# The impact of pilferage on inventory shrinkage essay sample

Economics, Trade

A. Background on the Study

Inventory shrinkage is one of the biggest expenses in the retail industry today. No single retailer is immune from this phenomenon. Each dollar of missing inventory at cost results in a dollar less of not only gross but net profit as well for the retailer (The Retail Owners Institute, 2006).

Shrinkage is more than just stealing. Inventory shrinkage is the difference between a retailer's book or calculated inventory amount and the physical amount as accounted. Inventory shrinkage is a combination of employee theft, shoplifting, vendor fraud, and administrative error, the latter includes accounting and data entry error (The Retail Owners Institute, 2006; Vargas, 2002).

The largest source of inventory shrinkage is pilferage which means stealing and includes both employee theft and shoplifting. These are also referred to as internal and external theft, or internal and external crime. According to the National Retail Federation, a lost of approximately 1. 8% in revenues are due to theft for all types of retailers in recent years (The Retail Owners Institute, 2006).

A second cause of inventory shrinkage, which is not quite as covered in related literature as pilferage, is administrative error. This refers to unrecorded dollar fluctuations, bookkeeping errors, accounting errors, and data entry errors. Examples of this type of inventory shrinkage are unrecorded markdowns, transfers, giveaways, damaged goods, misreading or misrecording sales and/or receipts invoices, and similar bookkeeping sloppiness (The Retail Owners Institute, 2006). These types of inventory shrinkage may not actual result in actual loss of goods but can be costly to the retailer when discrepancy between book inventory and physical inventory occur.

Aside from minimizing losses, retailers should be concerned about retail theft since ultimately it is the consumers who get hit in the form of higher prices. According to University of Florida criminologist, Richard C. Hollinger, who directs the National Retail Security Survey, an average family of four will spend more than $ 440 a year in higher prices because of inventory theft. Hollinger said, " Thieves also generally target hot selling items, which means those must-have toys on your child's holiday wish list are less likely to be available on the store shelves" (Vargas, 2002).

Employee theft and shoplifting combined account for the largest source of property crime committed annually in the U. S. (Vargas, 2002). These two sources are the primary threats to a retailer's inventory. As such threats, retailers must learn to adapt and manage retail loss prevention measures, as an important aspect of security risk management. Risk management involves a set of principles and practices which allows the retailer to evaluate the value of his assets, possible threats to them, and to determine appropriate measures to secure them (Tulloch, 2006). In this case of retail theft, these assets pertain to the retailer's inventory. Determining appropriate measures to secure retail inventory will allow the retailers to be proactive in dealing and preventing against the threats of employee theft and shoplifting, instead of merely reacting to them when they occur.

B. Research Questions and Hypothesis

The research paper will study retail loss prevention and security. The issues involved in internal and external crime, retail theft, inventory shrinkage, and in-store loss prevention will be presented. The methods which retail loss prevention departments use in preventing these problems will be examined, and whether these methods have been effective or ineffective.

The subject of this research will be U. S. retailers, and statistics as to the instances of retail loss and employee theft will be presented to gain an overview of the situation.

It would be difficult for an employer to access whether a prospective employee would turn out to be an honest or a dishonest one. This study will attempt to analyze the hypothesis on *whether labor shortage in the retail industry, leaving retailers short-staffed, has produced more opportunity to steal?*

The study will also attempt to answer the following research questions:

1. Where does inventory shrinkage happen and what are the estimated losses to the retailer?
2. How does security technology contribute in helping retailers minimize retail theft, and are such measures truly effective?
3. What are the factors that contribute to employee theft and how has the retail industry been successful and unsuccessful in dealing with these factors?

4. On the other hand, what preventive measures have retailers taken in minimizing external crime or shoplifting and how effective have these measures been as deterrents?
5. What are the necessary steps and precautions that retail loss prevention professionals must do in order to effectively prevent internal and external crime?

C. Methodology of the Study

The methodology to be used for this research paper be comparative data analysis. Existing data from a review of relevant related literature will be used and compared. Information data base, news articles, business information websites, case studies and white papers on security risk management, crime management procedures, and retail theft and inventory shrinkage will be collated and compared. Data collection will involve mostly online resources, and these data will in turn be examined and summarized in order to answer the questions proposed by this study, and to come up with the appropriate analysis, conclusions, and recommendations.

The comparative data analysis will thus also make use of quantitative research as industry statistical data will be used to understand the phenomenon of inventory shrinkage, how widespread it is, its impact on retailers, and its implications on consumer satisfaction. Quantitative research involves the systematic scientific investigation of quantitative properties and their relationships (Creswell, 1994). Measurement is central for this methodology since it provides for the connection between empirical observation and mathematical expressions of quantitative relationships

(Wikipedia, 2006). Such numerical data can be used to obtain information about the world since quantitative research is deductive – it tests or generates theory – as opposed to qualitative research which tends to be inductive (Ross, 2006; Jayaratne, 1993).

The three most common quantitative research techniques include observation technique, experimentation and survey technique. The survey technique may be through telephone, self-administered, or in-person interviews (Joppe, 2006). Observation technique are often used for descriptive studies, and one of the most simplest descriptive study is a case which reports data on only one subject (Gable, 1994). For purposes of this research, the observation will be used based on an examination of existing industry trends and circumstances regarding inventory shrinkage from related literature. This study will also make use of the survey technique will be used based on existing survey results from related literature such as (but not limited to) the survey results from the National Retail Security Survey, U. S., the University of Florida study on retail theft with a funding grant from Sensormatic Electronics Corporation, the 17 th Annual Retail Theft Survey from Jack L. Hayes, and the 2002 study by Ernst & Young.

Quantitative research was chosen over other methodologies such as qualitative and critical research. Qualitative research explores the feelings, understandings, and knowledge of others through interviews, discussions, or participant observation to gain a deeper insight into the processes shaping our social worlds (Limb and Dwyer, 2001; Lacity and Janson, 1994). This qualitative methodology however – especially observation or unstructured interviews – only provides for an overall picture of the subject under investigation, which may only be sufficient for initial phases of research (Jones, 1997). For purposes of this study, quantitative research is deemed as the more appropriate research strategy since the data gathered under this method is usually through the use of more structured research instruments. Even though the results in quantitative research provide less detail on behavior, attitudes and motivations, the results are nevertheless based on a larger sample size that are representative of the population. The results can usually be replicated or repeated, thus giving it higher reliability than qualitative research data, and, in addition, analysis of such results are more objective (Joppe, 2006; Kaplan and Duchon, 1988).

The study will make use of related literature deemed relevant for the study. Primary sources will include statistical data and scholarly papers available online regarding inventory shrinkage (which includes employee theft, shoplifting, administrative error, and vendor fraud). Previous studies and articles covering inventory shrinkage will be utilized for purposes of this research. Statistics from the National Retail Security Survey, U. S., the University of Florida study on retail theft with a funding grant from Sensormatic Electronics Corporation, the 17 th Annual Retail Theft Survey from Jack L. Hayes, a 2002 study by Ernst & Young, and other similar survey and analysis reports will be used for this paper.

Information from news articles, business information websites, crime management, security risk management databases, retail industry white papers, inventory shrinkage case studies will also be used.

D. Scope and Limitations

The study will only focus on retail theft and inventory shrinkage as one field of security risk management. It will not delve into other areas of risk management nor will it touch on other aspects that may lead to reduced profits for the retail industry. The study will also include crime management of retail theft. The scope of the study will adapt a general industry-wide approach as to the prevalence of retail theft and inventory shrinkage, examination thereof and recommendations will apply to the general retail industry, as opposed to focusing on one particular retailer.

Furthermore, the study will focus primary on pilferage – employee theft and shoplifting – as the main sources of inventory shrinkage, and will provide for retail loss prevention recommendations on this matter. However, the paper will also touch briefly, but not as extensively, on administrative errors, as another, if secondary, source of inventory shrinkage, as well.

E. Organization of the Thesis

Chapter 1 of this paper will include the Introduction of the study, which will present a brief background on retail loss and prevention, the objectives and research questions for the thesis, the methodology to be used, and the scope and limitations of the research. Chapter 2 will include the analytical framework. Chapter 3 will cover the review of related literature, which will be subdivided into retail loss and prevention, security risk management, and the four strategies to be used as provided for in the analytical framework: identification of factors involved in inventory shrinkage, security technologies and strategies, crime management procedures, and standard operating procedures to minimize employee theft. Chapter 4 will provide for the Conclusion and Recommendations.

CHAPTER 2

ANALYTICAL FRAMEWORK

Security risk management involves a set of principles and practices like any other management discipline. It includes evaluating the value of a company's assets, possible threats to them, and determining the appropriate measures to take in order to secure them. By identifying and learning to manage risk proactively, instead of merely reacting to it when an exploit, such as employee theft, occurs, retailers can better utilize their resources to protect their business (Tulloch, 2006).

Many companies don't manage risk and instead react to threats and exploits in an ad hoc fashion, which often leads to either of the two extremes: either there is complete neglect of a certain type of threat with concomitant results, or there is a paranoid lockdown of assets to the point that usability is impaired and business effectiveness is reduce (Tulloch, 2006). In the retail industry, these can have direct impact on consumer satisfaction.

Inventory shrinkage is one such risk that plagues the retail industry. For this study, an analysis will examine the factors behind inventory shrinkage, as well as an examination of the statistical data that point to the real threats of this phenomenon to the retail industry. In doing so, the following framework will be used for this paper:

- Examination of the factors involved in inventory shrinkage.
- Study of the security technology available to prevent it, and whether the available technology has been sufficient to respond to this threat.
- Crime management procedures, with particular regard to the role of retail loss prevention departments and professionals.
- Standard operating procedures in order to minimize employee theft and to encourage employee participation in helping to reduce external crime such as shoplifting.

Proactive risk management is a better approach to ensure security among retailers, rather than simply reacting to incidents when they occur. However, even risk management can take many forms, ranging from acceptance of risk to mitigating risk to transferring risk to a third party under a service level agreement. The latter is especially useful for smaller retailers which do not have the infrastructure to conduce full risk assessment or to effectively manage risk within their respective business environment (Tulloch, 2006).

Crime management will be analyzed by examining the role of retail loss prevention professionals. Retail loss prevention is a profession responsible for reducing inventory losses inside retail stores. Retail los prevention professionals manage in-store security programs that focus on reducing inventory losses due to employee theft, shoplifting, fraud, vendor theft, and administrative or accounting errors. Similar to others in the security industry, retail loss prevention professionals have to interact with store personnel and store customers when dishonesty or carelessness occurs. Since this is a sensitive issues, accusing someone for being dishonest or careless requires the utmost care and professionalism (McGoey, 2006).

For purposes of this study, retail loss prevention will involve an examination of the facts, probable cause, procedure for detention and arrest, false arrest, and excessive force in shoplifting.  It will also study loss prevention experts, exit bag checks, and expert witnesses.

The effective inventory shrinkage strategy to be recommended for this study will include: identification of factors involved in inventory shrinkage, security technologies, crime management procedures, and standard operating procedures to minimize employee theft.

*Identification of factors involved in inventory theft* .  This involves pin-pointing the sources of inventory shrinkage (employee theft, shoplifting, administrative or accounting error, vendor fraud), and what are the percentage of losses that the company suffers due to this phenomenon.  This will also include an examination of each specific element of inventory shrinkage, with a description of these instances in order to provide an understanding on how each element comes about.  The factors that contribute to the occurrence of each element will also be presented.

*Security technologies and strategies* .  This involves an examination of the technologies currently in place that provide for effective or ineffective risk management.  Example of security technologies to be examined would include point-of-sale data mining software solutions which detect potential theft problems at the cash register and alert appropriate personnel in real-time. Another example would be source tagging programs were tiny anti-theft labels about the size of a paper clip are placed inside actual product or product package, hiding it from view from both store personnel and store customers. A third example would be self-alarming anti-theft tags which broadcast an audible alarm throughout the store whenever a shoplifter attempts to improperly remove it from merchandise (Vargas, 2002).

*Crime management procedures* . Shoplifting is a common crime which occurs when someone steals merchandise offered for sale from a retail stores. Shoplifting from retail stores costs merchants an estimated loss of $13-46 billion per year (McGoey, 2006; Ernst & Young, 2003). However, to be convicted of shoplifting, the intention to permanently deprive the merchant of the value of the merchandise is required. This has often lead to confusion among merchants (or retailers in this case) about the procedures for lawfully detaining someone suspected of theft from their establishment. An examination of the crime management procedures in this study will provide information as to the rights of the merchant, the rights of the customer, how much force can be used to detain someone who has stolen merchandise, the existence of probable cause, and the procedures for detention and arrest (McGoey, 2006).

Crime management procedures also include employee theft. Employee theft from a retail store is a term used when an employee steals merchandise, food, cash, or supplies while on the job. Under the law, employee theft is simply theft, with the elements of the crime being identical. Thus, similar to shoplifting, to commit theft, it is required that the employee has the intention of permanently depriving the employer of the value of the item stolen (McGoey, 2006). For this study, an examination of employee theft profile, cost of employee theft, and loss prevention will be included.

*Standard operating procedures* . According to a 2002 study by Ernst & Young, an effective prevention action plan involves four steps: 1) conduct a thorough analysis of current state of shrinkage within stores; 2) develop cause-and-effect models for data analysis; 3) test the optimal strategy; and 4) implement and roll-out. Standard operating procedures for stores are included in Step 4 on implementation and roll-out. The paper will make use of this four-step prevention action plan as recommendation for retailers to minimize inventory shrinkage.

## CHAPTER 3

## REVIEW OF RELATED LITERATURE

### A. Background on Retail Loss

According to a 2002 National Retail Security Survey, inventory shrinkage cost U. S. retailers over $31 billion in a year (Vargas, 2002). Shoplifting or external theft alone accounts for an estimated loss of $13 billion dollars per year for retail merchants (McGoey, 2006). The survey conducted by the National Retail Security Survey involved the analysis of theft incidents from 118 of the largest U. S. retail chains, thus data on smaller chains remain unaccounted for. According to the survey (2002), retailers lost 1. 7% of their total annual sales to inventory shrinkage per year, with the surveyed portion of the retail economy transacting over $1. 845 trillion dollars annually, making the loss worth more than $31. 3 billion. Total inventory shrinkage was down slightly from $32. 3 billion in the year 2000 (Vargas, 2002).

Inventory shrinkage remains the single largest category of larceny in the U. S., more than motor vehicle theft, bank robbery and household burglary combined. Employee theft and shoplifting combined are deemed to account for the largest source of property crime committed annually in the country (Vargas, 2002).

Table 1. Where Inventory Shrinkage Happens

| Sources of Inventory Shrinkage | % of Losses | $ Lost |
|---|---|---|
| Employee Theft | 48. 5% | $15. 1 billion |
| Shoplifting | 31. 7% | $9. 7 billio |

| | | |
|---|---|---|
| | | n |
| Administrative Error | 15. 3% | $4. 8 billion |
| Vendor Fraud | 5. 4% | $1. 7 billion |
| Total Inventory Shrinkage | | $31. 3 billion |

(Source: National Retail Security Survey, November 2002; *based on 2001 retail sales and inventory shrinkage; ** total not equal to 100% due to rounding)

Thus there are four general sources of inventory shrinkage: employee theft, shoplifting, administrative error, and vendor fraud. Employee theft and shoplifting account for the primary sources of inventory theft, with vendor fraud and administrative errors composing the secondary sources.

The study by the University of Florida, with a funding grant from ADT Security Services, a unit of Tyco Fire and Security Services, discovered that retail security managers attributed more than 48. 5% of their losses to employee theft, with internal theft costing an average of $14. 1 billion to the retailers as indicated in Table 1.  On the other hand, shoplifting accounts for 31. 7% of retail losses and costs $10-13 billion in losses per year for the retailer (Vargas, 2002; McGoey, 2006).

Although administrative errors are considered only secondary sources of retail loss, they do still have significant impact on the costs to the retailer when discrepancies between actual inventory and physical inventory occur. Unrecorded dollar fluctuations and bookkeeping errors can distort a retailer’s financial statements and negatively affect planning decisions.  For instance, an unrecorded markdown could inflate the retailer’s gross profit, and bookkeeping errors could either increase or decrease gross profit.  These instances could negatively affect planning decisions by causing the retailer to over-buy or under-buy.   Open-to-buy, inventory budgeting and purchasing could also be distorted and adversely affected.  When the retailer’s books indicate a higher level of inventory than what is actually on hand, the result is that the retailer can end up under-buying (The Retail Owners Institute, 2006).

Ernst & Young’s Study of Retail Loss Prevention (2002) examines how retailers can manage inventory shrinkage as well.  As per the study, similar to the one conducted by the University of Florida previously discussed, inventory shrinkage includes employee theft, shoplifting, administrative and paperwork errors, and vendor errors/issues.  The Ernst & Young (2002) study included 55 of the largest and most successful American retailers operating a mean of 1, 076 stores with mean revenues of an estimated %8. 8 billion.

The average shrinkage loss at retail incurred by each respondent in the study was 1. 7% or approximately $19 million a year. Study participants in this survey represented a cross-section of the retail industry: 14% were from the apparel and footwear segment; 12% from supermarket, grocery and convenience stores; 12% from drug stores; 10% electronics and hard goods retailers; 6% from department stores; 4% mass merchants and discounters; and 42% from other specialty retail formats (Ernst & Young's Study of Retail Loss Prevention, 2002). The information from the Ernst & Young (2002) study was accumulated through interviews with financial executives of the participating retailers.

According to the Ernst & Young study (2002), the U. S. retail industry loses an estimate of $46 billion annually to inventory shrinkage, and that employee theft delivers the heaviest blow in terms of dollars lost. The study recommends programs and tools for retailers to combat inventory shrinkage, and emphasizes the need to manage inventory shrink through effective retail loss prevention in order to improve retail profitability in a difficult economic environment (Ernst & Young's Study of Retail Loss Prevention, 2002).

The task of retail loss prevention thus, as an aspect of security risk management, is to reduce inventory losses inside retail stores. Retail loss prevention professionals manage in-store security programs focusing on reducing inventory losses due to employee theft, shoplifting, vendor fraud or theft, and administrative errors. It requires interaction with store personnel and store managers and the adaptation of certain programs, measures and technologies to reduce inventory shrinkage (McGoey, 2006).

The first step in preventing retail loss is to calculate the amount of inventory shrinkage and discerning where the shrinkage is taking place. This involves identifying the sources of inventory shrinkage and the factors behind them. This study will focus primarily on employee theft and shoplifting as the sources of inventory theft, and the identification of factors behind each source.

B. Identification of Factors Involved in Inventory Theft

Employee theft and shoplifting are the number one and two biggest concerns, respectively, among retail loss prevention professionals. Retail segments with higher than average inventory shrink rates as a percent of sales include: gifts (2. 91%); toys and hobbies (2. 82%); optical (2. 59%); convenience stores (2. 23%); discount stores (2. 01%); sporting goods (1. 91%); department stores (1. 89%); drug stores (1. 82%); and supermarkets (1. 81%) (Vargas, 2000).

According to the 17 th Annual Retail Theft Survey from Jack L. Hayes International, Inc. (2004), more than 750, 000 shoplifters and dishonest employees were apprehended by just 27 U. S. retail companies in 2004. Even though shoplifting and employee theft recovery and apprehension were up, these retail companies still lost over $4. 7 billion due to inventory shrinkage. According to Mark R. Doyle, President of Jack L. Hayes International: " The losses are staggering and continue to amaze us, especially the shoplifting statistics over the past several years. Both the number of shoplifters apprehended and the dollars recovered from those apprehensions increased for the fourth straight year. On the internal theft issue, both the number of dishonest employees apprehended and the dollars recovered from those apprehensions increased in 2004, reversing a 3 year trend" (Jack L. Hayes International, Inc. 2004).

Retail theft survey participants in the 17 th Annual Retail Theft Survey (2004) were composed of 27 large retailers with annual sales of $4441. 4 billion, employing over 1. 7 million employees in 12, 908 stores across the country. Total apprehensions of both shoplifters and dishonest employees in 2004 increased 4. 78% to 752, 629 in 2004 from 718, 264 in 2003. Total dollar recoveries from apprehended shoplifters and dishonest employees exceeded a staggering $112 million. According to the survey (2004), this was an increase of 3. 26% over recoveries in 2003. Only 2. 74% of total retail theft losses resulted in a recovery. For every $1. 00 recovered by the retail companies surveyed, $36. 47 was lost to retail theft – internal and external theft combined (Jack L. Hayes International, Inc. 2004).

According to Jack Hayes (2004): " Shoplifting and employee theft are serious crimes which continue to plague retailers and have a serious negative effect on their bottom-line profits. These crimes continue to hurt our economy, costing consumers higher prices at the cash register, and causing a loss of jobs when retailers are forced to close stores or even go out of business" (Jack L. Hayes International, Inc. 2004).

The serious implications thus of employee theft and shoplifting to not only the retailers but to the consumers as well requires an extensive examination of the factors involved in these sources of inventory shrinkage.

- Employee Theft

Employee theft is a term used when an employee steals merchandise, food, cash, or supplies while on the job. Under the law, the elements of the crime of ordinary theft are identical to employee theft. Thus, in order to commit employee theft, the employee must have the intention to permanently deprive their employer of the value of the item stolen (McGoey, 2006).

Employee theft is also referred to a internal theft and can happen whether the business is manufacturing, retail, wholesale, service, hospitality, or high tech. The list of items employees steal can range from such items as inventory, money, parts, components, supplies, information and customers. It is estimated that 95% of all businesses experience employee theft and management is seldom aware of the actual extent of losses or even the existence of such internal theft (Case, 2000).

According to studies by the Department of Commerce, American Management Association (2000), organizations estimate that employees steal over a billion dollars a week nationwide from their unsuspecting employers. Other studies estimate that nearly one-third of all bankruptcies are caused by employee theft and that it takes approximately $20 in sales to offset every $1 lost to employee theft (Case, 2000).

In the retail industry, employee theft can occur by concealing merchandise in a purse, pocket or bag, and removing it from the stores – in the same ways that shoplifting can occur.  Internal theft however can also occur by stealing cash, allowing others to steal merchandise, eating food, and by refund, credit card, or check fraud.  It can sometimes be charged as embezzlement due to the trusted fiduciary status of the employee (McGoey, 2006).

According to the 2002 National Retail Security Survey presented in Table 1 of this paper, employee theft was estimated to account for 48% of inventory shrinkage for retailers.   That means employee theft results in a loss of about $15 billion per year for retail owners.   This staggering figure makes employee dishonesty as the greatest single threat to profitability at the store level.  The study further provided that the average dollar loss per employee theft case is $1, 341. 02 compared to $207. 18 for the average shoplifting incident.  Employee theft is considered the single biggest contributor to inventory shrinkage even though shoplifters far outpace dishonest employees since the dollar value of employee theft on a per incident basis is much higher than that of shoplifting.   Although dishonest employees accounted for only 1 out of every 10 apprehension, the average value of merchandise recovered was nearly seven times that of the average shoplifter, $1, 525 and $223, respectively.   According to the Ernst & Young study (2002), 47% of dollars lost to inventory shrinkage are attributable to employee theft.  However, despite these figures, most retailers focus retail loss prevention efforts on shoplifting and tend to ignore employee theft.

There is thus a need for effort to identify and deter internal theft (McGoey, 2006; Ernst & Young's Study of Retail Loss Prevention, 2002).

According to the 17 $^{th}$ Annual Retail Theft Survey (2004), of the retailers surveyed, 1 in every 27. 8 employees was apprehended for theft from their employer in the year 2004 alone. Both the number of dishonest employees apprehended and the dollars recovered during those apprehensions increased from 2003 to 2004. Retailers recovered $42. 2 million in 2004, an increase of 6. 10% from 2003, from 63, 289 dishonest employees apprehended in 2004, which in turn was an increase of 4. 01% over the prior year (Jack L. Hayes International, Inc. 2004). The same study provides that on a per case average, dishonest employees steal approximately $6712. 03 which is 6. 6 times the $101. 60 stolen by shoplifters. In 2004, the average case value recovered from employee theft rose by $13. 25, an increase of 2. 01% from 2003 (Jack L. Hayes International, Inc. 2004).

Statistics from other studies show that the amount of financial loss caused by the typical dishonest employee theft can go to as high as $1023, and that a dishonest employee typically for his or her employer for an average of nine months (Vargas, 2000).

Unfortunately, there is no real physical profile for a dishonest employee. They come in all shapes, sizes, ages, sexes, ethnic backgrounds, religions, levels of education, and economic status. It is extremely difficult to accurately determine who is likely to steal based on a consumer's demographic status alone (McGoey, 2006).

It has also been difficult for retail managers to accept the possibility that employees that he or she hired, trusts, and works with, are capable of engaging in disloyal and dishonest activity. Some common management misconceptions about employee theft include (Case, 2000):

- Most theft is caused by non-employees.
- Well-paid and/or senior employees are trustworthy/loyal and don't need to steal.
- Honest employees can be counted on to report employee theft.
- Employee theft is conspicuous and can be detected in its early stages.
- There is no need to formally inform employees that theft will not be tolerated.

Retail owners and managers thus must keep an eye for signs of theft and must do away with the misconceptions listed above. The key is for retail managers to realize that certain conditions or incidents may not be result of mere carelessness or incompetence, but indications of theft in progress. All irregularities and deviations thus must be evaluated with an open and creative mind. Inventory or product found near employee exits or dumpsters, sensitive documents discovered in copy machines, employees in key positions who refuse to take time off, photocopied documents used in lieu of originals, are just some signs of past theft and may be indications of existing dishonesty. Other signs or indications as theft, apart from unexplained inventory shortages, are declining profits and rumors (Case, 2000).

Some factors behind employee theft has been the tight labor market which has lead to higher dollar losses across the retail industry. The record labor shortage leaves retail companies short-staffed, thus allowing for greater opportunity for employees to steal. This is further compounded by the issue of more dishonest employees being allowed into the workplace due to the same retail staffing shortages (Vargas, 2000).

Employees themselves rationalize their action and state that the opportunity for theft presented itself because of lax policies, controls, and management indifference. Many employees also cite opportunities created by management as the main motivation for theft, not their financial need. Another reason employees resort to theft is their perceived belief management was stealing so it was all right for them to do so as well. This indicates that if management wants a theft-free work environment, it must set an example of honesty and adherence to policies. Other common examples of employee ration for internal theft include (Case, 2000):

- " I am underpaid and I am only taking what I deserve."
- " Everybody does it, besides, they can write it off."
- " The company makes a large profit and I deserve some of it."
- " The company angered me and I got back at it."

Management and employee attitude, and the need for management and employee education on internal theft and its repercussions, are thus important factors behind internal theft.

- Shoplifting

Shoplifting or external theft occurs when someone steals merchandise offered for sale from a retail store, with the intention of permanently depriving the merchant of the value of the merchandise (McGoey, 2006). Shoplifting is especially prevalent during the holiday season when crowded stores and busy staff make it easier to pilfer products. Hot categories for shoplifters are expected to be sneakers, earrings, and health and beauty products, most of which are frequently carried by supermarkets, discount stores, and department stores. According to the Retail Theft Trends Report, these types of retailers account for 41% of retailers surveyed, and represent a whopping 88% of the shoplifting or external theft cases (Vargas, 1999).

Fortunately, these types of retailers also have the highest apprehension rates, often catching shoplifters in action. The reason is that supermarkets, discount stores and department stores usually have a dedicated security staff which makes monitoring and apprehension easier. These retailers are among the largest users of electronic detection devices and video surveillance systems, and are thus usually the best equipped in protecting their merchandise from shoplifters (Vargas, 1999).

Nevertheless, that shoplifting is a serious threat to the retail industry, second only to employee theft, can be gathered from the figures. According to the National Security Survey (2002) as seen in Table 1, shoplifting accounts for 31. 1% of inventory shrinkage. In 2004, 689, 340 shoplifters were apprehended, which is an increase of 4. 86% over the previous year. Retailers in 2004 recovered $70. 0 million from shoplifters apprehended, up by 1. 61% over 2003. Dollars recovered from shoplifters during the same year with no apprehensions made also increased by 4. 86%. This is largely due to retail companies' emphasis on shoplifting as the primary objective behind loss prevention measures (Jack L. Hayes International, Inc. 2004).

Other studies show that in the U. S., as many as 1 in 12 customers is a shoplifter, and that shoplifters commit an average of 50 thefts before being caught. If caught, only 10-15% are actually apprehended (Delaney, 2006).

A more extensive description of the elements involved in shoplifting will be covered in the section of Crime Management Procedures of this chapter.

C. Security Technologies and Strategies

Large and small retailers have resorted to the use of security technologies to minimize external and internal theft. According to a study by the Loss Prevention Specialists (1999), technology is especially critical to maintain low loss levels since shoplifters largely target small, highly desirable merchandise. The use of electronic article surveillance devices thus have contributed significantly in helping retailers to protect their merchandise.

Some common security technologies used by retailers are anti-shoplifting, digital video, and point-of-sale systems to help their employees zero in on theft problems (Vargas, 1999). The following are security technologies used by retail owners (Vargas, 1999):

- Point-of-sale data mining software solutions . These detect potential theft problems at the cash registrar and alert appropriate personnel in real-time. These systems can be tied to digital video recorders to provide clear images of who sold what to whom with a click of a button and can be delivered to any location around the world.

- Source tagging programs . Tiny anti-theft labels about the size of a paper clip are placed inside the actual product or product package, effectively hiding it from view from both store personnel and store customers.
- Self-alarming anti-theft tags . These tags broadcast an audible alarm throughout the store when a shoplifter attempts to improperly remove it from merchandise.

Retailers that utilize security technologies are reported to generally have lower overall inventory shrinkage compared to retailers who don't. Such technology allows employees to focus more time on assisting customers and less on patrolling the aisles, and thus contribute greatly to enhance customer satisfaction (Vargas, 1999).

However, technology alone will not eliminate retail theft. Retailers, and especially managers, must take note of certain security programs and policies in order to minimize internal and external theft.

Thus in addition to surveillance equipment, the retailers should also develop an anti-shoplifting strategy, policy or program to combine electronic security devices with employee attentiveness. In the case of internal theft, preventive measures are necessary to reduce the threat of inventory shrinkage. The Ernst & Young (2002) survey claims that employees who were caught stealing took seven times as much per person as customers who were apprehended did. The solution then is to tackle the problem with a consistent and committed management, and flowing downwards towards staff.

The following strategies have recommended measures to reduce internal and external theft (The Retail Owners Institute, 2006; Case, 2000):

- Management's Attitude . Management must effectively communicate its goals and concerns for reducing employee theft and shoplifting. Staff should be taught to focus on the most frequently stolen merchandise, and should be allowed to contribute to the program by sharing their ideas. Management should emphasize that prevention directly affects profits for everyone involved. There is also a need to establish and practice a safe action plan to use for approaching suspected shoplifters. [2]

One note on employee theft however is that managers often have to deal with this issue with some caution. Putting security technologies and strategies in place may often offend staff since they feel that they are not trusted or that their every move is being watched. However, involving employees in loss prevention programs will help with any uneasiness and should increase in more positive results (The Retail Owners Institute, 2006).

D. Crime Management Procedures

Employee theft and shoplifting are common crimes synonymous to ordinary theft, and thus involves identical elements, such as the requirement of intent to permanently deprive the merchant of the value of the merchandise. In employee theft, it is considered an insidious crime since the merchant is paying a wage and benefits to the thief on top of paying for the cost of their dishonesty (McGoey, 2006). Since employee theft and shoplifting are considered crimes, retailers should be aware and adapt crime management procedures to minimize and deal with these threats.

*Internal Theft* . To be effective, loss prevention systems must be designed to reduce the opportunity, desire, and motivation for employee theft. Basic loss prevention steps involve good procedures for hiring, training, and supervision of employees and managers. These procedures must be clearly defined, articulated and fully implemented.

One example of a crime management procedure regarding employee theft is the procedure for interview an employee suspect for internal theft. There are several issues involved in this case. On the one hand, the employer wants to know the truth regarding possible guilt of an employee suspected of theft even if the employee is reluctant to cooperate. On the other hand, there are serious legal and employee relation problems which can arise from not handling the situation in the most appropriate and professional manner. Some basic steps to follow in determining the facts of a theft incident leading to the interview of suspects are as follows (Case, 2000):

- Carefully evaluate the source and validity of any information that alerts management to a potential theft problem.
- Gather as much information or evidence regarding the alleged theft as possible prior to taking any action.

- If necessary, review facts and findings with an attorney and/or auditor in areas of legal and accounting concerns.
- Know all the legal and labor concerns regarding the interview of a suspect.
- Stick to and discuss issues at hand without deviating or allowing deviation from obtaining the truth and facts surrounding the situation.

Dealing with employees suspected of internal theft tests the emotions, restraint, legal knowledge, and objectivity of every manager and supervisor. There is thus a need for handling the investigation of the employee suspect appropriately and professional, and the key is to learn the procedure before an incident actually occurs (Case, 2000).

*External theft* . Shoplifting is a crime, and aside from the requirement of intention on the part of the offender to permanently deprive the merchant of the value of the merchandise, there also needs to be a solid base for probable cause. This is necessary to prevent false arrest claims. There are six universally accepted steps that a merchant can follow before detaining someone suspected for shoplifting (McGoey, 2006):

- You must see the shoplifter approach your merchandise.
- You must see the shoplifter select your merchandise.
- You must see the shoplifter conceal, carry away, or convert your merchandise.
- You must maintain continuous observation of the shoplifter.
- You must see the shoplifter fail to pay for the merchandise.

- You must approach the shoplifter outside of the store. (Although not technically necessary, this step eliminates all possibility that the shoplifter still intends to pay for the stolen product.

In some states, detaining someone for shoplifting inside a retail store does not establish the criminal intent of theft. However, in other states, shoplifters can be detained once they have concealed the merchandise. When approaching a shoplifter outside of the store, it is important to have at least one trained employee as a back up and witness (McGoey, 2006).

Following the six steps outlined above will allow the retailer to prove criminal intent to shoplift and establish probable cause to detain a shoplifter. This will also protect the retailer from any civil liability that may arise from the incident.

E. Standard Operating Procedures

Apart from the security technologies, strategies, and crime management procedures discussed in the previous sections, a loss prevention action plan is vital to minimize inventory shrinkage. The plan to be adapted, based on the Ernst & Young study (2002), involves four steps as outlined below (Ernst & Young's Study of Retail Loss Prevention, 2002):

- <u>Step 1. Conduct a Thorough Analysis of the Current State of Shrinkage Within Stores</u>. This allows for discovery of where and how much shrinkage is occurring, and provides a view of the resources currently devoted to inventory shrinkage reduction. This also enables categorization and estimation of spending in specific areas in the company.

- Step 2. Develop Cause-and-Effect Models for Data Analysis . This relates inventory shrinkage reduction to various types of loss prevention expenditures and reveals preliminary or directional return-of-investments. It also allows for identification of best and worst performing stores.
- Step 3. Test the Optimal Strategy . This allows for validating the return-of-investments of specific initiatives and justifies reprioritization of existing loss prevention investments, in addition to allowing for measurement.
- Step 4. Implement and Roll Out . Standard operation procedures for all stores should be established, included steps regarding crime management (be it dealing with shoplifters or employees suspected of internal theft as previously discussed in the section on Crime Management Procedures). Management should also continually refine and monitor their loss prevention program.

## CHAPTER 4

## CONCLUSION AND RECOMMENDATIONS

The losses attributed to the retailers due to inventory shrinkage are staggering. The primary sources for such shrinkage are first, employee theft, and second, shoplifting. Most security surveillance measures adapted by companies tend to focus on shoplifting, even though employee theft accounts for 41. 1% of the losses to retailers annually.

For both internal and external theft, retailers need to focus on management attitude, employee education, store layout and environment, developing a loss prevention program, use of security technologies, and conducting an audit of their inventory.

To deter shoplifters, retailers are recommended to adapt the following steps: application of the six universally accepted rules to establish probable cause and detaining a shoplifter; use of electronic article surveillance (EAS) on merchandise, use of close-circuit TV (CCTV) cameras in plain view and other security technologies available to allow staff to monitor customers (Vargas, 2000). Such measures must ensure that the staff still has time to provide good customer service instead of constantly patrolling the aisles for shoplifters.

To deter employee theft, retailers are recommended to improve job satisfaction levels of retail sales associates, lay down clear and well-articulated policies on the impact of employee theft, set an example, perform systematic background screening of job applications, use of video surveillance of sales associates particularly for those working at cash registers, and to motivate and constantly reward more dedicated employees (Vargas, 2000).

It should be noted that although security technologies are important in reducing inventory shrinkage through pilferage, other non-technological measures are required of the retailer to minimize this threat. The key is for the retailer to be proactive in developing a loss prevention program and policy for his or her organization, and to educate and train both employees and management before the actual threat or incident occurs.

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[1] To be discussed in the section on Crime Management Procedures in Chapter 3.

[2] To be discussed in the section on Standard Operating Procedures in Chapter 3.