Every Retailer Needs a KPI Strategy

Part 3 of 3: Strategic KPIs

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KPI Strategy

***Key performance indicators** only tell you how well you are performing. To actually improve your performance you first have to know what KPIs mean and how to use them. In Part 1 of this series we looked at the role KPIs play in answering the big questions successful retail companies ask to achive outstanding results. In Part 2, we examined the tactical KPIs these retailers focus on every day and every week. In this third installment we show how strategic KPIs can point the way to long-term retail success. KPIs can be tracked in many retail point of sale solutions making it easier for senior management to create a KPI strategy from the top down.*

Assuming you in fact are running your retail operation at its full potential day in and day out, the next question is: "What can I do to increase my retail operation's potential?" To answer that, you need to stand back and look at the operation in broader perspective — over a longer time period than just a day or a week, and using a much wider range of KPIs and benchmarks. That's working at a strategic level rather than just a tactical level.

Strategic questions concern issues like staffing policies, store locations, branding, channel selection, vendor relations, and other factors whose impact can take months to fully assess, to fully register on retail performance, and which probably can't change overnight. Nevertheless, strategic decisions have the biggest return on the time you invest in KPI management. Indeed, the best example of strategic decision-making is whether to even remain in business — and, if so, then how, when, where, in what form, and at what speed you should grow your business.

As with tactical KPIs, strategic KPIs are most effective when framed in the form of big questions. As a practical guideline these fall into two groups:

- ✓ monthly KPIs
- ✓ semiannually or annually

Let's start with the monthly.

Monthly

Are average stocks and weeks of supply on target to meet sales projections as reflected in historical performance, seasonal patterns, planned promotions, economic cycles and other factors? Retailers obviously can't sell what they don't have (usually). On the other hand, if stock is piling up over a month's time then it may be time for a course correction — new pricing, a new ad campaign or a different product mix, for example.

What is shrinkage as a percentage of sales? As previously noted, a shrinkage problem is not something likely to show up over a single day or week. According to the University of Florida's 2009 National Retail Security Survey, 44% of shrinkage in 2008 was due to employee theft, totaling over $15.9 billion, and another 35% due to shoplifting, totaling over $12.7 billion. Aside from pure greed, employee theft and shoplifting are systemic problems. They happen over time as a result of lax security and poorly implemented point-of-sale systems.

The solution is in being able to monitor sales and shopping activity to spot both a pattern as well as specific incidents.

How are markdowns performing? In other words, is your markdown strategy working? Are the right items marked down and by the right amount? To answer these questions you must monitor the markdowns, but also other KPIs like sales, margins, open-to-buy, sell-through rates as well. The key is striking the right balance between sales and profits while avoiding stockouts of hot-selling items and excessive inventories of others. To strike that balance, you may want to look at how markdowns performed for similar items in the past. You also have to consider the effect markdowns will have on the value of your business (as seen perhaps through the eyes of lenders). If your inventory's value (and hence your company's net worth) is less than you owe, you may be declared insolvent.

Semiannually or Annually

Are inventory turns aligned with averages for my industry and my sales projections? Inventory turn is the number of times within a period (usually a year) that the average inventory is sold. It is either the cost of goods sold divided by average inventory at cost, or it is sales divided by average inventory at retail. Over time a turn rate that is too low will cause a retail business to underperform, like a runner wearing weights. The more cash that is invested in inventory the less cash there is available for other needs. On the other hand, having too little inventory can mean stockouts and lost sales, and so also lost profits. Industry benchmarks are a guide since some merchandise, like pillows, don't lose value over many months; while other items, like spring fashions, do. Obviously open-to-buy, sell-through rate, margins and sales are all KPIs — in addition to turns — that must be considered before answering this big question.

How does my labor expense-to-sales ratio compare to my competitors? Although you should track labor expense in the short term, you should also track it in the longer term against competitors. Like inventory turn, this KPI tells you whether you are under or over-weighted for your industry generally. In other words, it may be okay to have a big inventory or a big headcount for a short time — say, to support a major promotion. A larger concern would be if the low turn rate or high labor expense persisted over a longer period. (It also may not be possible to compare competitors' labor expense ratios more frequently, as public companies only publish those figures every six or 12 months.)

How's my ROCE compare to industry averages and returns on alternative investments? As stated at the very beginning, ROCE is the most important KPI since it really addresses the question of whether you should be in this business at all. Different industries expect different profit margins, starting with groceries, which typically average less than 2% ROCE. Most retailers should expect a return somewhere in the middle teens, if not more. However, beyond the question of sheer business viability, the ROCE KPI points you in the direction of what other KPIs to examine — starting with sales, profits and expenses — and what actions to take for the business to go where you want it to go. From there you can drill down in to markups, inventory turns, and expense ratios as a group and by category.

To make strategic KPIs truly actionable, you should compare them across equivalent periods.

For example, the same six months this year as last year. Reports should include current actuals, last year's actuals and planned. What's "key" about KPIs is not just knowing a number but knowing the trend and having a meaningful basis for comparison. That will point the way toward specific actions. Again, look for clues that make KPIs stand out, such as sharp differences when compared to equivalent time periods, products, locations, competitors or your own performance objectives.

KPI Ownership

A complete KPI strategy needs to include KPI ownership — i.e., who is accountable for monitoring the KPI, investigating related performance issues and making KPI-based decisions? Because C-level management is responsible for everything, they should monitor all KPIs. C-level managers may also be the only ones to see, and therefore manage, global KPIs like total company sales and ROCE. Of these global KPIs, some are also actively monitored and managed by mid-level executives, such as those in purchasing or merchandising. Examples would include open-to-buy, average stocks and weeks of supply. Store managers should monitor store-level KPIs and share those with their staffs as directed by top management.

Each retailer will assign KPI ownership differently. Some, for example, may feel that sharing sales figures widely with staff each week is a good motivator. Others may want to keep that information private. What's important is not a specific ownership formula per se but rather that there is KPI ownership — and that ownership decisions are deliberate, logical and communicated to the senior management. There should also be follow-up. For example, if inventory turns start to increase unexpectedly, or sale through ratios start to decrease dramatically, senior management might want to hear about it first from whomever is directly responsible for purchasing merchandise and controlling inventories.

How Do You Know It's Working?

At this point you should be asking yourself: What are the big questions I need to answer to succeed? What mechanisms are in place to answer those questions? What KPIs are involved and who owns them?

When all that has been established, you should have a front-row seat on the real-time performance of your retail business. You'll be able to see what's really happening, with clear indicators of what should be done to keep your company on track. The KPIs themselves will tell you if you are gaining or losing ground, and by how much and how fast. Other ways to know your KPI strategy is working include:

- Executives spend no more than a half hour per day reviewing reports.
- Reports don't just show information; they also show where to take action.
- Reports happen automatically — no busy work required.
- People feel more confident and in control; they're not just flying blind.
- Meetings and communications in general are more fact-based rather than political.

Note To Self:

What is my KPI strategy based on "Every Retailer Needs A KPI Strategy?"

1) ____________________
2) ____________________
3) ____________________
4) ____________________
5) ____________________

A retail operation that has a good KPI strategy has a different feel to it than does a retail operation without that strategy. That may not be why you have one, of course. You may simply want to see more cash this year as a result of all your hard work. Then again, that would feel pretty good too.

KPI Strategy

This is Part 3 in a 3-part series about KPIs or Key Performance Indicators.

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