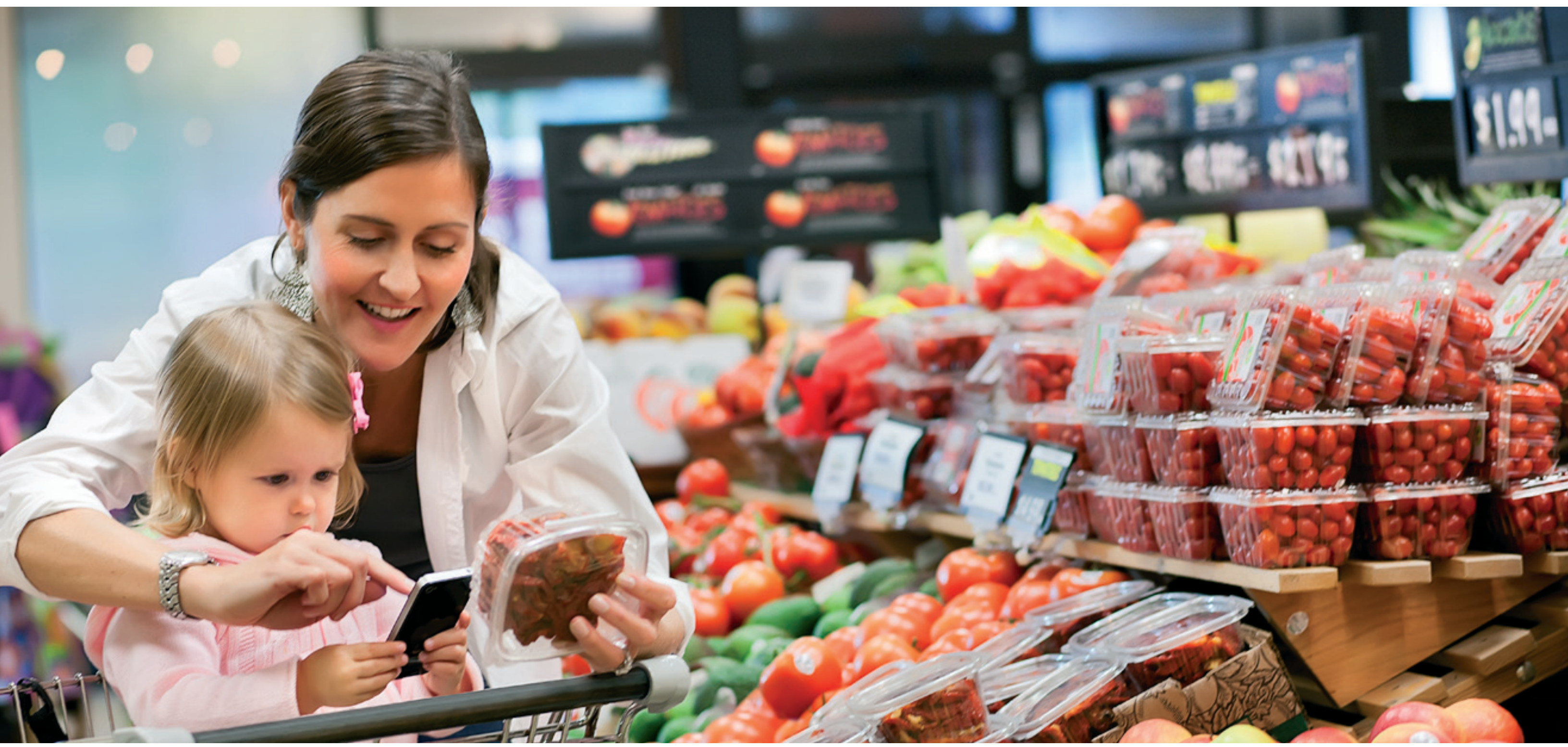
Retail 2020: Reinventing retailing—once again

A joint project between IBM and New York University Stern School of Business



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Introduction

Shopping is part of all cultures. At times it’s the way we meet the basic needs required to get through our daily lives. At other times, it’s an exciting adventure of discovery and fun. This is as it has been for over 100 years. Throughout that time retailing has evolved from local, specialized “mom and pop” stores to enormous global corporations operating big-box stores offering everything from food to fashion. Along the way retailing has become a huge part of the global economy. In the US, for example, consumer spending today represents 70 percent of gross domestic product (GDP).

As retailing evolves, it impacts everyone. We have seen this in the past as retailers moved from large emporiums in cities to specialized shops in suburban malls and then to big-box formats offering large selections of goods at discounted prices. Today we are in the midst of the most profound change that the retail industry has ever gone through. We are seeing significant changes in the way consumers shop, where they shop and when they shop. These changes will, once again, change the retailing landscape, as consumers shift to those retailers that evolve while others are forced to liquidate.

This paper offers a glimpse into what retailing will look like in 2020 and outlines the implications for retailers today. In order to succeed, retailers will have to rethink their strategies and their points of differentiation; the customers of 2020 will require it.

Are you ready for these changes? You have no choice.

Déjà vu all over again

The great recession was not kind to retailers. Weak players have been sold or have gone out of business as consumers have pulled back, resulting in slumping retail sales. Consumers have seen their balance sheets decimated as their retirement funds and homes have lost much of their value. These losses, combined with stubbornly high unemployment, have reduced the amount of money consumers are willing to spend on themselves and others. This change is not temporary. It has become what some have called "the new normal" and it is preoccupying discussions among retail executives as they consider how to adjust to this new reality.

At the same time, there are subtle shifts occurring in the consumer markets that are converging with innovations in retailing brought on by the Internet, which are redefining the structure of retailing as we now know it. It's hard to see subtle shifts until the cumulative impact is upon us, especially when the distraction of delivering the day-to-day results has become so difficult. So many retailers are not yet focused on the changes that are occurring.

We've been here before. Retailing has gone through major transformations in the past. These transformations have been driven by a combination of four external factors—*economic conditions*, *demographic changes*, *consumer behavior* and *technology innovations*. As we look forward to 2020, it makes sense to first look back, with "20/20 hindsight," over past retail transformations, to see what lessons can be learned from these shifts and how they might apply to the events reshaping the retailing industry today.

Retailing transformations of the past

Retailing has a long history, dating back to medieval traders and merchants. For thousands of years, retailers operated locally with merchandise often limited to a single product category. All of that changed in the postindustrial world. As incomes rose and middle markets emerged, so did the consumer's appetite for consumer products. With that, we saw the roots of modern retailing emerge as channels of distribution began to evolve. Modern retailing has rocketed since then into one of the largest industries in world. As we look back over the history of modern retailing, there have been four distinct periods that have defined the retail industry as we know it today.

1900 - 1945: Modern retailing emerges

At the turn of the century, retailing was mainly dominated by mail-order merchants who offered a broad assortment of just about everything available on the market. Market leaders included **Sears, Roebuck and Co., Montgomery Ward, Inc.** and **J.C. Penney Company, Inc.**, all of whom published immense "books" that became staples in every household in America. Small towns were lined with independent shops and variety stores, such as **F. W. Woolworth Co.**, **S. S. Kresge Company**, **T.G.& Y. Stores Company** and **W. T. Grant Stores**, offering basic goods for everyday needs.

Large cities were the centers for retail shopping, as enormous emporiums full of beautiful clothing, accessories and home goods from around the world became the shopping destinations for affluent Americans. These "department stores" offered new and unique products and gave birth to the notion of "window shopping" as a form of entertainment for aspirational consumers. Names like **Macy's, Wanamaker's, Lazarus** and **Dayton's** were among the most famous of this era.

In this period we saw tremendous technological innovation, which completely reshaped the way America shopped. Inventions like the automobile, cellophane and iceboxes (followed by refrigerators) provided the impetus for "supermarkets" to develop. These retailers provided one-stop shopping and fair pricing for a wide variety of foods and household goods. One of the pioneers of this concept, The Great Atlantic & Pacific Tea Company, more commonly known as **A&P**, went on to become the largest retailer in the world, a spot it retained for over 40 years.

1945 - 1975: "Baby boomers" drive postwar growth

As WWII came to an end and soldiers returned home, the world entered a period of rebuilding and growth that impacted consumers' needs for everything. Births took off, creating a "boom" that still echoes today. The so-called "baby boomers," children born between 1946 and 1964, were 79 million strong. This cohort went on to become the defining consumer trend for retailers for a generation.

As consumer demand accelerated, retailers responded. They followed consumers to new suburbs being developed along major new interstate highways and built large shopping centers conveniently located near where consumers lived. These shopping centers became the new destinations for retailing, housing department stores, national chains and other smaller "specialty" stores, all in one convenient location. The specialty stores were small, highly focused shops carrying a limited assortment of goods. Prolific mall development catapulted many of these retailers, such as **Gap, Inc. (The Gap)** and **Limited Stores, LLC (The Limited)**, to national prominence.

Technological innovations fueled the emergence of a new "mass market" as televisions in every home and newspapers in every driveway created the vehicles for manufacturers and retailers to reach consumers with advertising offers and brand messages. Modern credit cards created consumer "open to buy" and retailers responded by deploying point-of-sale systems and credit card scanners that allowed them to take advantage of this new cash alternative. By the end of this era there were over 2000 shopping centers and over 20 department store chains in the US. **Federated Department Stores, Inc., Allied Stores Corporation, The May Department Stores Company, Associated Dry Goods, Dayton Hudson Stores** and **Sears** all boomed in this era, as they struggled to keep up with growing consumer demand.

Perhaps the single biggest retailing event of the 20th century occurred in 1962. Brought on by the repeal of fair trade laws that restricted discount pricing, and driven by the huge growth in consumer spending, a new form of retailing emerged called the "discount" store. In 1962 **Wal-Mart Stores, Inc.**, **Kmart**, **Target** and **Woolco** each opened their first store. These stores aimed at meeting the needs of consumers for branded household goods and apparel, all at prices below those suggested by manufacturers, the MSRP. They built "big boxes" with large parking lots and offered limited service in a bare bones retail environment. Their low-cost structure allowed them to be price leaders, and they quickly turned this advantage into high growth, becoming the new retail market leaders.

1975 - 2000: Mass market fragments

As baby boomers moved into their 30s and 40s and their incomes soared, they continued to spend on themselves and on their growing families. Their evolving needs took them well beyond the needs of their parents into areas of self-expression that began to define them as individuals. The Vietnam War, women's rights movements, civil rights movements and rock and roll music all came together to create a new awareness among boomers that they controlled the future and that they were different from past generations. Differences became more in vogue, contributing to the shift away from "sameness." This shift began to cause cracks in the mass market, as individuals with differing needs took charge, showing they indeed were very different from their parents.

Retailers once again responded to the evolving marketplace. Specialty stores fit well with consumers' need to express themselves differently, and they thrived. Even discounters became specialized as new big-box stores filled with an extensive assortment of just one category of goods exploded onto the scene. Invented in the late 1950s by Charles Lazarus, founder of **Toys"R"Us, Inc.**, these "category killers" grew aggressively in the 1970s and 1980s into many product segments, including sporting goods, electronics, office supplies, home improvement, home furnishings, books and even pet supplies.

Together with traditional discounters and specialty stores, the category killers began to take significant share away from department stores, forcing them to consolidate and, in many cases, to file for bankruptcy. **Walmart** emerged as a clear market leader in this period and forced many traditional discounters out of business as their supply chain efficiencies and sophisticated use of IT provided them with an undisputed price leadership position. Among the top 100 discounters that operated in 1976, only 24 remained in business by 1992.

Toward the end of this period we began to see the early stages of what would become the next revolution in retailing. Enabled by the launch of the "World Wide Web" in 1991, online retailing, or "e-commerce" as it was labeled, began to show up in the marketplace. The explosion of personal computers and widespread availability of the Internet marked a step change in innovation not just in retailing, but also in every aspect of consumers' lives.

2000 - Present: Consumers take increasing control

The early part of the 21st century began in an inauspicious way for retailers. The "Y2K" frenzy and the enormous early promise of e-commerce, which fueled many questionable businesses such as **Webvan** and **eToys.com**, led to a market bubble, which eventually burst, creating the "dotcom bust." The NASDAQ stock exchange went from 5,000 to 1,500 in two years, leading many to believe that online retailing was over-hyped. They were wrong.

With a huge advantage in terms of selection, convenience and pricing, and with the ability to provide expert information and product comparisons instantaneously, the Internet has quickly become a very serious shopping alternative to traditional "brick and mortar" retailers. Growing at five times the rate of traditional retailing, e-commerce is close to a USD200 billion market today, with analysts expecting that it will be over USD500 billion within the decade.

Amazon.com, Inc., launched in 1995, has quickly become a broad marketplace for many categories of merchandise by offering unmatched selection, customized offers, high product availability, low-cost delivery, simple checkout and excellent pricing. Amazon will likely reach USD50 billion in sales this year or next and, given their rate of growth, they could be over USD100 billion by 2015. They will have reached these goals in half the time it took Walmart to achieve them. Along the way they, and other online retailers, are forcing traditional retailers to rethink their value propositions and embrace multichannel retailing as the only way to survive. Traditional retailers don't have much time to get it right.

Lessons learned with "20/20 hindsight"

Looking back over the past retail transformations, there are four clear lessons that have been common to each. Understanding them should help retailers better navigate through the changes that are occurring today.

1. **The pace of change is accelerating, causing competitive advantage to erode more rapidly.**
   Department stores maintained their competitive advantage and thrived for over 100 years. Discounters and category killers have seen their competitive advantage erode in less than 50 years. New forms of retailing will continue to evolve more quickly, and as they do they will challenge others who thought their market position was strong. Nothing lasts forever.
2. **All retail strategies become obsolete—but it is possible to reposition successfully if you see shifts occurring.**
   A corollary to the previous point is that all retail strategies eventually fail. Given the nature of innovation and consumer market shifts, competitors will continue to emerge who are better positioned with more compelling offers. No one is immune to this, even the strongest retailers, including among them recent failures, such as **Borders Group, Inc., Loehmann's Inc., Circuit City Stores** and **A&P**. The retail landscape is littered with many great retailers who did not see the market changing quickly enough to shift their position.
   However, there are a few who learned from the past and have been successful in redefining their competitive position. Retailers like Macy's, J.C. Penney and Dayton's (known today as Target) are among those who have done a good job of this, but the list is pretty short.
3. **Major power shifts in the distribution channel have occurred over time, creating huge dislocations and opportunities for new retail concepts.**
   As you consider the major players in the retail distribution channel—from producers to distributors to retailers and, finally, to consumers, it is clear that influence over pricing, product availability and product innovation has shifted over time. In the early part of the 20th century, producers were in control. Over time, control has completely shifted for many types of products to the point where today's consumer is calling many of the shots. The Internet has provided transparency, information and options that enable consumers to shift demand rapidly to retailers and brands that they prefer. Maintaining customers' loyalty and trust has become harder, but more important than ever, as consumers can shift providers in a moment, if unsatisfied. Knowledge of the consumer, their shopping behavior and how to influence them has become a science. Successful brands and retailers will have to learn to adapt to this reality.
4. **Innovation and technological advances periodically redefine retailing—and will once again.**
   In 1942, economist Joseph Schumpeter coined the term "creative destruction" to describe the painful process by which innovation and technological advances make an industry more efficient while leaving older, less adaptive businesses by the wayside. Creative destruction has transformed the retail

industry over the past 100 years and is doing so once again. The Internet, mobile platforms, social networks and smart sensors and smart shopping agents are transforming the way consumers shop and destroying traditional retail business models. Many retailers who are successful today will not survive this transformation. Some will.

Retail 2020

As we look forward to 2020, understanding that we are in the midst of a seismic shift in the retail landscape, it's fair to say that retailing will be changing dramatically between now and 2020. Based on what we are seeing in the marketplace today, and using the lessons learned from past transformations, here are several of the changes we can anticipate, along with the impact they will have on today's retailers.

- **Millennials in charge.**
  Baby boomers will mostly be in their 60s and 70s in 2020 and still financially hampered by the great recession. Focused mostly on healthcare, caring for aging family members and unemployed children and attempting to rebuild savings for their retirement, they will no longer be spending as much on discretionary retail purchases.
  Millennials, who will be reaching their late 30s in 2020, and whose numbers are similar to those of the boomers—roughly 80 million—will be the main story for retailers in 2020. They value quality over quantity, have a real passion for social causes and have grown up using the Internet for everything. Retailers who can appeal to this cohort and offer them the products and experiences they value will be the most successful.
- **Consumers continue to trade up and down.**
  As consumers have adjusted their spending and buying behavior over the past few years to respond to having less disposable income and shrinking balance sheets, we have seen luxury retailers do well as have value-priced retailers. At the same time, those positioned to serve the middle market have seen their share shrink. This trend will continue into 2020, resulting in a further squeezing of the middle market, particularly in the US but also in other mature markets, creating what some analysts have labeled an "hourglass" effect. Retailers positioned in the middle need to rethink their value propositions in order to avoid continued loss of market share.
- **Emerging markets provide opportunities for growth.**
  While the middle market shrinks in some markets, it will grow rapidly in emerging markets, such as Brazil, China and India, creating exciting growth opportunities for those retailers who have the brands, resources and value propositions to compete effectively. Notwithstanding the political and cultural barriers that will make it risky to venture into these markets, the sheer size of the opportunity and the demand for consumer products, fashion and brands will make these markets very attractive. China, for example, is expected to be the largest market for luxury goods by 2020.
  We are already seeing many examples of retailers with strong brands move into foreign markets. We will see this trend accelerate as retailers who have the resources go after consumers who fit with their brands, wherever they are.
- **Too much space. Too few sales.**
  Though mainly a US phenomenon, excess retail space will become a problem in other parts of the world, as well. The US more than doubled its amount of shopping-center space from 3.3 billion sq ft in 1980 to 7.2 billion sq ft in 2010, much faster than overall retail sales growth warranted. Mall vacancy rates are up significantly.
  When considering that most retail sales forecasts over the decade are for sluggish growth, around 2 - 3 percent per year, most of which is coming from faster growth in online sales, we will only see the space problem get worse by 2020.

- **E-commerce challenges the business model of most "brick and mortar" retailers.**
  By 2020, online sales are forecast to be USD500 billion or 20 percent of nonfood retail sales. For many types of retailers, the percent-to-total sales could be even higher, as e-commerce growth continues to significantly outpace overall retail sales growth. Much of this will be fueled by the accelerating use of mobile platforms for shopping online.
  Traditional retailers will continue to see eroding sales productivity in their brick-and-mortar stores, as they struggle to redefine the role of the store in a multichannel, millennial-led world. Being locked in to long-term leases with less retail demand for the space will make it difficult to downsize quickly, which will lead to many more poorer-performing store locations spanning retail enterprises. Although this shift will likely have a larger impact on big-box stores, initially, eventually all forms of retailing will see the effects of consumers shifting their purchases online, unless they find a way to create a differentiating value proposition that exploits the physical store advantages in a more compelling way.
  Those whose competitive advantage is based solely on price or selection will be the ones most at risk as the Internet largely neutralizes these advantages.
- **Mobile platforms, smart sensors and social media enable new ways of shopping.**
  More shopping on mobile devices enables online offers to be localized and personalized, taking smart shopping to a new level. As more stores become Wi-Fi enabled and begin to utilize smart sensors around the store, shoppers will be able to use location-based services within stores to assist with checking product availability, locating products, identifying alternatives and finding complementary items. Offers will be real time and one to one, which will create much more meaningful value propositions for consumers and higher success rates for retailers.
  Armed with mobile devices in the store, sales associates will be able to provide real value to consumers while they shop. Associates' roles will be redefined to "solution specialists" who can match products and services with shoppers' exact needs, much like Apple employees do within their stores today. This will require business insights that cut across the enterprise and enable retailers to seamlessly interact with individual customers throughout the shopping process—from awareness to acquisition and support.
  Tomorrow's "smarter consumers," as IBM has labeled them, will require all retailers to address the new ways they will shop, and how they will expect to be served.

- **Four giants reshape the retail landscape.**
  As traditional retailers work hard to respond to these changes, they will be facing a set of online competitors that will be focused on taking advantage of their speed, flexibility, knowledge of technology and business models to offer freshness, selection, convenience and value in new ways. Retailers like **Amazon**, **Gilt Groupe, Inc.**, **Rue La La, Alice.com, Inc.**, and **Groupon, Inc.**, are already threatening to disrupt the business model of many traditional retailers. Over the past few years we have seen several notable bankruptcies of traditional retailers that could not compete. Perhaps the biggest threat, though, will come from four giants that have built their strengths and their fortunes by controlling different aspects of the online shopping experience and that will only get better at what they do by 2020.
  Amazon offers the broadest selection online through its own products and marketplace relationships, and it is moving into new product categories each month. Amazon is investing in the infrastructure to stay out front in terms of technology and logistics, and with its Amazon Prime program it has found a way to offer even more convenience and value.
  Google wants to be the place where consumers go first to search for the products they are looking for. By controlling the product search, Google can influence where consumers buy and, coupled with Google Offers and Google Wallet, can customize a compelling deal and assist with the payment transaction. In the process Google will learn more about who is shopping for what and where, and be in a position to influence all of that.
  Facebook knows what you "like," who you like to get advice from and, in some cases, what you have purchased. Although Facebook has not yet found a compelling way to monetize these assets, it remains a sizable threat. If Facebook can figure out how to convert its assets into shopping influences, without alienating its constituents, then it too will have sizable control over the future consumer's shopping behavior.
  Apple Inc. has set the standard with regard to the in-store shopping experience. Of course, its innovative products set Apple apart; however, how it combines these with its store design, sales associates and with its in-store and online services and content has made Apple a market leader. As it continues to build on its product and retail successes, Apple has the ability to capture an even larger share of the consumer's spend.

Implications for retailers today

To compete and succeed in 2020, retailers will need to challenge and, in many cases, rethink their current value propositions to make sure they are sufficiently differentiated and compelling to the consumers they are targeting. For most, this will be a very difficult task, as it means radically redefining the role of the store and how to turn it into an asset instead of a liability.

As brick-and-mortar retailers prepare for battle with the online merchants, they must transform into truly seamless multichannel businesses. In doing so, there are several areas they can draw upon for competitive advantage.

1. **Find ways to appeal to millennials**. They will be the shoppers to target for most categories of goods. Understanding them, embracing their new approaches to shopping and connecting with them individually will provide a strong foundation for a winning strategy.

2. **Invest in building and maintaining a strong, compelling brand**. Owning or controlling a strong brand and offering unique and compelling products within the brand will provide a basis for a differentiated offer. Simply offering others' brands without adding significant value will not be sufficient for sustainable competitive advantage. In a market in which anyone can instantaneously share their experience with hundreds, if not thousands, of others, having a strong brand and a consistent way to measure the perception of your brand, is a necessity.
3. **Reduce the amount of retail space in your portfolio**. With larger shares of retail sales moving online, retail space will become an increasing problem for many retailers. Downsizing, recycling, repurposing and eliminating unproductive space and locations will be critical in order to maintain the level of productivity required to provide adequate returns.
4. **Make it easy to shop, wherever, whenever**. Get creative in engaging the consumer wherever it makes sense in order to make it as convenient as possible for them to shop. Pop-up shops, kiosks and intelligent displays integrated with mobile devices can offer a multichannel experience that engages the customer. It's clear that retailers need to aggressively embrace customer-shopping platforms of all types (for example, mobile) and integrate them into their channel mix.
5. **Speak to your customers personally**. Online retailers know who their customers are and are in a position to tailor their messages and offers to each individual in a way that adds to the overall shopping experience. Most brick-and-mortar retailers will need to do this in order to remain relevant. Making sure your brand messages and offers are heard and understood will require you to engage your customer in a consistent dialog which reflects insights into their needs, wants and prior actions. Generating offers in real time while navigating through the privacy, marketing and IT issues will be difficult, but by 2020 this should be the normal way of communicating to customers.
6. **Become a low-cost operator in the segment in which you operate**. Price and product comparisons will be made even easier and more relevant in 2020 and will be the starting point for most buying decisions. Competing against online retailers will require a more flexible business model, so that when you need to compete on price, you can. Embracing and integrating technology and shifting costs for nonstrategic functions will, no doubt, continue to be a core competency of successful retailers in 2020.
7. **Use the store and technology as a competitive weapon**. Consumers have to be motivated to go to a store when there are likely going to be alternatives for shopping that are more convenient. Give them a good reason to do it. The store should offer an environment that makes shopping a positive experience that delivers compelling value versus the alternatives.
   The shopping experience has been largely unchanged, from a consumer perspective, for over 30 years. Retailers have the ability to integrate analytics and location-based technology to invent new ways to serve their customers. Whether it's something fresh and unique, someplace visually exciting or entertaining or services that are truly valued, the bar will be much higher for the consumer of 2020 than it is for today's customers.
8. **Invest in associates who solve customer's problems**. Retailers have spent years taking money out of store payroll in order to deliver better financial results. In most cases today's store associates are at a real disadvantage when they are asked to serve customers. They haven't been selected and trained properly for that role. They probably don't have mobile devices as good as their customers'. They are not as informed about what's available in the market as are their customers. Finally, given all of the back-office tasks they are assigned, they have little time or incentive to help customers, even if they were properly equipped. Successful retailers in 2020 need to rethink the role of the store associate and how they are enabled and measured, to turn them into part of the reason consumers come to shop their stores.

Concluding thoughts

Retailing is a dynamic industry and as history has shown, it is one that has gone through dramatic transformations, becoming even more dynamic in the process. No one knows exactly what the future will deliver, and therefore it's hard to know now exactly how to prepare. However, the lessons of the past and the conditions of today provide a pretty good road map.

There is no question that we are *reinventing retailing—once again*. The question is: Do you have a compelling strategy that will differentiate you and meet the needs of the consumers of 2020? If not, shouldn't you get started working on this now?

For more information

For additional copies of this report and further information on trends in retailing, please visit the following websites: **ibm.com**/retail or http://www.stern.nyu.edu/retail2020

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