Retail in the 21st Century

What Value Does the Brick and Mortar Store Still Have in an Online World

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Executive Summary

New technologies and innovations are constantly threatening the way established industries operate. In the last twenty years, countless industries – from music to sports to print news – have either successfully learned how to adapt to the new world or perished trying to do business as usual. With the rise of Amazon and other price-focused e-commerce sites, there has been much speculation on the future of the retail store. Is the decline of Border’s, Circuit City, and RadioShack a foreshadowing of what is to come for all brick and mortar stores alike? Will consumers completely abandon shopping malls, shopping centers, and their retail stores for pure-play (online only) retailers?

Whether a business is a traditional retailer or an up-and-coming e-commerce startup, being wherever shoppers are – which typically spans online and offline – and creating a unified consumer experience across these different channels (e.g., online, social, mobile, in-store) is critical to staying relevant and competitive. An effective omnichannel\(^1\) solution should be driven by where shoppers are, convey and deliver a retailer’s value proposition, and be adaptable to future technology and innovation changes.

From examining how traditional retail was disrupted by the internet and what the current options are for adapting and innovating, the lessons from this paper are applicable to any industry, as all industries face similar disturbance from innovation. Additionally, during a time when more and more of our interactions take place virtually, understanding what value real physical presence has may be critical to solving problems in a hybrid real-digital era.

\(^1\) Omnichannel (or multichannel) retailing is the use of a variety of channels in creating a customer’s shopping experience.
Introduction

New technologies and innovations are constantly threatening the way established industries operate. In the last twenty years, countless industries – from music to sports to print news – have either successfully learned how to adapt to the new world or perished trying to do business as usual. With the rise of Amazon and other price-focused e-commerce sites, there has been much speculation on the future of the retail store. Is the decline of Border’s, Circuit City, and RadioShack a foreshadowing of what is to come for all brick and mortar stores alike? Will consumers completely abandon shopping malls, shopping centers, and their retail stores for pure-play (online only) retailers?

This white paper examines three questions: i) what is the current state of the retail industry; ii) what does the brick and mortar store still offer in an increasingly digital world; and iii) what are some solutions and opportunities presented by the changes in consumer expectations?

The Current State of the Retail Industry

Department stores and big box retailers rose to popularity in the twentieth century by offering shoppers variety, affordability, and convenience. In the last two decades, Amazon has disrupted traditional retail by further improving on price and convenience (e.g., one-click buying and two-day shipping) and led the way for other e-commerce sites to do the same. As once seemingly invincible retail chains shutter stores across the country, the remaining players are experiencing an existential crisis and wondering what it means to still be a brick and mortar retailer in the digital age.

Though there is reason for retail chains to be concerned, the numbers are misleading. While e-commerce has been growing at a faster rate than retail stores (17% compared to 3.5%), it is starting from a much smaller figure. In absolute numbers, physical retail stores are still the channel where the majority of shopping takes place. In 2013, U.S. in-store sales totaled $4.3T, whereas online retail sales only accounted for $263B (6% of total sales). Furthermore, 95% of U.S. retail sales was transacted with retailers with physical stores and only 5% was with pure-play online retailers.

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Figure 1 – Total U.S. retail sales (2013)

Brick and mortar stores are still a significant channel, but as behaviors and expectations change with technology, traditional retailers know they cannot fully capture the market opportunity if they do not adapt. Unfortunately, retailers are at a loss for what to do in the new landscape of online, social media, mobile, and in-store technologies. First, they lack a way to measure how much their stores contribute to net sales versus their online channels. For example, though a purchase may have taken place online, the shopper may have checked out the item at a store and then decided to order it online to avoid carrying the product home. As a result, these retailers may be broadly underestimating the value of its retail stores.

CURRENT SHOPPER BEHAVIOR AND EXPECTATIONS

71% of consumers expect to see in-store inventory online
39% of shoppers will not visit a retailer’s store, if its website does not provide store inventory
50% of shoppers expect to be able to buy online and pick up in-store

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Furthermore, brick and mortar businesses face additional issues to adapting to consumers’ new preferences including i) building buy-in within the organization to invest in new IT, ii) integrating new software tools with legacy software, and iii) creating an inventory management and tracking process that provides real-time inventory data to both employees and customers.  

**The Value and Role of Stores in the Digital Age**

As retail chains struggle to keep up with e-commerce competitors and have closed retail locations across the country, it is surprising and counterintuitive to see pure-play online retailers expand into brick and mortar. In the last few years, many e-commerce companies, from established to up-and-coming startups, have opened pop-up shops and stores, including Amazon, eBay, Warby Parker, Bonobos, Etsy, and Birchbox.

While at first it may be surprising, the rationale to invest in physical stores is borne out in the data. A great majority of shoppers still prefer visiting physical stores to shopping online across almost all categories. (Figure 2) On average, shoppers spend more time per shopping trip and more per purchase in stores than online. After factoring in returns, omnichannel retailers enjoy 95% net sale compared with pure-play e-tailers’ 77% net sale. (Figure 3)


7 Forrester Consulting, “Customer Desires Vs. Retailer Capabilities: Minding The OmniChannel Commerce Gap”.


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**MAJORITY OF RETAILERS ARE STRUGGLING TO ADAPT**

Only a third of retailers have operationalized the basics, such as store pickup, cross-channel inventory visibility, and store-based fulfillment

Only 6% of retailers reported no significant barriers to becoming an omnichannel business
When an e-commerce retailer opens up a brick and mortar store, they are reinforcing their brand and being top of consumers’ minds. After opening a physical store, not only...

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9 International Council of Shopping Centers, “Brick and Mortar Is the Dominant Format”.

10 International Council of Shopping Centers, “Brick and Mortar Is the Dominant Format”.

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do e-commerce retailers’ total sales increase but so do their online sales. Wharton marketing professor David Bell studied two comparable cities with Warby Parker customers, one with a showroom and one without. He saw total sales increase by 9% in the city with a showroom and online purchases lift by 3% among shoppers in that city as well. The old thinking went that opening a new channel would cannibalize the sales for existing channels. However, the evidence shows that the effect of multichannel retailing is synergistic.

Warby Parker, a “Pure-Play” Case Study

Founded in January 2010, Warby Parker is an e-commerce startup that designs and sells eyeglasses and sunglasses. It started off as a pure-play retailer and generated much buzz with its innovative online try-on feature and unique business model sending shoppers five pairs of glasses to try on at home for five days completely free of charge. In 2011, it began partnering with boutiques to have Warby Parker kiosks in stores. In 2013, the startup opened nine of its own brick and mortar stores across the U.S. Most recently, in April 2015, Warby Parker raised $100M in venture capital financing to expand its physical presence from 12 stores to 20 as well as invest in technology that helps customers conduct eye exams on their mobile phones.

Warby Parker currently has two types of physical stores: showrooms (kiosks within boutiques) and its own standalone stores. The services the company provides at these locations includes full collection try-on, same-day purchases for nonprescription glasses, optical measurements, frame adjustment, returns and exchanges, next-day delivery, and on-site optometrist / optician. Its standalone stores offer most of these services if not all of them, while its showrooms tend to only have a handful. Each location has its own distinct look catering to the neighborhood it is in and to what resonates with local residents. For example, the flagship store in New York City resembles the New York

“Warby Parker has raised $100 million to expand physical store locations from 12 to 20 by year’s end…”

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12 “When Does the ‘Human Touch’ Matter in Retail?”, Knowledge at Wharton.

13 Jose L Nueno, “The Decline of Main Street, the Rise of Multichannel Retail”, ISEEinsight, Fourth Quarter 2013.


Public Library and is outfitted with brass lamps, rolling ladders, and classic books.¹⁶ (Figure 4) Meanwhile, the Warby Parker store in Venice Beach looks like a 1950s beach club with sea blue walls, ceilings, and tables.¹⁷ (Figure 5)

For the Warby Parker co-founders and co-CEOs David Gilboa and Neil Blumenthal, “the future of retail is at the intersection of bricks-and-mortar and e-commerce.”¹⁸ On the eve of opening their Venice Beach store in March 2015, Gilboa explained to Fast Company, “When we launched, a lot of people bucketed us as an e-commerce company, but we never thought of ourselves as an e-commerce company. And I think it surprised a lot of people when we started opening these stores. The only products we sell now are glasses, but we think our brand can stand for much more than that over a long time period.”

For Warby Parker, the impetus for expanding from pure-play into offline is to build and strengthen its conscientiously crafted lifestyle brand. In 2013, Blumenthal described the value of opening and having physical stores: “It is really an opportunity for us to showcase the brand and to have our customers experience it live. We can create really special experiences online, but there’s nothing quite like walking into a physical space, a world we’ve created. To some extent these stores can be considered a form of marketing and customer acquisition.”¹⁹

The results speak for themselves. Warby Parker stores sell an average of $3,000 per square foot annually, which is higher than most retailers except Apple Inc. The first stores generated enough profits to recoup investment costs after a year, when the average payback in retail is two years. Not only are Warby Parker’s stores profitable on a standalone basis, they also drive sales broadly. Gilboa observed this trend, “We quickly realized that while we were seeing all the benefits we expected from branding and marketing—the ‘halo’ effect of having a store open—stores could be a meaningful driver of sales and profitability, which was really unexpected.”²⁰


¹⁹ Tschorn, “Warby Parker Broadens Its Focus to Include Physical Stores”.

Figure 4 – Warby Parker Soho store page

Source: Warby Parker company website

Figure 5 – Warby Parker Venice Beach store page

Source: Warby Parker company website

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Bonobos, Another “Pure-Play” Example

Warby Parker is just one example of many pure-play retailers who have decided to move into the offline world. Bonobos, another e-commerce startup darling, started experimenting with physical stores around the same time as Warby Parker. Founded in June 2007, Bonobos made its name in great-fitting pants for men. Initially, the company wrote off ever going offline. In 2011, Bonobos decided to grow its offering to include shirts, but found that none of its customers were buying the shirts or even looking at them online. The startup decided to try an experiment and opened up the lobby of its headquarters with some fitting rooms to see if customers would want to try on the shirts. What Bonobos found from the experiment was that sales increased for its shirts as well as its pants. The company also discovered that these customers did not want instant gratification and would spend hundreds to thousands of dollars at a time and receive the product a day or two later in the mail.23

Bonobos currently has sixteen retail locations and plans to reach 40 locations by 2016. Unlike Warby Parker, Bonobos’ stores, called “guideshops”, offer a full selection of merchandise for customers to try on but do not carry any inventory. Customers make an appointment to visit a store. When at the store, stylists, called “guides”, walk customers through the Bonobos line, help them find the right fit, and place the order online and have the products sent directly to customers’ homes.24

Going offline provided Bonobos a way to really delight its customers with superior customer service and allow them to feel and try on Bonobos clothing. While many believe that e-commerce is the way of the future, Bonobos realized that the disadvantage of being a pure-play brand is greater than the advantage of having lower overhead. Specifically, for online-only brands, cost of customer acquisition is high and customer lifetime value is low. Bonobos guideshops are not the biggest acquisition channel for the company but they do significantly increase customer lifetime value by allowing customers to experience the Bonobos brand, quality, and customer service. Thus far, its retail locations have driven sales and growth. The

“Bonobos won’t win because of ecommerce, but in spite of being ecommerce.” – Andy Dunn


average order at a guideshop is $300, compared to the average online order of $180. The guideshops are profitable and have one of the highest sales per square foot in the industry. In July 2014, Bonobos raised $55M in venture capital financing on top of the $70M it raised earlier to further expand its physical presence around the country.25

It is easy to look at iconic retailers – such as the aforementioned Border’s, Circuit City, and RadioShack – struggling and think that it is only a matter of time before all brick-and-mortar retailers fold under the competition of online retailers. However, early on, Amazon trained online shoppers to look for discounts and convenience, with little regard to brand loyalty. As a result, pure-play retailers are vulnerable to the whimsy of online consumers and may be in vogue one day, but forgotten the next. Some of the hottest e-commerce startups have only stumbled upon this realization too late. While the internet provides a low-cost platform to launch a business, physical locations remain a cost-effective way to build a profitable, differentiated brand and higher customer lifetime value. And the data corroborates this – a majority of shoppers still want to shop in store; 95% of all shopping happens with retailers with physical locations; shoppers spend more time and money per shopping trip at stores versus online; and both online and offline sales lift when a retailer opens a new retail location.

Solutions and Opportunities

Though physical stores are still a critical channel going forward, consumer behaviors and expectations are changing and traditional retailers are struggling to keep pace. First, shoppers now demand the ability to search for and purchase products anywhere they are – online, mobile, in store. They also want to buy and pick up or return in any of those locations and to be able to mix and match (e.g., buy online, pick up in store). Lastly, consumers expect the experience to be congruous between the different channels. What shoppers are asking for is omnichannel retailing.

Currently, most traditional retailers do not have the IT capability to deliver on shopper’s new expectations. The main issues facing these brick-and-mortar retailers are i) building buy-in within the organization to invest in new IT, ii) successfully integrating new software tools with existing ones, and iii) creating an inventory management and tracking process that provides real-time inventory data to both employees and customers.

Traditional retailers have been in the business of creating experiences through physical stores and understand that very well. With omnichannel, these retailers now have to translate the brand and the same experiences using new media. That is a difficult task.

for anyone to tackle, not to mention the retail industry which has a technophobic culture.26

Each solution will be different for each retailer. In crafting a solution, retailers should identify metrics they will use to measure success, understand how their target shopper shops, and lay out what a uniform brand experience would look like across the different channels. Therefore, an effective omnichannel solution is driven by where shoppers are, should compellingly convey and deliver companies’ value proposition, and be flexible to future changes and innovations.

One of the reasons why traditional retailers are having trouble adapting is because the IT problems they face are largely unaddressed by the market. The upside is that it presents an opportunity for businesses and startups to come in and provide meaningful solutions to hundreds of traditional retailers. The three opportunities that stand out are i) a solution that integrates new and legacy software and data for retailers, ii) a dynamic inventory management and communication software that can deliver real-time inventory information to both employees and shoppers, and iii) a unified commerce platform across the different channels.27

Conclusion

Retail is at the beginning of a colossal change that will unfold over years. Consumers are ahead of businesses, demanding information, convenience, and unique experiences everywhere they are. Real, physical shops are a key asset for retailers to differentiate their brand and develop long-lasting relationships with customers. For traditional retailers who already have retail locations, becoming an effective omnichannel retailer should be the highest priority. In order to do so, brick-and-mortar retailers should consider how their target shopper shops, how to deliver a congruent experience and brand message across channels, and how to garner the necessary buy-in within the organization to create and execute an omnichannel initiative.

Consumers are eager to spend and are waiting to be delighted. The market opportunity – for retailers and retail software companies – is huge. Traditional retailers, don’t be afraid – know your brand, follow your customer, and be open to change.


Sources


Nueno, Jose L. “The Decline of Main Street, the Rise of Multichannel Retail”. ISEInsight, Fourth Quarter 2013, Issue 19.


