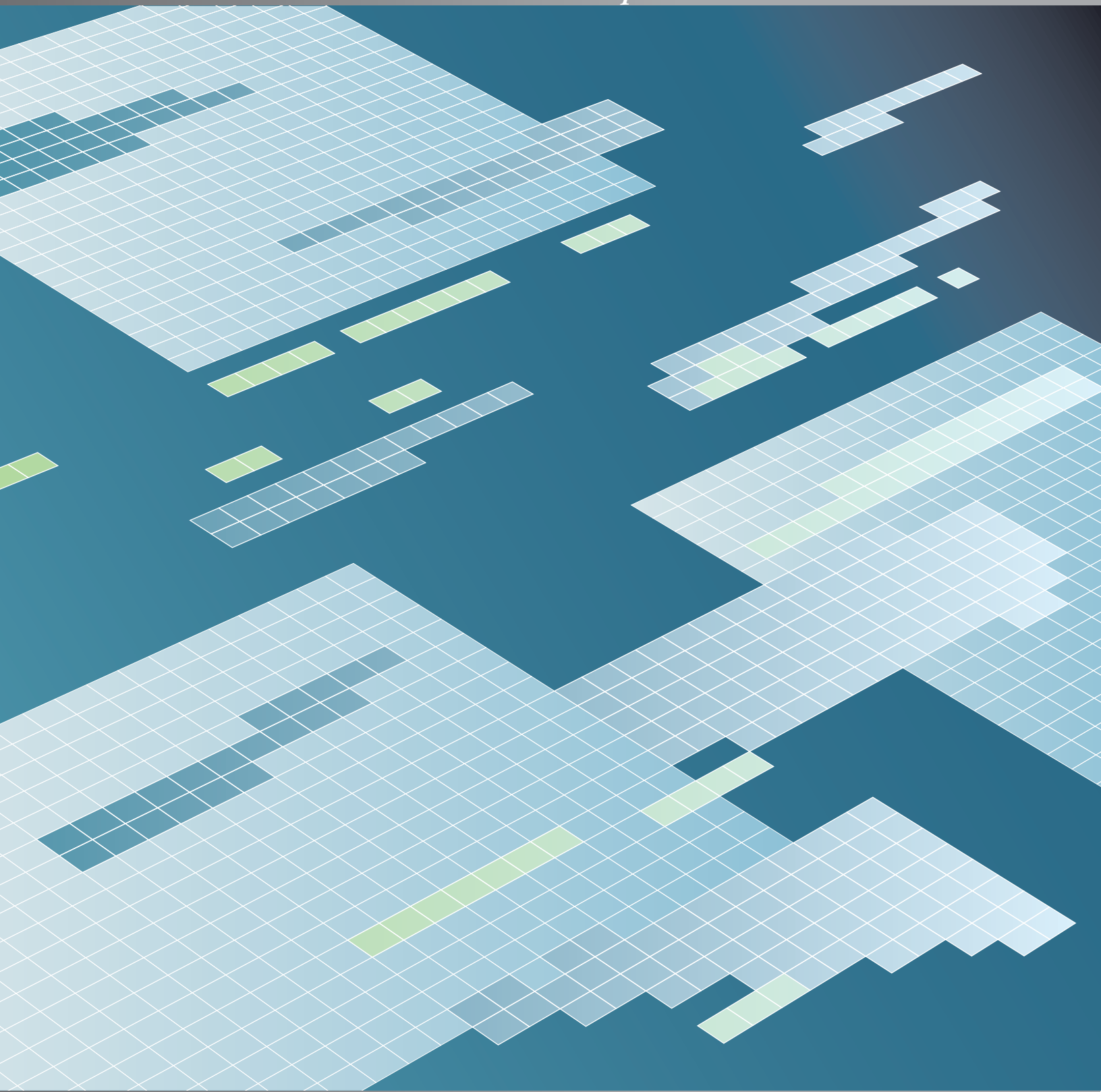
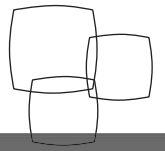


State of Retail

The Canadian Report 2010



State of Retail: *The Canadian Report 2010*

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State of Retail

The Canadian Report 2010



Highlights

The retail sectorⁱ plays a key role in bridging production and consumption, and as a result has significant direct and indirect effects on the Canadian economy. While directly contributing \$74.2B to Canada's gross domestic product (GDP) in 2009, the retail sector affects other industries as well through its pioneering of innovative practices.

The retail sector's productivity growth and success are spurred by innovation in critical areas, including key performance indicators (KPI) measurement, customer relationship management (CRM), e-commerce, and supply chain mandates.ⁱⁱ While retail supply chain mandates have directly improved retailers' bottom lines, they have also contributed to business benefits in other industries. Whether through collaborative planning, forecasting and replenishing (CPFR) or sustainability initiatives, the competitiveness of other industries has increased by adopting practices developed within the retail sector.

The ability to access and utilize strategic information and performance indicators in decision making enables retailers to focus on initiatives that deliver a strong return on investment. For this reason, Retail Council of Canada (RCC) has partnered with Industry Canada to undertake the first Canadian *State of Retail* report. This unique analysis is intended to help Canadian retail sector executives as well as decision makers enhance their understanding of current market trends, the strategic significance of retail sector innovation and practices that improve business competitiveness across industries.

ⁱ The *retail sector* comprises establishments primarily engaged in retailing merchandise, generally without transformation, and rendering services incidental to the sale of merchandise.

ⁱⁱ *Supply chain mandates* refer to the system or departments within firms that ensure supply chain participants are aware of and take steps to comply with a clearly defined specification and/or standard.

Key Findings

- Cost of goods sold (COGS), the need to control non-revenue related expenses, and static merchandise pricing are the leading business pressures for North American retail firms.
- The retail sector invested:
 - \$5.9B in machinery and equipment, of which \$1.6B was in information and communication technologies (ICT) in 2008, greater than both the Canadian manufacturing sector and the U.S. retail sector in terms of dollars invested in ICT per GDP.
 - \$5.5B in infrastructure and led to a further \$2.7B invested by other industries in the development of shopping centres, plazas, malls and stores in 2007.
 - \$1.0B in logistics and transportation services in 2008.
- The share of the retail market in Canada has shifted steadily toward chain stores over the past several years.
- The integration of advanced technologies into core business practices has contributed to the retail sector outpacing the Canadian economy in terms of labour and multifactor productivity growth.
- Retailers have developed process innovations through their global supply chain mandates that have been broadly adopted by other sectors, including automotive, aerospace, and industrial electronics manufacturing.
- The retail sector is a leader in incorporating sustainability mandates that deliver business and environmental benefits to the entire consumer product goods global value chain.
- Best-in-Class retailers are more likely to adopt enterprise-wide business analytics and inventory visibility applications, utilize customer demographics and demand trends to drive their marketing initiatives, and implement a combination of technologies to facilitate the achievement of business goals.

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Background

Canadian retailers need quality information on drivers, future trends and best practices to succeed in the highly competitive globalized marketplace. This strategic information can also be used to identify competitiveness factors, develop benchmarks, justify investment and innovation decisions, and help inform decision makers of current and future retail sector needs. Also, the retail sector's innovative business practices can serve as leading indicators for innovation by non-consumer product goods manufacturing sectors. In this context, the Retail Council of Canada (RCC) partnered with Industry Canada to undertake the first Canadian *State of Retail* report.

This report provides Canadian retailers and decision makers with insights on the:

- Top business drivers facing retailers;
- Retail sector activities including financial performance measures by trade group;
- Key performance indicators for chain and non-chain stores, analyzed by trade group, for key financial and supply chain agility metrics;
- Innovative practices by retailers, including specific examples of organizational, process, marketing, and service innovation integrated into retailing operations; and
- Knowledge and process management practices by Best-in-Class (BiC)ⁱⁱⁱ retail firms enabling retailers to benchmark their performance in relation to industry leaders.

Approach and methodology

This report is based on a collaborative undertaking between RCC and Industry Canada's Service Industries and Consumer Products Branch. The RCC research committee defined industry needs, drivers, and metrics and offered valuable insights from an industry perspective. By using information from industry partners and international research organizations, and by applying economic models developed in-house, Industry Canada provided the overall analysis and brought together all the components needed to produce Canada's first State of Retail report.

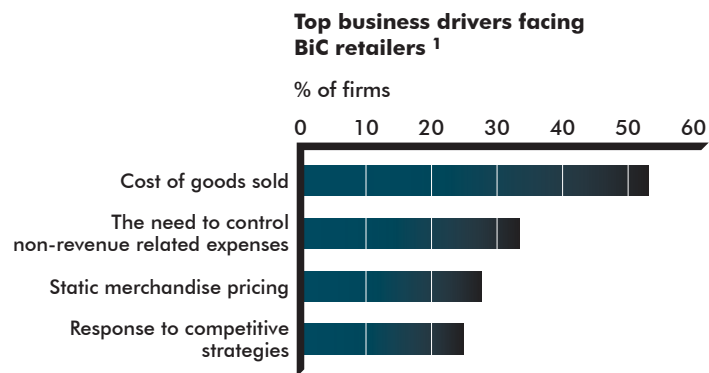
Industry Canada's analysis draws upon Statistics Canada data from the Census, Labour Force Survey, Annual Retail Trade Survey, Survey on Electronic Commerce and Technology, and GDP tables. For the U.S., Census and Bureau of Economic Analysis data were used.

ⁱⁱⁱ *Best-in-Class* (BiC) retail firms are defined as the top 20% of North American firms benchmarked to five performance metrics: average comparable store sales improvement, average gross margin improvement, average customer conversion rate increase, and channel in-stock performance.

Retail Drivers for Competitiveness

In a highly competitive sector with traditionally low profit margins, controlling costs has a major impact on a retail firm's profitability. As a result, the priority of retailers emerging from the global economic downturn is to focus on cost control rather than revenue growth. Best-in-Class (BiC) firms most often identified "cost of goods sold" (COGS, i.e., procurement, landing, transportation, selling costs) as the top business driver (Figure 1). Cost centres that are not directly operations related have been identified as a secondary target in retailers' efforts to control costs.¹

Figure 1



An additional retailer focus is the ability to respond quickly to changes in customer demand. Thus, BiC firms were likely to consider increasing their investment in innovation to develop dynamic pricing techniques that can quickly reflect market conditions.¹

Drivers for Retail Distribution Investment

As retailers further integrate global production processes into their business, efficient and effective management of their distribution systems has become increasingly challenging. This has led to most large retailers committing to maintain or increase their investment to improve their supply chain management.² A key driver for investment in retail distribution is managing increased lead times^{iv} for product delivery (Figure 2). Overall, integrating into global value chains while responding better to market demands are driving investment in retail distribution activities.⁴

^{iv} *Lead time*: a quantitative indicator measuring the time difference between stimulus and response. This indicator can be applied to different levels of the logistics process, for example to measure the actual time taken between the placing of an order and the delivery of a product.

Figure 2



A common response to manage increased lead times is to raise inventory levels, which decreases the likelihood of a stockout^v but also leads to increased total landed cost.^{vi} Leading retailers have taken an alternative approach to this challenge by improving the efficiency and effectiveness of product flows throughout their global value chains. Collaborative planning, forecasting, and replenishment (CPFR) between suppliers and retailers have enabled retailers to lower their inventory levels and the frequency of stockouts, while increasing their inventory turnover.^{vii} The results of increasing inventory turns for retailers are two-fold: retailers lower their inventory carrying cost (and ultimately COGS) while at the same time avoiding having to depreciate sale items that are not on the shelves in the correct quantity, and at the right time. Overall, increasing agility and responsiveness to changes in the supply chain allows retailers to hold less inventory and lower costs while raising the level of customer service.⁴

^v *Stockout*: a situation where demand for an item cannot be fulfilled from the current (on-hand) inventory.

^{vi} *Total landed cost*: all costs associated with making and delivering cross-border shipments, including actual costs of all the goods, inventory carrying cost, product quality cost, transportation cost, insurance and freight, custom duties and preferential rates, taxes, tariffs, and additional charges.

^{vii} *Inventory turnover* = COGS / Average inventory, where Average inventory = (Starting inventory + Closing inventory) / 2. (For example, 1 inventory turn is equal to a retailer having 365 days of inventory, 12 is 1 month of inventory, and 365 is 1 day of inventory.)

Retail Sector Activity

The retail sector is a vital part of Canada's economy and society. The direct contribution of retail trade to the economy was \$74.2B in 2009, representing 6.2% of Canada's gross domestic product (GDP). The rate of Canada's retail sector GDP growth was 34% faster than the U.S. retail sector and 96% greater than the Canadian economy between 2004 and 2008.⁵ Retail employment grew 2.4% per year from 2002 to 2009 while employing 2.0 million people, or 11.9% of the total working population in 2009.⁶

Through its investments in information and communication technologies (ICT), commercial infrastructure, and logistics and transportation services, the retail sector has significantly affected other sectors of the economy. The retail sector invested:

- \$5.9B in machinery and equipment, including \$1.6B in ICT in 2008, greater than both the Canadian manufacturing sector and the U.S. retail sector in terms of dollars invested in ICT per GDP;^{6,7}
- \$5.5B in infrastructure and led to a further \$2.7B invested by other industries in the development of shopping centres, plazas, malls and stores in 2007;⁶ and
- \$1.0B in logistics and transportation services in 2008 (e.g., value-added distribution centres).⁸

Sales & Profitability

After a prolonged period of growth, Canadian retail sector sales decreased in the last quarter of 2008 and through the first three quarters of 2009 (Figure 3). The impact of the economic downturn on sales of the Canadian retail sector varied more among the economic regions of the country than on a product line basis.⁴ The Alberta and British Columbia retail sectors had the largest percentage sales decline amongst the Canadian provinces during the economic downturn.⁶

The economic downturn affected the sales of each retail trade group differently. Home furnishing stores, furniture stores, home electronics and appliance stores, and home centres and hardware stores experienced some of the largest year-over-year sales decreases through the first three quarters of 2009. Meanwhile, the sales growth of supermarkets, pharmacies and personal care stores, and department stores and general merchandise stores remained positive throughout the downturn on a year-over-year basis.⁶

Although the Canadian retail sector experienced negative annual growth over four quarters due to the economic downturn, its growth has consistently outpaced the U.S. retail sector over

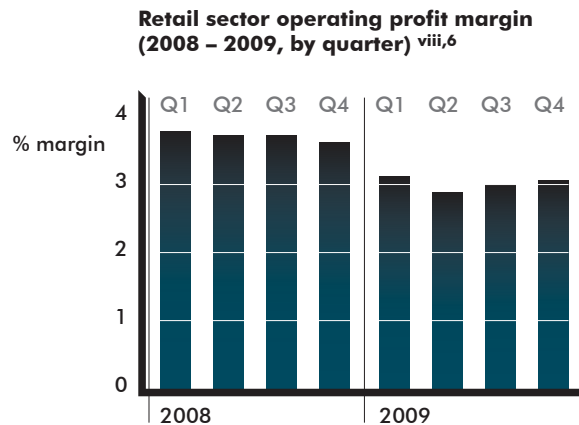
the past several years. In addition, the sales of the Canadian retail sector were less affected by the global economic crisis than that of the U.S. retail sector.⁵ American retail executives cited low consumer confidence as a major concern of their operations in early 2009.²

Figure 3



Although retail sales have decreased during the economic downturn, the sector has remained consistently profitable (Figure 4) in part due to better control of global sourcing activities and responsiveness to changes in consumer demand. Also, retailers are moving beyond operational improvements based solely on measuring averages. Managing and controlling the variability in their operations — especially regarding their supply chain — is driving their profit margin.⁴

Figure 4



^{viii} *Operating profit margin (%) = Operating profit / Operating revenue*

Chain and Non-chain Stores Analysis

Over the past several years the share of the retail market in Canada has shifted steadily toward chain stores^{ix}, with their market share increasing from 39% in 1999 to 47% in 2008.⁹ Chain stores are particularly dominant among clothing stores, and department stores and general merchandise stores, with respectively 79% and 77% of store-based revenues accounted for by chain stores (Figure 5).^x Pharmacies and personal care stores are one of the few trade groups where non-chain stores have much larger revenues than their chain counterparts. This trend is attributable to regulations in several provinces requiring pharmacies to be owned and operated by a pharmacist or a corporation where the majority of directors and share owners are pharmacists.⁴

Figure 5



Although the operating revenues of both chain and non-chain stores have grown over the past several years, the faster growth rate of chain stores is increasing their market share. The chain stores of the home furnishing stores, home electronics and appliance stores, and clothing stores trade groups had some of the largest increases in market share between 2002 and 2008.^{xi,9}

^{ix} *Chain stores* are defined as organizations operating four or more outlets in the same industry class under the same legal ownership at any time during the survey year. Stores operating under the franchise model are usually classified as *non-chain stores*.

^x For a detailed breakdown of operating revenue by chain and non-chain stores, see Annex I.

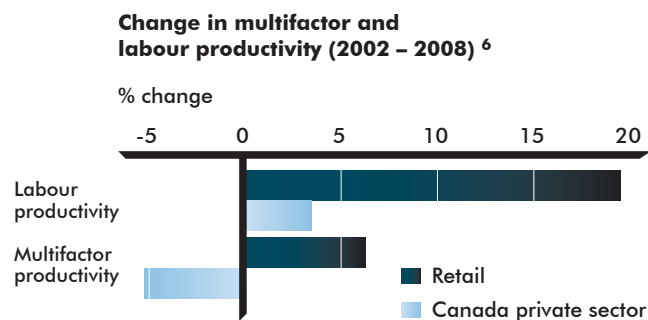
^{xi} For a detailed breakdown of operating revenue growth by chain and non-chain stores, see Annex I.

Finally, return on sales^{xii} provides insight into how much profit is generated per dollar of sales. Overall, in most trade groups, chain stores tended to have slightly greater return on sales. The business models of the various trade groups dictate their return on sales; most of the trade groups with the largest revenue show a lower return on sales compared to smaller trade groups, as their business model is based on a higher volume of sales.^{4,9}

Innovation & Productivity in Retail

It is widely accepted that innovation is central to the growth of output and productivity. Labour productivity is a measure of how efficiently an economy transforms its labour into goods and services, while multifactor productivity (MFP) represents the joint effects of many factors including entrepreneurship, economies of scale, managerial skill, new marketing practices and business models. Overall, productivity is key to economic success and the retail sector was a leader in labour productivity and MFP growth between 2002 and 2008 (Figure 6).

Figure 6



From 2002 to 2008, retail MFP and labour productivity growth significantly outpaced that of the Canadian private sector. Specifically, the labour productivity increase in the retail sector was more than five times the increase in the Canadian private sector over the same time period. Furthermore, MFP increased in the retail sector by 6.8% while the Canadian private sector MFP decreased by 5.2% from 2002 to 2008.⁶

The retail sector has invested heavily in innovative solutions to drive its productivity gains.⁴ Innovation in retail is not isolated to certain practices; it is integrated into retailers' and their suppliers' core business activities to drive their competitiveness. The innovative activities undertaken by the retail sector align with the Organisation for Economic Co-operation and Development's (OECD) definitions of the different types of innovation — organizational, process, marketing, and service.¹⁰ The retail sector has been a leader in incorporating all four types of innovation into their business practices (Table 1).

^{xii} *Return on sales* = Gross margin as a percent of sales, where Gross margin = Total operating revenue – COGS
For a detailed breakdown of operating revenue by chain and non-chain stores, see Annex I.

Table 1: Innovation in retail

Type of innovation ¹⁰	Examples in retail sector ⁴
Organizational	Performance measurement practices, supply chain mandates, supplier certification
Process	Collaborative planning, forecasting and replenishment (CPFR), advanced logistics methods, sustainability initiatives
Marketing	Customer relationship management (CRM), dynamic pricing models, geographic-specific marketing, social media
Service	e-Commerce (multi-channel retailing)

Organizational innovation is the implementation of a new organizational method in a firm’s business practices, such as new approaches to KPI measurement or supply chain mandates. *Process innovation* includes the implementation of a new or significantly improved production or delivery method, such as CPFR, advanced logistics methods, and sustainability initiatives. Linking logistics networks to customer relationship management (CRM) is an example of *marketing innovation* by the retail sector: it is part of a new marketing method involving significant changes in product design or packaging, product placement, product promotion or pricing. Finally, *service innovation* is the introduction of a service that is new or significantly improved in its characteristics or intended uses. In the retail sector, this is demonstrated through the sector’s development and evolution of the e-commerce and multi-channel retailing model.^{4,10}

These four types of innovation within the retail sector are each discussed in more detail in the sections that follow.

Organizational Innovation — Performance Measurement and Supply Chain Mandates

Developing and implementing the measurement of KPIs that are specific and tailored to each level within an organization — executive, tactical, and operational — leads to employee engagement and commitment to improving the business (Table 2). The focus at each level is toward utilizing KPI measurements where workers can have a direct impact. Metrics that focus

on quality, such as achieving perfect orders and customer satisfaction ratings, are suitable KPIs to measure at the operational level. Meanwhile, the tactical level's KPI measurement should focus on operational efficiency including inventory turnover, on-time shipments, order fill rates, and stockouts. Finally, the focus of KPI measurement at the executive level is toward business strategy, with specific metrics such as return on investment, profit margin, operating costs, comparable store sales, product line performance, as well as customer preferences.^{4,11}

Table 2: KPI measurement in retail

KPI measurement at all levels of the organization ⁴

Executive	Return on investment, profit margin, operating costs, comparable store sales
Tactical	Inventory turnover, on-time shipments, stockouts
Operational	Perfect orders, after-sales customer satisfaction ratings

KPI measurement with supply chain partners ⁴

KPI dashboards and rewards	<ul style="list-style-type: none"> • Partners • Group levels • Sites
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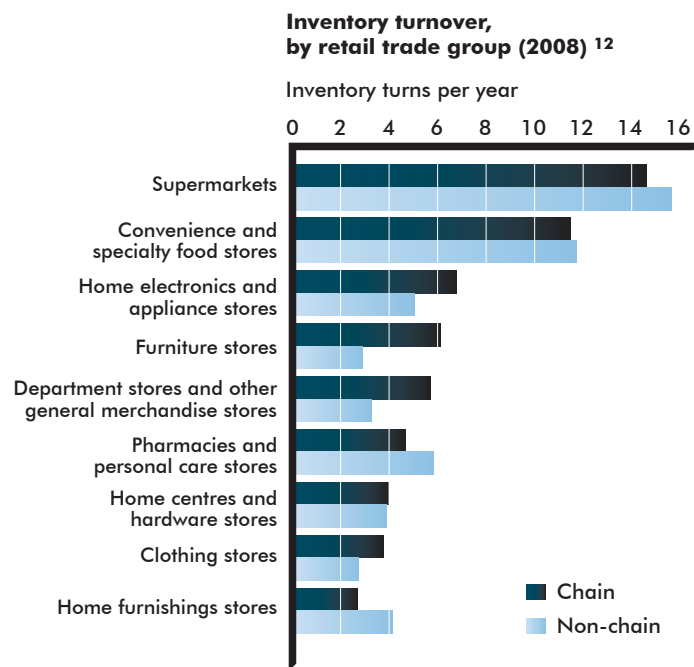
In the retail sector, the organizational innovation in KPI measurement extends beyond internal metrics to include supply chain partners through supply chain mandates and specifically the use of KPI dashboards and reward systems. One example of retailers and supply chain partners using joint KPI measurement is the establishment of common goals for a metric (e.g., percentage of perfect orders) and attributing a dollar amount to the achievement of the goal.⁴

Among the KPIs utilized in the retail sector, one fundamental aspect is supply chain agility as inventory often represents a large share of retailers' assets. Sales, profitability and cash flow are directly related to how efficiently and effectively a retailer utilizes its inventory. Inventory turnover^{xiii} measures how quickly the merchandise of a retailer is sold and replaced over a given time: a higher turnover generally implies a lower holding cost for the retailer. Inventory

^{xiii} *Inventory turnover* = COGS / Average inventory, where Average inventory = (Starting inventory + Closing inventory) / 2. (For example: 1 inventory turn is equal to a retailer having 365 days of inventory, 12 is 1 month of inventory, and 365 is 1 day of inventory.) For a detailed breakdown of inventory turnover by chain and non-chain stores, see Annex I.

turnover is a primary KPI used to benchmark the agility of a retail firm within a trade group. Clearly, the inventory turnover rate varies among the retail trade groups as the business models for supermarkets and clothing stores, for example, are quite different. Variance can also occur within a trade group: for example non-chain supermarkets defy the general trend of higher inventory turnover of chain stores (Figure 7). This can be explained by the non-chain supermarkets' focus on food — particularly perishables — and the chain supermarkets expanding their product lines to include more non-food items.⁴

Figure 7

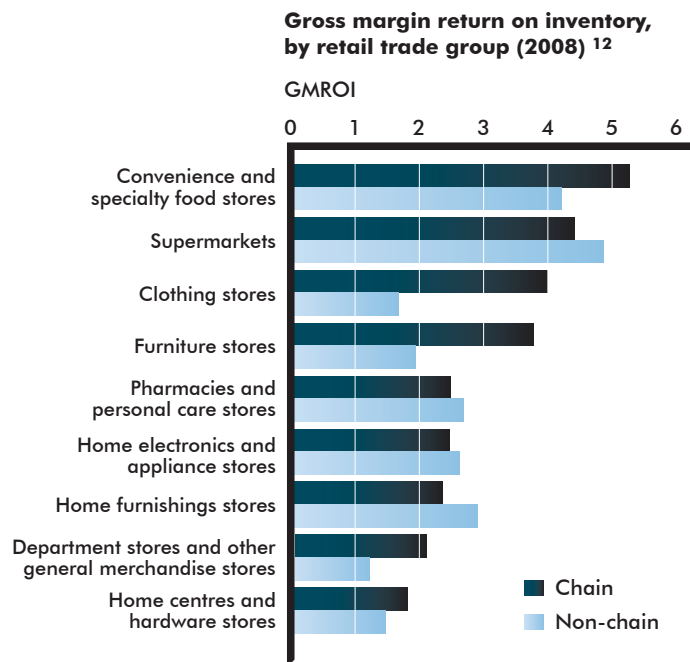


The supply chain agility of chain stores has improved over the past several years, as evidenced by their ability to increase inventory turnover by 2.6% per year between 2002 and 2008.^{xiv,12} The largest discrepancies between the chain and non-chain stores regarding inventory turnover growth occurred in the home electronics and appliance stores, computer and software stores, specialized building materials and garden stores, and miscellaneous stores — where the chain stores of each trade group increased their inventory turnover more than 7% per year between 2002 and 2008.¹²

^{xiv} For a detailed breakdown of the change in inventory turnover by chain and non-chain stores, see Annex I.

Another metric utilized by retailers to measure the effectiveness of their supply chain is the gross margin return on inventory (GMROI).^{xv} GMROI is a ratio measuring the return on every dollar spent on, or invested in, inventory. GMROI is an extremely effective measure of supply chain productivity because it includes buying and pricing components, along with an inventory control aspect (Figure 8).

Figure 8



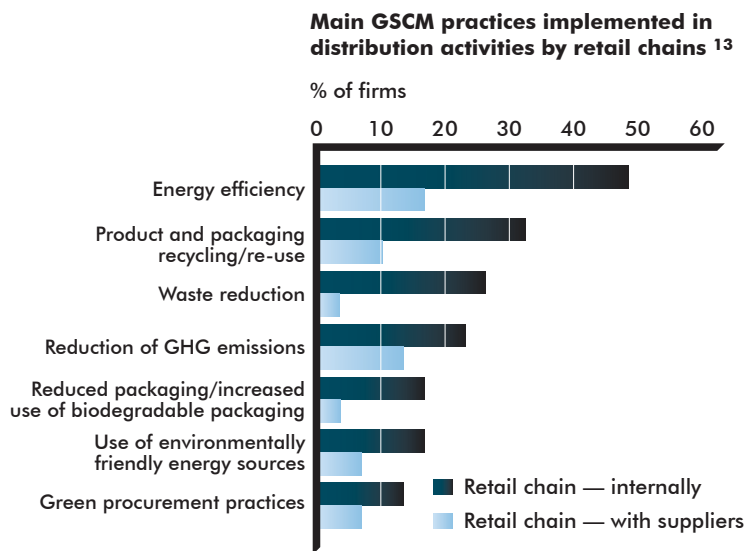
GMROI can provide profitability indicators and a benchmark for retailers within a trade group. The GMROI metric demonstrates that it is possible for products with low gross margin and high turnover to be as profitable as those with higher margins and lower turnovers; it also demonstrates that if gross margin decreases, inventory turnover must increase to maintain the same profitability. As well, GMROI can be used within a retail firm to measure the productivity of inventory across product categories to assist in planning a retailer’s merchandise mix.⁴

^{xv} *GMROI* = Gross margin / Average inventory. For a detailed breakdown of GMROI by chain and non-chain stores, see Annex I.

Process Innovation — Sustainability in Retail

Retailers are leaders in integrating green supply chain management (GSCM)^{xvi} with their suppliers. Retail chains that have implemented GSCM mandates with their suppliers achieve at least 20% greater improvement in distribution cost reductions, compliance and distribution efficiency.¹³ Retail mandates have led suppliers to improve energy use, reduce greenhouse gas emissions and waste, and recycle packaging (Figure 9).

Figure 9



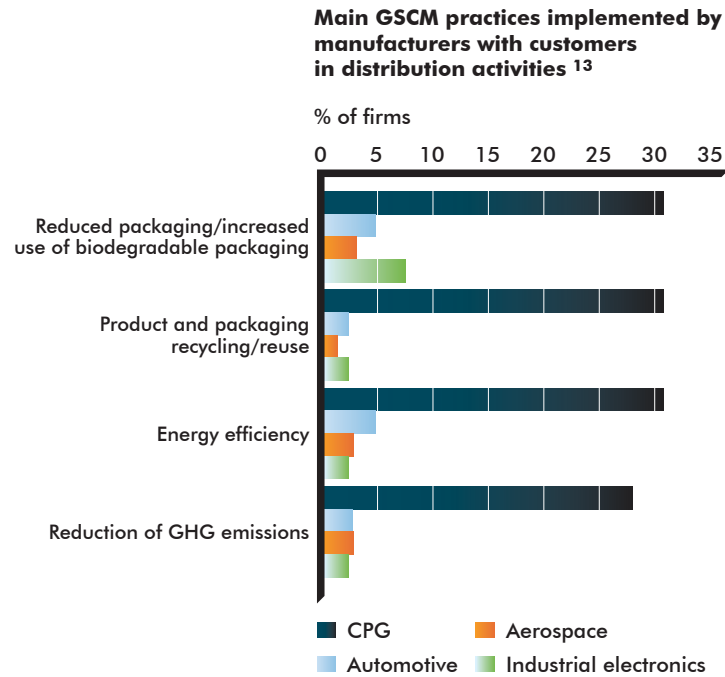
In response to retail chain GSCM mandates, many consumer product goods (CPG)^{xvii} manufacturers have implemented GSCM practices with their customers. Consequently, when compared with automotive, aerospace and industrial electronics manufacturing firms, CPG manufacturers are at least four times more likely to engage in energy efficiency, packaging and product recycling, or the reduction of GHG emissions in distribution activities with their customers (Figure 10). As a result of the retail chain GSCM success, non-CPG manufacturing industries are initiating implementation of their own GSCM mandates.⁴

While the first sustainability movement by retail was focused on distribution activities, the second upcoming movement is committed toward sustainability in product manufacturing, including the use of product scorecards. In this vein, CPG manufacturers are currently developing frameworks to benchmark and raise the sustainability of their operations.⁴

^{xvi} *Green Supply Chain Management* (GSCM) integrates environmental thinking into supply chain management, including the introduction of technical and innovative processes into materials sourcing and selection, delivery of the final product to consumers, and end-of-life product management.

^{xvii} *Consumer product goods* (CPG) are products manufactured for the end consumer and include: apparel, food, jewellery, dolls, toys, games, cleaning products, hand and power tools, home furniture, housewares, sporting goods, linens and consumer electronics and appliances.

Figure 10

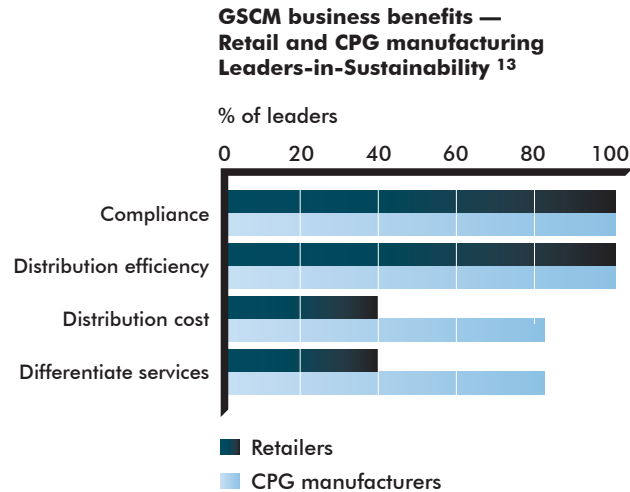


The business benefits achieved throughout the CPG value chain as a result of the adoption of these sustainability mandates are worth noting.¹⁴ Retail Leaders-in-Sustainability^{xviii} have driven GSCM initiatives in the operations of both their own firms and their suppliers. Leaders-in-Sustainability CPG manufacturers have enjoyed the most business benefits of these GSCM initiatives. Reduced distribution costs and increased distribution efficiency^{xix} are two examples of retail sustainability mandates that have produced significant business benefits to both retailers and CPG manufacturers (Figure 11).

^{xviii} *Leaders-in-Sustainability* firms are defined as businesses that achieve positive environmental improvements in the two main GSCM practices specific to the firms' sector. For retail, these two main improvements are reduced energy consumption and decreased waste in distribution activities. For CPG manufacturers, the main improvements are energy reduction and decreased packaging in distribution activities.

^{xix} *Distribution efficiency* is defined as having the right product distributed to the right place, at the right time, and at the right cost.

Figure 11



Further, more than 80% of Leaders-in-Sustainability CPG manufacturers were able to differentiate themselves from their competitors as a result of GSCM initiatives, which enabled them to access new markets. The Leaders-in-Sustainability retail and CPG manufacturing firms also reported more easily attained compliance with domestic and international regulations as a result of GSCM initiatives.¹³

Process & Marketing Innovation — Advanced Technology Adoption in Retail

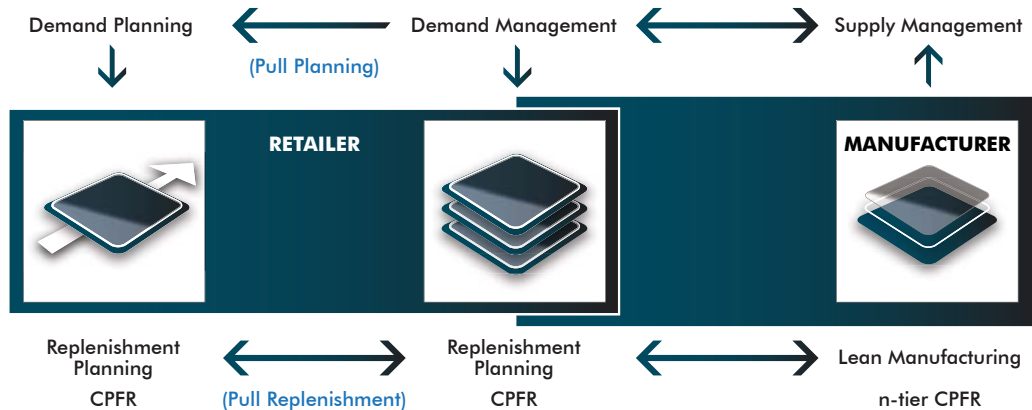
Collaborative planning, forecasting and replenishment (CPFR) innovates and enhances supply chain management by providing a common purpose and structure to retailer-manufacturer partnerships. This e-based system^{xx} and joint long-term commitment of a retailer, logistics and transportation service providers, and a manufacturer enables all partners to establish mutually beneficial supply chain metrics along with common incentives and goals. The key drivers behind CPFR are to reduce the frequency of stockouts in stores and to maximize retail floor space by centralizing retailers' logistics activities in distribution centres — in effect minimizing direct-to-store deliveries.⁴

Utilizing historical data, including seasonal considerations and trend management, as part of demand and supply management enables retailers to increase sales and reduce both stockouts and inventory carried while improving the manufacturer's production planning.¹⁵ Following a sales transaction to the consumer, joint replenishment planning is integrated into the production plans of the manufacturer and the ordering process of the retailer to complete the CPFR cycle (Figure 12).

^{xx} *e-Based system* – business process operationalized by the structured exchange and management of information over networks using Internet architecture. These systems are also referred to as *Internet business solutions*. The network can be open (e.g., accessible to everyone through the WWW) or closed (e.g., accessible only to employees or suppliers on a LAN or WAN).

Figure 12

Collaborative planning, forecasting and replenishment (CPFR) model ⁴

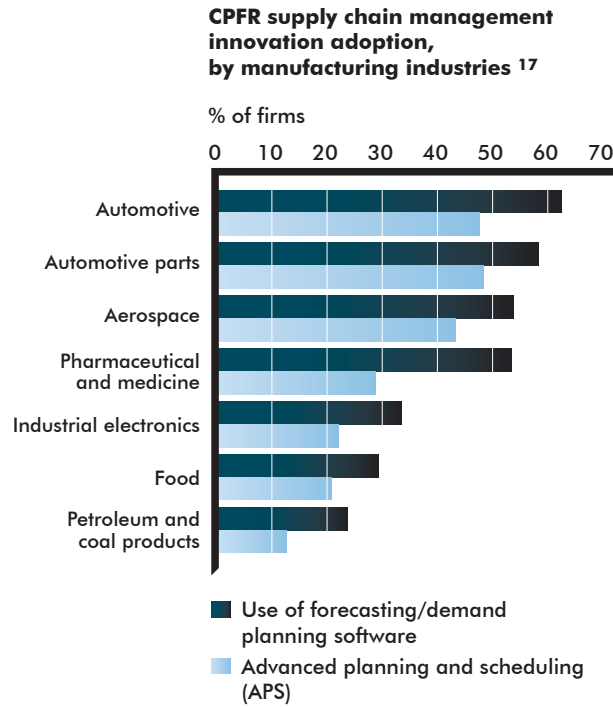


Linking the CPFR and point-of-sale information allows retailers to replenish stores with pallets that contain multiple products based on real-time or near real-time sales information. Further innovation has enabled retailers to plan the cartonization (pallet configuration optimization) at the distribution centre based on store layouts. These innovations enable retailers to reduce costs and inventory while decreasing environmental impact. Finally, the CPFR model for some retailers includes store-to-store shipments to manage changes in customer demand on a store-to-store basis.⁴

Retail sector members have also collaborated with each other to develop a central registry to maintain accurate product information, ensuring that retailers and their suppliers efficiently share correct and complete product information electronically. This has resulted in improved supply chain efficiency and product safety. A centralized electronic platform enables small and medium-sized retailers, manufacturers and logistics service providers to contribute to this value-added activity.¹⁶

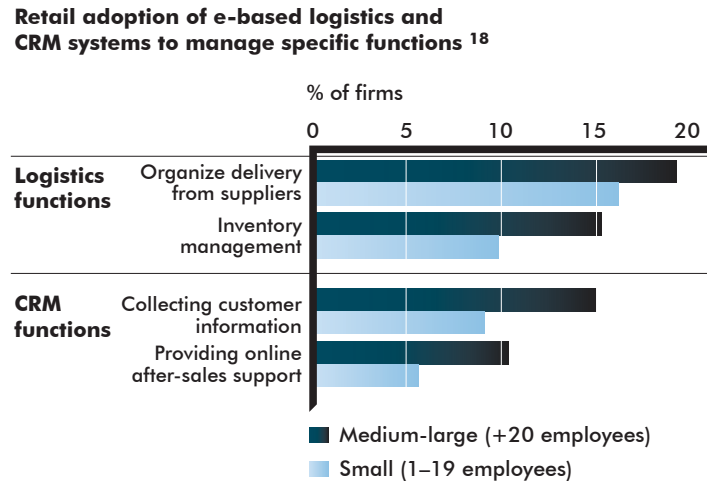
Although large retailers originally developed the concept of CPFR, it is now being adopted across non-CPG supply chains through the use of forecasting/demand planning software and advanced planning and scheduling (APS) (Figure 13). This planning supports the coordination of the point-of-sale, replenishment, and statistical modelling required to arrive at consensus forecasts and promotional plans. In addition, CPFR participants have access to production plans and use demand and inventory signals to optimize their replenishment efforts.⁴

Figure 13



The ability of CPFR to drive retailer competitiveness necessitates the integration of advanced technologies into core business practices. Adoption of e-based systems has enabled retailers to improve their competitiveness through targeted initiatives. Compared to other industry sectors, the retail trade sector leads the integration of e-based logistics systems to back-end and suppliers' systems.¹⁸ Regardless of firm size, retail adoption of e-based systems is more focused on logistics than CRM.¹⁸ Retailers utilize logistics technology to enhance supply chain coordination by organizing supplier deliveries and inventory management. With a predominant business-to-consumer model, retailers focus their logistics innovations on coordinating with suppliers. A secondary key role for advanced logistics technologies is inventory management, which is more likely to be adopted by larger retailers (Figure 14).

Figure 14



Collecting and utilizing customer information to enhance marketing strategies is a key component of e-based CRM systems. Customer information is used for cross-selling, up-selling^{xxi}, and geographic-specific marketing to improve customer acquisition, retention and conversion. Retailers’ use of centralized customer and inventory data in CRM systems enables decision makers to introduce optimized initiatives that impact the bottom line. Proper data management allows a firm to not only better understand consumer demand and market trends to guide future initiatives but also to measure the effectiveness of current loyalty activities and track the success of up-selling and cross-selling efforts.⁴

In addition to data management, retailers are committing CRM efforts in both internal and external social networking initiatives. Internally, social media can provide a conduit for operational level employees to communicate ideas on how to improve business processes and enhance the shopping experience of the customer.¹⁹ Externally, retailers can utilize social media to grow customer engagement while increasing customer loyalty.²⁰ Similar to advanced logistics technologies, large retailers are more likely than their smaller counterparts to use e-based systems to manage their marketing and customer relations functions.¹⁸

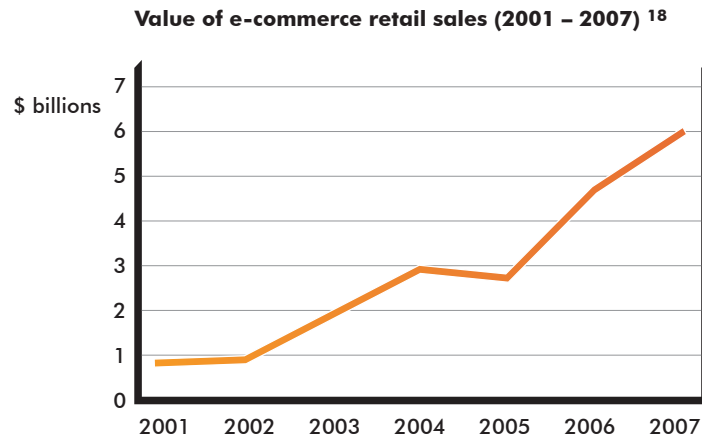
Service Innovation — e-Commerce in Retail

The efficiencies gained through e-based CRM and logistics systems have contributed to retailers’ ability to increase their access to consumers through multiple sales channels — specifically e-commerce.^{xxii} Retailer implementation of this service innovation increased overall retail e-commerce sales by an average of 37% per year between 2001 and 2007 (Figure 15).

^{xxi} *Cross-selling* is a sales technique in which certain additional products are recommended based on what a customer is purchasing. *Up-selling* is selling something that is more profitable or otherwise preferable for the seller instead of the original sale.

^{xxii} *e-Commerce*: sales over the Internet, with or without online payment. Included is the value of orders received where the commitment to purchase is made via the Internet.

Figure 15



While initial e-commerce models for retailers involved placing all of their products online, the model has evolved as a parallel operation that enables retailers to increase their market coverage beyond bricks-and-mortar locations. Today's e-commerce enables retailers to offer specialized products with high profit margins without disrupting the flow of distribution centres. Furthermore, e-commerce provides retailers a channel to consolidate clearance items in one distribution centre while increasing product selection for consumers without exhausting floor space.⁴

Innovation in e-commerce has also enabled retailers to focus their in-store offerings on higher-volume products, which reduces stockouts and ultimately maximizes floor space. In addition, the option for the consumer to pick up the product at the store enables retailers to leverage existing logistics networks by piggybacking onto normal store deliveries. Other benefits of in-store customer pick-up include lowered costs for retailers and reduced environmental impact, as well as an ensured "repeat" visit by the customer when picking up the purchased product. Also, by offering in-store pick-up, retailers have the distribution network in place to efficiently manage any reverse logistics needs (i.e., returns, exchanges).⁴

Although online sales represent a small fraction of total retail sales, the influence e-commerce has on off-line operations is significant.²¹ In addition to consumers increasingly conducting product research online for their purchases in traditional bricks-and-mortar stores, e-commerce has enabled retailers to leverage their existing logistics networks, customer service and branding to drive their competitiveness.²²

Skill Development in Retail

Innovation in the retail sector requires a diverse and complex set of skills. Needed skills in the retail sector include: operational skills that are required to deliver specific services; tactical or specialist skills that are cross-functional; and skills such as project management needed to foster a culture of innovation (Table 3).⁴

As multi-channel retailing becomes further integrated into retailers' business practices, innovation will increasingly be driven by a range of overlapping skill sets. This is particularly true given that innovation within the service sector often spans entire global value chains as well as channels to market. By developing in-house solutions, retailers drive their productivity while developing and maintaining their innovation potential.²³

Table 3: Skills in retail

Management and tactical occupations training focus ⁴ (30% of workforce) ²⁴	Operational occupations training focus ⁴ (70% of workforce) ²⁴
<ul style="list-style-type: none"> • Multi-channel retailing • International retail markets and culture • Store design and planning • Productivity • Logistics management • Relationship marketing • Advanced buying process 	<ul style="list-style-type: none"> • Customer service • Merchandising • Product safety • Material handling • Order management • Sustainability

The skill development focus for those employed in operational roles (70% of the retail sector workforce) is oriented toward customer service, merchandising, product safety, material handling, order management, and sustainability. Meanwhile, the remaining 30% of the workforce (those in either a tactical or management roles) require a different focus toward skill development.^{4,24}

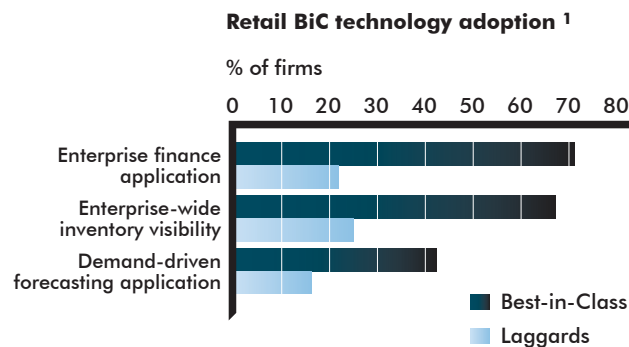
The retail sector's dramatic growth in both size and scope has created an increased need for specialty expertise in core business functions. While Canadian retailers are on par with the U.S. regarding management performance, well-managed retail firms in both countries are likely to employ more university-trained managers than poorly managed firms are.²⁵ Understanding and leveraging knowledge in multi-channel retailing, international retail markets and culture, store design and planning, productivity, logistics management, relationship marketing, and advanced buying processes is key for tactical and managerial roles in the retail sector.⁴

Best-in-Class Analysis

Best-in-Class (BiC) firms are defined as retailers that achieve positive results in key performance criteria: average comparable stores sales (year-over-year), average gross margin improvement (year-over-year), average customer conversion rate increase (year-over-year), and channel in-stock performance. This section examines how BiC retail firms compare to laggards regarding their organizational and knowledge processes along with their technology adoption. BiC retailers represent those firms, regardless of size, that constitute the top 20% of aggregate performance scorers while laggards constitute the bottom 30%.¹

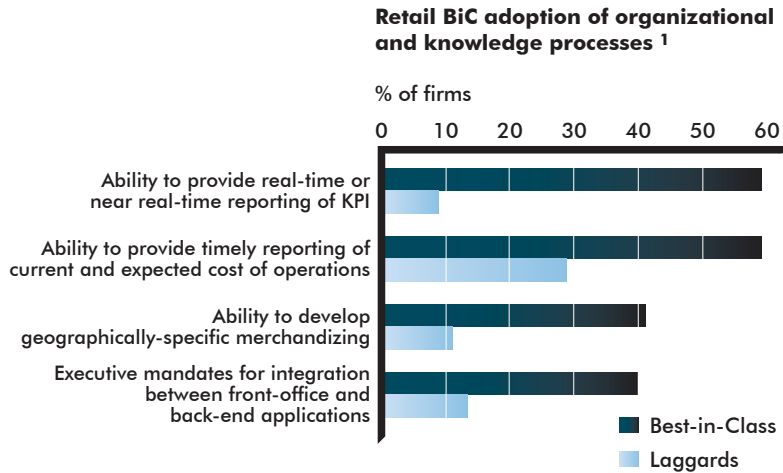
At the corporate level, BiC firms are more likely to adopt enterprise-wide business analytics. Specifically, BiC firms are three times more likely than laggards to have enterprise-wide inventory visibility (Figure 16). Also, BiC firms invest in and implement a combination of technologies to facilitate the achievement of business goals.¹

Figure 16



In addition to increased technology adoption, BiC retailers are also more likely to have organizational and knowledge processes in place that help foster competitiveness. BiC firms are more likely than laggards to improve inventory management and operational flows through timely information integration. Real-time business analytics reporting enables BiC firms to quickly adjust to the changing playing field. In particular, BiC are seven times more able than laggards to provide real-time or near real-time reporting of KPI (Figure 17).

Figure 17



BiC firms also have a stronger focus on cost factors in addition to revenue evidenced through their ability to timely report current and expected costs of operating. Finally, BiC firms are three times more likely than laggards to utilize customer demographics and demand trends to drive their marketing initiatives.¹

Final Remarks

The retail sector serves as a vital link between manufacturing and the end consumer. To maximize benefits from innovative retail practices, individual retailers should develop their own specific business cases and action plans consisting of a long-term vision, KPIs, return on investment targets and project time frames.

Overall, Canadian retail firms have considerable potential to continue enhancing their supply chain agility and their relationships with customers through increased adoption of logistics and customer relationship management technology and strategic integration of e-commerce into their operations. Increased adoption enables them to leverage customer relationship and supply chain management to ultimately optimize initiatives that affect the bottom line.

The BiC analysis identifies core processes including organizational and knowledge management, technology adoption, and KPI measurement utilized by BiC retailers. BiC retailers distinguish themselves by improving average comparable stores sales, average gross margin, average customer conversion rate, and their high channel in-stock performance.

The findings presented in this report demonstrate that the retail sector is a leader in innovation and that it disseminates innovative practices to other industries. The research also presents the important linkages between retail drivers, firm activities and resulting business benefits. These connections can help foster a continued dialogue among stakeholders. This report also sets the stage for those interested in the retail sector, productivity, and innovation trends to pursue new research opportunities and projects.

Annex I: Data Tables

Operating revenue (2008) and revenue growth (2002-2008), by retail trade group ^{xxiii}

	Operating revenue, by trade group (2008) in \$ billions		Operating revenue CAGR ^{xxiv} , by trade group (2002-2008)	
	Chain	Non-chain	Chain	Non-chain
Total, all trade groups	213.8	240.9	7.3%	3.2%
Beer, wine and liquor stores	15.1	1.6	5.2%	3.0%
Clothing stores	14.7	4.0	5.9%	-1.9%
Computer and software stores	0.4	1.8	13.9%	-3.5%
Convenience and specialty food stores	3.0	10.9	4.8%	0.5%
Department stores and other general merchandise stores	40.5	12.1	5.3%	5.1%
Furniture stores	6.3	3.8	5.4%	1.2%
Gasoline stations	37.4	15.5	13.8%	4.2%
Home centres and hardware stores	12.5	9.5	7.5%	6.5%
Home electronics and appliance stores	10.0	4.0	12.0%	3.1%
Home furnishings stores	1.9	4.0	8.7%	2.7%
Miscellaneous store retailers	5.1	7.1	3.5%	0.9%
New car dealers	3.2	77.9	11.4%	1.3%
Pharmacies and personal care stores	5.9	25.6	2.8%	7.5%
Shoe, clothing accessories and jewellery stores	3.8	2.4	4.5%	2.8%
Specialized building materials and garden stores	1.1	5.7	6.1%	6.4%
Sporting goods, hobby, music and book stores	6.3	5.5	6.5%	2.2%
Supermarkets	44.1	28.0	6.3%	2.9%
Used and recreational motor vehicle and parts dealers	2.5	20.2	11.0%	7.1%

^{xxiii} Statistics Canada. *Annual Retail Trade Survey*. 2010.

^{xxiv} CAGR – compound annual growth rate

Return on sales (2008) and change in return on sales (2002-2008), by retail trade group ^{xxv}

	Return on sales, by trade group (2008)		Return on sales CAGR, by trade group (2002-2008)	
	Chain	Non-chain	Chain	Non-chain
Total, all trade groups	30%	25%	-1.5%	2.1%
Beer, wine and liquor stores	46%	25%	-1.7%	3.2%
Clothing stores	54%	41%	2.4%	0.4%
Computer and software stores	16%	31%	-5.3%	3.2%
Convenience and specialty food stores	32%	27%	-0.4%	1.3%
Department stores and other general merchandise stores	27%	27%	0.4%	0.6%
Furniture stores	39%	41%	-0.9%	2.9%
Gasoline stations	16%	17%	-9.3%	-0.8%
Home centres and hardware stores	33%	30%	2.1%	1.6%
Home electronics and appliance stores	27%	35%	-2.1%	2.0%
Home furnishings stores	49%	43%	1.4%	3.0%
Miscellaneous store retailers	43%	42%	-0.5%	0.3%
New car dealers	14%	15%	3.6%	3.0%
Pharmacies and personal care stores	36%	32%	1.6%	1.1%
Shoe, clothing accessories and jewellery stores	54%	46%	2.0%	0.6%
Specialized building materials and garden stores	36%	37%	-0.5%	4.4%
Sporting goods, hobby, music and book stores	37%	38%	-0.4%	1.0%
Supermarkets	24%	24%	-1.8%	1.9%
Used and recreational motor vehicle and parts dealers	34%	25%	-0.8%	3.1%

**Inventory turnover (2008) and change in inventory turnover (2002-2008),
by retail trade group^{xxvi}**

	Inventory turnover, by trade group (2008)		Inventory turnover CAGR, by trade group (2002-2008)	
	Chain	Non-chain	Chain	Non-chain
Total, all trade groups	7.2	4.6	2.6%	-2.0%
Beer, wine and liquor stores	7.0	6.6	-0.9%	0.9%
Clothing stores	3.4	2.4	-1.8%	-1.7%
Computer and software stores	9.9	7.0	8.4%	0.5%
Convenience and specialty food stores	11.2	11.5	6.6%	-0.8%
Department stores and other general merchandise stores	5.7	3.5	0.8%	-0.2%
Furniture stores	5.8	2.7	4.2%	-2.9%
Gasoline stations	61.8	26.8	12.5%	9.8%
Home centres and hardware stores	3.6	3.6	-2.0%	-1.1%
Home electronics and appliance stores	6.4	4.8	10.6%	2.0%
Home furnishings stores	2.4	3.8	-2.4%	0.1%
Miscellaneous store retailers	4.2	3.0	7.9%	-0.2%
New car dealers	5.1	4.2	-1.1%	-4.1%
Pharmacies and personal care stores	4.4	5.5	-1.5%	0.0%
Shoe, clothing accessories and jewellery stores	2.0	1.3	-1.8%	-0.8%
Specialized building materials and garden stores	5.4	3.5	6.7%	-3.8%
Sporting goods, hobby, music and book stores	3.2	2.1	2.6%	-2.1%
Supermarkets	14.3	15.4	-2.0%	-0.1%
Used and recreational motor vehicle and parts dealers	3.1	3.0	2.3%	-2.9%

Gross margin return on inventory (GMROI) (2008) and change in GMROI (2002-2008), by retail trade group^{xxvii}

	GMROI, by trade group (2008)		GMROI CAGR, by trade group (2002-2008)	
	Chain	Non-chain	Chain	Non-chain
Total, all trade groups	3.1	1.5	0.4%	0.7%
Beer, wine and liquor stores	5.9	2.2	-4.2%	5.1%
Clothing stores	4.0	1.6	3.1%	-1.0%
Computer and software stores	1.9	3.1	1.4%	5.1%
Convenience and specialty food stores	5.2	4.2	5.9%	0.9%
Department stores and other general merchandise stores	2.1	1.3	1.4%	0.6%
Furniture stores	3.8	1.9	2.6%	1.8%
Gasoline stations	11.5	5.4	-0.6%	8.8%
Home centres and hardware stores	1.8	1.5	1.0%	1.1%
Home electronics and appliance stores	2.4	2.6	7.3%	5.1%
Home furnishings stores	2.3	2.9	0.2%	5.1%
Miscellaneous store retailers	3.1	2.2	6.9%	0.2%
New car dealers	0.8	0.8	3.0%	-0.8%
Pharmacies and personal care stores	2.5	2.7	0.9%	1.7%
Shoe, clothing accessories and jewellery stores	2.3	1.1	2.3%	0.3%
Specialized building materials and garden stores	3.0	2.1	5.8%	2.6%
Sporting goods, hobby, music and book stores	1.9	1.3	2.0%	-0.5%
Supermarkets	4.5	4.9	-4.3%	2.3%
Used and recreational motor vehicle and parts dealers	1.6	1.0	1.1%	1.0%

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