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The Future of Retail: From Revenue Generator to R&D Engine

Tough economic times and emerging technologies are prompting consumers to change their buying behaviour, and smart retailers are responding with innovative in-store offerings.

by **Dana Cho** and **Beau Trincia**

OUR TOUGH ECONOMIC TIMES have hit traditional retailers hard, particularly in North America. **Circuit City** and **Borders** have filed for bankruptcy; **Ann Taylor** and **Home Depot** have closed hundreds of stores; and **American Apparel** is reportedly millions of dollars in the red, to name but a few. The official reasons for these failures range from overly-aggressive expansion strategies to unfortunate investment decisions – but, in reality, a big driver of this retail upheaval is old-fashioned belt-tightening. Financial uncertainty is prompting consumers to change their buying behaviours. Enabled by new technologies, shoppers are now using mobile phones to comparison shop on the fly, access in-the-moment promotions, and consult friends or family before buying anything.

As the ways in which people make purchase decisions multiply, retailers of all kinds are at a crossroads. One of the key reasons for operating a bricks-and-mortar store – building a strong, Customers today want retailers to be less about well-orchestrated brands and carefully rehearsed answers and more about transparency, authenticity and passion.

distinctive brand experience – no longer seems relevant. Thanks to the rapid rise of social media and corporate transparency, consumers now wield tremendous influence in shaping retail brands and are growing increasingly skeptical of overly-slick store designs, clerks and marketing messages. The once-dependable competitive edges for bricks-and-mortar retailers are eroding, which means they can no longer afford to assume any inherent advantages over their online competitors.

For instance, store owners have long believed that the 'thrill' of shopping – that visceral, emotional rush that people get when touching or interacting with a product before they buy it – would uphold their popularity. But e-commerce Web sites are disproving this axiom by generating similar excitement online with concepts such as 'flash sales' and 'social shopping'. For example, **GILT Groupe** offers its members daily flash sales, which feature luxury goods in low quantities for an extremely limited time, giving people only a few minutes to make purchase decisions. The site, which launched in 2007, now has a valuation of US$1 billion. Meanwhile, **Svpply** has built a social network around shopping, letting its users track trends, including the items their friends buy. Its popularity has grown seven-fold since its introduction in late 2009.

As online retailers slash shipping times and costs to next to nothing, bricks-and-mortar retailers can no longer depend upon instant gratification as a competitive edge. Online giants **Zappos** and **Amazon** now send purchases overnight at a discount and provide second-day service for free. The success of these tactics suggests that virtual storefronts can be at least as effective as physical ones, if not more so. So, how can bricks-and-mortar retailers survive – and thrive – as consumer attitudes and buying habits change?

They could, of course, expand their online presence, and many are doing just that. But a few leading-edge companies are also challenging long-held industry beliefs and re-examining how they use their *physical* presence. These retailers are discovering that the sales floor presents them with opportunities to develop more open relationships with shoppers that help them better understand their audience and create an inspiring experience that drives customer loyalty.

Although digital channels may be better positioned to provide short-term transactional value, bricks-and-mortar stores still give retailers the best space in which to establish long-term connections with customers. Let's look at how a few companies are shifting their mindsets and moving from driving transactions to encouraging inspiration and discovery; from featuring 'expert staff' to 'informed enthusiasts'; from targeting shoppers to targeting product owners; and from focusing on revenue generation to R&D.

From Driving Transactions to *Encouraging Inspiration*

The focus on convenience, straightforward navigability and seamless transactions in the name of making in-store purchases as easy as possible runs counter to what consumer behaviour tells us. During the 2010 holiday shopping season, 48 per cent of consumers who used a smartphone in some way said they purchased goods in retail stores, while nearly as many – 45 per cent – bought items online via computer. However, the majority also said that, regardless of how they ultimately acquired the product, they had visited an actual store to browse. This suggests that although consumers often opt for the convenience of digital channels to make purchases, bricks-and-mortar stores continue to play an important role in the shopping journey – primarily where product discovery and inspiration are concerned.

The types of products purchased online versus at retail stores also varies. Shoppers are increasingly off-loading mission-based errands, or the acquisition of commoditized products (i.e. household staples) to other channels. This gives traditional stores both room and permission to be less about enabling convenient, seamless transactions and more about inspiration, discovery and serendipity. Stores could focus more intently on enticing browsers, using the physical space to convert exploratory shoppers, who arrive with little to no intention to buy, into potential buyers, who may make a purchase in the store or through another channel later.

J.Crew's Liquor Store provides a prime example of doing exactly that. J.Crew opened its first men's clothing store in 2008 with the goal of inspiring exploratory shoppers – people who weren't current customers of the brand. At the time, J.Crew's menswear had little following, and the retailer sought to raise its profile through a dedicated storefront. It took over a historic watering hole in New York's TriBeCa neighborhood, and rather than focus on packing in as many items into the 935-square-foot store as possible, J.Crew kept the bar's atmosphere intact, stocking shelves with bottles and filling the room with vintage furniture and non-J.Crew brands such as **Timex**, **Red Wing** and **Mackintosh**.

Retailers who believe in conventional wisdom would consider this a waste of precious floor space that could have been devoted to as many sellable brand-specific products as possible. However, J.Crew's goal was to *raise awareness* of its men's line – and pique the interest of potential customers. The concept appears to be working: J.Crew has subsequently opened three more Men's Shops, and although the company declines to provide sales figures for individual stores, CEO **Micky Drexler** recently told investors, "We are beyond thrilled with the performance of our stand-alone men's stores." J.Crew earned $44.7 million in the first quarter of 2010, up from $20.4 million during the same period a year ago. In addition, its chief menswear designer, **Frank Muytens**, was ranked among the top in his field in *GQ*'s 2010 Best New Menswear Designers competition.

Using physical spaces to drive inspiration rather than transactions isn't limited to the retail industry. In 2010 **Crédit Foncier**, a mortgage lender in France, invested in a high-profile store in Paris's Opera district to inspire people to want to own a home. Most lenders make in-person visits from prospective borrowers as perfunctory and short as possible, gearing information toward people who plan to buy a home in the near future. In contrast, Foncier Home targets anyone who might be thinking about home ownership – even if it's just a long-term goal or dream. The store includes a café, where people can meet casually with a real estate agent while looking over residential listings. It also includes a section with information about renovations and remodeling – services that Foncier Home doesn't yet offer but are an exciting, aspirational aspect of home ownership. Although the company sells nothing tangible and has no real need to maintain a large retail space, Foncier is banking on the notion that a discovery-based experience such as the one made possible in its flagship store will encourage more people to become home buyers. And when they do, Foncier Home will be top-of-mind as the go-to lender. Crédit Foncier expects this concept to drive growth in the future and has plans for expansion.

From Expert Staff to *Informed Enthusiasts*

Powered by social media, peer recommendations are gaining ground in power and influence. In a recent survey, nearly eight out of ten people said they trust peer recommendations *above all other sources of information*. Yet retailers are still pouring billions of dollars into service training on a workforce that routinely sees 50 per cent turnover each year. The fact is, as consumers rely on friends, social networks and other independent resources for expert information, the role of the store associate is shifting dramatically.

The *new* purpose of a retail store lies in its ability to represent an organization's actual culture and values, captured and rendered by its sales associates. Customers today want retailers to be *less* about well-orchestrated brands and carefully rehearsed answers and *more* about transparency, authenticity and passion. Store associates, therefore, need to evolve from 'expert staff' into informed brand enthusiasts who are proud of their organization.

How might a retailer and its sales associates reveal a brand's organizational values? Consider the UK department store **John Lewis**, which operates on a partnership model that makes every employee a partial owner of the business. Not surprisingly, because they are partners who share in the company's profits, employee engagement and retention are high; compared with others in the industry, John Lewis staff stays on the job twice as long. The store's hiring practices de-emphasize retail experience; what counts in recruitment is *behaviour*. "You can train anyone to do things," one partner told the *Guardian UK*. "But nobody can teach someone how to *be*."

"We ask not only that you do your day job, but that you play an active role as an owner," a member of the partnership board explained in the same article. "That you engage with your colleagues and work with them in thinking through what will make the business successful. Our shareholders aren't passive and distant ... they have lots of opinions." And those opinions are voiced through democratic channels: the chairman and board run the company's commercial activities, but an 82-member partnership council elects nearly half the board (which could, if needed, fire the chairman). The partnership council is elected primarily through a network of forums representing every department of every company store. So, the board looks after the partners; the partners look after the customers; and the customers spend money in the store. For John Lewis, this 'virtuous circle' works well: in the depths of a global financial downturn, John Lewis has turned an operating profit of 20 per cent, and customer satisfaction remains high.

The shift from being an *expert* to being an *enthusiast* – someone who believes in the brand and organization they work for and can speak passionately about the products at hand – has less to do with scripted service and more to do with organizational design. In the John Lewis example, hiring, governance and accountability create a foundation for empowered, engaged and impassioned associates. Many leading-edge U.S. retailers have taken similar personnel-oriented approaches. Perhaps the best known is **Apple**, which transformed consumer technology retail with its retail stores. For the Apple Store's tenth anniversary 'refresh' this year, the company invested heavily in supporting its enthusiastic store associates with service-enabling technology rather than in a redesign of the bricks-and-mortar interior.

From Targeting Shoppers to *Targeting Owners*

Retail stores have traditionally been designed for shoppers with the intention to buy and, perhaps as a result, retailers have long depended on in-store marketing and communications to sell the quality and other worthy attributes of their products. Under the new paradigm we are describing, bricks-and-mortar retailers have an opportunity to acknowledge the value of the *product owner*'s role as a brand ambassador and key influencer on other shoppers.

In a study conducted by social-networking site **myYearbook**, 81 per cent of respondents said they had received online advice

WHAT RETAILERS SHOULD BE ASKING THEMSELVES

Realistically, retailers need to continue to drive in-store sales, but they should also consider other ways their stores add value to the business. Rather than simply close up shop when an outlet fails to turn a profit, companies should ask:

- What consumer knowledge could we gain by fostering a research- and learning-driven dialogue with shoppers in the store?
- Are there costs associated with sales-associate education and training that could be better spent on increasing engagement?
- How could we use the store as a platform to inspire consumers, even those who are non-buyers and not considering an immediate purchase, to drive future revenue?
- Are we deriving as much value as we can from the owners of our products? What could the store offer to drive owner traffic and increase owner recommendations?

from friends and followers related to a product purchase, and 74 per cent of those who received such advice found it to be influential in their decision. Meanwhile, 90 per cent of online consumers trust recommendations from people they know; and 70 per cent trust the opinions of unknown users. The 'owner' or existing user of a product, then, can be the most powerful influencer of all.

As a result, designing the bricks-and-mortar store for the consumer who already owns your products (versus the consumer who is shopping) can have profound effects on a brand. By focusing on participation in the store – through education, trials and membership experiences rather than marketing, promotion and sales – retailers are positioning themselves for a longer-term, more open relationship with customers, helping them successfully evolve with the 21st century.

We would argue that the very future of retail depends on this ability to make stores participatory and desirable to an owner audience. One retailer that 'gets' this is **American Girl**, based in Middleton, Wisconsin, which draws owners of its customized dolls back into stores with a Doll Hair Salon where kids can get makeovers for their dolls, have repairs done and socialize with other owners at the same time. This presents an obvious opportunity to sell new accessories, too, but more importantly, the stores can passively evangelize the doll experience: when girls and parents tell their friends and family about their positive experiences onsite (which often have nothing to do with buying the original doll), they bring new owners into the fold.

Likewise, **Nike**'s branded stores pull in repeat visits from owners via its Nike+ Run Clubs, which meet at designated shops worldwide. Building on its platform of performance-tracking products and Web site, Nike+ is now the largest running club in the world, with more than three million members. In 2009 alone, membership grew by 50 per cent. Athletes of all skill levels train together and are privy to product trials and expert clinics. Nike motivates owners to use its products as a group, and the group inspires other curious runners to join them – and buy Nike gear – through camaraderie and knowledge-sharing. Taking the concept a step further, in 2010, Nike opened its first 'category experience store' dedicated solely to the sport, Nike Running Stanford, in Palo Alto, California.

From Revenue-Generator to *R&D Engine*

The paradigm shift we are describing questions, at a fundamental level, the role of the physical store in a retail organization's business. As the channels to buy continue to multiply – from new e-commerce models to mobile-phone payments – traditional retailers face more competition than ever before. If consumers can buy anything anywhere at anytime from anyone, bricks-and-mortar stores needs to derive new meaning and value for their business in order to remain a strategic asset.

Fortunately for bricks-and-mortar, not all channels are created equal, and the traditional retail store maintains an important edge over the digital realm: the physical space provides a direct, personal connection with consumers. Smart retailers have begun using the storefront to foster relationships with people, which means going beyond selling products or presenting a well-orchestrated brand experience to understand existing and potential customers and their needs. In short, they are using the retail floor as a platform for learning.

These retailers realize that developing a new offering behind the scenes until it is exactly right is a slow strategy that doesn't

Smart retailers have begun using the storefront to better understand existing and potential customers and their needs.

allow for quick adaptation in a rapidly-shifting market. Instead, they 'beta test' new offerings and experiences and quickly pivot the offering on the fly as dictated by actual customers. For example, at the height of the recession, **Urban Outfitters** opened an experimental store in Los Angeles called **Space 15Twenty**, which aims to attract – and study – customers other than its typical college student. Brand collaborations with Santa Monica bookseller **Hennessey + Ingalls** and New York vintage shops **What Comes Around Goes Around** and **Generic Man** act as magnets for people who don't typically shop at Urban Outfitters. In a sense, it's a store for *tomorrow's customer*, rather than *today's sales*. The store is an investment in market reconnaissance, rather than solely a means toward hitting revenue targets and achieving profitability; its primary goal is gathering customer information from which Urban Outfitters can learn.

While recession has hit some retailers very hard, in the first quarter of 2010, Urban Outfitters saw a 72 per cent increase in profits. CEO **Glen Senk** credits creativity and experimentation. "We don't go about revenue and profit as a goal. Rather, we focus our energies on the customer experience: innovating, making beautiful products, really pushing the limits of our brand expression and constantly refining how we operate. Revenue per square foot is the result of that focus, rather than the starting point or motivation."

The threshold where companies interact with customers can be a leading element in driving innovation, rather than being the last thing they consider. In August 2011, **State Farm** opened its doors to a new retail venture called **Next Door**. In contrast to its other locations, Next Door's purpose isn't solely to sell products. Instead, it offers personal financial coaching, classes and community space – all for free. It's self-described as 'an open-source learning lab and community space' – no catch, no sales pitch. Why? While Next Door helps people work toward their goals, State Farm learns more about what consumers want and need, and how it can help. The store employs an on-site research analyst whose job it is to learn about the needs of the community and translate those needs into meaningful, actionable insights for the company. The store, then, is a channel for consumers to shape and influence the organization's strategic direction.

In closing

The future success of retailers may depend greatly on their ability to challenge what the industry has simply accepted as true: that a brand experience is crafted by the design and messaging around a physical experience, and that a store's primary purpose is to *sell*. Increasingly, traditional retailers are openly questioning the role that the physical store plays in their business strategy – and opting to use these spaces to effect long-term change over short-term sales growth. We believe this is a great way to solidify long-term customer loyalty and provide shoppers with that increasingly-important window into an organization's soul. ***R***

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