OPERATIONAL EXCELLENCE
WHY DO SO MANY PROJECTS UNDER-DELIVER?
“Achieving superiority in Store Operations is one of the best ways to ensure long-term success, yet it is a goal that continues to elude many retailers. Even though most have clear objectives for their operations initiatives, many have been frustrated by the complexity of the change process. The challenge is not what to do; it is how to make it happen.”
Store Operations are at the very heart of retail: Stores are both the point of contact for customers and one of the biggest costs a retailer faces. The retailers that master the challenges of Store Operations can deliver a better customer experience, and do so in a more profitable way—it’s no surprise that many of the world’s most successful retailers have built their success around competitively superior operational capabilities.

At the moment, with many companies struggling in the face of falling unit volumes, the stakes have been raised even higher. Retailers can no longer rely on rising volumes to improve their operational leverage. When volumes were growing, operational efficiency could be driven relatively painlessly by holding down hours. When operational efficiency must come from explicit reductions in hours, the change management challenge is much harder.

And the challenge over the long term will not be any easier. Cost inflation forces retailers into an unending quest for greater efficiency. The biggest cost in operations is labor and benefits, with a long-term inflation rate of 4–5%, compared to perhaps 2–3% for retail prices: This difference erodes profitability every year unless productivity improvements close the gap. Retailers need to run to stand still, and those that run fastest can invest more in their customer offer or real estate, and pile pressure on their competitors.

Over time, the battle to control costs has seen retailers launch a steady stream of productivity-improving initiatives. But too many of these fail to live up to their promise: What seemed like reasonable expectations for savings from a particular project don’t materialize, or the project is lost in a tangle of practical problems in the field.

This paper presents our view of why efficiency gains prove so elusive in Store Operations. It draws upon our discussions with senior executives, and our long experience of working in this field.
WHAT RETAILERS SAY
Of course, different retailers offer very different customer propositions and therefore have different operational practices—no-one would expect Walmart and Whole Foods to run their stores the same way, for instance. But when we talk to COOs and EVPs of Operations across the retail world, common themes emerge:

Under-delivery is widespread: There is a shared sense of frustration about operations initiatives—we consistently hear of initiatives that fail to live up to expectations. A host of different reasons are given. Many take much longer than expected; others fail to get buy-in from associates; still others simply don’t deliver the cost savings that were expected.

It is clear what ‘best-in-class’ is: Interestingly, Store Operations executives feel that the capability level they are aiming for is pretty clear—this is not so true in other areas of the business. Retailers feel they understand what they are trying to achieve when they work on their automated ordering systems, or front-end scheduling tools.

Exhibit 1 Example capability staircase: Product inventory and ordering

Basic competence
- Inventory is not taken as part of ordering process
- No central forecasting or order recommendation is given to the stores
- Orders are not placed from sales floor
- The responsibility for buying is left to individual buyers, accountable solely for filling store orders
- No metrics connecting company buying with sales or shrink

Mostly intuition with weak processes

Quantified scientific decision making backed up with strong processes and tools

Advanced capability
- Perpetual inventory tracking, with in-store processes that maximize accuracy using handheld scanning technology, verifying inventories at frequencies appropriate for each category
- Centrally calculated ‘single version of the truth’ sales forecast
- Orders are placed from the sales floor using handheld technology, with integrated upstream and downstream ordering minimizing the need for allocations
- All ordering parameters are centrally stored and controlled
- Reporting suites provide feedback loop for stores, managers and executives
No-one is best-in-class in all areas: When you look at different retailers’ capabilities in different aspects of operations, it becomes clear that no single company excels in all areas. Some retailers are generally better than others, but even those with the highest levels of overall capability struggle in places. Exhibit 1 shows the capability levels different operators achieve in just one aspect of Store Operations—no individual retailer is at the ‘Advanced Capability’ level across the board.

The issue is making change happen: The question is not what needs to be done to improve operations—it’s how to make it happen. Retailers were struggling with how to make sure that their projects succeed: how to engage the store associates, how to make sure that the value that is expected is actually delivered, and how to do it all on time with minimum disruption. These are the issues we discuss in this paper.

WHY THINGS GO WRONG

Store Operations is an immensely complex system: thousands of people with very different motivations and skills; hundreds of tasks defined to very different levels of detail, performed in different ways across the chain; hundreds of stores in a huge range of structural situations (sales levels, customer demographics, physical configurations, etc.); and a host of systems, applications and reports. Moreover, decisions made by other parts of the business—outside the stores—affect Store Operations, often without the decision-makers actively considering the costs they are imposing. A company’s merchandising strategy and supply chain configuration have a structural influence on operations costs.

This certainly goes some way toward explaining the difficulty of getting operations projects to deliver to expectations. Our experience helping retailers tackle Operational Excellence suggests there are a number of other problems as well.

A misconception of where the ‘fat’ is in operations: Operations is not an area with a lot of fat that can simply be cut out. It is more like a well-marbled steak: There is fat, but it requires a considered approach to remove it, and crude budget-slashing does more harm than good. The Operations team often instinctively understands this, but it can create tension with executives in other areas, who would like the world of operations to be simpler.

Failing to engage associates: No operations project will succeed unless store associates support it, and store associates can be an unforgiving group. One problem is that the desired outcome from most operations projects is reduced costs. It is always hard to get store associates excited about higher shareholder returns, and when those returns clearly come at the expense of their hours or even jobs it is even harder. Another problem is that many operations projects make life more difficult for store associates, at least initially. Store associates are a resourceful, practical group, adept at finding ways around obstacles and getting their jobs done. With outdated legacy systems, many retailers rely on this resourcefulness—but when you’ve just spent millions on a new system that is being bypassed, that’s a problem. The solution is
to recognize this up front. Finding a way to emphasize how associates’ jobs are being made easier and customers are being served better will motivate them much more. Many operations projects can be designed as win-wins that provide these benefits and lower costs as well.

An overreliance on technical, systems-based solutions: Many operations projects rely heavily upon new systems and tools for the stores. In principle, this offers an easy way to impact the tens of thousands of people involved. But despite the bold claims made by the purveyors of software packages, there is a big difference between setting up new systems and getting them consistently used and delivering the promised value. Too often, a narrow focus on the systems aspect of a problem means neglecting the more subtle dynamics that determine how effectively new tools get used. IT-led project teams rarely have an intuitive feel for how a store really works, and may make missteps that undermine associate engagement. Example 1 illustrates what can go wrong when technological solutions are implemented purely as IT systems without the support needed to change the behavior of thousands of individuals.

MAKING STORE OPERATIONS PROJECTS WORK
The good news is that there is a way to improve the success rate for operations projects. The key is to focus the whole initiative around the store management and associates. Getting them on board from the start and keeping them engaged is the most important aspect of any operations project—so a combination of soft change management processes with hard targets and accountability standards maximizes the chances of success. The five golden rules are:

Redefine the goal: To put it simply—focus on customers, not costs. Set a project goal that motivates people. Cutting costs won’t often do this, so even when it needs to be part of the outcome, it’s better to emphasize the benefit to customers. This doesn’t preclude cutting costs. Better on-shelf availability can be delivered with a lower-cost in-store supply chain; better perishables freshness can be delivered with lower shrink; shorter checkout lines can be delivered with less front-end labor. For example, consider shrink in the perishables departments of a grocer. Since it can run at 6–8% of perishable sales or higher, grocers constantly strive for significant reductions in shrink—but most of the time they fail. Again, part of the explanation for this lies in poor change management.

Cutting shrink is unlikely to inspire store associates. But delivering the freshest possible product to customers is something you can get the business excited about—and of course, freshness is simply the flip-side of shrink. By reducing warehouse dwelltimes, right-sizing displays, and improving ordering to lower inventory and maximize turns, the product that you sell will be fresher and ultimately shrink will...well, shrink. Improving profitability may be the ultimate goal, but the message can be focused on the fact that it’s better for customers.
One retailer introduced a computer-assisted ordering system, only to find that its recommended orders were being ignored by most stores. Why? Because the system requires users to provide accurate inventory counts for every product so it can suggest appropriate re-order amounts...and shrinkage, mis-picks, and other glitches require frequent adjustments to keep in-stock inventories correct.

The assumption that users would save time on placing orders did not take into account the extra hours required for taking inventories, so not enough labor hours were added to allow items to be scanned for ordering and keep inventory counts accurate. The stores began working to ‘fool’ the system by taking quick—but erroneous—inventory reads. As a result, the system’s order recommendations were inaccurate because they were based on inaccurate information. Stores quickly lost confidence in the system’s recommended orders and went back to ordering ‘the old-fashioned way.’

Meanwhile, no-one from the head office was in the stores keeping an eye on the system—senior management treated it like an IT project, just watching the metrics they had created to measure success. Since inventory counts were being provided routinely by stores, the head office believed that the inventories were being kept up to date accurately, a clear misinterpretation of the data.

Stores complained that the system did not provide useful order recommendations, and it was pulled out of pilot. But this was not really a technical problem; in fact, it was a change management problem. The retailer needed more than just a technically sound system that worked and could make life easier for the stores. They also needed to take the time to properly train stores and get them excited about the project. In the end, a lot of time and money was wasted because the change management challenge wasn’t tackled properly.

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**Treat the store as a system:** Right from the start, it is crucial to recognize the interconnectedness of the store. This is much easier to do if you focus on the end customers, because it is natural to look at everything that affects them. In contrast, cost-focused projects usually take a narrow view of the store and often ignore the customer impact completely.

A simple example of managing on-shelf availability shows how interconnected a problem can be. Out-of-stocks are obviously influenced by day crew labor, because the day crew fills holes and is responsible for good ordering. However, the day crew’s ability to do that depends on whether the night crew (if there is one) has put up the full overnight load, or left some of it unfinished so that the day crew needs to do that first. In turn, the night crew’s ability to finish the load depends on how well they are scheduled and how efficiently they work. And that depends on how the warehouse is slotted and how trucks are loaded…not to mention that promotional strategy and planogram design also play a major role in out-of-stocks.

**Understand store performance in detail:** Many aspects of Store Operations can be analyzed at a detailed level. For example, checkout line lengths and lane utilization can be worked out from transaction and footfall data without needing to invest in expensive cameras and computer systems; onshelf availability can be deduced from the rate of sale of items through the checkouts (see Exhibit 2); and centrally stored timesheet data can offer new insights into the drivers of labor productivity across stores. The aim is to distill the maximum insight from the vast amount of data a retailer already collects, without being overwhelmed by it. This is a challenging problem but it is not insoluble, and the rewards from solving it can be very large indeed.

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**Exhibit 2 Lost sales due to DSD vendor service**
Saturday sales in an example store

Sources: Disguised client transactional data; Oliver Wyman analysis
At one client, we found stock-out issues on several popular varieties of a DSD item (for which the vendor had replenishment responsibility). The vendor’s replenishment schedule was not providing the level of service needed to stay in stock on these products when customers wanted to buy them.

By putting new processes and tools into place, the retailer could track vendor deliveries and service visits to each store, as well as monitor on-shelf availability by minute (Exhibit 2). This information was used to identify availability problems caused by the vendor’s schedule, including situations where vendor performance was not meeting the service levels agreed to with the stores.

Buyers were also given reports on their vendors, including information about the impact of poor service on product availability. Once the buyers understood the issues and had solid data to support them, they were able to work with their vendors to reduce stock-outs. This immediately improved availability, and sales increased accordingly.

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Why? Because understanding store performance in greater detail than ever is the key to creating new and powerful metrics and helping the stores continually improve. It is much easier for the stores to tackle bottlenecks in their in-store supply chain, for instance, if they have a clear view of which items are going out of stock every hour of the day on every day of the week.

**Explicitly manage the impact on associates:** Store associates can be an unforgiving group, and will quickly give up on an initiative they see as a waste of time. They have plenty of experience outlasting the latest flavor-of-the-month, so every step needs to make their lives easier, and everything needs to work perfectly the first time. The project team will never be able to convert people who have been turned off by early mistakes—a poorly-conceived initiative can be dead and buried in a matter of days, even if senior management only realizes it much later. Tesco is an example of how the impact on associates can be managed well. Their ‘Every Little Helps’ philosophy requires the champion of every initiative to demonstrate how it makes life better for customers, associates, and the shareholder before it is approved. It has been one of the foundations of their success in operations.

**Measure success and hold people accountable for it:** Too many aspects of store performance are poorly measured. For example, few retailers have high-quality availability reporting because they rely on infrequent in-store surveys; even fewer actually measure line lengths systematically. Without knowing exactly what is being delivered, it is very difficult to tell whether a project is succeeding. Metrics need to be created for the customer experience a store delivers and for the experience of associates, as well as for the direct costs involved.

Once the right metrics are in place, they should become part of an explicit accountability and feedback process. Every store should have fair performance targets, set in a way that accounts for structural differences between stores. Changes in these targets should be explicitly linked to providing the stores with new tools to manage themselves better. Reports should be produced to help each store understand its level of performance, and highlight areas for improvement. Accountability calls should be used to ensure each store knows that senior management expects the store to hit its targets. Finally, support should be offered to stores that consistently miss their targets, so they can learn how to improve.

One retailer used a series of workshops to educate all department, store and regional managers about improving freshness and reducing shrink costs in perishables. These workshops began by introducing new targets for freshness and shrink and by explaining how they had been arrived at fairly: Stores were grouped into ‘peer groups’ with similar structural characteristics (weekly sales, size of department, department layout, etc.), and store managers were measured against others in their peer group. This provided a fairer comparison than simply looking at averages in particular neighborhoods or regions.
The workshops also introduced new tools and reports to help stores manage to their new targets. This was an explicit quid pro quo with tougher targets linked to the introduction of new tools. Everyone from department clerks to store managers was trained on the new tools and how to ‘think freshness.’

The workshops were also used to launch monthly ‘accountability calls’. These made it clear that the targets were serious, and that poor performance would be called out. They were also used to identify consistent under-performers who would need further help. The results were immediate. Not only did many more stores begin hitting their targets, but the deviation from those targets narrowed considerably—a sure sign of a tightly managed process.

**TURNING THE PROBLEM ON ITS HEAD**

Achieving superiority in Store Operations is one of the best ways to ensure long-term success, yet it is a goal that continues to elude many retailers. Even though most have clear objectives for their operations initiatives, many have been frustrated by the complexity of the change process. The challenge is not what to do; it is how to make it happen.

A variety of factors contribute to this low success rate, but chief among them is the failure to recognize the interconnected nature of many operations problems—this increases the risk of mishandling the change management process for associates, and losing their support. In our experience, following a simple set of rules can make it much more likely that the lofty promises of those cost-savings plans and new systems will actually be delivered. This is a fundamentally different approach to most operations projects because it starts by turning the problem on its head and makes cost reductions a byproduct of the process rather than the aim itself. Counter-intuitive though this might seem, it is the key to improving the odds of success.

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**Exhibit 3 Deviation from store target**

<table>
<thead>
<tr>
<th>Stores</th>
<th>Before</th>
<th>After (against tougher targets)</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 %</td>
<td>Most stores missing targets</td>
<td>Most stores beating targets</td>
</tr>
<tr>
<td>2 %</td>
<td>Wide range of deviations</td>
<td>Much narrower range of deviations</td>
</tr>
</tbody>
</table>
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