OPERATIONS EXCELLENCE

THE RISE AND RISE OF COST REDUCTION

HOW TO CUT BETWEEN 20 TO 40 PERCENT OF COSTS FROM A RETAIL OPERATING MODEL

Cost is always on any good retailer's agenda. Cost inflation is usually higher than price inflation, so the business must continuously generate efficiencies to maintain the same level of profitability. However, this treadmill can generate an incremental approach toward cost: squeezing out a little more each year, salami slicing labor budgets, pushing suppliers a bit harder, challenging expense budgets.

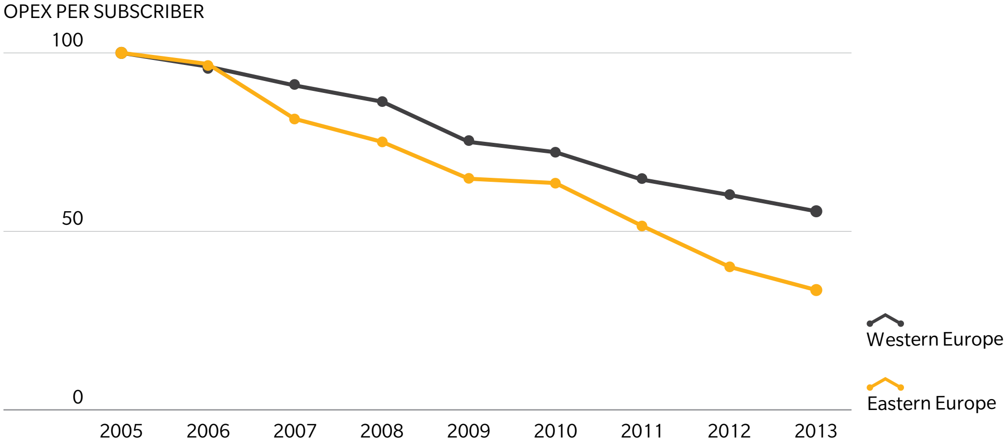
Such programs are part of the day-to-day for most retail executives. But in today's market, such incremental efforts are no longer good enough.

Faced with flat demand, excess space, and competition from lower-cost business models, what many retailers really need to do is dramatically change their cost structure by stepping up cost savings by an order of magnitude – we're talking 20 percent instead of 2 percent. Other industries have already lived through this: over the past decade, to remain profitable as the average revenue brought in by each user has declined, mobile telco operators across Europe have had to cut business costs per subscriber by up to 30 percent. (See Exhibit 1.)

Similarly, retail banks are cutting costs dramatically as their products become digital and physical branches are needed less and less.

For the first time, we're seeing many retailers getting ready to look at cost step-change programs. A few years ago, step-change conversations on cost were rare among retailers; today, they are common.

Exhibit 1: Telco operators successfully reduced OPEX per subscriber by over 30 percent in less than a decade



Source: UBS; Wireless Matrix (BoA, Merrill Lynch); Informa Telecoms & Media; CISCO; IEEE; Oliver Wyman Research

Exhibit 2: Three steps to a zero-based approach to cost

Step 1: Identify survival minimum

- Base services, such as regulatory reporting
- Justified internal demands, such as health and safety
- But no frills, no comfort, no breakouts

Step 2: Identify strategic minimum

- Short-, medium-, and long-term targets are all considered
- No frills, with only a few people creating impact, but targeted investments are delivered

Step 3: Agree a realistic optimization target

- Limited amount of extra activities included
- No unnecessary internal demand
- Few activities that do not create extra value

So how can a retailer step-change its cost position? One way is for the retailer to switch from ongoing incremental reductions in head office staff to a zero-based approach toward each function. (See Exhibit 2.), Here, the focus is on tasks that are truly business critical or ones with a real business case – eliminating “nice to have” activities.

Across the business, it’s also important to examine radical process simplification and automation – for both internal and customer-facing activities – learning lessons from the new breed of digital retailers. There are now online-only retailers turning over in excess of $1 billion that operate with as few as 200 full-time equivalent staff in the head office. Of course, incumbents are not the same as digital businesses, but the approaches these new entrants take, particularly around using analytics and algorithms to lower staff costs, are instructive. We describe one case of transforming an insurance business through digitization in Case Study 1.

In retail, taking out significant amounts of “tail” range in categories where customers do not value a broad choice enables the customer proposition to be simplified. In Case Study 2, we explain how one discounter reduced its average store product range by 20 percent. While removing products needs to be done carefully, if the cuts are focused on duplicative products and/or categories that are not “choice elastic,” then the sales hit can be minimized and sometimes reduced to zero. Simplifying the range in this way enables efficiencies in supply chain and store operating models and a consequent reduction in cost.

The final activity that can bring about a cost step-change is simplifying and rationalizing the supplier base to collaborate much more closely with a smaller number of suppliers and as a result, get significantly better terms (see our report “MoreTrust Wins More Value”). Among some retailers, there is also an opportunity to remove middlemen from the supply chain, as well as shift share to higher-margin, white-label products.

CONCLUSION

As other industry sectors have made vast improvements in their cost position, retailers may take heart from their success – but they also need the vision to think big. Substantial increases in cost savings have not been achieved through small-scale incremental change to existing business models. Instead, retailers need to go back to the drawing board – leaving behind the “this is how we’ve always done it” mindset and following a zero-based approach to cost that focuses on what customers really want and need. By redesigning products and services against a low-cost model – for example by using new technology to help customers help themselves or by reducing complexity – retailers can follow those other industries into a profitable future. This kind of change doesn’t happen overnight, but we expect to see more retailers in more markets attempting similar programs over the next few years.

CASE STUDY 1

COST REDUCTION THROUGH DIGITIZATION

BACKGROUND

A traditional personal insurance company in Europe was losing customers to new digital rivals. It had identified that digitization was the key to survival, and wanted to use it to become more agile with pricing and to streamline the operating model.

WHAT WE DID

We benchmarked the company against insurance competitors and other successful digital disruptors, which challenged the management team to think differently about how to get things done. We showed the team that one competitor was able to update its prices every 15 minutes, while another needed only 30 customer service staff on 750,000 policies.

With these benchmarks in mind, we helped the company reinvent its key processes in the mold of a digital disruptor. One way was to allow customers to log and track claims online; another was creating a one-stop-shop for its claims suppliers. We also took over a terabyte of data and created a custom analytics engine, which looked at 8,000 risk factor combinations, 750,000 data points, and over 200 million individual quotes, to deliver weekly risk assessments of its clients.

RESULTS

The benefits to the company were significant:

- Over £100 million of quick wins delivered within 18 months, by rapidly moving the business towards the agreed target cost levels.
- More than 5 points of margin improvement, achieved through dynamic pricing, risk reduction, and add-on penetration.
- Improved agility to react to price changes from competitors.

CASE STUDY 2

COST REDUCTION THROUGH REDUCED COMPLEXITY

BACKGROUND

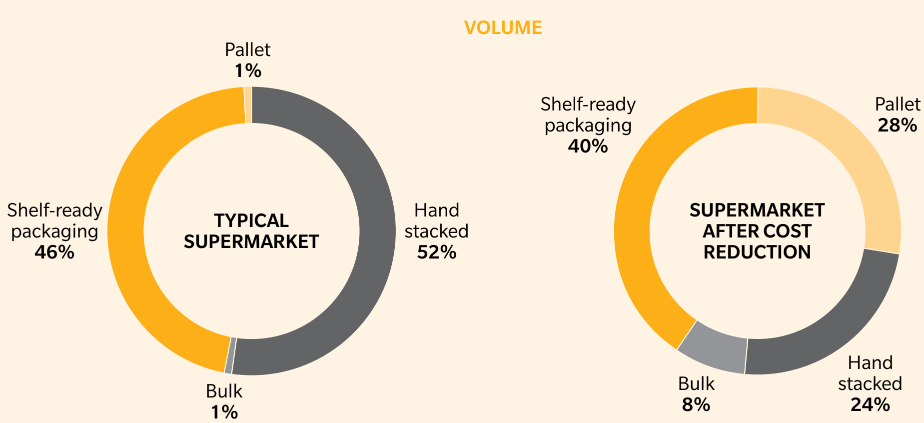
A struggling US discounter identified that it had a vast product range that was contributing extra complexity to the business model, resulting in higher costs across the business.

WHAT WE DID

Working with suppliers, the retailer switched to only stocking fresh products ready to sell, without any cutting or wrapping in store. When rationalizing the fresh range, we removed high-waste items and focused on stocking products sourced nearby the retailer's distribution center, reducing supply-chain costs. We reduced the number of hand-stacked products by introducing cases ready-to-go direct onto the shelves and, in some instances, by shifting from cases to mini pallets. (See Exhibit 3.)

For faster checkouts, the placement of bar codes on items was optimized to ensure the products scanned the first time, and we increased the height of the checkout counter so items could be slid directly through the bar code scanner and into the shopping cart.

Exhibit 3: Fast and efficient replenishment solutions can deliver 1–1.5 percent operating efficiencies in store



RESULTS

The retailer achieved a 25 percent reduction in the number of different products sold in a typical store, which supported further reductions of:

- 20 percent in supply chain costs
- Over 5 percent in other store costs such as utilities, maintenance, and cleaning
- Over 30 percent of store labor costs