Lessons from the Front
Return on Invested Labor

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Making Payroll Pay

We estimate that, as a group, U.S. retailers lose $40-$60 billion in sales every year by not converting shoppers already in their stores. While grocers typically convert more than most retailers, some new thinking can help attack lost sales. In particular, grocers should consider thinking about payroll as an investment, rather than an expense. This concept is called Return on Invested Labor (ROIL) and can drive sales increases of as much as 10%, at a return on investment that far exceeds any other typically available.

To be sure, grocers have always enjoyed conversion rates that make other retailers jealous. But that said, research shows time and time again that many customers walk out of grocery stores without everything they need. The reasons vary, but at the core, this can be traced to an inability to convert completely. And it costs grocers handsomely.

Grocers are in their own league in more than just conversion rates. They're also in a class by themselves when it comes to workforce operational complexity. Full-service grocers are part manufacturing, part assembly, part stocking, part checking, part bank, part post office, part obstacle course (have you ever had to chase carts around a parking lot?) and part zoo. At times, it can seem like just keeping the store properly staffed requires a PhD.

This has led to behavior in grocery specifically, and across retail in general, of viewing payroll as an expense to be managed because, in a way, this simplifies the complexity. Leveraging payroll to improve operating margin is a necessary activity for all retailers, but labor also needs to be deployed strategically to effectively drive conversion and sales. Too often we see grocers making across-the-board adjustments to labor under the mistaken belief that pro rata change is the best approach; the thinking is that the fairest way to make a change is to spread the pain (or wealth) equally across all stores. In practice, however, this “peanut-butter” approach always impacts the big stores and does not account for those stores who, regardless of size, truly need incremental labor.
Fixed vs. Variable Labor

There is a better alternative. It requires an understanding of the difference between “Fixed” and “Variable” store labor. “Fixed Labor” is the labor required to run a store. Think of this as the absolute minimum payroll required to open, close and staff (at minimum) all stores in a chain. All store labor above this amount is “Variable Labor” and should be thought of as an investment, rather than an expense. Once isolated, it is possible to calculate the return on this “Variable Labor” investment. This is what we talk about when we talk about ROIL.

As noted earlier, optimizing ROIL can lead to sales increases of 2-10% at an unusually high rate of return on investment. Figure 1 shows a group of stores for a sample retailer where this retailer can invest up to $8 million in payroll at a ROIL of 250% or greater to generate $60 million in incremental sales. The graph also shows what should come intuitively, which is that the return diminishes at a certain point; you can’t grow profitable sales indefinitely without sacrificing return on investment.

**FIGURE 1 - RETAILERS SET THEIR OWN ROIL HURDLES, WHICH DETERMINES THEIR INCREMENTAL SALES AND LABOR INVESTMENT REQUIRED**

*ROIL is calculated as: [Gross Margin net of Invested Payroll] / [Invested Payroll]
The simple act of asking, “How can I invest my payroll?” rather than “How can I manage my payroll expense?” fundamentally turns retail labor planning on its head—to the benefit of increased conversion, dollars per transaction, sales and margin. The critical change in thinking is to view store labor in the context of other potential investments a retailer may make, rather than as an expense to be managed.

The analytical challenge involved in supporting ROIL is significant, but manageable. It starts with detailed, historical data, which is then analyzed for the impact-potential at every store. This data allows retailers to pinpoint exactly where and how much to invest for maximum benefit, and what the expected outcome should be. Once a grocer identifies which stores are in most need of additional payroll, the work begins for the store’s team to define and roll-out a test, measure the results and prove that investing payroll in the right stores leads to profitable sales growth that would be otherwise impossible. In other words, ROIL helps answer, once-and-for-all, the key question retailers ask about store payroll – how do I know how much payroll to spend, and what return should I expect?

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