

# Ernst & Young Study Estimates Retailers Lose \$46 Billion Annually to Inventory Shrinkage; Employee Theft Is Biggest Problem

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Ernst & Young LLP today released its Study of Retail Loss Prevention.

The study examines how retailers manage one of their most significant costs -- inventory shrinkage, which includes employee theft, shoplifting, administrative and paperwork errors, and vendor errors/issues. In addition to the financial impact of "shrink," the survey provides new insight on the effectiveness of the programs and tools employed by retailers to combat it. The study estimates that the U.S. retail industry loses a staggering \$46 billion annually to inventory shrinkage, and that employee theft delivers the heaviest blow in terms of dollars lost.

"Companies are placing a renewed emphasis on managing shrink to help improve profitability in this difficult economic environment," said Jay McIntosh, Americas Director, Retail and Consumer Products, Ernst & Young, "Based on the results of our survey, which indicate a median loss of 1.7 percent, or \$19 million per participant, translating to an industry-wide loss of \$46 billion annually, the profit at risk most certainly justifies this renewed focus."

## The Employee Factor

According to the study, employee theft is the single biggest contributor to inventory shrinkage even though shoplifters far outpace dishonest employees. "This is because the dollar value of employee theft on a per incident basis is much higher than that of shoplifting," said McIntosh. "But according to our study, apprehensions of shoplifters far outpace apprehensions of employees." Though employees accounted for only 1 out of every 10 apprehensions, the average value of merchandise recovered was nearly seven times that of the average shoplifter, \$1,525 and \$223 respectively.

"These numbers should raise a red flag for retailers. If, as our study indicates, 47 percent of dollars lost to shrinkage are attributable to employee theft, there should be less satisfaction with the ability to catch shoplifters, and more emphasis on efforts to identify and deter in-house theft," said McIntosh.

The average study respondent spends more than \$2 million a year on loss prevention. However, less than half the study respondents (45 percent) reported a decrease in shrink over the previous year, while 29 percent reported an increase and 27 percent said shrinkage was consistent. Respondents said they use a dozen different employee awareness programs including hotlines, codes of conduct and incentive compensation programs to try to address employee theft, but the problem is likely the way these programs are deployed. Simply having programs and procedures in place, or announcing them to employees, isn't enough. To maximize ROI, companies must follow up by enforcing the policies visibly and directly.

"A company can employ a dozen, or a thousand, programs to deter theft, but if the discrepancies are simply being overlooked, then the problem clearly has roots in management, and not procedure," said McIntosh. "We believe that what's needed is

a combination of analytics to better identify deviations, better in-store procedures such as cycle counts of inventory, and stronger corporate policies to enforce anti-theft programs."

As capital markets continue to punish companies for poor performance and earnings surprises, substandard shrinkage reduction efforts pose a serious risk to retailers. An analytical approach can provide a valuable understanding of the causes of shrink and help retailers develop loss prevention measures that more effectively address their issues. Transactional systems such as Point of Sale (POS) systems have both increased the amount of data available to retailers and decreased the cost of collecting it.

"While rules of thumb or intuition have been employed in the past to make loss prevention investment decisions, today's environment demands a more rigorous approach," said McIntosh. "By using sophisticated analytics, retailers can make better loss prevention decisions. Just a relatively small improvement can have a significant impact on a retailer's bottom line."

### **Four-Step Action Plan**

No. 1: Conduct a Thorough Analysis of Current State of Shrinkage within Stores

- Allows discovery of where and how much shrinkage is occurring
- Provides a view of the resources currently devoted to shrink reduction
- Enables categorization and estimation of spending in specific areas

No. 2: Develop Cause-and-Effect Models for Data Analysis

- Relates shrinkage reduction to various types of loss prevention expenditures
- Reveals preliminary or directional ROI
- Identifies best and worst performing stores

No. 3: Test the Optimal Strategy

- Validates the ROI of specific initiatives
- Justifies the reprioritization of existing loss prevention investments
- Allows for measurement

No. 4: Implement and Roll Out

- Standard operating procedures for all stores
- Continually refine and monitor