

Retail: Strategic Perspective

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A PwC Strategy & Perspective

Main messages for today



Two “mega segments” in retail – dynamics are different



In **common goods** retailing, competition boils down to “utilitarian” factors such as price, convenience and quality



Historically, **common goods** retail has experienced waves of format invasion: new, more efficient and effective formats replace the old, over the course of a generation or so



View **common goods** retail through that lens: in many common goods sectors, e-commerce is an existential threat -- Those who do not learn from history are doomed to relive it!



Differentiated goods are different: differentiating capabilities are likely to be those that enable end-to-end merchandising: having the right product in the right place at the right time...



...though e-commerce enjoys further advantages, beyond pure cost: inventory management, forecasting etc. is radically simplified, resulting in better sell-through rates and margins



But physical stores will play a role – perhaps increasingly as show rooms supported by a single DTC supply chain

The retail market can be divided into two broad, quite different categories – Common vs Differentiated Goods

Common Goods



Differentiated Goods



Common Goods

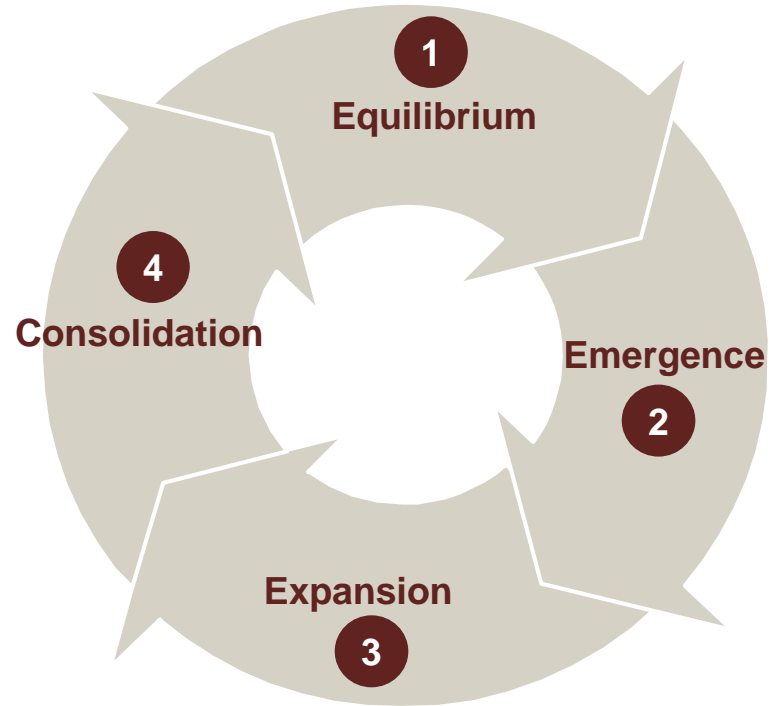
Gray Zone

Differentiated Goods

~60% of retail sales

~40% of retail sales

In common goods, new formats invade – following a consistent cycle

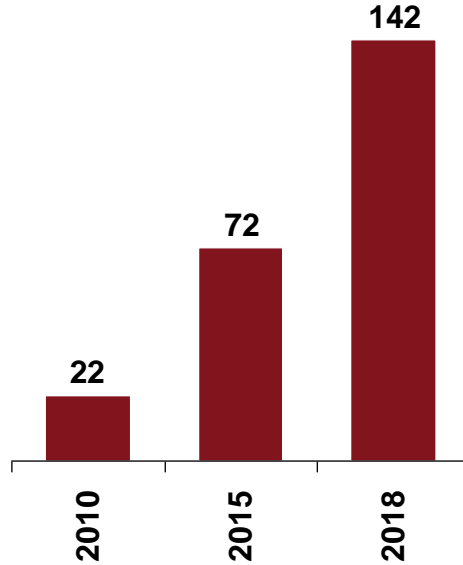


Amazon is just such a format invader

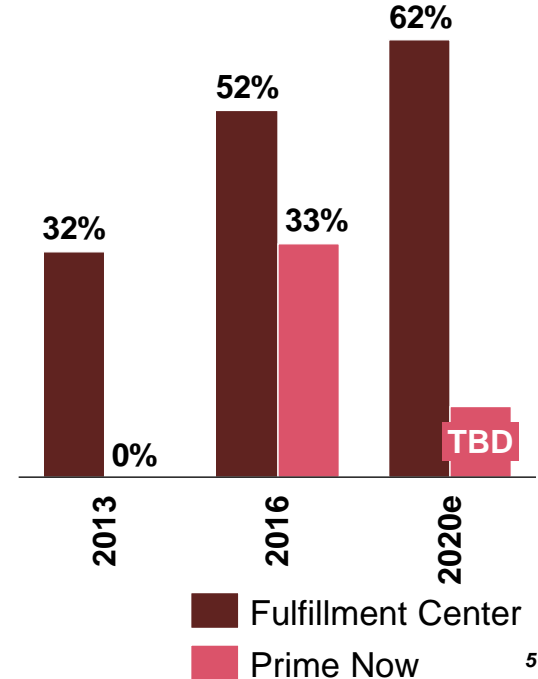


*“They [shoppers] care about having the **lowest prices**, having **vast selection**, so they have choice, and **getting the product fast...**”*

US FC Network
(# facilities)



Next Day/Same Day(?) Reach
(% US Population)



Common Goods: Lessons from history...implications for the future



In the many common-goods sectors, where e-comm has a strong cost/price advantage, retail stores are very challenged



In those cases, most/all investments in existing store formats will very likely be “regret investments” – throwing good money after bad



In particular, investments in “store experience” may actually worsen the store’s cost disadvantage



The role of the “store” will change – few retailers will have the scale to build the necessary dedicated fulfillment infrastructure, so leveraging stores for e-comm fulfillment may be the only way to compete with Amazon on cost and speed

*In common goods
the new format
often (**always?**)
entirely replaces
the old.*



In differentiated goods, consumers are:



Much less certain what they are looking for: only about 30% of shoppers entering the store buy anything on that occasion



Less “educated” or familiar with the products – so they may feel a need to see, touch, try-on the product



Potentially susceptible to a sales pitch – many of these goods are “SOLD not BOUGHT”



Less price sensitive between competing products and outlets (since the products are less easy to compare directly) – so contribution margins are higher



More valuable: incremental transactions are usually significantly more valuable, so it makes sense to invest in “consumer experience” to attract and convert customers

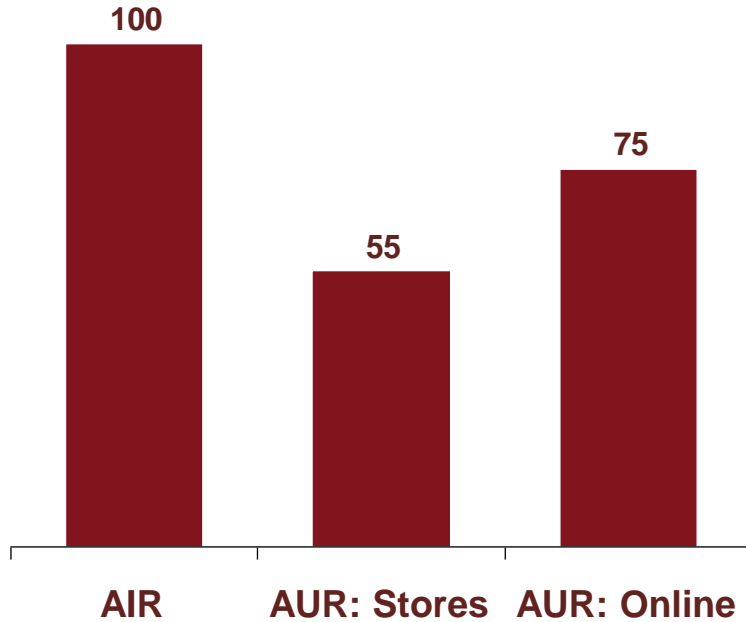


More fickle: tastes and needs change quite quickly so having the right merchandize in the right place at the right time is both a lot harder – involving existential career bets by merchants – and critical

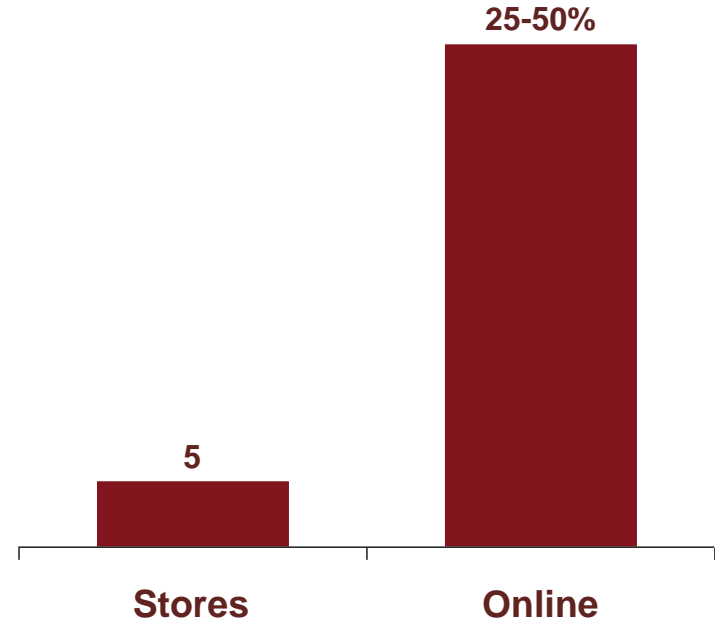
E-commerce has structurally lower markdowns – offsetting potentially significantly higher return rates...

Initial and Average Pricing

Indexed

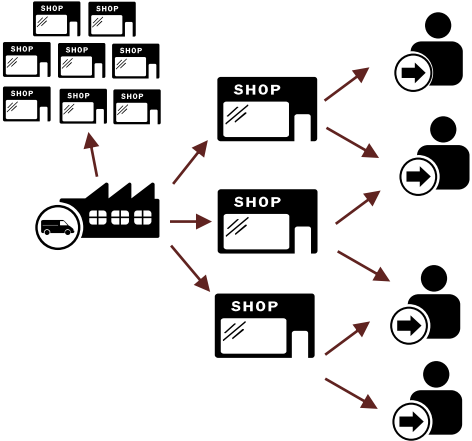


Returns Rate



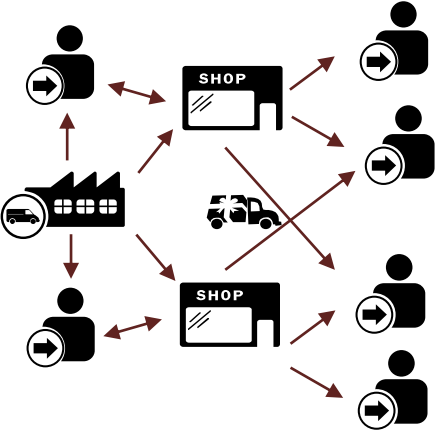
...driven by supply chain architecture and inventory management

**Mono-channel
Brick and Mortar**



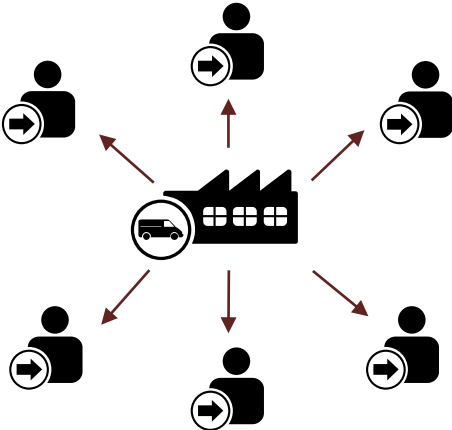
Numerous inventory pools

**Omni-channel – with
ship from store**



Numerous inventory pools with
rebalancing

**Mono-channel
E-commerce**



Single / very few inventory pools

For some differentiated goods sectors, showrooms may offer the best of both worlds

- Intercept customer foot traffic in the traditional way – convenient locations and eye-catching displays
- A very limited amount of inventory is shipped to the “store” – the vast majority is kept pooled in a central location
- Consumers are able to touch, try-on the merchandize, driving down returns to typical brick and mortar levels
- Wrap around a pleasant browsing experience – conducive to conversion
- Sales associates have the opportunity to upsell and cross sell – building the basket and improving shipping economics
- Radically simplifies operations – no need to have two supply chains – one for stores and one for consumers’ homes

Bonobos is leading the way in apparel



Differentiated goods: Key takeaways

- In differentiated goods stores will likely always have a role – some segment of consumers will always want to “touch and feel” and – let’s face it, this is “retail therapy”
- But the economics of online retailing are still compelling – so retailers must capture them
- Leverage e-comm’s tendency to pool inventory, reducing expected and actual markdown...
- ...and its rich data stream to improve forecasting accuracy
- Showrooms as a means to enjoy the best of both worlds -- a high touch consumer experience without stranding inventory
- Give consumers what they want: great products, great experience, great prices

Thank you



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