

Agilence

# Shrink

## in Retail, Restaurants, and Grocery Stores

# What is Shrink?

Shrink, also referred to as shrinkage, can be defined as any unknown or unaccounted loss of inventory. Examples of shrink include internal or external theft, fraud, waste, human error, inefficient processes, and vendor issues.

Shrink is a core issue for retailers, restaurants, and grocery stores, as it is difficult to identify damage to profit margins in these segments. A simple way to calculate shrink is to look at the difference between the optimal sales profit from the expected inventory and the actual profit earned from sold goods.

Shrink Value = (Optimal value of products) – (Actual value of products)

### Industry-Specific Approaches to Shrink: Retail, Restaurants, and Grocery

There are many similarities in the way organizations manage shrink across retail, restaurants, and grocery stores. However, there are industry-specific strategies that can be applied to further understand the causes of shrink and fortify an organization's systems to help decrease shrink in the future.

#### Retail

Retail shrink rate can be calculated by the following equation:

**Retail Shrink Rate** = (Retail shrink value) / (Optimal retail value of products)

For example, if a retailer purchased $1,000 worth of goods, but could only sell $975, the shrink rate would be $25 / $1,000 = 2.5%.

There is a concept in loss prevention called Total Retail Loss (TRL) that provides an alternative to shrink as a method of understanding losses and evaluating future risks. While some experts claim that Total Retail Loss should be used as a replacement to shrink as an evaluation tool, both offer valuable insights that can be viewed in tandem to get a complete picture of all loss that is unable to be accounted for.

#### Total Retail Loss vs. Shrink – A Comparison

*Total Retail Loss*

Total retail loss gives retail organizations the ability to manage retail complexity in a way that properly accounts for the scale, nature, and impact of losses. TRL also focuses on higher levels of transparency, which unearth forms of loss that may otherwise be left unidentified. This increases accountability within organizations as well.

Additionally, TRL helps executives improve decision-making by evaluating operations more holistically and revealing cross-functional trade-offs that may be costing the organization money.

*Shrink*

Although TRL is a helpful tool that can be used to reduce retail shrink, it should not be used to replace the investigation of shrink itself. Retailers should continue to define shrink as any unknown inventory losses to hone in on this specific aspect of the problems that are leading to shrink in the first place.

In retail, acceptable shrink rates typically lie somewhere between 1-2%, with the retail average being approximately 1.6% in 2020.

## Restaurants

Restaurant shrink can be difficult to understand based on the variable nature of the business. There are several factors that can be monitored to give organizations the ability to reduce shrink across multiple restaurant locations.

*Monitoring Food Costs*

Keeping a close eye on food cost percentage gives companies the power to identify areas for potential shrink and be proactive in creating solutions. Monitoring food costs also helps reduce restaurant shrink by identifying rising supplier costs, issues with portions, spoilage, and other forms of shrinkage ***before*** profits are affected.

*Analyzing Net Profit Margin*

Net profit represents the money that a restaurant or restaurant chain makes after accounting for all additional costs. These costs include operating costs such as cost of goods sold, labor costs,




rent, equipment, and utilities, as well as any other costs that need to be subtracted from revenue to provide a more complete picture of an organization's financial state. Restaurant shrink is used to determine where unaccountable losses are eating away at profit margins so organizations can implement effective changes.

With 6% being the average net profit margin in the restaurant industry, restaurateurs and executives are well aware of the value that can be added by reducing shrink by even the thinnest margins.

How to calculate net profit margin:

**Net Profit Margin** = (Gross sales – operating expenses) / gross sales

### Grocery

Grocery shrink is a dynamic challenge that continues to evolve at a rapid pace. Grocers must focus on reducing waste and remaining profitable while adapting to the shopping habits of their respective market.

Spoilage, theft, and fraud are three of the most common types of grocery shrink. Food spoilage is a form of perishable shrink, which we will discuss in further detail in the section titled **Analyzing Shrink — Causes & Solutions**.

Theft and fraud are present in virtually every industry, but the large inventories, constantly changing workforces, and third-party services present in grocery store chains create additional problems. LP experts and operational teams can mitigate shrink by improving operational systems and food packaging to reduce spoilage, as well as bolstering security and organization-wide accountability to reduce theft and fraud.

*Shrinkflation*

There are additional challenges that face grocers in times of recession or supply chain issues. Namely, there is a new concept called "Shrinkflation" that refers to the practice of a grocer increasing prices or charging the same amount for less total product. The burden of Shrinkflation is largely carried by consumers, and it can be used as a technique to remain profitable in times of economic turmoil.

Keep in mind, Shrinkflation results in offering a lower value to customers, so it is important that organizations do not overuse this technique and only apply it when necessary. Grocery shrink can be mitigated by leveraging cost-saving methods when it makes sense to do so and by focusing on optimizing customer acquisition and experience on a continual basis.

## eCommerce Shrink and the Omnichannel

eCommerce is one of the fastest growing segments across virtually every industry, which places an increased pressure on organizations to optimize digital channels to help mitigate eCommerce shrink. Due to several factors, retailers lose between 3-8 margin points when customers take online purchasing journeys compared to buying in store.

### Online, BOPIS, and BORIS

With the rise in the omnichannel comes a proportionate rise in eCommerce shrink. Online shopping, BOPIS, and BORIS all open the door for shrink due to the variable nature of the transactions taking place. This requires companies to focus on optimizing these channels to prevent fraud and improve operational efficiency.

According to a recent study, nearly two-thirds of North American consumers still choose to shop in a physical store for essential goods, while shopping online for the remaining third of purchases.



### Third Party Delivery Services

Another important element of the omnichannel that contributes to eCommerce shrink are third party delivery services. While companies can closely monitor and manage inventory coming in and out within the confines of their own processes, keeping track of inventory and losses from third party delivery services can be challenging.

Operations and executives who manage partnerships are responsible for keeping a close eye on the quality and success metrics of potential partners to determine whether the third-party organizations have strategic measures in place to combat shrink.

## Which Departments Focus on Shrink?

When it comes to the retail, restaurant, and grocery industries, shrink impacts three primary departments: finance, loss prevention, and operations.

### Finance

At its core, shrink focuses on the money that is lost but cannot be accounted for. This directly impacts the finance department, as the Head of Finance and his or her team are responsible for overseeing all financial data and analyzing the financial health of the company.

The finance department collaborates closely with management teams to facilitate growth while maintaining a focus on the bottom line. Additionally, it is the job of the finance department t o build systems to support cost reduction and margin expansion. These efforts depend on the amount of shrink a company is facing, so a finance team will often identify shrink early and participate in planning and improvement efforts.

### Loss Prevention

As one of the most challenging loss contributors a business will face, shrink is a constant area of focus for loss prevention teams. LP departments focus on all efforts surrounding asset protection, loss control, and audit initiatives. Because shrink can be difficult to identify and track, loss prevention experts will review, analyze, and evaluate the effectiveness of operations and policies in effort to make improvements to areas that may be leading to shrink.

Fraud is often a primary contributor to a company's shrinkage. Loss prevention teams collaborate with finance and operations departments, as well as in-store managers and staff, to evaluate occurrences of fraud and see where the company is facing the highest risk. The process of mitigating shrink is dynamic and requires continual iterations, and it is the LP team's responsibility to uncover the root causes of shrink as the business evolves over time.

### Operations

Operations teams, from entry-level analysts to the COO, work together to continuously measure, analyze, and focus on improving performance to increase the operational efficiency of a company. Because shrink is often caused by operational inefficiencies or organizational blind spots, operations teams are often involved with projects that focus on reducing shrink and tightening systems to prevent further issues with shrink down the line.

One key task for operations departments is to perform analysis on BOPIS (Buy Online Pay In Store) and BORIS (Buy Online Return In Store). BOPIS and BORIS are options made available to improve customer experience and increase sales, but they also make companies susceptible to shrink due to the margin damages taken from higher rates of BOPIS and BORIS.

Operations and loss prevention teams often work hand-in-hand in effort to improve profitability without compromising the customer experience. Both departments, along with the finance department, utilize integrated analytics solutions that offer a holistic view of sales, day-to-day operations, and loss across all channels.

## Challenges of Evaluating Shrink

### Identifying Areas of Loss

Understanding where the greatest areas of loss are within an organization is more difficult than it may seem. This is the essence of why shrink is important to understand. If a business is unable to identify where they are losing money and cutting into profit margins, finding a solution is going to be challenging.

Whether developed in-house or purchased through a third party, systems that allow an organization to track analytics, flag events, and collaborate on cases in real time help ease the challenge of identifying the cause of shrinkage.

### Monitoring Shrink Across Hundreds of Stores / Districts / Employees

Analyzing and identifying shrink across hundreds of stores/districts/employees creates a problem for many organizations. Without a holistic view of a business's total loss, identifying recurring instances of shrink is especially difficult. On the other hand, organizations that utilize cloud-based solutions create a system where loss prevention experts can monitor the data across all locations to uncover key insights into the root cause of shrink.

### Determining the Source of Operational Inefficiencies

As we've discussed, one of the leading contributors to shrinkage are operational inefficiencies. There are other facets of loss that are easier to understand, but the very nature of shrink consisting of unaccountable loss makes it challenging to evaluate. However, improving operational efficiency is a valuable method to reduce shrink, as it allows companies to avoid unnecessary waste, create more efficient processes for employees, and put systems in place to mitigate theft and/or fraud.

A key component to optimizing operations is to get adherence from employees across the organization. By introducing operational changes that prioritize transparency and accountability, organizations can get a clearer picture of where losses are coming from. Because increased accountability incentivizes employees on an individual level, workers tend to increase their quality of work and follow company protocols more closely to help further their career, earn salary raises, and achieve other performance-based incentives.

## Analyzing Shrink — Causes & Solutions

### Perishable Shrink

**CAUSE:** When left unchecked, perishables shrink profits. In restaurants and grocery stores, perishable shrink is the cause of the majority of all shrinkage. Perishable shrink can be defined as any unaccounted-for loss due to spoilage and mishandling of perishable food, drinks, or floral items.



**SOLUTION:** To make up for damages that accumulate from perishable shrink, grocers and restaurants can implement company-wide strategic measures to combat the losses. One potent solution is to improve product packaging in order to extend the shelf-life of an item and reduce instances of perishable shrink. Companies can also prioritize SKU expiration and rotation to increase the likelihood of customers purchasing items that are nearing expiration or staff preparing cooked items with ingredients nearing their expiration dates.

Additionally, organizations can focus on equipping employees with the best practices for handling food to reduce the amount of waste that occurs before the items are ready to be sold.

### Poor Inventory Management

**CAUSE:** Failure to adapt to the evolving demands from customers across retail, restaurant, and grocery segments leads to poor management of inventory, and, as a result, higher shrinkage. This issue is often due to short-sighted inventory ordering and a lack of vision on changes to economic and cultural demands that will influence future buying decisions.

**SOLUTION:** Strike the right inventory balance by improving the accuracy of forecasting. The practice of forecasting involves ordering the right amount of products to avoid going out of stock on items that are high in demand without ordering excess quantities of goods that will eventually expire, or in the case of retail, be resold to smaller retailers. Company leaders who oversee inventory must consider profitability, customer demand, supply chain availability, price, display, and waste potential in order to optimize their inventory management system.

### Operational Issues

**CAUSE:** Over-ordering, merchandising, and rotation issues can lead to high levels of shrink that are often difficult to quantity. Stores that are not thoughtful about their order quantity and assortment run the risk of underperforming during spikes in demand that stem from seasonal or regional influences. Additionally, undertraining employees in merchandising, food safety, and rotation can lead to inefficiencies that further exacerbate the operational problems.

**SOLUTION:** Use analytics to reduce shrink. As companies optimize their ordering practices, shrink tends to improve. Operational issues can be navigated by making sure that operations and LP teams are working closely and utilizing the same data in a combined effort to uncover shrink-causing activities to improve profitability. Data from transactions, inventory, in-store employees, customers, and location should all be reviewed and leveraged to discover operational issues and inefficiencies, and of course, a strategy to solve them.

### Sales Reducing Activities (SRAs)

**CAUSE:** Sales reducing activities happen when inaccurate adjustments occur during checkout. This includes checkout in both physical stores and in eCommerce. SRAs include price adjustments, line voids, refunds, manual entries, coupons, tax overrides, and similar transaction alterations. Whether these reductions are intentional or done in a fraudulent manner, SRAs lead to a loss of profits and shrinkage that may not be immediately apparent.

**SOLUTION:** Flag SRAs to discover trends before they get out of hand. SRAs can be controlled or reduced through changes to policy, procedures, or systems. These efforts require more than simple observation but must utilize advanced analytics that include exception-based reporting (EBR) to identify potential trends.

Because of the valuable information already present in transaction systems, EBR analytics can target SRAs and other risk variables to help companies get a better overview of their current SRA-related shrinkage.

Additionally, organizations can put measures in place to increase employee accountability and improve training to reduce the rate of both accidental and intentional sales reducing activities.

## Conclusion

Reducing shrink by even the smallest margins can create massive savings and improve profits for a company. However, identifying shrinkage can be a challenge and requires a comprehensive strategy that is implemented on every level of an organization. In order to do this effectively, companies must identify the best approaches for their industry and unique business model. Operations and loss prevention departments can find ways to mitigate shrink-related losses by accounting for eCommerce shrink and maximizing their approach to doing business across the omnichannel.

Organizations can combat the common challenges of shrink by putting systems in place that allow them to look beyond simple data and acquire insights that can open the door to large-scale improvements to operational systems. By understanding the primary causes of shrink and developing solutions that will help reduce shrinkage, companies can put themselves in the driver's seat to control the direction of their shrink and loss in effort to increase net profits over the long term.

Agilence has helped hundreds of retailers, restaurant operators, and grocers increase their profit margins by reducing shrink. **Find out more about our platform**.

## QUICK LINKS

- Solutions
- Platform
- Resources

At Agilence, we specialize in uniting digital and physical transactions to help cutting-edge loss prevention teams expand beyond traditional theft and fraud to tackle preventable loss in all its forms — in the store, online, and at the corporate office. Agilence customers realize an average 33x ROI and breakeven in 38 days.

Every day, Agilence analyzes over 24 million transactions for our customers, transforming data into insights, and insights into actions. Our platform combines data from 200+ sources, including point-of-sale (POS), eCommerce, HR, labor, inventory, product, third-party delivery platforms, alarms, case management, loyalty, access control, video surveillance, and more.

Companies have saved millions of dollars by optimizing operations, identifying sources of margin erosion, and reducing shrink using Agilence. Many have also improved employee and customer safety, identified training opportunities, improved customer experiences, increased promotional success, and eliminated productivity gaps.

Agilence

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