UNDERSTANDING BIG DATA

RETAIL THERAPY FOR A LONG-TERM RESTRUCTURING SOLUTION?

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Have you ever wondered why Bond Street in London is always flooded with people? At the same time, try to marry that vision with what is typically perceived in today's market, not only in Europe, but globally – i.e. very few apparel retailers make money but they are always competing 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 ever-changing consumer preferences and new lifestyle trends. The highly competitive market environment forces retailers to engage in 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, mobile devices 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 of the U.S. dollar against the euro has 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 market 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 pre-existing funding constraints leads one to conclude that operational improvements are the "golden key" to being successful in retail. For many years, the corresponding 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 their 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. However, before this, it is first worth looking at the entire retail space in Europe in the past year.

RETAIL IN EUROPE IN 2014[1]

When reviewing specific geographies in Western Europe in 2014, the retail sector 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 percent

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

of all insolvencies were in the retail sector, despite increased consumer spending and changes in insolvency legislation, leading to a more turnaround-focused culture. It is expected that the Spanish government will stimulate the economy further to hopefully prevent further derailing of the Spanish retail sector.

France experienced a lower number of retail insolvencies, in spite of lower household consumption, comparing 2014 to 2013, but the overall number of insolvencies across all sectors was significantly up, leading us to confirm the conundrum as previously stated. 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, in certain cases, entered insolvency proceedings.

Example I: Profitability by Article within Product Group

Each bar represents one Article, sorted by high contribution margin to low

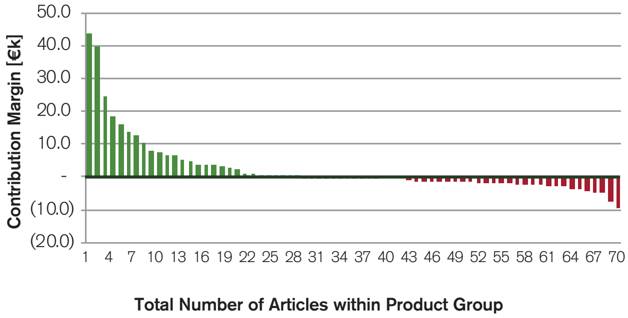

FIGURE 1: A small number of articles generate the majority of contribution margin within a specific product group (Long Tail).

USING BIG DATA AS PART OF THE RETAIL TOOLBOX

As we already described, most professionals on the outside claim 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).

Example II: Gross Profit, Gross Margin and Net Sales by Product Group

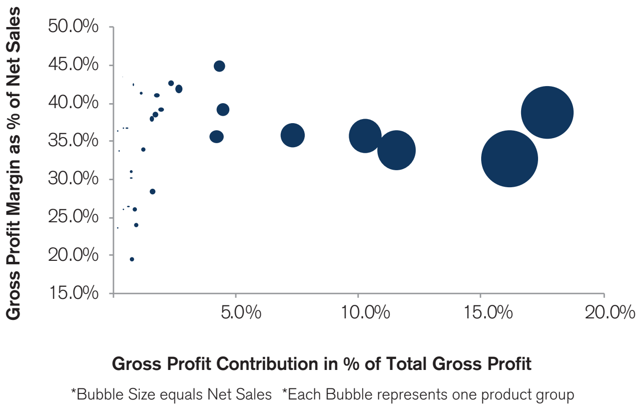

FIGURE 2: Below critical mass - Product Groups with minimal volume need to be eliminated. Lower volume product groups should generally aim for a higher margin than high volume product groups. What sounds simple is very rarely the situation.

Secondly, “first price, right price” and managing subsequent price reductions is another highly sophisticated area. In fashion retailers, the question of seasonal inventory and managing write-offs is always a subject of great debate. Whereas setting the initial price requires the veteran experience of retail operators, restructuring professionals should 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 down to zero or a negligible level between one to three percent? Should inventory be blown at season end or should management start to discount earlier in the season? These are the questions that management should understand. 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 slow-sellers 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 situations with low liquidity, we suggest a rather fast and aggressive clearance of slow-sellers and older seasonal stock. Despite possible high losses, the generated liquidity can be used for re-stocking of fast-sellers or investment in promising new product. Depending on the enterprise’s business model, price reductions should be managed locally (department stores, large shops) or centrally (discounters, small shops).

Thirdly, the ability to think quickly and have the right stock at the right time 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, if not expensive, costs in any retail profit and loss statement; however, equally, there also lies the greatest cost-saving opportunity. Like 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, we suggest a thorough data analysis in order to cluster stores by certain customer preferences and supply them accordingly.

The analysis of sizes and colours of garments will likely reveal significant differences among stores of the same retail chain (located in different geographies). Drilling down one further level to determine where top-sellers are located in each individual store (what we like to call inventory density) and how much contribution on a square metre basis is generated will improve communication between store management and logistics management and optimise inventory by implementing the right push-or-pull distribution framework. Additionally, eliminating the “long tail” of slow-selling SKUs further reduces inventory levels and overall supply chain costs.

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 are endless of what they will be able to do. 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, typically a fraction of that cost. This new m-commerce 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 (compare this to 50 percent 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 to understand customer preferences and to ensure customer loyalty.

[2] Learning from South Korea’s Mobile-Retailing Boom, McKinsey & Company Insights & Publications, May 2015

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 take into 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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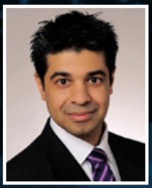

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