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2017 Retail Industry Trends

Showrooms, consumer experience, and compelling economics

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Introduction

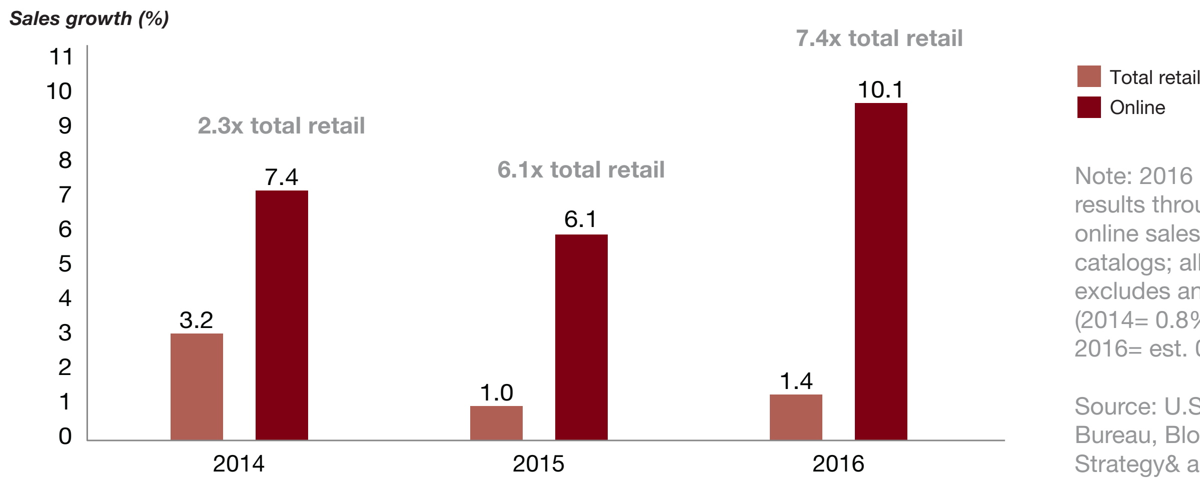
Ever since Amazon began selling books online in 1995, retailers — and plenty of other commentators — have been asking what role, if any, physical stores might play in the retail arena. Some have gone so far as to predict the ultimate demise of stores, and others expound the virtues of various hybrid omnichannel solutions.

To be sure, the trends are not good for store-based retailers, which generally complain of challenging conditions and frugal consumers. Although overall retail sales performance is quite strong, during the last several years essentially all of the inflation-adjusted gains in retailer revenue have been driven by online channels, which enjoy growth rates as much as 7 percent higher than retail sector growth as a whole (*see Exhibit 1, next page*). Meanwhile, traditional retailers are faced with flat or declining sales and large, costly store networks.

Not surprisingly, legacy companies are restructuring their footprints. In 2016, large retailers such as Aeropostale, JC Penney, Gap, Walmart, and Macy's shuttered stores. At the same time, incumbent retailers are embracing omnichannel concepts, which aim to offer consumers a seamless experience whether they are purchasing items online or in a store. The best of these offerings work well: Consumers get the convenience of shopping on a computer, smartphone, or tablet, or in person, and retailers may reduce marginal cost-to-serve by, for example, encouraging consumers to pick up bulky items at a store rather than having them shipped to their home.

Exhibit 1

Online sales growth dwarfs that of the retail industry as a whole



Note: 2016 accounts for results through August; online sales include catalogs; all sales growth excludes annual CPI (2014= 0.8%, 2015= 0.7%, 2016= est. 0.5%).

Source: U.S. Census Bureau, Bloomberg, Strategy& analysis

Omnichannel efforts have underperformed

Omnichannel strategies — which seamlessly synchronize many forms of customer experience, including brick-and-mortar store environments, online sales, smartphone connectivity, and voice connections — have been a success for a few retailers. Generally speaking, though, these efforts have not succeeded in arresting declines in store activity, improving retailer profitability, or boosting online sales. Although many traditional retailers today highlight the healthy growth rate of their online sales, most are actually lagging behind and losing market share to Amazon and other online specialists. And even as their revenue is disappointing them, they are learning how costly the omnichannel approach is, as it requires retailers to maintain multiple supply chains (one direct-to-home, one to the stores); support networks; and, often, inventory pools.

For traditional retailers, addressing these shortcomings in the omnichannel model is difficult. They would have to seek hard-fought efficiencies in basic, routine operations, such as store network management, and then selectively (and successfully) invest accumulated savings in the big-ticket capabilities required to be profitable in the omnichannel market. Among those capabilities are consolidated inventory systems, a compelling digital consumer experience, and big data analytics.

Online-only retailers, although certainly in a better position than their physical store counterparts, have challenges to overcome as well. These include converting browsing consumers into actual purchasers in higher numbers and handling steep logistics expenses for shipments and returns.

The showroom option

Given the obstacles facing retailers today, we believe that there is an additional, largely complementary sales approach that retailers in some sectors should consider. They can replace underperforming stores and support e-commerce efforts with showrooms. A showroom, in its purest form, is a store that showcases products, but sells nothing — in the sense of providing goods to consumers. Instead, a showroom offers items for inspection, gives advice on products, and takes orders. The products are then shipped to the customer's home from some other location.

As it happens, many consumers use retail stores in this way already; they browse in person and purchase online. But because retailers still aim to sell from their store inventory, they have to maintain the full range of existing store support infrastructure, making the current arrangement not economically beneficial. A dedicated showroom has a crucially different intent.

Showrooms work best for differentiated goods — *products that vary significantly from one retailer to the next.*

Showrooms work best for *differentiated goods*. These are products that vary significantly from one retailer to the next (e.g., branded fashion apparel), are new to consumers (e.g., the latest electronic gadget), or can be said to be sold, rather than bought (e.g., a wireless data plan or expensive jewelry). Their counterparts are *common goods*, or items (such as ketchup, soft drinks, and athletic socks) that consumers are very familiar with and that are essentially the same in every store. Common goods sell well online, but differentiated goods are harder to move via e-commerce; consumers may need or prefer to browse for these items, examine them, and even seek out advice about what to buy. Furthermore, if they do buy, consumers return differentiated goods at much higher rates.

A showroom can add value in several ways relative to the online retail environment:

- Skilled and attentive sales staff can encourage conversion of browsers into actual customers, resulting in more sales. And face-to-face with consumers in an engaging retail environment, the staff can also potentially upsell and cross-sell, which increases both revenue per item (known as AUR or average unit retail) and units sold per transaction (UPT), both of which improve shipping economics.

- Since customers can touch, feel, try on, and otherwise familiarize themselves with the goods in a showroom, returns are much less likely. In fashion apparel, for example, physical stores experience a return rate of about 3 percent, compared with about 25 percent for online sales, and an even higher percentage in the case of highly fashionable or fit-critical items. And if showroom-using consumers do decide to return items, retailers can save some of the significant expense of return shipping fees, handling, and restocking by encouraging customers to make those returns to the showroom.

When a company is selling differentiated goods in a brick-and-mortar store, the key driver of performance is having the right merchandise in the right place at the right time. Consumers don't know what they want until they see it, and preferences shift with fashion trends. End-to-end merchandising, or planning and selecting the most lucrative product mix from the beginning of the supply chain to its conclusion, is a critical institutional capability for traditional retailers — and inherently difficult to master. As a result, stores often require more backup inventory to cover shortfalls as total sales volume grows.

And despite everyone's best efforts, stranded inventory is commonplace, which results in costly markdowns and lost sales or expensive piecemeal transfers between stores. This explains why apparel retailers often earn higher revenue per item and higher gross margins in their online businesses. Even a product that starts at the same price online and in-store will often sell for significantly more AUR on an e-commerce site over the ensuing months, thanks to less stranding and fewer discounts.

A showroom's inventory benefits

A showroom can alleviate the hardships of inventory management. By definition, a showroom carries only the stock required for customers to select their goods. In apparel, for example, that might involve, for any style of garment, one in every size and at least one in every color, but not one in every style–color combination (*see Exhibit 2*). The inventory for actual sale is held centrally, which makes it much easier to manage. As a result, the inherent markdown risk in a showroom product is substantially reduced. And because the showroom carries reduced inventory, it requires less time to manage, and the outlet can be much smaller than a store, minimizing real estate charges.

Exhibit 2
Showrooms significantly reduce inventory woes

Showroom
Total denim inventory = 220 items

Style	Washes	Sizes	Average #/SKU
A	x1	x44	x1
B	x1	x44	x1
C	x1	x44	x1
D	x1	x44	x1
E	x1	x44	x1

Retail store
Total denim inventory = 3,640 items

Style	Washes	Sizes	Average #/SKU
A	x5	x52	x2
B	x5	x52	x2
C	x5	x52	x2
D	x5	x52	x2
E	x5	x52	x2
F	x5	x52	x2
G	x5	x52	x2

Source: Strategy& analysis

Making it work

Bonobos, a trendy men's clothing company that caters to 18- to 40-year-old men, aptly illustrates the showroom retail concept. Since 2012, the company has been experimenting with showrooms it calls Guideshops, now in 30 locations. Consumers can walk in or book an appointment, and have a beer or a drink of water as knowledgeable salespeople called ninjas take measurements and help sort styles and sizes.

Guideshops have all the advantages of a high-end, high-touch retail store. Customers can try on clothing, get plenty of advice — and be enticed with possible accessories and add-ons. At the end of the sales appointment, the goods are ordered online and shipped to the customer at home. "We said we would never be offline, and then, wait a second," Bonobos CEO and cofounder Andy Dunn told the *New York Times* in 2014. "We hit a big turning point. We realized offline really works."

Guideshops save money by requiring fewer salespeople and having smaller footprints than a traditional retail store. Furthermore, since customer details (such as sizing and favorite styles) are recorded in the Bonobos data system, customers are more likely to make online purchases unassisted in the future, driving customer loyalty and lower returns, even for e-commerce transactions.

Moreover, the inventory savings are striking. We estimate that in its denim jeans inventory, Bonobos showrooms need to stock only around 220 items to cover its style/size/wash assortment. In contrast, a typical specialty apparel store might stock in excess of 3,600 items in jeans alone. And a Guideshop showroom avoids the expensive infrastructure needed to support physical stores, including complicated supply chains and point-of-sale systems with sophisticated bookkeeping and accounting backbones. When consumers are ready to make a purchase, the ninja simply hands them an iPad and helps them make an online purchase in the routine way they would if they were at home on their couch. Crucially, the sale is consummated on the spot, eliminating the possibility of cart abandonment partway through the purchase, a frequent occurrence when shoppers initiate transactions on the Web, as well as the risk that the customer might leave the store and choose later to buy similar items from another retailer online.

Other retailers, including Haier (the Qingdao-headquartered appliance manufacturer, in its own stores in China), Hointer (a Seattle-based apparel retailing startup), Paul Evans (a New York-based men's shoe store), Restoration Hardware (an American home furnishings chain), and Zalora (a fashion emporium in Southeast Asia), have adopted the showroom model. Many of these companies carry higher-end furniture or apparel, which are prohibitively expensive to stock in quantity. There is thus a natural transition to the gallery approach, where retailers can offer shoppers a sense of how these products look and feel in real-life settings in the case of furniture or in a more casual, less rushed environment for trying on clothing with attentive sales experts on hand.

Showrooms potentially offer the alluring prospect of a great consumer experience and solid economic fundamentals.

This model essentially combines experience retailing — a popular concept these days in the industry — and efficient inventory management. The store's space can be used for displays and visual merchandising and actual goods-for-sale can be held at a few central fulfillment centers, rather than at numerous retail outlets. Pooling inventory in a small number of warehouses makes forecasting sales volumes and stock levels much easier because volatile demand tends to smooth out over the showroom network.

Many retail executives may take a dim view of conventional "showrooming" — visiting a store before making a purchase online — far from seeing it as the solution to big challenges. But as it evolves in a way that lets retailers help customers make purchases on-site and have items delivered to their homes, many retailers are finding that the showroom phenomenon can be leveraged to their advantage in the form of higher sales, fewer returns, and lower costs. Put simply, showrooms offer the alluring prospect of a unique consumer experience and solid economic fundamentals.

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