Retail Loss Prevention Publications

Inventory Shrinkage

Facts, Figures & Strategies

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This article is intended to provide Ace retailers with useful information and data relating to U.S. retailers' typical annual shrinkage (dollar-wise and as a percentage of sales); the causes of shrinkage; and certain strategies that are widely recognized as being necessary to maintain an acceptable shrinkage figure. It is not all-inclusive, as the problem of shrinkage and, more importantly, the measures that must be taken to deter and prevent shrinkage, are things that cannot be adequately covered in an article of this size. If you are experiencing excessive shrinkage, either as a known fact or strong suspicion, contact RETAIL LOSS PREVENTION for assistance.

FACTS

- SHRINKAGE – the dreaded "S" word – the arch enemy of a healthy bottom line – is a negative aspect of your business ***you will never totally eliminat*e** and which ***you must continually battle*** to keep under control. If you do not make loss prevention an integral component of both your business plan and day-to-day operations, ***<u>you will suffer excessive losses</u>***.
- Shrinkage is the difference between what your book inventory (IMU) says you ***should have in stock***, and what a physical inventory confirms you ***do have in stock***.
- Inventory shrinkage, as reported and defined in retail publications and reports, is calculated at ***retail***.
- Shrinkage is caused by two things and two things only – ***theft and error***. If you take action to account for a change to your inventory, such as removing an item from stock for store use, or reducing the sell price of an item because of its condition, or donating an item to a charity, it will not show up as shrinkage because you have accounted for it.
  - There are three categories of ***theft***:
    (1) Theft by ***employees***
    (2) Theft by ***customers***
    (3) Theft by ***vendors***
  - ***Error***, on the other hand, is the unintentional loss of inventory value, with no dishonesty involved. Mistakes such as mispricing, entering inaccurate data into the IMU file, or neglecting to adjust the inventory when actions take place such as removing an item from display for store use or donating an item to a local charity, are all examples of shrinkage caused by an error.
- The ***National Retail Security Survey (NRSS)*** is a report produced annually by the Security Research Project, Department of Criminology, Law and Society, at the University of Florida. It is this report that is used by retailers and retail loss prevention personnel throughout the nation as the standard for assessing loss prevention experiences and data for the year reported. And while the reported percentages of total shrinkage that each of the four historic causes do change slightly each year, the overall averages are as follows:
  - EMPLOYEE THEFT – 45%
  - SHOPLIFTING – 35%
  - ADMINISTRATIVE ERROR – 15%
  - VENDOR THEFT – 5%

  You'll note that an average of 85% of retail shrinkage is due to theft. You should also know that all three theft categories can be dramatically reduced through implementation and enforcement of ***practical and realistic internal controls***.
- As you can also see, theft by associates accounts for the ***largest share*** of the shrinkage dollar. It is also the most diabolical, personally stressful and difficult for the Ace retailer to acknowledge, as it is committed by persons who are considered to be extended family members who have been trusted to protect the best interests of the business.
- When an annual inventory is conducted and a shortage is discovered, there is, unfortunately, no verifiable means of determining exactly what percentage of the loss was caused by (1) theft out the *front door* by customers; (2) theft out the *back door* by associates; (3) cash embezzled at the *POS terminal* by associates; (4) theft by a *vendor* who has access to your inventory; or (5) errors resulting from *mistakes* by associates with no criminal intent.

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- National retail chains with dedicated internal loss prevention departments have many advantages over small, independent retailers when it comes to dealing with shrinkage. They are able to assess the relative significance of each of the causes using continuing facts/data associated with associate theft and shoplifting cases, internal audit reports, etc. These facts and data are then used to concentrate internal investigative and administrative actions to deal with these problems, and are also provided for use in the National Retail Security Survey.

FIGURES

- The North American Retail Hardware Association reports that the ***bottom line net profit*** of the average hardware store owner is ***2.7% of sales***. Rounding that number up to 3%, that means that if an item valued at ***$50*** is stolen, additional sales of ***$1,667*** must be generated to compensate for the loss of the $50 item (and, of course, it's still gone). Conversely, if the theft of a $50 item is ***prevented*** by the action of an associate, it is the same thing as generating *additional sales of $1,667*. This chart provides a stark picture of just how much theft and error costs, as well as the true value of a successful loss prevention program.

LOSSES IMPACT THE BOTTOM LINE

IF YOUR NET PROFIT IS	2%	3%	4%	5%	6%	7%	8%	9%
You must generate sales totaling the amount listed below to make up for a loss of this amount								
$50	$2,500	$1,667	$1,162	$1,000	$833	$714	$625	$556
$100	$5,000	$3,333	$2,325	$2,000	$1,667	$1,429	$1,250	$1,111
$150	$7,500	$5,000	$3,488	$3,000	$2,500	$2,143	$1,875	$1,667
$200	$10,000	$6,667	$4,651	$4,000	$3,333	$2,857	$2,500	$2,222
$250	$12,500	$8,333	$5,813	$5,000	$4,167	$3,571	$3,125	$2,778
$300	$15,000	$10,000	$6,976	$6,000	$5,000	$4,286	$3,750	$3,333
$350	$17,500	$11,667	$8,139	$7,000	$5,833	$5,000	$4,375	$3,889
$400	$20,000	$13,333	$9,302	$8,000	$6,667	$5,714	$5,000	$4,444
$450	$22,500	$15,000	$10,465	$9,000	$7,500	$6,429	$5,625	$5,000
$500	$25,000	$16,667	$11,627	$10,000	$8,333	$7,143	$6,250	$5,556

LOSS PREVENTION IS GOOD BUSINESS

- There are typically over 100 national retail chains, all of which have corporate-mandated policies and procedures and data gathering mechanisms, which participate in the annual National Retail Security Survey. Normally three of those 100 national chains are in the ***Home Center/ Hardware/Lumber/Garden*** category. Ace Hardware is unable to participate, since data relating to store level shrinkage, associate theft and shoplifting cases, best practices actually used at store level, etc., is not available. Since the participating corporations have loss prevention departments, as well as policies, procedures and controls that are mandated, continually assessed and enhanced, it is realistic to conclude that ***their shrinkage numbers are, on average, lower than those experienced by the typical Ace retailer***.
- The national average retail inventory shrinkage across all retail markets, expressed as a percentage of total retail sales, as reported in the NRSS, is typically ***1.5% – 1.7%*** at retail.
- A survey of Ace retailers conducted by Retail Loss Prevention a few years ago concluded that the ***majority could not provide*** a precise annual shrinkage number (dollar or percent of sales). Those who did compute shrinkage (based on annual inventories and/or cycle counts) confirmed shrinkage numbers ***averaging 3% of sales***.
- The following four tools are deemed essential to creating and maintaining an effective and ongoing shrinkage reduction program:
  - o ***Proper screening of applicants*** (criminal history check, credit check, previous employers checks, etc.) prior to hiring.
  - o A ***clearly stated company policy*** that theft, in any form, is not tolerated and, when detected, will be prosecuted.
  - o A ***team approach to associate involvement*** in all aspects of loss prevention, along with the creation of a "culture of honesty" among associates.
  - o A ***practical and enforced system of internal controls*** that encompasses all aspects of store operations, from store opening/closing procedures, to POS operations, to trash removal, to access controls, etc.

STRATEGIES

- It is essential that the ***"book" inventory*** be as accurate as possible at all times. This file is the heart of your business. There is no more important file in your computer. Access to it and, in particular, the capability to adjust it, ***should be limited*** to the fewest associates possible, consistent with operational needs.
- ***Senior management review*** of all inventory and price adjustments is essential and should be done on a no less frequent basis than weekly. Use the ***Inventory Transaction Register (ITR)*** in the Epicor Eagle for Windows system to conduct these reviews. Question and follow up on any entry you do not understand.

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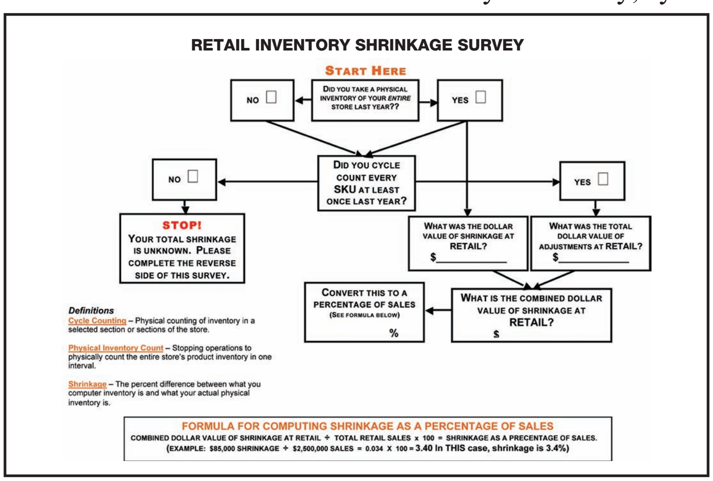
- Ideally, conduct a ***physical inventory*** (by SKU), at the end of each fiscal year. Remember that the "book inventory" at year-end represents the net result of all changes to it throughout the previous twelve months. That includes adjustments made during cycle counts or at any other time when it became apparent that the physical count did not match the count in the IMU. The value of these adjustments (again, ideally by SKU) must be maintained in a file or account throughout the year so that it is available at year-end. The cumulative value (presumably negative) of all such adjustments *must be added* to the inventory variance calculated from the year-end physical inventory. All values should be at retail. If the inventory is taken at cost or the adjustments accounts are at cost, convert cost values to retail by using the average margin for your store (e.g., $100,000 shrinkage at cost would be $140,000 at retail if your average margin is 40%). Once those two amounts are totaled, you will then have your total shrinkage and be able to calculate your shrinkage as a ***percent of sales***. Once you have that number, you will be in a position to know whether your shrinkage is above or below the national average. Plus, when this is done every year, you will know whether ***your efforts to control shrinkage*** are – or are not – working. Further, by keeping shrinkage data by SKU, you will be able to ***direct your loss prevention efforts*** to those departments or individual SKUs that are your significant problems.

- If an annual physical inventory is not practical, it is essential that ***programmed cycle counts*** be conducted. This means developing a schedule in which ***every SKU*** in the store is counted at least twice a year. Ideally, cycle counts should not be conducted by the associate responsible for the department being counted. If every SKU is not counted, there is no way of accurately determining your annual shrinkage.



- The flow chart in the previous column is provided to assist in determining whether you are in a position to accurately determine your true shrinkage.

- Make it a routine practice to ***review various reports*** available in the Epicor E4W system that can provide **RED FLAGS** of wrongdoing (or error). These reports include, but are not necessarily limited to, the **RDS** (Report of Daily Sales) – it also shows refunds and voids totals; the **RPE** (Price Exception Report); the **RVT** (Void Transaction Daily Report); the **RDI** (Daily Inventory Update Report); the **RDJ** (Daily Journal Report); and the **RPC** (Price Changes Report).

- Also make it a practice to ***access the various viewers*** available in the Epicor E4W system that can provide **RED FLAGS** of dishonesty (or error). These viewers include, but are not necessarily limited to, the **DAILY JOURNAL VIEWER** (this excellent viewer must be "turned on" by Epicor); the **INVENTORY MAINTENANCE CHANGES VIEWER**; the **CUSTOMER RETURNS VIEWER**; and the **CUSTOMER MAINTENANCE CHANGES VIEWER**.

- Be aware of and utilize the various ***options and security bits*** available within the Epicor E4W system to limit the independent actions of cashiers, particularly in the areas of refunds and voids.

- Control back (and side) door usage. Any door that must remain unlocked because of being a designated fire exit MUST be controlled in a manner that prevents unmonitored exit. An inexpensive, key-operated **EXIT ALARM** can literally save you thousands of dollars in stolen merchandise that would otherwise have gone out through an uncontrolled back door. Overhead receiving doors should remain **PADLOCKED** when not in actual use. And, of course, the keys to the alarms and padlocks should be accessible to managers, supervisors and responsible associates only.

- A properly configured and installed **CCTV SYSTEM** is a very effective deterrent to theft, particularly at the POS terminals and the back door.

CONCLUSION

Reducing losses and keeping them at a minimum is not easy to do. It takes dedication and constant attention; attention that must begin before an applicant is hired and continue each and every business day. Countless Ace retailers have discovered that when you "take your eye off the ball" there are those who have been waiting for that opportunity – and will take advantage of it. A successful loss prevention program will eliminate, or at least greatly reduce, those opportunities – **AND** give you a much better chance of being alerted when a violation of any part of that program occurs.

Contact Retail Loss Prevention to discuss how to develop an effective loss prevention program for your store. Call us at 630-972-2670 or email us at ***info@acelossprevention.com*****.**

It's what we do.

If you are concerned about the adequacy of your internal controls, have retail inventory shrinkage above 2% of sales (or don't know what your shrinkage actually is), or you just have an uneasy feeling about your loss prevention posture, call Retail Loss Prevention and discuss your concerns with one of our staff. Our only mission is to assist you in the prevention of losses. We and our preferred vendors offer services ranging from a detailed audit of your internal control posture, to the training of owners and senior managers in developing and maintaining an effective loss prevention program, to the training of team members in becoming active participants in your loss prevention program, to the investigation of known or suspected dishonesty within your workforce. We also have preferred vendors who provide a host of additional services and products, all of which are designed to support you in your never-ending battle against losses.

Call 630-972-2670 or email us at info@acelossprevention.com.
Visit us on the web at www.acelossprevention.com for more information on our services and the products and services of our preferred vendors.