Deep Dive

Why Not-for-Resale Savings Could Be the Key to Unlocking Profitability

Using the findings of a July 2020 Coresight Research survey of retail and CPG companies, we explore the impact of the Covid-19 crisis on retailers' profitability and opportunities to combat those declines, with a focus on not-for-resale goods and services (NFR), or goods and services that are not sold to the end-consumer.

This report is produced in partnership with LogicSource, a procurement services and technology business that focuses exclusively on assisting companies to drive profit improvement by reducing costs across NFR goods and services.

Our research highlights the following key findings:

- **Profitability challenges abound:** 88% of retailers from our survey stated that Covid-19 has had at least a moderately negative impact on the profitability of their business and nearly 50% said the impact was "extremely impactful."
- **Retailers have adjusted their strategies:** Retailers are thinking long-term and plan to minimize the use of professional services, reduce business travel, invest in digital technologies, maintain a leaner organization and downsize physical office properties for the foreseeable future.
- **Evaluating NFR pays off:** Of the respondents that have previously evaluated or are currently evaluating NFR, 65% experienced profit lifts of greater than 3%.
- **Opportunities to capitalize on NFR:** One of the top opportunities identified was rethinking supplier relationships; retailers believe there is tremendous opportunity with suppliers through volume discounts, reevaluating needs, contract renegotiation and supplier risk management.
- **Barriers to overcome:** Overcoming organizational barriers will be key to unlocking the true potential of NFR savings.

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Introduction: Retailers Need To Look to Alternate Sources of Profitability

For years, the retail industry has been challenged to keep up with rapidly changing consumer expectations. Prior to the Covid-19 pandemic, retailers were already struggling with profitability. Covid-19 has accelerated consumer trends, such as online shopping, and increased competition, exposing brands that have failed to innovate in the fast-paced retail environment.

As retailers search for cost-saving initiatives, we explore an often-untapped yet substantial resource for increasing profitability: not-for-resale goods and services (NFR). NFR expenses—across areas such as marketing, real estate, IT, professional services, and distribution and logistics—typically equate to about 20% of a company's revenue, according to benchmarks and data from LogicSource, so time spent and/or financial investment in evaluating these expenses can produce a hefty return on investment.

Retailers can overcome negative impacts of Covid-19 by finding unique sources of savings.

In this report, we analyze proprietary survey data to reveal the impact the Covid-19 pandemic has had on retailer's profitability, their current and forward-looking strategies to fight declining profits.

We dive into the findings from a July 2020 survey of 220 executives at North American retail and CPG companies. As well as the Covid-19 impact, we asked respondents about their familiarity with, awareness of, and openness to examining NFR expenses. We will highlight the key opportunity areas and typical organizational barriers and challenges that retailers face when evaluating these expenses.

Retailers Are Facing a Profitability Crisis: Survey Insights

2020 has yielded 28 retail bankruptcies so far.

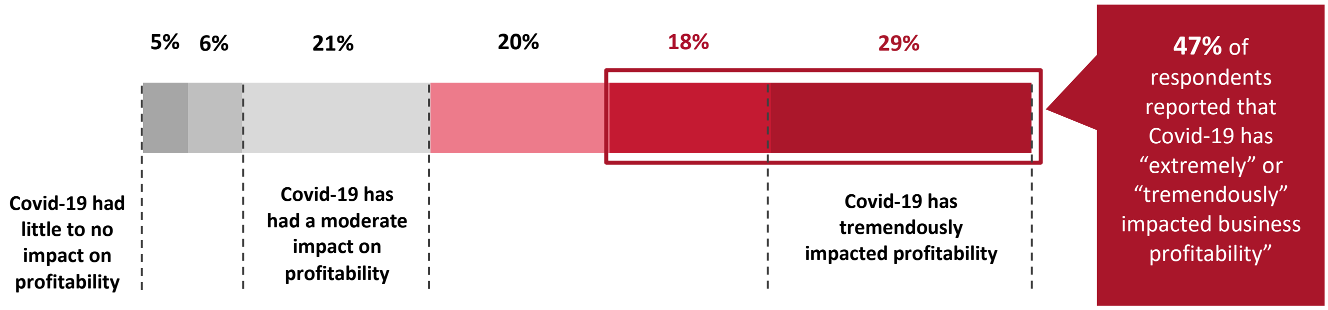
Amid the Covid-19 crisis, retail companies are laser-focused on profitability. As of August 26, 2020, US retail has seen 28 bankruptcies year-to-date (of which 23 were filed after lockdowns began)—the highest number of retail bankruptcies in a decade.

51% of retailers surveyed would describe their organization's financial situation as "critical," and 11% stated that the situation is critical enough that they "may not survive."

Our survey of retail and CPG executives provides details on the extent of the struggles:

- 100% of respondents had experienced at least some negative impact to their organization's profitability; not a single organization surveyed reported that they were unaffected by Covid-19.
- Some 88% of respondents stated that Covid-19 has had at least a "moderately" negative impact on the profitability of their business.
- 47% stated that Covid-19 has been at least "extremely" impactful on profitability.

Figure 1. The Negative Impact of Covid-19 on Business Profitability, on a Scale from "Little to No Impact" to a "Tremendous Impact" (% of Respondents)



Total may not sum to 100% due to rounding
Base: 220 retail and CPG executives
Source: Coresight Research

When asked about how critical their financial situation is, 51% of respondents said more than "moderately critical" and 11% stated that their business may not survive. Of the retailers that reported that their financial situation is more than moderately critical:

- Some 39% said that "a mix of both increased costs and decreased revenues" was the primary driver of their financial situation.
- 29% said only "increased costs" was the primary reason.
- Another 31% said only "decreased revenues" was the primary driver.
- 1% were unsure of the primary driver behind their moderately critical financial situation.

In the current situation, there are multiple drivers of retailers' profitability challenges, with the negative impact to financials having hit retailers swiftly, broadly and deeply. 97% of those respondents that reported at least a "moderately critical" financial situation saw profitability decline by more than 3% following the Covid-19 outbreak; 84% experienced profitability declines of greater than 5%.

Figure 2. Respondents in a Self-Reported "Critical" Financial Situation: Impact of Covid-19 on Business Profitability

Impact to Profitability	Proportion of Respondents
0–2% decrease	2%
3–5% decrease	13%
5–10% decrease	57%
>10% decrease	27%

84% experienced over a 5% decline in profitability

Total does not sum to 100 because 1% of respondents replied "Not sure"
Base: 115 respondents that rated their financial situation a five or higher on a scale of one ("not at all critical") to seven ("extremely critical")
Source: Coresight Research

Top Negative Drivers Impacting Profitability

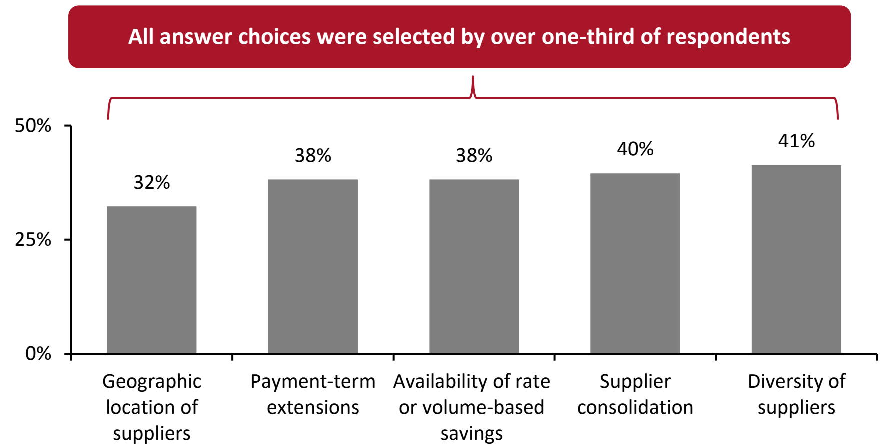
Our survey respondents reported myriad impacts on their retail and CPG businesses that are directly attributed to Covid-19. Of the options we provided, the following impacts were each cited by around 40% of our survey respondents:

- Issues with suppliers
- Increased costs due to increased investment in PPE (personal protective equipment)
- Substantially decreased revenues
- The shutdown of their business for a period of time

"Issues with suppliers" was the option most selected by CPG firms and retailers (41% of respondents). Suppliers hold a significant amount of power over retailers' operations and financials: they not only provide products and goods for sale, but also all NFR goods and services in a business. Covid-19 caused disruption along the supply chain as supplier factories and warehouses were forced to shut due to state mandates and as shifts in capacity and demand pressured logistics.

In Figure 2, we outline the top impacts on retailers' sourcing and procurement models. All of these options were chosen by at least one-third of respondents, indicating that almost all retailers' sourcing and procurement operations have been impacted in more than one way.

Figure 3. Impacts of 2020 Socioeconomic Events on Sourcing and Procurement Models (% of Respondents)



Base: 220 retail and CPG executives
Source: Coresight Research

Retailers Are Taking Steps To Offset Declining Profitability

Some retail companies have already turned to cutting costs not related to goods or services for sale. We asked our respondents to report the current steps they are taking to offset declining profitability and found that retail and CPG companies are focusing on internal and indirect costs.

- The largest proportion of respondents (30%) stated that they are making changes to their travel and expenses policies.
- Around one-quarter of respondents each reported that they are purchasing inventory on an as-needed basis, searching for less expensive suppliers, decreasing their budget for vendors and contractors, decreasing their marketing and advertising budget and renegotiating supplier contracts. Suppliers, contractors and travel budgets are extremely costly for businesses.
- Fewer than 20% of respondents are turning to options such as staff furloughs and layoffs, cutting benefits or selling through current inventory. Cutting expenses related to employees, while lucrative, poses a risk of souring employee morale or hurting the organization's reputation.

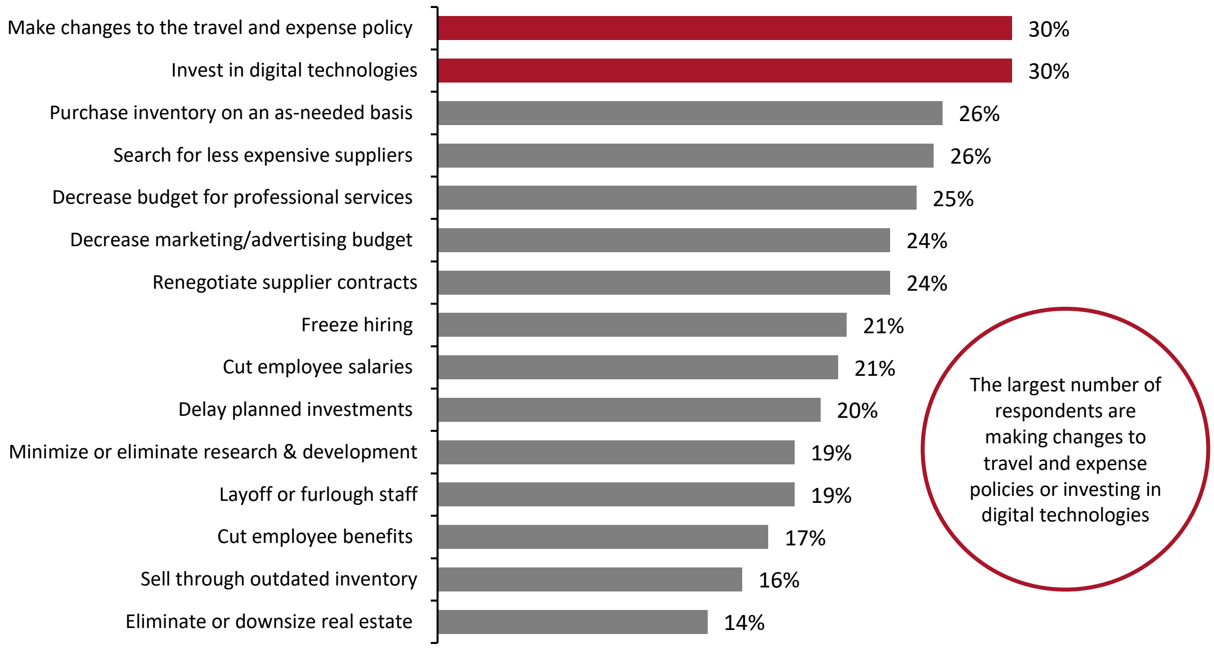
One-third of retailers plan to invest in digital technologies as part of a long-term profitability strategy.

Organizations have also been forced to think beyond the immediate aftermath of Covid-19 and have adjusted their investment strategies for the future.

- Almost one-third of retail and CPG organizations said they were planning to invest in digital technology.
- Another 27% of respondents stated that they are investing in supply chain & logistics.
- 21% are investing in the IT department and 20% are investing in a more diverse organization.

Retailers' selection of several investment opportunities indicates that they are not only cutting costs to improve profitability in the short term but are also thinking about the long-term longevity of their business. Covid-19 has served as a litmus test, illuminating those that have not advanced and innovated and incentivizing the survivors to rapidly get up to speed with consumer expectations and digital technologies.

Figure 4. Methods for Increasing Profitability or Offsetting Declining Profitability (% of Respondents)



Base: 220 retail and CPG executives
Source: Coresight Research

33% of retailers surveyed plan to keep all or most of their operations internal, minimizing the use of consulting services and other third-party vendors.

NFR typically represents about 20% of an organization's revenue.

Of the retailers that have evaluated or are currently evaluating NFR expenses, 65% experienced a profit lift greater than 3%.

NFR: An Often-Overlooked Route to Boosting Profit Margins

When retailers look to drastically cut expenses, the obvious answer is to reduce expenses related to goods and services for sale. However, NFR goods and services are often overlooked and can represent a substantial opportunity for retailers, particularly during these unprecedented times. In particular, NFR represents an opportunity for organizations to avoid cost-cutting measures that negatively impact their company culture or employee engagement.

So, what exactly is NFR? NFR refers to all goods and services purchased by an organization outside of the merchandise it sells to its customers. In retail, this is spending and organization costs associated with marketing, real estate, facilities, IT, professional services, packaging and distribution/logistics.

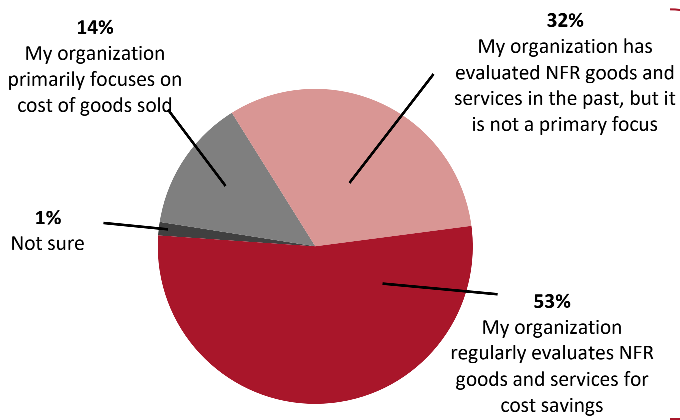
According to benchmarks and data from LogicSource, NFR typically equates to about 20% of a company's revenue, so the time spent on, and/or financial investment into, evaluating these expenses can produce a hefty return on investment. NFR cost reductions can improve an organization's financial situation in the short term, as well as provide a long-term solution for improving operational efficiency, managing suppliers, evaluating technology and avoiding layoffs and furloughs.

For retailers that evaluate NFR goods and services for cost savings, the majority report a significant impact on profit lift. Despite this, NFR expenditures are not always a priority focus area:

- Some 53% of those surveyed agreed that their organization "regularly evaluates NFR goods and services for cost savings."
- 32% stated that their organization "has evaluated NFR in the past, but it is not the primary focus."

In Figure 5, we can see that respondents that have evaluated NFR in the past, or are currently doing so, are experiencing profit lifts.

Figure 5. History of Evaluating NFR and Profit Lift (% of Respondents)



Profit Lift	Proportion of Respondents
1–2% profit lift	24%
3–5% profit lift	49%
>5%	16%

65% of respondents that have either evaluated NFR goods and services in the past or are currently and regularly evaluating NFR savings have experienced a profit lift of greater than 3%

Base for History of Evaluating: 220 retail and CPG executives
Base for Profit Lift: 187 respondents that selected either "My organization has evaluated NFR goods and services in the past, but it is not a primary focus" or "My organization regularly evaluates NFR goods and services for cost savings."
Source: Coresight Research

These data confirm that focusing on NFR expenses can directly translate to increases in profit. Retail and CPG companies that reported that evaluating NFR is "not the primary focus" were less likely than those regularly evaluating NFR to report a profit increase of greater than 5%—suggesting that the more time that is invested in evaluating these expenses, the greater the reward.

66% of respondents agreed that "there is a lot more [their] organization could be doing to cut costs associated with NFR goods and services."

Despite the data proving that retailers have evaluated NFR in the past, and that retail leadership is aware of and familiar with NFR goods and services, still 66% of respondents agreed that "there is a lot more [their] organization could be doing to cut costs associated with NFR goods and services."

Three Opportunities To Capitalize On Cutting NFR Expenses

For CPG and retail firms seeking to achieve NFR-related profit boosts, we outline three opportunity areas for cost savings.

47% of retailers reported that they're managing their supplier relationships as a way to cut costs in 2020

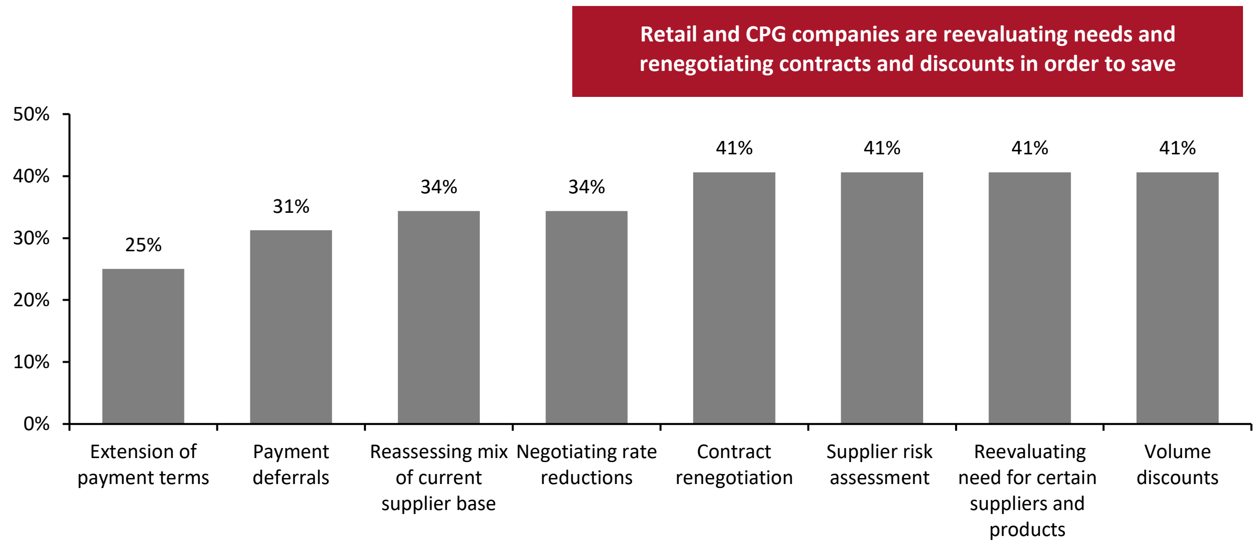
Opportunity 1: Reevaluate Supplier Relationships

Supply-chain management—and specifically procurement—represents one of the largest potential opportunities for retailers to capitalize on the power of evaluating NFR expenses. In response to the chaotic environment caused by Covid-19, retail and CPG organizations should renegotiate contracts and reevaluate their supplier network.

When asked specifically what actions were taken in 2020 to reduce NFR costs, the largest proportion of respondents (47%) reported that their organizations are managing their suppliers.

When asked to report on the greatest opportunity for savings with suppliers, our respondents selected volume discounts, reevaluating the need for certain suppliers and products, supplier risk assessment and contract renegotiation. However, as shown in Figure 6, there is a wide array of opportunity for savings through managing supplier risk. A common theme is that renegotiating terms or contracts can provide substantial opportunity for savings. Suppliers are also experiencing a stressful situation and may be more willing to negotiate.

Figure 6. Greatest Opportunity for Savings with Suppliers (% of Respondents That Selected "Supplier Risk Management" as a Benefit of NFR)



Base: 32 respondents that selected "supplier risk management" as one of the greatest potential benefits of NFR
Source: Coresight Research

Reducing headcount is often the first step to drastically decreasing expenses.

Opportunity 2: Streamline Internal Processes and Operations
Improving operational efficiency, reducing demand and eliminating waste opens the door for sustained cost reductions throughout the organization without turning to broad-based restructuring and layoffs.

Retail executives can unlock significant cost reductions through:

- Reducing and standardizing usage and inventories of consumables—for example, by reducing expenses related to maintenance and repair (such as supplies and janitorial items) and rationalizing SKUs across paper and corrugate expenditures.
- Eliminating waste internally and with suppliers—for example, by ensuring rate compliance for small parcel spend and improving processes internally to eliminate supplier upcharges, such as rush fees and emergency callouts.

- Optimizing or outsourcing internal teams and processes—for example, outsourcing facility maintenance operations, consolidating providers of contingent labor and automating administrative processes.

Every organization has room for improvement and can ultimately increase employee productivity and decrease costs. Taking the time to be thoughtful about where efficiency can be improved will be key.

30% of retailers surveyed have updated their packaging as a way to reduce costs.

Opportunity 3: Review and Update Non-Sales Product Specifications
Lastly, incremental changes on a large volume of products can reap substantial reward. Packaging and product specifications were both cited as offering potential benefits by our survey respondents—30% have updated their packaging in 2020 as a means of reducing costs. The details of product or packaging specifications are often scattered and disorganized throughout the organization, which can make the idea of cutting these expenses challenging, however, even small savings of pennies can add up to a substantial savings when applied against total unit sales.

Similar opportunities exist across different spend areas: Reviewing specifications for printed marketing materials, optimizing facilities maintenance services, reviewing IT hardware specifications and updating corporate policies for device usage all have the potential to yield significant value in terms of cost reduction.

Retailers Recognize the Substantial Opportunity but Acknowledge That Barriers Exist

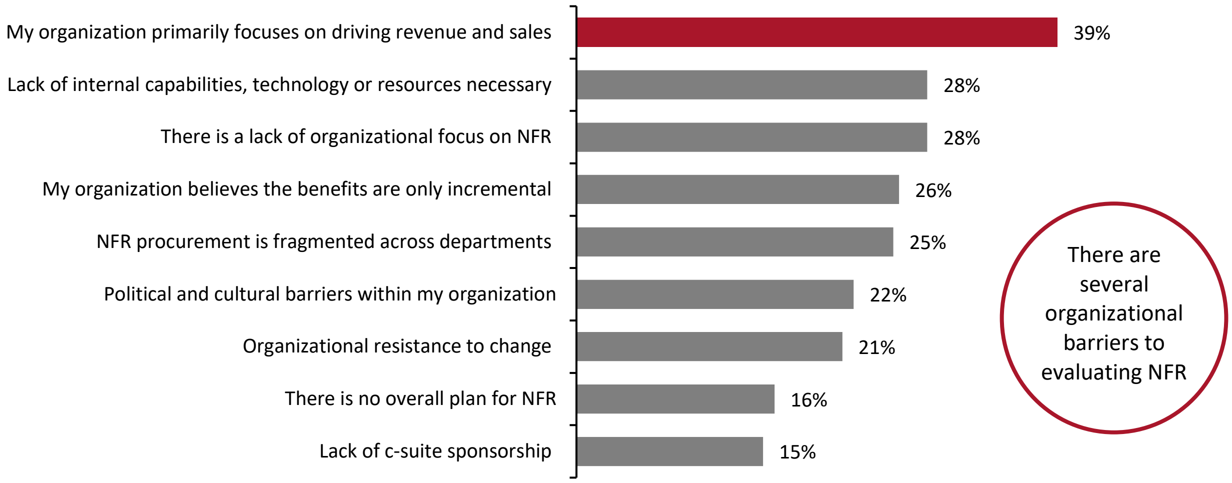
Although 45% of retailers we surveyed admitted that they are either not evaluating NFR expenses or that this is not a main focus, 72% agreed that NFR goods and services represent a "substantial opportunity" for cost savings.

Retailers are not able to harness the benefits of NFR savings due to certain barriers standing in their way. The number-one barrier reported by 39% of retailers and CPG companies is that their "organization primarily focuses on driving revenue and sales." Other barriers include a lack of organizational focus on NFR, a lack of internal capabilities, technology or resources, or the organization believes that the benefits are only incremental.

The top barrier to evaluating NFR expenses was cited as, "My organization primarily focuses on driving revenue."

Figure 9 shows all of the barriers mentioned by retailers in our survey. In summation, NFR is put on the backburner because it is not prioritized within the organization; there isn't a strong belief or understanding of the benefits; the organization is scattered and fragmented; or they just simply do not have the time and/or resources.

Figure 7. Barriers to Evaluating and Reducing NFR Expenses (% of Respondents)



Base: 220 Retail and CPG Executives
Source: Coresight Research

It can also be difficult for organizations to know where to start or which departments hold the largest potential for cost savings, generally. When asked which departments were the most important for leadership to optimize, 71% of our respondents said finance, 68% said marketing and 66% said IT.

When asked why particular areas of their business were challenging to cut, the majority of respondents said, "The amount of money spent in this area is necessary and cannot be reduced."

When asked which aspects of NFR cost savings would be the most challenging to reduce, at least 50% of retailers selected each of the following: finance, sourcing and procurement, distribution and logistics, and packaging. However, similar to the question about optimizing departments, responses to cutting departments were equally varied, and all selections were chosen by over 40% of our respondents. This once again indicates that that the importance of departments varies according to each individual company.

When asked why particular areas of the business were challenging to cut, the majority of retail and CPG businesses responded, "The amount of money spent in this area is necessary and cannot be reduced." See Figure 10 for the top five reasons our respondents gave for why certain NFR expenses are more challenging to reduce than others.

Figure 8. Top Five Reasons Why NFR Expenses Are Challenging To Cut

1. The amount of money spent in this area is necessary and cannot be reduced
2. Other areas of the business have greater cost-savings potential
3. My organization has already substantially cut costs in this area
4. This area of the business is not a priority in my organization
5. The potential cost-savings in this area are unknown and would require a lot of effort to uncover

Base: 220 Retail and CPG executives
Source: Coresight Research

Sources of untapped profitability will be unique from business to business, and all organizations will face barriers and challenges when attempting to unearth these not-so-obvious but potentially considerable cost savings; however, there are options to get started.

Evaluating NFR: Where To Start and How To Get the Value

While retail and CPG executives understand the payoffs from NFR and acknowledge that barriers exist, many are not sure where to start or how to find a solution. We have outlined three ways in which retail and CPG organizations can evaluate NFR:

1. **Solve internally**—Build a team internally to primarily focus on evaluating NFR.
2. **Invest externally**—Hire consulting services to conduct a thorough analysis and then complete execution internally or invest in a new technology to increase efficiency.
3. **Contract with a services firm**—Hire a services firm to conduct both analysis and execution.

In Figure 11, we compare and rank the options against a variety of criteria. For example, speed to value was ranked as "low" for those opting to solve internally, meaning that completing the analysis internally will likely require a substantially longer time investment in order to see any ROI than the other avenues.

Figure 11. Options for Evaluating NFR

	Solve internally	Invest externally: consulting services	Invest externally: technology	Contract with a services firm
Speed to value	Low	High	Low	High
Level of effort	High	Medium	High	Medium
Investment	Low	High	High	Medium
Expertise	Medium	High	Low	High
Advisory services	N/A	High	Low	High
Implementation services	N/A	Low	High	High

Indicates a **CON** for the business (red)

Indicates a **PRO** for the business (green)

Source: Coresight Research

Each method for evaluating NFR has both positives and negatives, and each retail organization will have to analyze which of these methods suites their unique needs. An organization that has a clear understanding of NFR and has resources with capacity to dedicate to this analysis may want to keep operations internal. However, an organization that does not have the expertise to conduct this analysis and has the ability to invest in other options may want to consider contracting a consulting or services firm. Consulting firms and services firms provide expertise and a quick turnaround for a higher price than internal analysis.

Conclusion: NFR Savings Represent a Substantial Opportunity To Increase Profitability for Retailers

Our research proves that NFR can deliver significant profit gains with focus and a clear strategy. There are opportunities for NFR savings in almost every area of a retailer or CPG's business, but the challenge is in driving effective change management to realize the associated value. It is important, especially in times of crisis, that retailers prioritize NFR and have a focused strategy for how to approach this analysis.

There are three primary avenues for evaluating NFR expenses and driving profit improvement opportunities:

1. Reevaluating supplier partnerships can result in substantial savings through sourcing events, contract renegotiations, rate changes, adjustments to payment terms and evaluation of overall needs.
2. Improving efficiency within the organization can include anything from restructuring and outsourcing non-core business functions to automating manual processes. Internal opportunities abound, but finding and valuing them is key.
3. Incremental unit cost reductions at scale can result in large savings. Small adjustments to packaging and supplies items, and elimination of over-

ordering and waste in general services and consumables can produce substantial profit gains.

In order to take advantage of the opportunities we have presented, retail and CPG companies must be committed to overcoming internal barriers and challenging the status quo within the organization.

To complete this work, we suggest evaluating the situation within your individual organization, assessing your capabilities and then deciding to either perform the work internally, contract for consulting engagements or partner with a services firm.

Opportunities to cut NFR expenses are meaningful and require different approaches depending on the individual organization.

However, as these opportunities are evaluated and acted upon, significant and sustainable profit improvement is created.

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