

Combating rising costs and leakages in the retail sector



Developments in the retail sector

The retail sector is one of the fastest growing sectors in the global economy. However, the sector has been volatile and was impacted by the pandemic. Substantial changes were wrought by the pandemic such as preference towards e-commerce platforms, adopting digital payments, hybrid workforce models, alternative sourcing mechanisms due to restrictions on domestic/international movement, focus on hygiene and safety among others. This sector is currently in a transition phase with many developments taking place in the retail scenario.

India has currently the fourth largest retail market in the world and is projected to reach approximately USD2 Tn by 2032 from USD690 Bn in 2021¹. The fast-changing consumer behaviour has augmented the growth of organised retailing, since consumers today prefer to shop at places where they can get grocery, food, entertainment and other daily routine items, all under one roof.

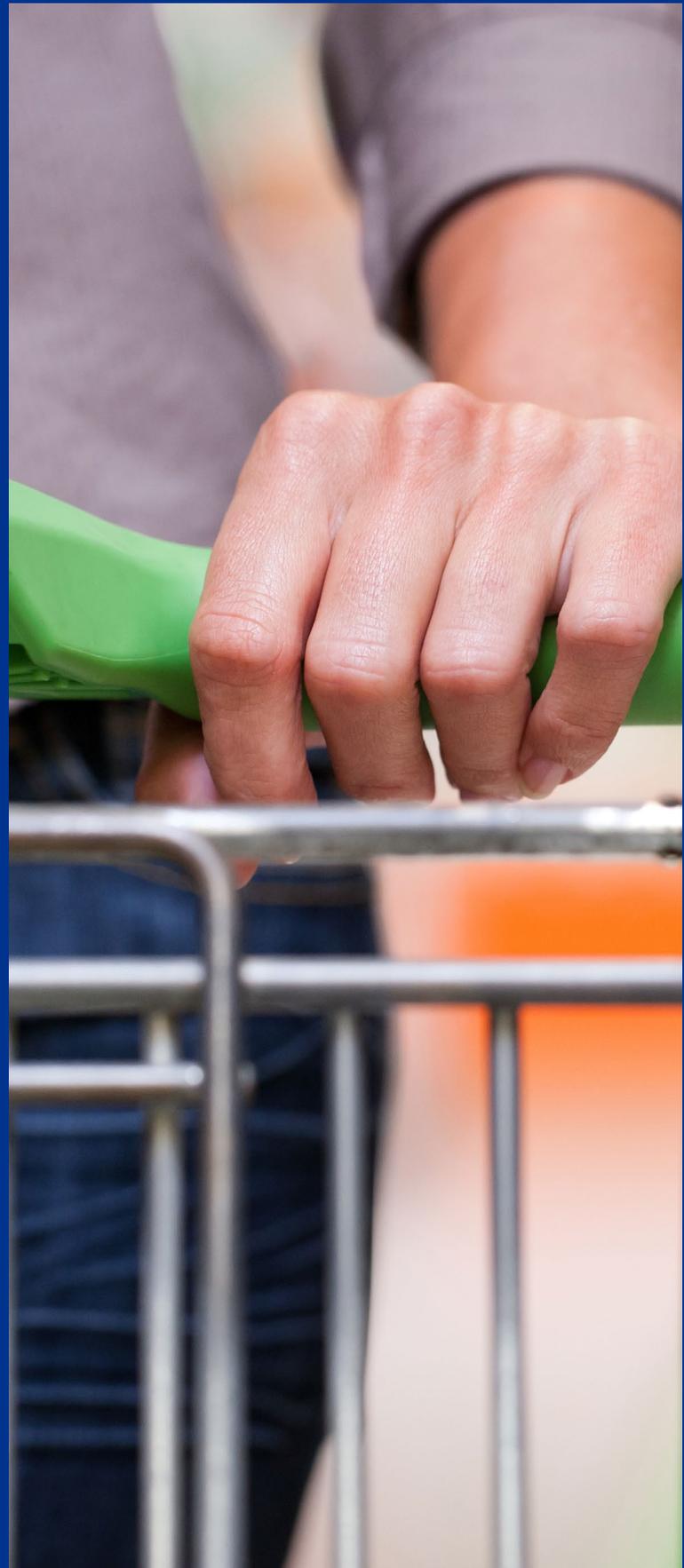
As store-based retailing moves beyond its zenith, the growth of omni-channel ecosystems is driving the next wave of competition and business model evolution. Traditional retailers with a heritage in brick and mortar operations are facing stiff competition from retail businesses with deep capabilities in data, technology and supply chain.



Challenges in the retail sector

Empowered consumers, digital disruption, growing pressure from suppliers to pass on material costs, escalating labour costs, increased speed to market and shifts in purchasing behaviour are challenging today's retail businesses.

Further, due to increasing costs across multiple aspects of the value chain, most organisations in the retail sector recognise that conventional forms of cost cutting may no longer be enough to shore up margins. The impact of rising costs and the pressure to maintain profit margins are likely to continue in the near future. Organisations have been adopting multiple technologies and strengthening their processes to optimise efficiency and minimise leakages.



¹ Retail & E-commerce, Invest India, Shruti Chandra, 29 June 2022



Typical vulnerabilities leading to leakages in the retail sector

As organisations in the retail sector are rapidly transforming to adapt to the new normal, heading towards the post pandemic era, they face an increased risk of leakages due to inherent vulnerabilities in their processes/systems and lack of adequate monitoring mechanism to identify early warning signals. This could adversely impact various key segments of the organisation, covering procurement, supply chain, inventory management, sales, setting up and maintenance of stores among others.

Typical leakages noted in our experience are as below:

Procurement of material/services:

- Procuring material or services either not required or procuring more than the required quantity due to lack of adequate controls
- Paying a higher price as compared to market price due to conflict-of-interest scenarios/ collusion with vendors and resultant kickbacks being received by employees.

Leasing of properties and store maintenance expenses:

- Undue brokerage costs being routed through non-existent brokers or incompetent brokers
- Capital expenditure for setting up stores awarded to vendors at higher prices or to non-existent/blacklisted vendors, leading to higher cost to the organisation
- Repair and maintenance vendors without adequate infrastructure or competence or non-existent vendors being awarded work at inflated costs.

Inventory management:

- Short receipt of material by warehouse personnel in collusion with transporters and payment being made for the full quantity
- Deliberate acceptance of substandard or expired or short shelf life goods due to collusion between employees and vendors
- Collusion with scrap vendors leading to pilferage of good quality material at lower than market rates
- Inadequate physical security controls and weak physical stock count mechanism leading to theft/pilferage of material and inventory adjustment entries being posted to manipulate stock in the system.
- Theft/pilferage during transportation of material between multiple warehouse locations, delivery centres, collection centres and retail stores.

Sales and sales-led initiatives:

- Price manipulation or markdowns, wherein products are intentionally sold at a price below the standard margin threshold, along with favouring a select group of customers by misusing credit notes, promotional programmes and schemes
- Window dressing of the financial position for select stores or regions to report a favourable income statement by booking fictitious sales at period end and corresponding returns recorded in the subsequent period
- Skimming of sales by recording the same in manual bills books, instead of company records
- Receipt of payments in fake currency, in collusion with a select group of fraudsters.





What organisations can do to combat cost leakages?

Due to the constant disturbance and upcoming challenges in the retail sector, organisations need to keep up with the pace in order to sustain in the market. The current change in the environment presents an opportunity for organisations to streamline their processes and systems to reduce the adverse impact of leakages and optimise their costs by implementing various measures such as:

Proactive reviews: Organisations usually respond to risks and misconduct, as and when incidents happen. Once an incident takes place, organisations generally advance their control and risk mitigation environment. Implementing an early warning signal mechanism to identify red flags on an ongoing basis would help organisations to detect anomalies at an early stage and build a mechanism which would prevent leakages in the future.

Employee training and awareness: Employee training and awareness sessions are a critical component for a well-rounded programme for preventing and detecting wrong practices and mitigating leakages. Employees should be educated regarding the organisation's vision, how misconduct harms everyone in the organisation and how to report/respond to any unethical practices.

Investment in technology: Organisations need to invest in the next generation of automated risk management measures to ensure sustainability, which will benefit the organisation in being agile, innovative and responsive to the constant changes in the environment. Having access to the latest technology can empower staff and improve employee satisfaction helping them work efficiently. Further, investing in quality manpower is an expensive affair. Hence, investment in artificial intelligence and machine learning could be the way forward.

Cost optimisation and transformation: High input costs and uncertainty over the supply chain are prompting companies to consider newer ways to save costs. Cost optimisation and transformation help the organisation maintain a balance between reducing the spending and getting the most out of each penny spent. Innovation and transformation are essential in order to get ahead of competition by reducing costs.





Outlook in the near future

Easing of the pandemic restrictions gradually is a boon for the retail sector since it encourages higher consumer spending. Also, according to Retailers Association of India (RAI) data, there is a strong uptick in consumer demand and retail businesses across India. Consumers are looking for opportunities to make up for their time lost during the pandemic and are shopping more, which brings them a feeling of being back to normal². Luxury retailers have also witnessed an increase in demand since consumers are now becoming more confident and have commenced luxury shopping.

Gradual improvement in global mobility and reduction of supply chain breakdowns would help organisations to curb their costs in the long term. In such an environment, organisations need to be innovative and agile in taking proactive as well as reactive measures to sustain themselves and stay ahead of the competition.

² Consumers don't mind paying for expensive items, The Economic Times, Faizan Haidar & Sagar Malviya, 14 June 2022

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