mastercard

BRICK-AND-MORTAR RETAILERS FIGHT BACK

Winning Strategies to Compete with Online-Only Players

Written by

The Economist Intelligence Unit

HOW ONLINE COMPETITION IS SHAPING RETAILERS' IN-STORE STRATEGIES

Written by The Economist Intelligence Unit

KEY FINDINGS

Growing competition from e-commerce giants is forcing traditional retailers to modify their in-store experience. This report, based on a global survey of 256 retail executives, reveals the most common strategies retailers are adopting in their fight against online competition.

75%

Increasing online investment

Traditional retailers are facing online competition head-on, with three-quarters of respondents (75%) reporting that they have increased their investment in online channels.

70%

Empowering employees

The most common in-store response to online competition is to train employees to be more knowledgeable, with 70% of respondents having done so. Almost as popular is training them to be more customer service-focused (58%).

68%

Growing product selection

The majority of retailers have responded to the infinite inventory of the internet by expanding their product selection: 68% have grown their in-store assortment.

54%

Introducing loyalty programmes

In a bid to deepen their customer insight, more than half of respondents (54%) have introduced loyalty programmes, and a further 24% plan to do so in the future.

44%

Lowering prices

In response to price pressure from online-only rivals, 44% of respondents have cut prices, and 12% plan to do so in the coming years. Among the retailers who have closed stores but successfully recouped revenue, almost three-quarters (72%) implemented price cuts.

The rise of online-only competitors has left its scars on traditional retailers: six out of ten respondent companies have closed stores in the past three years. But as this report reveals, there now exists a playbook of strategies that retailers can use to turn the tables.

INTRODUCTION

The retail sector has felt the disruptive impact of the internet more than most industries. Ever since the launch of Amazon.com in 1994, online retailers have relentlessly challenged traditional retailers on price, product selection, and the shopping experience they provide to customers.

So far, however, predictions of the death of "brick-and-mortar" retail have been unfounded. Instead, the rise of online-only commerce has challenged conventional retailers to adapt their offering. Many have failed to live up to that challenge, including some high-profile brands, but others have risen to the occasion. Some have reacted to online competition by closing physical stores, but others are attempting to reinvent them for the digital age.

To find out how, The Economist Intelligence Unit surveyed 256 retail executives based in the United States, the United Kingdom, France, Germany, and Japan. This report reveals which strategies they have adopted in response to online-only competition and what tactics they plan to adopt in the near future.

A LITTLE UNDER HALF OF RESPONDENTS (47%) SAY THEY FACE "SIGNIFICANT" COMPETITION FROM ONLINE-ONLY RIVALS, WITH A FURTHER 37% FACING "MODERATE" COMPETITION.

The survey shows that retailers are acutely aware of the competitive threat from e-commerce sites. A little under half of respondents (47%) say they face "significant" competition from online-only rivals, with a further 37% facing "moderate" competition. Amazon.com is the dominant source of such competition, as identified by 42% of respondents, followed by eBay with 14%. Pricing, delivery speed and cost, and marketing and brand recognition are the chief competitive strengths of such companies, they say.

This competition has taken its toll on retailers' physical stores. Six in ten respondents have closed stores in response to online competition in the past three years. Of those who have closed stores, fewer than one-third have been able to recoup more than 25% of their lost in-store sales through online channels.

But as this report reveals, retailers are not taking the threat lying down. Respondents are modifying various dimensions of the in-store experience to meet it head-on.

PRICING

The pricing which e-commerce providers offer presents the greatest competitive risk, according to 39% of survey respondents—the most frequently cited answer. The most common pricing-related response to online-only competition has been to drop in-store prices, with 44% of respondents saying that they have done so in the past three years. A further 12% have not yet dropped in-store prices but plan to do so in the next three years. Among the retailers that have closed stores but successfully recouped more than 25% of revenue, 72% have reduced prices.

Various forms of price matching have also proved popular. More than seven in ten (71%) respondents have introduced some variety of price matching, whether by default, on request, or in certain circumstances, and around one-third plan to do so in the next 2-3 years. This is an example of traditional retailers turning their face-to-face customer engagement—and the discretion of their employees—to their advantage.

29%

JUST UNDER THREE IN TEN RESPONDENTS (29%) COUNT MARKETING AND BRANDING AMONG ONLINE-ONLY RETAILERS' CHIEF COMPETITIVE STRENGTHS.

MARKETING

Just under three in ten respondents (29%) count marketing and branding among online-only retailers' chief competitive strengths. Here, again, e-commerce firms have some advantages: their online operations act as an exhaustive record of customers' shopping habits that can inform marketing activities, which is harder to create for offline and omnichannel retail.

Loyalty programmes are one way to do this, as they allow retailers to assess the habits of individual customers. More than half (54%) of survey respondents have introduced such programmes, and nearly one-quarter (24%) plan to do so in the next 2-3 years. Meanwhile, those retailers who closed stores but recouped more than 25% of lost sales online are more likely to have expanded their loyalty programmes than those who recovered less revenue (54% versus 37%).

Retailers who view Amazon.com as their main source of competition are also more likely to have expanded their loyalty programmes (55% versus 40%). A greater proportion of these companies also plan to introduce the ability to track individual customers' activity across channels (40% versus 26%).

IN-STORE EXPERIENCE

E-commerce providers have typically set the pace for the online customer experience, using their insight into buyer behaviour to create websites, apps, and other digital channels that customers enjoy interacting with. Indeed, customer experience is seen as one of the strongest competitive advantages of online-only retailers, cited by 27% of survey respondents. The in-store experience, therefore, is top of mind for traditional retailers seeking to tempt buyers back into their stores.

In recent years retailers have rightly focused on what distinguishes their stores most specifically from standalone websites, namely their employees. The survey shows that nearly three-quarters (70%) of retailers have trained their staff to become more knowledgeable, and 58% have trained them to be more focused on customer service. This focus on staff knowledge is more common among companies which have not been forced by online competition to close stores (75%) and those which have closed stores but recouped more than 25% of lost revenue with online sales (73%). Six out of ten respondents (60%) say they have increased staffing in-store, bolstering the case for traditional retailers that personal interaction is their best defence against online competition.

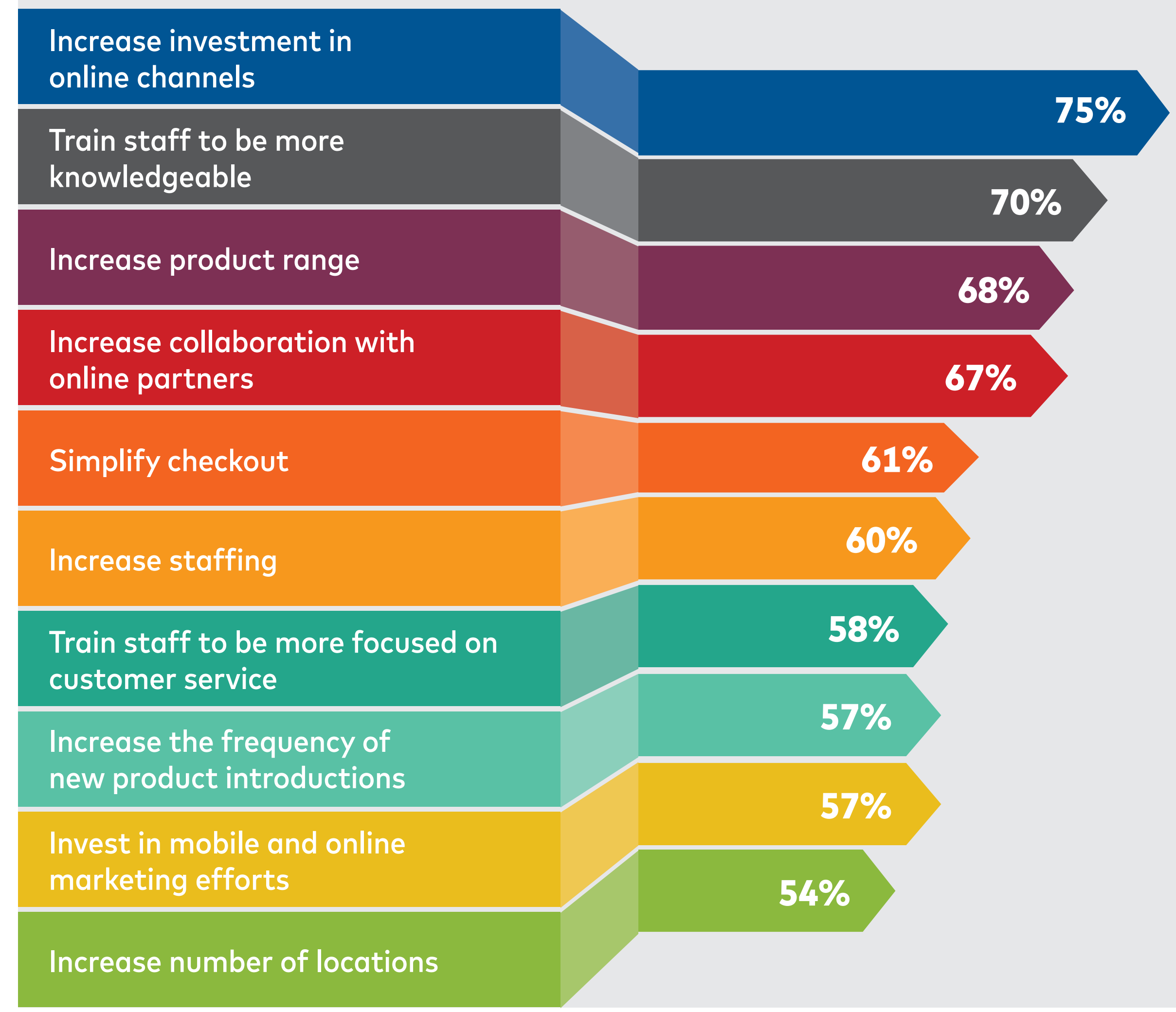
CUSTOMER EXPERIENCE IS SEEN AS ONE OF THE STRONGEST COMPETITIVE ADVANTAGES OF ONLINE-ONLY RETAILERS, CITED BY 27% OF SURVEY RESPONDENTS.

Comparatively fewer respondents have merged the online and offline experience through offering "click-and-collect" services (39%) or the ability to place online orders in-store (also 39%). Respondents who view Amazon.com as their chief online competitor are more likely to have adopted click-and-collect than others (44% versus 36%).

PRODUCT SELECTION

Perhaps surprisingly, fewer respondents rank product selection among their online rivals' greatest competitive strengths than any other (21%).

Top 10 Responses to Online Competition
(Percent of respondents)



This may be because they have already responded to this particular competitive threat: 68% of respondents say they have increased their product selection in response to online competition. This proportion is especially high among companies which did not close any stores in the past three years (80%). Similarly, 57% of respondents say they increased the frequency of new product introductions.

Beside the sheer range of products, the survey also reveals a trend towards more localised selection and more bespoke products. Some 45% of respondents are offering a more localised selection of products in-store in response to online competition, and a further 33% intend to do so in the next three years. A similar proportion has introduced bespoke or customisable products (43%) or plans to do so (33%). This again shows that traditional retailers are playing to their strengths: the region-specific insight that a good area manager develops can be used to counter the analytical capabilities of e-commerce providers, while the depth of customer interactions that are possible in person can be used as the basis for customisation.

THE STORE OF THE FUTURE

54%

LOYALTY FOCUS

In a bid to deepen their customer insight, more than half of respondents (54%) have introduced loyalty programmes, and a further 24% plan to do so in the future.

39%

IN-STORE ONLINE ORDERS

39% of respondents have introduced the ability to place online orders in-store.

68%

IN-STORE ASSORTMENT

68% of respondents have grown their in-store assortment.

45%

LOCALISED SELECTION

Some 45% of respondents are offering a more localised selection of products in-store in response to online competition.

80%

IN-STORE DEMOS & EVENTS

80% of respondents have either already introduced space for in-store demos and events or plan to do so in the next 2-3 years.

39%

CLICK-AND-COLLECT

39% of respondents have merged the online and offline experience through offering click-and-collect services.

70%

EMPLOYEE EMPOWERMENT

70% of retailers have trained their staff to become more knowledgeable and 58% have trained them to be more focused on customer service. Further, 60% say they have increased staffing in-store.

44%

PRICE CUTS

In response to price pressure from online-only rivals, 44% of respondents have cut prices, and 12% plan to do so in the coming years. Among the retailers that have closed stores but successfully recouped more than 25% of revenue, 72% have reduced prices.

AFTER STORE CLOSURES, RETAILERS WHO HAVE MERGED THEIR ONLINE AND OFFLINE CHANNELS (45%) HAVE RECOUPED MORE REVENUE THAN THOSE THAT HAVE NOT (27%).

STORE LOCATION

Online competition has challenged traditional retailers to rethink their property portfolio strategies radically. This much is evident from the fact that although six out of ten respondents have closed stores as a result of online competition, 54% have nevertheless increased their total number of stores. Only 21% have reduced overall store numbers.

This finding suggests that retailers' priorities regarding market presence and store location are shifting in response to e-commerce. Indeed, 51% of survey respondents say they have prioritised stores in higher-value markets. Interestingly, this strategy is more common among respondents who have not closed any stores (59%). Just under three out of ten respondents (29%) plan to pursue this strategy in the future.

Meanwhile, within markets, retailers seem to be deprioritising prime retail locations: 43% of respondents say they have moved to secondary locations (i.e., sites that are somewhat removed from high-streets and other concentrated retail zones), and 33% plan to do so in the future. One interpretation of this is that as digital channels become the primary channel of engagement with customers, a high-street presence—and the footfall it brings—is becoming a less important consideration, even for traditional retailers.

ONLINE STRATEGY

Of course, traditional retailers' response to online competition is not limited to their physical stores. Three-quarters (75%) of survey respondents have increased their investment in online channels in response to competition from e-commerce sites. A similarly high proportion (67%) have increased their collaboration with online partners.
Nevertheless, more than one in five respondents (24%) plan to reduce their investment in online channels in the next 2-3 years. This may suggest that for some retailers, a transformational period of heavy online investment is coming to a close, or that these firms are retreating from online competition to focus on their physical stores.

Online and offline retail may be very different, but retail companies which employ both should view them as two facets of a single system. The survey suggests limited adoption of this mindset, however: only 40% of respondents have merged online and offline channels, although a further 34% plan to do so. Retailers who have merged their online and offline channels (45%) have recouped more revenue after store closures than those that have not merged channels (27%).

DECISION-MAKING

The survey also investigated the factors that influence retailers' decision-making as they fight back against online competition. Unsurprisingly, they are most likely to be driven by their customers and competitors. Nearly four in ten (39%) say they make decisions on how to respond to online-only competition based on consumer surveys, and 35% base their decisions on what their competitors are doing. Companies which have successfully withstood online-only competition—those which have not been forced to close stores or those which have recouped more than 25% of lost revenue after they did—are more likely to draw on focus groups than other firms. This suggests a willingness to pursue deeper, more personal customer insights than can easily be revealed through customer surveys.

Top 10 Plans to Compete with Online-Only Players

(Based on percent of respondents)

1. Refresh brand to appear more contemporary / digital
2. Offer space for in-store demos and events
3. Sublet in-store space to other retailers
4. Introduce price matching by default
5. Merge online and offline channels
6. Redesign display windows / storefront
7. Move to secondary locations
8. Shift focus onto higher-value customers
9. Augment in-store assortment with online catalogue
10. Introduce bespoke / customisable products

So far, however, retailers have not adopted more sophisticated methods. Only 9% draw on academic research, and just 14% apply scientific testing.

Retailers are keenly aware that their industry is in a state of flux. They know that to stay in business, they must be in touch with both shifts in customer needs and the competitive environment, as illustrated by their focus on competitor actions and consumer surveys. Our survey shows that there are two ways in which retailers are responding to increasing competitive incursions from online-only players. First, they are minimising the competitive advantage of online-only retailers. This can be seen in the adoption of strategies such as increasing product selection, reducing prices, and expanding loyalty programmes to better understand customer behaviour.

The second, and arguably more strategic, reaction is to emphasise the unique strengths of the in-store shopping experience. The clearest example of this is the surprising popularity of staff training and recruitment. E-commerce companies are experimenting with automated systems that mimic the experience offered by a human shop assistant, although this approach has not yet been widely adopted. This demonstrates that customers value the knowledge and conversational engagement that brick-and-mortar stores offer, and that retailers are right to invest in this area.

A third approach, which is less evident among survey respondents and should be given greater consideration, is the creation of new, merged retail experiences that are only possible by combining online and offline channels. So far, these experiences remain mostly a work in progress. But with the giants of e-commerce beginning to stake their claim on brick-and-mortar retail, the need for conventional retailers to define their omnichannel strategy is becoming increasingly urgent.

Here ends the section of the report written by The Economist Intelligence Unit.

US

HOW US RETAILERS CAN SURVIVE AND THRIVE

Written by APT, a Mastercard company

SNAPSHOT SUMMARY

In this section of the report, written and based on analysis by APT, a Mastercard company, we examine US retailers' responses as they strive to fight back against online-only competition and the effectiveness of different strategies.

We also outline four strategies that every brick-and-mortar retailer must adopt in order to maintain market share in today's increasingly competitive retail environment:

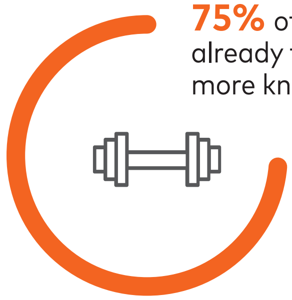
- Make Your Store Associates Core to the In-Store Experience
- Use Customer Insights to Drive Incremental Profits, Not Just Offer Promotions
- Take a Surgical Approach to Store Closures and Remodels
- Focus on Measuring Everything Across Channels

In the US, the majority of respondents (56%) say that they face significant competition from online-only retailers—a higher percentage than global respondents (47%). Further, 44% of US respondents indicate that Amazon is their biggest source of online-only competition. While 37% of respondents cite quality, another 37% cite pricing as the attributes of their top online-only competitor that create the greatest competitive risk. 31% say that product selection and delivery speed present the greatest risk.

When it comes to the toll online-only competition is taking on US retail, nearly two-thirds (64%) of respondents said they have closed one or more stores in the past three years as a result of this competition. Yet, of the US retailers that have closed one or more stores as a result of online competition in the past three years, only 31% have successfully recouped more than a quarter of their revenue through online channels.

MAKE YOUR STORE ASSOCIATES CORE TO THE IN-STORE EXPERIENCE

Overall, US retailers have focused on enhancing the in-store customer experience by capitalising on the advantage of face-to-face customer interactions. These efforts are primarily concentrated on increasing staff training:



75% of respondents have already trained staff to be more knowledgeable

61% have trained staff to be more focused on customer service

In retail, investing in staff training has always been an important ingredient in the recipe for a successful business, but with the rise of e-commerce, high-quality, face-to-face customer service is a critical differentiator for the in-store versus online experience. For retailers today, optimising personnel decisions and human resources investments is integral to developing a competitive edge.

While many retailers are analytically advanced in many areas, they have the opportunity to increase their focus on "people analytics" to unlock valuable insights from their personnel, HR, and sales data. People analytics, particularly test vs. control analysis, can inform which employee strategies—from hiring to training, staffing, and compensation—improve employee productivity and customer satisfaction as well as profitability. Such analysis can come in the form of designed business experiments, where a programme is intentionally introduced in some locations or with some employees and not others to measure the impact. In addition, organisations can derive insights through analysis of past changes; for instance, naturally-occurring variation in staffing levels, and its associated impact on performance.

For example, consider a leading retailer that wanted to increase the effectiveness of store employees, and designed a training programme intended to drive sales. Logically, the retailer might know the programme will have a positive overall impact. However, due to the high upfront investment required, it is key that the company understands its precise impact on profitability and how its effects vary across different stores and types of employees.

People programmes are not the only initiatives that test vs. control analysis can help evaluate. Many US retailers have already taken steps to innovate elements of the in-store experience, and have indicated plans to invest in other testable store experience strategies in upcoming years.

Top Store Strategies on the Horizon in the Coming Years

40% Offer space for in-store demos and events

39% Increase staffing

35% Offer click–and–collect services

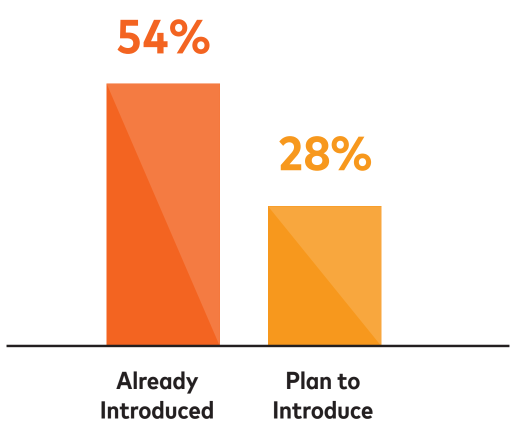
35% Introduce augmented reality and/or virtual reality technology in stores

As retailers continue implementing such programmes, they should also carefully consider the associated costs. Taking a targeted approach with these investments, and offering them only where they have proven to drive customer satisfaction and sales, can keep costs at bay while still acting as a differentiator.

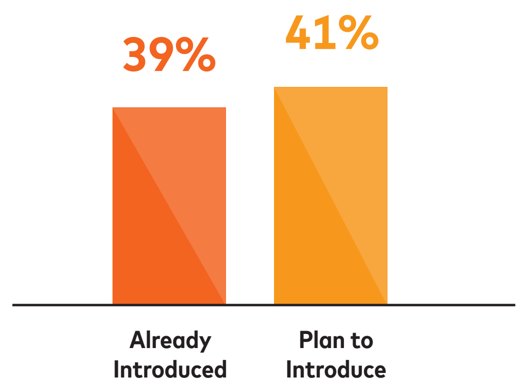
USE CUSTOMER INSIGHTS TO DRIVE INCREMENTAL PROFITS, NOT JUST OFFER PROMOTIONS

Mirroring international trends, US retailers are placing a significant focus on developing a complete view of the customer across channels. Findings show that loyalty programmes are a key area for US retailers, as they are globally: 75% have introduced or plan to implement a loyalty programme. Yet, despite the prevalence of loyalty programmes among US retailers, survey results also suggest a continued desire to gain a more refined understanding of the customer. This is evidenced by the percent of retailers increasing their focus on customer analytics.

Detailed Segmentation



Track Individual Customers' Activity



While retailers show progress in their commitment to customer analytics, to truly grow the business, they must move beyond data collection and developing customer segments based on static characteristics. Analytically sophisticated retailers inform their customer communication strategies based on an individual customer's predicted response to a particular action. Retailers that take this approach can understand if offering a customer a particular promotion will lead them to make an add-on purchase, or simply provide a discount on a transaction they would have made regardless. Targeting the most effective message—through both the optimal channel and format—to each customer is critical to driving ROI for a given campaign, and ultimately for making customer analytics make money.

Consider a retailer launching a new direct mail marketing campaign. The retailer could experiment with different variations of promotional offers with a subset of customers, and compare their performance to that of a group of similar customers that did not receive the campaign. Executives could then pinpoint which offer would be most effective with each type of customer based on their incremental response.

As retailers refine and target different marketing and promotional programmes, they can also leverage test vs. control analysis to identify how best to balance delivering the most relevant and profitable offerings with the operational complexities that accompany hyper-personalisation. In short, just because a retailer may have the technical ability to create individualised mailers for millions of customers does not necessarily mean that doing so is the right business choice.

TAKE A SURGICAL APPROACH TO STORE CLOSURES AND REMODELS

Interestingly, while some US retailers (14%) have already made the dramatic shift to online-only, shuttering all physical stores, this is not in the cards for most US respondents. Notably, over half of US respondents (58%) have not closed stores in response to online-only competition, and do not plan to. However, retailers that have already closed stores or plan to right-size their networks (42%) should carefully determine which stores to close based on how they can recoup lost sales.

One effective way to inform network strategy is to examine past closures of similar locations and the subsequent transfer of sales to nearby stores and other channels. Retailers can compare the impact on stores near a closed location to similar stores in areas that did not see a store closure to understand the net impact on the chain. From there, decision-makers could predict how much business they would retain following the closure of a similar location, to make closure selections that will maintain the most total network sales.

FOCUS ON MEASURING EVERYTHING ACROSS CHANNELS

The overwhelming majority of US retailers indicate that they have or plan to increase investments in online channels (84%). Findings show that a majority of respondents aim to drive business across channels through online promotions of in-store sales, and vice versa.

The rise of such initiatives highlights the importance of understanding the true, cross-channel financial impact of these programmes. In many organisations, there may be separate teams for online and in-store channels, or different data siloes for each channel. However, this fragmented approach can have negative consequences. Consider the scenario in which a retailer's online team introduces a free shipping offer in some markets that successfully drives online transactions. While online sales may grow, the increase may come at the expense of in-store sales. Such an insight is impossible to uncover without a consistent cross-channel view.

As US retailers continue to focus on combating online-only players by merging their online and offline channels (78%), it will be critical that they adopt a unified omnichannel

THE OVERWHELMING MAJORITY OF US RETAILERS INDICATE THAT THEY HAVE OR PLAN TO INCREASE INVESTMENTS IN ONLINE CHANNELS (84%).

approach in order to make decisions that are best for the business at large, rather than for sales in a particular channel.

Further, with 81% of respondents planning to or already investing in mobile and online marketing efforts, retailers should carefully evaluate their digital measurement capabilities. For example, it is important to not only consider how online ads affect online sales, but rather measure their cross-channel sales implications. By taking this approach, retailers can allocate investments to where they will have the greatest overall impact.

CONCLUSION

There is no question that traditional retailers must continue to bolster defences against online-only competitors by innovating with new omnichannel strategies and developing as seamless a customer experience as possible. However, with so many cutting-edge initiatives to try across so many areas of the business, the true challenge lies in correctly understanding which investments to make and which to skip. The retailers that can most effectively identify and implement winning ideas will be the victors in the age of e-commerce.

But how can retailers determine which ideas are the winners and in particular, help to develop an omnichannel edge? Report findings indicate that several main factors that influence decision-making include consumer surveys, competitor actions, and trends both within the retail industry as well as across industries and geographies. Yet, it is worth noting that in such a competitive environment, relying too heavily on others' strategies presents a risk of its own: perpetually being left a step behind your rivals.

While not the most commonly cited approach to strategic decisions, US retailers are slightly ahead of the analytical curve, with 15% reporting that they use scientific testing to inform their responses to their biggest online-only competitors, compared to only 14% of global respondents. But what is particularly notable is that among the respondents that utilise scientific testing to evaluate new ideas, the majority (60%) have either not closed stores as a result of online competition, or have recouped more than half of sales lost from store closures.

Scientific testing—or business experimentation—is applicable to many of the initiatives retailers are implementing to fight back against increasingly encroaching online-only players. By leveraging the proven approach of business experimentation to test new omnichannel strategies, retailers will rise above the competition.

For example, 35% of US respondents plan to introduce default price matching within the next 2-3 years. However, in some markets or stores, such as those with fewer competitors nearby or higher customer loyalty, such a programme may simply be giving away money without driving incremental sales, while in others, it may effectively retain market share. Before fully committing to such a programme, retailers should conduct experiments to understand its true impact on the business overall by first testing it on a smaller scale. Through designing and conducting an in-market test in a subset of stores, and comparing their performance to that of other, similar stores that did not receive the programme, a retailer could determine if the programme successfully drove incremental profits.

As retailers enhance omnichannel strategies and strive to create a more seamless customer experience from the store to online and mobile, failure to incorporate data from across channels will lead to partial, and often, inaccurate answers. In today's highly competitive retail environment, such strategic shifts are necessary, but what is at risk is market share—and survival, as any missteps come at a steep price. As retailers innovate to compete, they must strategically allocate every dollar of budget, and invest only in the programmes that will have the greatest positive impact.

AMONG THE RESPONDENTS THAT UTILISE SCIENTIFIC TESTING TO EVALUATE NEW IDEAS, THE MAJORITY (60%) HAVE EITHER NOT CLOSED STORES AS A RESULT OF ONLINE COMPETITION, OR HAVE RECOUPED MORE THAN HALF OF SALES LOST FROM STORE CLOSURES.

BRICK-AND-MORTAR RETAILERS FIGHT BACK

Winning Strategies to Compete with Online-Only Players