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CONSULTING & OUTSOURCING

RETAIL TRANSFORMATION

Evolving from a traditional to a modern operating model

Retail isn't dead, but it's undergoing a massive transformation

The retail industry is finding itself in a tremendous upheaval. Some industry observers are even calling 2017 the "Retail Apocalypse".

Don't believe it? Here are some early data points:

- Retail bankruptcies are happening at a record pace with 14 retailers filing as of April 6th 2017. This number comes close to the total of 18 filings in 2016[1].
- Moody's recently announced that the number of distressed retailers has tripled over the last six years and has reached levels not seen since the 2008-09 recession[2].
- Credit Suisse estimated 2,880 store closings announced this year through April 6th, compared with 1,153 over the same time in 2016. About 60% of store closure announcements historically have come in the first five months of the year, so extrapolating from there, the bank estimates the year could bring more than 8,640 store closings in total[3].

In other words, the US retail industry is on pace to close 39% more stores this year than the 6,200 shuttered during the Great Recession in 2008.

The US Retail industry is on pace to close 39% more stores in 2017 compared to the great recession in 2008.

Figure 1.
US Retail Bankruptcies (from Jan. 1st to April 6th, 2017)

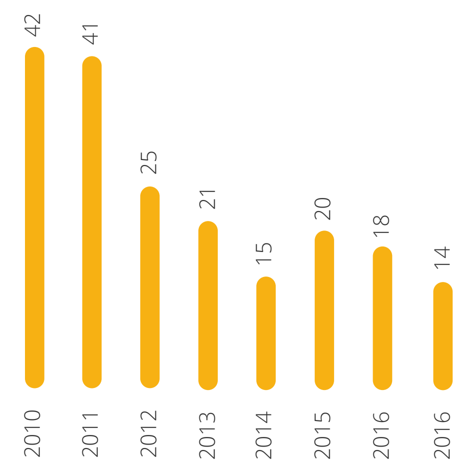
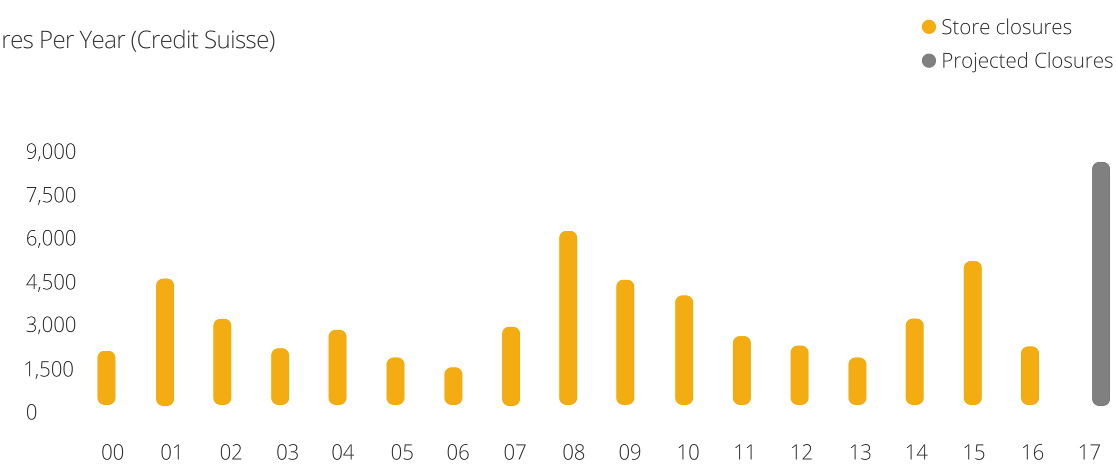


Figure 2.
US Store Closures Per Year (Credit Suisse)



(1) S&P Capital IQ. Data as of April 6, 2017
(2) Moody's Investor Service, 27 Feb 2017
(3) Credit Suisse Bank. Data as of April 6, 2017, with projections for the balance of the year.

Industry continues growing despite many players struggling

This is all happening even though annual retail sales have been consistently growing, disposable incomes are on the rise, and overall consumer spending was up 2.1% during the fourth quarter of 2016, reaching 11.7 trillion[4]. The consumer spending in the United States is forecasted to continue growing consistently at least until 2020, when it's projected to be at 12.3 trillion[5]. Typically, these would be considered positive indicators for the retail sector, but the conflicting data points suggest how the industry is undergoing a structural transformation rather than suffering an overall decline.

The competitive dynamics of the industry are being impacted by a myriad of factors including: the increasing move to online shopping, shifting customer demographics, and changing consumer demands.

Consumer spending grew 2.1% in Q4 of 2016 despite retail industry struggles.

(4) The Bureau of Economic Analysis
(5) Trading Economics – United States Consumer Spending Forecast 2016-2020
(6) The US Department of Commerce

Amazon accounts for 34% of total online sales in US, with projections to reach 50% by 2021.

The transformation goes beyond e-commerce

Due to all these market forces, retail executives are going to need to become more aggressive in disrupting and innovating their own operating models if they are going to survive and thrive in this new environment. Unfortunately, many in the industry have been slow to adopt new strategies and technologies, and have let new and more innovative competitors - most notably Amazon - come in and outmaneuver them.

For perspective, Amazon now accounts for 34 percent of US online sales with projections by some industry analysts that this will reach 50 percent by 2021. It is also estimated that Amazon captured 53 percent of all online retail sales growth in 2016!

These new players have created a new business model by offering more choices and flexibility, and being built from the ground up to provide the more personalized customer experience todays' consumers expect at a much lower price point. Procuring less real estate, employing a smaller salesforce, making better use of information technology, and reducing the size of inefficient back offices have enabled the new generation of retailers to get an edge up cost-wise.

All that said, it's overly simplistic to attribute all the turmoil in retail to the rise in ecommerce. While the growth of online sales is impressive, it still only represents 11.7% of total retail sales. Despite the uptick in ecommerce, brick-and-mortar operations are still very important.

Many retailers that began as pure online players are realizing this and are looking to establish a physical store footprint to drive better branding, reduced shipping costs, improve the returns experience or, basically engage with customers at a larger scale. Good examples of this are Amazon's plans to open over 100 Pop-Up Stores, and specialty retailer Casper Sleep's which recently announced its plan to sell products through Target with its massive footprint of 1,200 stores nationwide.

Online retail sales still only represent 11.7% of total retail sales.

US represents an over-stored retail landscape, with the highest retail square foot per capita in the world (24 versus 10, in Australia, the second highest country).

While digital retailers are adding a brick and mortar footprint, the overall picture in the U.S. is that of an overstored retail landscape. The U.S. has an estimated 24 retail square feet per capita. That's much higher than any other country in the world. For example, Australia and the UK rank the next highest countries with 10 and 5 retail square feet per capita, respectively. Given this, it may be safe to say that the only tougher position to be in the U.S. than that of a traditional retail executive may be that of one in Commercial Real Estate!

Relationships within the industry are also growing increasingly blurred. Industry roles used to be clearly defined between retailers who sold to consumers and manufacturers who sold to the retailers. The system was pretty simple and well understood by all parties involved. Customers and competitors were clearly defined, but that's not the case anymore. A growing number of CPG manufacturers are selling direct and opening their own stores while retailers are adding their own private label products. Now, your customers and vendors are also increasingly your competitors! In short, these relationships are now more complex and extremely sensitive.

Getting ready to compete

Given this tremendously volatile and complex environment, it is now more urgent than ever for retailers to have strategic clarity and be ready to adapt and modify. This all begins with being able to clearly answer some very basic, but fundamental questions about their business:

- What customer are we really serving?
- What does that customer really want?
- What are the preferred methods and channels through which our customers want to interact?
- What will our competitive differentiators be in this new landscape?
- What differentiated value are we really providing or should be?
- Are we in a position to deliver that value?

The reality is that many retailers don’t have clear answers to these types of questions, and even if they do, they are hampered by a legacy operating model that doesn’t have the necessary flexibility required for today’s rapidly changing retail environment. Many are still struggling with outdated and poorly designed information technology platforms, a bias towards the traditional operations of yesteryear, and bloated organizational structures that prevent them from reacting fast enough to the changes happening around them.

The modern retail operating model

We believe the rules of the game have fundamentally changed. To survive and thrive in todays' retail landscape, executives need to modernize their operating models. Retailers that adopt a Modern Operating Model will be better positioned to compete by being more strategically than transactionally oriented, future versus historically focused, and superior in analytical insights. These "Modern" retailers will break down the debilitating silos within the organization, that make implementing change so difficult, exhibit a bias and capability to move fast and develop a more productive, adaptable and effective workforce.

Organizations with an Agile Operating Model will be better able to compete.

Defining your core competencies

The change to an Agile Operating Model will not be easy, but must happen. For most organizations, this will be a transformational change, not incremental. This journey will require a clear definition of what truly is the organization's core competencies.

In our view, too many organizations are trying to do too much, thereby losing focus on the core value and differentiation they can provide to customers through their respective products and services. This mistake has watered down their operational effectiveness, flexibility, and more importantly, their strategic focus

The reality is that the great majority of activities performed in most companies are not truly adding value to the end product or service. These "non-core" support activities must be done, and must be done well, but they are not competitive differentiators and therefore should not meet the threshold of a core competency. Unfortunately, they also take away focus, time and resources from the activities that are true value drivers. They can be a major distraction!

The journey to a more Modern, Agile Operating Model should begin with a clear and disciplined assessment of your core business strategy and value proposition, and the customer-oriented differentiators required for success. This will dictate the identification of your core competencies which are the areas where the organization needs to increase its focus, resources and capabilities. Everything else outside these core competencies needs to be performed in a manner which delivers the required level of service while maximizing efficiency, cost effectiveness, and minimizing management focus.

To have a deeper conversation on the modern back office:

Authors

Raul Vega
Founder & CEO
raul.vega@auxis.com

Fabiana Corredor
Strategy & Finance Manager
fabiana.corredor@auxis.com

Contacts

Dan Day
Marketing & Analytics Executive
dan.day@auxis.com

Eric Liebross
Senior Managing Director
eric.Liebross@auxis.com

About Auxis

Auxis' is a management consulting and outsourcing firm focused on helping Retail and CPG companies achieve Peak Performance in their Back Office Operations. The firm was founded in 1997 by former PepsiCo executives who realized that what companies needed to optimize their performance was a customer-centric approach that focused on flexibility, collaboration, customization and faster speed to benefit. We focus on 3 primary areas: Finance & Accounting, Information Technology and Customer Service.

To learn more, please visit us at: **www.auxis.com**.