THE NEXT RETAIL REVOLUTION

Threats and Opportunities in Changing Consumer Behavior

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ALVAREZ & MARSAL

Love it or hate it, people don't shop like they used to. Retailers that can tap new technology to enhance the customer experience across channels, create demand-driven supply chains and optimize real estate will be best positioned to compete as the retail industry enters a new era.

INTRODUCTION

Retail is a key driver for the U.S. economy, approaching $5 trillion — more than 25 percent of the nation's gross domestic product (GDP). Overall, sales in 2017 and 2018 are expected to grow 3.5 percent and 4 percent, respectively, almost double the projected inflation rate. The industry is thriving. However, changes in consumer behavior and digital technology are creating new threats and opportunities, specifically in the areas of **omnichannel commerce, supply chain management** and retail **real estate.**

E-commerce has been around for more than 20 years, and the term has become ubiquitous among retailers and consumers alike, but fresh advancements in digital technology like radio frequency identification (RFID)[1], beacons[2] and **m-commerce[3]** — the buying and selling of goods exclusively via mobile device — are opening unprecedented opportunities to gather data and customize the shopper experience across channels. The potential impact isn't limited to the digital space. Per a recent report by Retail Dive citing data from Forrester, **web-influenced offline sales** — which are either brick-and-mortar sales-driven by online research or online purchases picked up in-store — are expected to account for 41 percent of retail purchases by 2020, up nearly 8 percent from 2016.

In addition to enhancing the customer experience in-store and online, advancements in digital technology are changing the way and speed at which retailers can respond to consumer demand. Studies show that product availability and convenience have a much greater impact on brand loyalty and customer retention than they did just a few years ago. Today's shoppers not only expect the latest trends, but also full **inventory transparency** and immediate access to products. In response, more retailers are exploring **demand-driven supply chains.**

Store closures of major retail brands have made top headlines repeatedly over the past several years, and the "overstored" status of the country is widely accepted. However, more than 90 percent of retail sales in 2016 were made in physical locations, and retail stock per capita — one way of determining if an area is "overstored" — varies widely from market to market. **Brick-and-mortar is not dead.** Recent investments in physical storefronts by online brands like Amazon, Warby Parker and Bonobos affirm that conclusion, but retailers must use their physical storefronts to the best advantage as traffic patterns and shopping culture continue to evolve.

This isn't the first time that major changes in the economy and consumer behavior have dramatically reshaped retail. In fact, it happened during the last two centuries along similar lines. During that period of change, businesses that clung to traditional models faded into history. Those that seized the opportunity to evolve became retail icons and dominated the industry for more than a century. As the real-world lives of consumers become more integrated with digital technology, retail experiences must evolve once again. By optimizing both digital and physical aspects of an **omnichannel retail** strategy, retailers have an opportunity to grow and compete through the industry's next revolution.

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[1] Radio frequency identification, or RFID, uses electronic tags to automatically track objects.
[2] Beacons are small digital devices that use low-energy Bluetooth technology to send targeted information to mobile devices based on a user's precise location in a store or shopping center.
[3] M-commerce is a subset of e-commerce. It is distinguished because it uniquely allows consumers to browse and make purchases anywhere, anytime, without necessarily needing access to an electrical outlet or modem.

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A BRIEF HISTORY OF MODERN RETAIL

This isn't the first time rapid changes in economic conditions and consumer behavior have dramatically altered the retail industry. Knowing the circumstances that created modern retail will shed light on the revolution currently underway.

The story of modern retail began about 150 years ago. The Industrial Revolution in the mid-19th century rapidly expanded the global economy as well as middle-class assets. Not only did consumers suddenly have more disposable income, they also had more leisure time. Department stores like Harrod's of London, Macy's and Bloomingdale's emerged in the mid- to late-1800s not only as central emporiums where shoppers could browse and buy a wide variety of goods, but also as venues for entertainment. Harry Gordon Selfridge, founder of London-based Selfridges department store, famously said, "Excite the mind, and the hand will reach for the pocket." Department stores sought to excite the minds of consumers by offering concerts, art exhibits, fashion shows, celebrity visits, traveling showcases and, in the case of Macy's, an annual Thanksgiving Day parade.

The rise of department stores jump-started the modern retail industry, and as competition grew so did new innovations in retail marketing and technology.

In 1875, Montgomery Ward was the first to promise "satisfaction guaranteed or your money back." Others implemented new marketing tactics, like automatic mark-downs designed to continuously push inventory, and mail-order catalogs, which extended brand reach and distribution beyond the storefront. In the mid-1940s, 7-Eleven set new consumer expectations for accessibility and convenience by opening from 7 a.m. to 11 p.m., seven days a week — hours that were unprecedented at the time.

Simultaneously, technological advancements made large-scale operations manageable and steady growth attainable for retailers. In 1879, James Ritty patented the first cash register, calling it "Ritty's Incorruptible Cashier," helping retailers better manage and track high-volume sales. One hundred years later, the invention of barcodes further enhanced retailers' abilities to manage and track inventory.

WHAT DO THE SEARS CATALOG AND AMAZON HAVE IN COMMON?

The Homestead Act of 1862 fueled westward movement in the U.S., creating a greater need for direct order and delivery services in retail. While it was not the first mail-order publication to reach consumers, the Sears, Roebuck and Co. catalog was, by far, the most extensive and well known, publishing more than 300 pages of products including clothing, appliances, tools, jewelry, musical instruments, groceries, books and even cars. Taking advantage of special postage rates for mail-order catalogs, including a "Rural Free Delivery" service offered by the U.S. Postal Service, Sears made itself one of the most affordable, convenient ways to shop from anywhere in the U.S.

Over the past 20 years, Amazon has seized similar opportunities created by new technology and distribution methods, becoming the new leader in product variety and convenience.

As retail culture grew throughout the 20th century, so did store footprints. Between 1977 and 1987, the number of U.S. shopping malls increased by 57 percent, eventually doubling by 2007, according to CoStar Group and U.S. Census reports. In 1962, Kmart, Walmart and Target all opened their first stores, giving rise to "big-box retail" in just a three-month span. Thirty years later, Minnesota laid claim to the nation's largest-ever shopping mall, the Mall of America (MOA).

Just as the MOA was making U.S. retail history with a gross acreage that could contain seven Yankee Stadiums and more than 500 stores, a brand-new technology was taking shape. Like the Industrial Revolution a century and a half before, it would spur dramatic changes in the ways people work, play, live, communicate and consume.

In 1991, scientists at the European Organization for Nuclear Research (CERN) launched the very first website and laid the foundation for the World Wide Web. Four years later, Amazon was open for business. In its first month of operation the new online-only retailer had customers in all 50 states as well as 45 countries.

With technology enabling real-time, low-cost, multimedia communication worldwide, people embraced new forms of entertainment. Pioneers like AOL and MySpace ignited social media culture by changing the way and frequency at which people communicate. Facebook, the world's largest social site, launched just a decade after Amazon. In June 2017, Facebook, which now hosts more than 65 million business pages in addition to personal profiles, announced its goal to become a virtual storefront for retailers.

Just as department stores rose to meet changing consumer behavior in the 19th century, the internet is affording opportunities along those same lines. In addition to browsing and buying online, shoppers can also research products, share feedback, interact with brands and fellow consumers, monitor inventory and find locations. Brick-and-mortar stores are still desirable destinations for some, but their role is evolving thanks to advancements in supply chain and delivery methods. The purpose of retail real estate is certainly changing as commerce becomes an omnichannel experience.

Retailers, stakeholders and advisers who understand both how and why consumer behavior is changing, and can adjust to better meet demand and provide fresh customer experiences, will be best prepared to compete and succeed, just as Selfridge, Ward and other innovators did during the last retail revolution.

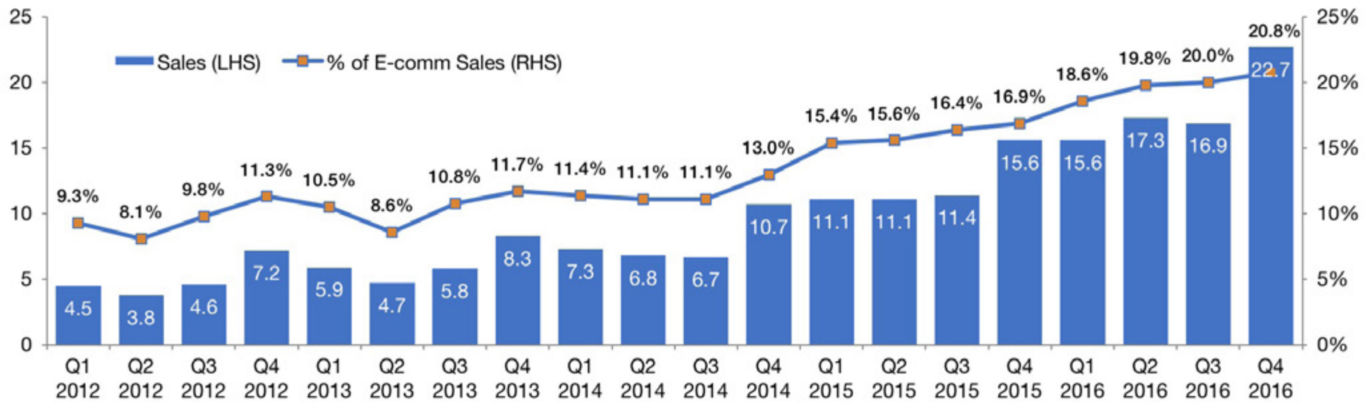
THREE AREAS OF THREAT AND OPPORTUNITY

In 2016, retail accounted for the second-highest number of bankruptcies and was the second-largest distressed sector with a Standard & Poor's 500 Index distress ratio of 20 percent, an increase of more than 21 percent over the previous year. The year 2016 also saw the highest number of retail defaults since the financial crisis earlier this century. Of those defaults, 75 percent were in the apparel segment, and a significant number of apparel manufacturers are currently on the S&P "Negative Watch" list. New business models, including online retail, fast fashion and off-price retail, are causing price deflation and an overall decrease in average unit retail (AUR).

These factors cast a bleak light, but the industry overall is growing. The same changes in technology and consumer behavior that are threatening the status quo are also posing new opportunities for innovation and success.

Exhibit 1

US M-Commerce Sales as a Pct. of Total E-Commerce Sales, 2012–2016 ($ billion)



Data Source: comScore

OMNICHANNEL COMMERCE

Threats

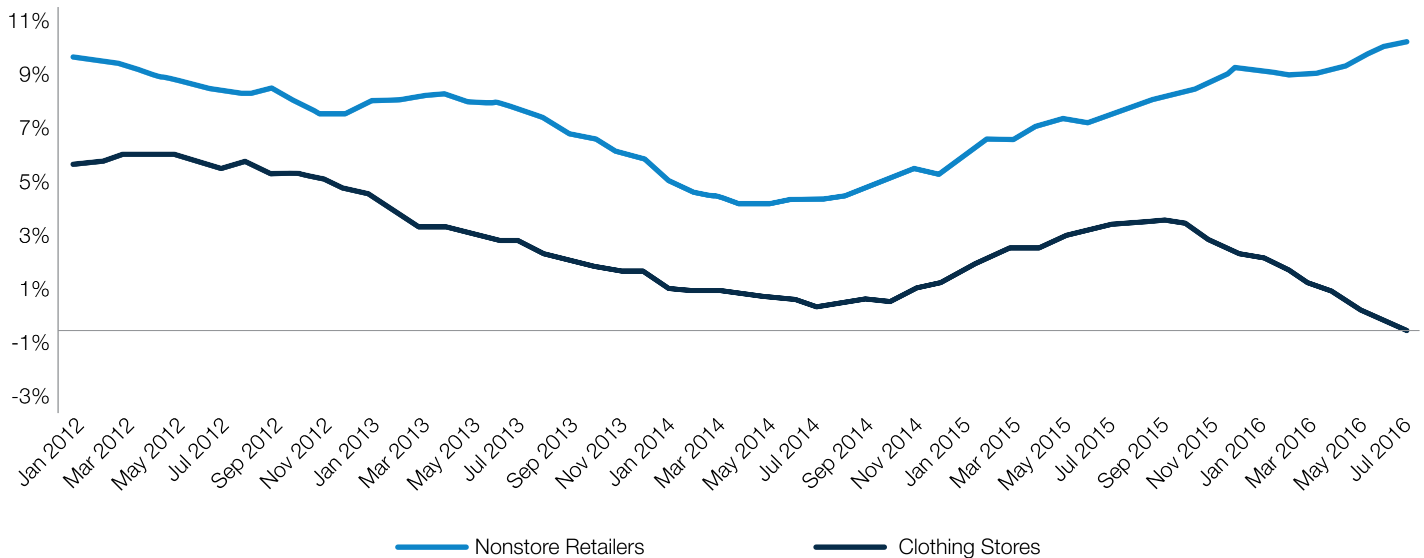
Non-store retail has been a factor in the industry since the advent of mail-order catalogs (See "What do the Sears catalog and Amazon have in common?", p. 2.) and the rise of teleshopping in the 1980s. However, non-store retail hasn't been truly disruptive until the last decade. In 2015, e-commerce made up 7.4 percent of global retail sales, according to *eMarketer*, and that number is expected to reach 12.8 percent by 2019. That growth is fueled by decreasing shipping costs and new advancements in media, technology and data analytics. Emerging trends like **m-commerce** (Exhibit 1) and **web-influenced offline sales** are impacting all segments.

Digital commerce, as a whole, now accounts for 10–15 percent of all apparel sales with specialty store penetration of about 20 percent. Online clothing sales are rapidly growing as in-store purchases approach negative growth (Exhibit 2).

In the home furnishings sector, e-commerce is also expected to be the fastest growing distribution channel. Home delivery is usually required anyway, and new interactive technologies like augmented reality enable shoppers to virtually "try before they buy." According to eMarketer, online furniture sales in the U.S. are expected to increase at a compound annual growth rate (CAGR) of 12.3 percent and will account for 30 percent of total furniture sales by 2018 (Exhibit 3).

Exhibit 2

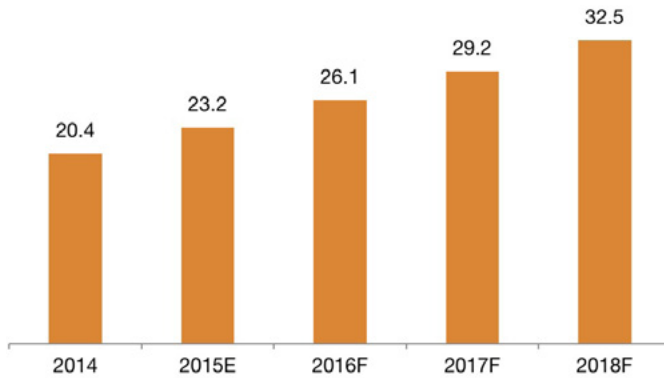
Year-Over-Year Change in Traditional and Online Clothing Sales 2012–2016



Source: RBC Capital Markets, "Department Stores & Specialty Softlines – 2017 Outlook"

Exhibit 3

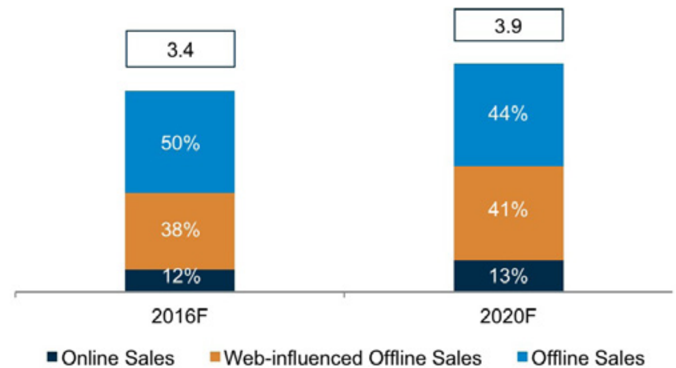
Online Furniture Sales 2014–2018F ($ billion)



Source: eMarketer, Inc. "Furniture and Home Goods Retailers and Digital Commerce 2016"

Exhibit 4

US Retail Sales Forecast 2016–2020F ($ trillion)



Data Source: Retail Dive, "Mobile's Influence on Offline Sales Continues to Grow: Forrester," February 2016

Even the grocery segment, in which brick-and-mortar had been previously unbeatable against home delivery services, appears to be reaching an inflection point. According to a 2017 report by the Food Marketing Institute and Nielsen, online sales are expected to compose 20 percent of total grocery spending — an estimated $100 billion — by 2025.

The growing popularity of meal kit services like Blue Apron and HelloFresh, as well as Amazon's recent and widely talked about acquisition of Whole Foods Markets, are strong indicators that omnichannel strategies may soon be as critical for the grocery segment as they are for apparel.

Opportunities

The good news is that sales are growing. In fact, overall retail sales are projected to increase 3.5 percent in 2017 and 4 percent in 2018. While a portion of that growth is fueled by e-commerce, a recent report by Retail Dive citing data from Forrester shows that **web-influenced offline sales** are expected to account for 41 percent of total sales in 2020, up 8 percent from 2016 (Exhibit 4) as consumers more frequently use their smartphones in stores to research products, compare prices and check online inventory.

While it might not be technically or financially feasible for an established business to go from a Web 1.0 digital presence to a full-fledged Web 3.0[4] sales platform in one fiscal year or less, focusing omnichannel retail strategies on a few key areas may help build momentum. Three emerging areas of omnichannel opportunity are:

1. Customer **personalization**
2. Optimizing existing digital channels for **m-commerce**
3. Enhancing **in-store experiences**

CUSTOMER PERSONALIZATION

Cross-channel influences — including websites, mobile apps, social media, email, buyer reviews and digital advertising — are playing a growing role in consumer decision-making. More and more, customers are impressed by, and even prefer, brands that can deliver a personalized experience across channels. According to MyBuy's 7th Annual Consumer Personalization Survey, 53 percent of consumers prefer brands that suggest products based on past purchases, and 49 percent prefer brands that personalize ads. Brands that personalize emails and brands that personalize the shopping experience across all channels are preferred by 48 percent of consumers, respectively. Of course, providing a highly personalized customer experience requires data collection on a granular level. Fortunately, mobile apps, beacon technology and social media are making data collection and message targeting ever more feasible.

[4] Web 1.0, 2.0 and 3.0 are stages of internet advancement. Web 1.0 refers to sites that serve as information portals exclusively, providing read-only content. Web 2.0 sites allow users to share information and contribute content such as comments, photos, videos or blog posts. Web 3.0 is a yet-to-be-fully-realized stage of the internet that incorporates advanced technology like machine learning, data mining and artificial intelligence. To some extent, sites that make recommendations based on a user's past actions fall into this category.

GETTING PERSONAL TO INFLUENCE OFFLINE SALES

Gino Rossi

The Poland-based footwear seller wanted to drive customer loyalty by offering promotions tailored to a customer's individual needs. Integrating in-store beacon technology with its mobile app, Gino Rossi collects real-time data and relays it back to an analytics platform that generates customized promotions for individual shoppers based on their unique habits and interests. In fact, there are no standardized promotions at Gino Rossi. They're all customized. Up to 98.5 percent of users continue using the brand's app after receiving a personalized notification, and notifications achieve an average click-through rate of 85 percent. Both metrics are significantly above industry standards.

Chick-fil-A

To improve customer experience and increase sales, the fast food chain wanted a mobile app to provide the same level of personalized service that customers expect in its restaurants. The Chick-fil-A app generates a unique storyline for each customer based on the customer's order history, routine and location. It greets the user, incorporates real-time visuals and provides a detailed menu that varies based on time of day. It also stores preferred locations and personal payment information and offers an Allergens filter that warns users based on their meal selections. When the app launched in 2016, it made the number one position in the iTunes App Store, displacing giants like Facebook and Snapchat. It also received rave reviews on Google Play and was highlighted on CNBC and in the *Atlanta Business Chronicle*.

MAKING IT BETTER WITH MOBILE

Starbucks

Over the past few years, the Seattle-based coffee company has invested more than $400 million in digital technology with a primary focus on improving its mobile app. Introducing new features that allow customers to do nearly everything from their smartphone — find a store, choose a product, place an order, finalize a purchase and earn rewards — Starbucks has been able to not only streamline the process for customers but also for employees, improving productivity across the board. In 2015, Starbucks saw a 15–20 percent increase in the number of U.S. transactions driven by its mobile app and a 17 percent increase in total revenue year over year. In Q1 2016, consumers had loaded $1.9 billion onto their Starbucks cards through the mobile app, and in 2017, average Starbucks app spending has increased almost 20 percent.

Nike

No longer just an apparel retailer, Nike has invested heavily in tech to deepen its relationship with athletic consumers. In 2016, the company launched the Nike+ app, which provides not only product information, but also custom news feeds and training tips based on a user's inputs and behavioral patterns. Overall, Nike has more than a dozen smartphone apps to engage consumers. It also has an investment in wearable tech with the Nike FuelBand, an electronic bracelet that tracks a wearer's activity. In 2016, Internet Retailer reported that Nike's e-commerce sales had grown 51 percent year over year.

M-COMMERCE

E-commerce is now more than 20 years old. Retailers are well aware of its presence and impact. However, **m-commerce** — the buying and selling of goods exclusively via mobile device — is a growing trend and one that should be top of mind when shaping an omnichannel retail strategy.

The release of Apple's first iPhone 10 years ago sparked widespread adoption of mobile technology. According to a report by the Pew Research Center, as of 2016, 77 percent of U.S. adults now own a smartphone, which is higher than the number of adults who use social media (69 percent) or have broadband internet at home (73 percent). In 2015, comScore reported that the number of mobile-only users surpassed the number of desktop-only users for the first time ever.

Mobile devices afford the unique advantage of giving users access to content anywhere, anytime, without the need for an electrical outlet or modem to connect to the internet. With the integration of GPS technology, users can find information (and be reached)

based on their real-time location. This subset of e-commerce is creating additional opportunities for both online and brick-and-mortar retailers. Having a **mobile-first approach** to omnichannel strategy will be even more important in the future.

ENHANCING IN-STORE EXPERIENCES

A theory exists that consumer spending is shifting away from tangible goods toward experiential activities, including dining, spas, entertainment and travel. While retail sales are growing, in a world where personal experiences are being shared and compared more frequently on social media — from food photos to entertainment reviews to travel routes and check-ins — the promotional value of a top-notch experience can't be denied. Today's retailers may have something to learn from the mid-19th century department stores that sought to "excite the mind" and inspire buying by creating entertainment destinations within their shopping centers ("A Brief History of Modern Retail," p. 2).

In 2013, Glimcher Retail Monitor surveyed consumers about their preferences between online and in-store shopping. At the time, half of respondents shopped both online and at the mall, while 30 percent shopped exclusively at the mall. The primary reasons for choosing an in-store shopping experience were the ability to try on clothes and accessories (74 percent), to enjoy the in-store experience (55 percent) and to have store variety (49 percent). Apparel newcomers like Stitch Fix, LeTote and Gwynnie Bee have recently introduced subscription models that let customers order online, try on at home and return items as needed with no additional shipping fees. However, a significant number of shoppers still value the experience and variety afforded by in-store shopping. The key for retailers is having an omnichannel strategy that makes the shopping experience personal, engaging and shareable whether online or in-store.

SUPPLY CHAIN MANAGEMENT

Threats

When it comes to modern **supply chain management**, retailers that embrace a **demand-driven** approach seem to be capturing market share. Studies show that **inventory transparency** and almost-immediate product accessibility are now critical to customer acquisition and retention.

According to a 2015 study by eMarketer, 82 percent of U.S. shoppers want the ability to see and search available inventory at stores in their vicinity. Furthermore, immediacy and convenience seem to greatly outweigh brand loyalty in their purchasing decisions. Surveys conducted by IBM in 2011 and 2016 indicate buyers not only expect real-time inventory visibility across channels, they are more willing than ever to switch brands if an item is out of stock. In 2016, 72 percent of consumers said that if an out-of-stock item was not available from their first-choice retailer they would switch to a competitor, compared to only 42 percent in 2011. In 2016, 66 percent of those surveyed said that

CREATING A 21ST CENTURY IN-STORE EXPERIENCE

VulcanoBuono

By deploying beacon technology throughout its venue, Italian shopping center VulcanoBuono has been able to drive greater store traffic and engage shoppers with personalized offers. More than 200 beacons recognize and communicate with shoppers as they walk by, offering them custom coupons for boutiques, restaurants and cinemas. The app also integrates with and gamifies the mall's loyalty program. For in-app activities or social interactions, users receive points and badges that can be redeemed for gifts at the mall. In the first six months after launching the new experience, the app was downloaded about 8,000 times, and the average user was interacting with it about 25 times per month.

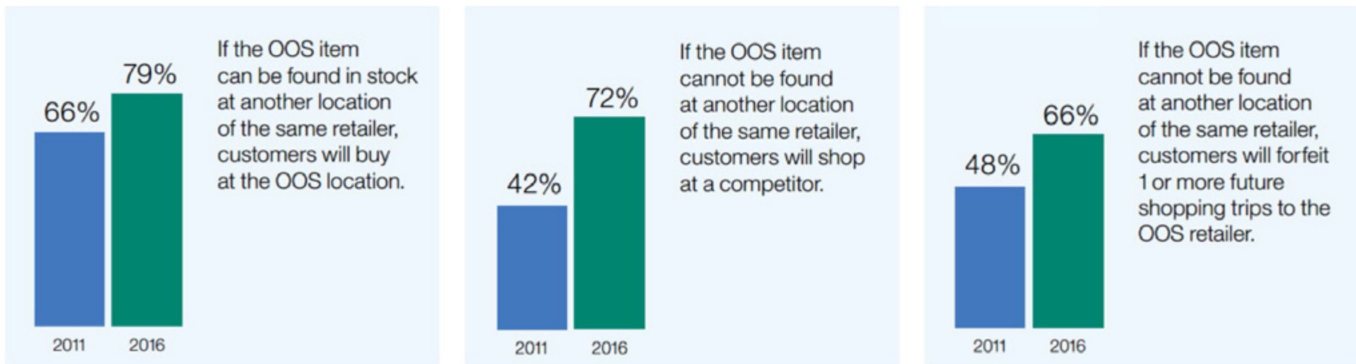
Rebecca Minkoff

In 2014, the luxury apparel and accessory retailer opened its flagship location in New York City as a "connected store." The space incorporates interactive screens, digital mirrors and RFID technology to create an immersive, personalized shopping experience with the added benefit of collecting rich customer data. The store's touch screens display videos and product information and allow shoppers to select items to be added to their fitting room. Shoppers can even order drinks and change the dressing room lighting. Preferences are stored and automatically reinstated when a customer returns to the store. Using RFID technology, the company can suggest products based on size, color and other user preferences. Rebecca Minkoff's full suite of digital features work in conjunction with the retailer's mobile app. According to a 2015 article by Digiday, this use of cutting-edge tech helped to triple expected clothing sales in the store's opening year.

Find retail solutions tailored to fit your needs.

Exhibit 5

US Consumer Sentiment on Inventory Transparency and Availability



Source: IBM "Consumer Expectations Study," 2016

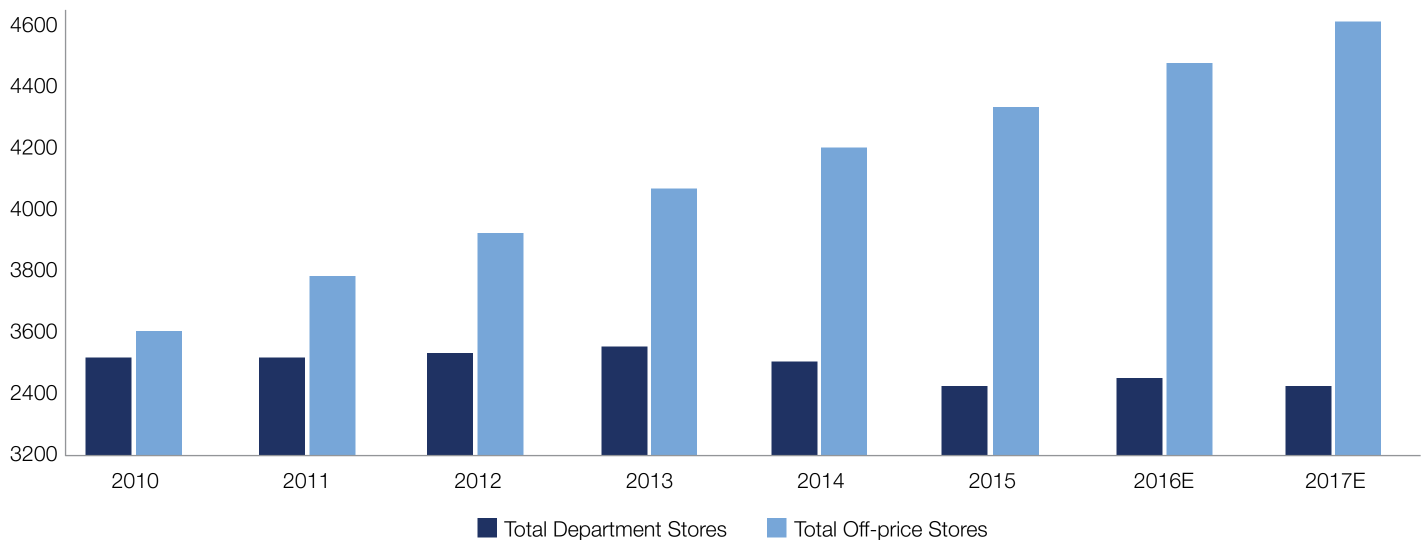
if an out-of-stock item could not be found at an alternate location of their first-choice retailer, **they would forfeit one or more future shopping trips**, compared to just 48 percent in 2011 (Exhibit 5). These results confirm that product availability and convenience have the potential to make or break consumer relationships.

The growing demand for inventory transparency and easy accessibility reflects an overall cultural shift driven by digital technology, the internet and social media. Now accustomed to having up-to-the-minute information and real-time results at their fingertips, today's consumers want control, customization and convenience in every area of their lives. To meet those expectations, retailers must embrace a more modern, demand-driven approach to supply chain management.

Off-price and fast fashion retailers have made some of the greatest strides in supply chain optimization. Those efforts have led to tremendous growth in off-price stores while department stores continue to decline (Exhibit 6). The impact of this shift is especially significant in the apparel sector where both department stores and apparel manufacturers are seeing a strain on EBITDA due largely to apparel deflation as online, off-price and fast fashion sellers offer lower prices for near-equal-quality products. Fast fashion brands like H&M and Zara seem to have mastered the art of turning fashion inventory quickly to make the latest trends available on a continuous, rather than seasonal, basis.

Exhibit 6

Growth in Department Stores vs. Off-Price Stores 2010–2017E



Source: RBC Capital Markets, "Department Stores & Specialty Softlines – 2017 Outlook"

DATA-INFORMED AND DEMAND-DRIVEN

Macy's

At the beginning of 2017, Macy's committed to tagging 100 percent of its inventory with RFID technology by the end of the year in order to track inventory movement at a granular level. Already, that initiative has increased inventory accuracy, decreased mark-downs, improved display consistency across stores and increased full-price sales by 2.6 percent.

DeFacto

The fashion retailer located in 11 European, Middle Eastern and African countries consistently struggled with excess ordering, resulting in high mark-downs and eroding margins. The business was relying on old systems and spreadsheet-based forecasting methods. It needed a modern method for predicting demand. DeFacto opted for a cloud-based solution that integrated with its legacy systems but offered new data-collection and forecasting tools. Products were segmented into two categories: fast fashion and fashion basics, the latter having a longer shelf life. Demand forecasts were calculated separately for each category and considered a wide range of variables such as style and color. In the first six months of implementation, DeFacto saw an 85 percent increase in shelf availability, a 24 percent reduction in out-of-stock items and $7 million in additional revenue from store-to-store transfers.

Supply chain efficiencies and consumer demand for better bargains have enabled the growth of off-price retailers across multiple segments. Already, off-price stores outnumber department stores, but that variance is expected to increase even more as off-price retailers build to more than 5,000 locations nationwide. Collectively, TJX Companies, Inc. (including T.J.Maxx, Marshall's and HomeGoods), Ross Stores, Burlington and Nordstrom Rack's expansion plans include 2,400 new locations.

T.J.Maxx sales grew 6.4 percent in 2015 to more than $30 billion. President and CEO Ernie Herrman is hopeful the brand will reach $40 billion soon. Marshall's and HomeGoods saw strong growth through 2016 as well. The company's leaders attribute this success to an extensive global structure that has helped them **deliver new products to consumers in record time.**

MODERNIZING TO COMPETE WITH GIANTS

McLendon Hardware

The family-owned business operating stores in seven cities around the Puget Sound area of Washington needed to dramatically improve its inventory management and warehouse operations to compete with Home Depot and Lowes. By implementing a modern warehouse management system, it was able to consolidate store deliveries, reduce warehouse staff by 30 percent and eliminate the need for manual in-store inventory counts. The small company offers more than 100,000 distinct products through its e-commerce site and brick-and-mortar locations, and the new system has enabled it to better ensure its supply meets consumer demand. In April 2017, the business was acquired by Central Network Retail Group of Memphis with a vision of facilitating growth regionally and beyond.

The grocery sector is also experiencing a significant off-price impact, as discount competitors and dollar stores present discounts up to 15 percent lower than private-label products from established grocers and up to 200 percent lower than name-brand products. Furthermore, two highly successful German discount grocers, Aldi and Lidl, have recently announced plans to open approximately 2,000 stores in the U.S. by 2022.

Opportunities

While consumer loyalty seems more uncertain than ever, implementing a **demand-driven supply chain, inventory transparency** and faster ways to get goods to buyers, including **click-and-collect** options, can help to increase customer retention and sales.

Traditional demand forecasting models take a long-term approach, looking at aggregate sales — as opposed to demand — on a monthly or quarterly basis to inform inventory decisions up to a year in advance. This approach can yield highly inaccurate results because sales don't necessarily predict demand, and many variables can change over the course of a year. Alternatively, **demand sensing** (as opposed to forecasting) uses technology to gather large quantities of real-time consumer data and assess behavioral patterns. Social media, RFID and beacon technology are all relatively new sources of consumer data that can be combined with information from point-of-sale (POS) and inventory management systems to inform a demand-driven approach and create a shorter supply chain.

In addition to adopting demand-driven supply chains, retailers can improve customer retention by offering inventory transparency and convenient product access.

In the same IBM study mentioned above, 79 percent of respondents in 2016 said they would still buy from their first-choice retailer if an out-of-stock item could be found at an alternate location, compared to only 66 percent in 2011. Additionally, click-and-collect options have the high potential to **generate additional purchases in-store** at the time of pickup. Per a 2016 Internet Retailer survey of online consumers, of those who made click-and-collect purchases within the last year, **48 percent bought additional items at the time of pick up** at least some of the time.

In January 2016, *eMarketer* reported that in-store pickups are accounting for a growing percentage of e-commerce sales, particularly for big-box retailers. In 2015, buy-online-pickup-in-store (BOPUS, another term for click-and-collect) purchases accounted for more than 30 percent of Sam's Club sales, more than 22 percent of Kmart sales and nearly 12 percent of Best Buy's. This trend is driven partly by discounts offered for BOPUS purchases, which save retailers on shipping, but also by greater online inventory transparency. Shoppers can confirm product availability online before investing in a trip to the store.

HIGH-TECH TRANSPARENCY

Nordstrom

The company has integrated its main website and the Nordstrom app with its inventory management system, allowing customers to find products all in one place and either have them delivered or made available for pickup at the location of their choice. Through its click-and-collect model Nordstrom customers can buy online based on real-time, in-store inventory and pick up purchases as little as one hour later instead of waiting 2–3 days for shipping or paying high same-day or next-day shipping costs. The program has helped the company improve both online and in-store sales. In 2015, Nordstrom generated 20 percent of its sales online, up from just 8 percent in 2010. A study by L2 found that an in-store pickup model resulted in sales exceeding the original bill value by 7 percent on average.

Drive significant results with practical approaches.

Exhibit 7

Metropolitan Areas With the Most Store Closures 2015–2017E (in square feet)

	Neighborhood and Community Center Retail	Power Centers	Malls	Total
Philadelphia	655,677	195,068	1,046,998	1,897,743
Houston	168,666	318,504	767,000	1,254,170
Chicago	623,720	403,717	149,000	1,176,437
Central New Jersey	682,130	268,124	-	950,254
Long Island	452,158	251,470	193,530	897,158
Boston	65,605	358,541	432,923	857,069
Detroit	42,610	15,000	767,000	824,610
San Diego	334,186	86,375	385,000	805,561
Northern New Jersey	669,411	134,132	-	803,543
St. Louis	164,598	376,378	180,000	720,976
Seattle	335,420	40,000	310,679	686,099
Los Angeles	545,562	79,917	-	625,479
Dallas	145,513	132,085	347,000	624,598
New Orleans	-	110,112	456,000	566,112
Charlotte	-	223,276	340,517	563,793
Total Top 15	4,885,256	2,992,699	5,375,647	13,253,602
Total Primary Metros	9,981,903	6,342,463	9,433,061	25,757,427
Total Tertiary Metros	3,173,804			3,173,804

Source: Reis, "Impact of Large Chain Store Closures on Retail Rents"

RETAIL REAL ESTATE

Threats

There's a rising sentiment that the U.S. is **"overstored,"** having more brick-and-mortar retail locations than shoppers can support. Over the past several years, many department stores have made significant closures to reduce operating costs and raise capital.

According to a report by the International Council of Shopping Centers (ICSC), more than 2,000 stores closed in 2016, and by the first quarter of 2017 that number had already been surpassed. Sears / Kmart, Macy's and Walmart were among the biggest names to announce widespread closures in 2016.

More than 13 million square feet of retail space was eliminated between 2015 and July 2017 in the top 15 cities for store closures alone (Exhibit 7). In terms of square feet, Sports Authority contributed the biggest cuts in 2016 at 8 million, or 28 percent of total closure square footage, due to its bankruptcy. Macy's was second with 6.7 million square feet, and Kmart was third at 4.3 million.

The loss of big-name anchor locations impacts surrounding retailers as well, and some locations are at risk of becoming "ghost malls." In fact, in 2013 the nation's oldest shopping mall, Rhode Island's historic Arcade Providence, established in 1828, was converted to an upscale apartment complex.

Exhibit 8

15 Most Over-Retailed US Metro Areas 2017–2022, by Retail Stock per Capita

Location	Sum of 2017 Retail Stock per Capita	Sum of 2022 Retail Stock per Capita	Sum of Change
Myrtle Beach	95	85	(10)
Huntington	80	82	2
Toledo	75	78	3
Lubbock	74	69	(5)
Charleston, WV	74	75	1
Mansfield	73	76	3
Roanoke	70	69	(1)
Jackson	69	70	1
Burlington	68	69	1
South Bend	67	72	5
Youngstown	67	69	2
Racine	67	68	1
Knoxville	66	67	1
Utica	66	68	2
Portland, ME	66	67	1

Source: A&M Insights

One way to measure whether an area is “overstored” or “over-retailed” is to evaluate retail stock, or square footage, per capita. The top 15 over-retailed cities in the U.S. have a retail stock per capita (RSPC) of 66 or greater in 2017, which is well above the national average of 53 (Exhibit 8).

Opportunities

Brick-and-mortar is by no means dead. In fact, about 90 percent of all retail sales are still generated at brick-and-mortar locations and will be for the foreseeable future. Nielsen’s Total Consumer Report July 2017 edition notes, “For the first time in over a decade, shoppers actually took more trips to stores last year than in the year prior.”

While the U.S. overall may be **overstored**, from market to market the measure varies significantly. Furthermore, different brick-and-mortar locations have different competitive advantages. Some may offer high-traffic brand exposure while others may be best positioned for distribution and delivery. The key for retailers is to focus real estate investments on primary business objectives. Depending on a retailer’s market position and goals, opportunities may exist to:

- Expand in relatively under-retailed areas
- Optimize brick-and-mortar facilities
- Consolidate strategically

While some cities have a relatively high retail stock per capita, others fall below the national average (Exhibit 9). As noted earlier, many department stores are closing locations, but off-price retailers are on track to have more than 5,000 locations sooner rather than later (Exhibit 6). While many community and regional shopping centers are anchored by department and big-box brands, other retailers sell goods and services that consumers need quickly and frequently. Hardware stores, delis, pharmacies, salons and grocers, for example, still have a distinct advantage in brick-and-mortar.

Exhibit 9

15 Least Over-Retailed US Metro Areas 2017–2022, by Retail Stock per Capita

Location	Sum of 2017 Retail Stock per Capita	Sum of 2022 Retail Stock per Capita	Sum of Change
Los Angeles	39	39	0
Provo	38	38	0
Visalia	38	38	0
San Diego	38	38	0
Honolulu	38	37	(1)
Stockton	38	38	0
McAllen	37	37	(1)
New York	37	37	0
Salinas	37	37	0
San Jose	37	36	(1)
Santa Cruz	36	36	0
Lebanon	36	36	0
Madera	36	36	0
Greeley	35	32	(3)
Bakersfield	32	32	0

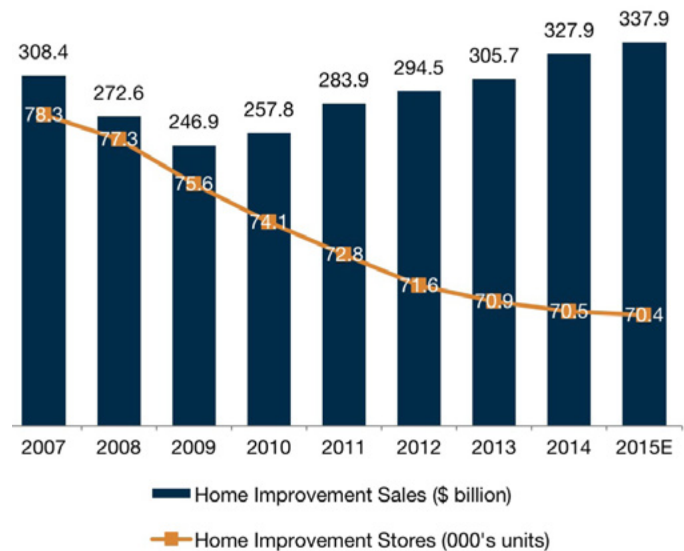
Source: A&M Insights

Even online retailers recognize that some needs are better met with a physical presence. In a microtrend known as "**clicks-to-bricks**," online eyeglass seller Warby Parker, men's clothing manufacturer Bonobos and, most notably, Amazon, among others, have invested in brick-and-mortar locations to either provide customers a more tangible shopping experience or to better position inventory for faster distribution. The integration of GPS technology in smartphones has also given rise to new forms of marketing based on a customer's physical location at any given time, making physical presence and proximity that much more valuable to retailers.

Still, some brick-and-mortar locations were built to meet consumer needs and behavior patterns that have long since changed and are not likely to return. In those cases, consolidating strategically can still have positive potential in the form of higher sales per store and liquid capital. For example, from 2007 to 2015, the home improvement industry witnessed a 10 percent reduction in stores. However, sales per store increased by approximately 22 percent (Exhibit 10).

Exhibit 10

Home Improvement Sales vs. Stores 2007–2015



Data Source: RBC Capital Markets, "Home Improvement Sector is Alive and Well; Lots of Legs Left to the Cycle"

CONSOLIDATING FOR GREATER CAPITAL

Sears

In 2015, Sears completed a real estate investment trust (REIT) transaction, creating Seritage Growth Properties to manage the redeployment of its retail assets. Seritage currently owns 266 properties totaling over 42 million square feet of leasable space. Third-party retailers are driving new traffic and customers to the properties and, in 2016, were renting at 4.5 times the rate of what Sears paid. Sears plans to use proceeds to reduce obligations and generate cash. Sears Holdings CFO Jason Hollar said in 2016, "We will continue to focus on our best stores as part of our shift to a member-centric integrated retail model. As we reduce our overall store base, we believe we will inevitably end up with stores that are profitable, operate at a small loss or have a clear path to profitability."

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CONCLUSION

Consumer behavior in the 21st century is driven by higher-than-ever demands for **convenience, control** and **customization**. While today's consumers still desire shopping experiences that "excite the mind," they expect those experiences to be available across multiple channels anytime, anywhere. Foregoing a digital presence is simply not an option for retailers who want to remain viable now and into the future. In fact, digital firms are far more likely to be considered superior or "industry leaders" than non-digital firms (Exhibit 11).

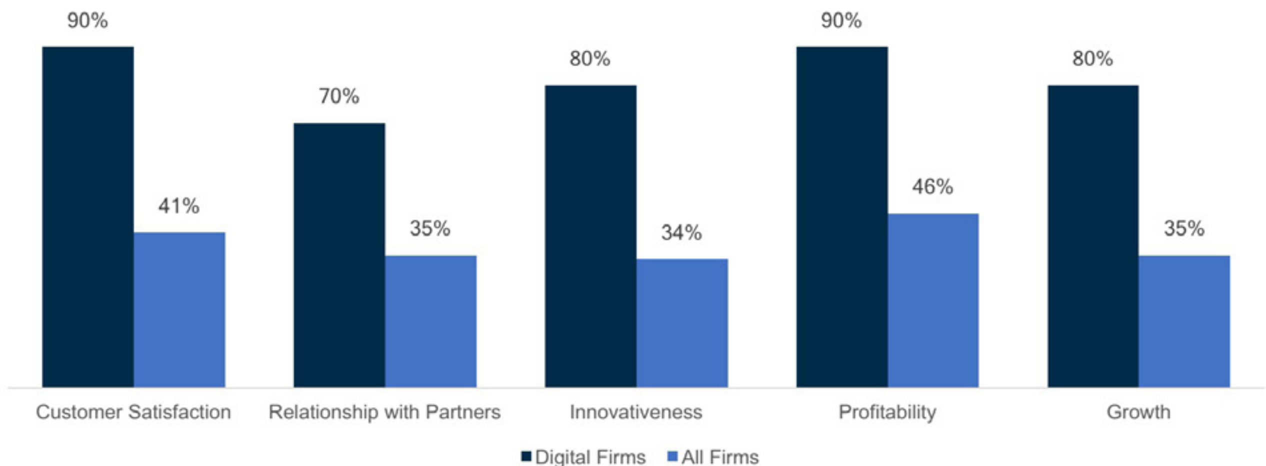
Digital technology is not only extending brand reach and enabling more convenient and more personalized shopping experiences, it's also helping to optimize supply chains, improve inventory management and streamline processes. Retailers that can focus both their front- and back-end digital strategies have an opportunity to improve performance across the entire value chain.

While digital technology has permeated nearly every aspect of our lives, brick-and-mortar is not dead. Fresh, original in-store experiences are still in demand for many segments, and as mobile and geo-based technologies grow, physical storefronts can meet new demand for tangible shopping experiences and fast distribution if positioned and scaled appropriately.

Consumer behavior is changing fast, but it's not the first time. Retailers can either succumb as new trends in **omnichannel commerce, supply chain management** and **retail real estate** threaten the status quo, or they can seize the opportunity to change and become the industry icons of this century's retail revolution.

Exhibit 11

Performance Comparison of Digital Firms vs. All Firms



Source: Capgemini, "Organizing for Digital: Why Digital Dexterity Matters"
NOTE: Percentages indicate share of firms that respondents report to be "Better than most" or "An industry leader" relative to their competitors or industry.

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