OLIVER WYMAN

THE OLIVER WYMAN RETAIL JOURNAL

VOLUME 1

MARSH & McLENNAN COMPANIES

EDITORIAL

JAMES BACOS
james.bacos@oliverwyman.com
+49 89 939 49 441

2012 has been another year of anaemic economic growth, and trading conditions have again been tough. But things are not all doom and gloom. While individual retailers obviously cannot mend the global economy single-handedly, there will be opportunities to win market share from competitors. Such opportunities are often more numerous than one might think, yet remain untapped because they require a sometimes wrenching shift away from what worked in the past.

In our experience, the key to winning in retail lies in recognising a fundamental truth: a mature, established retailer needs a different set of capabilities than a young, fast-growing one. This is not a new idea, but one in which the change of emphasis required is easy to underestimate.

For a young company, where locations for new stores are plentiful, rapid and profitable growth requires finding the right sites and paying the right amount for them, tightly controlling capital spending, quickly and efficiently building and opening new stores and ensuring the supply chain can cope with rapidly changing demands. For retailers in this lifestage, real estate and logistics are the most important elements of the business – and it is a case of getting the big decisions right, fast, rather than obsessing over details.

But most retailers passed this point long ago. With few new sites available, the challenge is to defend and incrementally grow market share. This requires very different capabilities: identifying the products customers really want on the shelves, negotiating hard to drive down costs relentlessly, and pricing and promoting aggressively enough to outmanoeuvre the competition, but not so aggressively as to bankrupt the business. Meanwhile, store labour and supply chain costs need to be tightly controlled, delivering the service levels and availability customers want without overspending.

For mature retailers, advanced capabilities in trading and store operations are the key to success. These businesses need to get tens of thousands of small but important decisions right, and build a proposition that beats the competition in every way possible, in the eyes of as many customers as possible, while still generating a profit.

This compendium presents some of our thinking on how a retailer can do this. It brings together all the individual articles we produced during 2012, each of which addresses a different aspect of the capabilities a retailer needs to compete in a mature market. I hope you find it interesting and thought-provoking.

Best regards,

James Bacos
EMEA Retail Practice Leader

CONTENTS

PERSPECTIVES

INSIGHTS

POINT OF VIEW

CUTTING PRICES WITHOUT CUTTING PROFITS

Many retailers have run price-cutting campaigns – but most have failed to produce a dramatic improvement in competitive position, and have simply started price wars and hurt profits.

One major US grocery chain is a notable exception, having recently improved its shelf price position by 10% relative to competitors, while at the same time protecting its bottom line. This paper describes how it pulled off one of the boldest value repositionings ever undertaken.

It's one of the biggest paradoxes in retail: price cuts are unprofitable, but the most aggressive and fastest-growing competitors often have the sharpest prices. Many successful mature retailers see their market share being eaten away by newer players offering seemingly unbeatable value, while their own efforts to lower prices at best produce barely measurable volume gains, and at worst provoke crippling price wars.

In some sectors, after decades of profitable growth, the mature players have reached a stalemate in which they match each other move for move. Respectable financial performance often masks a less certain future: like-for-like sales growth is in many cases driven by inflation, while volumes are flat or declining. Developing a price advantage over key competitors has never been more important – or more difficult.

Despite the challenges, a few retailers have found sustainable, profitable ways to improve price competitiveness. This paper describes one such example of how a top-ten US grocery chain transformed its value position with a bold program of price moves. In doing so, it broke the cycle of tit-for-tat price adjustments and slow volume decline, and achieved significant market share gains by improving customer perceptions.

CONTEXT

After decades of successful growth, one of the major US supermarket chains had reached a critical point: customers began to see it as no better than average in terms of value and quality. Sales volumes were slowly declining, and WalMart and other everyday low price (EDLP) operators posed a rapidly growing threat. Meanwhile newer, smaller players had carved out a reputation for both value and quality, and were winning customers wherever they opened stores.

In this situation, the natural response would have been to launch a succession of cost-reducing and revenue-boosting initiatives in the hope of shoring up market position. But although making small improvements to the performance of the business might generate better financial performance over the short- to medium-term, the management team understood that this wouldn't address the erosion of market share. Only a dramatic improvement in value perception would allow the retailer to regain its place among the leaders in the industry and ensure its long-term survival.

However, the management team knew that price cuts would cost money in the short term. In the past, price-cutting initiatives had done little to increase sales volumes, and had quickly been matched by competitors.

The problem is one faced by all retailers: although "indirect", long-term price elasticity may be quite high, "direct", short-term price elasticity is much lower. Any significant price cuts have a serious adverse impact on margin for two years or more, during which time they need to be paid for in some way. 'Price elasticity in retail' on page 8 explains this in more detail. The subtle relationships between price position, price perception, and market share present two major difficulties. First, how to pay for price cuts in the short term, before there are any big changes in volume to offset the unit margin decrease; and second, how to ensure competitors don't simply follow suit and remove any chance of building a long-term advantage.

PAYING FOR THE PRICE CUTS

The objective was to bring prices close to those of WalMart, requiring reductions unprecedented for a retailer this size. Shelf prices were slashed by an average of 10%: this massive cut was implemented across all categories, affecting over 20,000 products and requiring reductions of 20% or more in some cases. In addition, the business moved from being heavily promotional to being 'EDLP+', with sharp everyday prices and lower promotional participation. This bold approach had massive financial implications, as the immediate cost of the cuts – the size of the discount 'given away' through price reductions – was between $1 BN and $2 BN, more than the EBIT of the entire company.

Since conjuring up more than $1 BN overnight was obviously out of the question, the price cuts could not all happen at the same time. The management team devised a carefully phased roll-out plan: the price cuts were executed in waves, with those scheduled later paid for in part by extra cash margin brought in by those already carried out. Even with careful sequencing, however, volume would build slowly, and a huge gap would remain in the short term – meaning that other sources of cash needed to be found. With this in mind a set of initiatives aimed at boosting profits was implemented.

The promotions programme was cut by half, and through negotiation with suppliers the vast majority of the "lost" promotional funding was channelled into shelf price cuts (despite the buyers' initial scepticism over whether this would be possible). Significant improvements were made to assortment and space allocation, and a comprehensive SKU rationalisation exercise was carried out. Narrowing down the assortment meant the buyers could use the credible threat of de-listing products to carry out a round of aggressive cost renegotiations, generating additional cash. Better monitoring systems and shelf life protocols were established to reduce shrink and improve the freshness and quality of products; and store operations were comprehensively overhauled in search of greater efficiency.

Taken in combination, these initiatives represented a massive push for simplification, with the retailer unwinding much of the complexity that had built up over the previous decade, streamlining its business and refocusing its attention on its customers.

Another, more subtle source of funding for the price cuts effectively came from competitors. Short-term price elasticity is low, but it isn't zero: as long as competitors were unable to react to the price cuts, practically all of the short-term volume increase for the grocer would come directly from its competitors' sales line. This would put them on the back foot and force them to focus on short-term financial performance at the expense of long-term investment. The usual instincts for a retailer in this situation are to run increasing numbers of promotions, raise prices on secondary lines, and cut back on investment in core aspects of the business – all tactics that would work against them in the long run.

MINIMISING COMPETITOR REACTION

For the price cuts to produce an improvement in value perception, the business needed to open up a significant price gap on its competitors, meaning their reaction needed to be kept to a minimum.

This was where the management team realised something absolutely crucial: although the lag between a major price cut and a significant volume gain presented an immediate cash flow problem, it also offered a way of outmanoeuvring the competition. The very challenges that the retailer faced could be turned to its advantage.

If the retailer could find a way to fund big price cuts, competitors simply wouldn't be able to react. Caught unawares, each would face the choice between doing nothing and becoming uncompetitive, or slashing prices and becoming unprofitable. It seemed a safe bet they would choose the former and allow a price gap to open up.

Because the size of the investment required the price cuts to be rolled out in a wave, there was a risk that competitors would have the chance to react. So in planning the cuts, timing was everything. The most obvious approach might have been to start with the most important, highest-volume products and then work down the list. But although a "Top 1000 SKUs" price cut would have made for a great marketing message, it would also have been relatively easy for the competition to understand and match; besides, given the scale of the cuts, it would have produced a dysfunctional pricing architecture and unfavourable margin mix within each category.

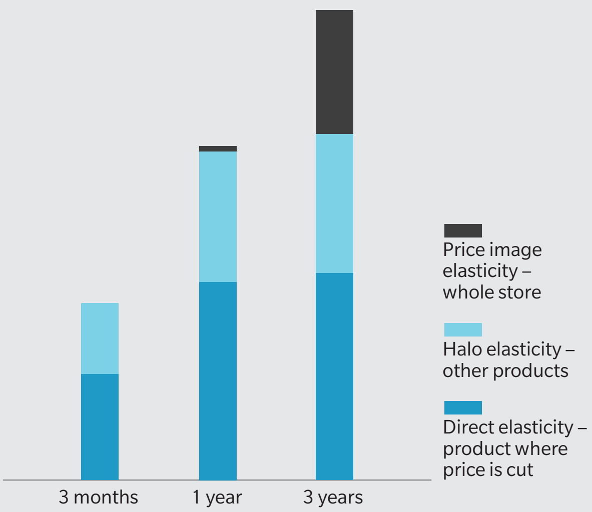
Price cuts were therefore implemented aisle by aisle, beginning with those identified as key drivers of footfall and moving on to cover the whole store over a period of two years. This approach presented fewer practical and operational difficulties, and meant the price cuts would still be very difficult for competitors to match.

The retailer spent months preparing for each stage of the value repositioning, determining how best to revise the assortment and designing an entirely new pricing architecture from the bottom up. These improvements were then rolled out overnight simultaneous with the dramatic price reductions – a set of changes so overwhelming that it would take weeks for competitors even to understand what had happened, and much longer to decide how best to react.

PRICE ELASTICITY IN RETAIL

- For most products and in most stores, cutting prices today produces very small volume uplifts tomorrow – but over time, sustaining a price differential versus the competition has a powerful effect on customer perception, which translates into significant changes in market share. Moreover, taking trade away from competitors reduces their profits, hampering their ability to invest in their own business and weakening them in the future.
- The implications are clear. First, most benefits produced by price cuts only materialise after a significant lag of a year or more (because customers adapt slowly). Second, most of the benefits are indirect – improvements in customer perception produce thinly spread gains in volume across the store as a whole, not major uplifts for any individual product. The volume changes seen in the first few months are typically less than 40% of those that will eventually occur – so making pricing decisions based on short-term, product-specific elasticity measurements is a risky proposition. See *Exhibit 1* for an illustrative example of short-term and long-term price elasticity.

EXHIBIT 1: IT TAKES UP TO THREE YEARS FOR A PRICE CUT TO ACHIEVE ITS FULL EFFECT ON STORE SALES VOLUMES



THE RESULTS

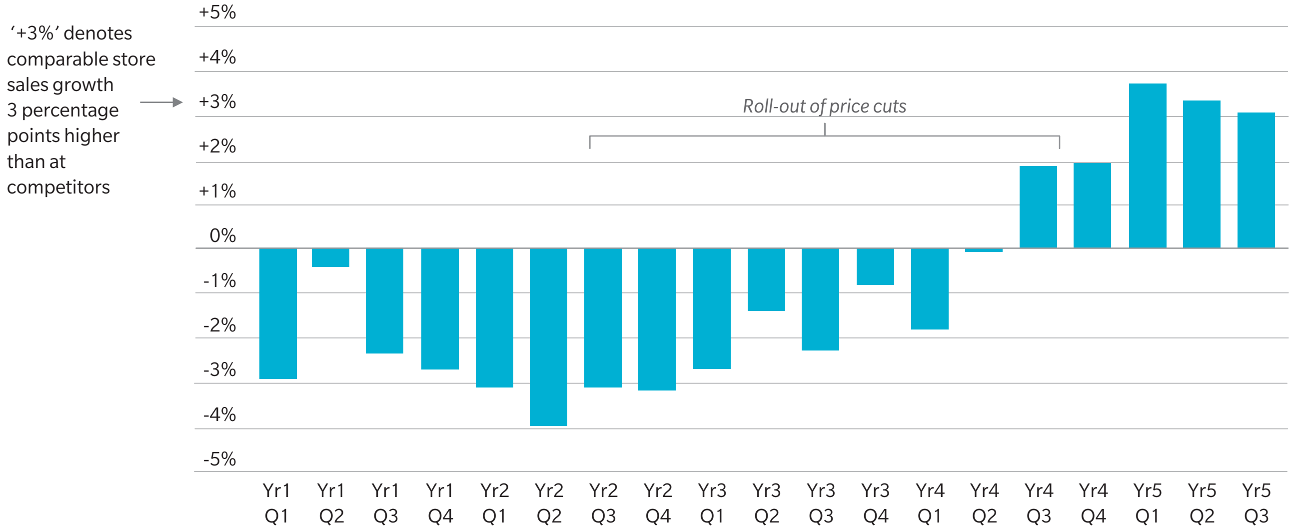
As planned, the scale and phasing of the price cuts meant that competitor reaction was very limited – in fact even less than had been expected. At the same time, the management team understood that volume would respond very slowly at first, and had taken care to communicate this message clearly throughout the business. They knew that holding their nerve would be a serious challenge in itself: the first few months would produce some frightening sales figures.

Ultimately, their boldness was rewarded: over time customers began to take notice of the price cuts. By the halfway mark of the two-year program of price cuts, value perception ratings that had long been declining were showing significant improvements. Sales volume was increasing dramatically and comparable store sales growth began to outstrip that of the competitors for the first time in years, as shown in *Exhibit 2*.

The bottom line held up well through the whole period despite the radical changes affecting the business. The plan to fund the price cuts succeeded, with sufficient vendor funding reallocations, cost reductions, and volume gains offsetting the lower prices introduced.

The overall result was a massive strengthening of the retailer's long-term strategic position: the business became a leading player again and began gaining market share. As intended, the competitors saw their sales figures decline, found themselves unable to react effectively, and began to pull the usual levers in an attempt to meet their budgets. Running more promotions and afterwards raising shelf prices in an attempt to shore up margins ultimately damaged profits. This in turn restricted competitors' ability to invest in their own businesses, to their long-term disadvantage.

EXHIBIT 2: DIFFERENCES IN COMPARABLE STORE SALES GROWTH VERSUS AVERAGE OF MAJOR COMPETITORS



Source: Published quarterly financial results, Oliver Wyman analysis.

The value repositioning described here was massive in every sense – in terms of its financial impact, the change in customer perceptions it generated, and the amount of hard work and level of commitment required from the buying teams. With the last of these in mind, it's worth emphasising the effect it had on business culture.

In the past, the grocer had been heavily influenced by its suppliers, but in planning and executing the overall campaign there was a definite change of emphasis. The transformation had a huge impact on the organisation's culture: the focus shifted to customers, to systematically analysing past customer behaviour and identifying the areas where performance improvements would create most value. The way the transformation and change was communicated internally was crucial. Rather than focusing on the ultimate benefits to shareholders, the management team stressed that the goal was that of 'investing in customers' – a far more inspiring message for the organisation. Today, while the value repositioning itself remains part of the reason for the company's ongoing success, in the long term the cultural changes that it brought about may ultimately prove an even greater source of competitive advantage.

CONCLUDING REMARKS

If a retailer is a generalist catering to all customer segments, it cannot survive indefinitely without offering sharp prices – because its market share will steadily be eroded by those who do. But there are obvious reasons for retailers to be wary of launching large-scale price-cutting campaigns. The long lag between price cuts and volume increases means such initiatives must be meticulously planned if they are to avoid damaging profitability; and the threat of a price war makes it vital to minimise competitor reaction.

There are many examples of retailers who have implemented half-hearted price-cutting campaigns or who have cut prices and destroyed their bottom lines in the process. In contrast, the performance of the grocer described in this paper shows what can be achieved through careful planning and bold leadership. In this case, value repositioning ultimately generated significant sales and profit improvements, transforming the grocer from a player that typically under-performed to one with best-in-class comparable store sales growth. It demonstrates that when successful, a campaign of this type can be a powerful way of galvanising the organisation and instilling a new emphasis on serving the customer.


CLOSED

TACTICS FOR TOUGH TIMES: NEW SOURCES OF VALUE IN RETAIL

In 2012, the pressure on retailers in mature markets will be more intense than ever – and to meet their financial targets, most will need to find ways of rapidly improving their performance. But many short-term tactics can inflict serious long-term damage on a retailer's brand and strategic position. This note describes some of the challenges of managing performance in a particularly tough trading environment, and highlights four safe sources of short-term value.

As recent results show, things are not getting any easier in retail. Consumer spending remains muted, and competition is becoming ever fiercer as large retailers keep adding space. Meanwhile, e-commerce continues to grow in importance, posing a major threat in most sectors. In this environment, there is an even greater premium on being able to deliver the numbers. Unfortunately, hitting targets is becoming ever more difficult as falling volumes hit the bottom line hard.

One of the biggest dangers in this environment is falling back on "easy" ways of driving performance improvement. The intuitive response is often to slash discretionary spending, while holding firm on traders' financial targets in the hope of getting as close as possible to meeting them. But although both can indeed improve short-term results, they often store up long-term trouble. Cutting discretionary spending usually means scaling back vital investments in the business and its capabilities, hurting a retailer's ability to keep up with ever more sophisticated competitors and suppliers. Pressuring traders to meet unrealistic targets has subtler but arguably even more damaging effects – the unintended consequence is usually that prices are nudged upwards, more promotions are run in pursuit of sales, and big suppliers acquire more influence over their categories in return for additional funding. The combined effect is to reduce investment in giving customers what they really want.

Cutting back on investments in the business or in customers can certainly drive short-term improvements in profitability: weaker capabilities cause a gradual erosion in performance rather than a seismic shift, and customer perceptions take time to change. All the same, these short-term gains genuinely are borrowed from the future well-being of the company. And because customer perception is always much easier to lose than to win back, the longer-term impact will be to undermine your brand equity.

The good news is that there are a number of much safer – if less obvious – tactics that can quickly boost performance and buy the time you need to carry out your long-range plans. Just as important, tackling these issues doesn't require rewriting your strategy or turning your organisation upside down.

In Trading, for instance, four key initiatives should be part of every retailer's toolkit. Each is worth at least 50 basis points to the bottom line, meaning that taken together they can transform performance. Tackling these topics is not in itself a substitute for sound long-term strategic planning, but it will ensure that you have more time to deliver your plans – and more cash to invest.

SAFE, SUSTAINABLE SOURCES OF PROFIT IMPROVEMENT

The opportunities outlined here do not harm the brand or borrow profit from the future: they do not require any reduction in the power of the customer proposition, and in many cases will actually improve it. Neither should they prove a source of major distraction for the management team, nor require fundamental changes to the long-term strategic plan. They offer very low risk improvements in profits and/or sales: *Exhibit 1* describes each in more detail, outlining what drives the value, and the financial gains available over different time periods.

Why do these opportunities exist? Because although retailers' capabilities have improved significantly over the past two decades, in most cases this has not been enough to keep pace with the increasing complexity of the business. As a result, decision making in Trading and Operations often relies upon imperfect information and an incomplete understanding of the economics, particularly where long-term customer behaviour or cross-product volume effects are concerned. In certain key areas, fixing this yields a step change improvement in financial performance, either through rebalancing investment from low-yielding to high-yielding aspects of the offer (for example, from unproductive promotions to productive ones), or through changes in the proposition which achieve higher profitability and increased customer satisfaction at the same time (for example, by matching assortment more closely to customer needs).

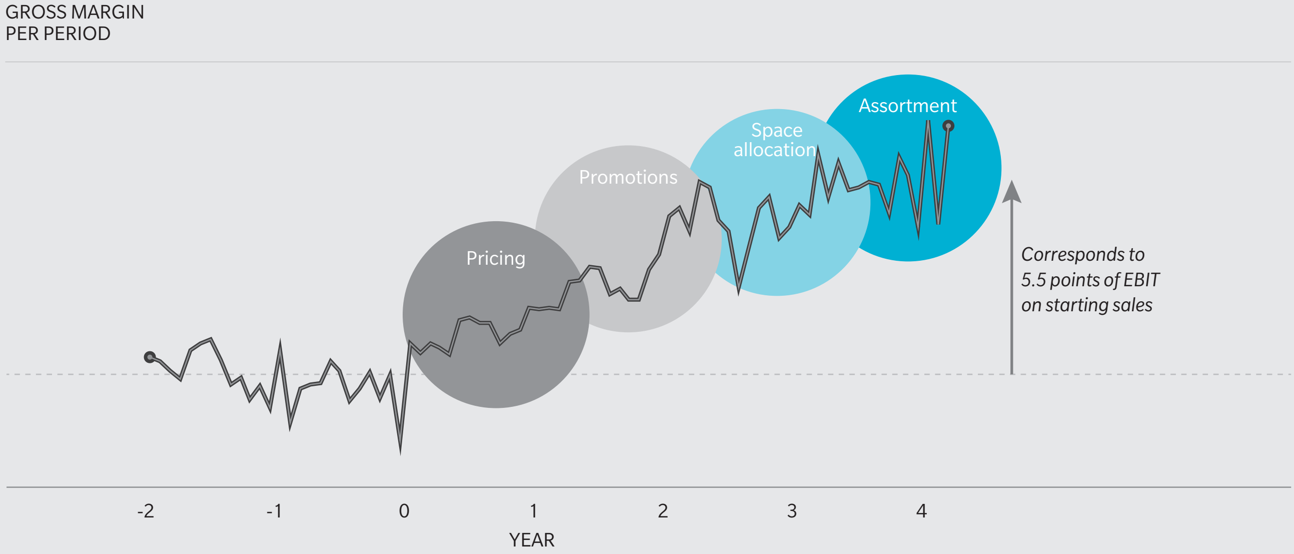
EXHIBIT 1: PROFIT IMPROVEMENT OPPORTUNITIES

OPPORTUNITY	WHERE DOES THE VALUE COME FROM?	VALUE
Rebalancing price investment across products, stores, and categories.	Understanding the trade-off between price sensitivity (elasticity) and margin in each category and store and rebalancing investment into higher-yielding categories and stores at a constant overall price position.	50-100 bpts Half after 3-6 months Full value within 12-18 months
Reconfiguring the promotional program to identify and focus on the most effective promotions.	Understanding all of the different promotional effects in detail (uplift, cannibalisation, stock-up, halo, funding) and identifying the tail of unprofitable promotions and the core of profitable promotions.	80-120 bpts Half after 6-9 months Full value after one year
Resetting space and assortment to better match the needs of customers in each store.	Understanding how each product drives incremental sales and margin by adding effective choice after cannibalisation of other products in the range and how demand variations across stores can be addressed with low complexity.	50-150 bpts Building up gradually from six months to two years
Reviewing terms with vendors to drive lower purchasing costs.	Understanding vendor term structures better; freeing decisions from reliance on vendor data; better understanding the relative economics of different vendors; developing a structured negotiation process.	50-300 bpts depending on sector Half after six months, 2/3 after one year Full value over three years

CASE STUDY – U.S. GROCER

Exhibit 2 shows how tackling a number of profit improvement opportunities in sequence can have a dramatic impact on performance. Our client, a large U.S. grocer, wanted to achieve a significant improvement in its level of profitability and sales per store. A series of different initiatives, each designed to eliminate risk to the client's long-term position, had a dramatic impact on profit per store. Over three years, profit per store increased by an amount equivalent to 5.5 points of starting sales. At the same time, sales per store increased by 12%.

EXHIBIT 2: AVERAGE GROSS MARGIN PER STORE



THE CIO AS CHIEF INNOVATION OFFICER

Chief Information Officers in retail need to deliver reliable platforms for day-to-day trading, at the same time as developing new systems that will improve financial performance. Because these objectives sometimes conflict, few retailers realise the full potential of the CIO's role: this article describes ways a retail CIO can unlock additional value for the business.

The retail CIO has two goals: to ensure 100% reliability for core systems, and to use technology to create value for the business. The checkouts and the ordering system obviously need robust IT, since failure can spell disaster. But as well as keeping day-to-day operations running smoothly, the CIO has a key role to play in building capabilities which confer a real competitive advantage. Retail is a data-rich industry, and high-quality management information is vital for improving operating efficiency, negotiating more successfully with suppliers, and getting the right assortment on the shelves at the right prices. While systems reliability is vital, then, systems innovation is the key to better performance.

THE IMPORTANCE OF INNOVATION

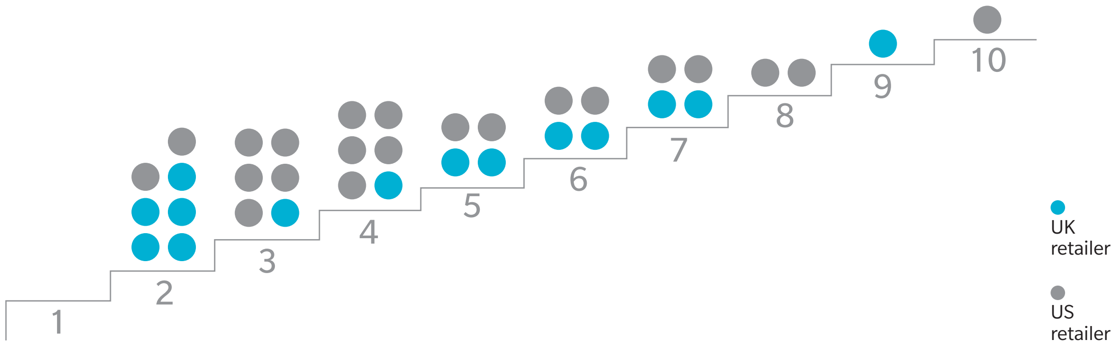
The CIO's role in building the business tends to be underestimated because the stakes seem lower than for the "traditional" aspects of the job. Since a systems failure can be hugely damaging for a retailer (to say nothing of what it might mean for a CIO's career), it's understandable that making business-critical platforms bulletproof is the top priority, with innovation and development a secondary goal. But in the long term, focusing *solely* on reliability and efficiency can be just as damaging as running the business based on shaky systems.

Fail to build robust core systems, and the cost will quickly become obvious. Fail to innovate and no-one may notice, even though this means foregoing a key source of competitive advantage, and perhaps losing out on tens of millions of dollars in earnings growth. The slim profit margins in retail make continuous capability improvement essential: a small performance advantage can fuel a virtuous circle, allowing a retailer to invest and re-invest in its proposition, and to keep offering customers more. Ultimately, then, *improving* the business is just as important as running it smoothly from day to day.

EXHIBIT 1: PROMOTIONS "CAPABILITY STAIRCASE" AND THE ROLE OF IT

We recently interviewed over thirty major retailers in the UK and US, and compared their approaches to running many aspects of merchandising and operations. We found clear differences in level of sophistication, and also a wide variation in financial performance.

Below is an example of one of the outputs from this process, a 'capability staircase' for managing promotions. Basic capabilities are described on the left, while advanced capabilities are further up the staircase to the right; the IT systems typically required to support different levels of capability are described below. The dots represent the positions of the retailers we talked to in the study. In our experience, moving from the bottom steps of the staircase to the top can be worth as much as +2–3% EBIT, and +3–5% comparable store sales growth.



DESCRIPTION	• Economics not fully understood – Basic quantification of direct uplift – Brand switching, impact on total footfall, stockpiling unmeasured • Mainly cycle last year's programme, many offers vendor led • Promotion planning process disorganised, with limited "wash up"	• Economics fully understood • Buyer decision support tool to aid planning, negotiation • Reporting in place to increase transparency and oversight – but limited joined up thinking between promotions and other levers – Forecasting often an issue	• Promotions managed as part of overall category strategy • Deliberate differential investment across categories and offer types (portfolio approach), linked to pricing and other levers • Advance planning ensuring buys are appropriate, and strong negotiation with vendors
IT ASPECTS	• Systems typically not "joined up" • Management information systems are rudimentary – "20th century technology" • "Fog of war" makes it difficult to know true competitive position, and retailer often relies upon vendors for customer insights • Lack of agility restricts response to competitors' initiatives	• Better integration between systems • Reliant on "off-the-shelf" platforms – which don't always meet the retailer's needs perfectly – or expensive, often outdated systems developed in house • "Waiting for the new system" is often a barrier to progress • Partial picture of the competitive battlefield – vendors usually have the upper hand where data is concerned	• Fully integrated suite of management reporting tools, appropriately combining off-the-shelf and bespoke systems • Agile development program, with a prototyping approach that means new systems are rolled immediately when they are ready – but no sooner • Richness of customer and sales data puts retailer on an even (or better) footing with sophisticated FMCG manufacturers

Sales promotions give a good illustration of how better capabilities enable better performance, but also require better systems. Retailers with more attractive, more cost-effective promotions programs outperform their rivals: earnings can be as much as two full percentage points higher, with stronger sales growth besides. *Exhibit 1* illustrates the importance of technology in driving improvements in promotional effectiveness. It shows a "capability staircase" for managing promotions, describing increasing levels of sophistication from left to right, and highlighting how more advanced capabilities rely upon better and more flexible IT.

Like many other aspects of retail, promotions are a complex activity, and readily-accessible, high-quality information is essential for managing them. For example, setting the right strategy relies on knowing the true financial impact of each promotion. This requires accurate measurement of how every promotion affects sales volumes across the rest of the store (not just for the product being promoted), and understanding how much of the cost of the promotion is genuinely being covered by suppliers.

Information must therefore be gathered from an array of separate systems designed for different purposes; it needs to be analysed based on a sound understanding of the underlying economics; and the results need to be presented to decision makers (in this case, category managers or buyers) in a clear and accessible format. Even the best, most robust systems designed for "business as usual" will not deliver this: in our experience, it always takes more sophisticated management reporting tools, tailored to the individual retailer's needs and based on a full understanding of the economics.

Promotions aren't the only area in which superior financial performance requires better management information, and there are plenty of other examples in merchandising and operations. Designing the best possible catalogue of products; making the right local assortment decisions; negotiating effectively with suppliers; maintaining competitive prices; effective forecasting and ordering; tight labour scheduling in the stores – all have significant implications for profitability, and all rely upon well-designed, high-quality systems. The CIO therefore has a central part to play in driving continuous improvement, and ensuring the long-term success of the business.

DELIVERING VALUE AS A CIO

But few retailers realise the full potential of the CIO's role. The biggest obstacle is a cultural one: in many retailers, IT managers are not heavily involved in business decisions, and are confined to a role in which they merely provide a service. In our experience, the CIOs who are most closely engaged with the business create the most value for the business – and they tend to have three things in common:

- They ensure IT is an enabler of change, rather than a barrier
- They understand the economics of the business, and ensure IT is "more than just a service"
- They recognise that different areas of IT require different approaches

The rest of this article discusses each of these in turn.

IT has huge potential as an enabler of change, but it's more commonly viewed as a constraint, something which limits options and slows progress. In our experience, this is usually because communication between IT and the rest of the organisation tends to be poor. A lack of clear dialogue, particularly during the early stages in the development process, means that what the business thinks it will get is rarely well aligned with what the IT department is intending to build: disappointment with the end result is almost inevitable.

The CIO can help address this by making full engagement with the business *the* top priority during any major project. IT professionals often have only a partial understanding of day-to-day working practices in merchandising and operations, of how well existing management information systems perform, and of what those "at the coal face" would most like to see improved. Deepening this understanding by working much more closely with the business makes a big difference to the end result – and greater engagement itself breeds greater trust, and a more open dialogue when addressing teething troubles later on. A CIO knows they've succeeded when the organisation asks "how can IT help us solve this problem?", rather than "how can we solve the problems IT causes us?".

At the same time, those in the business rarely take as much as interest as they should during the early stages of an IT project. For the CIO, the challenge is to get their full attention, forcing them to engage in serious discussion. This is easier said than done, but straight talk about what is at stake and dogged persistence can still go a long way. One thing to note in this context: it's important to make appropriate allowance for differences in "tech literacy". Something that is clear and straightforward for those from an IT background may be unintelligible to others, and as a result, IT professionals often have false confidence about how much everyone else understands. While it's difficult to ensure that everyone is speaking the same language, the CIO needs to provide the leaders of the business with the translation they need.

Beyond this, the best CIOs understand the economics of the business**.** When setting the development agenda, the CIO is uniquely positioned to understand the costs and benefits of different possible systems solutions. The CIO should therefore shape and guide the debate over systems development projects, and not simply try to deliver whatever the business asks for. To this end, the IT department needs to perform an "internal consulting" role, committed to understanding what different systems solutions will really mean for the way people work, and what value is at stake. Other senior executives have at best a partial knowledge of IT, and as a result the system the business *thinks* it wants is rarely the one it really needs, and many large-scale IT initiatives are ill-conceived from the start. CIOs tend to come from a different background than other senior executives – but the expertise of the best CIOs always stretches far beyond IT, and includes a deep understanding of what it takes to run a successful retailer.

Based on this understanding, the best CIOs recognise that different areas of retail IT require different approaches. Delivering high performance systems in a cost effective way means deploying resources where they will deliver most value. A big part of this is devising the most appropriate mix of "bought" and "built" solutions, and understanding which functions are suited to outsourcing and which aren't.

In recent years, many retailers have relied heavily on off-the-shelf solutions, and there has also been a trend towards more outsourcing. Both can generate cost savings, but they also mean passing up opportunities to turn systems into a source of competitive advantage, since competitors will have similar platforms. For some businesses – for example, retailers whose formats rely on a simplified, low-cost business model and a streamlined product range – this may be the best strategy to pursue. But for most retailers in mature markets, better management information can provide a significant edge, as described earlier.

The key is to identify areas in which bespoke, best-in-class systems will provide a real competitive advantage, and those in which "plain vanilla" systems can deliver satisfactory performance at minimum cost. Regardless of prevailing trend in systems buying and outsourcing, every decision needs to be evaluated on its own merits, recognising that the right answer will be different in different areas of the business.

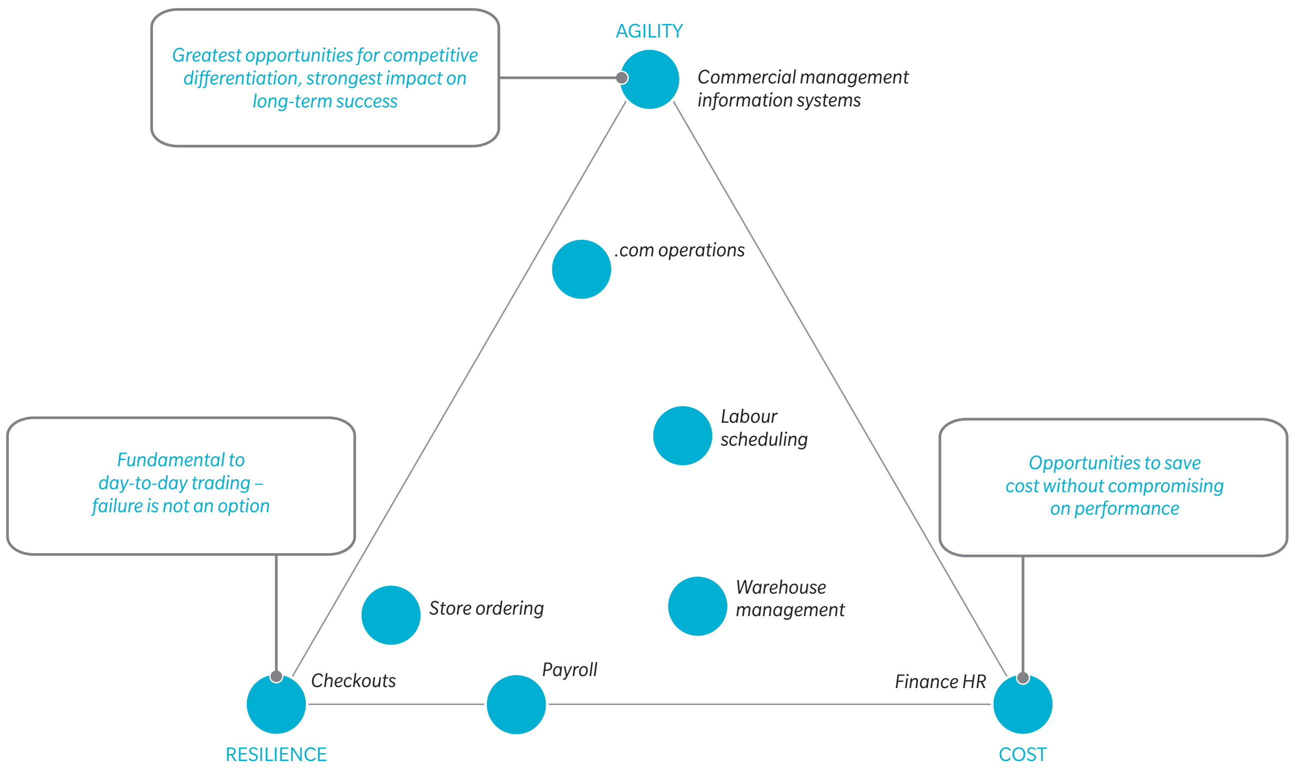
In our view, there are essentially three competing priorities when setting IT development strategy: resilience, agility, and cost. The relative importance of the three varies across areas of the business: in some areas, robustness and reliability is everything, whereas in others there is room for innovation to deliver real competitive advantage. Meanwhile, certain systems are critical to day-to-day financial performance, whereas others are not, with implications for how much it's worth spending in each case. Overall, these differences in priorities mean that the right approach in one area may not be the right approach in another. *Exhibit 2* gives a schematic picture of how they tend to vary across different areas of retail IT.

CONCLUDING REMARKS

Retail is a particularly data-rich sector, and its slim margins mean the right systems really can make the difference between success and failure. The retail CIO has a key part to play not merely in ensuring smooth day-to-day operations, but also in driving improvements in performance – and ultimately, in finding new sources of competitive advantage.

To overcome the cultural barriers that typically exist, and to become a full participant in key business decisions, the CIO needs to see themselves as not merely "providing a service" but instead "delivering value". This means engaging with the business much more closely; developing a rich understanding of its economics; and pursuing a flexible, dynamic approach to systems development, to give the business what it needs in the most cost-effective way. Those CIOs who do this are a powerful force for innovation, and are central to the long-term success of their business.

EXHIBIT 2: DIFFERENT RETAIL IT SYSTEMS HAVE DIFFERENT PRIORITIES




save 50¢
save $1.
50¢
COUPON
save $1
SAVE $2.00
$1.00 Save
Save $1.00
COUPON
COUPON
Save 50¢
$2
save $1.00
$0.50
save $1
$2
save $1
COUPON
COUPON
save $1
save $5
COUPON
save $1
$2.00
$2.00
50¢
$1.00
COUPON
COUPON
Save $2.00
save

PROMOTIONS ON TRIAL: ARE THEY WORTH THE TROUBLE?

Many retailers invest heavily in promotions. It's not unusual for a grocer to give away 5-10% of revenue through promotional discounts, and the economic slowdown of the past two years has seen this figure creep steadily upwards. Retailers now find themselves in a difficult position – they suspect that promotions hurt the bottom line and generate a lot of extra work for the organisation, but the need to preserve sales volume makes them wary of cutting back.

So are promotions worth the trouble?

THE CASE AGAINST PROMOTIONS

Here's the bad news: promotions tend to be even less profitable than most retailers realise. Despite being one of the main tools for managing short-term sales performance, they account for much less incremental volume than first appears. It is common to underestimate the extent to which promoted products cannibalise other items, or encourage stockpiling by customers: analysis of this behaviour shows that the economics are a lot worse than is generally acknowledged.

Exhibit 1 illustrates the difference between a typical view of the economics of promotions, and the true picture once all volume effects are accounted for. In this example, the true revenue increase from the promotions programme was only about one-sixth of what it first appeared to be, and the true profit benefit only around one-third. In our experience this is not unusual: when we look at promotions on a case-by-case basis, somewhere between 30% and 60% of them turn out to be unprofitable.

It's worth noting that this analysis assumes all promotional funding is genuinely tied to running promotions. In practice, we often find that funding from a particular supplier can be redirected to support its products in other ways, such as through lower everyday prices.

In addition to frequent poor financial performance, promotions create a lot of additional work for businesses They disrupt the supply chain, require extra labour in store, and complicate the relationship with suppliers, making it much trickier to calculate the true cost of each product. They can sometimes force buyers to take a short term, reactive view by creating pressure to match competitor activity or last year's sales performance. Promotions can also generate a lot of friction within the organisation, for example between merchandising and operations teams, and between different banners in businesses with multiple formats.

THE CASE FOR PROMOTIONS

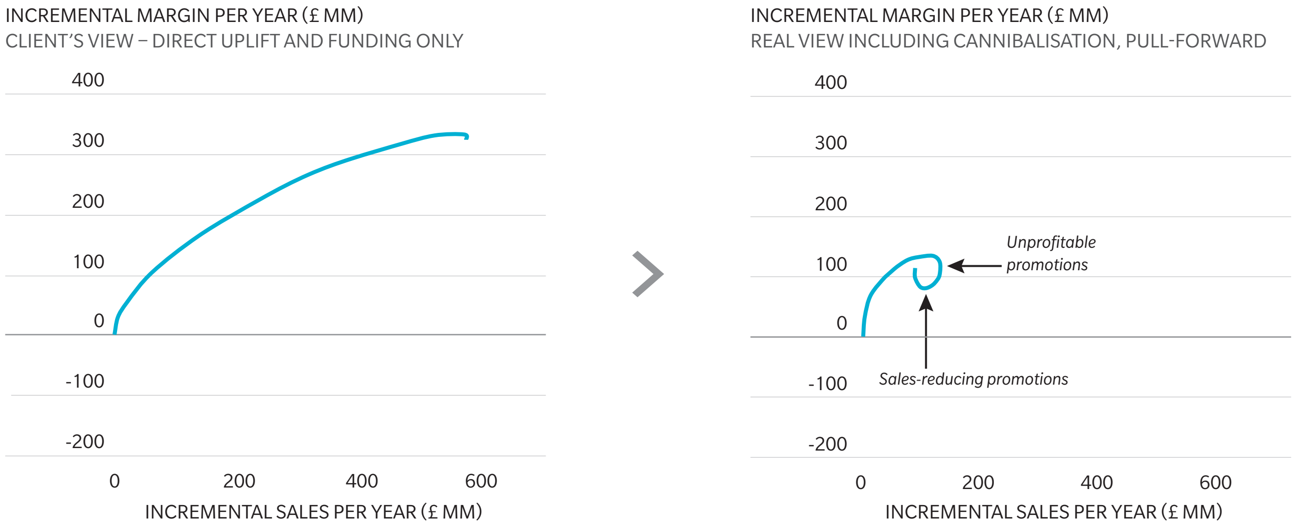
If promotions often perform badly, and generate a lot of disruption, should retailers give up on them completely? Not necessarily.

First, some promotions' financial performance certainly justifies the hassle of running them. Promotions that are well funded by suppliers, feature the right products with the right promotional mechanism, and have an appropriate level of discount, make sound financial sense.

Second, retailers are right to fear the volume losses that deep cuts to the promotions programme will cause. High fixed costs make it vital to continue driving volume through the store. Even more importantly, lost volume is usually handed to competitors, enabling them to run their own operations more efficiently. Third, there is an identifiable – and large – segment of customers who actively seek out promotions.

EXHIBIT 1: THE TRUE ECONOMICS OF PROMOTIONS

CUMULATIVE IMPACT – PROMOTIONS RANKED IN DECREASING ORDER OF EFFECTIVENESS



It appeared that all promotions were profitable…

…but in fact, many promotions were unprofitable, and some reduced sales as well

An everyday low price (EDLP) strategy represents the clearest way of communicating 'great value', and can work well if a retailer is only targeting value-sensitive customers. But many retailers are trying to capture as much trade as possible from the area around their store, which means appealing to many different types of customer, and this need may outweigh the extra complexity that promotions generate.

Finally, promotions can be a valuable tool for marketing purposes. A well-designed set of deep-discount offers can provide a clear message for use in store or for advertising campaigns. In most retail sectors, there are few other ways of creating comparable 'news' or excitement to attract new customers.

OUR VERDICT – AND THE SOLUTION

Some promotions are worth the trouble – but plenty are not. Given the high levels of promotional activity in the market today, many retailers would benefit from reductions in promotions, as long as they can adjust the mix of activity to preserve volume. In most cases, the aim should be to do a little more of what works, a lot less of what doesn't, and at the same time to adopt a more forward-looking, efficient approach to managing promotions. In our view, there are three requirements for making sure promotions are worth the trouble:

1. Understand how customers really behave.
   To know which promotions work and which don't, a retailer needs to understand how customers respond to them. It is vital to measure how much of the volume generated by promotions is truly incremental, and how much is merely cannibalised from other products on the same shelf, or pulled forward as customers stockpile non-perishable products. Store-switching behaviour and differences in customer profitability are another major influence on the economics of promotions. Ultimately, a retailer needs to systematically measure and analyse the customer behaviour that determines promotional effectiveness, and reshape its promotions programme accordingly.

2. Understand supplier objectives.
   If a supplier's 'promotional' funding can be used to drive additional volume in other ways, the true economics of its promotions will often be unfavourable: with this in mind, it is important to understand what each supplier's promotional strategy seeks to achieve. A retailer's private label manufacturers can provide useful information on production costs, allowing a retailer to calculate its suppliers' economics – and thereby to infer which promotions truly are 'fully funded', and which aren't.

3. Bring the promotions programme under tighter control.
   Retailers should take careful stock of how much time and effort is being spent on running promotions, and strive to reduce it. Though it might sound straightforward, minimising the trouble promotions cause often entails a major change in approach: planning in batch, well ahead of time, and based on the retailer's agenda, not its suppliers'. In addition, the cost and disruption which promotions generate for store operations and the supply chain need to be fully understood, accounted for, then minimised through better coordination with merchandising. Ultimately, retailers control promotions – not the other way round.

NEGOTIATING WITH SUPPLIERS FROM A POSITION OF STRENGTH

Suppliers have a natural informational advantage when it comes to understanding and exploiting rising raw material costs to push through increases in product prices. Retailers often feel they lack the arguments they need to counter supplier demands – but some have developed the capability to fight back.

Commodities markets have been volatile in recent years. Retailers are being confronted with scores of cost increase demands from their suppliers – while the ability to pass these increases on to the consumer remains as limited as ever. In addressing this challenge, retailers need to ask themselves a few important questions:

Does your supplier's argument really make sense or is he hiding something? Is your supplier saying different things to different people, for example reporting EBIT improvements to the investor community due to input cost savings while at the same time asking you for more money? Are the cost increase demands actually in line with the importance of the raw material as a proportion of total product cost?

The exhibits show just one example of how better information and some homework can help fend off or mitigate unjustified price increases. Given the increased volatility of many commodities markets, retailers must do everything they can to gain an edge in commodity-related negotiations. While this does mean extra analysis, it does not require investment or increases in headcount. In our experience, four things suffice to get the job done:

- Access to up to date and comprehensive raw material information, centralised in a company data base.
- An analysis of the most important commodities per supplier and category and an estimate of product cost structures.
- Automated calculation of list-price development over time, normalised for mix and other relevant effects.
- A software tool with an easy to use-interface that allows buyers to view and integrate supplier and cost information.

FENDING OFF A LIST COST DEMAND

OLIVER WYMAN RETAIL NEGOTIATION TOOL

EXHIBIT 1: PAPER PRODUCT SUPPLIER DEMANDS A PRICE INCREASE OF 10% BASED ON SOARING PULP COST

PULP COST

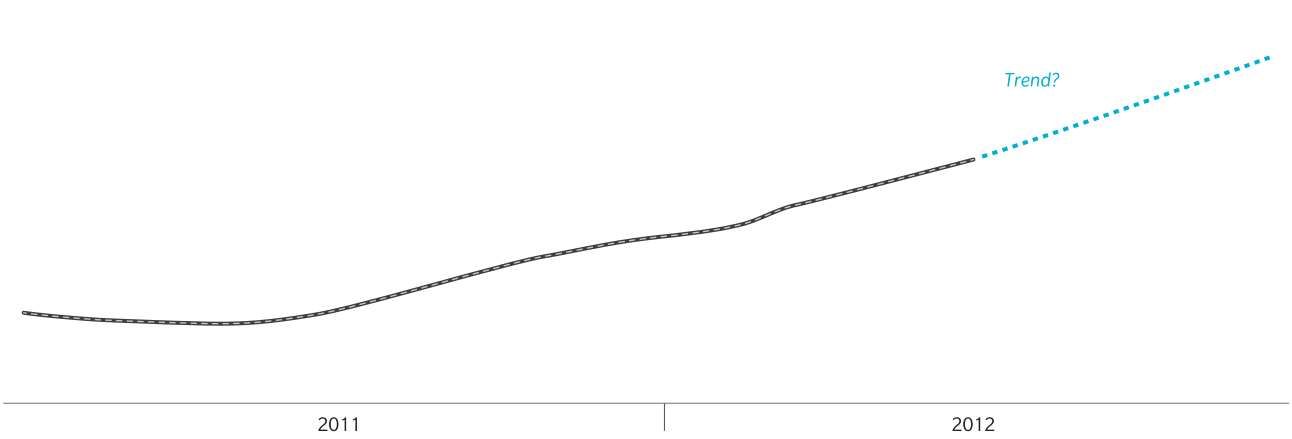
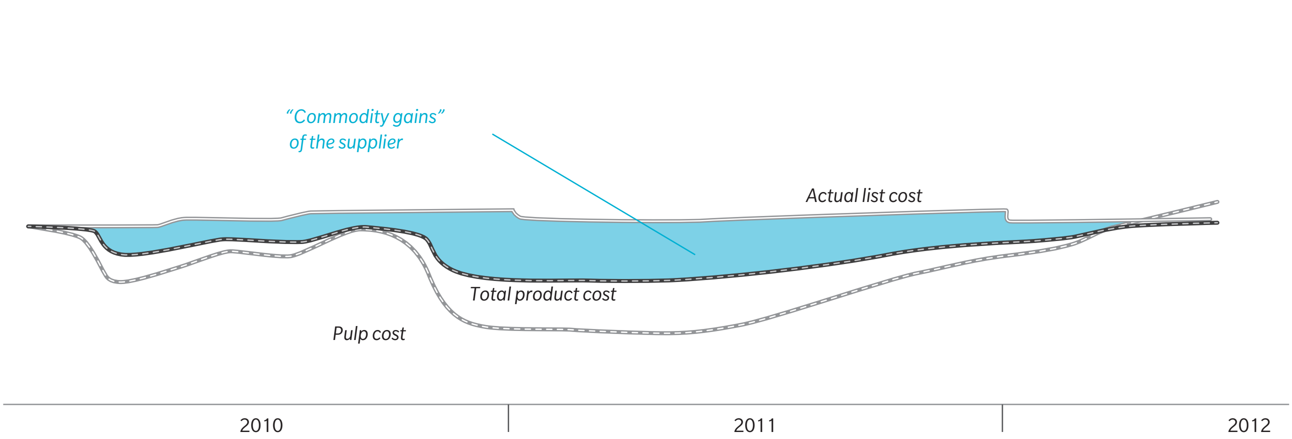


EXHIBIT 2: RETAILER REPLY: SUPPLIER OWES THE RETAILER MONEY
PULP IS ONLY A PORTION OF TOTAL PRODUCT COST AND IN THE LAST QUARTER PULP HAS REVERTED TO HISTORIC LEVELS FOLLOWING AN EXTENDED DOWNTURN

INDEX†



† Index: **Last commodity-driven list cost change as starting point (beginning of 2008)**

MAKING CATEGORY MANAGEMENT WORK

Category Management was supposed to transform trading departments from procurement specialists into customer-focused managers of strategic business units. But for most retailers, this hasn't happened: while job titles have changed, the fundamentals of the role – and the expectations and support provided – have stayed much the same. A few retailers are capitalising on the promise of Category Management by redesigning how their trading organisations work. This means not only having the right talent, but also the right tools and job design.

"Category Management" sounds like a straightforward idea: retailers should manage each product category for maximum customer appeal. A Category Manager should be a general manager of a business unit, not just a buyer looking to procure product. Rather than focusing only on wringing the lowest costs out of suppliers, trading departments should develop the best possible customer proposition, with competitive pricing, attractive promotions, relevant assortments, and appealing visual merchandising.

But when we talk to retailers, they tell us that putting this into practice has proven difficult. Trading departments have a longer list of responsibilities, but most buyers still spend their time dealing with the same tasks they faced a decade ago. Although changing job titles is easy, changing the way people work is much harder; and in many cases, implementing "Category Management" has meant giving the trading department responsibility without power.

The obstacles that must be overcome for Category Management to deliver on its promise fall into three categories:

Time: Category Managers must be able to dedicate enough time to being Category Managers.

Information: Category Managers need the right information for making decisions.

Skills: Category Managers cannot be expected to be experts in everything. They need to be supported by a small number of specialists with deep expertise in specific areas.

This paper describes these challenges in more detail, and suggests ways a retailer can ensure Category Management delivers on its promise.

TIME FOR CATEGORY MANAGEMENT

The first problem Category Managers complain about is lack of time – they just don't have the time to manage their categories, because the old work of buying never goes away. Category Managers must still deal with the same activities as in the past: placing orders, meeting suppliers, addressing problems highlighted by the stores, writing ads, and so on. Adding a new set of responsibilities won't work if there aren't enough hours to deal with them.

When overburdened with tasks, most people tend to focus on today's immediate concerns, and neglect the challenges of tomorrow. Since many of the "new" responsibilities associated with Category Management are strategic in nature and involve longer timescales, they tend to take second place to pressing day-to-day tasks unless Category Managers have additional resources to address them. It's worth noting in this context that the financial stakes for the strategic aspects of the Category Manager's role are in fact very high – but missed opportunities to drive sales and profit are less conspicuous than gaps on the shelves.

Exhibit 1 illustrates this problem. Across this group of retailers, category managers spend most of their time on administrative tasks and short-term crisis management, leaving little for setting strategy or long-term planning. The implication is clear: overstretched Category Managers are effectively just Buyers with a different job title. If your Category Managers are spending all their time on 'traditional' buying activities, then you probably need to hire some more Buyers.

BETTER INFORMATION EQUALS BETTER DECISIONS

Category Managers also tell us they find it hard to get hold of the information they need. Individual categories have hundreds of SKUs, so it's far from straightforward to figure out what product assortment, promotional program, or price architecture will deliver maximum customer appeal and the best possible financial performance. The massive advances in data collection and storage over the past decade mask an unfortunate truth: most retailers are data-rich, but insight-poor. Although a wealth of information is, in theory, available, gathering it often requires a long and difficult journey through different systems. So Category Managers rarely have the right tools to support decision making. Lacking good management information, some rely upon suppliers to provide customer insights. Besides the risk of allowing these suppliers undue influence over category strategy, this has another drawback: suppliers don't provide the information retailers really need. For example, data on customer segments and brand loyalty can shed light upon why customers switch between products on the same shelf (which is what suppliers care about), but is less helpful for understanding why they switch between stores (which is what retailers care about).

EXHIBIT 1: HOW A CATEGORY MANAGER SPENT THE WEEK – A REPRESENTATIVE EXAMPLE

	MONDAY	TUESDAY	WEDNESDAY	THURSDAY	FRIDAY
08:00	Data entry	Reviewing competitor activities	Preparing for supplier negotiations	Internal meeting – recent performance	Planning promotions
09:00	Analysing past week performance	Preparing presentation on past week performance		Supplier presentation	Running down and fixing bad cost data
10:00	Requesting reports	Supplier call		Internal meeting – pricing	Approving buys
11:00	Reviewing competitor activities	Data entry and validation	Internal conference call – distribution issues	Internal meeting – promo planning	Supplier meeting
12:00					
01:00	Staff meeting	Supplier call	Supplier meeting	Internal meeting – store fixtures	Supplier meeting
02:00		Supplier call	Supplier meeting	Supplier meeting	Internal meeting – promotions
03:00		Internal meeting	Handling e-mail	Handling e-mail	Internal meeting – pricing
04:00	Revising activity plan	Supplier meeting	Internal meeting – store fixtures	Reviewing deal sheets and pricing	Internal meeting – store issue

Execution Review Long term planning

HOW CATEGORY MANAGERS SPEND THEIR TIME

Senior trading executives are often shocked when they see how Category Managers actually spend their time. The sheer amount of administrative work – entering data, managing prices and ads, handling replenishment – squeezes out any time to think about the category strategy and how to drive sustained performance improvement. Meetings with suppliers take up vastly more time than preparing for such meetings – a big issue when tens of basis points of margin are at stake every time a Category Manager talks to a supplier. And this issue is not confined to a single geography or type of retailer. Oliver Wyman has seen the same pattern in our work with every type of retailer, from grocer to category killer, in half a dozen countries.

Over the past decade, many retailers have launched ambitious systems projects aimed at reducing their reliance on inadequate or incomplete data. But the long lead time these involve can be a problem in itself, if major decisions are put on hold while everyone 'waits for the new system.' More importantly, though, when the new system is in place, it often turns out not to deliver exactly what the Category Managers need. Good decision making typically requires many different items of data from different sources – if one piece of the jigsaw is missing, Category Managers are reliant on guesswork. The solution is to provide comprehensive information and insights specifically tailored to the decisions that need to be made.

Category Managers need industrialised, instantaneous reporting tools, but detailed data and in-depth analysis aren't enough – information needs to be presented in a clean and straightforward way, and needs to be easily replicated at the different levels Category Managers need (by brand, pack size, sub segment, store cluster, and so on). Data need to be presented in ways to enable commercial decision making. For example, for supplier negotiations, data on supplier performance should be presented in a comparative fashion – to enable the easy identification of strongly and less strongly performing suppliers. Finally, tools need to go beyond just presenting data. In promotions for example, category managers typically need an intelligent planning tool which enables them to predict the performance of potential promotions before they are run.

SKILLS: THE NEED FOR SPECIALISED SUPPORT

The final challenge is that Category Management draws on a broad range of skills. Senior management rarely acknowledges just how broad, and rarely provides the buying teams with the specialised resources they require. Even if Category Managers had more time and better information, they would still face the daunting challenge of being not just a "jack of all trades", but an effective expert in diverse areas – from understanding and shaping customer tastes and preferences, to building budgets, to managing sensitive levers such as price and promotions.

Add in the ever growing complexity facing retailers, and the challenge is greater still. Customer propositions span a wide range of banners and geographies, and offerings must be tailored to smaller and more focused markets. Managing this complexity requires an understanding of local demand (differential assortment based on affluence, ethnicity, and so on) and local competition (differential pricing by category depending on competitors and their overlap to the offering). Strong analytical skills and strategic insight are essential – but the typical retail talent model, with its emphasis on promotion through the ranks, does not always foster these.

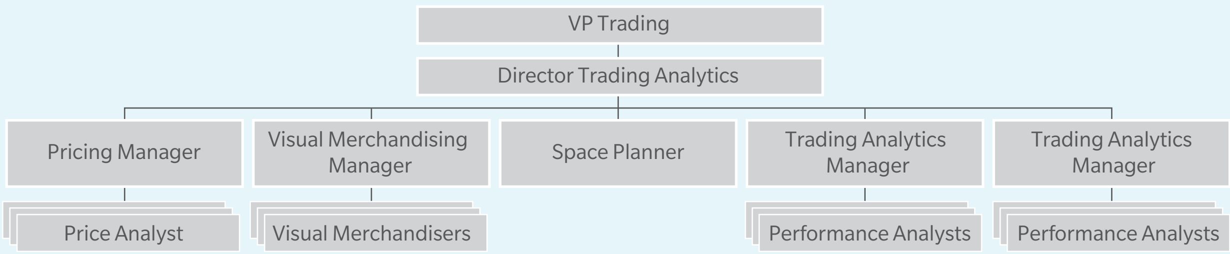
Part of the answer is to create specialised, centralised teams to provide advice and support, while final decisions remain with the Category Manager. This frees up time for Category Managers to think strategically about managing their business, rather than spending countless hours pulling together data and crunching numbers. In addition, specialist support groups can help develop and support the customised management information tools described in the previous section, and can standardise, simplify and improve the approach to category management across the business. Two example configurations are shown in *Exhibit 2*.

EXHIBIT 2: PROVIDING SPECIALIST SUPPORT FOR CATEGORY MANAGEMENT – TWO JOURNEYS

European National Retailer

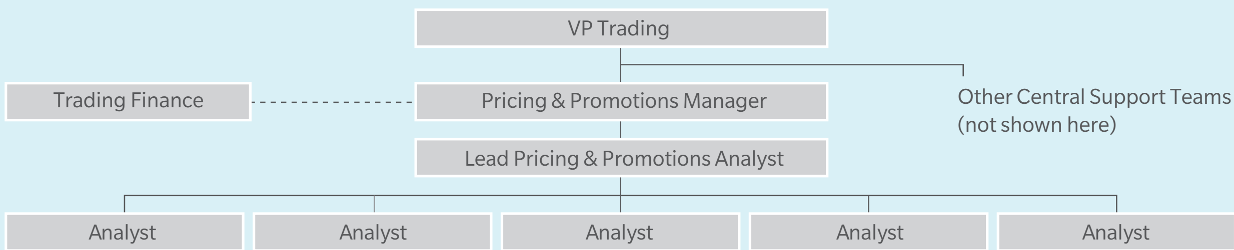
POINT OF DEPARTURE FOR THE JOURNEY	APPROACH	SUSTAINING THE RESULT
Historically strong results, but recent steep performance decline. Organisation resistant to change – even the word “change” had become negatively charged.	Incremental approach to change. Narrow but highly visible capability upgrades at first. Early quick wins generated trust and ‘pull’ from the organisation. Broader capability building later in the programme.	Established a Specialist Support Team for each of the major trading levers: Pricing and Promotions, Assortment, Supplier Management, etc. Each team is composed of a mix of trading and finance personnel, with responsibility for providing expert advice to Category Managers – but decision rights and responsibility for results remain with Category Managers.

EXAMPLE: THE PRICING & PROMOTIONS SPECIALIST SUPPORT GROUP



North American Regional Retailer

POINT OF DEPARTURE FOR THE JOURNEY	APPROACH	SUSTAINING THE RESULT
Strong performance but increasing competitive intensity. Recognition throughout the organisation that current capabilities were not sufficient.	Used a major pivot point – significant restructuring of the assortment and attending supplier negotiations – to drive home the new for better capabilities and tools. Senior management set very aggressive goals and provided CMs with the tools they needed to achieve them, including dramatically scaling back low value administrative work that had accumulated over the years.	Category Manager job descriptions revised to focus on longer term planning, with administrative tasks pushed down to clericals. Established the first category-level budgets to provide a framework for CMs to sign up for the performance they wanted to deliver, and be held accountable. Created a new group within Trading to provide comprehensive support to Category Managers on pricing, promotions planning, supplier management and visual merchandising. The central support group was lean and scale-appropriate but staffed with individuals who understand the merchants’ jobs and had the tools to support them effectively.



Even with specialist support, to expect the Buyers of yesterday to transform themselves into the Category Managers of tomorrow is asking a lot, because although a few may have the skills required, most do not. Diversifying the talent model can greatly improve the odds of making Category Management a success: the key is to make the best possible use of people with different backgrounds and skill sets, and ensure a diversity of experience by combining internal 'through the ranks' promotions with external hires. It is also important to recognise that not everyone in the trading department will have the skills to be a great Category Manager, even if they were very effective as a buyer. True category management will always be a demanding role: the focus should therefore be on finding the right people for it.

CONCLUDING REMARKS

So far, Category Management has rarely lived up to its potential to deliver both a more powerful customer proposition and better economics – mostly because the challenges it presents have been underestimated. Viewing it as an evolution from the existing business model has in many cases prevented it from becoming the revolution it promised to be.
On the other hand, retailers who have relied on systems solutions to deliver Category Management have also ended up disappointed. The solution lies in acknowledging that Category Management represents a fundamentally different approach to trading, and that the increased complexity of the role requires a new organisational structure, along with new systems and resources. Building these capabilities is a challenge in itself – but it can also bring significant financial benefits, and provide a decisive edge in a competitive marketplace.

ADVANCED CATEGORY MANAGEMENT

Many retailers are less than satisfied with their category management practices. In an increasingly tough retail environment, weaknesses in such a core process are a serious handicap to a retailer's ability to be responsive to changing circumstances and to maintain sales growth and profitability. Oliver Wyman's in-depth interviews with the largest retailers in the UK and North America reveal that a few are setting a new standard in category management, helping them to overcome these challenges. Creating a more effective category management system requires more disciplined and streamlined processes, a culture of analysis supported by the right tools, and an organisational model that supports category managers with the right expertise.

Retailers vary widely in how they approach their core category management process, and in the outcomes that they see. In our work with many retailers over the years, we have observed that there are a few leaders that do things very differently to the average retailer, with much better results. Fascinated by the wide variation in category management practices, we sought to analyse and quantify these differences and to answer the following questions:

- What are the most significant differences between the various approaches retailers use? Are these differences unique to the individual retailer or do they form part of a more general pattern?
- How important a role do these differences play in driving the success of the retailer?
- What can we learn from how the leading practitioners carry out category management?
- What are the implications for those firms that are not leaders? How should they set about upgrading their category management capabilities?

SURVEY APPROACH

To answer these questions, we interviewed category managers from over 30 of the largest UK and North American retailers, including grocers, category killers, apparel chains, home improvement chains, department stores, and convenience stores. Our survey had four areas of focus:

- How retailers manage their overall category management processes, as well as how they manage each trading lever (their approach to pricing, promotions, assortment, etc.).
- The organisational, cultural, and behavioural context within which the category management process operates.
- The degree to which the category management process is delivering high-quality and timely outcomes, and whether this is driving the overall success of the business.
- The daily experience of the category managers and whether these processes enhance or diminish their job satisfaction.

The Oliver Wyman Category Management Study (please contact us for a copy) describes the detailed findings from our interviews. It covers many aspects of the category management process (data and systems, organisational structures and talent models, and process controls) as well as the approaches that different retailers take to managing each of the main trading levers (pricing, promotions and mark-downs, assortment and space allocation, private-label management, and supplier management).

For each area, we describe the approach taken by a retailer with a relatively advanced capability and contrast it with the approach taken by a retailer with a more basic capability. We also score each of our interview subjects on a ten-point scale. This report brings to life the detailed differences in approach between the leaders and the rest. *Exhibit 1* shows an example of the output from the study.

While the emphasis of the Category Management Study is on the detail of how each part of the process and each trading lever is managed, this article draws out the broader lessons. We discuss some of the less obvious structural differences that allow a small number of retailers to stand out from the crowd.

KEY FINDINGS

Four main themes emerge from the study: first, category managers report a wide sense of frustration with their present processes; second, retailers show widely varying capabilities in category management; third, the level of sophistication of any individual retailer is fairly consistent across all its trading levers; fourth, greater sophistication drives greater profitability.

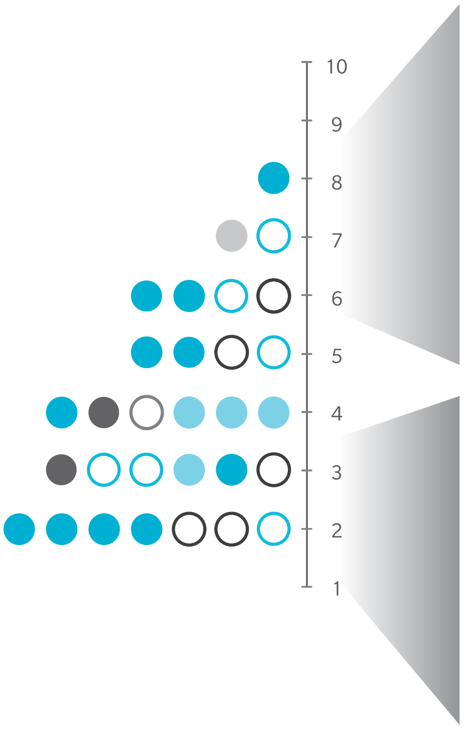
A WIDE SENSE OF FRUSTRATION

In many of our interviews, category managers communicated a palpable sense of frustration. In particular, many found their category management processes time-consuming and tedious, with too much emphasis on template-filling and data gathering. There were three common complaints:

First, many category managers feel they get little guidance from senior management about how their categories fit with the overall business strategy. The guidance they do receive suffers from being poorly communicated, poorly linked into their key performance indicators (KPIs), and insufficiently actionable.

Second, the category management processes don't allow enough time for them to think strategically about their categories. The work involved in gathering data, filling in templates, and working through the process delays any strategising until the very end. In fact, many managers feel their category management processes actually interfere with their ability to think strategically about the businesses they run.

EXHIBIT 1: CAPABILITY SCORECARD – PROMOTIONS EXAMPLE



Relatively advanced capabilities

- Promotional analysis is done by a separate group
  - Full understanding of customer effects of promotions, including lift, switching, stockpiling, traffic and perceptual impacts
  - Ability to forecast expected incremental sales and margin contributions
  - Scenario modeling for discount optimisation
- Promotional strategy is viewed as part of the overall category strategy
  - The company's overall strategic direction is a key driver of the promotions planning process
  - Promotions are viewed as one element of a total customer value proposition
  - Supplier funding does not drive promotional decisions
- Planning is done well in advance, ensuring that buys are appropriate

Basic capabilities

- Promotion performance economics are incomplete, based mainly on item sales uplift
- Critical effects of promotions, such as brand switching, impact on total footfall, and stockpiling, often go unmeasured
- Promotional decisions are not customer-driven
  - Heavy focus on repeats of previous promotions to ensure comparable sales spikes
  - Vendors often drive promotional programmes by offering funding
- Promotional planning process is disorganised
  - Feature space allocated quarterly by category, but subject to constant shifts
  - Last-minute changes in strategy lead to accumulation of unnecessary inventory

Mass merchant | Category killers | Apparel | Convenience
Grocery | Home improvement | Department

Source: Oliver Wyman Category Management Study

Third, category managers feel they do not have the high-quality support they need to help them generate high-quality outcomes. In many cases, they rely on vendors to provide them with data – and often this data is of dubious quality and objectivity.

WIDELY VARYING CAPABILITIES

The companies we surveyed show a wide range of capabilities. For each element of category management, we think of these varying levels of capability as part of an overall "capability staircase", with the higher steps representing more sophisticated approaches.

Most of the retailers we surveyed are still on the lower steps of this staircase and have relatively weak category management capabilities (*Exhibit 2*). Only a very few stand out from the crowd. They have built a significant and hard-to-close advantage over competitors, and are setting a new standard in category management.

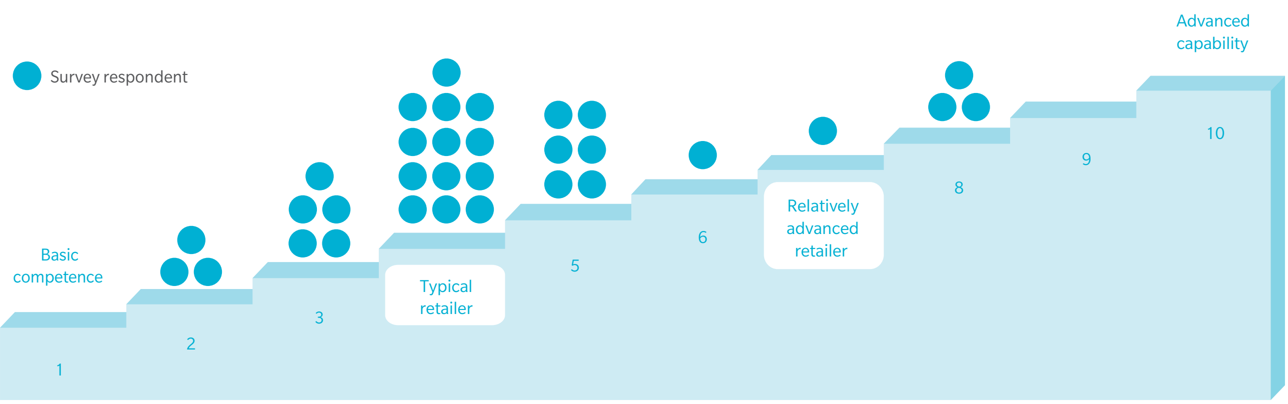
Later in this paper we discuss what differentiates the leaders from the rest and what retailers can do to "climb the staircase" and build their own next-generation category management capabilities.

CORRELATION ACROSS LEVERS

We also find that, in general, the retailers with a high level of capability in one area have higher levels of capability across the board. That is, they are towards the top of the staircase in all aspects of their category management processes. We see very few examples of retailers that have outstanding strengths, for example, in their pricing capabilities, and yet have a more basic approach to other levers. The leaders show an institutional capability that permeates all aspects of a company's approach to category management.

Later we will discuss the role that leadership expectations, culture, and organisation structure play in creating the foundations on which to build strong capabilities across all the different elements of category management.

EXHIBIT 2: OVERALL CATEGORY MANAGEMENT CAPABILITIES – A STAIRCASE MODEL



Source: Oliver Wyman Category Management Study

There are, of course, some exceptions. A few retailers do manage to reach a high standard on certain, but not all levers. Often, they are in the midst of upgrading their overall capabilities by improving one lever at a time. This lever-by-lever approach can be one way to successfully climb the staircase.

HIGHER CAPABILITIES DRIVE HIGHER PROFITABILITY

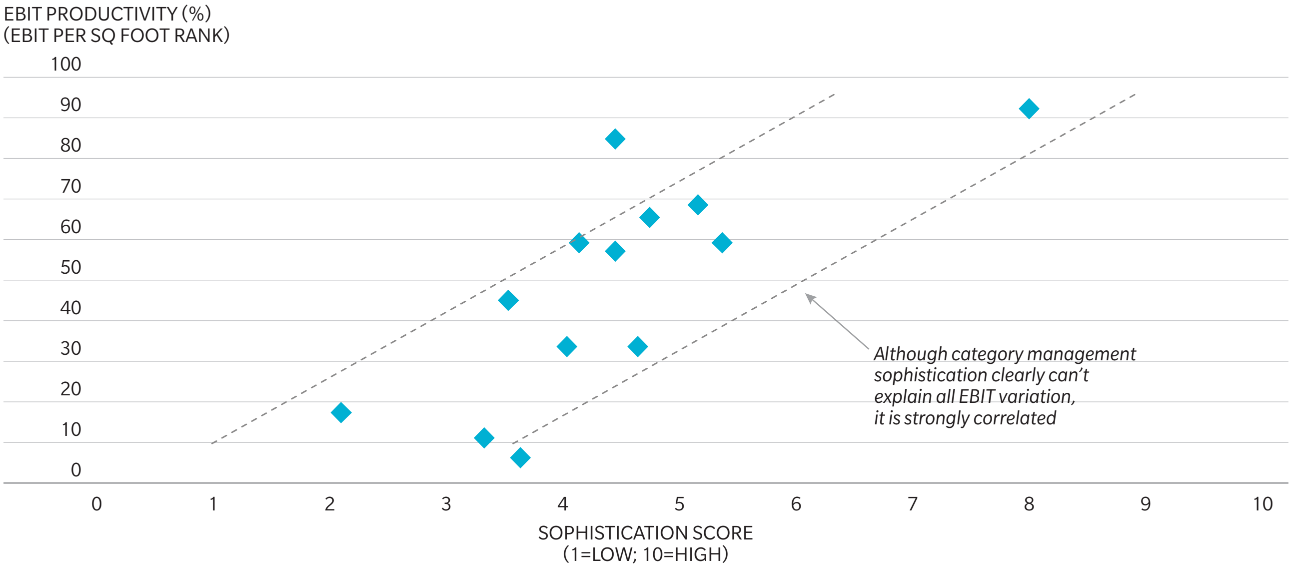
As part of the study, we investigated the impact that a higher level of category management capability has on the overall performance of a retailer – clearly, the additional investment in building better capabilities only makes sense if it produces a greater return.

We use EBIT per square foot relative to each retailer's sector as our metric for performance. This metric captures the company's ability to drive more traffic through its stores than competitors do, and to capture value from this traffic.

The power of a company's category management approach is far from being the only driver of performance. Nevertheless, there is a clear relationship between the capability scores and the performance of the retailers we analysed *(Exhibit 3)*.

These findings are validated by benchmarks from our past work with clients, which suggest that a comprehensive upgrade of all aspects of a retailer's category management processes can be worth between 250 and 650 basis points of profit improvement at constant sales. Alternatively, the money generated can be reinvested to drive higher sales growth. As one would expect, better category management capabilities really do drive better economic performance.

EXHIBIT 3: CATEGORY MANAGEMENT VERSUS EBIT PRODUCTIVITY



Note: Public data only available for 13 companies
Source: Oliver Wyman Category Management Study

SECRETS OF THE LEADERS

Three characteristics differentiate the leaders from the rest: They spend less time on their category management processes but are able to generate much better outcomes from the time they do spend on them. They place much more emphasis on using data and analysis to make better decisions. Finally, their superior capability does not exist in a vacuum, but derives from a different model of organisational and talent management.

LESS TIME AND BETTER OUTCOMES

Several characteristics ensure that the leaders' category management processes take less time and produce higher-quality outcomes:

More concise and focused: The leaders' category management processes are not multi-month affairs. Their processes are streamlined with less time spent on time-consuming and low-value data collection and template filling. This allows more time to be spent on strategic planning.

A continuous process: Category management is not treated as an annual or biannual clean-up. It is an ongoing process, typically carried out every quarter, which involves constantly reviewing and refining the strategy. The outcomes of the process are measured and quickly fed back into the next iteration, so that there is continuous improvement. The category plan is a living document that is continuously updated, not left on a shelf for months at a time.

Action-oriented: The outcome of the process is not a completed set of templates or reports. It is a set of actions that have implementation plans, KPIs, and measurement plans. Success and failure are defined up front, and the results feed back into the next iteration of the category plan. Category managers have the authority to execute their plans and are held accountable for their success.

A natural extension of company strategy: The goals of each category are spelled out as part of the company strategy. Category managers understand what is expected of them. Goals are specific, going beyond generic category roles, and include hard KPIs that are used to measure the fit with the company's strategy. Category plans are directly and explicitly linked to the budgeting and forecasting processes.

HIGHER-QUALITY DECISION-MAKING

The leaders have developed a "culture of analysis" in which there is an expectation that high-quality analysis will be used to support decision-making. These capabilities are built on three foundations:

Easy access to reliable data and analysis: The leaders have access to and make use of a wide range of different types of data, such as point-of-sale, customer, market, and competitor data. They link data together in an attempt to derive the fabled "single version of the truth", although this is not necessarily always achieved. Reports are distilled into their simplest and most actionable form and kept small in number. The emphasis is on producing genuine insight, not reams of numbers.

Better decision-support tools: Decision-support tools are used to support all significant trading decisions. They are customised to the needs of the individual organisation and its processes and ensure that decision-making is both faster and more standardised.

Systems infrastructure as a source of competitive advantage: The leaders don't rely on "plain vanilla" or even "best-of-breed" systems, which in many cases are not good enough to reach the higher steps of the staircase. Instead, they invest in better systems as a source of competitive advantage.

A DIFFERENT ORGANISATIONAL AND TALENT MODEL

The leaders put in place organisational structures that look very different from the standard models typical of the majority of retailers. They use a different hiring model and think about the category manager's role in a different manner. They have been successful in creating a learning organisation that can deal with the complexity of the higher levels of the staircase. This makes continuous improvement possible.

Appropriate organisation structures: The leaders have built centres of excellence for each of the major trading levers. These centres own the analytical approaches and the task of improving them over time. They advise the category managers as part of "virtual teams" that work together on building category plans.

Mixed talent models: The leaders don't rely on one source of talent for their category managers. They do bring people through the traditional retail route (from the stores and through the assistant buyer and buyer roles). However, they also look outside the organisation to consumer packaged goods companies, direct MBA hires, and even ex-consultants and investment bankers. This combination of people with different backgrounds creates an environment that fosters a powerful combination of pragmatism and creative thinking.

WHAT SHOULD I DO ABOUT IT?

The results of the study suggest that retailers with a systematic plan to "climb the capability staircase" can deliver higher sales growth and profitability: a finding strongly supported by our own experience of working with retailers. But what's the best way for a retailer to do this – where should they begin?

They need, first of all, to be clear about where they are starting from. What are their current capabilities? How do they really compare to the leaders? How much time and energy goes into the process and how good are the outcomes? What is the case for change? How ready, willing, and able are their people to take on this challenge?

They also need a well-defined ambition. Are they looking to drive improved performance quickly? Are they trying to build better capabilities that can be a long-term growth engine? Are they trying to use improved category management as a way to help the company achieve a more fundamental repositioning of its entire customer offer? Do they want a growth story for investors that could encourage a re-rating? Or some combination of all of the above?

Finally, they need to decide on the right path for getting there. The truth is that there is no single way to approach the task of building their category management capabilities: there are as many paths as there are retailers. Some retailers will get there by walking up the staircase one step at a time; others may leap up three or four steps at a time. Nevertheless, there are commonalities among the different paths, and a few elements that will always need to be addressed:

Process and discipline: A disciplined process is a prerequisite for any capability upgrade. Without discipline, there is no vector for improving capabilities. Category management improvements should also have clear links to the strategic planning process (so that category plans get built within the context of the overall company plan) as well as with the budget and forecasting processes (so that misalignments with the budget don't force category plans to be quickly abandoned).

Data, analysis, and tools: The value of a capability upgrade derives from making better use of data, adopting more sophisticated analytical approaches, and introducing tools that make the data and analysis more readily accessible. This enables each of the thousands of decisions that category managers have to make daily to be made that much better and, if these improvements are well-designed, will also reduce the amount of time it takes to make each decision.

People and organisation: Upgrading the company's processes and analytical sophistication may require making changes to the organisation structure and talent model. The organisation needs to be set up in a way that supports the new processes. The talent model needs to provide people who can thrive in a new and more demanding environment with increasing standards and evolving expectations.

The plan for a capability upgrade should seek to find the right approach to each of these three elements, balancing the construction of long-term capabilities and organisational structures with the need to quickly see financial results from the program.

CONCLUDING REMARKS

Oliver Wyman's survey suggests that many retailers have relatively weak category management capabilities. These weaknesses cause plenty of frustration, especially for category managers. A few leading retailers stand out from the crowd, however. They not only exhibit a much higher level of capability but also show that building these capabilities becomes a significant driver of profitability.

The leaders differentiate themselves by putting in place more effective category management processes that require less time to operate and generate better outcomes. They build a culture of analysis and provide the tools and systems to support it. All of this is underpinned by an organisational and talent model that supports the retailer's ability to sustain higher levels of trading capability.

There is no single path to build stronger category management capabilities. Each retailer will have a different set of priorities and constraints. Nevertheless, the rewards are great. A sustained programme to build category management capabilities can add significantly to sales and profit growth over the course of several years.

GETTING AVAILABILITY RIGHT: BRINGING OUT-OF-STOCKS UNDER CONTROL

Keeping products on the shelves and available to customers is a vital part of the retail business. Increasing inventory or in-store labour isn't the only way to drive down out-of-stocks: significant gains can be achieved at much lower cost by improving the way on-shelf availability is measured and managed. Ensuring product is on the shelf is essential for any retailer, but even today it remains a major challenge. For example, it's not unusual for a supermarket to miss out on 5% of sales through out-of-stocks. As well as hurting revenue, poor availability means dissatisfied customers, and poorer financial performance over the long term.

Often, availability suffers because it is not well understood. It is the final outcome of a complex chain of events: buyers need to forecast and order accurately, suppliers need to deliver the right quantities at the right time, distribution needs to ensure the product reaches the stores, and the stores themselves need to get it onto the shelves. This cross-functional complexity means that when an out-of-stock occurs it can be unclear who or what has caused it – making the problem very difficult to fix.

This paper explains why out-of-stocks are so costly, and suggests ways that retailers can tackle availability problems by better understanding their causes. It reflects our experience of working with retailers in a variety of geographies over the past decade.

THE IMPORTANCE OF AVAILABILITY

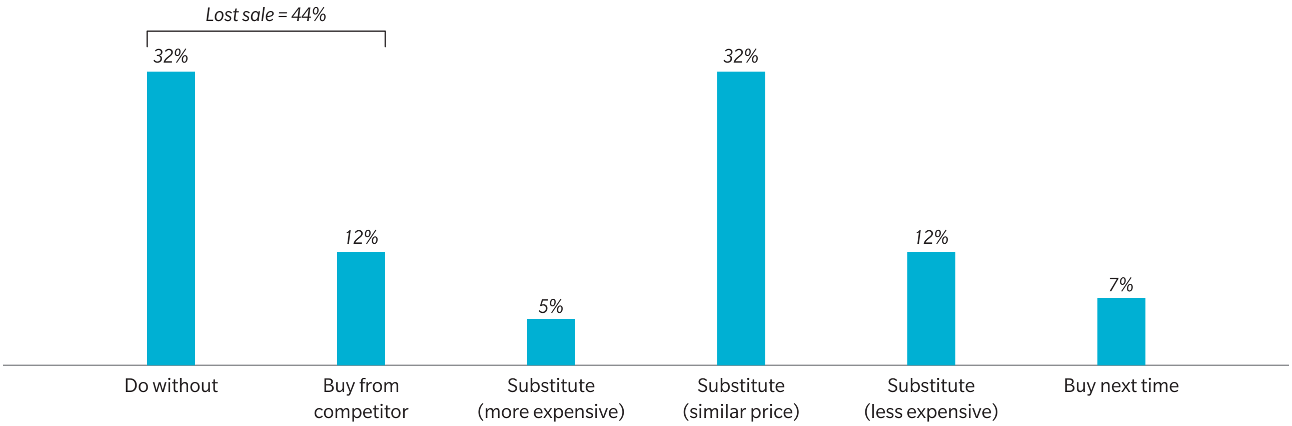
When they can't find the product they want, customers react in a number of different ways. *Exhibit 1* is based on research we carried out by accompanying customers on their weekly grocery shops: as it shows, most customers purchase a substitute product, and only around one in eight ends up buying the item from a competitor. But it's important to keep in mind that indirect effects multiply the cost of out-of-stocks: although customers will rarely switch an entire shopping trip to a competitor to find an item, losing an entire basket in this way can be twenty to thirty times more expensive than losing the sale of a single item.

Less common still – but even more costly – are cases in which an out-of-stock represents the 'final straw' for a customer, and they defect to a competitor for the long term. Such behaviour is often impossible to measure, but is very important. In retail sectors where shoppers visit a store to buy one specific product, availability problems can provoke 'permanent' store switching by removing a store from a customer's consideration set for future purchases. And in grocery – with its high visit frequency – it is worth considering that if as few as one in five thousand customers inconvenienced by an out-of-stock is permanently lost, the ultimate cost will be similar to the direct sales loss. Note in this context that almost one in three of those who experienced an out-of-stock cited it as the thing they were least satisfied with about the store, and over two-thirds were at least mildly annoyed; more worryingly, many also commented on out-of-stocks experienced during previous visits.

We typically find that for food retailers, around 94-97% of products (on a sales-weighted basis) are in stock at any given time. Combining this figure with the pattern of customer responses just described implies that out-of-stocks can cost more than 5% of total sales, once longer-term effects and customer dissatisfaction are taken into account. All in all, then, achieving better availability is a worthwhile goal – and since there is also a big difference between the best and worst performers, most retailers have room for improvement.

EXHIBIT 1: HOW CUSTOMERS RESPOND TO OUT-OF-STOCKS

SHARE OF TOTAL (%)



DEVELOPING AN ACCURATE PICTURE OF OUT-OF-STOCKS

Correcting availability problems begins by better understanding their root causes. While it may sound surprising, few retailers have a good grasp of where, when, and why out-of-stocks occur.

The flow of product from a supplier or distribution centre to the store may be systematically tracked, but the availability that matters is on the shelf – not in the stockroom.

The methods used to track availability are often low-tech. A common technique is to perform manual checks of the quantity of key items on the shelves at specified times every day or week, in some cases supplementing these with store inventory tracking data (retailers who pick product from their shelves for home delivery can generate this type of information at much lower cost). Additional data may also be provided by vendors, though this gives only a partial picture, and risks being subject to bias.

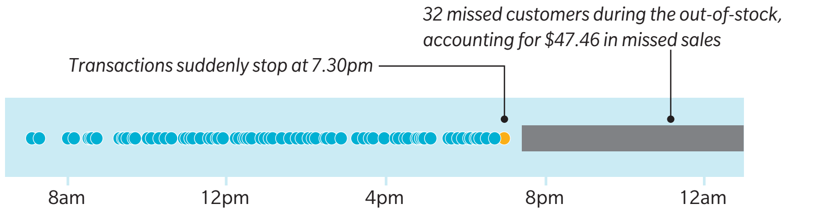
However, such approaches suffer some fundamental flaws – all of which mean the true extent of out-of-stocks tends to be underestimated. First, they don't track availability for all products, only those with sufficient volume to justify the (high) cost of manual checks. Second, they miss a significant proportion of out-of-stocks, since checks take place periodically. If a product is unavailable between checks, then the business will not know about it – only customers will. And third, they don't give a good indication of how long a product is out of stock, making it impossible to quantify the missed sales opportunity with any degree of accuracy.

EXHIBIT 2: STATISTICAL AVAILABILITY MONITORING

DISGUISED CLIENT EXAMPLE

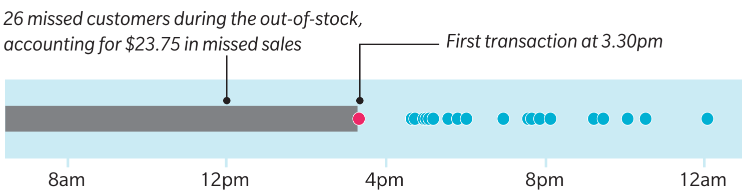
SKU Z (CANNED VEGETABLES)
Sales that day: $147.20

End of day out-of-stock
- Could be caused by
  - – Daytime replenishment missing the item?
  - – Store not ordering enough product
    - - Forecast too low
    - - Inventory thought to be higher than reality
  - – Delivery not arriving, mispick, depot out-of-stock



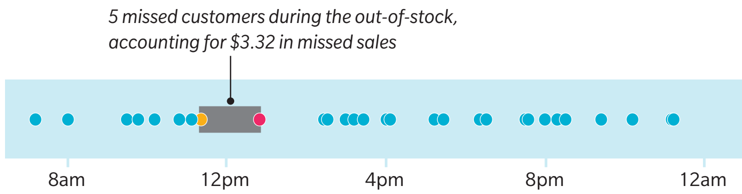
SKU X (FRESH HAM)
Sales that day: $20.45

Beginning of day out-of-stock
- Could be caused by
  - – Night replenishment missing the item?
  - – Late or damaged deliveries?



SKU Y (COOKIES)
Sales that day: $19.14

Intra-day out-of-stock
- Item out-of-stock at around 11:00am, coming back into stock at around 1:00pm
- Could be caused by
  - – Insufficient shelf/off-shelf space leading to the shelf emptying too quickly?
  - – Daytime replenishment missing the item?

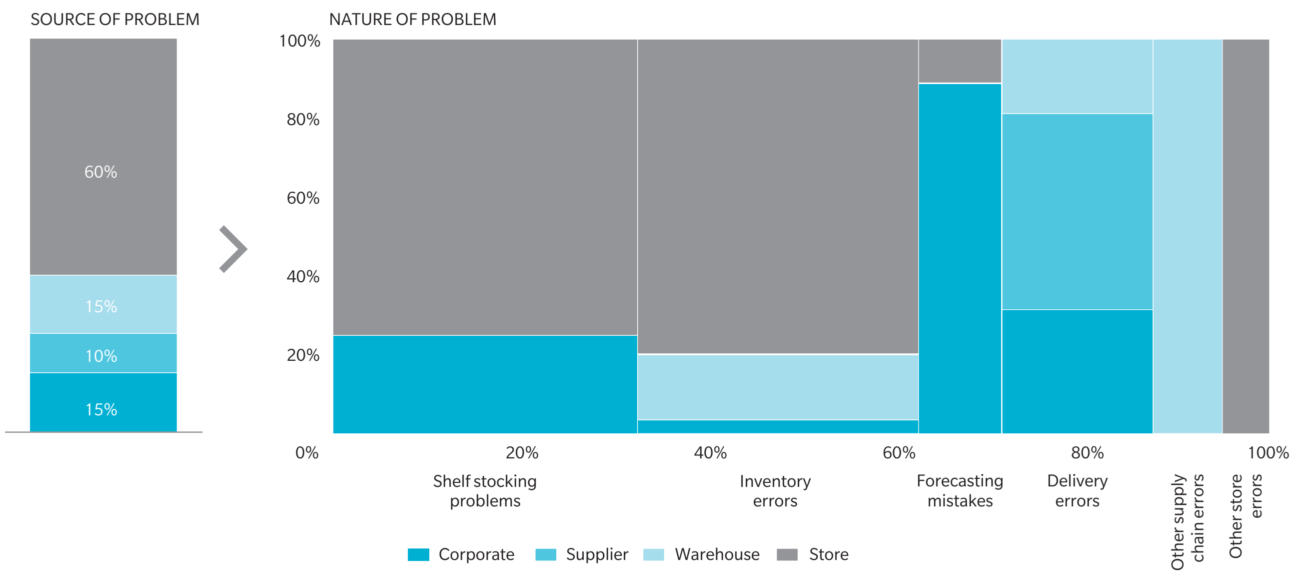


All this information is important, because there is a strong relationship between the cause of an out-of-stock and its timing, duration, and which products are affected. This makes it essential to track availability at a detailed level, and on a continuous basis rather than relying upon occasional snapshots.

A better way to spot out-of-stocks is by analysing sales data. *Exhibit 2* gives a simplified output generated by Statistical Availability Monitoring, an Oliver Wyman technique for doing this. When an item registers zero sales for a certain period, this might be an out-of-stock, or it might just mean the item is a slow seller. Which is more likely can be predicted by applying statistical algorithms to the historic sales pattern of each product, allowing those cases where availability problems are highly probable to be highlighted. Results at store-SKU level can then be used to pinpoint out-of-stocks during any time period (the length of which will vary across retail sectors based on their different rates of sale – minutes in grocery, hours in most non-food retail).

Armed with an accurate picture of when and where out-of-stocks occur, a retailer can diagnose the root causes – because different problems have different 'signatures' for the out-of-stocks they create. *Exhibit 3* shows an example breakdown of out-of-stocks and their causes, again drawn from a grocery retailer. Over half of the problems originate from the store, not the supplier or the distribution centre: in our experience this pattern is typical, though in many cases it is not acknowledged by retailers.

EXHIBIT 3: WHAT CAUSES OUT-OF-STOCKS?



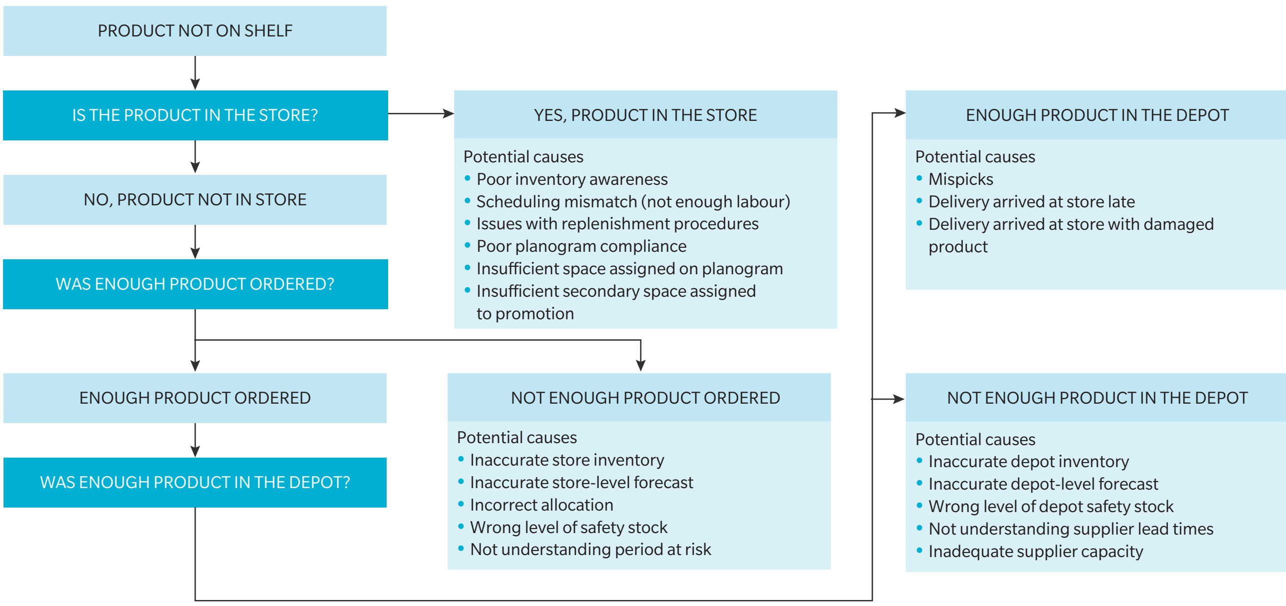
HOW TO GET AVAILABILITY RIGHT

Different types of availability problem require different remedies with different associated costs, so the financial impact of better availability depends on how it is achieved. Developing a comprehensive picture of the root causes of out-of-stocks is therefore the first requirement for tackling them in ways that make financial sense. Clearly, there are many other obstacles which must be overcome in order to deliver improved availability on the shelf. A detailed discussion is beyond the scope of this paper, but in closing we make a few comments about some of the key organisational considerations.

Many retailers adopt a simple philosophy to improving availability, 'making it the store's problem' by introducing new targets and incentive structures that motivate managers to minimise out-of-stocks. This can generate small improvements, but it will not address availability problems that originate outside the store. Moreover, the cost of store labour, shrink, and shelf space needs to be balanced against the sales benefit from better availability: simplistic approaches may reduce out-of-stocks only by reducing profits at the same time.

Understanding exactly why a product didn't make it onto the shelf allows more effective solutions. For example, if a product sometimes goes out of stock for a few hours during the day, replenishment practices may need to be changed. One retailer established a troubleshooting process similar to the one shown in *Exhibit 4*.

EXHIBIT 4: OUT-OF-STOCK TROUBLESHOOTING



Providing store managers with detailed and up-to-date information – about which products went out of stock, when, and for how long – equips them to work through the troubleshooting process and address failures in specific areas. At the same time, it is essential not to underestimate the change management challenge involved in addressing availability problems: invariably, both upgraded systems and new management processes are required, often in diverse areas of the business.

Because as well as making out-of-stocks difficult to diagnose, the complex chain of events involved makes them difficult to fix. Where availability problems originate in corporate HQ or the warehouse, there needs to be a process in place to identify and deal with this, and to avoid blaming stores for failures over which they have no control.

On the other hand, store managers should be given full visibility of and responsibility for managing out-of-stocks which originate in the store. Targets and budgets need to be carefully revised, and in a way that is both fair, and seen to be fair: each store needs to be compared to other stores whose availability might be expected to be the same, not just estate-wide ‘best in class’ benchmarks or a crude top-down target.

Since better availability usually implies additional costs for the stores and additional revenue for the business as a whole, this also needs to be recognised and reflected in budgets and personal targets.

Overall, then, it is important not to underestimate the barriers to change, especially when considering a ‘systems-centric’ solution. Although better information is always necessary for better availability, it is never sufficient by itself.

CONCLUDING REMARKS

Managing on-shelf availability is a significant challenge – but it also offers a significant opportunity to increase sales and customer satisfaction. To reap these benefits, a retailer needs a clear picture of where, when, and why out-of-stocks occur, and a strategy for dealing with them that acknowledges the financial trade-offs and organisational challenges involved. Ultimately, since most availability problems can be traced back to the stores, store management needs to be equipped with more accurate ways of pinpointing them, and empowered to change operating practices accordingly.

BACK TO BASICS FOR BETTER PERFORMANCE

As the tide of consumer spending has turned, retailers are under intense pressure to make sure they are mastering the basics of category management, customer insight, and the drivers of their economics.

In the *Oliver Wyman Category Management Survey*, we spoke in depth to many large and mid-sized retailers across North America and Europe. We discovered that, while a few companies have invested heavily to develop advanced trading capabilities, many are still working on the basics:

- Forty percent of retailers struggle with information management and can't always get an unambiguous answer to a simple question, such as how much an item actually costs from a vendor.
- More than half don't have completely reliable data on competitors' prices; even fewer have such data on competitors' promotions or assortment.
- Half fail to quantify the price sensitivities of the different categories and products they carry.
- Three-quarters don't take account of substitution effects, such as the extent to which a new product simply switches sales from existing products.

Category managers often lack access to all but the most basic data, get overwhelmed by a profusion of poorly designed and often contradictory reports, and rely on weak processes to support decision-making. The result can be poorly allocated investments and an inability to react quickly to fast-changing market conditions – a dangerous situation when the margin for error is so slim.

Fortunately, many of these issues are fairly easy to correct, and investing in simple improvements can result in rapid benefits:

BETTER INFORMATION AVAILABILITY

Many retailers find themselves burdened with obsolete systems that make it difficult to extract basic data – and some important data is not collected at all. At the same time, managers are frequently overwhelmed by too many reports, but still can't get their hands on the information they need. It is hard to manage pricing or negotiate effectively with vendors if you can't get a reliable view of competitor pricing or item costs.

The answer is often to start with a change in thinking – don't rely on massive IS upgrades with multi-month timeframes that try to solve everything at once. They take too long. Most retailers already have most of the data somewhere. Instead use a small central group to aggregate data from across different systems and provide (fewer) standardised, value-added reports.

DEEPER UNDERSTANDING OF CUSTOMER BEHAVIOUR

Making good decisions requires a solid understanding of how customers are likely to change their behaviour and how this will impact sales and profit. Price cuts should be made where customers most value them. Promotions need to drive incremental increases in volume, not cannibalise other lines. Not understanding how sensitive your customers are to price changes, or how your customers switch between different products, can lead to incomplete or even incorrect decision-making. Flawed decisions in these areas can leave hundreds of basis points of margin on the table.

This deeper understanding won't just come out of your Customer Insights department. To be sure of extracting the right insights from the data, reverse the usual process of starting from the insights and figuring out how to apply them; instead, determine exactly what you need to know about customers to improve the trading decisions you are already making.

IMPROVED RESPONSE TIMES

Retailers need to pick up on the way consumer priorities have recently changed and adjust their offer accordingly. Yet many retailers find it hard to react quickly. The category management process is usually the main mechanism for changing the offer in each category. But category managers are swamped by keeping their business running day-to-day, and category management reviews are an annual process at best. As a result, retailers often fall back on their promotions programme alone – a short-term answer which can drive sales, but will usually hit profitability.

Even though there are now more fires to fight than ever, it is also more important than ever to make the time to step back and think strategically. What should the overall offer be and how can one ensure it is well aligned with what today's customers want? Simply increasing the frequency of your existing category planning process can help make sure you are taking account of changing needs. Reviewing a category once every two years might be fine in normal times, but not at the moment.

CONCLUSION

In tough times, retailers need to plan carefully and execute precisely. It needn't take months of effort to make a real difference. Often, much of the data required for better decision-making already exists within the organisation, and better reports, which streamline decision-making, can be rolled out in weeks. *Exhibit 1* shows an example of a simple scorecard that can be used to assess current category management capabilities and highlight where easy wins are available.

Systematically measuring the different aspects of consumer behaviour and embedding them in your management processes might take a little longer, but the profitability improvements that result can be huge – enough to make a substantial impact within the first year.

EXHIBIT 1: SCORECARD

THE BASICS	PRICE SETTING	PROMOTIONS DESIGN	PRODUCT ASSORTMENT	VENDOR MANAGEMENT
Systematic data collection *Examples*	Do you regularly track competitor prices around all your stores, including secondary competitors?	Do you monitor the items and prices of your competitors' promotions every week?	Do you regularly benchmark your assortment against competitors' and understand where you have gaps?	Do you have an accurate, up-to-date database of item list costs and all other discounts and vendor funding?
Deep understanding of customer behaviour *Examples*	Can you identify the items to which customers are most price sensitive and explicitly account for the impact of price changes on volume?	Do you have ways to account for seasonality, cannibalisation, stock-up effects, and halo when measuring the performance of promotions?	Do you know how unique each product is to your customers, and how much of its sales are truly incremental?	Can you quantify how customers switch between brands to know how important a given brand or vendor really is to your overall offer?
High-quality tools and management processes *Examples*	Do you have a price management tool to model 'what-if' scenarios for item, category or department pricing?	Does your promotions design tool accurately forecast the full impacts on sales and margin of your promotions, accounting for cannibalisation and halo?	Do your assortment decisions account for the true net impact of adding or removing product lines in different stores, including switching effects?	Do your Category Managers have easy access to the right data and templates to support the most effective negotiations with vendors?

THE CIO'S VIEW: AN INTERVIEW WITH COLIN COBAIN

COLIN COBAIN
was Group IT Director at Tesco from 2000 to 2007, and subsequently acted as interim CIO of SAB Miller and then of Supervalu, Inc. He has been a Partner at Oliver Wyman since 2011.

What are the most important lessons you've learned during your time as a CIO?

First, projects should be conceived, developed and implemented as business projects and not just systems implementations – meaning that people, process and systems all need to be taken into account. Second, the focus on value for money in retail means that services delivered need to be exactly what is needed, and not simply what someone wants, or a "one size fits all" approach which is likely to turn out much more expensive. Finally, you should be clear where you feel you can competitively differentiate yourselves through your IT, then ensure that you retain the knowledge internally in those areas, while keeping costs down by using standardised approaches elsewhere.

What do you see as the specific challenges facing a CIO in retail, as opposed to other industry sectors?

The retail sector has tight margins and fierce competition. So all investments have to be closely linked to the benefits they will produce, and delivered in a way which makes them sustainable. Too often, change is temporary – when the pressure mounts, people revert to what they already know and give up on finding better ways of doing things.

So IT investment decisions are even trickier in retail than in other industries?

Yes. When you are being very careful with how much you spend, it is essential to focus on areas which deliver the best return, looking as broadly as possible across the business. By doing this, you can identify parts of your operation where you're happy to outsource support (bearing in mind you are unlikely to retain any intellectual property in these areas), and parts where it's important to deploy your own people, to develop your own expertise and then keep it closely guarded. I believe the prime candidates for internal focus are store operations (particularly the tills), trading support (how to get the offer to your customers optimised), customer information (and how to apply that to your operational processes) and stock replenishment (ordering and the processes involved in getting the stock on the shelves/maintaining accurate stock records). Clearly, what it is most important to focus on varies based on the needs of the individual business and its customer offer, but I feel these are likely to be important for any retailer.

In your experience, which aspects of systems development present the greatest challenges?

One of the hardest parts is focusing on what is genuinely needed for the business to succeed, and not just "giving people what they want". This requires significant challenge during the process of deciding what to do, as well as thorough measurement of potential benefit. It's usually best to use off the shelf "packages" for many areas of the business, since that allows the organisation to focus on areas where there is the potential to make a big impact, and differentiate itself from competitors. When implementing these packages there also needs to be a robust approach to evaluating any changes requested, to make sure they'll deliver a benefit which justifies the delays and costs involved. Aspects such as response times and disaster recovery should also be viewed through this lens, so that when it comes to delivering service, areas such as the supply chain and till processing are prioritised over financial systems of record.

How important is IT as a source of competitive advantage for a retailer?

It's vital. The lifeblood of a retailer is the data it captures about sales to its customers, and how it uses that to create information, insight and knowledge. It enables fact based decision making to be built into its processes and ensures that the customer can be at the centre of everything. A huge amount of data is generated by retailers, and how well they use this has a huge impact financially. The best example is the stream of data which flows from the tills, which can be used for many purposes – fraud identification, measuring the impact a particular promotion has on customer behaviour, staff scheduling, estimation of lost sales through products being off the shelf – it's already a long list, and it'll only get longer as inquisitive retailers explore the possibilities. One of the most important challenges is how to drive the processes used within the business with timely, accurate information to make better decisions about what to do. A good example of this is promotions effectiveness where complex analysis of the data can help you to understand which promotions deliver value – and which destroy it! Simply creating this information is potentially valuable, but this isn't enough – the real value comes from embedding it into the processes the traders use to make decisions.

You mentioned earlier that IT projects should be seen as business projects, not just systems implementations. What does this mean, in practice?

Close working between the IT department and all other areas of the business is essential if the right investments are to be made in a way that delivers sustainable benefit. At Tesco, the simple mantra – Better for Customers, Simpler for Staff and Cheaper for Tesco – described the way potential projects were evaluated. The ideal project would deliver something of value to the customer (supporting the company mission of "deliver value to Customers to earn their lifetime loyalty"), in a way which was simpler for Staff to operate (ensuring that it was sustainable and allowed the staff to focus their efforts onto customers), while delivering value to Tesco and its shareholders. This approach also ensured that improving processes was a key part of the project, not simply doing the same thing with a shiny new tool (which almost always fails to add value!). This can also mean that sometimes the first deliverables for a project are process changes within the existing systems landscape, which allows for rapid delivery of the first improvements.

If you had to give one piece of advice to a newly-promoted retail CIO, what would it be?

Understand that your role is to deliver business change, and focus your efforts on areas where you can add real value by doing this.

ABOUT OLIVER WYMAN

With offices in 50+ cities across 25 countries, Oliver Wyman is a leading global management consulting firm that combines deep industry knowledge with specialised expertise in strategy, operations, risk management, and organisation transformation. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC].

In the Retail practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we've built our business by helping retailers build theirs.

FOR MORE INFORMATION PLEASE CONTACT

Matthew Isotta
Global Retail Practice Leader
matthew.isotta@oliverwyman.com
+971 4425 7026

James Bacos
EMEA Retail Practice Leader
james.bacos@oliverwyman.com
+49 89 939 49 441

Paul Beswick
North American Retail Practice Leader
paul.beswick@oliverwyman.com
+1 617 424 3259

Bernard Demeure
French and Iberian Retail Practice Leader
bernard.demeure@oliverwyman.com
+33 1 45023 209

Nick Harrison
UK Retail Practice Leader
nick.harrison@oliverwyman.com
+44 20 7 852 7773

Sirko Siemssen
Central European Retail Practice Leader
sirko.siemssen@oliverwyman.com
+49 89 939 49 574

Riccardo Trentini
Italian and Turkish Retail Practice Leader
riccardo.trentini@oliverwyman.com
+39 02 305 771

E 500 – 12/12– A 240/150

OLIVER WYMAN