

Shareholders vs Customers //

Now is the time for a balanced equation

By Mike Hrabe, Vice President Sales and Marketing, Quantum Retail

As I write this, the credit crunch is cementing itself into its second year. It's apparent that households on both sides of the Atlantic are now feeling the pinch brought about by a soaring cost of living, weak income growth, falling house prices and rising mortgage bills. Retailers' expectations of future sales are now also said to be at a record low. In the US, the clampdown on credit has hit consumers hard – and retailers are feeling the effect as people have no more instant money to turn to and are now resorting to the old fashioned process of budgeting what they have, instead of spending on future income.

In the current global economic climate – which looks set to last into 2010 at least – it's going to be increasingly difficult to please investors. Not only is continued growth unlikely, but the current levels are not sustainable in the face of a prolonged recession and credit crunch. Retailers are starting to batten down the hatches for tough times which some say have not even begun. It's a fact of business life that some will not survive, however those that do will be able to grab hold of market share in preparation for when times do improve. How can this be done? By looking after both customers and shareholders and ensuring the needs of each are addressed. It's not impossible: the good news is that with the right attention to detail, it can be done.

The customer versus shareholder divide

While retailers gamely attempt to address both sides of this problem, most have limited means and tend to disproportionately focus on one side or the other. When seeking to raise profits for shareholders they lower inventory investment, also lowering customer satisfaction in the process. As the number of unhappy customers increases, retailers will increase stock levels in a bid to pacify them. Usually the net result of this will be as much, or even more, inventory than the retailer began with, leading to a depressed gross margin, increased operating expenses and a negative effect on cash flow. This destructive cycle erodes both customer loyalty and profit margins.

In the past few years, retailers have tried numerous permutations to balance the customer-shareholder equation. To boost earnings they have reduced staff numbers, sold off real estate assets and cut down the amount of inventory on hand, or in the supply chain. To better serve customers, they are also investing in discounting in an effort to gain market share. At the same time, they have implemented loyalty programs designed to reward customers for continuing to shop with them while gathering useful data on buying patterns that can be used in optimizing customer offers.

And there are still those who are investing in higher inventory levels to chase sales and keep customers happy. This can be a good short term strategy to right a sinking ship or unlock unrealized value, but can be devastating in the long term as it tends to ignore top line growth and

the fickle nature of customers. The tendency to adopt whatever is hot at the time further complicates things: markdown optimization is a classic example, with everyone jumping into new technology without first considering how to reduce the need for markdowns.

Inevitably even the most experienced retailers will find it easier to lean more strongly towards one end of the customer-shareholder scale. This is illustrated by two US retailers: Sears and Target. When Eddie Lampert of ESL acquired Sears, shareholders were getting very little for their investment. The creation of Sears Holdings drove returns to investors by concentrating on increasing the company's value. Lampert achieved this by engaging in massive cost-cutting through staff reduction and inventory. He also sold off real estate holdings as well as Sears' credit card portfolio. While the value of the company was skyrocketing, comparative stores sales were decreasing and, to this day, lag their peers by alarming numbers. Putting shareholders first had cost them customers and market share.

The opposite is true of Target. When Bill Ackman of Pershing Square Capital Management purchased a stake of almost 10% in the retailer he immediately tried to unlock more shareholder value using the Lampert model by pressuring Target to evaluate its real estate holdings and to sell off its credit card portfolio. The initial reaction of Target's board was to reject his proposal, citing the credit relationships with their customers as strategic. Eventually they agreed to sell off only a minority stake in the credit cards business.

While consistent growth for shareholders is one of Target's goals – and one where it has delivered – their preference is for customer satisfaction. Therefore their priority is to invest in high stock levels to ensure that customers can always get what they came in for. There is little question where Target's priorities fall.

The battle between the interests of the shareholder and the demands of the customer exists largely because retailers have reached the limits of inventory efficiencies that can be driven through their supply chain. They cannot throw any more people at it, and there is no more time to make better decisions. Today's economic environment has already exposed retailers who have disproportionately focused only on customers or shareholders; yet there are rewards for those who pay attention to both.

Q unlocks unprecedented value

Smart retailers know that success lies in gaining a more accurate understanding of demand for each individual item at each individual store. The retailers who are doing things right are not relying on store/product clustering and store grade groupings. These averages smooth over the details, leading to overstocks and understocks. The ramifications are clear: Too much inventory in the wrong place means reduced sales and a hit on inventory turn. Only by managing the inventory at a more micro level can efficiencies be driven – but for most retailers this cannot be achieved with the resources they have today.

Q, from Quantum, is a system that enables retailers to quickly understand customer preferences all the way down to the SKU level and allocate stock according to actual store demand. In this way, full price sales can be maximized – and margins optimized. The complexity of the inventory problem can be absorbed to create a better balance across the chain with positive impacts on both financial and merchandising objectives.

Because Q simplifies the stock replenishment process by allocating less stock, it creates a pool of inventory that can be used to react quickly to actual store demand. For fast fashion retailers this has huge payoffs: from reductions in markdowns through to targeted purchasing, focused distribution, and the ability to be more responsive to rebuy opportunities. Having more of the

product in the right place, during full-price selling periods, means the need for markdowns is drastically reduced something which Q has proven again and again.

One example is a UK-based fast fashion retailer which saw a 2% increase in full price sales (4% increase in gross sales) within six months of installation, with a resultant 4.5% increase in margin. In the US, a major retailer achieved to a 10% plus reduction in inventory with a 2% plus increase in sales just weeks after installation, and these improvements have proven to be sustainable.

The ability to be up and running in a matter of months also makes Q attractive looking for retailers looking to quickly turn around their fortunes. Q requires no new hardware and can work alongside existing systems: it can also be phased in gradually. A retailer might start by using Q to make decisions about the initial allocation of a certain range of SKUs in its stores, increase that to all SKUs then add in replenishment activities followed by forecasting and order planning.

The fact is there will always be some retailers who do better – for both their shareholders and their customers. By ensuring that customers get the right stock when they're ready to pay for it and better understanding how they're buying on a micro level, Q enables retailers to avoid overstocks and markdowns and maximize those all important margins. In a weak economy it is also more important than ever to preserve the integrity of the brand.

This means avoiding frequent and unnecessary markdowns – while this might attract consumers, after a while it just confuses them. At the same time it weakens the brand that both your customers and shareholders have bought into. And when the economy does shed its gloom, the brand that remains intact will be better equipped to grab the spoils. Will that be yours?

Quantum Retail Technology, Inc.

The market is asking new questions... you need new answers.

Q answers the new questions facing grocers and retailers today with solutions that enable them to profitably buy, move and sell merchandise, solving the most complex and costly problems they face - **quickly and permanently.**

Q is the answer for: Assortment and Range Planning - Forecasting and Order Planning - Replenishment and Allocation

Every Quantum Retail customer has achieved 100% return on investment in less than 6 months. For more information visit <http://www.quantumretail.com>. Follow Quantum Retail on Twitter at <http://twitter.com/quantumretail>.