



EAS

MERCHANDISE-PROTECTION STRATEGY

What Is the Right Choice for Your Stores?

By Ryan H. Smith

Over the last four years, Gap Inc. has implemented a number of electronic article surveillance (EAS) solutions, including in-store applied hard and alarming tags, factory-applied source/soft tag labels, and factory-applied hard tags (FAHT). This article explores the key decision points, financial rationale, infrastructure requirements, and benefits of why Gap Inc. moved toward a blended solution; the key component of which is the FAHT program. This article also seeks to provide a framework for your company to evaluate the appropriate strategy that Gap Inc. has found very effective.

Source Tagging

Gap Inc. has implemented the FAHT program in each of its three brands—Gap, Banana Republic, and Old Navy—in North America and Europe. However, each brand had an existing soft tag/label infrastructure in place prior to the transition to the FAHT program.

FAHT differs from traditional in-store applied hard tags and factory-applied source/soft tags in three key ways. The key differences will vary depending on your current EAS strategy, that is if you are using in-store applied hard tags, source/soft tags, or if you do not have any tagging program.

Labor Savings. By moving tagging out of the store, there are significant labor savings. As you can imagine, paying factory wages in Vietnam to tag is significantly less expensive than paying domestic store labor in New York City.

Shrink Savings. The well-established benefit and deterrence of applying a hard tag reduces shrink not only in the store, but with FAHT, the benefit is realized throughout the supply chain by placing EAS pedestals at the entry way of distribution centers.

Ongoing Cost. With in-store hard tags there is a one-time expense to purchase the tags with limited replenishment due to in-store tag attrition in later years, while there is ongoing annual expense with FAHT.

The differences outlined above force retailers to consider the following five key areas when exploring the feasibility and financial benefit of implementing a FAHT solution.

- Shrink rate/dollars and sales impact
- Cost of tags and product coverage
- Store payroll savings
- EAS infrastructure and vendor consideration
- Location of shrink in your real estate portfolio

Gap Inc. built a strong business case by successfully triangulating these five components. In other words, we were able to show that a FAHT strategy reduces overall expenses, through lower shrink and payroll, even though these savings are partially offset by higher expenses associated with purchasing the factory-applied hard tags on an ongoing basis.

Shrink Rate/Dollars and Sales Impact

Not surprisingly, factory-applied hard tags have a greater positive financial impact when a company has higher shrink dollars and/or a higher shrink rate. Simply stated, the greater the shrink, the greater the dollar savings from tagging. This is the case for almost any tagging technology.

The evaluation criteria for FAHT shrink savings, however, hinges on what type of tagging, if any, is present in your stores. The more tagging currently employed in-stores, the lower the shrink savings are and vice-versa.

Gap Inc. has experienced shrink savings of five to seventy percent in product categories protected by FAHT with the lower-end savings experienced in categories previously protected by in-store hard tags and the upper-end savings on categories without any previous protection.

The most astonishing impact of our FAHT experience was the shrink improvement realized in departments that were previously covered by in-store applied hard tags. We did not expect any benefit in these categories. However, due to the near perfect tagging compliance from the factories and the uniformity in tag placement, we experienced an improvement in shrink. In conjunction with merchandising and store operations, LP communicates specific placement standards to the factories for all product tagged.

The other key benefit associated with reducing shrink is the opportunity cost of not being able to sell the merchandise. Without a doubt sales and margins improve when shrink is reduced because the product is sold rather than stolen. The challenge is estimating the recapture in gross margin dollars due to the reduced shrink. The recommended method to include this benefit is to use a weighted average gross margin of the tagged product multiplied by the estimated shrink savings. This way not only is the benefit from shrink savings included in your business case, but the margin upside as well.

Cost of Tag and Product Coverage

The second critical component for evaluating FAHT for your stores is to understand the price your company would pay for tags. The pricing largely depends on the expected volume of tags your stores will use on an annual basis. Tag cost is *the most crucial component* of the FAHT evaluation because the business case is more sensitive to the tag cost than any other input. This is a result of the significant number of tags that will be purchased annually.

Depending upon the size of your company and the number of units tagged, your tag purchases may very well reach into the tens of millions or more. The price that you pay for each tag on a per unit basis from the EAS provider will in almost all circumstances not be the final cost of adding the tag to the merchandise. The same holds true for any source tag or label.

There are typically five factors to consider when determining the total tag cost, referred to as the “fully loaded tag cost.”

- Tag price
- Cost to ship tag to factory from point of manufacture

- Duties applied by country of production
- Retailing country customs duty
- Applicable rebate if, for example, you recycle or reuse the tag and can negotiate a rebate from your recycling company or provider

Fully Loaded Tag Cost. As duties and taxes can have a significant impact on your fully loaded tag cost, a more in-depth discussion is necessary.

Duties vary by factory location and may be applied to both the tag and the freight costs. The customs duty may not apply and therefore lower your total cost of ownership if your company uses a recirculation program for sending the tags back to the factory (the factory cannot be in the retailing country) and your company has a government customs ruling in place to identify that the tag will be removed from the merchandise and recirculated.

It is advisable to partner with your company's finance and/or production departments to determine the exact fully loaded cost for your tag. You should diligently research this important aspect of the FAHT program because it can have a significant impact on your tag cost and business case.

Product Categories to Tag. When evaluating what product categories to tag, it is important to consider the shrink improvement, incremental cost of the FAHT program, and payroll savings. Generally, higher priced, lower unit categories are more likely to show a positive return on investment as the

savings on shrink and payroll exceed the incremental cost of the tags. In contrast, lower priced, higher unit categories are less likely to demonstrate a positive return because the cost of the tags overwhelms the shrink and payroll savings.

Shrink-reduction estimates due to FAHT should be a combination of historical rates from your company in conjunction with improvements ranging from 5 to 70 percent depending on your current EAS solutions. As a rule of thumb, Gap Inc. has used a 20 to 25 percent improvement.

Gap Inc.'s decisions regarding which products to tag are based upon both financial and production-level analysis; that is, the financial benefit of applying a FAHT at the product department level and the ability to apply a tag without damage to the merchandise. When these two decision points meet, we apply a FAHT.

For example, categories tagged generally include denim, bottoms, outerwear, dresses, suiting, sweaters, and woven shirts. Categories not tagged often include knits, furnishings, and accessories. At this point, select product may receive a soft tag/label or stores may elect to use an in-store hard tag or an alarming tag applied to high-shrink items, such as leather handbags or silk dresses to minimize shrink in these categories with a high average unit retail.

Another key consideration for Gap Inc. revolved around how to protect children's merchandise (0 to 12 years). In order to meet Gap Inc.'s stringent product-safety standards, tags

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with sharp points cannot be applied at source to this product category. In addition, tags with metal components may activate a factory's needle-detection machine. Therefore, Gap Inc. elected not to include children's merchandise in the initial FAHT program.

Interestingly, results indicate that theft has migrated to children's merchandise as it is not protected with a tag. To mitigate loss in this category, we are testing a tag developed specifically for children's merchandise in an effort to overcome the safety and needle-detection issues.

Store Payroll

As was stated earlier, moving tagging out of the back of the store to the factory provides opportunities to reduce store payroll, likely your company's largest controllable expense category. Gap Inc. has realized this payroll decrease through higher productivity in store receiving with a 30 percent increase in our units per hour (UPH) standards.

To assess the payroll allocated to tagging, you will likely have to partner with your finance and store operations business partners. Once the potential payroll savings are determined, this can be included as a benefit in your business case. Reducing payroll expense not only provides additional benefit, but it is also an opportunity to simplify store operations and gain support from your field and store operations business partners. Without

fail our in-store field teams recognized the positive impact on workload and morale through the elimination of in-store tagging.

EAS Infrastructure and Vendor Consideration

Since tags are applied at the factory and merchandise flows to all stores, it is important to emphasize that *a FAHT program requires a consistent, single-technology EAS infrastructure in all stores*. This requirement may cause you to add and/or replace existing EAS equipment.

If necessary, the sales on the secondary market of your existing EAS pedestals, detachers, and tags can be used to pay for or offset the cost of new equipment for a FAHT program. You may also need to consider any remaining book value associated with the existing equipment and the potential accounting implications.

Moreover, your existing equipment will likely play a role in your decision about a FAHT vendor. The ability to leverage existing equipment can reduce the overall cost of rolling out FAHT and provide a strong return on your equipment investment.

Additional considerations when evaluating a vendor is the aforementioned cost of the factory-applied hard tags, and the vendor's ability to reuse and/or recycle the tags to reduce tag costs over time. The vendor also may be able to provide opportunities to reduce the tag cost through volume discounts and long-term contracts.

This is an important evaluation because the lowest possible tag cost is crucial to developing a successful business case.

Location of Shrink in Your Real Estate Portfolio

The final decision point requires an understanding of where your shrink is occurring across your store base. One of the greatest benefits of a FAHT program is its universal coverage in all stores. This can also be its greatest downfall.

For example, if your shrink is highly concentrated in one region with little to no shrink in the remaining regions, a FAHT strategy is, in all probability, not the right solution for you to reduce shrink. In this scenario, likely the greatest financial benefit would come from using a regional in-store hard-tag strategy where you are concentrating the expense and savings associated with tagging where the shrink is occurring.

However, if your real estate portfolio covers a larger, more geographically dispersed area with shrink less concentrated in any particular region, a FAHT program may very well be the right strategy for you.

Implementation of FAHT

In addition to realizing the shrink savings associated with the FAHT program, solid program execution is a valuable way of gaining support for the success of your overall merchandise protection strategy. The program is essentially a production program with the tag or label considered "trim," just like a shirt button or denim rivet. Partnerships with the production, sourcing, and store operations departments are critical to the

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program's operations, and it is important that they understand the entire business case.

For example, increasing merchandise manufacturing costs by adding a security tag or label may not be well accepted by a merchant, which may lead to poor compliance in adding the tag to the merchandise bill of materials. However, when the same merchant understands that the program will enable stores to retain the product to sell at full price, they will understand that the tags provide a significant benefit.

Sourcing and production teams will be important points of contacts for your tag provider and factories. They can provide planning forecasts and factory details to yield on-time tag deliveries, as well as directing vendors on placement, costing, and ordering details via technical bulletins.

Store operations may support the program by evaluating and providing timely feedback, including tag application and factory compliance to adding the tag.

It is noteworthy that tag recycling/recirculation programs also support many environmental principles and practices that both customers and employees value today.

In-Store Tagging

Though this discussion offers an in-depth exploration of evaluating and implementing a factory-applied hard tag program, we would be remiss if we did not review Gap Inc.'s in-store tagging strategy and evaluation criteria.

Gap Inc. has largely moved away from in-store tagging for the reasons described above except in particular circumstances. However, depending upon the factors involved, in-store tagging can have a greater financial return than FAHT. This can occur when one or more of the following criteria are met:

- A lack of a fleet-wide EAS infrastructure,
- An acute shrink issue in a particular geographic area, and/or
- A product mix where significant hard tagging may not be suitable.

The first and foremost challenge with FAHT is the requirement to have the aforementioned fleet-wide consistent technology platform. The financial return from shrink reduction may take years to pay off the cost of the infrastructure. This depends upon your company's existing infrastructure and the size of your shrink opportunity. Your company may obtain a higher return on investment with a more surgical, less capital-intensive approach by using in-store applied hard tags.

Second, as was previously stated, FAHT is a "shotgun" or

"blanket" approach whereas in-store tagging can be leveraged in a "rifle" or "scalpel" approach. For example, if there is an acute shrink issue in Dallas, the city and surrounding area can be covered while not simultaneously covering Phoenix where there may not be an issue. This way your resources can be focused on reducing shrink in specific geographic areas of concern.

Third, the product mix found in your stores may not be best suited to a FAHT solution. For Gap Inc. and our predominately soft-lines product mix, FAHT is an optimal solution. However, your stores and product mix may be different and in-store tagging may operationally be a favored solution.

This was the case for one of our brands where these three factors combined to favor the continuation of in-store tagging. First, this brand did not have a fleet-wide infrastructure to enable FAHT. Second, there was not enough shrink savings associated with fleet-wide tagging to justify the infrastructure investment. Finally, the average unit cost/unit was lower in this brand, which further made the ongoing cost of FAHT less palatable versus the one-time cost of in-store tagging.

Overall Benefit

Gap Inc. gained relative short-term benefit following the transition to source-tag labels. Stores that had not previously protected their merchandise with an in-store hard-tag program realized a significant improvement in shrink; however, the opposite held true for stores that used hard tags. Therefore, the larger benefit of the soft tag program was the operational framework it set to build the FAHT program upon.

Gap Inc. has realized significant savings and success from implementing the FAHT program. The framework of five factors included in this article helped us to effectively and successfully evaluate the financial, store, and production impact of moving to a FAHT program. Presenting a holistic review of the optimal shrink-mitigation strategy, whether it be FAHT or in-store tagging, enabled us to gain internal buyoff from business partners in finance, store operations, production, and merchandising in addition to our own loss prevention team.

By consistently applying this methodology, by being transparent with our assumptions, and by ultimately delivering on what we promised, LP has gained traction and credibility internally. Hopefully, by sharing our experience and successes, your company can leverage the framework described in this article to make informed decisions about the right merchandise-protection strategy for your stores. ■

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