Mid-Market Differentiates with Multi-Channel Retailing

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EXECUTIVE SUMMARY

The mid-market is the sweet spot of 21st century retailing. It seems to have the best of both worlds. Retailers with revenue of $50 million to $1 billion per year are large enough to have economies of scale and effective supply chain planning and execution operations, yet small enough to cater to specific demographic segments with either their product offering or customer service value proposition. They are not so big that they have to be all things to all people, but they are not so small that they have to rely on the idiosyncrasies of local clientele. Benchmark studies and Wall Street earnings calls have shown mid-market retailers frequently outperform their larger and smaller brethren. With this as a backdrop, it was only natural to look at how the phenomenon of multi-channel retailing affects the mid-market retailer.

THE BUSINESS CHALLENGE

Much has been written about the higher transaction value of multi-channel customers, with the presumption that these customers are also more profitable. Our survey showed something different: 65 percent of mid-market retailers acknowledge that their multi-channel customers aren't really any more profitable than their single channel counterparts, even though they spend more on per average transaction. Worse, a disturbing 35 percent don't know or can't tell whether multi-channel customers are more profitable or not. Efficiencies are required to reclaim profit dollars left on the table.

OPPORTUNITIES

Although many have identified customized and unique product offerings as a good niche for the mid-market, they self-identify differently. Getting to efficient and effective multi-channel information and delivery strategies are most important to survey respondents. They hope that creating a single brand identity across all channels coupled with these new efficiencies will help them continue to satisfy their customers.

ORGANIZATIONAL BARRIERS

Mid-market retailers expressed frustration with lack of synchronization across channels, as did our overall survey base. As we have found in virtually all of our recent surveys, they also expressed a groundswell of frustration with inflexible technology infrastructures. Having built out their infrastructures in a scattershot fashion, they are ill-equipped to create a cohesive multi-channel technology base. They are focused on improved integration tools as a way to improve their system infrastructure, but must look past that to also integrating their business processes and organizations.

TECHNOLOGY ENABLERS

Mid-market retailers are even more concerned with the basic blocking and tackling of multi-channel retailers than are larger retailers. Cross-channel content and product information management and expense reduction tools like transportation management systems and returns management systems topped their list of critical technology enablers. Given the business issues they face and the opportunities of which they hope to take advantage, this group of retailers felt re-designed ecommerce sites are less critical than getting a sound infrastructure in place.

"BOOTSTRAP" RECOMMENDATIONS

Rule #1: Put an integrated cross-channel system in place as early as possible. Make investments ahead of the curve. While most retailers tend to wait until their existing systems are groaning under the weight of growth, sustained success can only be achieved if an infrastructure is put in place in advance. While a sub-$50 million retailer can manually manage a combination of direct-to-consumer and store shipments from their distribution centers, larger retailers will find this expensive and hard to control.

We also encourage retailers to watch carefully the developments around customer-owned mobile technology. The empowered consumer, with an Internet-enabled phone in her hand can do comparison shopping right from your selling floor. Retailers ignore this upcoming disruptive technology at their own peril.

SECTION I: WHY LOOK AT THE MID-MARKET?

Retailers come in four distinct sizes. The smallest retailers have annual revenue of less than $50 million in revenue. They may be aspire to become larger, but, more typically, they are family-owned and operated niche businesses. Their raison d'etre is either an interesting and unique product mix or very high-touch customer service.

On the other end of the spectrum are the largest retailers, typically called "channel masters." These retailers rose to prominence in the late 20th century and most typically distinguish themselves through supply chain excellence: they are low-cost, operationally efficient multi-national corporations.

Prior to the age of channel masters, "Tier 1" retailers, with more than $1 billion per year in revenue in general merchandise and apparel and $2.5 billion in fast moving consumer goods were the largest retailers in existence. Their numbers diminished as their place in the ecosystem was supplanted by channel masters. Companies like Bradlees, Hills, Caldor, HQ and others were unable to compete with the likes of Wal-Mart and Home Depot. Those that remain often struggle to find their identities in a world where they are surrounded by the very large and the very small.

In the middle lies the sweet spot of 21st century retailing: the mid-market. With revenues from $50 million per year to $1 billion (for general merchandise and apparel), the mid-market seems to have the best of both worlds. They are large enough to have economies of scale and effective supply chain planning and execution operations, yet small enough to cater to specific demographic segments with either their product offering or customer service value proposition. They are not so big that they have to be all things to all people, but they are not so small that they have to rely on the idiosyncrasies of local clientele. Benchmark studies and Wall Street earnings calls have shown mid-market retailers frequently outperform their larger and smaller brethren.

With this as a backdrop, it was only natural to look at how the phenomenon of multi-channel retailing affects the mid-market retailer. We culled data from our annual Multi-channel Retailing Benchmark Study, written in December 2006. Our goal was to understand if the brick and mortar nimbleness of mid-market retailing translates to the new world of cross-channel and multi-channel selling and delivery, and how the best of the best drive success.

METHODOLOGY

RSAG uses its own model, called the "BOOT," to analyze issues in the Extended Retail Industry. This model is built with our proprietary survey instruments. Specifically, the "BOOT" methodology is designed to reveal and prioritize the following:

- **Business Challenges** – RSAG queries enterprises to help them identify the biggest external challenges they face. These issues provide a business context for the subject being discussed.
- **Opportunities** – Every challenge brings with it a set of opportunities, or ways to change and overcome that challenge. RSAG's surveys ask respondents how

they're choosing to meet their challenges. We also identify opportunities missed – and describe leading edge models we believe can drive success.

- **Organizational Inhibitors** – Even as enterprises find opportunities to overcome their external challenges, they may find internal organizational inhibitors that keep them from executing on their vision. Opportunities can be found to overcome these inhibitors as well. RSAG's surveys help respondents determine what their organizational inhibitors are and how to conquer internal challenges.
- **Technology Enablers** – The Extended Retail Industry can no longer function without a strong technology foundation. RSAG surveys question retailers about the technologies they employ to help solve business challenges.

RSAG believes winning is not an accident in the Extended Retail Industry. Sustainable sales improvement and successful execution of brand vision are direct results of an enterprise's recognition of external and internal business issues, its ability to take advantage of opportunities for improvement, and its use of technology enablers to simplify and rationalize business processes. Data that emerges from the BOOT model helps us understand the behavioral and technological differences between winners and their peers.

THE MID-MARKET OUTPERFORMS AND USES MORE CHANNELS THAN OTHER RETAILERS

Our definition of retail winners is straightforward, following Wall Street's methods. Wall Street judges retailers by year-over-year comparable store sales improvements, and RSAG does the same. Assuming an industry average comparable store sales growth of three percent (roughly equivalent to inflation), we define retailers with sales above this hurdle as "winners," those at this sales growth rate as "average," and those below this sales growth rate as "laggards" or "also-rans."

In the 21st century, most retailers need a consistent brand identity across multiple channels to retain their customers. Even regional retailers must maintain a universal presence across the Internet, provide accurate and consistent product feature and benefit information, and offer a means for local customers to order online or through a call center, and pick up in store. Maintaining a catalog and call center help spread their brand name and sales presence to cities and towns where it might otherwise not be feasible to open brick and mortar stores.

As illustrated in Figure 1, the mid-market outperforms retailers as a whole in comparable sales improvements.

Figure 1:
Mid-Market Retailers Outperform the Industry

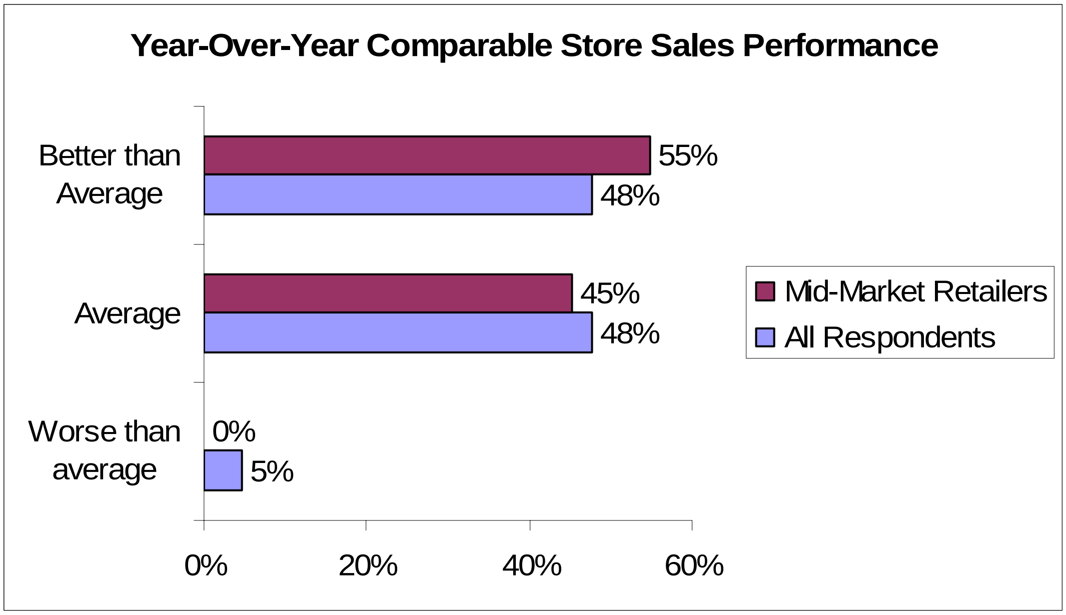
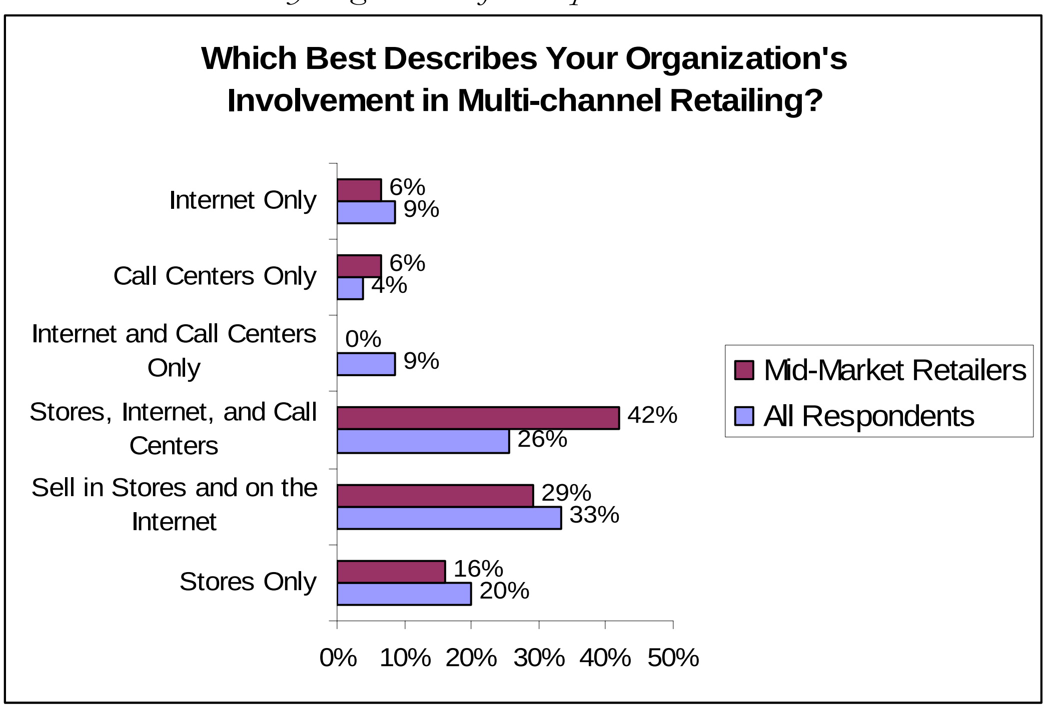


Figure 2 illustrates the extent to which mid-market retailers make use of stores, call centers, and the Internet to achieve that performance. More than 42 percent of mid-market retailers use all three channels vs. 26 percent of all survey respondents.

Figure 2:
Dramatically Higher Use of Multiple Sales Channels



SURVEY RESPONDENT CHARACTERISTICS

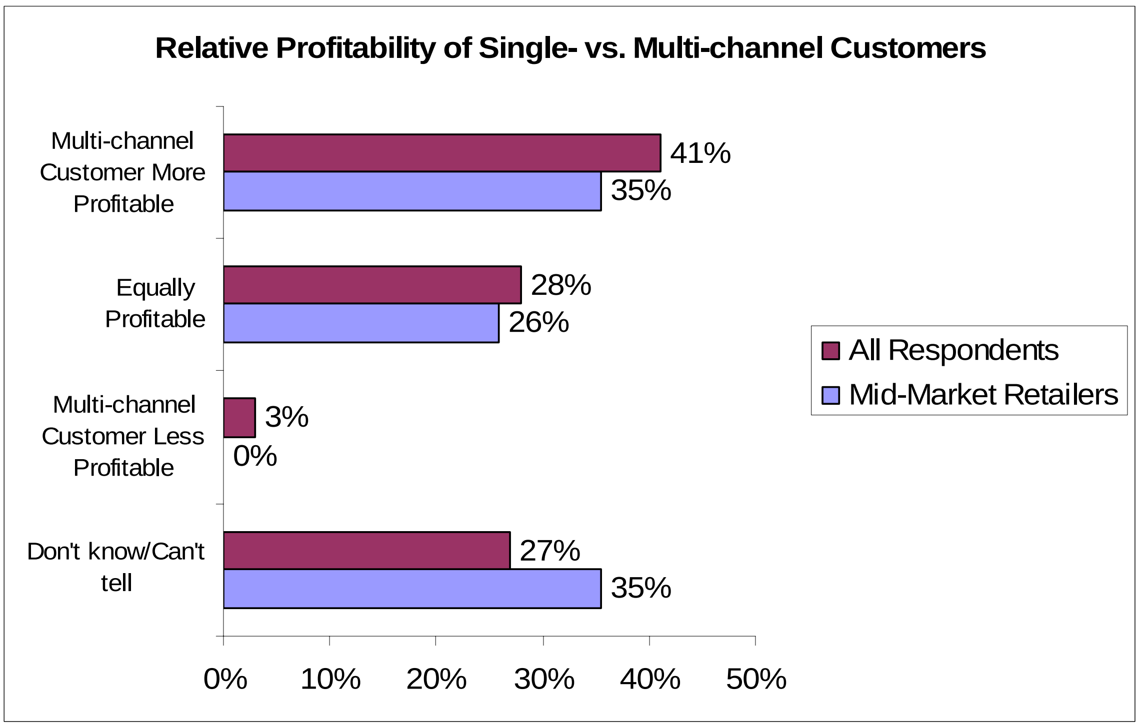
RSAG conducted an online survey between October and December 2006 and received complete sets of answers from 125 retail and supplier respondents. Full details of respondent demographics can be found in the benchmark report "*Searching for the True Multi-channel Retailer*". Thirty percent of respondents were mid-market retailers with revenues of $50 million to $999 million per year.

SECTION II: THE BUSINESS CHALLENGE

HIGHER TRANSACTION VALUES DON'T ALWAYS TRANSLATE INTO HIGHER PROFITS

Much has been written about the higher transaction value of multi-channel customers, with the presumption that these customers are also more profitable. Our survey showed something different: 65 percent of mid-market retailers acknowledge that their multi-channel customers aren't really any more profitable than their single-channel counterparts, even though they spend more per average transaction. Worse, a disturbing 35 percent don't know or can't tell whether multi-channel customers are more profitable or not (Figure 3).

Figure 3:
You Can't Fix What You Don't Measure

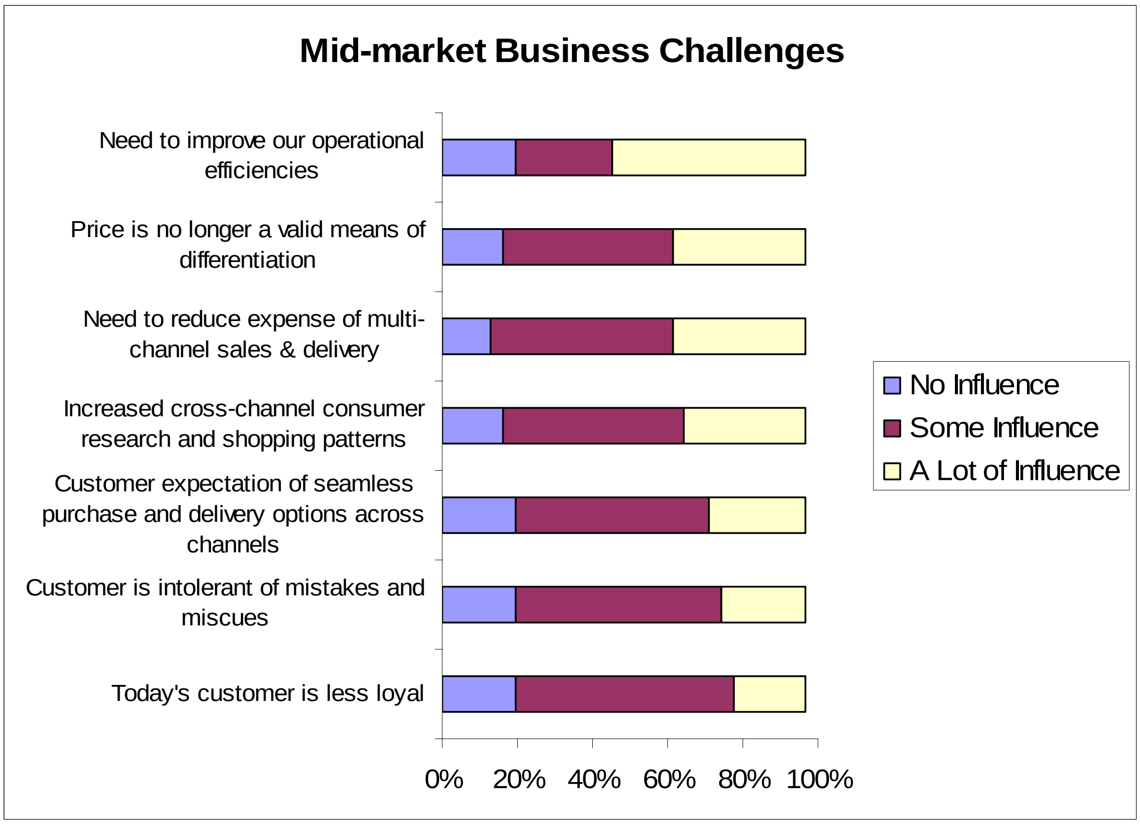


Given the high percentage of mid-market retailers engaging in multi-channel operations, it's imperative for them to get their arms around what their multi-channel customers actually cost them. As we will see below, while mid-market retailers viscerally understand the importance of becoming more efficient, too many of them are flying blind. Without the ability to quantify the baseline of profitability, determining Return on Investment (ROI) for any additional technology initiative or business process change will border on impossible, and will doom most to failure. *The baseline critical issue for retailers today is identifying and courting their most profitable customers regardless of channel preferences.*

RELATIVELY SMALL SALES VOLUMES BREED INEFFICIENCY

With ecommerce sales currently running at approximately 8 percent of total retail sales and call center sales running at 3 percent or less, the total "non-brick and mortar" dollar sales volume for a typical mid-market retailer is small. IT budgets are equally small, and business processes are often an afterthought. Even the largest retailers have failed to put their multi-channel houses in order. It's not surprising then to find the mid-market in even worse straits. Recognizing that they are "dancing as fast as they can," our survey respondents identified their most influential business challenge as a need to improve operational efficiencies (Figure 4).

Figure 4:
The Critical Challenge to Become More Efficient



Overall this was the biggest differentiator between mid-market retailers and their larger and smaller counterparts. Double-digit compound annual growth rates of multi- and cross-channel research, discovery, and shopping patterns have left the whole retail industry scrambling to keep up, but the mid-market retailer's overall revenue growth is also typically on a steeper incline than smaller or larger retailers.

Ironically, these retailers have the greatest need for efficiency and accuracy. Their value proposition is based on economies of scale with a personal touch. Comprehensive solutions are their best hope for reducing costs while still providing them room to grow.

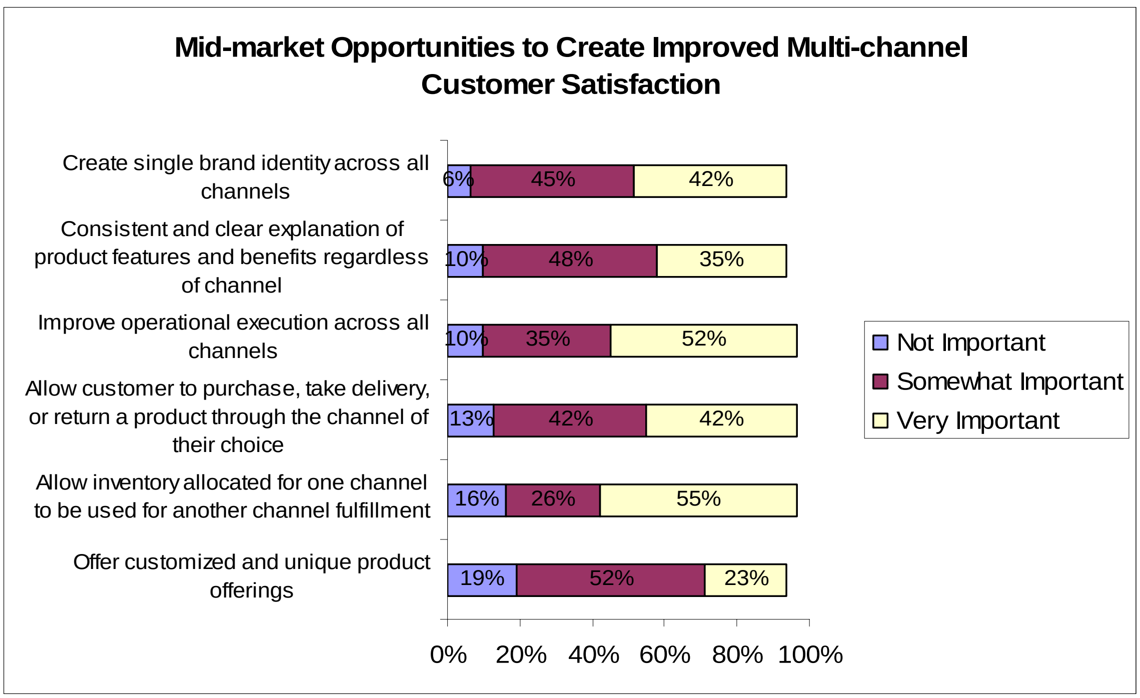
SECTION III: OPPORTUNITIES

IT'S ALL ABOUT THE BRAND

Retailers of all sizes and shapes recognize the importance and potential value inherent in creating a single brand identity across all information, sales, and delivery channels. The mid-market, in particular, understands consistent cross-channel brand identity is a fundamental building block for their success.

When asked to rate the top three opportunities they see to improve customer satisfaction the mid-market responded as shown in Figure 5. Only 6 percent of respondents felt a consistent brand identity was "not important" to create improved customer satisfaction. Not surprisingly, retail winners of all sizes concurred, with 94 percent seeing the opportunity inherent in establishing a single cross-channel brand message and delivery model.

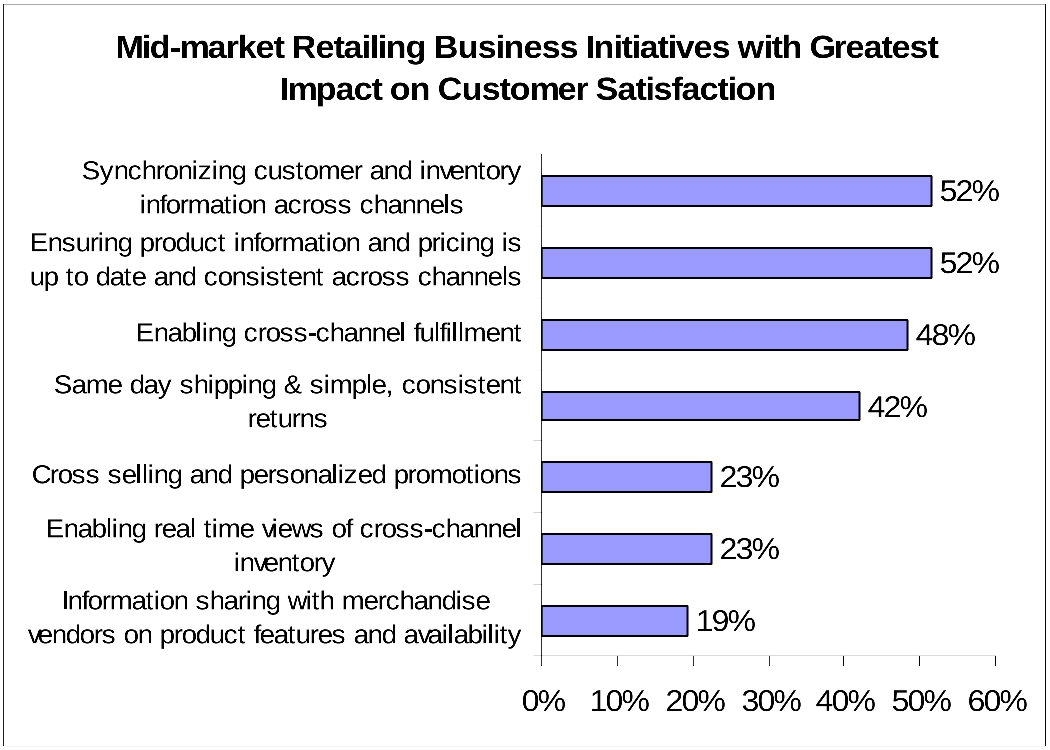
Figure 5:
Opportunities Lie in Brand Identity and Efficient Execution



CLARITY, CONVENIENCE, AND EFFICIENCY TRUMP CUSTOMIZATION

Although many have identified customized and unique product offerings as a good niche for the mid-market, they self-identify differently. Getting to efficient and effective multi-channel information and delivery strategies are most important to survey respondents. Business initiatives that have had the greatest impact on customer satisfaction reflect this point of view, as illustrated in Figure 6.

Figure 6:
Customer-Facing Cross Channel Initiatives Most Important

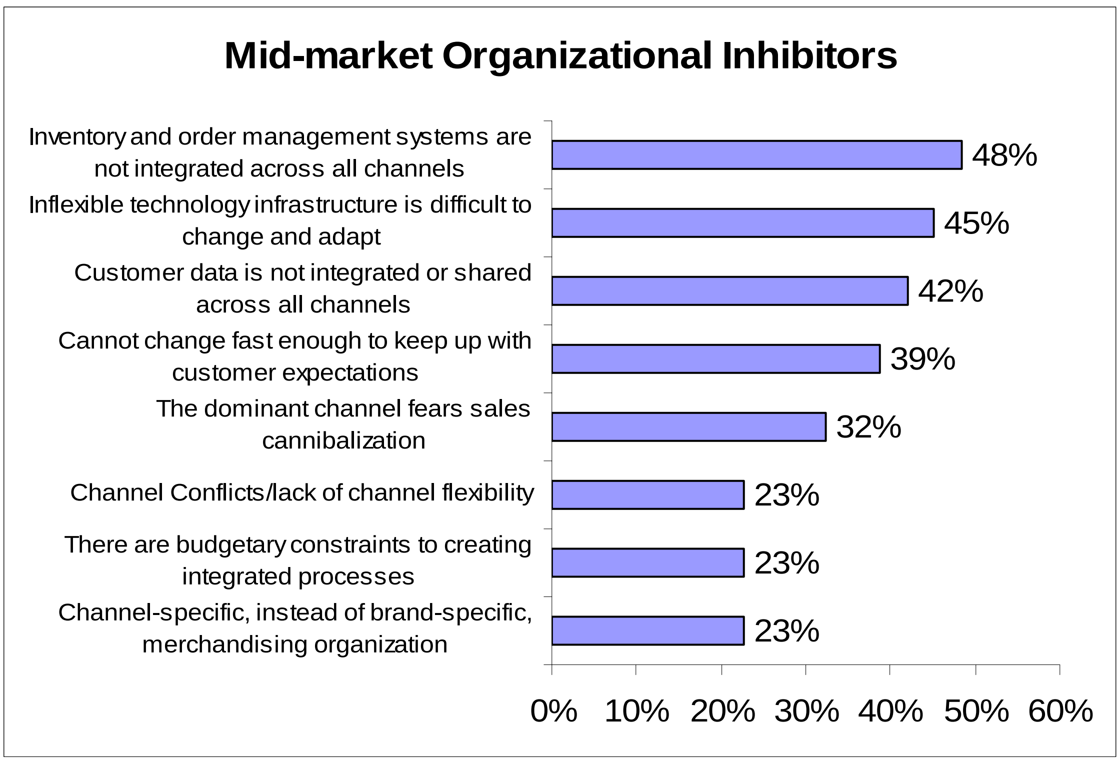


SECTION IV: ORGANIZATIONAL BARRIERS

FRUSTRATION WITH FRAGMENTATION

Similar to our survey respondents as a whole, mid-market retailers expressed frustration with a lack of synchronization across channels and, as we have found in virtually all of our recent surveys, a groundswell of frustration with inflexible technology infrastructures. Having built out their infrastructures in a scattershot fashion, they are ill-equipped to create a cohesive multi-channel technology base (Figure 7).

Figure 7:
Lack of Flexibility in Systems and Organizations Breed Frustration

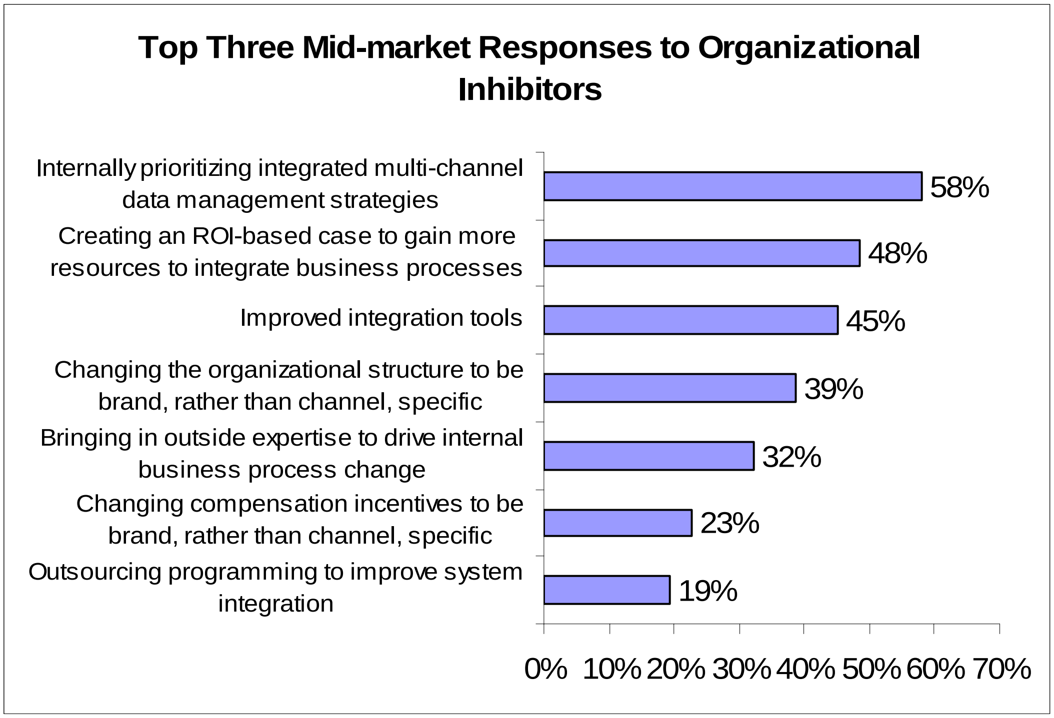


It's interesting to note that organizational structures were deemed less important than systems infrastructures. RSAG believes that fragmented organizational structures contribute to fragmented system infrastructures. Until retailers finally get beyond their fear of channel cannibalization and create brand-wide organizational incentives that get all groups working together, they will remain challenged to create unified systems architectures to support them. This seems like a mundane observation, but the issue of channel conflicts has persisted for more than a decade after the advent of Internet-based shopping. Retailers are seriously lagging in recognition of this new reality.

THE DRIVE FOR BETTER INTEGRATION TOOLS CONTINUES

Even with their somewhat broken organizations, mid-market retailers recognize the importance in internally prioritizing multi-channel data management strategies (Figure 8). They want their technologies to be better integrated across channels, to demonstrate clear and demonstrable Return on Investment (ROI).

Figure 8:
Interested in Integration, Disinterested in Outsourced Programming



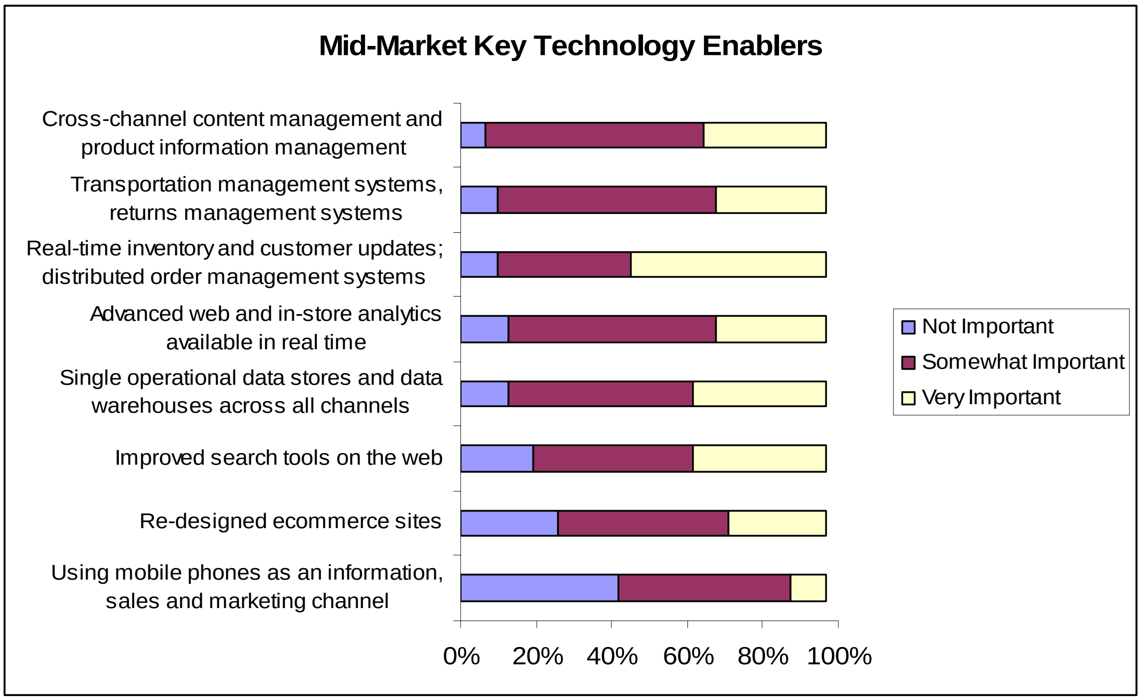
RSAG believes it is imperative for compensation incentives to be aligned by brand rather than by channel to encourage different groups to work together toward a single brand identity. Unfortunately, while many of our mid-market respondents understand the importance of prioritizing multi-channel data management strategies, far fewer understand the importance of prioritizing multi-channel human management strategies.

SECTION V: TECHNOLOGY ENABLERS AND BOOTSTRAP RECOMMENDATIONS

FOCUSING ON THE BASICS TO DRIVE EFFICIENCY

Mid-market retailers are even more concerned with the basic blocking and tackling of multi-channel retailers than larger retailers. Cross-channel content and product information management and expense reduction tools like transportation management systems and returns management systems topped their list of critical technology enablers (Figure 9).

Figure 9:
Key Technology Enablers: Getting the Basics Right



Given the business issues they face and the opportunities they hope to take advantage of, this group of retailers felt re-designed ecommerce sites are less critical than getting a sound infrastructure in place. The fastest growing retailers will put a unified, scalable infrastructure in place to ensure they can avoid distractions of a "rip-and-replace" approach while they focus on their core brand identity.

While RSAG agrees with this overall, we must add a word of caution: we expect customer-owned mobile devices like smart phones to be a suddenly disruptive influence on the market. Customers can already access the web from their phones. Technology is already available allowing shoppers to take a picture of a barcode, send it as a text message to Amazon, and get their price and availability. Retailers in Japan are already using mobile phones as payment devices. We are concerned that retailers in other parts of the world have not prepared adequately for the onslaught of mobile technology. Certainly, retail technology implementations must pass ROI hurdles and must be prioritized based on immediate need, but retailers ignore the mobile phone at their peril.

"BOOTSTRAP" RECOMMENDATIONS: GO INTEGRATED SOONER RATHER THAN LATER

It is incredibly tempting for retailers to use their scarce capital to invest in new store growth, rather than in infrastructure investments. The mid-market in particular, with its entrepreneurial roots, will prefer opportunistic growth to foundational investments. Nonetheless, we strongly recommend a more measured approach.

Put an integrated cross-channel system in place as early as possible. Make investments ahead of the curve. While most retailers tend to wait until their existing systems are groaning under the weight of growth, sustained success can only be achieved if an infrastructure is put in place in advance. While a sub-$50 million retailer can manually manage a combination of direct-to-consumer and store shipments from their distribution centers, larger retailers will find this expensive and hard to control. Advanced planning for growth is critical to sustained retailing success. The challenge of growth is big enough without the added pressure of systems that require manual care and feeding.

Retail winners use all channels at their disposal. Smart retail winners have their multiplicity of channels integrated into a single brand identity.

ABOUT THE SPONSOR

Junction Solutions delivers enterprise software solutions for mid-market retailers built on the Microsoft platform. Our integrated Retail Product Suite includes multi-channel retail, point-of-sale, e-Commerce and business intelligence software, so your entire retail business can be easily operated and analyzed to enable new opportunities for profitable growth – through any sales channel. As a Gold Certified Microsoft Business Partner, we combine business process know-how, comprehensive services, and the best technology for a high-value, low-risk implementation. For more information, visit our web site at www.junctionsolutions.com.

ABOUT THE PUBLISHER

RSAG (Retail Systems Alert Group) is the leading provider of objective, high-quality information resources for the Extended Retail Industry (ERI). We have followed the advancements of technology and business process innovation in this industry for almost two decades, and we deliver our insights and analysis through high-value conferences and tradeshows, publications, research, training, and Web-based services. For more information, visit www.retailsystems.com

RSAG services the Extended Retail Industry. This term, coined by RSAG, describes a broader consumer-focused ecosystem encompassing retail, manufacturing, transportation, distribution, logistics, warehousing, solution providers, and other supporting organizations.