BEYOND SHRINKAGE
INTRODUCING TOTAL RETAIL LOSS
By Adrian Beck
A major new report published by the Retail Industry Leaders Association (RILA) puts forward a dramatically different way of thinking about the problem of retail loss and how it might be defined and measured in the future.

The Situation
There is little consensus on what constitutes “loss” within the retail world nor how it should be measured. The terms “shrinkage” and “shortage” have been loosely applied to encapsulate some of the areas that generate loss, but they are not terms enjoying a clear and agreed-upon definition across the sector. Equally, measuring losses at retail prices is probably the most common method adopted to capture the scale of the problem, but again, it is not without its critics. While the term “shrinkage” has been used for probably the last hundred years of retailing, there continues to be wide variance on what is included and excluded when this term is used, with some retailers using it to describe only those losses captured through identified discrepancies in inventory counts, while others add in additional types of loss recognized through other forms of recording practices.

The inclusion or exclusion of losses associated with the retailing of items such as food adds further ambiguity. Should products that have been recorded as going out of date be included as shrinkage? What about those items that have been reduced in price to encourage a sale due to oversupply or a change in consumer demand, or products that have been damaged in the supply chain? Even more variability exists when the losses associated with what are sometimes called “process failures” are considered. Should those losses that are generated by mistakes within the business be included in the overall shrinkage figure, such as product set-up errors, non-scanning at the till by members of staff, the reduction in sales caused by products being out of stock, or shelves not being replenished accurately? In addition, there is increasingly a tranche of losses that can be associated with discrete and purposeful decisions made by retail organizations as part of pledges and guarantees to consumers, such as price matching, compensation for poor service, and guarantees of product availability. Should these be included in a definition of
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Some regard it as a catchall for a wide range of losses suffered by retailers, including both crime-related events, such as staff and customer theft, and errors incurred as part of the process of retailing, such as incorrect pricing, changes in price, damaged products, and food items going out of date, while others only seem to use it to refer to variance in the value of expected and actual inventory. The review of the existing literature on how shrinkage is defined and understood can be summarized as follows:

- There is no agreed definition of what constitutes shrinkage.
- Most published estimates of shrinkage are based primarily on measures of unknown loss where the root cause is unidentifiable.
- The focus of most definitions of shrinkage typically relate only to the loss of merchandise.
- In most surveys the measurement of shrinkage is requested at store level—the retail supply chain rarely features.
- There is relatively little consensus on how shrinkage should be measured although most surveys collect information at retail prices.
- Expressing shrinkage as a percentage of total sales is the most commonly used method to illustrate the scale of the problem.
- The categorization of shrinkage is confusing and often relies on catchall phrases that lack firm definitions or seem incapable of capturing the various types of risks associated with an increasingly complex retail environment.

- The terms “retail crime” and “shrinkage” are sometimes used interchangeably with the former including the costs of responding to losses, while the latter may or may not be based on known and unknown losses.

Developing Total Retail Loss

Among the difficulties of benchmarking any retail business using the indicator of shrinkage are the problems associated with understanding what categories of retail loss are included or excluded, particularly under the rather catchall terms of administrative error/process failures. Some companies taking part in this research adopted very strict criteria—shrinkage is only the value of their unknown losses based on the difference between expected and actual stock number/values, with anything else being regarded as known and therefore not included in the calculation. Other companies were much more inclusive, incorporating a number of other types of loss ranging from damages, wastage, spoilage, and price markdowns to the costs of burglaries, robberies, and even predicted losses from organized retail crime (ORC).

Some of the respondents, however, were increasingly concerned about the continuing applicability of the term “shrinkage” in a modern retail context. One respondent said, “Listen, I think the word has become obsolete because loss prevention has evolved into asset protection, and now it’s asset profit and protection, and God knows where it’s going to be three years from now. The names have changed, the roles have changed, the roles have gotten significantly wider, but we still hang on to this word that we’ve been using that describes something that we did a hundred years ago.”

Part of this definitional variance seemed to be based on how respondents interpreted the difference between what could be regarded as a loss compared with a cost, the latter being viewed as everyday planned and necessary expenditure in order for the business to achieve its goal of making a profit. However, a considerable number of respondents made a key distinction between the value of the outcome and
how this differentiated costs from losses:
“Costs—they bring value to the business, they are incurred because there is a perceived positive purpose in having them, they are part of the revenue generation process, and without them profits would be negatively impacted. Losses are things, which if they didn’t happen there would be no negative impact upon profitability; they do not offer any real value to the business and simply act as a drain on profitability.”

It was also instructive to hear how some respondents adopted a process of normalizing what some considered to be losses into costs: “We plan a lot of those costs [possible types of losses], so when we’re looking at it from a planning perspective, we have that built in. Anything that we can account for and process and know what it is, we take more so as a cost rather than a loss, when we’re defining it.”

Another respondent talked about how the planning and budgeting process enabled many losses to be redefined as costs: “If it goes above budget, then it becomes a loss; otherwise, it’s a cost.” Interestingly, one respondent reflected on the dangers of this approach of “hard baking” losses into costs: “People always viewed [workers’ compensation] as a cost of doing business, but I think we’ve been incredibly innovative, and we’ve shown that, no, you can really change the way we do things… When you view it as a cost to doing business, that’s when you lose innovation and when you lose really looking at how do you prevent [it]. We’ve done some incredibly strategic things around here in that area. In particular, I can just remember the conversations when we were doing it—it was like, a lot of people thought don’t mess with that. That’s just going to be what it’s going to be; it’s just going to gradually increase every year.”

This is a good example of how labeling something as a cost can begin to drive particular behaviors. And this can be particularly the case when a budget or target is set for a given cost/loss. It is also worth noting that many respondents adopted a much more accepting tone when types of expenditure were described as the cost of doing business—a reassuringly benign phrase, which seemed to absolve them of taking responsibility for the consequences: “We try and convert as much of these losses to costs. It’s then not on my agenda anymore—I deal with shrink.”

**Defining Total Retail Loss**

From the interviews with senior US retail executives and feedback from the roundtables held in Europe, the following definitions of costs and losses were developed:

- **Costs**—expenditure on activities and investments that are considered to make some form of recognizable contribution to generating current or future retail income.

- **Losses**—events and outcomes that negatively impact retail profitability and make no positive, identifiable, and intrinsic contribution to generating income.

Using these definitions, various types of events and activities can begin to be categorized accordingly. For example, incidents of customer theft can clearly be seen to be a loss—the event and outcome play no intrinsic role in generating retail profits. It makes no identifiable contribution whatsoever, and were it not to happen, the business would only benefit. Alternatively, incidents of customer compensation, such as providing a disgruntled shopper with a discounted
price, can be seen to be a cost. In this case, the business is incurring the cost because it believes that by compensating the aggrieved consumer they are more likely to shop with them again in the future. The policy of compensating is regarded as an investment in future profit generation and is therefore categorized as a cost and not a loss. (That's not to say it shouldn't be recorded and monitored for review.)

Another example of a potential loss is workers’ compensation, where a retailer will cover the legal, medical, and other costs associated with an accident at work, such as a member of staff being hurt falling off a ladder. There is no intrinsic value to the business of a member of staff incurring an injury while at work. If it had not happened, the business could only benefit through not having to pay out for the consequences of the event. It is therefore a loss, and while a number of respondents to this research argued that it is a predictable and recognizable problem that can and is budgeted for, it still remains an event that ideally the retailer would prefer not to happen as it impacts negatively on overall profitability.

In contrast, expenditure on, for instance, loss prevention activities and approaches, such as employing security guards or installing tagging systems, can be seen as a cost. The retail organization has committed to this expenditure because it feels there will be some form of payback from the investment—hopefully lower or acceptable levels of loss that in turn will boost profits.

What these examples focus on is not whether an activity or event can be controlled or not, or where the incurred cost was planned or unplanned, but on its fundamental role in generating current or future retail income. When a clearly identifiable link can be made between an activity and the generation of retail income, then it should be regarded as a cost, whereas all those activities and events where

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no link can be found should be viewed as losses.

**Categorizing Total Retail Loss**

There is little point developing a typology made up of a series of categories that are either impossible or implausibly difficult to measure or once measured offer little benefit to the business undertaking the exercise. It is also worth noting that while use of the term “total retail loss” might better capture the range of losses occurring across the retail landscape, the associated typology does not necessarily encompass every form of loss that a retailer could conceivably experience. The word “total” is being used in this context to represent a much broader and more detailed interpretation of what can be regarded as a retail loss, rather than necessarily claiming to be a reflection of the entirety of events and activities that could constitute a loss. For instance, there are a number of potential losses not included such as those associated with brand reputation, lost sales associated with counterfeit goods and the grey market, and lost sales that may arise from stolen product being sold on Internet auction sites. While some of these types of losses are beginning to be better understood and measured, as yet they remain, for most retailers, highly problematic to calculate with any degree of confidence. No doubt in the future the scope and range of total retail loss will change to accommodate new forms of loss, and this is to be welcomed. Like retail itself, the world of loss prevention needs to continually adapt to meet the demands of a highly dynamic sector of the global economy.

In such a short article, it is not possible to go into any great detail describing the various elements of the proposed typology. A fuller, more detailed description is available in the RILA report. But as can be seen in the diagram, the typology is firstly organized around a series of centers of loss: the store, the supply chain, e-commerce, and corporate. The losses in stores and the supply chain are then separated into those that are known and unknown, with the latter being the category that most closely resembles many of the current definitions of loss. It is important to note that the typology design enables the value of retail losses to be calculated and not necessarily the number of events. Where an associated value cannot be calculated or there is no loss of value associated with an incident, this should not be included. For instance, if a shoplifter is apprehended leaving a retail store and the goods they were attempting to steal are successfully recovered and can be sold at full value at a later date, there is no financial loss associated with this incident. While the retailer may still want to record the fact that an attempted theft took place and was successfully dealt with, it would not be recorded in the total retail loss typology. In this respect the typology is recording the value of retail losses and not their prevalence.

**The Total Retail Loss Typology**

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of shrinkage. All losses are then broken down into two types: malicious and non-malicious. The former brings together types of loss associated with criminal activity, while the latter focuses on losses often regarded as process or administrative in nature.

The typology then goes on to propose thirty-one types of known loss covering a wide range of losses across the retail enterprise and incorporating events and outcomes beyond just the loss of merchandise. There are of course a multitude of root causes that make up each of the proposed core categories of loss. These will vary depending upon the retailer, but it is hoped that those selected provide sufficient macro-analytical capacity to provide value when it comes to understanding the broad landscape of loss within a business. The purpose of the typology at this stage is not to offer micro-level identification of all causes of loss but more to act as an organizational tool to compare the distribution of core categories of loss across a business, which in turn could then stimulate deeper analysis of any given category warranting further investigation. This list of known causes is still a work in progress, and it is hoped that future research and application of the proposed typology will enable it to be further fine-tuned and amended to ensure it has as high a degree of applicability across as many types of retailing as possible.

Total Retail Loss: Helping Your Business Make Good Choices

It is clear that the proposed total retail loss typology is a radical departure from how most retail companies have understood and defined the problems of loss within their companies—moving away from a definition focused primarily on unknown stock loss, mainly in physical retail stores, to one that encompasses a broader range of risks across a wider spectrum of locations. While there is a simple elegance about the approach adopted in the past, based on the traditional four buckets of loss (internal theft, external theft, administrative errors, and vendor frauds), it is increasingly recognized that these rather broad-brush and often ambiguously defined categories are no longer capable of accurately capturing the complex risk picture now found in modern retailing.

As increasingly rich veins of retail data become available, it is becoming more apparent that most retail losses are a product of business choices—the scale of many losses are directly related to decisions made about how a retailer wants to operate. For example, introducing customer self-scan checkouts is a choice. It has some clear benefits associated with it, such as lower staffing costs, but it also has some very clear risks, such as increased levels of loss associated with non-scanning or missed scanning of product. Deciding on the overall value of these retail choices requires high-quality data on both sales and all possible losses, and they must be viewed together rather than in isolation. The interplay between sales and losses needs to be viewed in the round and not as a series of cross-functional trade-offs where losses and profits are allocated separately, inevitably driving behaviors that do not benefit the business as a whole.

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Within this context, the proposed total retail loss typology can bring value. By identifying as many of the manageably measurable categories of loss across the entire retail business as possible, it will enable greater transparency to be achieved and better avoid the shifting of losses/costs between one category and the next, depending on whose interest it best serves. By agreeing what should and should not be defined as a loss, the proposed typology will help to inform decisions that are in the interest of the business as a whole and not just certain key stakeholders.

Helping to Develop the Role of Loss Prevention in the Future

The total retail loss typology combines data from across a wide range of business functions. It has the potential to offer a unique macro overview of how all forms of loss are affecting a business and from there provide an opportunity to reflect on how an organization’s resources are being allocated. In many respects it could provide current and future loss prevention practitioners with an even greater opportunity to make a significant and lasting contribution to maintaining and improving the overall profitability of their businesses. As levels of what might be described as traditional shrinkage begin to reach levels where it increasingly becomes either uneconomic to reduce further (because the required investment is not justifiable based upon the likely return to the business) or positively counter-productive to reduce (because of the negative impact required interventions will have on sales and profits), then it makes sense for loss prevention practitioners to use their resources and established skills to better effect on other problems faced by the business. After all, the goal of loss prevention is not necessarily to reduce losses to zero—this could easily be achieved by a series of draconian measures that would likely induce bankruptcy in most retail companies. The goal is to achieve a level of loss that, based on the operational choices made by the business, optimizes the profitability of the organization.

Dealing with unknown loss, which is what most loss prevention practitioners typically focus on (given they have responsibility for shrinkage), is probably one of the hardest challenges faced by a management team in retailing, requiring them to develop a high level of analytical and problem-solving capability. Trying to solve problems where the cause is typically unknown is at the hard end of the management spectrum—it requires creative thinking, imaginative use of data, and considerable experience. Imagine if these capabilities were put to use on the broader range of known problems encapsulated in the total retail loss typology. The impact could be profound. This is not to say that a loss prevention team should not continue to ensure that unknown losses (as defined in this document) remain at an acceptable level for their business and try and convert as much of them as possible to known losses. But the typology could provide them with an opportunity not only to become the agents of change for the better management of loss throughout the business, but also to take on new challenges that use their considerable established skill set. As one respondent to this research said, “I don’t own ‘damage.’ I could really make a difference [to it]. It would be a walk in the park compared with dealing with ORC!”

In effect, the loss prevention team of the future could become the drivers of a total retail loss group, marshaling data on losses across the business, coaching and encouraging other retail functions to better manage the problem, and using their problem-solving skills to help the business sell more through managing losses more effectively. It would enable the loss prevention team to reimagine their role within the business, providing them with an opportunity to remain a relevant, agile, and highly valued function in a rapidly changing retail landscape.

Total Retail Loss: Next Steps

Moving from something as established as “shrinkage” as a core measure of how loss is generally understood to one described in this document is never going to be easy. Roles, functions, surveys, indeed an entire industry has evolved using this word to describe retail loss.

The current research set out not only to better understand how modern retailing is thinking about the issue of loss—how it is defined and measured—but also to begin to put together a more comprehensive typology that it is hoped will add value in the future.

Through enabling businesses to view the big picture of loss, across their entire retail landscape, the typology potentially offers an analytical tool that can be used to better understand how losses are impacting business profitability and how current resources are being allocated.

Through a process of engagement, further testing, and refinement, it is hoped that the total retail loss typology will begin to add value to retail companies, enabling them to better understand how all forms of loss impact their capacity to make customers happy and their businesses profitable. ■

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