Footprint 2020

Offline retail in an online world
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By 2020, we expect online sales shares in the Netherlands to grow from 9% to 27% in four categories analyzed (Health and Beauty, Consumer Electronics and Appliances, Toys and Games, Apparel). Offline sales will decline as a result of online growth. Our estimate is that by 2020, 2.0 to 2.5 million square meters of sales area in urban areas will have become redundant. This is 17% to 21% of the current sales area of 11.7 million square meters in city centers (excluding grocery retail). To prepare for these developments, retailers should start developing their (physical and virtual) footprint for 2020, which includes location management, new store formats, digital technology solutions, and store productivity management capabilities. Not responding is not an option — we see big shifts in customer needs and behaviors happening fast, resulting in different roles for stores to play in the future. Customers expect a seamless shopping experience across channels, and retailers need a solid multi-channel plan.
Introduction

While focusing on establishing and/or growing a profitable online business, traditional retailers often overlook a looming problem: the liability of a physical store network in the face of shrinking offline sales.

Strategy& analyzed the possible impact of online sales growth on offline sales and physical sales area in stores in the Netherlands in four retail categories: Health and Beauty, Consumer Electronics and Appliances, Toys and Games, Apparel. We present implications for retailers and a path forward when planning the retail footprint for 2020.
The impact of e-commerce on offline sales

While many retail categories show limited overall sales growth (or even a decline), online sales continues to boom in spite of the economic downturn. Consumer adoption rates are growing as commonly stated barriers to online shopping are starting to disappear. Free delivery and returns are becoming more common. Although currently still mostly used as a marketing tool to stimulate repeat purchase (for example at Internet retailer Wehkamp), or as a way to differentiate the customer value proposition from competitors (like Zalando), free delivery and returns will at some point in the future become a standard service for web shops. Dutch postal company PostNL is taking away the barrier of inflexible or half-day time slots for parcel delivery with their ‘Checkout’ service for retailers which allows to set a much more accurate delivery time. Even the main consumer barrier of not being able to try or test the product is to some extent alleviated by augmented reality technologies such as Top Shop’s virtual dressing rooms and ditto.com’s 3D video technology to try on glasses and sunglasses at home. Ironically, new service propositions offered by some pure play online retailers which were primarily meant to remove online shopping barriers are starting to create ‘barriers’ for offline shopping. For example when traditional retailers refuse to accept in-store returns for items purchased online.

By 2020, we expect online sales shares in the Netherlands to grow from 9% to 27% in four categories analyzed (Health and Beauty, Consumer Electronics and Appliances, Toys and Games, Apparel). This is largely at the cost of offline sales. Online sales shares will reach different levels across these categories. In apparel (including shoe stores, sportswear and department stores) we expect Internet sales shares to grow from 5.6% in 2012 to 26% in 2020. In health & beauty (including drugstores, perfumeries and grocery health & beauty segments), online share is currently 1.6% but could end up between 5% and 10% of category sales by 2020, mainly in health & wellbeing products (e.g. vitamin pills, nutrition and dietary products) and high-end cosmetics, beauty and perfumery products. In toys & games (including digital games) online sales could grow from 17% in 2012 to 50% or more in 2020. This is largely driven by the fact that category growth is almost exclusively
driven by online games sales, which is boosting online shares. We expect offline sales to drop 17% from the 2012 level. Online consumer electronics sales is expected to grow from 20% to 40% or higher in 2020. Household appliances currently have an online share of just below 10%, which could grow to 25% in 2020. In an accelerated scenario this could grow to 50% because for this category offline shopping has limited value over online shopping; customers do not have to see nor try appliances and retailers. might actively stimulate online sales as this will free up store space.
Implications for stores

Offline sales will decline as a result of online growth. Store traffic will go down, especially in peripheral shopping areas with big box retailers since online takes over the role of aggregating a wide product range and providing product recommendations and expert advice. Store conversion rates will also go down. A new emerging way of shopping has already been named “showrooming”: customers check out products in the store and order them online. Lastly, the growth of online will put more and more pressure on offline prices due to increased (price) competition and increased price transparency. When offline retailers don’t respond adequately, these dynamics will result in a drop in store productivity (€ per square meter) that will put many small stores out of business and provide larger chains with a large set of ‘zombie stores’ with low traffic and low (or negative) profitability.

Our estimate is that by 2020, 2.0 to 2.5 million square meters of sales area in urban areas will have become redundant. This is 17% to 21% of the current sales area of 11.7 million square meters in city centers (excluding grocery retail). In apparel we expect a drop of 25% from 5.0 million to 3.7 million square meters. In this estimate we have factored in that larger apparel chains could accept lower store productivity as they leverage the store to generate online sales. Small boutiques might be able to attract a steady base of customers with a unique assortment and personal sales approach. Small and mid-sized stores that sell mostly branded products are expected to be hit hardest. In health & beauty, the impact from online on square meters is more modest: a 3% to 8% decline in sales area from 600.000 square meters to 550.000-580.000 square meters in 2020. The reason for this is that overall category sales is expected to grow moderately (1% to 2% per year) combined with relatively low Internet penetration levels. In toys & games we estimate 15-20% redundant floor space from 300.000 square meters today (see Exhibit 1, next page).
Exhibit 1
Forecast of online sales share in 2020 and impact on retail sales footprint

Online share of total sales
2012 vs. 2020, in % of total category sales in the Netherlands

- Apparel: 6% → 26%, +20%
- Consumer electronics and appliances: 16% → 33%, +17%
- Beauty and personal care: 2% → 5%, +3%
- Toys and games*: 17% → 50%, +33%

Retail sales footprint
2012 vs. 2020, in million m² sales area in the Netherlands

- Apparel: 5.0 → 3.7, -25%
- Consumer electronics and appliances: 1.2 → 0.7, -41%
- Beauty and personal care: 0.6 → 0.6, -3%
- Toys and games*: 0.3 → 0.2, -17%

*Includes software and video games.

Source: Euromonitor; GfK; Blauw; ING; Strategy& analysis
Store formats of the future

Flagship stores

Flagship stores are large stores on prime locations in major cities. Some brands and retailers already have flagship stores in the major high streets in Europe (for example on the Champs Elysees in Paris or Kurfürstendamm in Berlin), we expect to see more stores with flagship roles in the future, also in smaller cities. Compared to regular stores flagship stores have more and better trained staff. The customer value proposition is geared towards service and hospitality — making these stores a great place to spend some more time in than in other stores (examples include the Apple’s company operated stores). These stores are primarily driven by marketing and branding goals; experience and emotion are more important than sales (for example the M&M’s store in New York which serves as an extension to the ad campaign).

Flexible formats

Flexible stores are used to temporarily serve specific customer needs or create a buzz. Examples are pop-up stores (where a store ‘pops up’ at a specific location and disappears within weeks) and the “on-wheels” concept (where a mobile store is placed at events). The flexible format is used by brands to create marketing buzz for new launches, trigger impulse buying, or do consumer testing. The power of flexible formats is that they draw attention (and traffic) due to an element of surprise and temporary character of the store. Examples include the Hermes Silk Bar, Magnum Pop-up Store in London, Stumptown Coffee Amsterdam. This format originated with retailers who were seeking alternatives for their long term rental contracts. It has become a playground for labels and brands testing new concepts and stimulating marketing buzz.

Complementary systems

Complementary systems are formats that have evolved around crossselling opportunities or other mutual benefits and/or target groups for both consumer brands and retailer labels. Usually an incumbent retailer allows emerging labels or brands who are testing new markets or new customer segments to use part of the store space with a clear mutual benefit for both. Complementary systems are an opportunity for small brands to obtain prime store space before investing in long-running retail contracts, and they are an opportunity for the incumbent to remain agile to pick up new trends and to keep the store fresh and exciting with revolving ‘guest assortment’. With declining demand for sub-prime retail locations this movement may ultimately lead to ‘mega department store’ formats, where traditional retailers turn into a ‘house of brands/trends’ — with a selected (and revolving) collection of brands and stores together forming an attractive and entertaining consumer proposition.

Virtual showrooms

Virtual showrooms are mid-sized store formats that feature digital interaction via touch screen walls and other devices. This format allows retailers to display their full collection on a limited floor space, which is especially attractive for big box retailers and car brands as this gives them a way to enter urban areas. An example is Audi, which is planning to open twenty Audi City formats in
the next years (London and Beijing already opened). This is a digital car showroom allowing the car maker to move into city center shopping streets. For customers virtual showrooms provide the benefit of ‘experiencing’ a product that is customized to their liking and needs (like a customized car, kitchen, or shoe). An additional feature of virtual showrooms is the high degree of connectivity with a customer’s social network and their digital ‘me’, presenting a more seamless shopping experience online and offline. Showrooms are expected to grow as a concept in the inner cities, where retail square meters are most expensive. First movers are car manufacturers and apparel retailers, for example American Apparel, Adidas, John Lewis and Marks & Spencer.

**Segment concepts**

Segment stores are spin-offs of bigger store chains that focus on a specific segment: a specific part of their range, or a specific target audience. Examples include H&M who launched their ‘& Other Stories’ luxury concept, Hema that opened Hema Beauty stores focusing exclusively on Beauty products, and G-Star with their G-Star women store in Amsterdam. Segment stores allow retailers to deepen relationships with customers, extend their product assortment, and diversify their brand image.

**Pick-up and drop-off points**

Pick-up and drop-off (P&D) points are designed to overcome important barriers for online shopping; the payment of shipping costs, and the inconvenience of fixed delivery windows (‘between 7 and 9 pm’). P&D points allow customers to pick-up and/or drop-off products bought online. P&D serves both online and offline purchases, which also includes returns of offline purchases. P&D points can either be small local stores (e.g. Kiala points), high traffic or highway locations (railway or gas station), warehouses, neighborhood supermarkets, or even postboxes and lockers in the streets (DHL), in shopping malls (e.g. De Buren), or urban centers. The format can be a customer service desk in-store, a drive-through concept or a wall with lockers and codes. Some grocery retailers are even experimenting with pick-up during set timeframes from delivery trucks (e.g. Relay in the USA).

**Mash-ups**

Future store formats are flexible and not easily categorized. We expect combinations of the abovementioned store roles to appear: pop-up stores within complementary systems, a virtual showroom alongside a drop-off point, segment concepts on wheels, and many other combinations.
How retailers should respond

Cutting store operations costs is not a solution to retain store profit levels. Even though staff labor cost can be as high as 20% of sales in some retail categories, compromising on either staff numbers or staff quality is a bad response that could lead to further erosion of revenues. Real estate costs are the next biggest operating cost for stores (averages range from 5% to 10% of sales across retail categories). Prices and rents for commercial real estate have been going down slowly in the past years. A further drop in real estate costs will relieve the pain for some stores, but it is definitely not a remedy for a structural change in store productivity levels. The underlying fundamental problem is that customer flows are shifting. Customers won’t only go from offline to online, but also in the ‘offline world’ store traffic patterns will change. The proper response for retailers is to shrink and adapt their physical store network and make it part of a multi-channel experience. But how and by how much?

First of all, retailers should develop new store formats in different locations, effectively shrinking their average store size. Traditional roles of the store (e.g. getting product advice, doing comparative shopping, trying and testing, and purchasing products) are increasingly being fulfilled by other channels and media. At the same time the role of the store needs to change in line with evolving shopping behaviors. Retailers have to think beyond traditional size-based format development and management, and instead move to a portfolio of formats based on the purpose of the store in a specific location. We see the following new types of store formats emerging: flagship stores, complementary systems, flexible formats, virtual showrooms, segment concepts, pick-up and drop-off points, and mash-ups (see “Store Formats of the Future,” page 10).

Second, retailers have to compensate lost offline sales with new online sales providing customers a seamless cross-channel experience. Various apparel retailers and department stores are experimenting with virtual clothing racks and dressing rooms in-store, allowing them to present a complete collection, provide better product recommendations (based on other customers with similar style preferences and/or a customer’s social
network), and to extend a customer’s online shopping trip in the store (and vice versa). John Lewis, one of UK’s oldest department stores, has been very successful in transforming from a traditional store to a multi-channel retailer using advanced interactive technologies in the store. About 25% of John Lewis’ sales go through online channels, with a reported year-on-year growth rate of 40%. British apparel retailer Next also reports an online sales share of roughly 25%. H&M, the leading apparel retailer in the Dutch market, has an estimated online sales share of 15% with a growth rate of approximately 15%.

Having a long heritage as a bricks and mortar retailer can be an advantage in terms of being a household name with high brand awareness offline and online. But it can also be a disadvantage when such retailers enter the multichannel world with a conservative mindset regarding their physical stores. The belief that the physical stores don’t need to change when retailers go multi-channel is a dangerous one. Retailers leading the pack focus on providing a seamless and coherent experience across all channels, turning their traditional stores into “connected stores” (see “The Connected Store,” next page). Features and applications that originated online are entering the physical store. This allows new brands — including pure play retailers — without heritage in a market to seize an opportunity to leapfrog traditional players and become a household multi-channel brand.
The connected store

Technology is a key enabler for succeeding in a multichannel world. It is not only the catalyst for sales shifting from offline to online, it is also changing the role of the physical store. We see four types of digital innovation in physical stores.

Digital in-store technology (‘unplugged’)

The in-store shopping experience itself is enriched by technology-enabled services (in an ‘unplugged’ way, so not necessarily connected to digital channels). There are various digital technologies enabling consumers to connect with the retail offering, to tailor products to their needs, or to differentiate the shopping experience:

- Gesture-based window shopping — Orange store in London features a gesture-based window touchscreen where consumers can scan offering and mix & match products
- QR-based window shopping — Many retailers, like Diesel, Adidas and BoConcept (furniture) are experimenting with QR codes in the shopping window to connect to a certain promotion or event, or to add more background to the products displayed
- Non-connected virtual showrooms — ‘Vending machines’ (American Apparel, Streetology, Havaianas), touchwalls (Adidas) or even table touchpads in restaurants (Inamo) are connecting customers to staff to order products for fitting, purchase or consumption

Interactive technology, connecting on- and offline retail

Retailers are engaging with customers in the ‘parallel universes’ of online and offline, in the same way, at the same time. Technologies enable customers to continue an online shopping trip offline in the store, and vice versa. Examples are:

- Connected virtual showroom concepts — Longtailing (John Lewis) or Virtual Store concepts (Marks & Spencer) are best examples of connecting customers in-store to the full assortment and collection variants offered online
- Digital loyalty — Cross-channel and social CRM, rewarding customers for their loyalty in terms of frequency, monetary value (Bijenkorf), and even positive reviews in social media (Hunkemoller), independent of the purchase channel
- Instant social sharing — Platforms which enable shoppers to share fitting experiences in their social network (Diesel)

Shopper ‘savvy’ CRM technology, adding a layer to on- and offline interaction in-store

Technology is enabling retailers to tailor their proposition real-time to customer needs by using customer knowledge translated to an in-store offering. A good example is mass tailoring, where instant customization is used as a key differentiator. Suit Supply started doing this before the digital era in retail, and today manufacturers are exploring

Continued
this model mixing online access and insights with offline propositions. Other examples include:

- Instant customization — Nike has built a total concept around ‘design your own shoe’, where a Nike ID, mobile portal, website and offline ‘design stores’ blend well together in the customer journey to the perfect shoe

- Data pushed offering — Using direct access to customers (customer ID, FourSquare, near field technology) to offer relevant benefits or promotions (AT&T, Starbuck Foursquare rewards)

- Loyalty service desks — Using cross-channel loyalty levels to differentiate service levels to the extent of personal client recognition (Hunkemoller) and loyalty desks (Apple Genius Bar)

‘Halo effects’ of interactive technology, changing the role and experience of the physical store

Advanced mobile technologies (mobile payments, augmented reality) will enable consumers to scan and buy everything they see in real life. In effect, the world itself becomes a shopping window. Scans of products, in-store, or even in use or as worn by others, will connect consumers to direct purchase options, to be fulfilled either via online or offline channels. These technologies are adding a virtual layer to reality, with direct shopping access. Apart from some QR tests in the US and Asia — only impacting the real store if used as a pick-up point — there are not many ‘lighthouse examples’ yet. Tesco and Ahold are known examples, testing in Tokyo and New York with QR coded shopping in metro stations. Future formats which are exploring options for direct purchases of items ‘from real life’ possibly can be found in social platforms (Pinterest/Luvocracy) where product pictures turn into ‘mini-shopping windows’, directly connected with links to specific online platforms.

In the future this ‘halo effect’ of technology will impact the shop floor, turning stores into inspiration house, service center, showroom or fulfillment point. Today, offline stores can find the most relevancy in this evolution by linking their offering to these platforms, and finding a way to capture these consumers online, and generate offline traffic (for example by using CRM technology from the third level).
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Endnote

1. Source: RetailTrends; PSFK Retail Reports; Trendwatching.com; TrendHunter.com; Strategy& analysis.

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