THE BAD BUSINESS “S” WORD: SHRINKAGE

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Abstract

This study focuses on critical management problems faced by retail and service companies in their quest to become or remain profitable. One highly critical management problem, oft unrecognized, is that posed by shrinkage and losses. To stem the disastrous impact on profitability Managers must undertake strategic planning and proactive management decision-making. They must provide a rational set of programs, procedures, and incentives to enlist the support of employees at all levels. Once organized, Management must provide effective education for the entire workforce. The organization must minimize shrinkage to enable survival in the competitive marketplace.

KEY WORDS: Shrinkage, loss prevention, employee theft, retail management, training, change management, and leadership. (Please note that the keywords encompass the full circle of subjects required.) Focusing on operations might begin with shrinkage...focusing on change management and leadership might prove an effective starting point for upper level managers.

INTRODUCTION

During the last decade, the business environment in the United States has become more competitive, more mergers and acquisitions took place, and more companies failed than in previous decades. Retail organizations and service providers have developed elaborate planning strategies to expand markets, save money, increase profits, remain, or become competitive. An area of increasing concern for managers in the marketplace is the bad business “S” word: shrinkage.

Shrinkage is the term used for inventory losses resulting from internal and external theft, and poor management practices. Today, these factors affect the bottom line of an increasing number of businesses. The data are shocking! In 2004, twenty-seven U.S. retail companies apprehended 750,000 shoplifters and dishonest employees.

The 17th Annual Retail Theft Survey conducted by the ‘loss prevention and inventory shrinkage consulting’ company Jack L. Hayes International provides more informative data. Some would say this is just the tip of the business iceberg since this survey only examines mass merchandisers. The problem is pervasive, 72 companies lost more than $4.7 billion to shoplifting and employee theft during 2004-2005.

The Progressive Grocer reports a very disturbing trend with respect to internal theft. Based on a survey on 1.7 million employees, one in every 28 employees was caught stealing from the company. Externally, retailers are also under siege from organized gangs of shoplifters. Retailers have joined forces using databases from their retailing industry trade groups. These databases open up the information flow and allow retailers to log in information on stores, weapons, types of products stolen and even post digital images to identify suspects and provide evidence to police to assist in solving retail crime. Often retail executives point out that state shoplifting laws are not dealing with organized crime rings and that shoplifting is not a federal crime until at least $5000 has been stolen across lines and that many attorneys will not get involved until the amount stolen is often 10 times higher. So retailers have
now turned to the process of developing national crime databases to help build legal cases against suspected theft rings. The retail shrinkage from employees, customers, or organized gangs of shoplifters is front and center on the retail industry agenda for resolution.

Shrinkage is also an international issue. Europe's consumer goods/grocery reported stock losses at €18 billion a year with many retailers losing one-third of their profits. The ECR Europe studies combined researchers from The Cranfield School of Management and the University of Leicester who collaborated with the ECR Shrinkage group. These studies analyzed data from retailers across Europe with in-depth analysis of four retail chains.

The ECR pragmatic guidelines for shrinkage prevention include eight guiding principles:

1. engage senior management and prioritize shrinkage,
2. identify accountability—measure, monitor, and motivate,
3. prioritize inter-and intra-company collaboration,
4. adopt a systemic and systematic approach,
5. unlock the value of the "hot concept",
6. focus on process failures first,
7. encourage innovation and experimentation, and

The summary conclusions were:
1) that shrinkage in hot stores is mostly a function of poor management and a lack of adherence to procedures, and
2) the environment in which a store is located affects shrinkage.

Both the European and American shrinkage intervention practices show that shrinkage reduction requires collaboration between trading partners in the supply chain as well as collaboration with employees and leadership by senior management.

In 1994, *The First Australian National Survey of Crimes Against Business* reports that retailers throughout Australia are losing approximately 1.97 per cent of gross sales. Earlier general comparisons from international surveys report the United States with 1.58 per cent (Median) shrinkage loss [Berlin, Sep, 1993 p.1], Canada with 2.3 per cent shrinkage loss (Average) [Berlin, Nov/Dec 1991 p.1], United Kingdom with 1.1 per cent shrinkage loss (Average) [Braithwaite, 1992, p. 4], and Australia with 1.97 per cent shrinkage (Average) [Walker, 1994, p. 111] [Maanenberg, p. 3].

Two mini cases are provided on shrinkage, one in a large retail firm and the second in a medium size retail firm. The appendix provides an instructors manual with opportunities for engaging students in a variety of exercises for further exploration of shrinkage issues. Teaching notes provide additional questions that can be posed about the two cases for more exploration about the various strategies and solutions that different personnel can use to manage and solve store shrinkage.

**CASE 1: WHAT CAN HAPPEN IN A STORE WHEN RETAIL SECURITY SYSTEMS ARE IGNORED?**

Every thirty minutes Jane would hear the security system go off on the first floor of a well-known Houston retail store shoe department. She was a new intern working in the store during the busy fall season in 2005. Jane had two years of retail experience working for small boutiques, but she was shocked that her new internship company, a major department store in an upscale mall, was letting the sensor system sound go off without store personnel taking any action. As a new employee, she didn't understand how her current employer could allow so many customers to leave the store with merchandise that was possibly stolen. Present employees surrounding Jane seemed to ignore the constant security system alarm like the high school fire drill alarm.

Jane wondered why her store training had not encouraged employees or security people to check customer purchases to remove sensors, or to apprehend customers who were stealing merchandise. As she thought about it, if she had been a thief shopping in her store and experienced walking through a security system with no response from the store, she would spread the word to others and target this store for many repeat visits. Jane knew that the company had a security force and cameras located in strategic store areas. However, she did not believe the store was taking an active role in monitoring shrinkage. The first floor shoe department seemed isolated from any security follow-up in her day-to-day selling floor experience. Jane wondered if the constant ringing security system was also signaling poor employee service where customers were paying for merchandise and not having store personnel remove
the security sensors resulting in a bad customer relations practice. She had personally experienced going home with a dress with a sensor still attached. She had to return that dress to the store to have the sensor removed. Jane remembered vividly how much this inconvenienced her and the negative feeling that she had about the store and their employees, so she knew her store had some problems.

A PLAN OF ACTION FOR REVERSING THE CURRENT STORE SECURITY PROBLEMS

Jane decided to approach her new department manager with a proposal for having employees monitor the ringing security system to remove customer sensors or reduce theft. Margaret was the new shoe department manager, and she was spending her time learning all the management paperwork and inventory management with limited time on the selling floor. On Saturday morning, Jane knocked on Margaret's office door eager to present her new ideas. "Good morning Mrs. Morgan, could I have about 10 minutes of your time to present a new idea that I think will save our store money and reduce our shrinkage?" "Of course Jane, I am always anxious to hear new ideas, but I do have a management meeting in about 30 minutes, so I must keep this meeting short."

Jane presented her description of the security system going off at least 10 times a day for the last two weeks, with no customer being approached. She quickly described her fears and then presented an idea for changing this process. Jane suggested that the store present a short employee training program on security and improving customer satisfaction. She knew the store manager would know whom to choose to present the program. Her proposal was to train each employee to approach each customer when the security system rang and say, "I’m sorry sir (or madam) an associate must have left the sensor tag on one of your items, may I check your bags and make sure that an employee did not leave a sensor on your purchase?" Jane explained that customers should feel comfortable, and that they were not being accused of stealing. She was also sure that if the person were guilty they were likely to drop the merchandise or try to take off. Security could be signaled to apprehend those customers that appeared to have taken the merchandise, ascertain the facts, and follow store security regulations.

Jane also followed the procedure by having the employee look at the purchase slip and the employee number, writing up the incident and sending the report to the department management, who would send the report to the store manager. Jane told Margaret that the company could choose to reprimand the employee who failed to remove the tags after some warnings, and reward the employee who triggered the security follow-up and theft actions.

Jane finished her new shrinkage control, customer relations proposal in eight minutes. Margaret was amazed that a new intern would be so insightful. She thanked Jane and said she would take Jane’s idea to the department manager meeting. Margaret also thanked her for sharing her idea and promised to follow-up with Jane after review by other department managers and the Store Manager. Margaret was not sure whether the proposal would have to go to the corporate office or if other managers and the Store Manager would be as positive, but she thought, the proposal was a good idea. Jane did not hear from Margaret until a week later, and much to her surprise, Margaret announced a new program in the Monday morning staff meeting that would be initiated through a new training meeting in November and credited the new intern, Jane, with coming up with a great new idea.

CASE 2: ANOTHER RETAIL STORE NEEDS TO MOVE TO A MORE PRO-ACTIVE SHRINKAGE AND LOSS PREVENTION SYSTEM

Mary Lewis was excited about her new position as lead key holder in a mid-size clothing store located in an upscale Houston clothing mall. She had worked in one small boutique and a bank while attending the city university. As key holder, she would open and close the store and learn to function as a second assistant store manager. She was eager to learn all that she could about retail and enter an executive training program after graduation.

During her first week she heard stories about the many changes in management, that employees were pleased because the current store manager was interested in employees and in improving the store. The new manager indicated she would like to see the store grow and was dedicated to working hard to make this happen with employee support. Mary was glad to see the employees were interested in working together. She was anxious to make her mark on improving the store as part of the team.
It was Friday night and Mary was closing the store when she noticed two people come into the store, split up, and randomly look at merchandise. She became suspicious that they might be planning to steal some merchandise. She asked one of the sales associates to watch the younger woman and she approached the second woman carrying a large bag and greeted her and asked to assist her with some of the merchandise that she was looking at. The woman was not interested in help, but Mary stayed with her and she quickly exited the store followed by the other customer. Mary talked with her experienced sales associate about store security measures and employee training on reducing theft. She was surprised to learn how informal the security system was and that her sales associate had no training on theft detection even through she had worked at the store for two years.

THE DECISION FOR ACTION AND THE PROCESS FOR CREATING A PLAN

Mary decided on the spot to research the current store practices and develop a plan for implementing a more proactive loss prevention system, hoping to make her special contribution to her new employer. She looked over the store policy manuals, and found that the store was not using any type of sensor devices in clothing or accessories. Mary went to the university library and read all she could find about shrinkage control and loss prevention. She quickly observed that there were various opportunities to use technology, employee training, and a range of strategies to reduce shrinkage in retail companies. Unfortunately, she also found evidence that many of the rising shrinkage numbers were largely due to employee theft that must be managed. Her research suggested that some companies had chosen less intrusive measures for monitoring shrinkage due to the costs of installing surveillance systems or hiring a permanent loss prevention manager, or using teams to act as shoppers and stop thieves as they left the stores without paying for merchandise.

Mary found out that the corporate benchmark for loss prevention was 2.1% and that her store had missed this benchmark for the last three years. As she walked the malls during her short lunch breaks she observed that many of her competitors were using ink sensors. These were usually affixed to clothing items in two pieces and if prematurely broken away from their respective items would displace a small quantity of ink. The ink alerted employees that the clothing had been tampered with and spurred them to action for theft prevention. Mary observed the sensors being removed at checkout counters, and if missed during checkout, the sensor detector at the entrance of the store was automatically triggered. Mary asked the sales associate waiting on her how she thought their security system was working. She told the associate that she was working at a store that was not using the ink sensors. The sales associate was pleased to say that they had reduced their external theft by 3% this year and were getting a company award for their new security practices that also included surveillance videos. Mary praised the sales associate and questioned her further about the ink sensors. The associate volunteered that the sensor detector at the entrance was bar code sensitive, meaning that the specific items would require that they be scanned as sold while being checked out under the usual methods. She praised the newly added surveillance systems because its cameras were strategically placed throughout the store, and were installed to take a sweeping view of a given area. Their experience confirmed that properly installed TV cameras and monitors deterred theft. Mary thanked the associate and left the store with newfound confidence in the new security opportunities for her company.

Mary continued her research and conversations with employees at various stores in the malls. Her reading suggested that most theft occurs in the dressing rooms where clothing is layered on by the customer in the privacy of the room and topped with their own clothing, followed by quick exits from the store. She was surprised to read that some states had laws that restricted the use of equipment such as cameras mounted in dressing rooms and realized that other interventions would need to be considered for her store.

As Mary continued her informal inquiries, she observed that many stores restricted the number of items that you could take to a dressing room and used their employees more overtly to remove clothing and assist their customers in the dressing room areas. The large clothing discounter in the mall used a person stationed at a counter with a number handed to each customer after checking the customers’ actual number of items to be tried on, followed by checking the return of the merchandise with the number as each customer left. The associate carefully monitored the items returned in a secured space behind their dressing room counter. She also noticed that stores were posting signs inside the stores, dressing
rooms and even in store windows about their surveillance systems and policy to prosecute people stealing merchandise.

Mary continued to explore security options. In conversations she noted that many stores were checking inventory systems and comparing transactions daily, looking for gaps and potential shrinkage areas. She found that her corporate group did not have any loss prevention manager, and that security was delegated to the stores essentially by default. Her store did not use any outside shoppers roaming the stores to spot thieves, and were not formally training employees to spot theft or giving them training about actions to deter shrinkage. She was pleased to see that the company had a hotline and if an employee reported another employee stealing, after confirmation, the employee would receive a $500.00 award, or if they caught a thief, they would get a $50.00 reward.

She also observed that although employees kept their bags and purchases in the supply room, the company did not attempt to spot check or search employee purses when they entered or left the store. Mary thought this lax approach encouraged employees to steal, and her research suggested that employees often worked in teams, leaving clothes in trash areas, and then removing the trash later recovering the items previously stashed. Sometimes they might use other employees to under-ring transactions. Even when stores use sensing devices, employees understand the security systems and can work to outsmart them if overt checks entering and leaving the store are not required.

A closer look at her store security practices led Mary to believe that her plan should be realistic, perhaps suggesting incremental changes, but that loss prevention strategies were critical if her store would even begin to reach the corporate shrinkage benchmark.

It was time to write the plan, Mary decided to keep the proposal short with a brief history about retail security practices, a checklist of what her store polices and procedures were, a description of her observations of stores and conversations with employees located in their current mail, and an action plan for reaching the company shrinkage benchmark.

THE STRATEGY FOR UNVEILING THE NEW PLAN FOR IMPROVING STORE SHRINKAGE AND LOSS PREVENTION

It seemed appropriate to write a humorous but realistic loss prevention manual to educate the store employees. She decided not to surprise her store manager with this plan, but took her to lunch and talked about how much she had learned in her new working experience, and that she was very interested in helping her manager achieve the corporate benchmark for shrinkage. The store manager was surprised that Mary had been so interested in researching these issues and was pleased that Mary was developing a manual for training and a potential action plan. She did let Mary know that any equipment would require careful negotiations with the corporate office, and that the store would have to assure savings and produce results to be considered for new expenses. She gave Mary the approval to continue her plan and suggested that she review the draft for additional input.

Mary left the luncheon pleased with the outcomes, and felt that her store manager had new respect for her leadership abilities. Her plan started with employee training and changing the dressing room policies--allowing customers to take only five (5) items into dressing rooms also requiring employees to monitor the process, actually providing more customer assistance, removing clothes that were not being considered, and placing clothing back on the sales floor. This process changed the whole approach used by employees in the dressing rooms and cleared the merchandise quickly back on the sales floor.

The training program provided steps for spotting thieves, assigned sales people to selling zones, and identified areas in the store that were hot spots because they could not be monitored easily. The plan developed a more aggressive system for alerting the mall security to approach quickly when suspected theft occurred, and promoting controlled follow-up on returning stolen merchandise. Mary suggested posting signs in the dressing room entrance, and at the checkout, proclaiming that the store would prosecute people caught stealing. In addition, she suggested moving the jewelry to the checkout area so that shrinkage could be more easily monitored. The current location was too easy for thieves to operate unobserved, creating a hot shrinkage spot for her store. Another important change recommended that each employee have their bags checked by managers on a rotational schedule as they entered the store and again as they left the store. The policy also required that employees produce receipts for all merchandise leaving in their possession. Managers were subject to the same process by varying key holders and assistant managers so that all employees were treated the same.
Stage two of the plan would install ink sensors in all merchandise priced above $15.00 accompanied by installation of the entrance alarm system. Mary suggested that the management team monitor inventory changes once a day rather than the current monthly process, which frankly occurred too late to take any real corrective action.

Mary praised the company for the hotline process and encouraged its continuation. Although the sensor system costs varied, Mary estimated that the investment would pay for itself during the first two years of anticipated shrinkage reduction. In year two the company could consider modifying the dressing room with an attendant similar to the current mall discounters. Sales associates would still service their customers, but the attendant would be responsible for checking the customers’ merchandise as they entered and left the dressing room, thus giving the sales associates more time to assist multiple customers.

Year three’s plan suggested looking at the results of the shrinkage program and considering more aggressive monitoring including surveillance cameras, hiring roaming customers to spot thieves, and looking for other cost effective methods and new technologies to improve the shrinkage and loss prevention of the store. Mary presented the draft to her store manager and included a draft of the humorous loss prevention manual. The manual included role playing exercises and ways to post announcements of employees successes, including the company monetary award, along with breakfast with the store manager and a 10 % discount card added to their regular employee discount for great loss prevention ideas implemented in the store, or for catching a thief.

Mary shared the final draft with the store manager. The manager liked the plan but was not sure that corporate would approve stage two. She knew she could help implement stage one and asked Mary to complete the draft assuring her that she would approach the corporate office with implementation of the plan. A month passed and as Thanksgiving arrived, Mary began planning her last university semester and thinking about her future. She had not heard anything about her security plan or the use of her manual, but she thought she had learned many new ways to improve security that would help her in her next position.

WHAT CAN HAPPEN TO CHANGE MAKERS?

On Tuesday morning, the store had a special promotion going on with a new hot embroidered jean. The jeans were flying out of the store and Mary received a call from the manager to step back into her office. She left the selling floor wondering what the manager wanted. The manager’s door was open, and someone was sitting in one of the office chairs, Mary was invited in to meet the new district store manager.

Bill Summers started the conversation by thanking Mary for the wonderful plan and the new employee manual. He told the manager how happy he was that managers and employees were working together to improve their store profits and that the company really was impressed with all of the ideas and potential changes. He said the company was giving approval for stage one, stage two, and expected a monthly report on shortages. Bill acknowledged the Manager for her great store performance and asked her to consider talking to him before graduation about their store-training program. Mary left the meeting feeling a sense of pride and accomplishment and looked forward to the implementation of her plan. She was excited that her work was going to be implemented and that she had the support of her manager, and the new district manager.

There was a happy ending to this aggressive change process. The store installed the security system and met the corporate shrinkage figure the first year. Mary graduated and went into the store-training program; the store manager was promoted to a new district manager position; and the Houston store was recognized by the corporate office for the most improved company store in shrinkage and loss prevention. The store is now developing a plan for stage three as an experimental trial for improving store shrinkage and loss prevention. It will be used as a model for other store improvements if the results prove to be successful. This real experience should be inspirational for managers who want to initiate change.

CONCLUSION

Shrinkage prevention requires an active participation of the management of a business that recognizes the problems presented by both internal and external theft, management practices, and
effective supply chain management which continually measures the impact of, and extent to which shrinkage affects the bottom line. It should be noted that the conclusions of case number two are based on a sample of one and are, therefore, limited.

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