It is time to optimize profitability by sweating the small stuff. Oracle Corporation sales consultant Mark asked Michael to discuss his perspective on the health of retail — here are his thoughts: Some years ago, I had a very sedentary lifestyle. I recognized I was unfit and was beginning to have complaints and ailments. Nothing too serious, but enough to alert me to the fact that I needed to do something different — get organized, make healthy lifestyle commitments, and get exercising. As part of this new me, I decided to take up running. Initially, it was hard work; just getting out there took enormous willpower, and actually running around the block seemed like a daunting task. But I persisted, and eventually I was regularly running 10Ks and even ran my first half-marathon. Then a funny thing happened. At one of my annual physicals, my doctor came to me with the EKG and a very somber look and said, “Your EKG pattern is completely different from last time. This is worrying, and you need to get this checked out immediately.” Fast forward to the heart specialist: “You performed very well in the stress test, and your heart is in very good shape. Your EKG looks similar to an athlete’s. It’s likely that your heart and blood flow have adjusted to your lifestyle, and that’s why you are seeing this difference. However, you do have a little gut weight that you could afford to lose. Perhaps you should consider running faster for longer.” I am working on his suggestion.

So, if we apply this analogy to profitability in retail, identifying the external symptoms of lackluster performance and eroding profitability requires recognizing corrective steps that need addressing. In a view that has been echoed by Forrester Research, the search for improved profits in retail is less about an
internal search for operational cost savings and more about focusing externally on the customer experience and ensuring the whole organization is structured and optimized to deliver on that experience. Hidden beneath this seemingly self-evident truth is a radical rethinking of the industry based on personalization, global reach, social engineering, and real-time interactions. (Time to get my priorities in order and get in shape — like the lifestyle squeeze I inflicted on myself.)

A corollary to this is that the focus on customer experience will require a precision retailing paradigm where “sales and profits will be driven to a large extent by direct micro-level profitability maximization” across the value chain, a network that integrates the supplier, retailer, and customer.¹ (This is my body rearranging itself to optimize the new me — the juice that was enabling a new, improved performance level.)

This retail re-engineering process takes place in conjunction with an evolving technology environment that provides access to an unparalleled level of granular data that are either (a) tangibly related to operations, (b) tangentially related, (c) seemingly unrelated pending causation and correlation analysis, or (d) definitely unrelated.

Harnessing the relevant and de-emphasizing the unrelated reveals a real-time, fact-based thesis on how best to service your customer.

On this strategic journey to alignment with your customer, the dialogue frequently returns to how to tactically and operationally squeeze out inefficiencies while enhancing customer loyalty and maintaining a competitive edge. Furthermore, is the juice of profitability improvement from the squeeze worth the level of effort?

In this article, we explore current trends in retail and the types of strategic, tactical, and operational decisions driving improved profitability.

The customer journey is a digitally inspired journey

The connected consumer, armed with his/her mobile phone and Internet connection, is in control. With access to an endless virtual mall of information and disinformation about you and your competition, there is no limit to the powerful influences that can affect buying decisions.

To establish a differentiated relationship with your customers, it is important to build social and mobile brand awareness in a way that contributes positively to your customers’ lifestyle. Moreover, only by knowing how your customers’ lifestyle is evolving will you be able to grow and expand your relationship. It is clear the experience should be relevant, enjoyable, and life affirming.

The mechanisms of engagement are many and varied, and the success of each depends on the maturity of the relationship. The push media (print, email, Internet video, web advertising) help to keep your brand and target assortment front and center, and this can maintain and generate demand interest. Once engaged with the brand, the more interactive digital social media (Twitter, Facebook, Pinterest) provide a platform to build positive sentiment, drive new traffic to web and store channels, and reinforce brand affinity. Did you know that 98 percent of Target shoppers shop digitally?

Companies that are investing in these activities, finding new and innovative ways to engage their customers that promote positive sentiment, are the companies that are at the leading edge of harnessing consumer momentum. Key performance questions include: How many times a day do customers engage with the brand? How frequently are you seeing positive messages about your brand? What is the correlation with the visits to your site via web or mobile? There is huge value in collecting and analyzing this information to determine demand up-sell, cross-sell, and customer collaborative development opportunities.

The customer journey is a data-rich journey

Within the physical store, systems are collecting large volumes of behavior-related data (heat maps tracking cus-
customer paths in the store), and near field communications (NFC) are tracking movements of the consumer in close proximity to the store. These systems make the store a target for localized, precision offerings through the retailer’s mobile app. Physical inventory may have radio frequency identification (RFID) chips, so we know where the product is and can alert the customer to the physical location of product. Maybe the physical product has sensing devices — dresses that move in response to eye contact or change color based on mood. Changing room mirrors allow the customer to virtually try on the product and experience the product in a variety of settings, capturing data on preferences, reactions, and behaviors. Nudges can influence their behaviors (be it a style nudge, price nudge, or accessory nudge).

In the home, we have the digitally connected refrigerators that can sense contents and sync with smart phones to auto-replenish. The diaper dispenser that senses low inventory sends an alert to your phone and gives the option to auto-replenish (either pick up in store or home delivery).

All these systems and sensing devices are generating “data exhaust,” a proliferation of data that will, with increasing sophistication, be used for intelligent analysis and then leveraged to more accurately gauge demand and improve the customer experience. Using this information to more effectively predict and influence demand will be a key to improving micro-level profitability optimization — a squeeze that holds the promise of even more flavorful juice over time.

**Logistics on demand**

Significant gaps exist between customers’ expectations and retailers’ capabilities (e.g., 70% percent of customers expect to view in-store inventory online, and 50 percent expect to be able to buy online and pick up in store; however, only one-third of retailers have operationalized these basic channel capabilities). But all recognize the continuously accelerating pace of change that requires a fundamentally elevated focus on speed, agility, innovation, and rapid deployment.

There continues to be significant investment in the supply chain to close the expectation gap and to do so in a way that improves performance and reduces cost. Integrating e-commerce activities with traditional brick and mortar and establishing a single view of inventory across the supply chain are table stakes. Evolving distribution and delivery capabilities to meet the customer’s ever-more immediate expectations is the goal. Examples of investments include more automation in the regional distribution centers (RDC) to expedite flow-through, exploring supply to and delivery from stores in conjunction with mobile and Internet, and working collaboratively with third-party delivery partners. In general, it is the competition that is driving the customer expectations — think of Amazon’s (and others’) same-day delivery. It is not enough to say that Company XYZ is delivering from stores, so we will, too. It has to be thought through in a way that builds on the attraction to your brand and delivers not only quickly, but also with added value and predictably high quality. It involves real-time mobile and social interactions that become a conduit to elicit a store experience that delivers an affinity-affirming experience. Supply chain and logistics groups are as entrenched in the customer experience as the rest of the organization.

Mechanisms to deliver the product to the consumer are evolving as fast as the customers’ demand for delivery. The logistical need can be predictive (given a detailed understanding of the anticipated demand) or reactive (based on impulse buys and/or opportunistic browsing).

The accuracy of demand predictions has an important bearing on the efficiency, and thus profitability, of the supply chain. The balance of allocation (push) or replenishment (pull) also has a direct impact on the customer’s perception of the assortment, with replenishment being more directly related to predictable demand and allocation more
related to generating demand. Demand is predicted in an increasingly sophisticated way, evolving from simple year-over-year performance to include:

- marketing demand shaping (new seasonal styles, lifestyle enhancements, colors, freshness);
- promotional demand shaping (personalized offers, discounts, bundles);
- lifestyle necessity and personalized replenishment (e.g., in-home diaper dispenser);
- in-store/in-home, on-demand custom design 3-D printing and book printing; and
- crowd-sourced apparel and product design.

Demand measurement is necessarily becoming more personalized and targeted. Recognizing and understanding behaviors, not only of your known customers, but also your unknown customers (captured and analyzed by software vendors such as Reflektion, RichRelevance, and others), is an evolving area leveraging machine learning and probabilistic inference that will lead to the realization of quicker relevant customer engagement.

Demand knowledge underpins how effective the supply chain can be, independent of inefficiencies built into the supply chain processing. If demand proves unpredictable, so then will the service provided to the customer.

If we have reliable demand projections, we can determine where we need to keep our inventory (whether owned, consignment, or produced to order) to support that demand and optimize the flow for as near just-in-time delivery as possible.

The following are supply chain options that are affected by demand:
1. direct to customer from warehouse/distribution center (DC) or regional DCs (warehouse/DC-consigned inventory or warehouse/DC-owned inventory);
2. direct to customer from manufacturer;
3. pick up in store;
4. ship to store, pick up in store;
5. ship from store; and
6. ship to lock-box/kiosk/car trunk.

Obviously, not all demand is known, and so a level of contingency needs to be built into the inventory levels being projected. The costs of operating each of these supply chain options for the known and unknown continues to be a source of squeeze, not just in terms of a macro-operating expense, but also in terms of understanding how to associate the micro-costs to the customer experience in order to more accurately measure and manage profitable operations. Financially, each option has operating expense, shipping, inventory, and property plant and equipment cost considerations that factor into the service being provided to the customer. The brand image being promoted and the strategic importance of the customer to the image can have a determining influence on the delivery method employed and the overall profitability of servicing that customer. Developing an economic model based on anticipated demand (item/category-based or per-unit demand including revenue, cost, and gross margin return on investment (GMROI)) is essential to determining the most profitable and effective operating model for the customer, thus creating a “future juice roadmap.”

Partnering for profit: The importance of collaboration, trust, and transparency

With a customer service strategy in place and having developed the tactical and operational plans required to support the customer vision, the challenge is how to implement the new changes and ensure the process supports continuous improvement (or rather, “continuous, disruptive change”). Consider the following organizational alignment questions: Where should an e-commerce buyer sit in relation to the brick-and-mortar buyer? Should there even be a distinction — should the buyer own the customer regardless of channel? As the strategic organizational footprint evolves, developing use cases can help challenge and reinforce the organization proposal and the collaboration required to deliver the desired customer experience. An example use case might be determining the target
basket for the brand-customer, mapping out the decision paths to be supported throughout the customer experience (see Exhibit 1) from discovery (web, print, store, social, etc.) through conversion to delivery, (home, store, locker, etc.), and validating the engagement follow-up.

If there is a fashion fit element involved in the purchase, there will likely be a need for a physical store visit to prove the fit and fabric feel before ordering from a broader range of coordinates and accessories. The buying organization will need to be co-ordinating the assortment across the multiple channels to support the anticipated customer desires, working in tandem with marketing, fulfillment, and operations. This in turn defines the roadmap and an enhanced perspective on what the organization should look like.

This obsession with the customer will ultimately lead to local assortments and emphasis on targeted and personalized marketing. Creating the personas that will live in this new world, and being able to describe the customer journey through these personas, is a compelling way to ensure everyone understands who they are serving, how they are influencing the behavior of their customer, and how they are going to excel in a truly omni-channel or channel-less environment.

It is critical to have a consistent measurement of performance related to key customer experience indicators. The leaders in the organization must take ownership of their results, as well as their impact on the customer and on the whole company.3

Different groups across the organization are compensated in different ways and specifically measure performance to best optimize those results. In a recent survey, 70 percent of retailers said they have individual departments responsible for their own analytics. This drives different agendas and a language gap across the enterprise and prevents the organization from operating in concert. Merchants may be focused purely on product profitability based on a merchandise margin, and store operations may be focused on four-wall profitability, but it is the customer who holds the key to current and future state profitability.

A typical question is: Who should be credited for a sale? Half of retailers will say they recognize the sale at the point of order, but what if the customer orders online and picks up in store — is there an opportunity to make the customer store experience a memorable one?4 If there is, how should we measure the cost of that experience, and how should we incentivize the store personnel to deliver on that experience?

The solution is tying back to the customer desire, pricing appropriately to align to value, and then embracing all internal and external partners to deliver the optimized product cost to maximize profitability.

In one example, a buyer insisted on a pack size that was optimal for their small format store. The vendor complied as all good vendors would, but there was a built-in cost passed on in order to ship the product to a third-party facility, where the original packs were unpacked and re-packed, and additional costs in shipping the product to the store due to the volume of packs. Additionally, at the large format stores, there was an additional labor cost due to the volume of packs now necessary to support the sales velocity at those locations. With concerted collaboration across the network of internal and external partners supporting the customer, costs can be minimized/optimized to realize the required level of profitability.
Organizations are coming to grips with the paramount leadership and change management dynamics of the customer journey and realizing that the transformation starts with senior leadership's commitment to driving change through the entire organization. In the face of so many competing priorities, it is vital to anchor improvement efforts to the broader customer strategy, linked to short-, medium-, and longer-term operational, tactical, and strategic initiatives.

Measuring to manage for the right return on investment

When we are called in to help companies, there is typically a macro-performance issue that is understood, while the micro-causes are not. The analysis undertaken to understand these micro-causes usu-
ally includes poring over financial and transaction information, processes and organizational decomposition, roles and responsibility analysis, and development of a roadmap that will allow fact-based decisions to drive corrective actions.

In many cases, the hindsight conclusion is that profit-eroding decisions have been unintentionally made with incomplete insight and transparency into profit drivers, lacking granular reference to views such as customer and channel and how the customer interacts across channels. The lack of insight brought about by process and organization disconnect drives a breadth of omission, and lack of the right level of granularity of the supporting data drives a depth of omission. This depth and breadth of disconnect can translate to significant bottom line impacts; in other words, this means lots of juice from a hindsight squeeze.

Steps to understanding what to measure and manage include developing the use cases that will support the customer and developing the cross-functional metrics that will promote the right kind of behaviors. (See Exhibit 2.)

Measuring the profitability of operations in supporting the user experience requires that discordant costs are aligned at a level that enables the appropriate profitability measurement. It must be aligned with accountability, and it must be based on transparent methods that have garnered cross-functional agreement on how the metrics have been developed.

For example, to effectively measure the profitability of customers serviced across multiple channels will require shipping costs, vendor costs, staff costs, marketing costs, and other attributable costs to be captured and aggregated or allocated to the appropriate measuring level.

When considering how to measure performance in this environment, there is an evolution required to move from a typical revenue/gross margin analysis at the product level (see Exhibit 3) to an environment that allows the capture and analysis of a network of related

EXHIBIT 4 Networked Costs

Mark Wright, Oracle Corporation 2014
Profitability in Retail, 2014
costs from many more perspectives (see Exhibit 4).

This takes effort to achieve, but the key benefit is that there is a common view of profitability that can be managed from the merchant perspective, the vendor perspective, the store and e-commerce perspective, and the customer perspective, yielding valuable consistent insight into operational performance.

Miss on value or quality (as perceived by your customer), and you risk negative sentiment both internally and, more damagingly, externally. Operational excellence to meet your customer’s perceptions is imperative.

It is important that the customer’s expectations, the retailer’s expectations, and the system’s capabilities are aligned on the squeeze, and the expected juice of return on investment is measured and managed.

It takes strong leadership, change management (the art of growing your people — giving them the appreciation of the service we are delivering to our customer), and a recognition that this is an ever-evolving journey.

Summary and call to action
The customer journey is a digitally inspired journey, and the rate of digital innovation is only going to accelerate. “It’s not about continuous improvement, but rather disruptive, discontinuous change.”

This will require strong management to nurture a culture of openness, collaboration, and imagination in harnessing the customer and executing profitably to service that customer.

The management and analysis of success must be based on consistent measurement of key performance metrics that provide a cross-functional contribution to servicing the customer, which must be fact-based and relevant to everyone’s perspective in support of customer engagement.

The granularity to which the measurement takes place will be indicative of the finely tuned control that can be exercised over operations. The customer is very attuned to detail, as is the competition, so being able to account for and manage the detail will be key to future performance.

Our edict? “Obsess over the customer.”

Apply the organizational squeeze and recognize that micro-level profitability measurement and management will generate flavorful juice for all to enjoy.

NOTES
2 Ibid.