In pursuit of comparative advantage:
Retail goes on demand

deep

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In pursuit of comparative advantage: Retail goes on demand

With increasing competitive pressures, more demanding consumers and shrinking profit margins, retailers are tiring – some even retiring – from the chase. Knowing that the future promises an even more frenzied pace, it’s time for retailers to consider trading in common practices for on demand processes that provide the speed and flexibility needed to stand out in a crowded retail marketplace.

On demand in action

On the way to her hotel, an excited NASCAR fan drives past one of your retail sporting goods stores and suddenly remembers that she forgot to pack the stadium seats that she and her husband will need for the race tomorrow – the ones she purchased earlier from your location in her hometown. As she enters the store, her presence is recognised thanks to the RFID-enabled fob on her key chain. Walking down the aisle, she gravitates to the NASCAR hats on the end caps, while watching a short promotional video on her cart’s electronic display. She wonders how you know it’s almost time for her to buy new running shoes, and hits the save button to tuck away the 20 percent off offer – just in case.

Anxious to find those seats, she pushes a button on the cart to call for assistance. As the associate approaches, the customer’s key chain fob provides quick access to the customer’s purchase history and segmentation information. After directing the shopper to the aisle and shelf that hold the desired stadium seats, the associate also mentions that you now carry an autographed stadium seat with lumbar support that might be ideal for tomorrow’s big event.

Meanwhile, your category manager and the maker of those stadium seats are watching demand rise and fall at various stores across your nationwide chain. The vendor suggests a change in standard order quantity and confirms with the category merchants – replenishing colours and styles at this store and lowering orders at other stores located farther from the race location. The ability to act on the last-minute sellout at tomorrow’s race means higher revenues for you and your vendor.

Back at the store, with race fans swarming, your store manager’s hand-held device alerts him to some good news (record sales) and some bad news (rising wait times). Not to worry, within minutes, he has three portable POS units assembled and open. Also via his hand-held device, the manager reallocates store personnel to the checkout lanes and converts one line to cash only. As wait times evaporate, each temporary checker is automatically advised when to return to his or her normal routine. The NASCAR fan – as you guessed she would – has zipped through self-checkout, with stadium seats, a Dale Jarrett hat and some irresistible running shoes.

So, how are you able to consistently turn unpredictable events into fortuitous windfalls? You’ve learned the art of operating on demand.
Pressure mounts

Retailers understand well that today’s consumers are different from their predecessors; they are more knowledgeable, savvy and just plain demanding. They have access to more information – and know how to use it to their advantage, putting the squeeze on retail prices and profit margins. Today’s shopper is comfortable, and sometimes prefers, browsing and checking out without assistance. And, while self-sufficiency is high, customer loyalty is low. Even in an IBM survey, ‘Making CRM Work,’ that targeted consumers who frequent specific retailers on a regular basis, nearly half the respondents disclaimed their loyalty, disagreeing with the statement: ‘I am a loyal shopper.’ With the economy still sluggish and consumer confidence shaky, shoppers need stronger motivation to open their wallets.

For retailers, financial scrutiny is intensifying. The public is demanding greater financial transparency to help ensure fiduciary responsibility, and stakeholders are holding corporate management responsible for the impacts of its business and financial decisions – through market reaction or, in some cases, the legal system. In spite of, or perhaps because of, recent market volatility, shareholders are demanding more predictable results, with the financial markets rewarding those businesses that can deliver steady returns. Lack of steady sales growth has forced retailers to focus on the cost side of the equation to produce expected shareholder value. Investments – now more than ever – must prove their merit in terms of real (and rapid) returns, typically in the form of productivity gains. Every aspect of the business has become a potential target for improvement – workforce effectiveness, store performance or back-office efficiency.

With spending slow or unpredictable at best, retailers have channelled their intense focus on revenue growth into a full-blown battle for market share. Faced with saturated markets, competitors are crossing over into new segments for growth, blurring historical lines of competitive demarcation. As an example, over half of U.S. retail food sales occurred in supermarkets in 1980; by 2000, food sales dispersed across a variety of other formats – such as supercenters, convenience stores, warehouses and drug stores – leaving supermarkets accountable for only 19 percent of the market. Supermarket dominance is expected to dwindle further, to a slim 14 percent by 2005. With competition growing fiercer, big retailers are growing bigger, merging to gain global scale and exploit cost efficiencies.
As competitors crowd in, competitive advantages are more difficult to sustain. New products have to move from vendor to shelf in days, not weeks. Shrinking product lifecycles are making it critically important to get products to market early, while customers with short infatuation spans are still interested and there’s time to make a reasonable return on product development. This means retailers must race to have their private label products hit the market at the same time as the branded innovation.

These unrelenting competitive and financial pressures, coupled with prevailing pain points, have led retailers to focus on three business imperatives:

- **Take out costs** – Optimising the supply chain and automating interactions with trading partners, sharing infrastructure and integrating applications and data across business functions
- **Enable employees** – Increasing employee productivity and operational efficiency through access to realtime information and broadening employee expertise through relevant, just-in-time training
- **Transform the customer experience** – Building a differentiated market position through customer interaction, influencing customers throughout the entire shopping process, applying emerging technologies selectively when and where they will make the most profitable impact.

Although many retailers have initiatives underway to improve these three areas, substantial untapped opportunity still exists. In the recent IBM/National Retail Federation (NRF) ‘Store of the Future’ survey, for example, a full 71 percent of respondents rated ‘faster merchandise scanning’ as extremely valuable although less than 40 percent planned to implement this capability in the near future. And even though 55 percent voted ‘providing employees with access to customer purchase records to improve returns process’ as extremely valuable – less than a quarter of the respondents had stated plans to provide this information to employees. On the customer-facing front, 45 percent of the respondents believed that alerting a manager or sales associate to the presence of a high-value customer would be extremely valuable, yet only ten percent had any plans to do so.1
Refining to redefining: The shift to on demand

Although the challenges imposed by these three imperatives related to customers, employees and supply chain operations are familiar, technological advances are enabling retailers to respond in entirely new ways. For instance, kiosks and self-checkout solutions are growing in popularity, allowing retailers to capitalise on consumers’ willingness to serve themselves; 63 percent of the retailers that participated in the IBM/NRF study plan to be using kiosks within the next two years, and 24 percent had similarly timed plans for self-checkout terminals. Retail businesses are also actively experimenting with other emerging technologies such as:

• **Mobile devices** – For both consumers and employees, to aid in personalised shopping and enable higher levels of service
• **Wireless payment alternatives** – To reduce transaction costs and provide added convenience for customers
• **Dynamic displays** – To tailor promotional efforts by store, time of day and even passing shopper
• **Radio Frequency Identification (RFID) tags** – To gain access to information in realtime, like detecting a customer’s presence or tracking inventory
• **Advanced data analytics** – To optimise pricing decisions, improve local market assortment planning and increase accuracy of forecasts.

At the McDonald’s in Times Square, hungry customers now have more than the smell of fries to entice them. The restaurant has traded in its static menu board for a digital display that shows video clips of food in action – fresh salad falling into a bowl or a juicy hamburger sliding onto a plate – and encourages customers to buy more. With traditional menu boards, promotions typically remained up for three or four weeks at a time, leaving customers a little bored. But with its high-tech menu, promotional video clips change every two hours, allowing the restaurant to advertise food appropriate to a particular time of day. In fact, breakfast sales are up dramatically, thanks in part to the ability to advertise breakfast during breakfast. Unlike plastic posters that only showed a single image, new menu board videos can spin through any number of featured products. And managers can even update featured menu items ‘on demand’ based on a particular situation. For instance, they can suggest apple pie when it’s cold and ice cream when it’s hot. By tapping into new retail technology, McDonald’s has been able to transform a rather static fixture into a dynamic and responsive sales tool that can deliver just the right message at just the right time.
Growing availability and acceptance of these technologies, along with increased bandwidth, greater levels of connectivity among enterprises and more defined standards, are providing retailers with the means to fine-tune and better integrate processes, creating opportunities to elevate business performance to new levels. Many retailers are already migrating to open source environments and packaged applications to increase their business agility.

This confluence of mounting business pressures and burgeoning technological opportunities is propelling the industry toward on demand retailing – where a retailer’s business processes are so well-defined and flexible that they can respond with speed to any customer demand, market opportunity or external threat.

On demand retailers can be best described by the key characteristics they exhibit:

- **Focused** – Committed to concentrating on differentiating competencies, using tightly integrated strategic partners to manage selected non-differentiating activities
- **Responsive** – Seeming almost intuitive in their ability to sense and respond rapidly to unpredictable changes in the market environment and the needs of all constituents
- **Variable** – Able to adapt cost structures and business processes flexibly, to reduce risk and do business at higher levels of productivity, cost control, capital efficiency and financial predictability
- **Resilient** – Prepared for changes and threats – be they technological, economic, or political – enabling the business to continue operating with consistent availability, security and privacy.

Intuitively, leading U.S. retailer Saks Incorporated recognised the cost burden associated with its decentralised spending. With every store handling the purchase of indirect goods (those not purchased for resale) differently – and often manually – the enterprise had difficulty determining its overall spending patterns, and it was also losing out on significant price breaks that could be negotiated if all purchases were bundled together. As Saks began investigating e-procurement options, it determined that while centralising all purchases would provide substantial savings, the company could save even more by leveraging IBM procurement expertise and the aggregated buying power of IBM and its leveraged procurement service customer base. Tapping into a utility-like procurement service for commodity goods also allowed Saks to focus its internal efforts on functions that provided greater differentiation. And with a centralised e-procurement solution now running across its multiple department store chains, Saks has reduced procurement expenses by 12 to 14 percent.⁴
These attributes form the foundation for how retailers create value in the three critical areas of their business: customer, employee and enterprise-vendor (See figure 1). As retailers learn to operate on demand, they can carefully orchestrate an outstanding customer experience through proactive interactions at many touchpoints across the buying cycle. They create this customer experience – and do so profitably – by equipping their employees with targeted, right-time information and by establishing highly automated, tightly integrated, collaborative processes that span the enterprise and their entire network of vendors.

**Figure 1. On demand retailers create value by becoming more focused, responsive, variable and resilient.**

<table>
<thead>
<tr>
<th>Customer</th>
<th>Employee</th>
<th>Enterprise/vendor</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Focused</strong></td>
<td>...on understanding the context for each shopping occasion to deliver with immediacy what is most important to the consumer</td>
<td>...on selecting, training, retaining and empowering employees to make timely and effective decisions that deliver value to customers</td>
</tr>
<tr>
<td><strong>Responsive</strong></td>
<td>...to changing customer interests, requirements, demands and market dynamics</td>
<td>...to changing scheduling requirements, sharing knowledge and replicating employee best practices</td>
</tr>
<tr>
<td><strong>Variable</strong></td>
<td>...by investing incrementally in customer relationships based on factors such as value, profit potential and ability to influence patterns of behaviour</td>
<td>...by maintaining flexible hiring and training capabilities that have the right people on hand at the right time, completing differentiating tasks</td>
</tr>
<tr>
<td><strong>Resilient</strong></td>
<td>...through development of systems and processes that provide a self-healing, highly-available environment for consumers, employees and the entire enterprise</td>
<td></td>
</tr>
</tbody>
</table>

*Source: IBM Business Consulting Services, 2003.*

**Payoff potential**

As retailers contemplate the promise of on demand retailing, it’s natural to wonder about bottom-line impact. Taken collectively, the benefits from operating on demand filter through every part of a company’s financial statements – growing revenues, boosting margins and optimising capital.
• **Revenue growth** – The business agility afforded by on demand permits retailers to ramp-up quickly to take advantage of unexpected increases in demand or emerging market opportunities. Greater responsiveness leads to higher customer retention, allows more accurate targeting of customers and enables more successful product introductions.

• **Margin improvement** – Heightened responsiveness and collaboration yield faster inventory turns, while allowing lower inventory levels. Plus, knowing enough about purchase activity to optimise pricing decisions enables retailers to make smart, realtime markdown decisions that preserve as much profit as possible while accelerating the sales velocity of slow moving goods. In areas of volatility, movement from fixed to variable cost structures allows on demand retailers to respond to peak periods of demand cost effectively.

• **Capital optimisation** – On demand retailers avoid investments in non-differentiating or under-utilised assets, turning outside for activities that external providers can perform more economically – and often better – than they can.

While the overall payoff potential is great, even incremental steps toward on demand can positively impact a retailer’s bottom line. Consider a few areas where financial pressure is particularly acute and on demand capabilities can help provide near-term relief:

• Worldwide, over eight percent of the items that consumers go to the store to buy are out-of-stock – and that rate regularly exceeds ten percent for faster selling or promoted products. But, as on demand retailers tune their supply chains and collaborate more with their vendors on demand and supply synchronisation, in-stock rates rise. *If you could recoup just half of your lost sales average, how much additional revenue might that generate for your business?*

• Employee turnover rates in retail are among the highest across all industries. In the U.S., voluntary turnover rates in retail reached nearly 40 percent in 2002, almost twice the total for all industries and government. Some best-in-class retailers have pushed annual attrition under ten percent. With on demand operations enabling better training and greater empowerment, employees have less reason to leave and more incentive to improve store effectiveness. *What kind of impact might retaining a greater percentage of your top employees have on customer satisfaction and loyalty? What could you save in training costs and improved store operations?*
A full 30 percent of all goods sold are marked down. IBM estimates that the average discounter makes about 17 million markdown decisions per year and a typical supermarket makes about 25 million initial markups each year. With that many opportunities for missteps, retailers’ bottom lines depend, in large part, on the accuracy of their pricing decisions. As retailers gain greater insight into customer buying patterns and achieve greater synchronisation with manufacturers’ promotional activities, they gain the ability to optimise each pricing decision. Knowing what initial price and markdown pattern is most effective positions them for a better overall return. By taking an on demand approach to pricing, one IBM client realised a 16 percent increase in gross profit along with a 6.2 percent increase in unit sales. Given the volume of pricing decisions made in your business, what impact could optimised pricing have on your margins and inventory turnover?

Indirect procurement typically accounts for over 60 percent of a company’s purchasing transactions. And 95 percent of all indirect purchases are made through paper-based processes, with as much as 30 percent of purchasing done off-contract, costing companies 15 to 27 percent more, on average. When it comes to indirect procurement, on demand retailers opt for electronic versus paper processes and centralised instead of decentralised procurement, virtually eliminating maverick buying and significantly reducing their procurement expenses. Some on demand retailers choose not to worry about managing indirect procurement at all, turning the entire process over to a provider that has more expertise and greater consolidated buying power. What type of profit windfall could on demand procurement generate for your enterprise?

The future has arrived at a Metro Group supermarket in Rheinberg, Germany. Metro has taken one of its Extra grocery stores and created a showcase of transformational technologies. One of the store’s many technologically advanced features is an inventory management system known as ‘Smart Shelves’ which controls supermarket stock that’s been equipped with RFID or ‘smart tags.’ As pallets of goods leave the distribution centre, the smart tags are read en masse. The store manager can then track each shipment through the warehouse information system, knowing which products to expect and when they are due. When the pallets arrive, another reading reveals if any cases are missing, eliminating the need to check each pallet and physically count the shipment. Once the goods are on the shelves, an embedded RFID reader sends a message to the store back-office system when stock runs low, allowing the store to restock on demand and avoid lost sales due to empty shelves. The system also traces how quickly stock is being sold, tracking the most and least popular items. At the checkout, tagged articles are scanned for the last time to update the inventory.
Getting there

By cultivating on demand levels of performance, retailers gain the wherewithal to differentiate themselves in highly competitive marketplaces. However, transitioning to an on demand business model is not a grand leap to a heightened state of business performance; it involves substantial business change implemented strategically and systematically, over time. Retailers are evolving through three stages of development – access, integration and on demand (See figure 2).

- **Access** – At this stage, retailers are providing customers, trading partners and perhaps employees with online access to information and the ability to perform simple transactions electronically.
- **Integration** – As demand for more sophisticated processes grows and IT capabilities mature, retailers seek out opportunities to increase productivity through greater levels of integration, linking critical processes and applications together electronically.
- **On demand** – This stage brings an entirely new level of integration of processes and applications, with suppliers and customers at either end of the business and among the employees within it. Here, retailers are no longer content to integrate and optimise a few select processes in relative isolation; instead, they build seamless, end-to-end integration (tying supply chain processes with customer relationship management processes, for example), making their entire value chain more rapid, responsive and resilient.

*Figure 2. Stages of business evolution.*

*Source: IBM Business Consulting Services, 2003.*
Although the ultimate goal is peak performance across all areas – consumer, employee and enterprise-vendor – in actual practice, some capabilities may evolve faster or slower than others, with a retailer remaining at an early stage in one area while achieving on demand performance levels in others (See figure 3). Thus, the exact route each retailer takes to on demand will be unique.

Figure 3. Retailers’ capabilities evolve through stages as they move closer to on demand performance.

<table>
<thead>
<tr>
<th>Access Management</th>
<th>Integration Management</th>
<th>On Demand Management</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer management</td>
<td>• Little/no true CRM • Fragmented multichannel • No customer segment managers • No customer-level metrics</td>
<td>• True loyalty programmes (not just discounts) • Some integration across channels • Customer analytics on drivers of profit and behaviour</td>
</tr>
<tr>
<td>Employee management</td>
<td>• Low-skilled, high turnover resources • Limited access to data and tools • High percentage of time on non-value-added activities</td>
<td>• Role-based employee portals • Performance evaluation and management tools • Chain-wide best practice sharing</td>
</tr>
<tr>
<td>Enterprise/vendor management</td>
<td>• Mass merchandising, pricing, promotions • Limited vendor/retailer data synchronisation or collaboration • Point solutions/applications</td>
<td>• Vendor/retailer price and promotion synchronisation • Selected collaboration for key processes – promotions, pricing, forecasting, replenishment</td>
</tr>
</tbody>
</table>


Start here

With such an ambitious objective in mind, where is a retailer to start? Here are three straightforward steps to help you begin mapping out your journey:

• Establish a ‘you are here’ marker – Evaluate your current performance in each of the three areas – customer, employee and enterprise-vendor, acknowledging at which stage of business evolution your capabilities are.
• **Pick prime on demand targets** – Based on your self-assessment, scope out underperforming areas to identify potential business process improvements. Quantify the potential economic value that could be unlocked by making those processes operate more on demand. Give higher priority to those changes that entail relatively low upfront investment and organisational risk and yet have the potential to yield tangible benefits, using them as a beachhead from which to launch more on demand initiatives.

• **Build a cohesive plan** – Inventory your existing initiatives; chances are, many of your planned projects will complement your on demand objectives, helping you become more focused, responsive, variable and resilient. Delay investments in those that don’t – re-evaluating them after you’ve moved further along in your on demand transformation. Start the plan with some of the ‘quick win’ targets that you identify – to build momentum and, perhaps more importantly, to create funds for investing in subsequent steps. Leverage current investments where possible and stage future initiatives in a logical progression toward more advanced on demand stages. In truth, your on demand evolution never actually ends because the market’s definition of what it means to be focused, responsive, variable and resilient keeps expanding.

**Start now**

With on demand capabilities in place, you can make greater headway toward critical business imperatives: taking significant costs out of your businesses, measurably improving employee effectiveness and transforming how you interact with customers in substantive ways. But benefits only begin accruing once you act.

To learn more about building an on demand retailing business or to discuss how we can help you become one, contact us at [iibv@us.ibm.com](mailto:iibv@us.ibm.com). To browse through other resources for business executives, we invite you to visit:

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10 IBM client experience.

