust fact-based marketing ROI capability can be a growth enabler and a key competitive differentiator that can help retailers better understand their customers, drive incremental traffic by tailoring promotions to match customer needs, and enhance customer loyalty through improved shopper experiences. This is particularly important in areas like advertising, which constitutes the biggest component of a retailer's marketing spend.

Within the retail industry, the capability to measure and improve the return from marketing investment varies

widely. Some retailers rely on sales history to guide future marketing decisions, while others employ sophisticated analytics. Deploying a more sophisticated marketing ROI approach requires not only analytics but also decision-support tools, better planning and execution processes, stronger metrics, and a decision-making model that drives accountability and incentives throughout the marketing organization.

#### **Lever 6: Process Automation and Technology**

Process automation and technology enable some of the other improvement levers. But in an industry where speed and agility are increasingly important for responding to customer needs and competitor actions, automation and savvy technology usage can become real competitive differentiators, while also significantly lowering the retailer's cost-to-serve. For example, cross-channel integration is a key retail industry trend with substantial benefits. But it requires automating and integrating marketing, pricing, and merchandising processes and associated systems across multiple channels to provide a seamless experience for the customer.

Retail has also generally lagged behind other industries in adopting

*Nimble retailers are improving data flows throughout the supply chain to improve speed to market, better manage working capital, and avoid markdowns.*

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packaged software. Instead, many retailers still rely on fragmented legacy systems that are difficult to maintain, not to mention enhance or integrate with new technology innovations. Integration among merchandising, in-store, and Web/mobile commerce processes will be particularly critical going forward, yet many legacy systems will not be able to support it. Leading software vendors such as SAP and Oracle are expanding their enterprise retail offerings, making it easier for retailers to retire their legacy applications and migrate to standardized platforms that can reduce overall IT service delivery costs while better supporting essential business processes.

To take full advantage of automation and technology opportunities, retailers need to comprehensively assess all parts of the business, identify manual activities that can be automated, and isolate those areas where integration is needed and where technology can play an even greater role in improving management and operational effectiveness and efficiency. They also need to adopt a more process-centric view, redesigning and optimizing processes end-to-end rather than optimizing pieces of the process within existing functional boundaries.

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### Optimizing New Marketing Channels

Retailers are trying to capitalize on the proliferation of new marketing channels such as social media and smart mobile devices. The key challenge is to have a value proposition for customers that will increase awareness as well as drive incremental traffic for the retailer. Fast-food chains (e.g., Starbucks) and high-tech stores (e.g., Best Buy) have been early adopters. Starbucks recently launched mobile payment capability using iPhone/iPod, hoping to drive incremental store traffic, given the widespread adoption of these devices among its target customers. Similarly, Best Buy recently announced 20 percent year-over-year growth in its online channel; its social media initiative with Twitter is cited as one of the key reasons for this success.

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## CREATING A SUSTAINABLE OPERATING MODEL

Applying any of these levers in an ad hoc, one-off fashion invariably leads to temporary improvements. But really sustaining the improvements and continuously stepping up performance requires a more systematic approach that touches the full range of operating model elements—organization structure, decision rights and metrics, processes, tools, talent, and cultural behaviors. Only then will the retailer establish a model that supports ongoing openness to discovering and executing new ways to achieve both efficiency and effectiveness.

*Organization:* While organizations can be resized or redesigned to reduce cost and improve effectiveness, developing the long-term capabilities necessary to sustain change requires going beyond merely moving lines and boxes on an organization chart. Leading retailers that deliver sustained performance clearly define decision rights, create incentives and performance measures to motivate the right behaviors, and implement processes that ensure the free flow of information throughout the organization. For example, empowering field managers with decision rights to respond to customer needs streamlines decision making and lowers management overhead cost.

*Processes and tools:* Retailers must put in place the requisite business processes and tools to plan for, implement, measure, manage, and sustain the changes associated with each improvement lever. Collectively, these will contribute to a more effective and efficient operat-

ing model. For instance, retailers that pursue shared services or outsourcing will need an appropriate governance model and service-level management and vendor management processes and tools to be successful.

*Talent and culture:* Creating and sustaining an effective and efficient operating model requires skilled employees and a culture that supports and drives desired behaviors. Focused training programs are helpful in realizing certain gains, but some retailers may need to take more decisive or aggressive actions. For example, one retailer laid off staff at headquarters while simultaneously expanding its e-commerce team to better integrate its stores and online channel. To create a performance-driven culture, the same retailer also clarified expectations for individual performance and tapped certain employees to act informally as “pride builders,” modeling new behaviors and subtly influencing peers to do the same.

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## CONCLUSION

Merely cutting costs or investing heavily in expansion has proven insufficient for ensuring long-term success or even survival for retailers. Instead they need to clearly identify and develop capabilities that create distinct competitive advantage, and build an operating model that continuously delivers improved performance. By systematically and rigorously extracting more efficiency and effectiveness out of targeted functions, retailers will find themselves well positioned to ride the next wave of growth and mitigate their risk when the next tide of turbulence strikes.

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### *About the Authors*

**Thomas Ripsam** is a Booz & Company partner in Florham Park, N.J. He specializes in strategy-based organization and operating model transformations to improve top- and bottom-line performance, with particular focus on Sales and G&A functions.

**Namit Kapoor** is a Booz & Company principal based in Chicago. He specializes in large-scale shared-services strategy formulation, design, and implementation.

**Matt Mani** is a Booz & Company principal based in Washington, D.C. He specializes in helping companies with organizational and cost transformations and globalization.

**Anu Sharma** is a Booz & Company senior associate based in Chicago. She focuses on organization design, effectiveness, and people issues in large-scale transformations.

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