Five golden rules to help retailers *take control* of their operational costs in challenging market conditions.

The ultimate retailer's guide to controlling operational costs and boosting profits.

"What we typically see amongst our retail clients is a disconnect between operational data and insights and use of those insights data to support end-to-end decision-making. All too often, decisions are made without full consideration of the downstream impact on cost and efficiency. In a backdrop where cost is king, there needs to be a different mentality around remaining profitable: one which doesn't penalise customers and which is sustainable from a colleague perspective. We created our five golden rules to support retailers on this journey to get back on top of product-level margins and drive profitable growth."

Catherine Strowger
Head of Retail at Capgemini Invent UK

It certainly isn't news that the global and national socioeconomic and political landscape in recent years has caused a challenging situation in the UK. Inflation highs, soaring costs, and a cost-of-living crisis have wreaked havoc on the UK economy and had a significant impact across organisations operating in these waters, driving additional costs across the full end-to-end supply chain. Such economic headwinds have resulted in a series of knock-on impacts for UK retailers.

Shifting customer behaviours, the digital dilemma, and a fast-growing pinching problem.

A few years on from the pandemic, and as the cost-of-living crisis continues to ease, consumers are still choosing own-label products over branded, with own-label sales now making up more than half of total supermarket spending. This isn't surprising considering over 50% of consumers say they're extremely concerned about their personal finances, according to Capgemini Research Institute's 'What matters to today's consumer' report. But for food retailers it can have significant implications for profit margins.

The same is true for general merchandise, with a report in Drapers saying many retailers are having to work harder to make the sale. This has forced some to make changes to their price architecture by lowering average price points and driving more promotional activity in concerning mid-season sales, compromising margins.

And it's not just what customers are buying (or are not buying), but how. Over the next five years, eCommerce is projected to be the fastest-growing grocery sector, with a CAGR of 9.1%. However, in what we coined 'Grocery's Digital Dilemma', these fast-growing digital channels are also the least profitable. By 2025, grocers will lose £10.8m in margin for every £772.1m in digital sales due to underdeveloped digital grocery capabilities – often forcing trade-offs to prioritise profitability-maximising investments. From a fashion perspective, there are also pertinent challenges around trading online profitably. There are many root causes for this, but the ever-increasing volume of customer returns can be seen as a key driver.

In addition to shifting consumer behaviour, loss of goods from within the supply chain (for example, startling high food wastage) and other explainable wastage from damaged or short-coded stock, shrinkage is on the rise. And it's a fast-growing problem, with UK retail shrinkage having increased by around 33% since 2018 and shoplifting up by a startling 25% year-on-year in 2023.

Government pressures haven't helped either with a 6.7% rise in business rates from April 2024 adding hundreds of millions of

pounds to retailers' bills according to The British Retail Consortium.

Though these headwinds paint a rather sad outlook for the future of UK retail, every good retailer knows that where there is austerity, there is also opportunity. Intense pressures, externalities, and squeezed margins have caused retailers to flex their strategy, with cost and operational efficiency now more important than ever.

The key question is, exactly how should you approach these challenges?

Capgemini's five golden rules for retailers taking control of costs.

Armed with deep industry expertise, Capgemini's retail team has helped some of the UK's largest retailers respond to continued pressures by identifying new ways to reduce costs, enable all-channel growth, and connect with customers.

It's through this experience that we've identified five 'golden rules' to help you get control of your costs:

1. **Think end-to-end**
2. **Align on a margin measure**
3. **Get granular**
4. **Understand the true 'why?'**
5. **Adopt a mindset shift**

Let's delve into each.

Golden Rule One – Think end-to-end:

No more siloed cost-saving initiatives. Instead, take a step back to see the full picture, and be able to model the impact of upstream decisions throughout the value chain by connecting the data and your teams. Those retailers who lack an end-to-end approach may miss significant cost-saving opportunities across the supply chain, potentially addressing only minor issues with quick tactical fixes.

We worked with a leading grocer to assimilate their key operational cost data across the supply chain, including transport, storage, labour, and wastage and surfaced these costs on an easy-to-use business intelligence (BI) dashboard. The grocer had never seen the full picture of the costs that take product from their depots to the end customer. The advantage of surfacing historically siloed data was that it brought the teams together, as well as the data. For the first time, there was a shared awareness and appreciation of how decisions impact the 'Product Profitability' across Commercial, Retail & Supply Chain.

Although this may appear daunting and labour-intensive, you can begin with less complex activities. By gaining a clearer understanding of the stock flows to model, the operations involved and the data available, it is possible to start small and scale up the complexity later. If you can't build a live data model yet, even connecting data in offline spreadsheets can have its advantages. You can use this exercise to get a rudimentary view of achievable cost-saving goals and use that to unlock the necessary resources and inputs for further refinement and/or execution. Executives may be surprised with what (potentially deep) pockets of opportunity these surfaces.

Golden Rule Two – Align on a margin measure:

Often, organisations place undue focus on gross profit rather than net, which although has it place, doesn't tell the whole story. Where we have seen Cost-to-Serve initiatives implemented most successfully is where retailers build on step one to apportion operational cost data down to the individual product and fulfilment location level to calculate a new operational margin measure. This translates operational cost data down into more digestible, actionable insights. From this, we've been able to see the difference in profitability of selling the same product, but in different locations with varying shelf space allocations and rates of sale. Or even the impact on a products case size or routing (i.e., nationally versus regionally) on operational profitability.

Implementing a business-wide operational profitability margin KPI that is used synonymously throughout the business for reporting, which everyone understands, is a robust way to embed end-to-end thinking and data-driven decision-making. A well-defined KPI guides decision-making at all levels, allowing you to better prioritise initiatives that drive a more effective output and cost-savings.

Golden Rule Three – Get granular:

We mean really granular. Once you have visibility of these costs down to a product level, you need to work out where the key cost drivers are coming from. Do you have problem categories? SKUs? Stores? How does the fulfilment route impact costs? How does the case size impact profitability? How big a problem really is wastage on your fresh products? Taking a critical, investigative lens to understanding your cost base will stand you in good stead for tackling these cost challenges head-on.

We worked with a UK fashion retailer who was trying to balance availability and markdown by optimising case sizes and the mix of boxed and hanging product. Size complexity, especially in departments such as tailoring and lingerie, exponentially increased the volume of data and analysis required. Critically, however, it demonstrated the power of insight-based trading and supply chain decisions across more than 100,000 individual SKUs.

However, this only stands if the data is accurate and reliable. Retailers need to invest in improving data quality and maturity to gain full trust in the insights surfacing and make targeted, impactful changes with certainty about the accuracy of decision-making. From our experience, many retailers base decisions on historical data, as opposed to real-time insights, which becomes even more of a challenge when working with multiple, disconnected data sources. It is critical to integrate and synchronise these disparate sources to enable a more precise understanding of cost-to-serve & product profitability. From here, you need to harness the data available, understand the cost levers and take decisions that align to strategic goals. At this point, working with offline spreadsheets becomes more of a blocker.

While it may seem complex, collaborating with experts who possess deep knowledge and expertise in building cost models will allow you to access a level of richness to the insights that static calculations can't get to. Ensuring your data infrastructure maturity supports your business ambitions is a worthwhile investment to help you achieve your goals – "data is king" after all.

Golden Rule Four – Understand the true 'why?':

Getting the data is just the start, but interrogating the insights and modelling scenarios is where the true value lies. With this, you can challenge assumptions and find new opportunities to optimise costs and improve operational margins.

You can uncover hidden opportunities and inform potential remediate actions to take just by asking questions like:

"What is the true cost of running a promotional period?"

"Why are some products underwater in terms of operational profitability?"

"Why do two similar products have such different operational costs?"

"What patterns in operational profitability are emerging?"

Additionally, using the data to challenge assumptions or conventional wisdom such as 'high-margin products are always profitable' will uncover areas to innovate and challenge norms.

We supported a retailer by building multiple modelling use case scenarios into the operational margin tool. One such use case involved modelling the impact on shelf allocation on product profitability. This allowed us to surface a significant challenge with macro-spacing and showed that an entire category was operationally unprofitable. This triggered a subsequent investigation into transforming store layouts and allocations.

Golden Rule Five – Adopt a mindset shift:

Having the data but not acting on it is no better than not having the data in the first place. But bringing the business on that change journey is often the hardest part. From buyers to space planners, logistics and store managers, the mindset of looking beyond their function in isolation can be significant. When end-to-end decisions are being made about what is ranged, how it is displayed, how it is flowed, cost considerations should always have a seat at the table, alongside customer. Having an ability to model different scenarios, alongside a shared KPI can help take emotion out of the process.

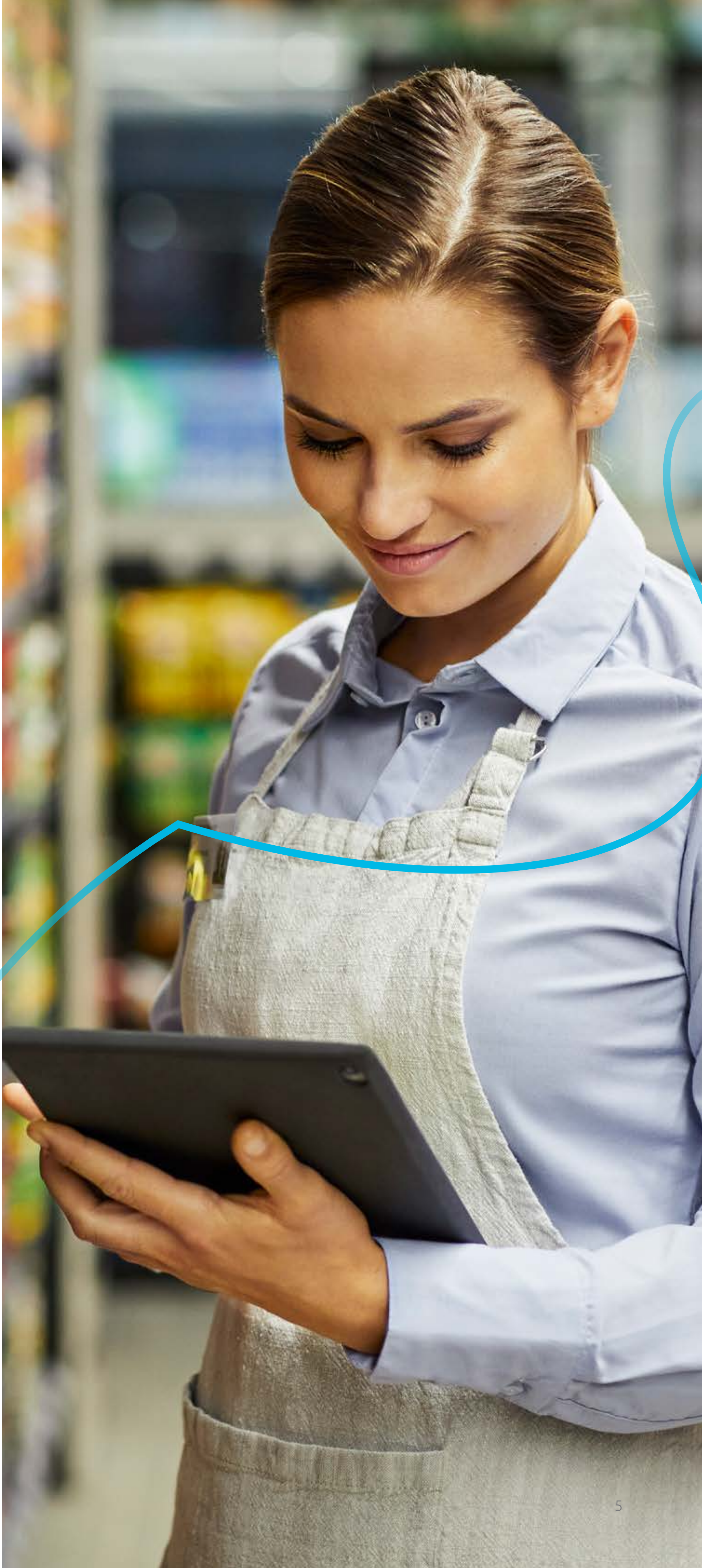
Whilst working with a specialist general merchandise retailer, we built a model that visually illustrated the cross-functional impact of strategic decisions such as the mix of own-brand and branded products and different customer returns propositions. The executive team could not only see the predicted impact on their functional cost base and their people, but also that of their peers. This enabled them to work more effectively as a leadership team, having a much better view of end-to-end implications.

Regardless, it's imperative that the full business is brought on the journey as this will drive fundamental shifts in ways of working and how the business operates. Engaging teams in the creation and rollout of this KPI will help with buy-in as they will understand how they can impact the outcome and become champions for change within their departments to achieve their goals.

How to start applying the five golden rules.

These shifts in mindset and approach will help you streamline your priorities and focus on the value-adding activities to achieve your long-term goals. To ensure they're successfully applied, it's imperative that there is a strong vision and leadership sponsorship.

Although it may not be realistic to start with the end goal and immediately build an automated BI tool that surfaces and models operational profitability, it is possible to start small. Pulling



together a group of motivated individuals who collectively represent the end-to-end stock flow is a good start.

Collaboratively mapping out the different stock routes and buckets of operational cost is an even better start. Engaging your data team to support you in identifying the operational cost data available and taking an extract for you to play around with will help you to understand the scale of the task, but also the scale of the opportunity.

It's at this point the fun starts and you can put your analytical skills to the test by building a spreadsheet-based model – this will allow you to think about what logic you'd like to replicate in a live, more advanced tool at some stage.

Once you've ratified your working in the group, it's important to get senior leaders' eyes on this early and demonstrate the potential size of the prize. If your in-house data & analytics capabilities allow it, getting senior sponsorship might be all you need to start developing an in-house operational profitability model. As you prove the value you can partner with experts in the field and iterate from there.

One final word of warning: don't forget the bigger picture. Taking a holistic approach to shifting the focus of the business towards operational profitability is critical and carefully managing the change journey will make sure all your hard work isn't for nothing.

How can Capgemini help?

Driving any change alongside business-as-usual is a squeeze. That's why we developed a 'Product Profitability Accelerator' to help our clients start small and scale fast, driving realisable in-year benefits to the bottom line.

Having collaborated with some of the world's largest retailers, Capgemini possesses extensive expertise in addressing our clients' most critical challenges and delivering successful outcomes. We are an end-to-end partner, who couples advanced data and applied analytics capabilities with deep industry expertise to drive business transformation.

To learn more about how we can solve your biggest challenges, head to our dedicated retail page or get in touch:

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About Capgemini

Capgemini is a global business and technology transformation partner, helping organizations to accelerate their dual transition to a digital and sustainable world, while creating tangible impact for enterprises and society. It is a responsible and diverse group of 340,000 team members in more than 50 countries. With its strong over 55-year heritage, Capgemini is trusted by its clients to unlock the value of technology to address the entire breadth of their business needs. It delivers end-to-end services and solutions leveraging strengths from strategy and design to engineering, all fueled by its market leading capabilities in AI, cloud and data, combined with its deep industry expertise and partner ecosystem. The Group reported 2023 global revenues of €22.5 billion.

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