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Omnichannel resolutions for 2014

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Omnichannel growth for the holiday season was 3.5%, slightly below our 4% forecast but above what many predicted. GAFO in-store sales grew 2.2%, in line with the 10-year average, while growth in digital sales slowed to 12% to 15% despite record sales from mobile devices. The implications for retailers remain unchanged: To win, they have to deliver new omnichannel experiences that delight their customers. In this issue we recap the season's results and highlight nine omnichannel resolutions that retailers need to act on in 2014.
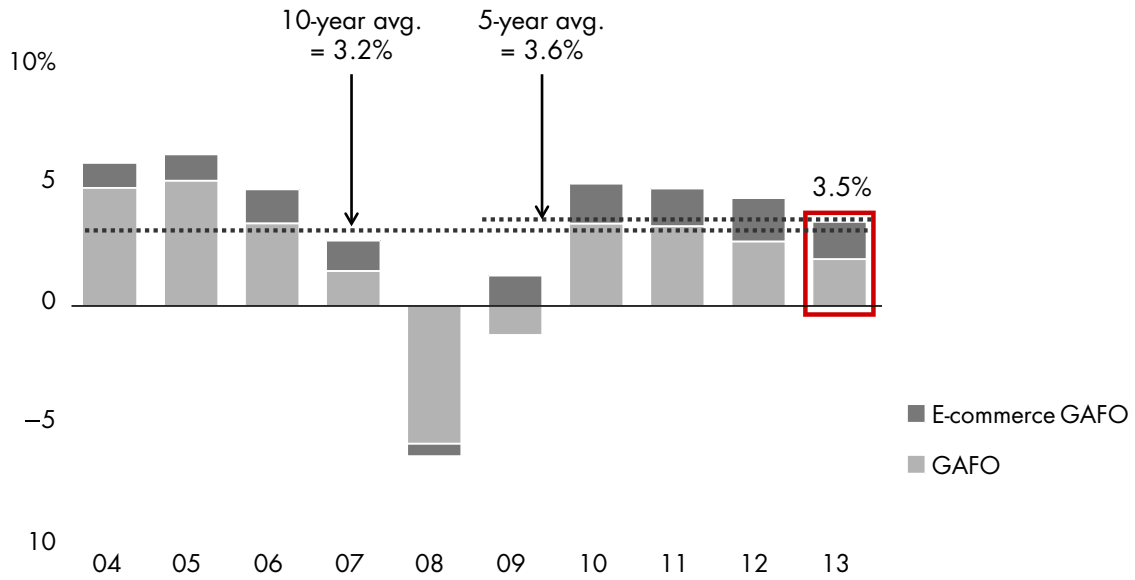
The season in review

Holiday sales in 2013 did better than many analysts feared: Omnichannel GAFO sales grew by 3.5%, slightly below our 4% forecast but above the 10-year average of 3.2% *(Figure 1)*.[1] Many retailers saw growth in line with this overall rate, among them Macy's and Costco, which both increased sales by roughly 4%. Other retailers, especially those catering to more affluent consumers, grew even faster: Tiffany & Co.'s sales in the Americas were up 6%; Anthropologie's same-store sales rose an impressive 11%; and Burberry's North American same-store sales increased "mid to high single digit[s]." A number of retailers that focus on mid- to lower-income consumers did not fare as well: Sears saw sales decline 9.2%; Kmart's sales dropped 5.7%; Toys "R" Us's sales fell 4.7%; and Family Dollar's same-store-sales were down by nearly 3% (at the time of this publication, Walmart, The TJX Companies and Dollar General had yet to release their holiday results).

Initial GAFO estimates suggest that in-store sales grew by 2.2% for the season, building off strong growth of 3% last year and in line with the 10-year average of 2.1% *(Figure 2)*.[2] Sales were stronger in November than December: Preliminary numbers suggest GAFO sales grew 2.7% in November, while GAFS sales estimates for December suggest 1.8% growth. GAFO category results were strongest in sporting goods (6.9% growth) and furniture (5.9% growth), and weakest in the general merchandise category (0.4% growth), which includes in-store sales from department stores, mass merchandise retailers and warehouses. All GAFO categories lagged the impressive 7.9% growth in the motor vehicle category, which continued to benefit from low interest rates.

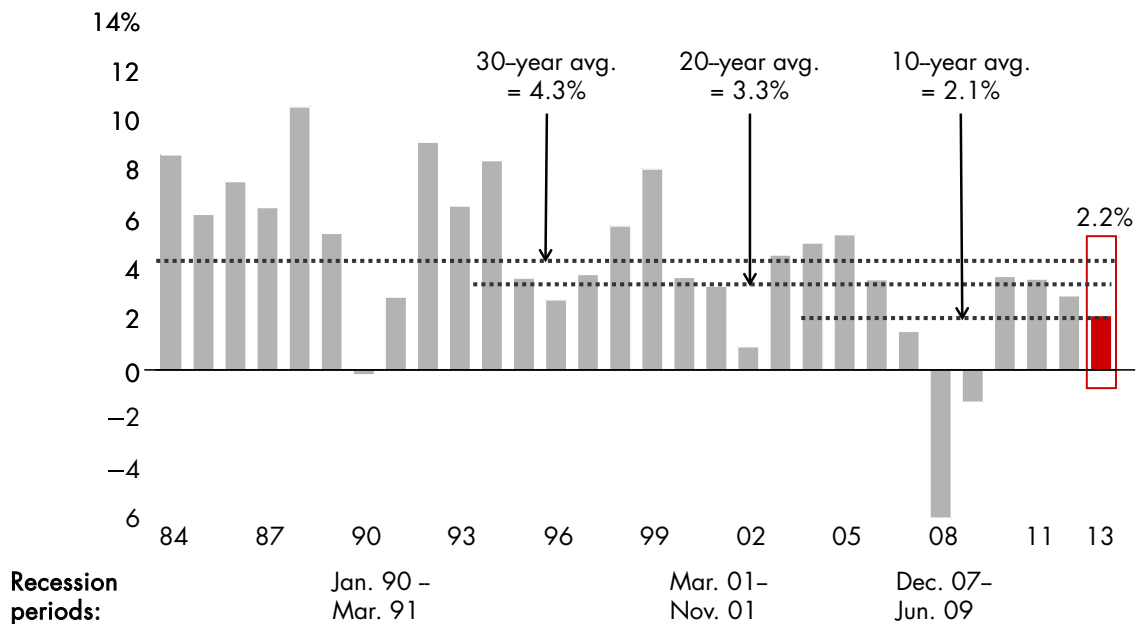[1] See Exhibit 1 in the Appendix for definitions of GAFO and other sales measures.

[2] GAFS data were used to estimate GAFO sales for December.

Figure 1: Holiday season (November and December) omnichannel GAFO growth, 2004–2013

10-year avg.
= 3.2%

5-year avg.
= 3.6%

3.5%

■ E-commerce GAFO
■ GAFO

10%

5

0

−5

10

04 05 06 07 08 09 10 11 12 13

Source: US Census Bureau; Forrester Research

Figure 2: In-store holiday (November and December) GAFO sales growth, 1984–2013

14%

12

10

8

6

4

2

0

−2

−4

6

30–year avg.
= 4.3%

20–year avg.
= 3.3%

10–year avg.
= 2.1%

2.2%

84   87   90   93   96   99   02   05   08   11   13

Recession
periods:

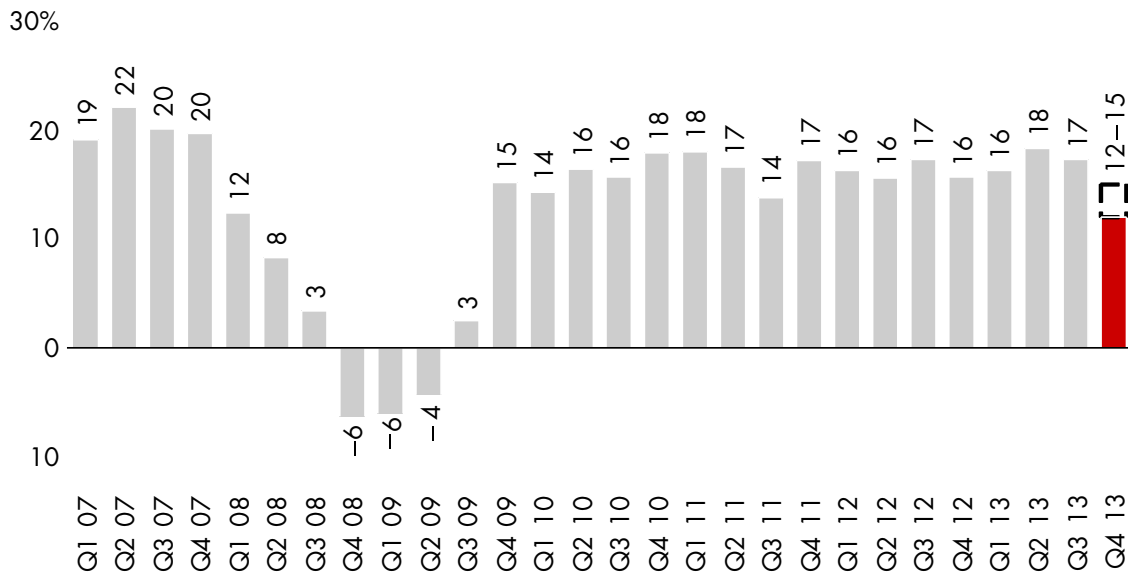Jan. 90 –
Mar. 91

Mar. 01–
Nov. 01

Dec. 07–
Jun. 09

Note: Growth rates are based on the most comparable data available by time; 1984-1992 growth rates are for GAF sales.
Source: US Census Bureau

Source: US Census Bureau; comScore

Growth in digital sales continued to outpace sales growth in stores, albeit at a slower rate than last year. Bain estimates that e-commerce grew by 12% to 15% this holiday season, down from last year's 16% growth *(Figure 3)*. Mobile sales (using smartphones and tablets) led the way. IBM estimates that mobile sales grew as much as 46% this season. That's not surprising considering increases in mobile device penetration: There are now 88 million active tablet users (an increase of 57% from 56 million last year) and 140 million active smartphone users (an increase of 16% from 121 million last year). Many retailers cited the impact of mobile sales during the holiday season. Amazon reported that 50% of its holiday traffic originated from smartphones and tablets, and Walmart reported that more than 50% of its online traffic over the Black Friday weekend came from mobile devices. But even this exceptional growth in mobile sales did not make up for the slowdown in personal computer-based growth, from 14% last year to 10% this year, according to comScore.

Does the deceleration in e-commerce mean that online sales are reaching a plateau? Or is there more to the story? Bain believes the data reflect the continued blurring of retail channels, a function of the push to improve omnichannel experiences. For example, in-store sales were likely fueled by programs that allow customers to order online and pick up in stores, and by price-matching policies to curb "showrooming" (shopping in a store and then buying online at a lower price). Retailers have suggested that digital innovations in stores, from Foot Locker's arming associates with tablets to Burberry's adoption of radio frequency identification (RFID) technology, have also helped grow store sales. ShopperTrak found that while more customers are doing their research online, more are coming into stores to make their purchases. As ShopperTrak founder Bill Martin explained, this behavior has positive implications for retailers: "There's an automatic improvement in shopper-to-associate ratio. The people in the store are in there to buy. The retailers are getting higher conversion rates and higher average transaction sizes."

The blurring of retail channels is also reflected in retailers' accounting policies. As many retailers expanded their "buy online and pick up in store," "buy online and ship from store," and "reserve in store" offerings this year, it becomes more difficult to attribute sales to a specific channel. Bain has seen some retailers treat these as in-store sales, while others count them as online sales. The result: Examining sales by channel is both increasingly difficult and irrelevant. Integrated sales results are what really matter.

New Year's no-regret resolutions

This holiday season highlighted the importance of nine omnichannel resolutions that will help retailers win share in the new year.

Resolution 1: Think big and innovate

Customers' expectations continue to rise, and the only way to ensure a company's long-term success is to find new ways to meet and exceed those expectations before someone else does. By the time Amazon decides to open its own stores or figures out how to make customers' "unrealistic" expectations a reality, it will be too late to play catch-up. Successful retailers must move beyond copying what digital leaders have already done and create entirely new wow moments (see "Retail Holiday Newsletter #4: Digital Darwinism").

Clearly there's risk in doing too little, but there's also risk in trying to do too much at once. Retailers need to balance incremental changes, new platforms, and radical innovations. Although the correct balance in this "portfolio" of innovations depends on the strategic and financial positions of the retailer, Bain has seen that the retailers who are best at innovation quickly test new ideas on a small scale, learning from their missteps and doubling down on their successes. Case in point: Today, Amazon Marketplace generates an estimated $50 billion in third-party sales (and $5 billion of Amazon's revenue), but the company's first forays into a marketplace weren't so successful. From launching and testing auctions, a service meant to compete with eBay, to zShops, its initial attempt at a fixed-price third-party sales platform, Amazon learned how to build the expertise and infrastructure it needed to make Amazon Marketplace a success. Retailers that develop a "test and learn" capability are in the best position to survive and thrive over the long run.

Resolution 2: Enrich mobile experiences

Mobile is more than an alternative channel; it's a new way of living and shopping. And retailers that don't harness the full potential of the technology are going to lose out to more innovative competitors. It's not as simple as creating a killer app. There are lots of platforms (Android versus iOS), devices and screen sizes, and retailers all too often settle for "desktop lite" instead of experiences optimized for specific devices and usage occasions (see "Retail Holiday Newsletter #2: Merry mobile shopping"). Of course new technologies increase development costs, which means choices have to be made. Retailers don't just need a plan for how they will improve customers' mobile experiences, they also need an understanding of how mobile fits with their overall strategies.

Resolution 3: Use advanced analytics to understand the customer (and more)

Big data has been a buzzword for some time, but the full potential of data analytics is only starting to be realized. For example, only with the proliferation of mobile data is it possible to build a holistic view of customers. Apple's iBeacon not only tells a retailer what individual customers are looking at in stores; it also lets retailers send messages to customers at critical times. And Drawbridge and other startups have technologies that allow retailers to track customers' searches and site visits across digital devices. There's more than marketing at stake here: Data analytics can improve the efficacy and efficiency of everything from store site selection to assortment and inventory management to post-sale support.

The question: Are retailers harnessing all the tools at their disposal? Do they know what customers researched online before they came to the store, what they looked at on their mobile device while in the store and what they looked at in-the store but didn't buy? Are retailers using customer data to dynamically change their product assortments, to select new-store locations and formats, and to improve shipping speed? Technologies to do all of this now exist, and the retailers that learn the most about their customers will be the ones who can deliver shopping experiences that stand out from the competition.

Resolution 4: Price intelligently and dynamically to stay competitive

This holiday season underlined the need for a comprehensive pricing strategy. Retailers discounted early and often, and many moved quickly to match competitors' price cuts. These policies may well have scored points with customers initially, but some of those points were lost by frequent stock-outs on popular items. Additionally, there's evidence that some retailers may have discounted too heavily. NPD Group data suggest that Best Buy's promotional activity helped increase its share in a declining market, but the company's US same-store sales still fell 0.9%, and CEO Hubert Joly noted that the increased promotional activity was likely to lead to a drop in margins. Other retailers may not have discounted enough: h.h. gregg largely held off on discounts this holiday season and saw same-store sales drop 11%.

A number of retailers used sophisticated pricing tactics leading up to the holidays. According to 360pi, many retailers actually raised their average prices heading into the Black Friday weekend and limited deals to just a few headline items.[3] But a pricing strategy has to be consistent with a retailer's brand. That's why Jeff Bezos hasn't acted on price-elasticity models that suggest that Amazon should raise its prices. Many retailers also have found it's not wise to change prices too often. When they do, customers stop believing that the retailers offer everyday value and start waiting for better deals, and other customers get angry when they see lower prices for an item they purchased for more. Pricing is a powerful tool, but it works best when it's used as part of an integrated strategy (see "Retail Holiday Newsletter #3: The art and science of pricing").

Resolution 5: Transform the in-store experience

Bain believes that winning retailers must adapt their physical stores to combine the best of both physical and digital shopping experiences. Omnichannel retailers are incorporating technology into their stores in many ways: using tablets to help consumers find products more easily, enhancing product interactions with virtual dressing rooms and communicating with shoppers through RFID tags. Many retailers are also equipping their store associates with digital tools and the training they need to make them even more valuable to customers who are looking to buy. Bonobos, Warby Parker and other "born-digital" retailers also see the value of a physical presence and have opened their own brick-and-mortar showrooms. Successful omnichannel retailers turn a physical store from an expensive liability to a differentiated asset by evolving its role in supporting the shopping experience (see "Retail Holiday Newsletter #4: Digital Darwinism").

Resolution 6: Turn the supply chain into a profitable growth engine

Retailers are realizing that their supply chains can become a source of competitive advantage rather than just a cost center. Flexible fulfillment services—services like "buy online and pick up in store" and "buy online and ship from store"—have gained traction with consumers who want fast and free shipping and an option that doesn't risk an expensive item being delivered when they're not home. Evidence of customers' thirst for fast, free and convenient shipping: Amazon Prime signed up 1 million members the week before Christmas alone (likely for the free two-day shipping); and eBay Now's one-hour-delivery service, which uses couriers to deliver items from retailers' stores, was so successful in trial that the company plans to expand to 21 new cities in 2014.

There are many considerations to weigh when rolling out flexible fulfillment services. They require significant investment, including redesigned store layouts, higher shipping fees and upgraded inventory systems, and reduced associate-customer-facing time. Flexible fulfillment options also raise thorny questions: Should a retailer move toward a single-pool inventory? If so, should the same merchandise be offered in stores and online? How should these assortment decisions be integrated with existing localization efforts? And if a

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[3] A pricing analytics company, 360pi (www.360pi.com) helps retailers make smarter pricing decisions. According to the company, it works with top retailers to enable them to "gain real-time visibility into the market, full awareness of the competitive pricing landscape and the ability to 'right-price' to shoppers, which often leads to revenue uplift and higher margins."

customer wants to return an online order in the store (where it isn't carried), should that be allowed? If it is, what should happen with the stranded inventory? Clearly, omnichannel retailers need to take a number of factors into consideration before they can provide services that please customers without hurting their own bottom lines.

Resolution 7: Maintain the trust and privacy of customers

Learning about customers begins with gaining their trust so that they're willing to share information. Retailers have to be transparent about what information they want to collect from customers, how they intend to use it and how customers will benefit from that use. And then they have to follow through, promptly delivering the benefits they've promised, in the process fostering more customer trust so that customers share even more data. When retailers don't follow this process, they alienate their customers and find it hard to earn their trust again. A cautionary tale: several retailers shut down their first attempts at in-store customer tracking and e-mail targeting after they did not communicate them transparently—they only asked for customers' permission after customers noticed they were being tracked.

Of course, fundamental to maintaining customers' trust is protecting their privacy. This holiday season, a number of well-known retailers suffered security breaches that put sensitive customer information at risk. With global hackers and criminal organizations trolling for customer information, retailers need to invest in robust infrastructure and protocols to guard their most-prized assets—their customers.

Resolution 8: Find the funding for omnichannel investments

Getting omnichannel right demands new investments, and while there's no question those investments pay off, the initial dollars must come from somewhere. Of course every retailer has to determine what tradeoffs make sense in terms of its individual strategy and financial situation, and what cost-cutting methods are most appropriate. Many retailers try to unlock investment dollars by finding more efficient ways to perform business as usual, or by cutting back in ways that customers don't see. A more difficult but potentially stronger solution is to reprioritize by adopting a zero-based strategy that shifts capital and expenses away from old priorities that are no longer delivering a strong return.

Resolution 9: Become a modern retail organization

Developing omnichannel capabilities requires retailers to work differently. Successful retailers will keep these critical points in mind as they position their organizations for the opportunities and challenges ahead:

- **Focus on new decisions:** Bain's experience suggests that omnichannel organizations most commonly face growing pains linked to new decisions in merchandising, planning and allocation, marketing and information technology. As organizations expand their commitment to the omnichannel model, they need to outline the decision-making process and determine both who is best positioned to make these decisions and what input they need from others. From buying and allocating inventory across channels to coordinating digital and traditional marketing campaigns, to transforming IT into a customer-facing differentiator, retailers should expect these questions to arise sooner rather than later.

- **Develop the infrastructure to support new decisions:** Making the right omnichannel decisions requires input from many stakeholders. Bain has seen that leading retailers use integrated processes and systems to facilitate coordination across the organization. For example, they may set up cross-functional and cross-channel working teams (organized around priority customer touchpoints), or they may rethink management dashboards and incentives. Intangibles play a critical role here. Leadership tone and corporate culture can make the difference between thinking differently—being willing to take chances—and defaulting to old ways.

- **Understand the tradeoffs integration requires:** Many retailers focus solely on organizational structure, asking whether functions should be organized by channel or integrated across channels. An

integrated structure can offer a more unified customer experience and reduce duplication of efforts. However, merging digital operations into the organizational structure can be risky. Integrated retailers can be slower to take action and more risk averse, and they may not focus enough on their digital capabilities, particularly when digital is not yet a major driving force of the overall business. Each channel needs sufficient focus and customization to create the optimal customer experience. Again, there's no one right answer. Each retailer must determine the best organization model for its operations based on its strategic goals and maturity level, and realize that the answer may change in the future.

- **Recruit and retain new kinds of talent:** A retailer's success ultimately depends on the talent it's able to attract and retain. For example, does the organization have people who know how to harness the full potential of mobile marketing campaigns? Does it have supply chain experts who know how to load-balance inventory across stores and channels? Does it have a pricing team capable of devising and implementing a well-conceived and competitive pricing strategy? Organizations need to make sure they're not only retaining their stars and offering the right training, but also injecting new talent in ways that keep current members of the organization motivated.

This is the last issue of this season's holiday newsletter series. We hope you've enjoyed following along with us. We look forward to starting 2014's series of holiday newsletters in the fall. As always, we welcome your questions on the content of our newsletters and your perspectives on the state of retail.

Appendix

Exhibit 1: Definitions of retail sales measures

	Omnichannel	Traditional in-store		
	GAFO	GAFO	GAFS	GAF
General merchandise stores	✓	✓	✓	✓
Clothing and clothing accessories stores	✓	✓	✓	✓
Furniture and home furnishings stores	✓	✓	✓	✓
Electronics and appliances stores	✓	✓	✓	
Sporting goods, hobby, book and music stores	✓	✓	✓	
Office supplies, stationery and gift stores	✓	✓		
Online sales in the categories above	✓			
All other retail trade sales not included in GAFO				

Note: Omnichannel GAFO sales include in-store and online sales for both traditional retailers and online-only retailers. In-store GAFO sales do not include sales of online-only retailers or the online sales omnichannel retailers that break out online sales in their reporting. However, in-store GAFO sales may include the online sales of omnichannel retailers that do not report a break-out between their online and offline sales in their census filings.

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