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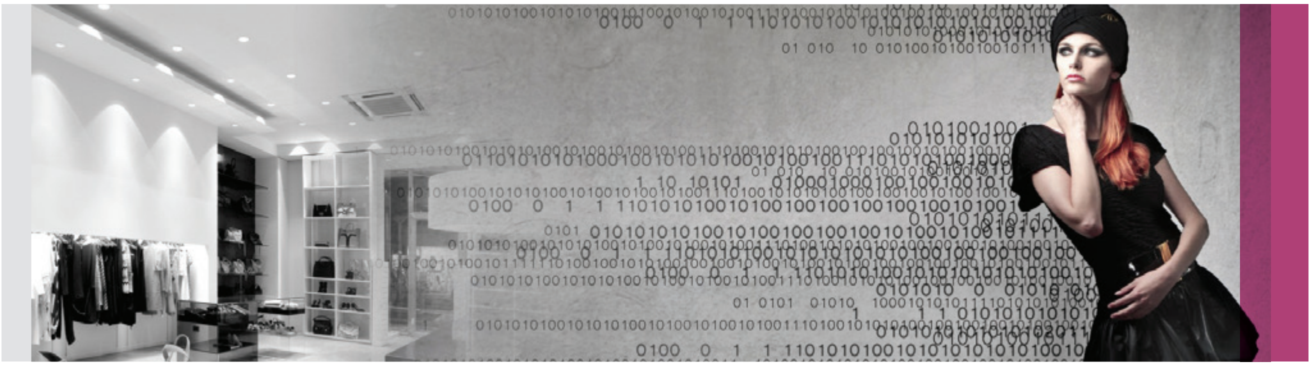

Are stores out of fashion… …or a competitive weapon in the digital era?

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Consider a few staggering facts about the deep immersion of digital devices…

- By the end of 2013, the number of digitally connected devices will exceed the Earth's population
- YouTube uploads more visual content every 2 months than what has been broadcast by the major U.S. television networks over the past 70 years
- Mobile traffic reached nearly 2 billion gigabytes per month and is forecasted to grow to 18 billion gigabytes by 2019, according to Ericsson Mobility
- The average U.S. teenager sends or receives 3,339 text messages per month, or nearly 110 per day
- Amazon expected more than 300 items to be ordered per second on Cyber Monday this year. Like other on-line shapers in the UK and Europe, they are redefining "got to have it now" with same day delivery.

Yet, in the world of fashion, digital market share still accounts for less than 10 percent of sales in most countries. But even in countries which have deep-rooted shopping behavior like France, this is changing fast. In fact, one-half of all French apparel shoppers made an online purchase in the past six months. And in emerging markets like China, the trend is even more pronounced, as digital apparel sales grew tenfold in just the last two years.

For global apparel brands and retailers, it is impossible not to think about how these transformative, technologically-driven changes are affecting the behavior of their core customers. As part of the Women's Wear Daily CEO Summit this year, we asked the world's fashion leaders what impact digital would have on their business strategy. Not surprisingly, the vast majority said that the impact would be substantial; yet unexpectedly only one in five of these CEOs thought that the impact would rise to the level of a total strategic transformation. As we see it, understanding this revolution and adapting to it could be a source of competitive advantage.

A new model for selecting fashion brands and products

For years, the process by which a consumer makes a purchase—the motion from awareness to consideration to decision—has been known as a marketing "funnel." Consumers start with a number of potential brands in mind and progressively narrow their selection as they move through the funnel. At the end of this decision journey they emerge with the one brand and one product they decide to purchase. The challenge for brands has been to understand consumer expectations at each step of this funnel in order to best influence their decisions.

But the rise of digital channels has disturbed the simplicity of the funnel. It is still useful for understanding a dimension of the consumer decision journey, but it fails adequately to account for the new touch points of consumer engagement. These touch points are bringing about changes that have decisive implications for the role of the store.

We analyzed the purchase decisions of almost 20,000 consumers across three continents and discovered that the consumer's decision-making process is no longer a linear funnel but a circular journey. Digital channels have reshaped the journey in two major ways. First they have allowed brands, consumers and third parties to share much more content, leading to a dramatic rise in the number and richness of touch points. Second, the development of digital channels has changed the role of the store, with physical stores occasionally becoming used only as showrooms or as delivery points. In their purchasing paths, consumers are describing an orbit that integrates physical and digital touch points, with the actual and virtual realms reinforcing each other. Consumers are truly embracing both sides of this division. So to those who say that the future of offline is online, we must add that the future of online is . . . offline!

Are apparel stores out of fashion?

No they aren't... on the contrary

The "anytime, anywhere" generation is insistently demanding a more satisfying real-life in-store experience. They value technology as long as it adds to the experience, but fundamentally what they want is a better in-store experience. Many apparel brands and retailers around the world have already started to experiment with solutions in this new paradigm. Some have arrived at the right strategy to transform their business models, thereby better engaging their existing customers throughout their journey and recruiting as many new customers as possible. Among WWD CEO conference attendees, 95 percent said they had begun the change while 42 percent said they had made significant progress toward transformation.

On the path toward retail transformation in apparel, three levers have stood out: better use of technology in stores, adjustment of the portfolio to formats befitting a new multichannel strategy, and adaption of the supply chain accordingly. These are the proven measures, but to apply them profitably retailers face numerous challenges.

A view from three continents . . .

Sales productivity in physical apparel stores has noticeably deteriorated over the last decade. In looking at three countries, the United States, China, and France, the picture is probably gloomiest in France. Over the last six years, the French apparel market has slightly declined, losing 2 percent in value. But with the advance of Internet sales, the physical retail industry turnover has dropped almost five times faster - by 9 percent. At the same time, the development of retail space has been on the rise, with 6 percent of selling space added over the same period. As a consequence, measuring by the square foot, average industry sales have plummeted 14 percent in six years.

In the United States the situation is slightly better, especially thanks to better market dynamics and more conservative development of retail real estate. Overall, the average sales per square foot have declined slightly, by 2 percent. In China, the apparel market is very dynamic, having almost doubled in the last six years. In the face of obvious online growth, physical apparel sales have still grown by almost 80 percent. Yet even so, because store openings have outpaced market growth, store sales productivity fell by a disappointing 12 percent.

Apparel store productivity has declined

Change between 2006 and 2012

Total sales	-2%	+3%	+93%
Offline sales	-9%	-2%	+79%
Retail space	+6%	0%	+103%
Offline sales per sqf	-14%	-2%	-12%

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. . . reveals unrelenting pressure on the traditional store

Historically a 5 percent decrease in sales productivity can trigger dramatic drops in profit by nearly 25 percent and return on equity by more than 30 percent. When the decrease in sales productivity is measured in double digits, the financial health of the brand itself can become unstable.

The buoyancy of some markets has masked this productivity decline, yet it cannot be denied that economic pressure on physical retail stores will become acute in many countries. Market growth is expected to be low in mature countries and slower than it has been recently in emerging markets. Since digital sales will continue to increase - possibly jumping to a 20 percent share in the next decade – store productivity will keep dropping. This productivity will be further depressed by the trend of continued commercial development, as more new malls, outlet centers, and department stores are created.

We can expect key cost drivers to drift, with margins squeezed between the rising cost of goods and high demand for markdowns. Labor costs in manufacturing are rising and in emerging countries the average salary of retail sales associates has increased by about 15 percent annually in recent years. Rental costs too are on the rise, especially in top retail locations.

As retailers design their digital offering, the sheer economic challenge of maintaining physical stores is growing rapidly. To meet it, retailers are finding it necessary to reduce costs by applying lean cost structures.

A strategic retail transformation

Apparel brands and retailers with brick and mortar stores face the difficult challenge of adapting their stores to rising customer expectations while simultaneously restoring long-term profitability. The only way to meet this challenge is through a full transformation of retail strategy. To set the stage for change, apparel retailers should take two initial actions. First, they must redefine the role of their physical stores within an integrated multichannel vision. Second, they will need to find a new definition for store formats, market footprints and network economics as they plan their future store portfolio.

Once retailers decide on their multichannel strategy and the role of their store network within it, then they can determine the number of stores, their locations and specific formats. Most retailers arrive at a configuration which includes a flagship location, larger and smaller free-standing stores, a shop-within-a-shop option, and an outlet format. Because each format plays a different role in the strategy, they each have different objectives, space and location specifications, optimal network size, and economic performance expectations. The exercise is also more difficult when the retailer starts from a legacy network

Finding out how best to capture value from each urban area can be a complex matter. In Paris, for example, high-end apparel retailers might want a flagship store on rue du Faubourg Saint-Honoré, a few free-standing stores in other desirable locations, a shop-within-a-shop in all three leading department stores, and possibly a luxury outlet in suburban la Vallée Village. The stores within such a network would complement each other as part of a larger multichannel strategy.

The implementation journey

Implementing the redesigned retail strategy is a holistic transformation journey that relies on a few key success factors. A customer-centric, multichannel mindset needs to be instilled across the entire organization, starting from a deep understanding of the consumer decision journey and the most influential touch points for the brand across relevant channels. Offering customers a flawless multichannel journey and delivering a distinctive in-store experience will also require a mastery of new technologies. A significant IT upgrade may be needed, as well as a redesign of the downstream supply chain, to enable fulfillment beyond click and collect offerings. For instance, enabling stores to function as regional distribution centers with pick and pack functionality for next day deliveries.

The importance of talent in the redesigned strategy cannot be underestimated. A successful retail transformation depends on the acquisition of new skills and capabilities. The role of real estate is changing from leasing and construction management to trade area optimization and deal making. The frontline staff is even more critical for building the brand and delivering an outstanding customer experience in the transformed stores

One further success factor is performance management. Many companies are already attempting to define the best indicators of online and offline performance within the context of the new strategy. In some multichannel strategies, the primary role of certain store locations is no longer to sell merchandise, creating a real challenge for measuring performance. One promising approach is to look at performance at the metropolitan level, rather than at individual points of sale, since in the new models the individual points are interlocking parts of the whole, and work together.

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The degree of change the digital revolution has had and continues to effect upon retailing is exponential. It naturally leads to speculation about the future of stores and they will survive or fade into history. However, one of the most remarkable insights to emerge from the digital revolution is the renewed role of the store. What was old can become new again and far from becoming a relic - the transformed store has become a new frontier.

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