Understanding Big Data: Retail Therapy for a Long-Term Restructuring Solution?

With the growing prevalence of online and mobile shopping, traditional retailers face significant hurdles to effectively compete in the global marketplace. Adding big data analysis to their toolbox presents an opportunity for retailers to enhance their decision-making process, improve supply chain management and reduce insolvency levels.

Bob Rajan, Managing Director and the Co-Head of Restructuring with Alvarez & Marsal in Munich, and Maximilian Baer, an Associate with A&M, were recently featured in INSOL World about the role of big data in retail restructuring. Mr. Rajan and Mr. Baer spoke with Global Marketing about the current challenges in the retail industry and the role that big data will take in the near future.

Q. Volatile demand, shifting consumer preferences and the increasing influence of online / mobile shopping are some of retailers' biggest issues that you highlight in your article. What are other barriers that retailers face when trying to improve performance, particularly as we move into the holiday season and 2016?

Leading into this year's holiday season, retailers are still facing relatively high stock levels, resulting in significant pressure on prices and promotion activities. Retailers need to be careful not to run into a vicious cycle with price wars and consumers focused on bargaining offers.

Long-term, retailers are facing many other challenges such as demographic change, privacy issues and sustainability, among other potential problems. However, in the end consumers' behavior and technological change seem to be the most important factors in a retailer's environment.

Q. You mentioned that investors across the board have been avoiding retail investments. Do you expect these funding constraints to continue to affect traditional retailers, or could they expect some relief to their liquidity issues in the near future?

We believe that retailers will continue to face significant funding constraints in the future due to the fact that retail in general is a highly volatile business. Particularly, the outlook for traditional financing instruments is unlikely to improve in the near future. However, alternative funding instruments (e.g. asset backed lending and traditional borrowing base facilities) might be an opportunity for many troubled retailers.

Q. Why haven't traditional retailers with physical presences fully taken advantage of big data in their decision-making process to date?

Many retailers seem to have ignored the early indicators of this changing retail environment. It is very difficult for retailers to compete and get ahead of their competitors when they have entered the race so late. And while some are still trying to fix their e-commerce platforms, the early birds have taken the next step by creating a "uniform omni-channel" experience for their valued customers.

Q. Your key recommendations for leveraging big data, with the assistance of restructuring professionals, include product range analyzation, write-off management and efficient supply chain / logistics operations. In what other areas can retailers apply data analytics for business performance improvement?

Generally, there are no limits for what you can do with big data. The focal point for analyzing one's customers is to develop a better understanding of their needs and to subsequently tailor offerings and communication according to his/her preferences, as well as enhance operational processes and make them more efficient. In countries with highly successful e-commerce platforms, people often joke that "your favorite shop knows you better than your family." However, particularly in restructuring situations, we recommend to rather focus on the few levers we mentioned. More data also means more complexity, which requires extensive experience and robust decision models. Some even argue that the complexity of big data can be a threat since being successful in retail means having a "good nose" for changing consumer preferences and new trends and doing it quickly.

Q. By adding big data to their toolbox, can retailers expect to compete with the online giants? Will this only be possible with a robust mobile e-commerce platform

Mobile platforms are just one piece of the puzzle, but it needs to be integrated into a wider omni-channel strategy. Retailers need to connect with their customers across all channels in a uniform, yet individual way to be successful in the long-term. Whether being successful means to compete with the giants or finding a sweet spot as a niche player is a question of each retailer's DNA.

Please continue reading below for Mr. Rajan and Mr. Baer's full article from INSOL World 3rd Quarter 2015.

Introduction

Have you ever wondered why Bond Street in London is always busy and flooded with people? Try to marry that vision with the typical perception in today's market, not only in Europe, but globally that very few apparel retailers make money and seem to always compete in a cut-throat environment.

From a bird's eye perspective, retail – one of the oldest industries in the world– sounds very simple – "Have the right location to sell the right product at the right price at the right time". However, when one looks closer, retailers are in fact exposed to diverse challenges from all angles in the market. Demand is highly volatile and driven by everchanging consumer preferences and new lifestyle, trends.

The highly competitive market environment forces retailers to engage in sometimes ungodly price wars and rebate battles to avoid ending up with high overstock levels. Low entry barriers heat up competition even more and the emergence of the Internet and, more specifically, the mobile device, opens the door for new innovative players with a low cost base. On the other hand, the rationalization and implementation of cost reduction measures has its limits and the competitive sourcing prices in the Far East can only be reduced to a certain level, taking into account the increasing demand for sustainability and corporate social responsibility. Recently, the strength in the U.S. dollar against the Euro has additionally created several sourcing issues for retailers who purchase their goods and/or raw materials from Asia, putting even further pressure on positive cash flow generation.

Based on the aforementioned thoughts, one might predict that many traditional retailers will continue to remain financially distressed, experience liquidity problems and perpetually remain in 'turnaround mode'. Although there appears to be extensive liquidity in the capital markets these days (and in the medium-term), even risk-taking investors are still quite cautious and reluctant to inject new money into retail investments.

Considering these funding constraints leads one to conclude that operational improvements are the 'golden key' to being successful in retail. For many years, the retail toolbox has not significantly changed. The four-wall cash flow (store by store), SKU analysis, footfall, effective merchandising, a robust supply chain and sales per square metre are some of the benchmarks and buzzwords often used. Unfortunately, with the evolution of giants like Amazon trying to apply predicative analysis to consumer preferences and expanding the number of channels to reach the customer, managing a retail enterprise has become far more complex. Many troubled retailers are unable to cope with the information overflow and the inability to react quickly. However, if correctly understood, the use of big data and the ability to rapidly collect, analyze and interpret this data might reduce retail insolvency levels in the future. This article will discuss three areas worth looking at in the retail apparel segment where big data analysis should be used. Before this it is first worth looking at the retail space in Europe in the past year.

Retail in Europe in 2014[1]

The retail sectors in specific geographies in Western Europe in 2014 experienced mixed results. In the U.K., it was almost guaranteed that the retail sector would improve compared to 2012 and 2013, due to an improved economy and more effective marketing techniques, leading to improved multi-channel business offerings. In Spain, almost 20% of all insolvencies were in the retail sector, despite increased consumer spending and changes in insolvency legislation to promote turnaround culture. It is expected that the Spanish government will stimulate the economy further to hopefully prevent further derailing of the Spanish retail sector. In 2014 France experienced a lower number of retail insolvencies than in 2013, in spite of lower household consumption, but the overall number of insolvencies across all sectors was significantly up, reinforcing the conundrum stated in the first paragraph. In Germany, retail still tends to be difficult for investors to throw new money at. In particular, the DIY sector, fashion and value-discount retailers and the personal electronic sector have all experienced distress and some insolvencies.

Using Big Data as Part of the Retail Toolbox

To reiterate, there is a perception that retail is simple: ‘Have the right location to sell the right product at the right price at the right time!’ Easier said than done.

First and foremost, having the right product is certainly the single most important issue in any retail organization. We would argue that buying the right product(s) can be more an art (as opposed to a science) and should be performed by true artists (i.e. buyers) rather than restructuring professionals. However, a clearly focused product range is key to optimising working capital and this is next to impossible when many artists have the natural tendency to expand or experiment in too many different categories and product groups, with very little rationale. Analyzing the current product range for profitability and/or cash generation, starting at a category level and drilling down to SKU level; helps to trim the product range to the right level. Basic mistakes like “long tails” and product groups “below critical mass levels” are unfortunately still extremely prevalent and typical in many retail organizations (Figure 1 and Figure 2).

Figure 1: A small number of articles generate the majority of contribution margin within a specific product group (Long Tail).

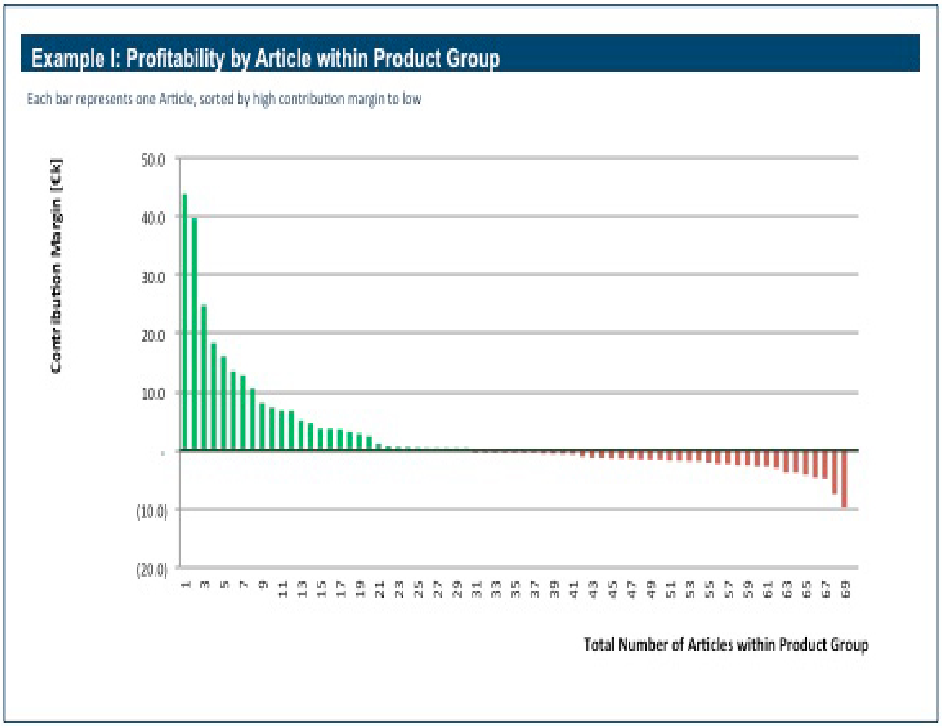
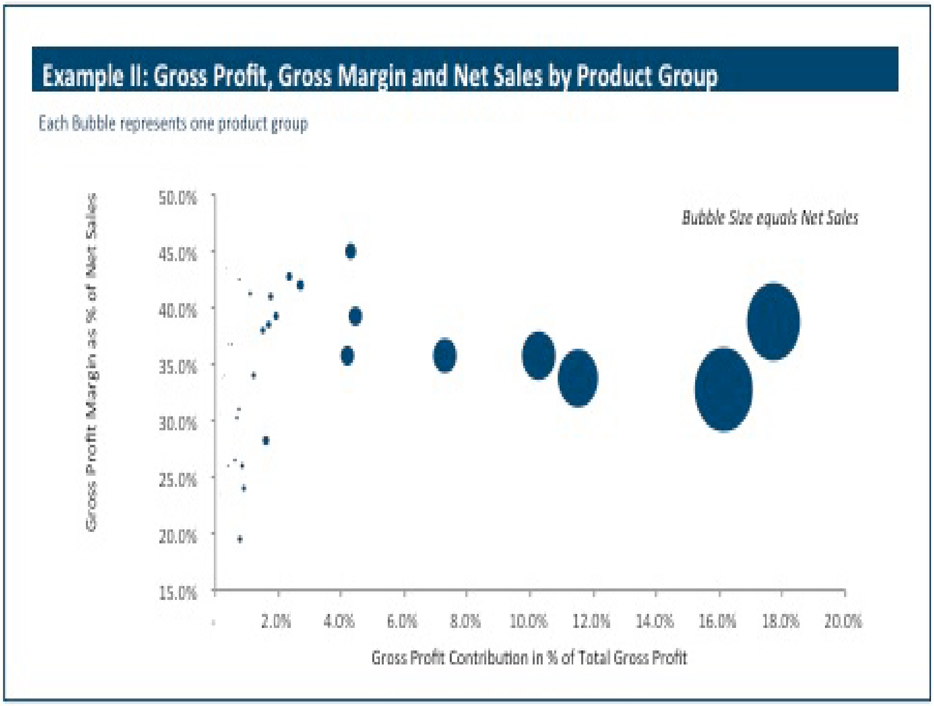


Figure 2: Below critical mass - Product Groups with minimal volume need to be eliminated. Lower volume product groups should generally aim for a higher margin than high volume product groups. Sounds simple but rarely the situation.



Secondly, 'first price, right price' and managing subsequent price reductions is another highly sophisticated area. In fashion retailers, seasonal inventory and managing write-offs are always subjects of great debate. Whereas setting the initial price requires the veteran experience of retail operators, restructuring professionals can assist distressed retail clients on the management of write-offs. When should seasonal inventory levels run down to zero? After a season ends, how long should one hold seasonal inventory? Should inventory levels be reduced to a negligible level between 1%-3% or less? Should inventory be blown at season end or should management start to discount earlier in the season? Efficient in-season management is all about a clear understanding of slow-sellers and fast-sellers within the product portfolio. Financial and merchandise management should ensure a weekly review of inventory turnovers, physical quantity sold and weeks coverage on SKU level. From our experience, large parts of retail organizations do not understand the implication of slowsellers on working capital and thus liquidity or financing cost. Furthermore, the timing of pricing actions is crucial and frequently, retailers initiate price reductions too late in an attempt to maintain margin. Particularly in low liquidity situation, a faster and aggressive clearance of slow-sellers and older seasonal stock may be preferable. Even if losses are high, the generated liquidity can be used for restocking of fast-sellers or investment in promising new product lines. Whether price reductions should be managed locally (department stores, large shops) or centrally (discounters, small shops) on the enterprise's business model.

Thirdly, the ability to think quickly and have the right stock at the right price at the right location requires both efficient supply chain /logistics operations and effective retail analytics. As mentioned earlier, supply chain and logistics are two of the most important, albeit expensive, costs in any retail profit and loss statement, although therein also lies the greatest cost-saving opportunity. As in other industries, uncertainties at the front-end can be mitigated by establishing a close information link between suppliers and the retail organization. On the back-end, a thorough data analysis in order to cluster stores by certain customer preferences and supply them accordingly is recommended.

So far, we have outlined three key fundamental areas where Big Data is critical, but what has transformed retail so far away from its original business, making it difficult for operators to tackle the aforementioned decisions? The invention of the smart phone has probably been the most unsettling factor in the last decade for retail organizations. Now customers compare vendors, search for alternatives and at the same time, purchase products and demand delivery of their purchases almost instantaneously and the limits of what they can do are endless. Unfortunately, senior executives often overestimate the cost associated with the information technology spend required to capture the relevant data. This is not the same cost as implementing an Enterprise Resource Planning ('ERP') system, but is typically a fraction of that cost. This new mcommerce boom involving mobile shopping is still most prevalent in Asia, but moving quickly from the East to the West. In South Korea for instance, approximately two-thirds of the population own a mobile device (compared to ca. 50% of people in the U.K.) and prefer to buy online[2]. Therefore, it is increasingly important that retailers establish solid m-commerce offerings as demanded by consumers, simultaneously harvesting insights from data analytics, understanding customer preferences and ensuring customer loyalty.

Conclusion

Data based decision making is a key success factor in any retail restructuring situation. The impact of tactical measures in pricing and product can be significantly strengthened by focusing on the right data. Data driven supply chain management helps to establish a low cost logistics organization in the medium term. Reducing costs needs to always take into the account the impact of working capital. Going forward, e-commerce (or possibly m-commerce) will be a decisive factor in any retail organization. While several retailers are rapidly building their e-commerce and online platforms, their online sales as a percentage of their total sales still pale in comparison to the big picture. Nevertheless, with Amazon trying to apply predicative analysis to guess what a customer wants before they 'click-and-buy' and using remote drones to deliver purchases, retailers need to act fast to collect their respective Big Data and interpret the relevant results. Converting these observations into actions that can be implemented almost instantaneously might just allow a retailer to become best in class.

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About the Authors

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[1] EU Retailers' Struggles Continue Amid Signs of Improvement, Journal of Corporate Renewal May 2015

[2] Learning from South Korea's mobile-retailing boom, McKinsey & Company Insights & Publications, May 2015
