The Case for Making Retail Smarter
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The world relies on retailers. They fulfill people’s constantly shifting demand for goods and services, such as food, clothing and medicine. Any disconnect in the global series of exchanges—from raw materials, to manufacturing, to transportation, to real estate, to media-driven fads and fashions—can profoundly influence people’s lives and the global economy.

Retailing plays a sizable role in most economies. In the United States, 70 percent of gross domestic product (GDP) is comprised of consumer spending. In China, where consumer spending is only 36 percent of GDP, the government is taking active steps to increase that percentage, knowing that a strong retail sector is key to economic vitality and social stability. Value-added or sales taxes collected by retailers also account for a large part of government revenue. In addition, retail generates a lion’s share of entry-level jobs.

So retailing matters. But it’s struggling, and not only because of economic conditions. Most retail processes today were built largely for the realities of another era, when products were manufactured in isolation and brought to market en masse from factory to truck to store, for consumers who did most of their shopping in physical stores. Today retailers must adapt to global supply networks, new ways and venues for selling—both physical and virtual—and a very different kind of customer. And with profit margins increasingly under pressure, retailers don’t have much room for error.

To compound matters, the global financial situation of the past two years put great pressure on retail sales and margins and retailers everywhere responded by sharply reducing inventory, headcount and capital investments—often at the expense of customer service levels. They took these steps just to survive—although of course many did not.

Now, as economies begin to show signs of life, retailers are seeking to grow again without returning to the levels of inventory, headcount and cost that they employed before the downfall. In order to do so, they will need to transform from a system that is product-centric, push-based and focused on mass markets to one that is experience-centric, pull-based and driven by unique insights about the consumer. In short, they have to become smarter.

Figure 1: Consumers have deconstructed the shopping experience. They are firmly in the driver’s seat.
Catalysts of change
Even before the economic downturn, three storms were gathering that now present themselves as immediate and unavoidable challenges for any retailer.

1. A smarter consumer
The single greatest change in retailing today is what is happening on the other side of the counter. Consumers are becoming infinitely smarter, not only in terms of the information to which they have access, but in the ways they choose to interact with retailers. Why? At the very time that retailing in general was deferring spending on new technology, consumers were embracing it as never before. The rise of mobile devices is just one case in point. In 2009, the number of mobile phone subscriptions topped four billion, with mobile phone subscriptions in the developing world exceeding the number of cars nine times over. Nearly two billion people are now online, with that number expected to increase to 2.2 billion by 2013. Tech-savvy consumers have quickly learned to use these tools to research products, prices and availability; they are also tapping into broad social networks of consumers who share ratings, views, shopping experiences and other information.

To illustrate, according to a recent study from the IBM® Institute for Business Value, fully one-third of shoppers are comfortable with the idea of using two or more technologies to shop and make purchases. This could mean seeing an item for sale on television and completing the transaction by sending a text. Or it could be getting a tailored promotion sent to one's mobile phone and going onto the retailer's website to make the purchase.

In short, consumers have deconstructed the shopping experience. Armed with knowledge and options from multiple sources, they decide when and where the buying process begins, what elements will be part of that process, in what order and how they will be linked. Consumers are firmly in the driver's seat.

Only retailers that keep pace with smarter consumers can hope to reassert their unique expertise in the buying process and guide these consumers through the buying experience in a way that will enable the retailer to consistently win their business.

2. Changing economic conditions
In the mature markets, economic pressures have reshaped buying patterns in ways that may persist for a generation. Consumers have tended to gravitate toward either the value or the luxury segment, whereas those retailers in the undifferentiated middle have underperformed.

Meanwhile, the newfound thrift of mature-market shoppers has manifested in a heightened desire for product durability. This trend opens up new opportunities for retailers; for example, offering value-added services after the sale, extending the customer relationship and its lifetime value. Retailers that don’t capitalize on such opportunities may find themselves losing customers to ever-lower-priced competitors.
If the retail landscape in the developed world is shifting and reforming, the changes in the developing world are seismic. The global population is simultaneously becoming more urbanized and more affluent—two extremely significant trends for retailers. The bulk of this growth is in developing economies, yielding a new pool of nearly 3.5 billion consumers with over $4 trillion to spend annually.

In addition, there remains an enormous population of rural poor who are hardly served at all by existing retail networks, but who hold great potential for retailers that can develop innovative, low-cost business models.

Both of these new opportunities—the exploding middle class and the rural poor—reside mostly in countries in which the retail industry’s global leaders have little presence or experience. And because today’s retailing infrastructure in the developing world will not be able to meet the growing demand, the door will open to local retailers that grow up fast, major players from the developed world that expand globally, or even those with entirely new business models.

### 3. New competition

The first two catalysts (a smarter consumer and the shifting retail landscape) have combined to yield a third: new forms of retail competition. We see this competition emerging as retailers extend core offerings, move into new geographies, or as new entrants redefine what consumers value from retailers.

Make no mistake: retail has always been a highly competitive industry. But historically the competition arose from firms that were recognizable as retailers, usually within a defined retail segment and generally from the same region, or at least the same country. These players have used size, speed, service or marketing to gain a competitive advantage, but usually they did so from a physical outlet, or more recently from a website.

But today, just about anyone can become a retailer, in just about any retail segment, from almost anywhere in the world.

At the individual level, many thousands of people now earn their livings full time selling goods on auction sites such as eBay. Meanwhile, supermarkets routinely offer bank branches, while drug stores practice medicine and sell fishing licenses. Recently, Best Buy announced that they would begin selling electric cars.
For their part, manufacturers have become retailers by selling directly to consumers over the Internet. And retailers have responded by investing heavily in private-label brands that compete with their manufacturers. Just as significantly, retailers and consumer products companies are competing for primary control of customer data, since they understand that this wealth of information enables them to deliver the more sophisticated merchandising and more personalized shopping experience that today’s smarter consumers demand.

But for all the jockeying among members of the extended retail supply network, a much more fundamental threat to retailers is arising from the electronic intermediaries that have staked out a position between the retailer and its customers. Search engines and social networking sites are often the first place consumers turn to begin the shopping process. So it’s no surprise that retailers have used them for advertising and as new channels for reaching the customer. But those new channels can easily become direct competition, by leveraging their analytical capabilities and huge amounts of customer information to disintermediate the retailer.

So there is a huge battle brewing for control of the customer experience and ownership of customer data and retailers will need to think creatively about their business models to avoid having both their role and their value diminished.

Fortunately, retailers have unique resources that they can use to respond to this threat, including physical stores and trained personnel who can provide a personalized and relevant experience—something that few manufacturers, distributors, social networking sites or search engines can easily match. Retailers have the opportunity to be the lifestyle brand to their customers, building stronger relationships through offerings that are fresh, relevant and meaningful.
Our approach to making retail smarter

Retailing in the 20th century focused mainly on the product and store location. If a retailer could offer the right product, at the right price and have stores in the right location, it was successful. But in the 21st century, retailing will revolve around the customer.

This means not only understanding and responding to the customer, but building customer insight into the fabric of how the business operates. It’s about using the customer’s actual and predicted behavior to identify, define and align offerings with what customers value.

Fortunately, a lack of data about the customer is no longer an inhibitor to this type of transformation. As consumers use technology to browse, tweet and blog, they are leaving behind a trail of data. With the help of advanced analytics, retailers can make the most of this data to understand—and predict—actual consumer buying behavior and transform into truly customer-centric enterprises. To do this, retailers must focus on three areas.

1. Deliver a smarter shopping experience

Today’s smarter consumers have more influence and control and are able to determine the elements and sequence of their own shopping experience. They start with information on products, pricing and location that is already available on the platform of their choice. In many parts of the world, mobility is becoming the norm as consumers carry their technology with them and use it to engage in two-way dialog with the retailer.

In other words, designing a smarter shopping experience is by necessity a collaborative act. Retailers will tap into the power of sophisticated business analytics to understand customer preferences, to tailor promotions, to deliver information that is timely and relevant and to create a seamless, unified shopping experience throughout all customer touchpoints.
A powerful example of a smarter shopping experience is 1-800-FLOWERS.com, which is replacing 14 distinct, siloed food and gift e-commerce systems with a single unified platform. The result is not just significant efficiencies but greater customer control over their total “gift experience,” setting 1-800-FLOWERS.com apart from their competition. As a result, they have increased revenue by being able to cross-sell throughout brands, decreased time-to-return-on-investment by bringing new capabilities on line in weeks instead of months and significantly reduced costs.

An example of a company using analytics to enhance the shopping experience is Yves Rocher, the leading French botanical beauty care company. This organization put in place a loyalty program that automates points management and rewards, standardizes promotions throughout 1,500 retail locations and provides the business with real-time visibility into customer buying patterns. Yves Rocher now better understands its customers—including recognizing 85 percent of them when they are making purchases—and can meet evolving customer needs.

By delivering smarter shopping experiences, retailers will be able to help customers shape their brand experiences in ways that reflect individual interests and lifestyles. Retailers will build stronger bonds with their customers and will be able to measure their efforts directly from customer behavior, inside and outside the store—and adapt accordingly.

2. Create smarter merchandising and supply networks

Complex supply networks, long lead times and historical-based forecasting have resulted in supply networks that are stockpiled with hundreds of billions of dollars in excess merchandise. At the same time, retailers lose almost $100 billion every year in missed sales because they don’t have the right products in stock to meet demand.

Creating a smarter retailing system is all about delivering the products and services consumers want, when and where they want them—and doing so at a profit. Most retailers still determine product assortments and allocations based on historical sales volumes and regional climates only two to six times a year. But consumers’ rapidly changing behavior is making historical-based forecasting obsolete. Smarter merchandising and supply networks will turn that model on its head by creating a customer-centric approach, in which retailers predict consumer demand based on near real-time analysis at the segment, location and/or individual level. In this way retailers can tailor assortments and place inventory throughout their network to both drive and meet this demand in the most efficient manner.

An early example of a smarter supply network is the elite fashion house Elie Tahari, which left behind its system of manually entered data throughout multiple systems and built a single, integrated, transaction-driven and real-time supply network. This approach allowed them to link actual store sales as they took place to manufacturing locations and to perform sophisticated analytics on that data. The results included a reduction in supply network costs by 30 percent, the ability to deliver a tailored and optimized mix of products, sizes and colors to each store in its retail base and store-level mix based on actual customer behavior in each specific store.
These changes will require new retail capabilities. Retailers will need to integrate merchandise and supply network planning and execution tightly, first by developing a single execution plan to be shared throughout the merchandising/supply network organizations. Benefits include greater collaboration and more consistent execution throughout the enterprise.

Secondly, the flow of product through the supply network must become more adaptable to consumer desires and to the changing business environment. Faster responses must be enabled by a more consistent and granular view of business events. By adopting instrumentation technologies, sensors, scanners, RFID tags, meters, actuators, GPS or other devices and systems, retailers can gain even greater visibility to new business events as they unfold. In short, smarter supply networks not only will be able to log more events and capture more information, they will also respond quickly by tapping the power of automation.

Ultimately, the availability of real-time contextual data with advanced analytics will advance the dialog between merchants and supply network managers; rather than solving the crisis of the moment, managers will be developing the next set of recurring actions they can automatically execute whenever the situation demands. Leading retailers will no longer just be attempting to match supply with a demand—they will be building capabilities that enable them to more quickly adapt to changing business and consumer demands. Flexibility and adaptability will be the order of the day.

The benefits of such changes will be substantial. As an example, one of China's most successful retailers, Yansha, has developed and deployed a first-of-its-kind supply network management platform that enabled it to reduce order lead time from 2.5 days to 4.5 hours and reduce order error rates to one percent. Another example is Carrefour, which needed to reduce costs and improve customer service levels. They implemented warehouse replenishment that receives information about suppliers, demand forecasts, schedules, stocks and other major constraints and then builds the optimal orders to suppliers. As a result, Carrefour has reduced supply network costs and improved customer service levels.

In short, smarter merchandising and supply networks become the infrastructure that delivers a smarter shopping experience.
3. Drive smarter operations

Inefficiencies in today’s retail systems can translate into declining profits, deteriorating customer service levels and environmental impact. Increasingly, retailers are turning to business model innovation so they can operate more efficiently while delivering new capabilities that differentiate them from competition. There are three types of business model innovation being leveraged by retailers: enterprise business model innovation, revenue model innovation and industry model innovation.

Traditionally, retailers have focused on their enterprise business model: reconfiguring what is done, how it’s done, in what location and by whom to achieve maximum efficiency. This is where retailers have historically made the most significant use of technology, whether in the stores, throughout the supply network, or by outsourcing functions. And by finding ways to take out costs and do more with less, retailers have been able use these savings to fund innovation and transformation in other areas.

An emerging approach to enterprise business model innovation is through cloud computing, which is particularly well suited to retail’s numerous physical locations, fast-changing needs and seasonal swings. Cloud offers a way for retailers to minimize capital outlays by aligning costs with revenues, access resources as required and speed the delivery of new services. Retailers will be able to deploy store services, including point of sale, through the store as needed, radically reducing checkout lanes and improving flexibility. One industry analyst has forecasted that over the next decade, retailers will double their IT productivity using cloud computing.

Figure 4: With cloud computing, retailers can deploy point of sale throughout the store, radically reducing checkout lanes and improving flexibility.
Retailers in growth markets are particularly interested in exploring cloud models. An early example of innovation around cloud is Wang Fu Jing, one of China’s largest retailers with more than 10 million customers per day. Wang Fu Jing uses cloud-based services to support their network of department stores. This approach enables them to easily share supply network information with thousands of suppliers, streamlining operations and reducing costs.

In addition to enterprise model innovation, we are seeing retailers focus on new revenue models, changing how revenue is generated through new value propositions and pricing. As consumers become accustomed to receiving home delivery of goods the same or next day, retailers are rethinking the role of the store, adapting them from being product fulfillment-centric to focused on the experience and solutions customers demand. This is requiring retailers to re-evaluate the new skills their employees will need in order to serve smarter consumers. In fact, just as consumers will continue to be empowered by new technologies and access to information, retail employees will be enabled to serve customers better by tapping into expertise and insights around the untapped demand for transaction-relevant services.

For example, Best Buy recognized that their value to customers resided not just in the products they sell but also the expertise and services they deliver around those products. This insight led Best Buy to transform their workforce by acquiring Geek Squad, a service team that helps customers design, install and operate computer and home entertainment systems. Innovations like this helped Best Buy continue to grow revenue and take share throughout the downturn while competitors were struggling or going out of business.

The third type of business model innovation is when retailers—or other consumer-centric industries—redefine retail, opening up the potential to transform an entire retail segment, reshaping the dominate industry model for that segment, or even creating an entirely new segment. This provides an opportunity for retailers and non-retailers to provide an environment where customers can access the solutions they need and want to live their daily lives.

An example is luxury brand Salvatore Ferragamo, which had essentially ceded the e-commerce marketplace to its channel partners, such Nordstrom and Neiman Marcus. But after evaluating its business model and assessing the tremendous growth opportunities, Ferragamo successfully launched its own e-commerce destination throughout multiple countries by transforming its organization, operational processes and supporting applications. Ferragamo now orchestrates the selling and delivery of products and services that support its unique brand.

In short, smarter operations are both tactically essential and a path to strategic transformation—the very transformation that retail CEOs around the globe are saying that they need.
**Conclusion**

The last two years have seen many retailers around the globe trim their sails, canceling or delaying much-needed investments. As the first glimmers of recovery have started to appear and economic strength returns, retailers will begin to recognize the current moment for what it is: a once-in-a-generation opportunity to take share and achieve new growth. To do so, retailers must provide consumers what they demand—a seamless shopping experience that delivers the merchandise they want where they want it, at a price they are willing to pay.

*Let's make retail smarter for the 21st century.*

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