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THE

# ROBIN REPORT

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FALL 2015



**COSTCO**  
**WHOLESALE**

+ GLOBAL REPORTS

FROM BRAZIL, CUBA, ITALY AND MEXICO

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+ MILLENNIALS:

TALKING LUXURY AND THE  
WORKPLACE OF THE FUTURE

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# COSTCOHOLICS

75 MILLION ADDICTS AND COUNTING

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# “COSTCOHOLICS”

## COSTCO'S \$113.7 BILLION ADDICTS

A good friend of mine was talking about Costco recently, raving on and on about how she couldn't resist shopping there at least two to three times a week. She said sometimes she doesn't even plan on buying anything. She just loves wandering around in the enormous, two-football-field-sized warehouse, hunting for what's new (Costco turns over its entire inventory 12 times per year). She is also obsessed by what the big designer or luxury “surprise” of the week might be; stuff like Waterford Crystal, Coach handbags or Omega watches, to name a few, all selling out quickly for shock-and-awe low prices. And even though she may have shopped with no intention of purchasing, she says she always finds something that seduces her to buy.

So as she is telling me about her compulsive obsession, or obsessive compulsion, for this almost out-of-body experience she has every time she goes in to Costco, I think I observe a slight tremor—almost as though she's going through some sort of withdrawal. The next thing out of her mouth is, “I must plan a dinner party for this weekend so I can get over there tomorrow and get some steaks and another case of red wine.” Just to give you some context, world renowned chef Julia Child bought her meat from Costco, and the retailer is the largest purveyor of fine wines in the U.S. Incredibly, to me, my friend did plan a dinner party just as an excuse to go to Costco. Now that redefines the neurological addiction I've been writing about for years.

### A “COSTCOHOLIC” INDEED!

She is just one of the over 75 million “mainlining” Costco members (and growing in high single digits annually), with an average annual income of \$100,000, paying a \$55 annual membership fee (or \$110 for an executive level membership). Three million members a day enter Costco's stores to get their fix.

Yes, you read those numbers right. In today's over-stored and over-stuffed retail environment, the equivalent of almost one-fifth of the U.S. population is paying for the privilege to shop at a particular

store. And this is not a one-off, let's-see-what-it's-like kind of visit. The renewal rate is a whopping 90 percent each year. I guess that captures the power of an addict's behavior.

Not only is 80 percent of Costco's gross margin and 70 percent of its operating income derived from its Costcoholics' membership fees, Costco collects most of its profits 12 months in advance, not at the eleventh hour of the fiscal year like most other retailers.

These “druggies” bought enough stuff during Costco's 2015 fiscal year (ended August 30th), to pump revenues up to \$113.7 billion (a 3 percent increase over 2014). Costco is the second largest retailer in the U.S. after Walmart, with 480 warehouses. Internationally there are 89 Costco warehouses in Canada, 36 in Mexico, 27 in the UK, 23 in Japan, 12 in Korea, 11 in Taiwan, 7 in Australia and one in Spain. And Costco plans to open 14 new warehouses (including two relocations) before the end of calendar year 2015.

### A COMBINATION DRUG

At the core of Costco's model is a philosophy that was embedded by its founder and CEO, Jim Sinegal, from its inception in 1993, then passed on to its current CEO, Craig Jelinek, when he took the helm in 2013. This philosophy was handed down to Sinegal by his longtime employer and mentor, Sol Price, who was the pioneer of the “warehouse store” retail model, launching Fed Mart in the 1950s and Price Club in 1976.

Price never allowed employees to use the word ‘discount.’ The way Price's mind worked was to focus on the lowest possible markup rather than the deepest discount. In Sol's mind, the word discount equated with cheap. So the core ingredient in Costco's addictive drug is its value proposition that stands for high-value products at the lowest prices.

How does Costco manage to offer such down-and-dirty prices? For starters, it has enormous economies of scale. Costco buys more apple juice, diapers, pasta,

towels—in fact, more of any product it decides to offer its members—than just about any other retailer, allowing it to negotiate the lowest prices from vendors. It sets the standard for the lowest pricing in the industry; not even Amazon can beat it. As a result, the Internet has disrupted Costco less than it has other retailers.

And since 80 percent of its gross margin and 70 percent of its operating income come from its membership fees, Costco keeps margins razor thin, with markups at 15 percent or less, compared to 25 percent for supermarkets and 50 percent for department stores. Costco's prices are on average 30 percent below large supermarket chains'.

Because of the relatively low number of SKUs that Costco carries, the Costco model is simpler, cheaper and easier to execute, and it is inherently more productive than that of the average retailer. It requires less time to sort, restock, reorder and deliver product. Costco eschews carrying multiple brands of products that are similar, except of course when it has its Kirkland Signature private label brand to sell. Think about it: A major supermarket chain like Kroger's might offer 40 different peanut butter SKUs; Trader Joe's has ten; and Costco's has two. Costco's 4000 total SKU's is narrow, but it allows them to buy huge quantities and charge lower prices.

A second part of the Costco drug combo is the treasure hunt—the discovery of something not needed, but impulsively desired. Each store's main aisle is designed in a racetrack layout, which leads customers to circle the entire floor and view the entire mix of product offerings, often enticing them to buy things they didn't necessarily set out to buy.

Costco's product categories range from tires and diamond rings to food, clothing, electronics, cleaning supplies, home décor items and everything else in between. And don't forget gas and the automobile aftermarket. More than 66 percent of its sales are food. Approximately 75 percent of merchandise sales are in what the company calls “triggers”—bulk sales of staple products like cereal, ketchup,

*Continued on page 4*

detergent and paper towels—that people use day in, day out. Need 20 pounds of sirloin steak or five pounds of whole cashews? Then Costco is your place. Eggs come in cartons of 90. Diapers are ten dozen to a box. You can buy Colgate Advanced Whitening toothpaste, but only in a pack of four eight-ounce tubes.

The other 25 percent of sales at Costco are in so-called treasures—opportunistic finds that Costco stocks to surprise and delight its customers. These are electronics, appliances and other less frequent purchases at extremely good prices. And then there's the fun stuff. Brands such as Andrew Marc, Calvin Klein, Adidas, Chanel, Breitling and many more, for incredibly low prices, compel the treasure hunters to keep coming back. Behind the curtain, these products are acquired from distributors, rather than the brands themselves, sold individually (not in bulk)—and often sell out quickly.

The three million shoppers per day who visit Costco stores are some of the most neurologically connected consumers on the planet. Many admit to falling prey to “the Costco effect,” shorthand for spending more than they'd planned to spend. One of those very connected customers, Kimberly Peterson, started a blog in 2006 to share news of what she bought at Costco with her mother and sister. Today, AddictedtoCostco.com has two million readers and generates enough ad revenue that Peterson was able to quit her day job and run the site full time.

Costco has immense respect for its customers, unlike its main competitor Walmart's Sam's Club, has lenient return and payment policies. So if you're unhappy with your six-pound wheel of Brie, you can get a full refund. AddictedtoCostco.com's Peterson recalls once standing in line behind a man who was trying to return a violin a year and a half after buying it because his daughter didn't want to play anymore. Costco cheerfully gave him a full refund for the



instrument. Financing is made easier. Costco is expanding the number of payment methods it accepts and has added gift prizes for frequent purchasers. For the moment, it only accepts American Express and its own private-label card, but that will change in April, 2016 when it will accept Visa and MasterCard.

### HAPPY EMPLOYEES, HAPPY CUSTOMERS

Though the physical plant might be spartan, the way Costco treats its employees is anything but. At a time when many retailers are cutting staffs and reducing employee hours to cut costs and avoid paying benefits, Costco is an anomaly. It sees employees as an asset to be respected and invested in, not as a cost to be minimized. Former CEO Jim Sinegal once told Stores magazine, “We've always had the attitude that if you hire good people, provide good jobs, good career opportunities and good wages, good things will happen in your business.” Current CEO Jelinek has learned well, and added the consumer into the equation. In 2013 Jelinek wrote to Congress urging an increase in the federal minimum wage for the first time since 2009. “We know it's a lot more profitable in the long term to minimize employee turnover and maximize employee productivity, commitment and loyalty.” He was also quoted as saying, “It also puts more money back into the economy and creates a healthier country.”

Costco pays its employees an hourly average that is more than two-and-a-half times the minimum wage, and almost twice what Walmart employees make. Almost 80 percent of its employees have company-sponsored health insurance. With initiatives such as these, Costco earns incredible employee loyalty, which in turn results in fantastic productivity.

Other companies that invest in their employees' workday happiness and loyalty are also performing well financially. Among them are Nordstrom, The Container Store, Sephora, REI and Whole Foods Market. Doug Stephens, founder of the consulting firm Retail Prophet, told Bloomberg Businessweek: “This is the lesson Costco teaches. You don't have to be Nordstrom selling \$1,200 suits in order to pay people a living wage. That is what Walmart has lost sight of. A lot of people working at Walmart go home and live below the poverty line. You expect that person to come in and develop a rapport with customers who may be spending more than that person is making in a week? You expect them to be civil and happy about that?”

Costco's labor-friendly attitudes date back to its origins. Another philosophy handed down by Sol Price was that he embraced organized labor. While other big retailers like Walmart and Amazon have implemented sizable campaigns to actively keep unions out, Costco is okay with the fact that the Teamsters represent some of its employees.

At Price Club, Sol marked everything up a small flat amount because he felt retailers added only limited value to the consumer purchase equation. He also believed firmly in treating employees, customers and vendors with respect—and in the process, rewarding shareholders. When Sinegal brought the Price Club model to Seattle in 1983 to start Costco, then merging the two and going public in 1995, Wall Street repeatedly begged the retailer to reduce wages and health benefits. Instead, Sinegal, in a nod to his former boss, increased benefits and wages every year, including during the recession. The company's attitude was “The economy is bad, we should figure out how to give people more.”

To preserve the company culture, it prefers to grow executives from within rather than hiring business school graduates. The many MBAs working at the company earned their degrees while working there. Said Sinegal: “Culture isn't the most important thing, it's the only thing.”

### EPILOGUE

My Costco-addicted friend wanted to go on a two-week vacation. Her husband wanted to go to Belize just to chill out. But my friend had a panic attack and demanded, with all kinds of threats, that they vacation in the UK—where she could find a Costco when she needed a “fix.”

With millions of Costcoholics like her, the behemoth from Bentonville had better be looking over its shoulder. **RR**



**ROBIN LEWIS**  
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## MY VIEW

A series of firsthand views from industry leaders on the retail landscape, careers, personal insights and the future of retail.



## By Nadia Shouraboura

CEO, Hointer

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### How did you get into this business?

I was born in Soviet Russia, where “retail” meant that when you see a line, you try to cut in and wait to grab whatever you can regardless of what it is. When I crossed the border into Hungary and saw my first food store, I was in awe. At that moment I fell in love with retail and most importantly with the impact it has on people’s lives.

### Who has been your greatest influence/mentor?

My grandfather, a Russian space scientist, taught me that we could put a man in space using the computing power of a T-84 calculator. When people ask me how expensive the Hointer solution is, I always think of high school calculators.

### What is your greatest source of inspiration, or where do you get your best ideas?

Making love to my husband is my source of inspiration. I always dream about making shopping as exciting and passionate as sex.

### What retail operation do you think is innovative and sustainable?

Convenience through technology. The reason tech has been used in so many ways in the online world is because we can easily learn about individual customers and change the way they interact with products. While harder to understand customers and their product interactions in the physical world, the retail experience is much richer—so we have greater opportunity over time to change the overall game. Innovation, though, is about constant change. It doesn’t sit still. So anything I call out as innovative is only sustainable if it soon becomes something different.

### What is your favorite place to shop?

Macy’s Herald Square on Thanksgiving put a spell over me since I was a student, and I love their ongoing makeover. Given the amazing history of that store and yet its ability to constantly reinvent itself, I always feel hope for the future of physical retail when I shop there.

### Over the last five years, what has been the biggest change in the industry?

The maturity of ecommerce and early attempts by retailers to fuse physical and digital shopping.

### What do you think will change the most in the next five years?

The in-store experience and fusion of digital and physical. This is our biggest opportunity, both in customer experience and supply chain.

### What would people be surprised to know about you?

I walked out of the Soviet Union and lived on the streets of Hungary before I could find my way to America. Also, I love to read and write computer programs. I used to read through millions of lines of code at Amazon, and I write a lot of code at Hointer.

### What books are you reading?

I’m reading about SpaceX and Tesla, by Ashlee Vance. I think when we create a Tesla-like fitting room at Macy’s, men will line up.

### What’s your favorite leisure activity?

I don’t have one. I love to work and I’m okay doing it all the time. When my daughter wants to spend time with me, she comes to Hointer.

### What lessons have you learned from elsewhere in your life that you can apply to retail?

I did my Ph.D. in mathematics and I learned how to apply many different ideas and use data to confirm which solution works best. We do the same at Hointer. Most things we try do not work, but the several things that work really well for us and for Macy’s have increased sales. So we double down on those ideas.

### What’s your favorite quote (and who said it)?

Jeff Bezos likes to say, “Step by step, ferociously”—and it sits well with me.

### What’s your favorite online site?

NASA’s website <http://www.jpl.nasa.gov/> It covers space missions. I keep thinking, if we can put a man on Mars, we can reinvent how people shop and make it magical.

# THE OMNISHOPPER: THE ONLY PERSON WHO MATTERS FOR RETAILERS

*Ted Iacobuzio*

You will find no shortage of excellent, well-researched and well-intentioned advice on the world of omnichannel retailing. For example, online mobile commerce is exploding. We know that. Mall stores are evolving. Online marketplaces are gaining momentum. In-store technology is continuing to gain traction.



Let's not forget the only real driver of the omnichannel world. It's the customer. It's the customer who is considering a constant stream of new information, new products and yes, new channels. We would like to suggest that although channel strategy is important, it will never be as important as customer strategy. In that spirit, we have just completed a global profile of what that customer looks like, how she thinks and how she shops. Meet the omnishopper.

## Experience and Possession

MasterCard has recently completed a global study of the omnishopper and found that today's consumer transcends channels. She is not interested in "stuff"—either she doesn't remember what life was like pre-2008, or she does so with a shudder. She is interested in the experience of shopping and possession. While hardly oblivious to price, price is only one ingredient in what adds up to a satisfying retail experience. Quality, brand, value—and a pleasing and even entertaining path to purchase are what are important to her.

Omnishoppers have become accustomed to ecommerce, but they're not devoted exclusively to it. Even if ecommerce holds concerns for 59 percent of omnishoppers, they understand what ecommerce is for. And that understanding is what's behind what many regard as ecommerce's stall-out at about 7 percent of total retail volume.

Through much of this year, there has been a good deal of heat and noise in the press, and, for that matter, when retailers talk to each other, about the supposed underperformance of ecommerce. We at MasterCard say, "Don't be afraid of this number: understand it."

First of all, not everything is so dire for ecommerce when sliced by category. Fully 48 percent of electronics and appliances were sold online in July 2015, according to MasterCard SpendingPulse, with 23.5 percent of apparel moving through the online channel during the same period.

## Shrinking Store Visits

But for the omnishopper, the path to purchase leads more and more to the stores on Main Street and in the mall—the venues that continue to provide her with the experience she wants.

The thing is, that list of stores is dwindling. The more she shops online, the more the omnishopper narrows her choice of stores to visit.

This was perhaps the most arresting result of market research MasterCard conducted to find out what the omnishopper is thinking, and how retail CMOs can place their next bets by anticipating her next move.

By startling margins, MasterCard discovered, first from a look at its anonymous and aggregated transaction-based insights, and later by asking a robust sample of the U.S. consumer base, the more sites omnishoppers visit online, whether to research, price or buy, the fewer stores on Main Street they are predisposed to visit. So ecommerce has taken on the role, in concert with other forces—the continuing impact of the financial crisis on consumers' attitudes toward their money, and the resulting focus on experience—of sharpening consumer choice.

MasterCard transaction data indicate that between 2010 and 2014, 53 percent of U.S. consumers were visiting fewer sites and stores, with unique merchants per active account falling 13.5 percent from 28.4 stores to 24.6 stores. Meanwhile, they are visiting more ecommerce sites, both for researching and buying. So the downward trend is driven almost exclusively by their sharpened focus, afforded by the internet, once they're interacting in the physical world.

## Loyalty Versus Commitment

This is not to say that consumers have become more loyal. They're not there yet, and, if retailers don't do their work, they're in danger of losing the chance to ensure something better than loyalty—what MasterCard is calling commitment.

Two years ago, the great fear stalking the corridors of retail was showrooming: the prospect of frictionless shopping on the Internet driving prices down as far as they could go, with stores serving simply as test-drive facilities.

Something like the opposite has happened. Ecommerce is not a race to the bottom. While some goods and services (the latter, in some cases, of necessity: think of digital music) are taking share online, both by category and in bulk, the store continues to attract consumers for service, for socializing and, perhaps most surprising, for inventory.

**THE OMNISHOPPER:**  
She is interested in the experience of shopping and possession.



## She Wants It Now

The last named is a critical point. More than safety, more than security, consumers are demanding selection and availability both online and in-store. Fully 73 percent of U.S. consumers surveyed told us their biggest frustration with shopping was “items not in stock.”

Online or in-store, the omnishopper wants what she wants when she wants it.

This goes to the heart of the omnishopping phenomenon (it is nothing less). Retailers can thrive only by concentrating on the omnishopper herself and the way she uses channels, devices, technology and indeed her own savvy as means to an end—in short, the path to purchase ending in a satisfying experience, as much as the purchase itself in a box with a receipt. This also is the way to obtain her commitment—a commitment based on trust to deliver merchandise swiftly, safely and in a digital and physical environment that the consumer finds welcoming.

Analysis of category spend is all very well: it would be foolish to know that nearly half of electronics in the U.S. move through the online channel and not adjust floor planning accordingly, for example. But it's just as important to realize that each category has a shifting equation of device, channel, geography, research, purchase, spend and planning—and that this equation is a result of the consumer's own understanding of her needs in this new environment. When she finds those needs met, she will commit. **RR**



## TED IACOBUZIO

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CREATIVE

DISRUPTION

## IN RETAIL DESIGN

BY ANTHONY ROBINS

## What Is a Store For?

As the digital tsunami continues to upend traditional notions of retailing, brick-and-mortar retail survives, and in many cases thrives, among the swirling waters of change. It is now pureplay ecommerce brands that are threatened by more nimble omnichannel retailers. Alibaba's recent \$4.6B investment in electronics retailer Suning and its earlier investment in department store operator Intime Retail Group are recent defensive reactions to this changing environment. But as omnichannel retailing becomes the dominant model, the role of the store is being redefined. And with the ease of buying online anytime, anywhere, one has to ask, "What is a store for?"

Beyond serving as a physical place where one can inspect merchandise and indulge in instant gratification, a store provides the opportunity for all touchpoints of a brand to come alive and be experienced simultaneously. The consumer can see, touch and try out the products, benefit from one-on-one service, and most of all, directly experience the brand vision through the store environment offering its multi-sensory immersion in sight, sound, scent and touch. No other channel can deliver this compelling experience. Consumers will increasingly demand these experiences, which will reinforce brick-and-mortar retail's position as the center of the omnichannel universe. A creative brand environment plays a central role in fulfilling this expectation. But how can one stand out in a retail landscape crowded with so many competitors?

## Disrupt, Always Disrupt

Creative disruption is a simple enough concept: Existing consumer behaviors and expectations are changed through an encounter with creative ideas. In advertising, it is the messaging that causes consumers to stop and think. Two great examples are the original VW Bug ads, where consumers were encouraged to buy a "lemon" and "think small" in an era of very large cars; and Nike's "Just do it" campaign

with its focus on the activity, not the product. Both were contrarian and highly effective. Likewise, Celine's recent advertisements, which feature 80-year-old author Joan Didion, disrupt and challenge traditional perceptions about fashion.

In store design, the creation of environments that are so unexpected, truly novel or comprehensive in the realization of a vision that they break from the norm, can make consumers redefine a category. One obvious example is the cluttered, confusing, noisy, poor service electronics store—think Circuit City or Best Buy—being disrupted by clean, friendly, easy to navigate Apple stores. The kitchen and bath fixture retailer Pirch is bringing this clean, friendly, easy-to-navigate model to a fragmented category that's been notoriously unfriendly to consumers.

## Comprehensive Design

Furniture retailer RH, formerly Restoration Hardware, is using store design in a compelling, bold way to support their drive to disrupt the upper end of the home furnishings market. The stores are conceived, inside and out, in a singular, grand, almost cinematographic vision. With their high ceilings, grand staircases and monumental exteriors, these stores appeal to every homeowner's aspirational dreams. RH stores really should be called RH Mansions. These stage sets don't rely on the consumer's imagination, e.g., "How would this sofa look in my living room?" Rather, RH serves up a complete vision, fully formed. The reality is that it can be difficult to replicate at home. But the RH perfect world is enough to get people to buy.

RH stores are examples of "comprehensive design" where every aspect of the environment is strategically created to reflect a brand vision. It is the environmental equivalent of a "wall of sound," rich, complex and all-enveloping. The design is intentionally creating a place you have never been before except perhaps in your dreams. If the artistic vision of this type of dream

space is authentic and resonates with consumers, it can be disruptive because it is unique from all others. While the technique has been used for centuries in the theater to transport you to another time or place, real or imagined, it was Ralph Lauren who first brought comprehensive design to life in retail at a scale that was a disruptive game changer.



## Extreme Localism

Australian skincare brand Aesop has taken a different approach to creative disruption in the design of their retail environments. As an extreme example of 'localism,' no two stores in the network are the same, even though they may be in the same city. For example, the two stores in Miami are very different from each other, each reflecting their specific micro-environments. This novel approach is central to the brand's core identity.

Each Aesop store is a design collaboration between the brand and an architect who brings insight into the local context and culture. Reflecting the brand ethos, the store designs are highly artistic and often incorporate reclaimed materials. This strategic diversity of store design is unusual for a multinational retailer, and sets Aesop apart. The artistic ethos extends to the website, which transforms the traditional, prosaic store locator into a visual portfolio of aesthetic achievement of store listings, each with a design concept statement and photograph.



## Ephemeral Design

A pop-up shop is by its nature disruptive. The location is usually unexpected and the brand presentation is usually quite different from its mother ship retail format. The temporary nature of a pop-up offers, even demands, greater creative latitude. Designers can be edgier, more provocative and more playful with pop-ups. As with window design, creative visual merchandising and in-store seasonal decor, short-term pop-up design can be more extreme in creative expression and attract new customers to a retail brand.

Box Park is an experimental hybrid built with multiple connected shipping containers. Located next to a railway line in the Shoreditch section of London, it's a pop-up mall that offers visitors an ever-changing lineup of fashion, accessories and food and beverage vendors. Events and live performances draw in an eclectic, diverse audience. Box Park juxtaposes local and global brands, with spaces available for rent for as little time as one week. Creativity and the shock of the new is encouraged. Box Park has become a testing ground for new brands, and brings together a diverse combination of people, brands and events. The concept is serving as an incubator of innovation, and promises to deliver some truly novel and valuable experiential retail ideas.

## Worshipping Janus

The diverse juxtapositions facilitated by Box Park offers a clue to all those seeking disruptive creative ideas. Janus, the Roman god of doorways is typically depicted as a two-faced deity looking in opposite directions—an apt symbol for the dynamics of creativity. Einstein, in arriving at the Theory of Relativity, used “Janusian thinking,” conceiving of two or more antithetical concepts, ideas or images simultaneously. This intellectual concept can actually be used to conceive disruptive design.

On the surface, this is a thought process that an architect would naturally employ during the course of any project. Designers are often given the opportunity to wrestle with opposing forces and conflict, whether it is resolving fundamental demands of quality, quantity, cost and time or the simultaneous conception of the interior and exterior of a building. More often, however, there is a temptation to avoid the complex psychic tension caused by such “oppositional thinking,” and fall back to mental triage, simply by reducing conflicting demands to either-or thinking.

Janusian thinking rejects either-or in favor of “all of the above.” For store design, Janusian thinking provides the opportunity to create design solutions with seemingly irreconcilable conditions. The result can be novel, disruptive design that is original and useful.

## Creative Disruption — A Cautionary Tale

Victor & Rolf's first store was the beautifully detailed “upside-down boutique” in Milan. It was a feat of ingenuity to realize what appeared to be an upside down neoclassical interior – parquet wood floors on the ceiling, chandeliers sprouting from the floor like trees, fireplace and logs convincingly attached to the ceiling – even the front



door and signage were upside down. It brought immediate and wide attention to the Dutch design duo.

It was disruptive even though it was only open three years. The imaginative design backfired. Although very complex and extraordinarily expensive to execute, it was too simple an idea – a one-trick pony. Once you experienced it, the novelty and its impact wore off. The “Alice in Wonderland” environment was also a bit disorienting and ultimately a distraction from the product being sold.

Five years after the upside-down boutique in Milan closed, Victor & Rolf opened a grey felt-lined, classically inspired “right-side-up” boutique in Paris. In contrast to the Milan store, co-founder Viktor Horsting commented to the architecture magazine *Dezeen*, “We said we would like a store that's invisible or a store that's hardly there because often we find store designs very intrusive and just too much.” Going against trend, the sensory-depriving design makes the merchandise the main event.

Creative disruption can be used in a variety of ways: to get the shopper's attention, to attract new customers, to create buzz and get good PR coverage or to win design awards. Creative disruption in retail design comes in all styles and shapes, from subtle to fantastical—it doesn't necessarily mean extreme or eccentric creative expression. Brazen boldness often passes as creativity, and has become the dominant cliché of originality. Ultimately, creative design disruption can be a powerful tool for any retailer who wants to make a statement, knows how to integrate the brand vision seamlessly and wants to give customers a meaningful, memorable experience. **RR**



**ANTHONY ROBINS**  
Chief Brand  
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# RETAIL'S LEARNING PIPELINE:

## From Clicks to Bricks and Back Again

By Bridget Johns

For the better part of 150 years, the art and science of retail has evolved slowly. In an era when brick-and-mortar stores controlled a stable shopping experience, there were occasional flashes of innovation, but mostly a slow, steady cultural shift focused on price and availability. Category killers cut down the mom and pop, and mass merchants like Walmart flexed muscles in ways never seen before.

### RETAIL WAS RETAIL, UNTIL THE INTERNET. CHANGED. EVERYTHING.

Online merchants and their ecommerce engines were the disruptive force heard 'round the world. They changed the landscape of the retail industry, and introduced entirely new channels, processes and methodologies. Online retail ascended to wrest control from physical stores.

But a funny thing happened on the way to ecommerce's domination of retail. As the online titans were unveiling disruptive change, something bigger and more important happened. Shoppers changed, undeniably and forever. Today's shoppers are now fully informed, fully empowered and today, they—the shoppers—are the ones fully in charge. Shoppers have conquered retail, and they're forcing retailers to relearn their art and science.

### STRANGE BEDFELLOWS

Brick-and-mortar retailers and their online brethren are seeing a change in the very nature of their relationship with one another. Once they were adversarial rivals, sometimes even when separate, "siloed" channels within the same retail organization.

In today's retail reality, there's no room for intra-organization cross fighting. The fight is outside the organization, against competitors—not inside, with teammates. Today's retail is about the ubiquitous multichannel—omnichan-

nel—and the brands that succeed are optimizing their shopper experiences across all channels.

### LEARNING'S TWO-WAY STREET

Every retailer is diversifying across channels, recognizing that each channel has significant inherent advantages. As they do so, they must acknowledge the expertise already developed in each channel, and the lessons learned that can be so valuable.

For online merchants opening their first physical stores, there's no better resource library than the brick-and-mortar professionals who have been there, done that—the good, the bad and the ugly. Likewise, new era retailers who grew up in the online digital space have lots of lessons to share—all learned through experience, and also inclusive of the good, the bad and the ugly—to enlighten old-school physical retailers about shoppers, their new shopping journeys, and best practices to serve and delight.

### FROM CLICKS TO BRICKS

Traditional online merchants have introduced some very different business models, and despite the often-contrasting nature of their core businesses, they have great applicability to physical stores.

Areas where the bricks are learning from the clicks include:

#### → Inventories.

While stockouts are bad, excessive inventories and their drain on precious working capital are every bit as bad, and quite often much worse. Online merchants have shown that stores do not have to have stacks and stacks of inventory, particularly with next-day and even same-day global fulfillment readily available. One just has to look at the success of stores like Warby Parker and Bonobos to see that a store can meet and exceed a shopper's expectation without carrying any inventory.

Regardless of fulfillment models, inventory management and demand generation planning come to the forefront, as does the ability to execute real-time promotional opportunities.

#### → Letting go of legacy technologies.

Online retailers recognize that technology is the enabler for today's new shopper and her shopping behavior and journeys. As a result, they are quick to adopt new solutions (not systems!) that ease friction points and result in a more customizable, personalized and seamless shopping experience.

The key for many old school physical retailers is to focus on these "solutions"—and to ensure they are shopper-centric solutions. Too often physical stores are bogged down with antiquated technology stacks, where obsolete systems don't mesh well together. If a store can't create a seamless internal efficiency behind its own walls, it can in no way expect to deliver an efficient, smooth and seamless shopping experience to today's customers.

#### → Better data means better decisions and better performance.

The click-and-mortar online shopping experience of 2015 is completely different than the experience of 2000.

The reason for continuous improvement in the online experience is the wealth of data acquired and analyzed, helping retailers understand shoppers and how they navigate and engage with different aspects of their online experience. Data shows what works and what doesn't, and it quickly identifies the most meaningful opportunities to capture.

Brick-and-mortar stores are now learning that data acquired over time and in scale empowers better

decision making from store design to merchandise assortment and display, from staffing/traffic alignment to promotional marketing, and more. With the shopper now clearly in charge, retailers can no longer dictate the experience. Instead, they have to provide the experience most desired, and learning more about shoppers and their behaviors is the only way to do so.

→ **Test, trash, and repeat.**

In an era of retail where companies are looking for solutions, there is no one, singular solution. Since its advent, it's been relatively easy for ecommerce businesses to test new ideas and tactics and immediately determine if the desired results are being achieved—there are literally no hard, physical capital assets to build, reconfigure or remove.

Pop-up shops are just one way brick-and-mortar retailers are getting involved in the learn fast game, trying new concepts and models in a lite-buildout approach, keeping what works and quickly changing what doesn't.

## FROM BRICKS TO CLICKS

Online retailers are far from the only teachers in today's retail game. Brick-and-mortar retailers have decades of experience connecting with customers on a most personal level, and they have plenty of teaching points of their own to share, particularly with ecommerce retailers jumping into physical stores for the very first time.

→ **Emotional connections matter.**

Connecting emotionally with shoppers, authentically and on a personal level, is the proven secret to long-term shopper retention and loyalty.

It's more than giving her what she wants, when she wants it and how she wants it. It's about understanding her, and even empathizing with her in her day-to-day life and aspirations.

Stores often have an inherent competitive advantage here, as they have star sales associates who develop and foster close relationships with customers. However, it's not a strategy for just a single channel. Many catalogues have made these connections, and

today's best catalogues are more lifestyle publication than traditional catalogue. Additionally, some niches—in particular fitness apparel companies like Nike and Under Armour—have apps and other digital tools that tend to make ironclad, authentic connections.

→ **Location, location, location.**

The old adage of real estate remains true, and today's overbuilt, "over stored" retail landscape offers further proof of the location equation. Before the Internet, retailers were forced to build stores in order to attract new customers to engage with the brand and understand their value propositions. The result of aggressive store expansion was overbuilding, and with so many online alternatives today, you see physical stores and malls in C- and D-tier markets get shuttered and mothballed every month.

Retailers are consolidating locations not only around market size and potential, but also around the company's ability to internally support them—especially critical in this age of experimentation, fast failures and continuous improvement. "Clusters" of locations are also valuable, as they allow a retailer to attack a market en masse and from all angles, driving brand awareness and shopper loyalty, providing the ability to A/B test and more. And don't forget those mothballed locations—they provide an opportunity for a different kind of branded retail experience, including physical stores with completely different display, inventory and staffing models—think high-tech, interactive, self-serve and quick (but not instant) fulfillment.

→ **The same, but different.**

With a web site, it's easy to fall into the trap of thinking that one size fits all—that there is one brand, one business model and one approach to customers. Today's shoppers, with their circuitous omnichannel shopping journeys, can be very difficult to pin down.

Leading brick-and-mortar retailers understand that markets and shoppers are different, and as a result, stores are different. It's a big mistake to treat every store the same. For example, conversion at a brand's flagship store will be



very different than conversion of a store elsewhere in the chain. Two stores not even a mile apart can work very differently. And, of course, different communities demand different approaches—what works in one region often doesn't translate to another.

Different shoppers and different retail markets/segments will require not only different approaches, but flexible approaches that can change and adapt to changes in the market place. The C- and D-locations mentioned above offer a proof point. Traditional approaches to those markets weren't successful, not for shoppers or for corporate profit ability. But, there is demand there. It just takes innovation, persistence and a willingness to experiment to unlock the secret.

While there's a lot of talk about stores of the future, today's shoppers, through their behaviors, are essentially drafting a request for proposal (RFP) for the preferred retailer of the future. It creates a two-way stream of learning between online and off-line, and the prizes are yet to be handed out. **RR**



## BRIDGET JOHNS

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# HOME for the Holidays

By Warren Shoulberg

## ATTENTION HOME FURNISHINGS RETAILERS: IT'S THE START OF THE FOURTH QUARTER: DO YOU KNOW WHERE YOUR CUSTOMERS ARE?

**AS THE HOLIDAY SHOPPING CALENDAR MOVES INTO PRIME TIME, IT SEEMS ONLY APPROPRIATE TO PROVIDE A PREVIEW OF WHAT'S IN STORE FOR THE NEXT THREE MONTHS AS WE COUNT DOWN TO THAT MOST SACRED, MOST IMPORTANT EVENT IN RETAILING: THE DAY AFTER CHRISTMAS SALE. NOT THAT WE HAVEN'T ALREADY SEEN ENOUGH EVIDENCE OF HOLIDAY PROMOTIONAL ACTIVITY. THERE HAVE BEEN 42 KNOWN SIGHTINGS OF BLACK FRIDAY SALES, RANGING FROM TARGET RUNNING ONE ON A COLD WINTER TUESDAY TO THE CHRISTMAS IN JULY EVENT ORCHESTRATED BY AMAZON THAT SUCKED THE LIFE OUT OF RETAIL SALES FOR A DAY OR THREE.**

The Rockettes at Radio City Music Hall in New York have had their heels on for weeks already, with the first ads for their run breaking amidst the back-to-school season. And workers in China, India and elsewhere in the sourcing (formerly third) world have been making the stuff that will turn up under Christmas Trees since Arbor Day (by the way, that's an April holiday when individuals are encouraged to plant trees). Against this backdrop, let's look at how the next 90 or so days will go down...with down being the operative word.

**OCTOBER 1: Macy's**, hoping to get a jump on the holiday shopping season, announces its first One Day Sale. It will run through the fourth of October.

**OCTOBER 2: Target** breaks its first holiday TV commercial, an upbeat, lively, feel-good spot promoting everything from pine-scented Tide

to Christmas towels with a singing Alvin and the Chipmunks controlled through an app. Shoppers immediately head to their nearest Kohl's, believing it is an ad for that store, since Target commercials never mention the store by name.

**OCTOBER 3: Kohl's** itself begins its Christmas shopping promotional cycle with a new slogan – its 18th in the past four years: “Put Kohl's, Not Coal in Your Christmas Stocking This Year.” Millennials ask, “What's coal?”

**OCTOBER 10: Keurig** debuts its Kold single-serve cold beverage-making machine. Retailers are counting on it to be a big driver of housewares sales for the season.

**OCTOBER 11: Retailers** mark down their Kold machines by 15% after sales immediately sputter, reliving their experience with Keurig's single-serve Vue machine a year ago.

**OCTOBER 13: Jet.com** sends out a press release announcing that it is still in business and that going head-to-head against Amazon was not the stupidest thing to do, ever.

**OCTOBER 15: Walmart** gets into the holiday spirit with its initial Made in America promotion, highlighting cookware, bed linens, curtains, towels and room-sized rugs. Shoppers flock to their stores in record numbers...to buy cheaper Not Made in America cookware, bed linens, curtains, towels and room-sized rugs.

**OCTOBER 18: Sodastream**, feeling the competitive pressure from Keurig's Kold machine, announces new flavors: tutti frutti, arachnophobia and New England clam chowder.

**OCTOBER 21: RH**—the retailer formerly known as Restoration Hardware but that everybody in the business still calls Resto—announces that it will now simplify its name to just R.

**OCTOBER 23: Bed Bath & Beyond** takes its famous coupon to the next level, offering free 20%-Off tattoos to all customers. Demand is strong.

**OCTOBER 25: Amazon** surprises the retail world with a Christmas in October one-day sale, offering dust ruffles, fingertip towels, soup spoons and Kold machines at significant discounts. All but the last sell well.

**OCTOBER 28: JCPenney** announces that Mike Ullman will return as CEO for the 18th time following a disappointing start to its holiday business. Ullman immediately announces that this marks a return to the old JCPenney days, and later that day the retailer issues 98%-Off Coupons at all stores.

**OCTOBER 31: Macy's**, having not run a sale in weeks, breaks its first Super Saturday event. It starts on the previous Thursday and runs through the following Tuesday.

**NOVEMBER 2: Every retailer** in America announces a First Monday sale.

**NOVEMBER 5: Kohl's** unveils another new slogan: “Baby, it's Kohl's Inside.” Millennials ask who's Frank Loesser?

**NOVEMBER 8: Exactly one year** before the next presidential election, the new Donald Trump Home Collection is introduced, debuting in Iowa and New Hampshire. Supremely confident of his prospects, the Donald offers discounts directly tied in to his poll ratings, breaking it at 24% off.

**NOVEMBER 9: Trump Home** now discounted at 22% off.

**NOVEMBER 11: Bob's Discount Furniture**, the heavily promotional Northeast furniture retailer known for its outrageous prices and sales, ups the ante, putting Bob himself on sale for \$399.99.

**NOVEMBER 14: In a shocker**, Target reopens its shuttered Canadian stores, announcing it will keep them in business for the holiday season as a test. Target president Brian Cornell hailed as a business genius for his decisive, unconventional thinking.

**NOVEMBER 15: Target** closes its Canadian stores. Target president Brian Cornell hailed as a business genius for his decisive, unconventional thinking.

**NOVEMBER 17: Trump Home** now discounted at 18% off.

**NOVEMBER 19: Macy's** promotional calendar spins out its newest event: a 12-hour sale. It begins at 8am and runs through midnight.

**NOVEMBER 21: Overstock.com** gets serious about holiday. It runs an 87-piece bed in a bag set for \$39.99... plus a free toaster.

**NOVEMBER 23: Trump Home** now discounted to 14%.

**NOVEMBER 25: Amazon** shocks the retail world with a Christmas in November sale. The only thing that's truly shocking is that Jeff Bezos thinks every day is Christmas at Amazon.

**NOVEMBER 26-27: Thanksgiving and Black Friday.** Stores put stuff on sale. Like, what else is new?

**NOVEMBER 28: Trump Home** discount now 11%.

**NOVEMBER 30: Cyber Monday.** Online stores put stuff on sale. Like, what else is new?

**DECEMBER 1: Macy's** announces its unprecedented first One Day Sale of December. In an equally as unprecedented break with tradition, the sale runs only two days.

**DECEMBER 3: Trump Home** discount cut to 6%.

**DECEMBER 5: Red Bull** enters cold beverage dispenser business with its Single Gulp machine. Company says all you need is one gulp.

**DECEMBER 7: R**, the retailer formerly known as RH that was formerly known as Restoration Hardware—but that everyone still calls Resto—announces a further modernization of its name, saying it will now remove all signage from the exterior of its stores and catalogs. It will also institute an unlisted 800 number.

**DECEMBER 9: Best Buy** puts every TV, DVD player, mobile phone, computer, audio system and accessory on sale. Shoppers notice no difference from any other day at Best Buy.

**DECEMBER 10: Trump Home** discount now stands at 2%.

**DECEMBER 12: Bed Bath & Beyond** announces that its cashiers are now mind readers and customers only need to be thinking about 20%-off coupons to have them honored.

**DECEMBER 15: Macy's** breaks its most audacious promotion ever: The One-Minute Sale. It will run this sale consecutively for 1,440 minutes.

**DECEMBER 18: With one week to go** before Christmas, **Kohl's** unveils its newest advertising slogan: "We Kut Our Prices More Than Any Sane Retailer Ever Has." Millennials run spell check.

**DECEMBER 19: Macy's** sues Kohl's for slogan infringement.

**DECEMBER 20: Trump Home** now available at full retail price.



**DECEMBER 22: In a last ditch** attempt to drive business, Target reopens twice-closed Canadian operation. Target CEO Brian Cornell admitted for observation at Mayo Clinic near corporate headquarters in Minneapolis.

**DECEMBER 24: Suddenly remembering** that Christmas is a retail promotional event, **Sears and Kmart** break their first TV commercials, offering anything in the store to anybody... for anything in their pockets. Nobody notices.

**DECEMBER 25: Amazon** announces first-ever July in Christmas sale. Online shoppers are so friggin' confused they respond in record numbers because it is, after all, Amazon.

**DECEMBER 26:**

**THE REAL PROMOTIONS START. RR**



**WARREN SHOULBERG**

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*is editorial director for several Progressive Business Media home furnishings business publications, and is still working on his holiday shopping list.*

# UNDERSTANDING OMNICHANNEL SHOPPERS THROUGH RECEIPT MINING

By Andy Mantis

Back in the day—and we mean the mythical, halcyon days of small-town America—shopkeepers were among the core, central figures in a community. Their prestige came from their well-recognized knowledge of the truths surrounding any given family. The shopkeeper knew who was short of cash, who ran late on their “layaway” plans, who scrimped and who squandered.

A successful shopkeeper did two things. First, he held his tongue. No one would trust a man who spread family secrets across town. If you were low on money and it was time to feed the baby, you wanted to deal with someone who would sell you things on the cuff, and not tell a soul. Second, he marketed to his customers based upon this secret knowledge. He knew when payday came, and when the crops failed. He knew when the kids were growing out of their clothes, and when Dad had drunk up the money in the cookie jar. He timed his offerings and personalized his approach, showing the inexpensive cloth to the struggling poor, displaying swaths of middling quality to the middle class, and offering the beautiful and pricey fabrics only to the truly wealthy or the pretentious hopefuls.

Those days are gone forever... or not.

In today’s retail world, we tend to think of the consumer as the one with the power. Certainly there’s some truth to that. The digital world is an endless trail of price comparison engines, customer reviews, and social media sites for voicing dissatisfaction. But the real power—the ability to derive sales and loyalty from knowledge—has remained with retailers with the rise of the Web. The digital-only shopkeepers of recent history, armed with recommendation engines, email lists, dynamic pricing and the like, have become the modern version of the apron-clad, all-knowing man behind the counter of the general store of old.

But this too shall pass.

## Disrupting the disruptors

Today, an entirely new group is making moves to assume the role of the omniscient shopkeeper. Manufacturers have recognized the power of knowing their customers and selling to them directly. The direct-to-consumer movement has

altered the very nature of how brands reach consumers.

Heavily centered in consumer packaged goods (CPG) (P&G, Kraft’s), fresh food (Good Eggs, Graze, Farmigo, etc.) travel-related loyalty programs (Starwood Hotels, FuelRewards, etc.) and apparel and accessories (Warby Parker, Everlane, Bonobos, et al.), the direct-to-consumer (DTC) innovators have inspired fear and envy from both competitors and traditional retailers.

Those emotions seem to be clouding the judgement of many a player in the shopping world. But The NPD Group, which has business relationships with retailers, manufacturers and millions of consumers, has an unusually clear line of sight. And things have grown even clearer since the debut of our Checkout Tracking service, through which we mine data from the receipts (both online and from brick-and-mortar stores) of millions of consumers. And what we’re seeing looks more like opportunity than danger, for both retailers and manufacturers



who can put emotion aside and embrace the data. To see what we see, and to understand what it means for your business, we need to tell you a bit about how Checkout Tracking works.

### Save your receipts

We collect Checkout Tracking data in partnership with our technology partner, Slice Intelligence. It's based on the millions of receipts sent to us by consumers. Those receipts yield detailed, item-level data about individual consumers across stores, across all retail segments, covering both online and brick-and-mortar, and over time.

Checkout Tracking can tell retailers if their most loyal customers are cheating on them by shopping at competitors once they leave the store.

Just think about that for a second: transaction-level detail across all retailers, across all channels and all time, at the individual buyer level. That, of course, is the Holy Grail of DTC. And now it's available even to manufacturers and retailers who haven't collected it themselves. Checkout Tracking can tell retailers if their most loyal customers are cheating on them by shopping at competitors once they leave the store. It can tell manufacturers what else customers buy when they picked up their products in-store rather than on the manufacturer's ecommerce site, and even what they likely had for lunch on the drive home. More importantly, it can illuminate how often buyers of DTC brands buy rival DTC brands, and how often they shop at other retail establishments.

### For example:

A direct-to-consumer apparel brand that sells from both a branded website and its own retail outlets wanted to know where else its customers shopped for men's pants. With the help of Checkout Tracking data, the brand learned that its customers did less than one third (28%) of their pants shopping with the brand itself. Where else did customers buy pants? They devoted 21% of share of wallet to three Big Box retailers and 4% to a rival DTC brand!

- The apparel brand learned something else valuable—and it's not particularly good news for traditional retailers. Even though the DTC brand's customers were shopping at big box retailers, they were doing so at a much lower rate than the rest of the population, and actually indexed quite low at big box retailers and department stores compared to non-customers. Rather, its customers indexed higher than the general population with five rival DTC manufacturers.
- Another direct-to-consumer apparel brand with both real-world and online operations wanted to know where else its customers shopped for children's apparel. With the help of Checkout Tracking data, the brand learned that its customers only did 9 percent of their children's apparel shopping with the brand itself. They mostly shopped for kids apparel at discount department stores, with more than half of wallet dedicated to four of the larger brick-and-mortar players.
- Similarly to the men's brand above, the children's apparel brand learned that its customers over-indexed at rival DTC brands apparel compared to non-customers. And despite a substantial share of wallet devoted to two of the larger Big Box retailers, customers actually under-indexed at these stores compared to the rest of the population.

### Getting to know you

What The NPD Group has learned from the manufacturers who work with Checkout Tracking data has proven illuminating ... and points to a future for DTC that is far less doom-and-gloom for traditional retailers than the conventional wisdom would suggest. Among the most interesting things we've seen:

- Many manufacturers are driven by a need to understand the consumer, not necessarily to sell to them directly without a middleman.
- Many companies express a commitment to creating and enacting a DTC strategy, either through retailers or on their own, but have only a limited sense of what that would entail.
- The more sophisticated manufacturers have recognized a need for persona analysis, segmentation and the like. Previous efforts in these areas, done on a high level using demographic information, are now seen as having been inadequate and conducted too infrequently.



- A very high percentage of manufacturers who operate ecommerce sites say they do so primarily to collect data about customers. Such sites aren't aimed at replacing traditional channels. For such manufacturers, selling through retailers is expected to be the primary revenue source for the foreseeable future.

It would seem that established manufacturers – those companies that make the brands that fill the shelves of retail operations across the country – aren't so much interested in changing their business as they are in improving it. They're not so much interested in eliminating the middleman as they are in getting closer to consumers. This suggests that the future of DTC will consist of retailers and manufacturers forming partnerships tied to understanding the consumers of specific brands. That's going to require a level of intelligence sharing that's well beyond what retailers and manufacturers have at their disposal today—but the advantages of such cooperation seem overwhelming.

With the exception of a handful of truly innovative companies in areas ripe for disruption (we're looking at you, Warby Parker), DTC is unlikely to become something that only manufacturers or only retailers do well. These partnerships will step in as the new, all-knowing shopkeepers of the future. **RR**



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# Mi Casa Es Su Casa — Maybe!

By Len Lewis

*“What I wouldn't give for twenty more years! Here we are, protected, free to make our profits without Kefauver, the goddamn Justice Department and the F.B.I. ninety miles away, in partnership with a friendly government. Ninety miles! It's nothing!”*

— Hyman Roth, *The Godfather Part II*

## How right he was! Well, at least partly right!

For all you devotees of the film—and you know who you are—this character was based on the real life gangster Meyer Lansky, who, along with a Who's-Who of organized crime, made millions investing in hotels, casinos and other businesses in Cuba during the 1940s and 1950s.

It was Vegas before there was a Vegas! And far more stylish.

## ★ Enter “the Beard”

As any student of history or the cinema knows, this came to an abrupt end on January 8, 1959 when Fidel Castro and his “barbudos,” bearded revolutionaries, rolled into Havana, sending the business-friendly Cuban president Fulgencio Batista running for greener and safer pastures, and turning elegant venues like the Hotel Nacional and the Tropicana into government-occupied chicken coops. Literally.

It was an ignominious end to what had once been a hotbed of trade and a playground for Americans, who swarmed to the island's beaches, hotels, shops and casinos.

Could it become that again? Condos on the pristine beaches of Playa Paraiso, new

designer shops in the Spanish Colonial architecture of Old Havana and maybe a JCPenney or Walmart in a suburban mall? (See related article, “Postcard from Havana,” page 18.)

## ★ An Emerging, Emerging Market

As the Stars and Stripes were being raised over the newly minted U.S. embassy in Havana in August—the first step to ending the 56-year, emotion-fueled U.S. embargo—industry watchers started licking their collective chops over the prospect of normalized relations with the island nation. Or, as they see it, commercial opportunities in an emerging fourth-world market.

And why not? We have a long history of making friends with former enemies. That's why you can book a luxury cruise along the Mekong River Delta without worrying about snipers.

For Cuba, the road back may be paved with good intentions, but it will be a bumpy ride. Getting a handle on the Cuban economy is tricky since the government dominates every aspect of it. Therefore, opening trade, tourism and capitalism is not simply accomplished by a flourish of the Executive pen.

As the International Council of Shopping Centers (ICSC) recently stated,

real progress won't happen in Cuba until the spending power of the island's 11.3 million residents increases and convoluted barriers to trade are dismantled. This could be a Herculean task for a do-nothing Congress, which, by the way, is the only body that can lift sanctions completely.

Although some feel that Communism's shelf life is getting close to its expiration date, the country has always had a history of political instability—not an attractive prospect for retailers who might consider multimillion-dollar investments (including gratuities to government officials for greasing the wheels of economic progress).

On top of that, we have the inflammatory rhetoric of the Cuban diaspora in the U.S. and the few narrow-minded politicians who side with them (hey, it's an election year and Florida is a swing state!). By the way, if you value your eardrums and “cojones” don't ever get into a political argument with a Cuban exile. They are an extremely passionate group.

## ★ Fueling Growth

Interestingly, the country's future may be fueled, in part, by Cuban exiles that have prospered in the U.S. and may be induced to return with the right financial,

political and social incentives. In fact, it's been suggested that the same energy and vitality that transformed Miami from a decaying city into the center of Latin American economics could work for Cuba.

Labor costs would be relatively low but under current laws foreign investors would have to hire people through a state-run employment agency, which is one reason for low worker productivity. Not exactly what today's retailers are looking for.

On the other hand, the island has a fairly high literacy rate, a functioning health care infrastructure that is used by a majority of Cubans and a small but growing entrepreneurial class of small businesses or "micro enterprises," made possible by government liberalization of private industry and \$2 billion annually in remittances to the island from Cubans overseas. The latter could quadruple if additional restrictions on money transfers are lifted and lead to significant income and spending power.

Cuba already imports about 30 percent of its food from the U.S., thanks to years of political pressure from the U.S. agribusiness industry—and this number is expected to rise with increased liberalization of government policies.

### ★ Jockeying for Position

Basically, Cuba should be viewed with cautious optimism. This is what companies like Kellogg and Hormel are doing as they reportedly jockey for position in order to stay ahead of the growth curve in an untested but potentially lucrative market.

Moreover, Cuba wants foreign investment in order to sustain its growth. It wasn't Communism that caused most of Cuba's economic woes—it was the collapse of Russian oil subsidies in the early 1990s that sent agricultural production plummeting and laid waste



Photo by Bruce Byers

to the fishing industry. Shortages developed when exports and imports took a nosedive. The same thing may be happening now with Venezuelan oil.

The good news for business is that imports and exports are continuing to recover thanks to projects like the Brazilian-backed \$1 billion modernization of the Mariel Harbor deepwater port as a free trade zone.

Meanwhile, a number of Canadian, European and Chinese firms have already staked claims on the island through joint ventures. And the last thing an American company wants is to fight an established monopoly. As such, getting in first—or being among the first—may offset a somewhat risky investment.

### ★ Retail prospects

How attractive a retail opportunity does all this present? It depends on your time frame. Tomorrow, next week, next month or even next year—no! Everyone knows that Cuba is a long-term play. But the situation—economically and politically—should be closely monitored, and that's exactly what the agricultural, automotive, energy, shipping and airline industries are doing.

As socialist policies dissipate, tourism will likely be the first business to be rebuilt. In fact, online rental company Airbnb has already figured out how to enable people from outside the U.S. to rent private homes in Cuba. This has provided an infusion of capital into the economy, and boosts the average wage, which is running a little over \$200 per month for the average government employee.

This might seem too meager to support retail initiatives. But consider what happened to the standard of living in China as business developed and a middle class with money evolved. I'll give you a hint—W-M!

*As socialist policies dissipate, tourism will likely be the first business to be rebuilt. In fact, online rental company Airbnb has already figured out how to enable people from outside the U.S. to rent private homes in Cuba.*

I'm sure the Cubans would welcome a Walmart Supercenter. It's an unlikely scenario at this point. But is it so far fetched to consider Cuba for a version of its Neighborhood Market or another small store format like Aldi, Lidl or Save-A-Lot—or even Target, if they've learned anything from their Canada debacle. But this will require a complete overhaul of the Cuban monetary and governmental subsidy system.

Cuba is not going to be a destination for Neiman Marcus or Bloomingdales any time soon. But observers say that a Sears, Walmart or JCPenney is not out of the question. Nor is it out of the question that opening the country to private industry could lead to a U.S.-infused apparel manufacturing industry only 90 miles away—China West. Clearly, the recent refurbishment of Mariel Harbor could facilitate imports and exports.

The next few years will be crucial to Cuba's economic and social development; even Raul Castro's designated successor, Miguel Diaz-Canel, has stated that the country has yet to deal with the big issues.

To again quote one of moviedom's most nefarious characters—"What I wouldn't give for another 20 years!" But... it may not take quite that long. **RR**



### LEN LEWIS

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# Postcard from Havana: Far Away, So Close

*By Deborah Patton  
Photos by Bruce Byers*

I was in Havana on August 14th, the day the American flag was reinstated in front of the American Embassy, still in lock-down. John Kerry must have sensed, as I did, the continuing gamesmanship with the Cuban government. The Stars and Stripes stood forlornly on a standard sized pole, overshadowed by the field of gargantuan flag poles Fidel Castro defiantly built facing the embassy with dozens of Cuban flags the size of small fishing boats. But it's a start.

The Cubans seem to be thrilled about the possibility of a return to normalized relations with the U.S., having had the American coast in their sightlines for over five decades of imposed isolation. But they have no idea how their lives are going to change. And it won't be anytime soon. U.S. companies are already meeting and planning to bring our commercial culture exports to this island caught between its colonial past and a future not yet realized. But that won't be anytime soon, either. Meanwhile, the Chinese are busy ramping up, already building a hotel near the Museum of the Revolution. But anyone who thinks Cuba is a golden opportunity might want to recalibrate.

## High Finance

Let's get the elephant in the room out in the open. The average Cuban receives \$20 a month from the state. And there are over 11 million average Cubans.

Every Cuban citizen is also given a ration book each month that entitles him or her to government-subsidized staples: one pound of chicken, 5 eggs, rice and beans, and cooking oil. No subsidies for vegetables, and no one is allowed to buy any fish unless they have a doctor's order for dietary reasons. These provisions have to be paid for in pesos, and those pesos come from the \$20 monthly stipend. Just to make life more complicated, Cuba has a dual currency. Pesos for the average Cuban, CUCs (Cuban convertible peso) for the

tourists and Cubans working in the tourism trade. From an economic perspective, the peso is keeping them down at the farm. Fruit and vegetables are sold off food carts from local farms. Canned goods are scarce in the sad and understocked food stores, which is a generous description. If you aren't living on food coupons, you pay much higher prices in the very few food centers outside central Havana.

The level of poverty in Havana is palpable. Yet it provides paler-faced tourists an opportune setting to snap endless photographs of the picturesque urban ruins. There is an ambitious program funded by the government to restore the extraordinary colonial buildings in Old Havana to their former glory. But that noble effort isn't doing

much for the majority of the population that's been living in temporary housing for the past 20 years. Nor for the people living just on the outskirts of Havana, in completely undeveloped, fourth world conditions.

## Can-Do Culture

What is impressive is the Cuban spirit of resilience. We know about the music; also Cuba is a rich haven for contemporary art. All those 1950s Chevys have been rebuilt, and rebuilt again. With a resource-constrained economy, stainless steel scrap is repurposed into formerly chrome bumpers and trim. Those cars continue to be a highlight for every visitor. It is as though they have been in stasis for 60 years. There is a very small wave of independently owned restaurants, though most are still government owned. Cuba will be the ideal place for micro-financing: the resourceful Cubans are ripe for building their own businesses.

The population is aging, and by 2030 about 30 percent of Cubans will be over 60. Resignation may etch the faces of the older population, but the next generation of Cubans is restless and ambitious. The government pays for everyone's education and healthcare, and subsidizes basic living expenses including housing, electricity, and water. But for the Millennials, who do workarounds to connect with the outside world via the Web, graduating from college with a degree in economics provides little hope for a job future. There is no MBA program, but a two-year stint in the military is compulsory once they graduate. Many of them choose not to complete university to avoid the military duty. It's a tough proposition to have a great degree, and nowhere to use it.

One 27-year-old graduate I met teamed up with his college friend to start a restaurant that has the most sophisticated food I found in Havana. His degree? Mechanical engineering. Now he is a bartender constructing complex cocktails and engineering architectural garnishes adorning the glasses. He is proud of his creations, and he co-owns the business. The Millennials are less interested in supporting the traditional constructs of Cuban society; they just want to make money.

## Retail on the Rocks

So, retail. The prospects are slightly bleak, in light of that \$20 monthly stipend. In Old Havana, there is Benetton and the absurdly overpriced Paul and Shark, a Ralph Lauren wannabe with branded yachting logos plastered on everything (both in Plaza Vieja); a

brand-new leather goods store and one stylish shoe store (both on charming Calle Oficios). All of these shops are Italian. The only reason they can be in business is to appeal to the tourists they hope will arrive sometime soon on oversized cruise ships. The residents of Havana could never afford \$177 ballet flats or \$100 leather bags. There are no jewelry stores. No lingerie boutiques. The one local retail apparel store in Plaza San Francisco offers perfume, and cheaply made clothes in the \$20 to \$50 range. Even that exceeds the monthly income.

On the carnival weekend while I was there, groups of families, dates, friends and teenagers strolled down the Malecon. Women in vivid leggings and form fitting tops, most with lace or net inserts, looked like a flock of brilliantly colored tropical birds. The men were in jeans and bright logo-emblazoned athletic jerseys and T-shirts. There is a lot of glitter, sparkle and gold on the clothes, a signature of Caribbean clothing culture.

So where are the Cubans getting these brightly colored clothes? There is the Galerías Paseo shopping center near the Tropicana selling upscale labels, but that's beyond the reach of most Cubans.

When you fly to Cuba you get a pretty good idea where the apparel is coming from. Suitcases and boxes the sizes of refrigerators arrive on the carousels, stuffed with merchandise. Resourceful entrepreneurs also offer catalogue sales for stylish women, manufacturing the clothes in Mexico and delivering them personally.

So back to that \$20 monthly income. Any way you cut it, there's not a lot left over for clothes, accessories, shoes – let alone Pizza Hut or McDonald's snacks. The purists resist the commercial colonization of Cuba with fast-food brands and other mass-market icons of American culture. But to the Cubans, this is a sign of success.

Personally, I think the Cubans are in for some major reality checks when credit cards, wireless internet and foreign goods eventually flood their system. Entrepreneurship will flourish, but consumers are still going to need the cash to buy things. Cuba will likely become another Caribbean tourist mecca, but without the infrastructure to sustain it. They have so far to go to catch up. My prediction? Online retail sales of apparel will leapfrog over brick-and-mortar for Cuban consumers. Amazon and other online retailers are going to have an absolute field day five years from now, when the Cuban gates are truly open for business. **RR**



## DEBORAH PATTON

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## Q&amp;A

with Gerry Storch,  
CEO Hudson's Bay Company

By Robin Lewis



**ROBIN LEWIS:** I told Richard [Baker, Governor and Executive Chairman, Hudson's Bay Company] a while back that he is a real estate guy, albeit a brilliant one, who's leading a retailing operation, and in my opinion, he needed retailers running the business. He certainly followed my advice by hiring you. What about this position appealed to you?

**GERRY STORCH:** What appealed to me most about this position was the people. It starts with Richard. He is an amazing guy and has a vision that he executes. He is a good person of high integrity and I appreciate that. I could have stayed independent, I was very happy, but I thought as I was working with him as an advisor, that I like this guy, and as I worked with the team, I realized I really liked the other people here too. There's a huge opportunity here to help Richard pull this all together. He's a very intuitive, high quality retailer, not just a real estate guy. I've been doing retail for decades and saw how we could be synergistic, bigger than sum of the parts.

**RL:** Tell our readers a bit about your background.

**GS:** I went to Harvard three times, for college, law school and business school. I always figured I would be a lawyer. I had 30 offers from Manhattan law firms, and an offer from McKinsey, because I had the MBA, and I thought that business sounded a little more fun and exciting than law, and I figured I would learn a lot. A friend of mine I worked with at McKinsey recruited me to Dayton Hudson. The lifestyle at McKinsey was grueling, and I wanted to spend more time raising my family. I thought the pace at retailing would be more like semi-retirement. Boy, was I ever wrong! We renamed Dayton-Hudson Target Corporation, and I started the internet business there in the late 1990s, taking it from zero to the first million dollars.

**RL:** So you were an Internet pioneer?

**GS:** At Target I was viewed as the wild-eyed crazy Internet guy. I talked my then-boss into buying the rights to Target.com for \$10,000 even though he thought it was a waste of money for a name. For the first five years or more, we were bigger than Walmart.com. At Target I started the grocery business, the financial services red

card business, eventually becoming Vice Chairman. I ran supply chain and the department store businesses reported to me. I left in 2005 and went to Toys 'R Us as Chairman and CEO. I was at TRU for seven years, and we grew that Internet business dramatically into the most complete omnichannel paradigm of any business. We were the first to ship from store. If the Internet at TRU were a stand-alone business, it would be valued at \$10 billion. We bought FAO Schwartz, and started a joint venture in China with Li & Fung.

**RL:** How did you and Richard start working together?

**GS:** I left TRU in 2013 and then started my own firm, Storch Advisors, and one of my clients was Richard. I remember flying around with him, and he said "I'm going to buy Saks Fifth Avenue," and he asked me to work on the Off Fifth off-price business. We repositioned it from being a pure outlet business to a true off-pricer. We started opening stores in locations in Costa Mesa and other locations where you would find a TJ Maxx, instead of just being in outlet malls. TJX in fact was one of my early

clients at McKinsey. They were at 300 stores, and thought they'd grow to 500 stores and that would be it because there wouldn't be enough off-price or overstock product available. But look at them now! Off-price has much more potential than outlet. It's the fastest growing part of the business, and we're very excited about Saks Off Fifth.

**RL:** What are your biggest challenges?

**GS:** Clearly, one of the biggest challenges is to rapidly expand our internet and all-channel capabilities. I use that term instead of omnichannel because it's everything, not just internet and physical stores. There are three critical nexus points in the all-channel paradigm. The first is where the customer is when he places the order, the second is where the product is and the third is where the customer receives the product. Where the customer is could be at home, at work, on a mobile phone, or it could be in the store. And the customer could receive it in any of those places. Product could be anywhere—in a distribution center, at the vendor, in the store, or not manufactured yet. And when you draw the possibilities there are over a hundred different options. Order online, order in store, ship to store, pickup in store, ship to home... We do some of this at Hudson's Bay, but not as much as other retailers are doing. So it's a huge priority for us, because it's the future of the modern American department store.

**RL:** Isn't it unusual to have a single CEO leading all these businesses in four different countries? I mean, it's difficult enough to be CEO of one brand.

**GS:** We have very strong banner presidents. I view myself as the coach. Liz Rodbell has been at Lord & Taylor for 30 years. She's a very skilled merchant and president. Then we have Mark Metrick at Saks, who's been there for 15 years. Then we have Jonathan Greller at Saks Off Fifth. He's newer but he's a tiger, very aggressive. The management team at Kaufhof in Germany is solid, or we wouldn't have bought the business. We have quarterly business review meetings, less formal monthly conversations.

**RL:** Do you think at some point you will take all the retail brands and make them the same, like Macy's did?

**GS:** I don't see that as a possibility, to be honest. Without commenting on whether what Macy's did was right or not, there are a lot of people in Chicago who will never forgive them for getting rid of the Marshall Field banner. There's a lot of equity in our brands and in our banners, and although our businesses are similar, they're not identical. With Saks we have a true elevated luxury brand. At Lord & Taylor, although it's an upscale brand more elevated than Macy's it's not at the level of Saks Fifth Avenue. So they're positioned

differently. Then by its nature, Saks is more of a full-price business—you don't discount Chanel—whereas Lord & Taylor is a bit more promotional. In Canada with Hudson's Bay you have a much broader line, with the home goods, and you serve customers from the high end to the low end, much more like a Macy's. Kaufhof is very similar to Hudson's Bay. But we can invest in the stores to contemporize them. We can add more capacity and elevate in the shoe, handbag and beauty business. These businesses are being managed the way department stores managed them in the U.S. ten years ago. Their management agrees there is opportunity there, and they're excited about it.



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**RL:** How do you bring those banners together culturally?

**GS:** The executive leadership team met and discussed this for a long time. We are a company that was built on acquisition, so we talked about what our core values are, and what the winning ways are—how to execute those values. We have big heritage. We operate the oldest department store in the U.S., in Lord & Taylor. Hudson's Bay is the oldest corporation in North America, since 1670. We need to treat people with trust, respect and integrity. We hire retail executives with those values and who are willing to take risks. We make sure our leaders embrace that. We want to have an adventuresome spirit – maybe that's the Canadian heritage. I'm a big believer in the heritage. You can see it in some of the things we've done, the real estate structures Richard has built. We do it differently. The money makes a round trip, so we're not leveraging the business—we're deleveraging it. Any money we get goes right back into the business. We're putting \$250 million into the Saks Fifth Avenue building. I didn't come here to do anything but build a great retail business. You say Richard is a real estate person, but he understands you can't let the retail business go, you have to keep investing in it.

**RL:** Many upscale retail brands are realizing that in order to survive they have to appeal to Millennials. How are you doing that?

**GS:** We're always focused on the customer, and it's clear that Millennials are becoming a bigger part of the customer base, so we have to address that. We segment our business, and think of that group as one of the clear targets for growth. The design lab at Lord & Taylor is serving that customer, and it's also exclusive product. It's different from what's available at other companies.

**RL:** One thing I noticed in the Toronto stores was what I considered a lack of technology considering what's available and what others are doing.

**GS:** It's important to keep in mind that there's a lot of technology out there, almost an unlimited supply, but it doesn't make sense unless consumers will actually use it. We're not looking for the nerd's dream, we're looking for what will help regular shoppers. Customers today want to interact with their smart phones, so we have mobile apps and beacons and other things you might not see because customers have to opt into them. We use RFID for stock keeping. The real genius is in knowing how to distinguish between the meaningful technologies and the fluff.

**RL:** Why are stores still important?

**GS:** They're more important than they ever were. Of the 100 all-channel possibilities, 70 of them are in physical stores. Anyone who says consumers don't like to shop in stores hasn't done their research. Shopping is the number one form of entertainment in the country. It's more important than ever to have attractive physical environments and great customer experiences.

**RL:** What's the next challenge for retail?

**GS:** I think using Big Data to personalize and actuate CRM is the next frontier. Some internet retailers do a good job, but they only have the internet data. We have the in-store too, which is a great advantage.

**RL:** Are you concerned at all that over time the off-price will devalue the mother brand?

**GS:** I think it's the reverse. I think it's a great way to get customers introduced to the Saks brand who thought it was unapproachable before. It's a great way to get new customers, maybe people in earlier life stages into the brand, so that they'll migrate to the mother brand later on. Nordstrom feels the same way about Rack.

**RL:** What is your vision for HBC?

**GS:** We want to build a multigenerational retailer that will have meaning for the next two generations. We frequently want to involve our kids in our meetings because we want to run a business that will appeal to them. We have a lot of restaurants, and we think food is a very important part of the experience. It helps with the in-store circulation, and we want to take that to a better place. As big as we've become, we've only just started. We think that within the next few years there will be another acquisition. First leg, running great retail banners; second is mergers and acquisitions; third is taking care of the real estate. **RR**



By Gwen Morrison  
& David Marcotte

# Expanding Globally?

## THEN CONSIDER MEXICO

This is a challenging time for retailers to invest in global expansion. About ten years ago the industry experienced a Gold Rush of sorts, heeding calls to “Go West” (or “Head East,” depending on your perspective) to China and India. Some launched seriously misguided formats, like those of Tesco and Carrefour, that didn’t properly serve local consumer preferences or failed to come to terms with political realities. (Since then, many adjustments have been made. Retailers who had the fortitude to stick it out stayed and eventually grew to understand and manage to the local shoppers’ environment and needs.

More recently, the call was to move into Brazil, Russia and South Africa, the balance of the so-called “BRICS” countries. No longer labeled “emerging markets,” BRICS offered opportunities for fast growth from both new money and the promise of government investments in infrastructure.

However, recent political and economic developments, including unstable currency and concerns about corruption, have caused retailers to rethink where and when to expand across borders. Many have postponed moves into what otherwise might be promising expansion markets. Much of Africa fits this description of potential shaded by high risk. With the possible exception of India, so far none of these regions look very promising in the next few years.

Enter Mexico, where we’ve recently taken a deep look into what we believe are tremendous opportunities for U.S. businesses. There is a longstanding though complex set of relationships between the two countries, intensified by the mechanics of free trade (NAFTA) and

substantial migration across borders. And clearly there is the influence of each culture on the other, with Latino traditions becoming well known in the U.S., and U.S. holidays, brands and entertainment quite familiar within Mexico. All of this makes setting up shop in Mexico far easier for a U.S. retailer than moving to most other countries.

### Why the Time May Be Right for Mexico

Many positive developments and indicators make Mexico worth considering as an expansion site. First and foremost, there is a growing middle class.

Until recently, there were two economic tiers in the country, the very wealthy and the very poor, providing little promise for U.S.-style retail, which serves busy, two-income households. The poor wouldn’t have been able to afford to shop there and the rich, with their big houses and staffs of domestic help, didn’t need it. However, the rapid expansion of middle- and high-quality manufacturing in the last decade has created a growing and educated middle class comprising almost half the country. Mexico now looks quite different than it did in its bipolar past. Mexican shoppers want to shop, and they want good retail experiences.

### Suburban Sprawl

This larger middle class is driving an overall shift of the population to the suburbs, along with a move to dual incomes in most cases. Not only do they want to shop in nicer stores, they want to do so after work and on weekends, which is at odds with the traditional informal

### Q&A with Miguel Flores, American Eagle Outfitters Mexico, who gives further insight into how a U.S.-centric brand can succeed in Mexico.

**RR:** How did you decide to launch in Mexico?

**Miguel:** Many retailers don’t pick Mexico as they consider expansion early on. They go to Asia or they go to Europe. At American Eagle Outfitters, we fielded a global study that told us Mexico was an obvious choice. We also knew that Mexicans love our brand and were already transacting heavily in tourist destinations and border stores. Culturally it’s embedded in the lives of Mexicans to go to the U.S. to shop for better value, better service, and better quality. So they are familiar with U.S. retail brands and we knew that AEO as a brand fit right in with Mexico’s teen and young adult aspirations. “Real Clothes for Real People” really strikes a chord with them.

**RR:** What hurdles did you see?

**Miguel:** The challenge for us was to overcome the unfortunate percep-

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retailers. Sound familiar? This is exactly where the U.S. was four decades ago, at the start of its big phase of retail sales growth.

Though malls are on a general decline in the U.S. as they age and lose out to online retailers, in Mexico about 50 malls per year, averaging a million square feet each, are being added. Since the new suburbs lack the infrastructure for large shopping areas, and the older cities have real physical constraints to being able to support these requirements, the new malls are being built on commuter routes between suburbs and cities, to give access to both.

The Palacio de Hierro and Liverpool department store chains have been remodeling and expanding their existing malls, and plan on adding five new ones each year between them. The supermarket chains Chedraui and Comercial Mexicana have similar plans.

Mexican shoppers are tuned in to American brands. Hundreds of shopper groups each month take organized bus trips from Mexico to Southern Arizona to stock up on merchandise that is unavailable at home or that is perceived as better priced stateside.

Since the burgeoning middle class does not have household help, there are more home furnishings and kitchen stores. The department stores and malls are creating destination food courts for these time-pressed and experience oriented shoppers.

### The Wealthy Want to Shop, Too

Not to be outdone, the very wealthy are flocking to their own new malls in cities like Cancun, Xalapa, Polanco (within Mexico City), Santa Fe and Monterrey. Carlos Slim, the most successful businessman in Mexico, is committed to creating more of these mega malls and integrated shopping experiences such as those on the north side of Polanco, where he has rebuilt the entire area around the old rail yards into multiple malls, with entertainment centers that include a world-class art museum and aquarium. Crate & Barrel, Saks Fifth Avenue and Gap are now in Carlos Slim's Plaza Carso development.

### Viva American Brands

Mexican shoppers are tuned in to American brands. Hundreds of shopper groups each month take organized bus trips from Mexico to Southern Arizona to stock up on merchandise that is unavailable at home or that is perceived as better priced stateside. But overall these trips are less about pricing and more about experience. The malls, shopping centers and retailers that receive the bulk of these visitors provide a superior shopping environment. It is telling that the older shopping plazas on the south side of Tucson and in the border town of Nogales have lost much of the Mexican trade on which they were built, as

Mexican shoppers drive past them to shop at Macy's, Nordstrom Rack and the major lifestyle malls.

### Challenges Remain

This is not to say that Mexico is an automatic route to success. While we're not exactly saying "Mexico is the new China," there are several challenges to doing business in Mexico.

**Corruption** in Mexico has come more into the glare of the public eye than in the past. However, though still a reality, it is not necessarily on the increase. Key services, such as water and the building of infrastructure, continue to be distorted by 'unseen hands'—but the government has become far more active (and successful) in reducing the impact of bribes and racketeering in some other areas. The police and public security organizations continue to improve, the oil industry has been made partially public, and even the Teachers Union has been challenged. Social Media has played a large part in driving public opinion to force these changes and is providing a backdrop of "social shaming" that has had some effect.

**Infrastructure** is improving more quickly, starting with the modernization of ports on the Pacific and the Gulf, along with the land ports on the U.S.-Mexico border. Rail freight and intermodal containers have improved greatly in the last ten years, resulting in a huge increase in air freight and commercial travel, particularly at the smaller airports. And although the highway system has enjoyed the biggest improvement, it has not kept pace with the increase in passenger cars and trucking. Home delivery remains challenged, with the last 1000 meters from the transportation network to the home still a problem.

**Violence** from the drug cartels is very real, but has lessened greatly in most areas also. It can flare up quickly, however, so it needs to be monitored accordingly. Organized crime is still a concern for business and for individuals in most parts of the country, and retailers have become remarkably quick to shift to a far more nuanced and effective security network to offset this challenge.

### eCommerce Still In Relative Infancy

Although the middle class shopper in Mexico is highly engaged with online activities, including social media tools such as Facebook and Twitter, Mexico's e-commerce sector has barely gotten started. The Latin American pureplay online retailers of Linio.com and MercadoLibra.com do reasonably well, but they also experience limitations in fulfillment due to the evolving infrastructure and perceived dangers of home delivery.

Amazon has announced it will be launching a Mexico site, and is aligning with the large distributor and retailer FEMSA—which not only owns 13,000 OXXO convenience stores and close to the 1,000 drug stores, but is also the largest distributor to the small retail store in the market. Being able to deliver to every neighborhood of any size in the country on a daily basis will be crucial to establishing a stable eCommerce business in Mexico, as will the ability to provide credit to Mexican consumers. So the opportunities in Mexico are primarily in the brick-and-mortar sector, at least for now.

Any U.S. retail brand considering expansion into Mexico must first ask itself a few key questions: How does the brand translate into the Mexican culture? How does the retail and brand experience offered serve unmet shopper needs? Are the broader infrastructure issues something the retailer is willing to deal with?

The growth in Mexico's middle class, increasing demands on consumers' time, and expanding payment options offer a sweet spot of opportunity for many retailers today, and should not be ignored.

Don't let the challenges of Mexico scare you. The ultimate reward might be more than worth the risk. **RR**



**GWEN MORRISON**  
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The Store

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**DAVID MARCOTTE**  
Senior Vice  
President for  
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*David Marcotte is Kantar Retail's Senior Vice President for Retail Insights in the Americas. He has nearly 20 years working in the Latin American region, and for 20 years was a retailer in the United States and Canada, including at A&P, SuperValu, and Big Y Foods. He is seen as an expert on all the dynamics of Latin American retail infrastructure and government, along with consumer studies.*

## Q&A with Miguel Flores

*Continued from page 23*



tion that you might not get the same quality of service in Mexico as in the U.S., and that the pricing is unfavorable. Shoppers were skeptical that our pricing would be fair. We maintain the same price with currency exchange from one country to the other.

The second issue was that many brands that have a certain positioning in their home market come to Mexico pretending to be something they are not. For consumers who know the brand, they always end up saying "You know, it's not the way I expected it to be here." So we needed to deliver the same standard of experience within the store and online.

**RR:** How do you evaluate if particular campaigns originated in the U.S. will play well in Mexico?

**Miguel:** It's always a fine line. We are a U.S.-based brand, and we want to have the same campaigns, but occasionally they don't translate. For example, for holiday last year, the U.S. windows featured down jackets with the line "Get Down." That would not play well, so we substituted a very typical Mexican phrase that means "We're Warming Up." So we keep the brand's DNA and the essence of the promotional message while making it relevant for the local consumer.

**RR:** Tell us more about how the AEO brand fits within the competitive set in Mexico.

**Miguel:** The denim market is a 1.7 billion (USD) market in Mexico. We thought that was very attractive. We knew the market was being dominated by traditional players, brands launched over 20 years ago, but that a lot of new brands were also coming, like GAP, Aeropostale, Hollister and Abercrombie. But consumers told us, "I don't like to be told what to wear, I have my own style but I still need some inspiration." They also said they liked our everyday fashion and unique styling. So we loved that positioning. It gave us an amazing opportunity, and we looked at this and we said this is exactly where we want to be. We saw that we could capitalize on our brand strengths and connect with Mexican consumers' personal sense of style.

**RR:** Can you describe your launch? Did you have a spokesperson from Mexico?

**Miguel:** The fact that we don't use celebrities worked well for our launch. We opened 18 stores in 12 cities throughout Mexico. Again, "Real Clothes for Real People" allows us to showcase great lifestyle and fun people in everyday life. The trick was to create buzz in social media before we were ready to launch an eCommerce site.

We did this by taking a pop-up experience to universities and malls around the country. We invited people to try on the jeans and share their love of the great fit with their friends. We gave them coupons to redeem at a physical store.

We started with 817,000 people that were already following us on a corporate Facebook page before opening in Mexico. In only two years, we've been able to grow that base to over 2 million people. And then we opened our Twitter organically and already we are at almost 100K people.

**Gwen:** Any advice you would like to share?

**Miguel:** First, we invested the time required to really understand the brand in the context of the Mexican market and our core shopper. We did not rush, in and this was key. Second, we capitalized on our brand's strengths relative to the lifestyle our consumer in Mexico aspires to. Third, we showed respect for the community. We started a campaign to fund public spaces where our consumers go to meet and have fun.

So we heard them, we asked them, we looked at them, and we followed them. We decided on how to approach our customers. We engaged them, we got them to go to the stores, and now the big challenge is to keep it going, to continually exceed our metrics for traffic and conversion.

YOU KNOW WHAT THEY WANT.  
YOU KNOW HOW THEY SHOP.  
YOU KNOW WHAT THEY SPEND.

WHAT IF YOU KNEW THEIR PERFECT FIT?  
LET'S TALK.



**DATA INSIGHTS**  
sales@me-ality.com





# MILLENNIALS AT WORK

The future of the Millennial workspace has finally hit its apex: from bringing our home to the office and the new extremes of socializing in the workplace to Holacracy (a new, flat framework for management), we Millennials are defining our new work style. Each of these emerging trends is emblematic of the pure sense of freedom and chaos Millennials need in order to succeed in the workplace.

By Maxwell Montgomery

In looking at how Millennials interact with each other at work, five key trends emerge that support a potential societal shift in the way companies can be built and managed in the future. We can look at these trends to help us understand how to create a workplace that meets the needs of Millennials; they also provide a roadmap to access your own future workplace.

## OPEN OFFICES

If you have to build a new office, you will hear the most influential designers and cultural anthropologists preaching about an open workplace. Where cubicles once dominated the landscape, a new school of thought believes that walls destroy collaboration and creativity. But ripping down the walls isn't the main reason Millennials are sitting around a Valhalla-like shared table. The open space naturally leads to the leveling of power in a workplace. By putting Millennials at a workbench on the same footing as their co-workers, and in many cases their boss, Millennials are drawn to the flame of equality and power distribution that an open workspace brings.

As to productivity, it can be nearly impossible to work with all the noise and chatter in an open space. When you bring down the walls, you increase the pressure to talk to your neighbors—not always a good thing, because it can be a time-consuming distraction.

This is why headphones have become the new office doors. You will often see whole groups of worker bees silently plugging away. But don't be deceived. The chatter is hidden in the new communication tools that we Millennials use to help keep a company on track. We're talking all the time—you just can't hear us. Chat, text, messaging, traditional

email (rarely), snapchat, apps, hangout, iChat—trust me, we are noisy online, and not just with our friends, but with our colleagues as well.

## DESIGNING A WORKPLACE THAT LOOKS LIKE HOME

While working from home is no new phenomenon, workplaces that mirror the comforts of home are starting to emerge, making the Millennial employee more comfortable. Contract furniture companies like Haworth and Vitra have recently introduced workplace lines that bring home to the office—residential fabrics and textiles, makeshift IKEA-esque first apartment furniture that takes the idea of furniture hacking from home to work. As the work/life balance continues to blur for us, Millennials will want to interact with their workplace in a way that doesn't resemble the traditional office. Offices will offer living rooms. Private nooks. Our co-workers are often our social partners. Don't be surprised if you see a couple canoodling on the weekend in a Scandinavian inspired living room... at work.

## A NEW SOCIALIZATION: DATING AND CLUBS AT WORK

Which leads me to another major shift. As Millennials take more and more of home with them into the office, it isn't surprising to see more social organizations crop up in the workplace. Dating in the office is nothing new; but having your co-workers comprising your main dating pool is. If you're going to live in your office, you're going to date in it, and the traditional barriers between social courtesy and professional obliga-

tion weave into each other in a hurry. With dating, you need events—and this is where clubs come in. From running clubs and pizza clubs to astronomy clubs and crafts clubs, specialized interests are becoming beacons of socialization for Millennials to cluster around and find solace. Our workplaces are increasingly going to become the hub of all our most important activities.

## SLACK = DEATH OF EMAIL

A new crop of communication tools is trying to re-center one of the pesky problems facing many organizations: death by email. Slack is one such innovation that is making waves in the way companies communicate, applying a level of transparency that is reordering how information is prioritized and processed. Slack creates chat groups or channels that individual people or teams can join. Slack can plug in directly to your company's web products' application program interfaces (APIs), pull important key performance indicators (KPIs) happening in real time, and dump that information directly into the hands of the business teams who need it. In other words, it integrates with all your business's software platforms and aggregates important notifications (Twitter, online search) and business information into feeds.

Ecommerce is a prime example of how Slack works. Using Slack, different retail divisions can get instant notifications centered around sales and other key moments. These notifications become the center of the online conversation, supplemented with key files and action items communicated transparently on a team level, helping deal with the chaos and unpredictability of the online retail business. It also taps into the Millennial need to know everything that is going

on. Employees are encouraged to join channels that interest them, and let workers spy on other business teams' comings and going, hopefully keeping everyone informed and on the same page. Private groups and direct messages let co-worker clicks replace the proverbial water cooler with interest groups they have in common. Slack is the first step to a future where, maybe, no emails are sent at all.

## HOLACRACY- THE PERSONIFICATION OF THE IDEAL MILLENNIAL WORKPLACE

Holacracy is a new management framework aimed at disrupting the ancient operational model of managerial command-and-control hierarchy. In fact, philosophically it does away with managers as a whole. Instead Holacracy focuses on self-organization, grouping people based on skill sets and then clustering these groups around core functions and projects that the company needs to get done. This is the Millennial dream: as long as you have skills and knowledge, you can argue and fight for the way you think things should be done. And if you get bored of your cluster, you can belong to more than one, and multitask among the groups.

Holacracy was created in 2007 by Brian Robertson, a 35-year-old former programmer because he was quoted that he had a sense that there had to be a better way to work together. Holacracy is a comprehensive practice for structuring, governing and running an organization. It replaces today's top-down, command-and-control paradigm with a new way of achieving control by distributing power. Borrowing from the

tenets of agile software development, Holacracy is ingrained in avoiding the worst mistake your company can make: committing resources to the wrong thing.

By creating an arena of debate, skillful employees can group around projects as equals, proposing ideas until a consensus has been reached. It also prides itself on bringing employees that are closest to the issue, the ground troops, into a position of being able to influence policy and strategy. While this sounds like it could be a little chaotic to organize everyone's activities and coordinate time management, a new crop of software products enables Holacracy—another integral disruption of the communication stack typical of traditional office environments.

Already practiced by retail titan Zappos and media publishing website Medium, Holacracy is the apex in emerging workplace models for Millennials. We're a demographic group that often wants to be calling the shots, but is also ready to be ultimately accountable; Holacracy fulfills our desire to be important and impactful on both project and company levels.

To be fair, outside my Millennial optimism, Holacracy isn't getting such a great rap – especially at Zappo's. The amount of pressure and shift in their culture required to make this model a home run is so taxing. It's really no surprise that lot of people at Zappo's are ready for the experiment to be over. The entire Holacracy genesis is really steeped in start-up culture. The opportunity, or opportunism—depending on your vantage point—is to be able to groom a cheap, young labor force from the ground up with a different model. This is the only prayer that Holacracy could work at scale.

## WHAT DOES ALL THIS MEAN?

Holacracy appeals to Millennials who want frequent change in their roles within a company. This is because we know the career path to the top is a long one—because older people aren't leaving, or if we're entrepreneurs, our bosses are the same age we are. We want to continue to grow and be challenged. If we're trapped in the same position for more than two years with no path forward, we're going to leave. We want mentors, personal/professional growth and a clear path leading to career advancement.

The physical workplace environment is also in a shifting sands type of transition. Since we have to spend so much time at the office, we want to be comfortable there (so you can keep us there even longer). Our social lives and professional lives are intertwined. The taboo of dating at the office is off the table. We view our workplace as our community. So, if you want happier and even more productive Millennial employees, sit down at the table with us. Trust that we are communicating all the time (albeit it silently). Invest in advanced software communications programs to facilitate our style, and provide us with a homelike workplace. We will give much more than we take. **RR**



**MAXWELL MONTGOMERY**  
Design Observer

*Maxwell Montgomery is a born and raised New Yorker with a love for architecture and design. He is a loyal subscriber to Uber and is slowly collecting a bespoke wardrobe, online and off.*



# THE Love OF A FAVORITE

A comfortable pair of jeans that makes you feel confident. A shirt filled with sentiment and inspiration. A trench that travels everywhere you do.



What makes any piece of clothing a “favorite?” Earlier this year, Cotton Incorporated decided to see what these reasons were in its new advertising campaign “Cotton. It’s Your Favorite For A Reason.<sup>SM</sup>” The campaign, which focuses on cotton’s style and substance, shied away from the celeb-centric TV commercials that had reintroduced a new generation to the “The touch, the feel...” jingle. Rather, it uses real people in real life situations discussing their favorite items of clothing in the television commercials and online videos. Consumers are meant to connect to the subjects in the commercials, relating to their feelings and experiences. To go along with the commercials, Cotton also decided to execute a more omnichannel approach to getting the word out, incorporating a much broader digital program to target a whole new audience.

## #ShopCotton

According to Cotton Incorporated’s Lifestyle Monitor™ survey, 41 percent of consumers say they go online to browse because they “just like to browse for clothes online,” followed by 29 percent who have a need to purchase new clothes, those who research before purchasing in-store (27 percent), and those who received an email from a brand or retailer about a new style or sale (25 percent). Another 14 percent of consumers browse for clothing online after hearing a commercial, and 9 percent head online after they see or read something on social media.

The search for cotton clothing became easier with the 2014 redesign of Cotton Incorporated’s consumer-facing website, TheFabricOfOurLives.com. This was an important step in reaching these online consumers when the new campaign launched, providing plenty of cotton inspiration all in one place. The addition of the Shop Cotton section not



only allows consumers to shop the looks found in the new commercials, but also allows them to browse collections of cotton-rich clothing from a range of designers at various price points. The shops and collections are updated monthly, focusing on certain trends (Made in America), seasons (Summer Scarves), events (Memorial Day Get-away), and even “Favorites through the Ages,” which shows modern takes on vintage finds. The subjects featured in the new commercials also each have their own curated collection on the website, showcasing designs inspired by their individual favorite pieces.

Cotton Incorporated also wanted the website to become more of a destination – a place where consumers would continue to visit, returning to read a new blog post or find inspiration for a new outfit. The “Shop Cotton” section not only features women’s fashion, but also items for men, kids and the home—categories that had not been touched on in previous campaigns. About 8 in 10 consumers say cotton is their fiber of choice for their own clothing (81 percent), their kids’ clothing (86 percent), and their home products, such as sheets (81 percent) and towels (90 percent).

Recently, Cotton Incorporated launched a new digital series, “Favorites Remixed,” which enlists Hearst editors to dispense style advice for their favorite cotton pieces. The videos can be found on Hearst digital properties, but also live on TheFabricOfOurLives.com with their own shopping sections.

In covering many trends and categories, the cotton shops on the site are designed to show consumers how seamlessly cotton can fit into their daily lives.

## #CheckForCotton

“I move a lot, so I need something breathable.” “This is perfect because it feels natural.” “I’ve noticed that the

more cotton that is in the jeans, the longer they'll last."

The campaign not only wanted to show how stylish cotton can be, but also wanted to convey its many benefits. Cotton Incorporated knows that consumers want pieces that are cotton, according to Lifestyle Monitor™ data – 69 percent of consumers say their favorite piece of clothing is at least 60 percent cotton. However, this doesn't mean they are necessarily checking the label for fiber content when purchasing new items. Many man-made fibers are now looking and feeling like cotton due to new technological advances, but this doesn't mean that they will perform the same way. The majority of consumers (52 percent) are dissatisfied with fiber substitutes for cotton, as well as with the performance of the clothing—especially over time. The only way to combat this is for consumers to check to the label to see if the item is cotton-rich before purchasing it.

The benefits of cotton are woven into the commercials and videos as the subjects all discuss why exactly a particular piece is the favorite. The reasons range from durability and comfort to breathability and versatility. The commercials also issue a call to action, telling consumers to "Check the Label" and asking them to find out more on TheFabricOfOurLives.com. These benefits are explained in detail on the site, giving consumers an opportunity to learn about why cotton should be their fiber of choice.

Speaking about the benefits of cotton is another way that the campaign is catering to the Millennial consumer. More so than Gen X and Boomer consumers, Millennials (57 percent compared to 35 and 42 percent, respectively) say they would be more loyal to brands and retailers who educate them on the products, according to the Lifestyle Monitor™ survey. They crave authenticity and have a quest for knowledge—they're looking to consume this information.



### Rue La La

In May of 2015, online shopping destination Rue La La announced a partnership with Cotton Incorporated in order to support the "Cotton. It's Your Favorite For A Reason.™" campaign. The partnership with Cotton is the first of its kind for

ing cotton styling tips and inspiration. The takeovers incorporate curated selections of "Molly Approved" cotton fashion and home items.

**Agreement with statement:** I would be more loyal to clothing brands and retailers that took the time to educate me on their clothing products

	GENDER			GENERATIONS		
	TOTAL	MALE	FEMALE	GEN Y	GEN X	BOOMERS
AGREE	44%	49%	42%	57%	35%	42%
DISAGREE	56%	52%	58%	43%	65%	58%

Source: Cotton Incorporated Lifestyle Monitor™

Rue La La. It includes four "cotton takeovers" on RueLaLa.com, showcasing cotton boutiques for women, men, children and home as well as highlighting digital videos from the campaign and sharing facts about and benefits of cotton. The initiative is supported through social media, dedicated emails to Rue La La's Member base, and cotton-specific packaging that highlights certain benefits. The packaging for the takeovers also uses the Seal of Cotton, which is recognized by more than 8 in 10 consumers.

When the partnership was first announced, Robin Domeniconi, Rue La La's Chief Marketing Officer, noted in the press release that "...whenever we think of cotton, we think of our favorite worn-in tees or a pair of perfectly fitting jeans—all things that inspire confidence. Every day at Rue La La, we encourage our Members to be confident in their personal style and be inspired by the new stores every day... Cotton is such a classic and versatile fabric, and we're excited to share the reasons why we love it and the different ways in which cotton can be incorporated into our Members' wardrobes and homes."

A 12-piece bespoke collection was also designed exclusively for the partnership, featuring custom jeans, dresses, scarves and even jewelry from designers Nanette Lepore, Hudson Jeans and Tamika Rivera. Cotton Incorporated's partnership with Rue La La has been a wonderful way to show consumers just how easily cotton can fit into their daily lives, and the experience encourages them to find new cotton favorites from designers they know and love.

In July, it was announced that model-actress Molly Sims would be the spokesperson for the remaining takeovers until November 2015, helping to tell the Cotton Incorporated and Rue La La story, as well as offer-

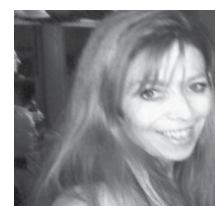
ing cotton styling tips and inspiration. The takeovers incorporate curated selections of "Molly Approved" cotton fashion and home items.

### Looking for A New Favorite

Almost 3 in 10 consumers (29 percent) say jeans are their favorite piece of apparel, followed by tees (15 percent), active bottoms (9 percent), and casual pants (8 percent), according to the Cotton Incorporated Lifestyle Monitor™ survey. When asked why it was their favorite, almost 8 in 10 (78 percent) cited comfort as the reason, followed by fit (62 percent), making them look or feel good (46 percent), and softness (45 percent).

Cotton Incorporated's new campaign was inspired by these findings and others like them. The company conducted extensive consumer research to see what consumers really wanted, and more often than not the results connected back to consumers wanting what cotton can offer. The campaign allows consumers a chance to appreciate their cotton favorites even more, giving them an opportunity to understand the benefits of the items already in their closet and giving them a chance to find and discover new favorites. **RR**

Visit [TheFabricOfOurLives.com](http://TheFabricOfOurLives.com) to learn more.



**CATHERINE SCHEITTING SALFINO**  
Fashion Retail Reporter

Catherine Schetting Salfino covers fashion and retail. Her work has appeared in the menswear publications Daily News Record, Women's Wear Daily, Saks POV, and the Sourcing Journal.



# APPLIED THEORY ON Brazil

## NOTES FROM THE TROPICS

By Paco Underhill

**Art, theater, and retail have all been intertwined in American culture going back nearly two centuries, to Godey's Lady Book in 1830. As recently as the 1950s, Andy Warhol, Jasper Johns, Robert Rauschenberg and Sari Dienes, all postmodern artists, paid their bills by doing commercial retail design work. Not a well-known fact: Andy, Jasper and Bob did store windows; Sari did fixture design.**

Going back to the first retail design firms of the '50s, many of them started as set design businesses. Even today, restaurant and retail design superstars like David Rockwell earned their chops on Broadway and migrated to retail as a way of generating steadier income.

### PIONEERS IN THEATER

Theater and stores share a sense of impermanence. The stage set, the store window, the focal point, even the pop-up, are all designed to be ephemeral. Whether they are opulent or minimal, their visual appeal is seminal to their ultimate purpose—to transport and charm the viewer. The power of store design and visual merchandising, as well as stage sets, is the transitory: the visual proposition is not designed to last forever. And when done well, that's what keeps people coming back for more: they continue to be delighted and surprised by the new.

The mix of physical design, merchandise and the operating culture

are constituent parts of the design experience puzzle. Get it right and you have magic; miss the mark and you fail. The late 20th and early 21st Centuries are littered with good and bad examples of retail design experience. Three early winners that actually turned out to be losers were the Warner Brothers, Disney and Nickelodeon stores.

These three companies decided to open retail stores with very healthy licensing deals. Disney's goes back to the 1930s, when Disney-themed merchandise populated many channels of retail. Disneyana, as cultural historians have dubbed it, included toys, jewelry, watches, tabletops—even furniture.

All three brands decided to “make love” directly with their customers in physical stores. All three were clear unquestioned winners the first year they opened. All three were theatrical and charming. The first, second and third visits were special... but somewhere after the fifth visit, the charm started to fade.

The Oxford shirt with Tweety Bird on the pocket and the plastic Little Mermaid cups and bowls did not age well, particularly because they were presented year after year in the same context, with no changes or updates to the design. The store didn't evolve either, so there was no new magic to draw customers back.

On the other hand, Zara, Mango and Kate Spade are all examples

of players that have managed to keep their windows and visual merchandising exciting. Kate does it with humor, the Spaniards with an ongoing dark tension. That all three of these players are fashion driven is no irony. It is hard to sell the same stuff year in, year out. Good lighthouse brands manage to keep the same reliable ethos, but move quickly with the times.

### WHAT VEGAS TEACHES US

Theater merged with retail design is intrinsic to success. For example, theatrical design equity is embodied in the architecture of the mall. The Grove in LA, Solentuna outside of Stockholm, and K-11 in Shanghai all use design to create an exciting sense of place. They become destinations. We typically have choices about where we spend our money, so places that please us usually trump miserable stores where we have unhappy experiences.

Theme parks, media companies, casinos, zoos and aquariums, even airports are learning and trying to adapt theatrical retail experiences to their own needs. The highest volume retail locations in the world using the old dollars-per-square-foot measure are not to be found in standard shopping malls or high-end shopping districts, but rather are located inside theme parks, resorts and casinos. Surprised?

Travel and shopping are deeply intertwined in the 21st century. Paris, London and Miami all thrive

as shopping vacation destinations. Visitors arrive with empty suitcases looking to fill them up. Another example is the all-inclusive resort, where the economic proposition is to ensure that all the money spent is spent on the premises. An early example of this idea was the development attached to Las Vegas casinos. The Venetian and Caesar's Forum built malls so that the spouses of gamblers never had to leave the property. And these sure weren't the typical hotel gift shops: they created a fantasyland worthy of the imagination of each casino's designer.

There are lessons to be learned in Vegas. Retail impresarios come to Vegas, look and process, then go home and reinvent.

## GLOBAL THEATRICAL DESIGN

Often where we spend our money is less a statement about what we are actually buying and more about the broader theatrical experience. Selfridges, in London, stages surprise fashion shows on its escalators on Saturday afternoons. On a weekday when the children are safely in school, it might be a wandering drag show, made all the more memorable by its setting and the security of the context. Go to an HEB in Texas on a Saturday morning and you might find a petting zoo in the parking lot or a clown performing on the floor.

More than a decade ago, a store opened in SoHo called The Apartment. It sold home furnishings and some clothing. On Saturday afternoons, the bedding department featured a chesty actress in a skimpy nightgown lounging on one of the beds. She

was happy to talk to you about thread counts in sheets. But like everything else in retail, it had to stay fresh. The Apartment lasted about a year and then closed.

I recently saw another great example of theatrical retail design, which provoked this column. And gets me back to the tropics referenced in the title. Fifty miles north of Salvador, the regional capital of Bahia in equatorial Brazil, a spate of resort complexes has opened over the past 20 years. High-end beach spas, condo complexes and small and not-so-small budget hotels cater to a global leisure traveler. White beaches, good diving and abundant aquatic wildlife are all stage set in the relative safety of a planned development, isolated from the poverty and crime that all too often characterize Brazilian cities.

## TROPICAL THEATER

Praia do Forte, a large multi-hotel development, has opened a reconstruction of a beach village as the epicenter of the property's leisure shopping. I see it as a tropical variation on the town center concept that has sprung up across North America. Cobblestone streets, open-air restaurants and lots of little shops make this project charming and attractive. Overhanging palm trees, dense flowering bushes (natural sunshade management), and yes, ambient live music, provided by half a dozen ad hoc musicians where someone taps on some drums or strums a guitar. The stores sell trinkets, handmade jewelry at modest price points and a few beach fashions. The net effect is something like a movie set from a 1940s-era tropical musical. I was half expecting Ginger Rogers to sashay past in a sarong. Unlike a real tropical seaside village, there are no stray dogs, no open sewers and no pungent drying fish. It is lovely.

Given the choice to climb on a bus and ride to a postmodern shopping mall or wander through an ersatz seaside shopping village, which would you prefer?

A nearby resort offers an upscale version of the same thing; only a local

band plays in the center court and a lineup of female samba line dancers shuffle to the beat. At the edges of the crowd, a young woman, adorned in a wedding dress and mask, has her picture taken with visitors over and over again, in one tourist's selfie after another. We talked with her, and not surprisingly, she works for the property.

That beach village may be bogus, but it's onto something, because for each new wave of visitors it is new and delightful. How long will that feeling last? Until it gets predictable and tired. Those of us who labor in the global retail trenches recognize that in the end we are dream weavers or even sorcerers. We must use our creativity and intuition to pull in the right cultural references to create new experiences—all the time.

Is this the starting point for our virtual reality retail future? Will we visit shopping malls through Oculus Rift, experiencing hyper realty shopping through attractive avatars that we create in our best image?

Retail is an industry reflective of social change. Where we go, it will follow. What remains constant is the need to feed our imaginations, be entertained, inspired and seduced into spending our money in meaningful ways. Theatrical retail design provides the magic and encouragement to be part of a commercial community that delivers more than the sale. **RR**



**PACO UNDERHILL**  
CEO and  
Founder  
of Envirosell

*Paco Underhill is the CEO and Founder of Envirosell, a behavioral research and consulting firm with 10 offices globally. Paco and Envirosell's work has been featured in The New York Times, 20/20, National Public Radio, Smithsonian Magazine, Wall Street Journal, and other major news media. Paco is also the author of **What Women Want**, which examines how women are affecting the future of commercial spaces; **Call of the Mall**, a walking tour of the American shopping mall; and **Why We Buy**, the bestselling book about retail in history. In addition, Paco's columns appear in retail: design (formerly DDI Magazine) as well as numerous trade publications. Paco is an expert on consumer trends, and is often tapped as an expert on purchase decision issues around the world.*



# UBERIZING:

By bringing hair, makeup and nail pros right to your door, on-demand apps are claiming an ever-bigger chunk of the beauty budget

By Dana Wood

## Pass the oxygen mask—StyleSeat is sucking all the air out of the room.

This past July, when the San Francisco-based startup announced that its Series B fundraising had yielded a cool \$25 million—on top of the \$15 million in VC money already sitting in its kitty (some even courtesy of Uber co-founder Travis Kalanick)—jaws dropped throughout beauty land.

Why have the money gods smiled on StyleSeat and not one of the umpteen other service-bookings apps? And why a service-bookings app instead of a good old-fashioned, scrappy little indie brand?

Launched in 2011 at TechCrunch's annual Disrupt NY newbies powwow, StyleSeat was a first mover in this now-crowded field. As such, it paved the way for a slew of similar services, including Glamsquad, Vênsette and many others in the "style" camp, i.e., Stylisted, Stylez and StyleBookings.

While some service bookings entities merely facilitate salon and spa appointments, connecting the dots between potential clients and providers, the newer wave brings the provider right to the client's door at a moment's notice. And though a handful are website-only, mobile apps are where it's at. After all, these companies skew young, and those young ones are on the move.

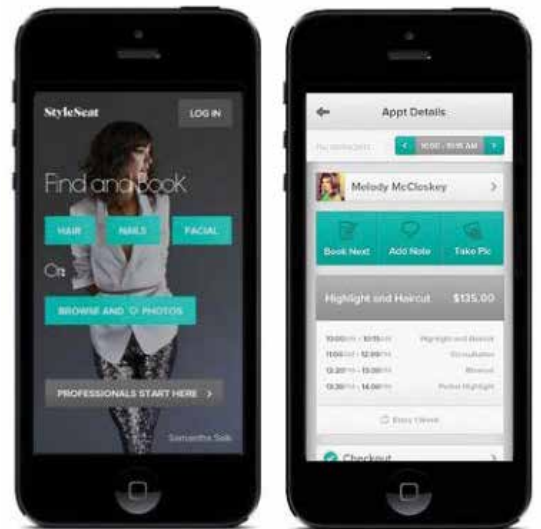
## A few little guys step out onto the stage

Before we take a deeper gander at StyleSeat—aka King Kong among a sea of Fay Wrays—let's investigate two up-and-comers: Stylez, an app launched in 2014, and StyleBookings, a website that made its debut this year.

Born in Miami, Stylez is a consumer-facing product by the very inside-baseball, industry-driven Hair Construction Co. Through the creation of mega training materials (look-books, videos, step-by-step "recipes," product recommendations), three-year-old Hair Construction does the heavy lifting for tens of thousands of salons around the world. Its team of 40 coiffeurs from 10 countries gathers in one locale twice a year to knock out these training tools, and then they take that act on the road—to Moscow, to Caracas, to Colorado Springs. Everywhere, basically.

But stylists and don't need to hike to a Hair Construction seminar to learn how to execute each season's trendy looks. For a monthly fee, they can join the digital platform, get access to the materials, and have a mini bookings website built for them, personalized with their portfolio and contact info.

Hair Construction's Stylez app, which is free, adds an incredibly consumer-friendly twist to all that stylist intel: users can choose from among 400 celebrity looks (300 for women, 100 for men), find a salon, and then get the exact style they're after because the participating hairdresser or barber can download the corresponding video tutorial, shot from all angles.



Consider Stylez the 3D version of ripping a picture out of Vogue or GQ, and bringing it to a salon or barber-shop, hoping for the best. Plus, there's a social media feature: Users can post before and after shots for their friends and followers to ooh and aah over.

It's a very smart idea; no wonder Hair Construction beat out 200 other applicants for a chance to present Stylez to Mark Cuban and billionaire hair guru John Paul DeJoria at the first BeautyPitch at CosmoProf Las Vegas this summer. "The crowd of 1,700 interrupted us with applause twice during our presentation, which was very heartwarming," recalls Hair Construction co-founder Cory Hoffart. "And we were approached by dozens of companies after the event with requests to work together. It was a game changer."

## For some, it's about the niche, not the numbers

On the far more niche end of the spectrum—but equally distinctive—is StyleBookings, the brainchild of superstar hairdresser George Kyriakos. Three years ago, after conceiving the idea of bringing top editorial talent to the doorsteps of chic New York women, Kyriakos rekindled an old friendship with makeup whiz and entrepreneur Vincent Longo.

Shazzam: Instant startup synergy. "Vincent and I go way back," says Kyriakos. "We used to shoot for Vogue and Elle and Bazaar together. And not only is he a brilliant makeup artist, he's a brilliant businessperson, too. He knows so much about branding."

Alongside their roster of 30 carefully vetted hairstylists and makeup artists in New York, Kyriakos and Longo expect to add Los Angeles to the StyleBookings mix shortly. But they're moving slowly and carefully, eschewing outside financial backing—for now—so they can call their own shots while beefing up their track record.

"I've been approached by two hedge funds in the last year," notes Kyriakos. "I know this sounds crazy, but I didn't actually want VC money. We have certain milestones we want to hit first, and we're also in the process of developing our app. With angel financing, they own you lock, stock and barrel, and they make every decision."

Let's hope that when Kyriakos and Longo are ready to cede a little control in exchange for investor dough, there's still some to go around. Especially with the kind of returns StyleSeat must be offering its angels. The company reportedly has 320,000 service providers in its network, spanning thousands of U.S. cities. It has booked 30 million appointments in four years, to the tune of \$1 billion.

No matter how you slice it, \$1 billion is a lot of money. But it's actually only sliver of the revenue StyleSeat expects to eventually generate. In 2011, at launch, company founder Melody McCloskey estimated the total bookings market at \$40 billion.

## The carving of the American beauty budget

Those numbers have to make beauty manufacturers and retailers nervous. After all, for every dollar spent on a salon or spa appointment, or hair and makeup done in the privacy of one's home or office, that's a dollar that won't be finding its way to the coffers of an Estée Lauder or a Saks Fifth Avenue.

"The question is: What are all these bookings services doing to the pie?" asks Wendy Leibmann, CEO and Chief Shopper, WSL Strategic Retail. "The pie isn't getting any bigger, and it's being sliced into lots of little slivers."

Right now, the retail pie-slice is nothing to write home about. "Growth has been incremental, it's been slow—however

polite or impolite we want to be about it," says Leibmann. "One percent, two percent."

At between six and 10 percent, growth in traditional online sales is more robust, but still far from stellar. Leibmann says she isn't remotely surprised that bookings services have caught on. "When you look at the tradeoffs people are making—and we call it 'the good life vs. stuff'—they're looking for, and willing to spend more on, things that are experiential rather than just another lipstick, or frock, or something else. That's where the \$75 for the at-home blowout is coming from. It's not additive to the budget; it's 'I'll do that vs. that.'"

More ominous, says Leibmann, is that consumers got used to buying fewer actual goods during the economic downturn, and they've yet to bounce back.

"One of the data points that jumped out at me from our 2014 'How America Shops' mega-trends study is that four out of 10 participants said to us: 'I had to cut back during the Recession and realized that I don't need all that stuff,' she says. "So that isn't a majority, but it's still a big number. And it's the same for Millennials as in all the other demos."

Still another factor aiding and abetting the bookings services, particularly the Uber-esque, on-demand apps: time deprivation. "People are incredibly overwhelmed and busy," says Leibmann. "Whether it's juggling several jobs in this 'gig' economy, or it's the house, the kids, and everything else



they have going on, people will step back and say: 'I don't have time to do [hair, makeup, nails] myself, so I'm willing to pay for it.'

## Getting off the sidelines, and into the mix

Rather than huddling in a corner, wringing their hands and watching the bookings services and on-demand apps eat their lunch, beauty companies should dive right in to the sector, says Leibmann. After all, most of the biggies—L'Oréal, Estée Lauder Companies, Coty—now have booming professional divisions, and vast networks in the salon distribution channel.

And hair is only part of the equation. Why not build a MAC fleet of on-demand makeup artists? An Essie team of mobile manicurists? Everything these beauty behemoths need to fight the bookings revolution is sitting right in their front yards. "They've got the door opened already with a lot of their brands," says Leibmann. "They have the ability to bring those brands to the shopper. It's a huge opportunity. And they're smart. They'll figure it out." **RR**



**DANA WOOD**  
Beauty  
Journalist

*A beauty journalist for 20+ years, Dana Wood has served as beauty director for BRIDES, Cookie and W magazines, has written for numerous national publications, and is an author and a blogger. She also spent several years in the Luxury Products Division of L'Oréal, as AVP Strategic Development. She recently relocated to Florida, and is embracing high-speed, expressway driving.*

# 7 SECRETS OF 'VOICE OF THE CUSTOMER' SUCCESS IN RETAIL

By Sarah Simon

Over the past few years, Voice of the Customer (VoC) programs have become an established path for retailers to deliver enhanced customer experiences, engage employees and drive business change. A June 2014 report by Forrester Research, "What Drives Profitable Customer Experiences?", notes that even the best retailers are missing out on revenue opportunities by failing to deliver the right customer experience - effectively closing the door on \$572 million in sales for a large retailer!



Why, then, is every retailer not running a slick and successful VoC program? The answer is simple. It's very easy to get VoC wrong. Programs created within the vacuum of a single department, or that lack sufficient budget, might deliver insight but not the financial clout to take action.

First, it's vital to identify the right model for your business and follow it. Ensure that you can define, design and implement your program with clear goals in mind, and then analyze and act on the insight you gather. But what else? What are the secrets to succeeding at each of those stages? As retailers, we need to know the secrets that will unlock our program's potential and secure its future success.

## Build Executive Support

Without support from the top of your company, your program is destined to remain a niche project. Executive buy-in means that stakeholders take the program more seriously, that targets must be met, and most critically, that budget is assigned. So how do you get your executives to support you?

Start by identifying an ROI model that works for you, and show them the numbers so you can clearly demonstrate the return that your program can deliver. Then, link your program directly to your key business priorities and demonstrate how your program can deliver success. It is clear that ROI is not only achievable though cost reduction and revenue increases, but can be very significant for retailers that invest in their solutions effectively. An August 2015 Forrester study commissioned by Confrimit

entitled "The Total Economic Impact™ Of Confrimit™ for Retail Organizations" found that businesses implementing a Voice of the Customer program with Confrimit stood to achieve a return on investment of up to 365% over a three-year period.

## FINANCIAL SUMMARY

SHOWING THREE-YEAR  
RISK-ADJUSTED RESULTS

**ROI:**  
365%

**TOTAL BENEFITS:**  
\$17,198,763

**TOTAL COSTS:**  
\$3,695,205

**NET PRESENT  
VALUE:**  
\$13,503,558

By boosting Lifetime Customer Value and Average Order Value, you can really impact the bottom line!

## Strategize and Plan

With executive support in place, you can now set a clear strategy that links your VoC program with key business priorities, such as those highlighted in the ROI model above. The trick here is

maintaining a balance between ambition, given what you've demonstrated to your senior team, and losing focus by trying to do too much at once. Ensure that you have a clear strategy, but think carefully about the phasing of your program so you can take one step at a time and make sure you've got each step right. Take time to tweak when you need to, before moving on to the next stage.

## Get Organized

With senior support and a clear plan of action, the next step is about organization. A VoC program can't be run by a single person, regardless of the level of executive buy in. You need to build a core team, supported by a steering committee with enough accountability to drive the process forward. This is one of the hallmarks of successful VoC programs, but one that is often overlooked. You also need to ensure that all of the key functions within your organization are aligned with your program. The core team cannot do this alone – even with an exceptional executive sponsor and steering group. VoC programs touch every part of the business, and you need to make sure that each department is represented appropriately.

## Lose the Silos

Now it's time to start driving some real business change. This is where lots of programs fail. But it's also the point at which you can start delivering real value—not only to your business, but to your customers as well—so it's a hurdle you need to overcome. But how? A tool at this stage is the customer journey map. This is something you can run as an exercise with a cross-functional group, asking the team to start by mapping the customer journey – reminding them that it's about more than your stores and website! Once they have identified the broad journey and touchpoints, they can then give their opinion on which touchpoints constitute a Moment of Truth. Then move on to how successful the customer experience is at each touchpoint. This sounds very simple, but as an activity, it can be a real eye opener for internal stakeholders. It gets them thinking about the way the business operates from the customers' perspective.

## Communicate

As with any cross-functional program, communication is critical if you want people to engage with your vision and goals. In theory, this should be easy.

After all, finding out how customers feel about their interactions with your business should be at the core of what you do.

The trick is to communicate what you're hearing from customers in a way that enables you to celebrate your successes. Internal social networking makes a huge difference, as does identifying the people responsible for delivering great experiences and singing their praises. For retailers with stores scattered across a wide area, it's useful to have a local representative of the program to share news, as well as ensuring that your reports are live and tailored to each region or store.

## Add the Voice of the Employee

Employees, particularly those on the front lines—such as in-store or in your customer service call center—are an incredibly rich resource when it comes to understanding the customer experience. Not only will they tell you things that you might not hear from customers themselves, but they'll also have insight into which processes cause repeated issues, and be able to offer suggestions as to how to make improvements. Listen to them.

They're also a captive audience with a vested interest in helping the company succeed. Front line staff are the first to come under fire when customers are unhappy, though in many cases the issue isn't their fault. So if they can help you pinpoint simple ways to improve the situation, not only will customers be happier, but you'll have made employees' lives easier too.

## Act Fast and Innovate

When you're getting it right, and you've got some early results—shout them from the rooftops! This is often easy at the beginning of the program, as there are often some relatively simple things that can be done that will make a real impact on the customer experience. That's why you need to identify what you're looking to achieve right at the beginning and be clear about your definition of success. **RR**

## CASE STUDY: LEADING U.S. RETAILER

One of the United States' largest retail brands has nearly 700 stores and is the leading provider of content, digital media and education products. The retailer placed little focus on soliciting actionable data from customers, and needed to better understand and improve the customer service experience.

The retailer implemented a Voice of the Customer program that employed a variety of dynamic email surveys. These included a number of variables that allowed survey questions to evolve and morph by crafting new and unique questions based on the previous answer.

### DRIVING ACTION

- ▶ 800,000 surveys per year, with 14 percent response rate
- ▶ 6.8 percent increase in customer satisfaction
- ▶ Targeted improvements to agent training
- ▶ Standardizing the customer experience through third-party sellers, no matter the location
- ▶ Hard data drives development of outsourced relationships



**SARAH SIMON**  
Director, Voice of the Customer, Confrimit

*Sarah is a career insights professional with 18 years of experience in the feedback industry. Specialties include VoC architecture, service mapping, customer journey mapping, developing linkages to business performance, reduction of customer defection, results analysis and communication, with expert survey design skills. Currently, she serves as a director, Voice of the Customer consulting at Confrimit, where she uses in-depth needs analysis to architect new feedback initiatives from scratch, and runs diagnostics on existing programs to optimize structure and function to yield business insight.*

# FALL INTO THE GAP

## A Sweet Memory, But The Gap Has Fallen

ROBIN LEWIS

Glenn Murphy exits. Art Peck takes over. It matters not who the players are because there has been a revolving door full of them for the past 15 years, all declaring how they would return Gap to its once dominant position as the cool apparel brand for America's youth. All of them failed to do so, and there is no reason to believe Art Peck will have any better luck. Actually, even luck would not be enough to reverse the ultimate fate of this storied brand. And this is not just a response to Gap brand's miserable 2015 second quarter results, which represent a steady continuance of its negative performance for more than a decade.

I predict that not even a lot of luck will reverse its descent to the bottom. I say this because the brand was driven into ubiquity (the anti-cool for young consumers, and therefore, the beginning of its end) in the late '90s and first two years of the Millennium under the watch of then CEO Millard "Mickey" Drexler. With a Gap on every corner, so to speak, cool turned to cold and its descent began. Ironically, Drexler would leave the helm of the brand that he guided through two decades of meteoric growth from \$480 million in revenues upon his arrival in 1983 as president to almost \$14 billion in 2000, an amazing 2,400 percent increase, when he left. Indeed, his success earned him the moniker of "prince of all merchant princes." Unable to right the ship when it started to sink, Drexler retired in 2002. Comp store sales dropped 5 percent in 2000, their first decline since 1989, and then a whopping 13 percent in 2001, with the overall Gap brand down 12 percent.

And the point I want to make crystal clear is that once a hot, cool brand turns cold and boring in a world of an excessive overabundance of equally compelling brands, it's finished. And nailing the Gap coffin were the up-and-coming

Millennials, who were then, and still are, redefining cool. Gap is not in their lexicon. No matter how much capital and time is invested in attempting to return the brand to its cool status and energetic growth trajectory, at best it will simply limp along, lucky to eke out a living. I predict it will eventually die, not unlike this last dying decade for Sears. At worst, Gap as a brand could crash and burn.

Over the last decade since the Gap's collapse and Drexler's departure, it has been the occasional slog up and then slog along as a best-case scenario. It would seem that the new CEO, Art Peck, might be at a tipping point that finally marks the end of the line for the Gap. The Wall Street-correct voice of its new leader mouths the usual bromides of cost cutting, closing underperforming stores, eliminating jobs, hiring more capable merchants/designers, repositioning the brand, developing a fast fashion process, and lately even mimicking Old Navy, blah, blah...and ho-hum. Such rhetoric might kick the can down the road and buy a few more quarters of slogging, but bringing the brand back to cool, it will not.

### Competition, Ubiquity, Momentum Complexity and the Consumer

Like silent Pac-Men, competition grew up all around the Gap and began to chomp away at all three of its brands during the 1990s. Gap Inc. and the entire apparel specialty retail sector realized explosive growth during that period, primarily taking huge chunks of market share from department stores; the specialty brands were also competing fiercely among themselves. In fact, the rate of growth for dollars spent on teen apparel grew at an incredible 14 percent per year from the late 1990s through to the Great Recession. And

many of them, like A&F, American Eagle Outfitters, Aeropostale and Zumiez, were hitting their stride right in Gap's sweet spot.

Even so, following Old Navy's repositioning in 1994, the Gap troika of brands was leading the specialty store pack through the latter half of the 1990s. In 1997, Old Navy hit a billion dollars in sales and Gap Inc. grew from \$6.5 billion up to \$9 billion in 1998. Plus they were opening stores at the rate of one per day.

The Gap had become the cool brand of all brands for consumers of all ages. And suddenly, it wasn't.

Somewhere in the blur of skyrocketing growth, opening 731 new stores in 2000 and hitting sales of \$13.6 billion, Mickey Drexler and his Gap brands lost their cool. The rapid growth and store openings made the brand ubiquitous, and, as I mentioned, ubiquity is antiquity, the anti-cool to the Gap's core consumers—the young. As a result, Gap began to lose their customers in droves.

It all started to fall apart at the dawning of the new Millennium. The Gap experienced its first two years of declining sales, and Drexler began to close stores and cut costs as he struggled to right the brand and reconnect with consumers. He departed in 2002 as the brands and the business began their steep descent.

### From the "Magic Kingdom" to Canadian Drug Stores

For the next 12 years, Gap would be run by two CEO's with retail experience, but virtually no experience in a Gap-type apparel model. Five of these years were under CEO Paul Pressler, an alumni of the Disney store chain, and the next seven were under CEO Glenn Murphy, previously CEO of Shoppers Drug Mart in Canada.

Hellooooo!! Both left brain guys, operations, supply chain, numbers, research, etc.—all skills necessary to run a widget factory. Apparently it was the Board's determination that the great right brain creativity of the "prince of all merchant princes," Mr. Drexler, had the wrong set of skills to turn around the still very large and complex business. The brand flailed around in search of a re-energized DNA.

So by 2005, under Pressler, the brand fell into a more accelerated decline, and the its relevance, positioning, image, consumer base and business continued to unravel. At the time, Wall Street bestowed upon Pressler the nickname "dead man walking."

Between June 2004 and December 2006 (eight months before Pressler would be replaced), comparative store sales declined in every month but three. Pressler stepped down in 2007. Does it surprise anyone that Gap Inc.'s publicly stated qualifications for its next CEO at the time read: "...with deep retailing and merchandising experience, ideally in apparel, and who understands the creative process"?

Given the Gap's next pick for CEO, the search firm apparently did not read those qualifications, or Gap's board and owners decided to override them with their own qualifications.

Enter Glenn Murphy from Shoppers Drug Mart in Canada. Hello? Am I missing something? Yes, drug stores are retailers and yes, they do carry merchandise, though not trendy apparel. And I'm not convinced of what creative process thinking there is in drug stores — maybe in the signage or advertising? Furthermore, there is no industry that even comes close to being as intensely competitive, fast moving and deathly cyclical as apparel retailing in the United States. To say nothing of my favorite mantra — "share wars" in an over-stored world.

I scratched my head then. And of course, seven years hence, the Gap brand still does not have a compass.

## Designer Déjà Vu

Amazingly, even after a decade of -1 percent (yes, that's a minus), topline growth and less than 10 percent bottom line growth, Mr. Murphy (and his predecessors) never figured out that the Gap brand's real problem was not just product. It was the brand name itself and all that it stood for, both real and as perceived by its consumers. And those consumers that left the brand

at the turn of the century did, in fact, leave the brand altogether, and product alone will not bring them back. The brief and failed efforts of two renowned designers, Patrick Robinson in 2007 and Rebekka Bay in 2012, should have confirmed the point that design and product positioning alone will not turn a brand around. The young customers who left the brand were followed by their younger brothers and sisters, many of whom simply bypassed Gap for H&M, Zara, Forever 21, and Uniqlo. These young customers have an "uncool" mental picture of the Gap, including its stores, products, advertising and imaging, plus its ubiquity. They hear or see the word Gap and the indelible visual that comes to mind is yesterday, not today—not cool.

The Gap had become the cool brand of all brands for consumers of all ages. And suddenly, it wasn't.

## It's All Up to Art Peck Now

Gap Inc. went on to gain some minimal growth from \$14.5 billion in 2011 to \$15.6 in 2012. But it was largely driven by Old Navy, as was the meager growth in 2013, (roughly 3 percent to about \$16.1 billion). In 2014, Gap Global had minus 5 percent comp store sales, and for first half of 2015, comp store sales are down 6 percent; Old Navy Global had a 5 percent increase with first half of 2015 up 3 percent, while Banana Republic's Global same store sales were flat in 2014, and they are at negative 4 percent for the first half of 2015. As stated earlier, all of this now leads to another déjà vu crisis moment. CEO Art Peck's bromides about cost cutting, closing stores and the fact that his team is all over the issues and challenges indicate yet, once again, that there is hope for a turnaround.

Hope and reality sometimes serendipitously merge. But before this happens at the Gap, Mr. Peck is going to have to address a laundry list of realities that inform and shape his business:

The brand is cold and is descending, particularly among Millennials, who are the next primary consumer segment for apparel. Everything the brand

used to stand for among America's youth has been co-opted by fast fashion brands like H&M, Forever 21, Zara, Uniqlo and others. These young consumers want more new, more often, whenever they want it. Fast fashion compels greater visitation rates due to more frequent and faster new line cycles, and most importantly, these brands also offer greater value.

Physical retail estate will shrink for both stores and malls as ecommerce accelerates, challenging Gap's mall locations. Physical stores must create great experiences to compel young consumers to take the time to come to and shop through the stores; the Gap in-store experience is lackluster at best. Smartphones are providing a wide range of more entertaining and enjoyable experiences that impel Millennials to spend time and dollars on than shopping for apparel.

Will Mr. Peck and his team address these realities in ways to successfully merge his hope with these real world issues? Can they bring the Gap brand back to a level cool enough to be embedded into the zeitgeist of today's youth? Or are we looking at another iconic brand in its death throes? Spoiler alert: that's the opinion I opened this article with.

At best, Mr. Peck and team will slog through this third déjà vu period, having accomplished nothing more than his predecessors, Paul Pressler and Glenn Murphy, by just keeping the brand alive. According to his comments during Gap's recent analyst meeting, his turnaround idea is to follow the highly successful Old Navy playbook. Sorry, Art, but the Old Navy playbook with the Gap brand name on it will not work. Get it? It's a brand issue, not a product issue. Anyway, the question then would be: Will the Gap Inc. board, its owners and Wall Street allow yet a fourth attempt at a turnaround?

Like the once iconic and enormous Sears brand, Gap will continue its descent with a whimper and sink slowly like Sears. Or in a worse case, it may finalize the collapse that started at the turn of the century with a quick and loud bang. **RR**



## ROBIN LEWIS

Publisher  
and CEO of  
Robin Report

# HOW TO TALK *Luxury* TO MILLENNIALS

By Pam Danziger

The next generation poised to become the core target market for luxury brands is bringing a whole new outlook on style and value into the luxury marketplace. As Millennials mature in their careers and grow in affluence, luxury brands need to connect with this generation in compelling ways that meet its unique set of expectations and needs. One thing Millennials don't want is their parents' or grandparents' traditional luxury brands. They want their own.

In an anecdotal example, a Millennial-generation associate lawyer told us that the grey-haired partners at his firm wear their Rolexes and other luxury brand watches to signify their wealth and status. But his status symbol watch isn't some expensive Rolex, but rather his Ironman Triathlon watch. He explained, "It says 'I am this kind of man, a triathlete. I need this watch.'" The status statement this young lawyer wants to make is not about how much money he has, but who he is and what he has accomplished. Another young woman said her status symbol isn't the car she drives, the handbag she carries, or the designer clothing she wears, but the initials after her name—in her case, Ph.D.

For this next generation of luxury consumers, making money, getting promoted or becoming a partner is all well and good, but the traditional rewards of their accomplishments are not the only prizes they are after. Rather, it's the non-material accomplishment of achieving a personal goal and digging deep to succeed at something truly remarkable, such as completing an Ironman triathlon or doctoral disserta-

tion. These smart, accomplished young people on the road to affluence know that just about anybody can make a lot of money, if that is what one aims for. But not everyone can achieve what he or she has set as a goal, so personal status watches are not icons that symbolize success. This next-gen female introduces herself as Dr. rather than Ms.

In a recent talk at the Hackers on the Runway conference in Paris, an event designed to foster collaboration between digital and luxury organized by TheFamily, marketer extraordinaire Seth Godin asked, "Is digital the end of luxury brands?" I think instead the question should be, "Is the digital generation, i.e. the Millennials, the end of luxury brands?" The key challenge for luxury brands is not about how they connect with this generation—through Internet marketing tactics, etc.—but how these brands create new and compelling reasons why they're meaningful and important to this digitally-empowered generation.

Getting to the "why" of the luxury brand is the foundation on which the future of the luxury market will be built. Tailoring the brand message to the unique psychology of younger consumers is what's needed, not just creative programming or digital marketing tricks. It is all about catching the Millennials along the road to affluence. Today, luxury brands telling stories of exclusivity, status, indulgence and over-the-top extravagance repel Millennials more than they attract them. New narratives are required that maintain the elevation of the brand above the masses, yet connect with the unique consumer

psychology of the next-generation luxury customer, which is by nature democratic, not elitist.

There are four thematic narratives that resonate with the zeitgeist of today's next luxury generation.

## Performance *Luxury*

Luxury can't exist only as a product concept any more—it has to deliver an experience that is meaningful to Millennials. It has to perform. Performance Luxury is exemplified by brands like Canada Goose—a name that has been around since 1957 and historically has associated with lumberjacks and polar adventurers. In a surprising marketing move, Canada Goose shed its functional image on the cover of Sports Illustrated, where supermodel Kate Upton appeared wearing little more than a \$595 Chilliwack Bomber jacket on a ship in Antarctic waters. Canada Goose has well earned its reputation as a provider of outerwear to battle the worst that a North American winter can throw at you. But it's become a hot brand in demand through clever marketing—not least of which is becoming a sustaining sponsor of the Sundance Festival in Park City, Utah, where a Canada Goose coat is both functional and stylish. Some fashion pundits suggest that the sudden popularity of the Canada Goose brand, enhanced by a reported \$250 million cash infusion from Bain Capital, will ramp up the tide on the brand. But the brand has become popular not because celebrities wear it, but because it does its job really well: it keeps you warm in

extraordinarily cold weather. As long as Canada Goose continues to perform for the customer—which the company guarantees—it may hold onto its luxury luster.

## Create-Your-Own *Luxury*

While Baby Boomers were once known as the Me Generation, Millennials have taken self-reflection to a whole new level. They are a generation raised on self-expression about everything, including making their own skin into a canvas for personal expression and creativity. The emotional need for self-expression in home furnishings that adapt to all different room sizes and life stages is what the Lovesac Sactionals furniture concept provides. Lovesac is a brand better known for its iconic beanbag chair. Today, Lovesac offers a uniquely customizable take on conventional upholstered furniture. Its Sactionals are described as a cross between “upholstery and Legos™.” Sactionals consist of two basic upholstered pieces that can be combined in any configuration imaginable—no tools necessary. With a starting price over \$2,000 for a basic loveseat configuration, Sactionals are pretty pricey for many young couples starting out, but the add-on flexibility that allows the furniture to grow and change as the couple’s needs change is the ultimate in luxury. Sactional furniture expresses an upscale performance vibe that delivers a personal experience in both design and function.

## Collectible *Luxury*

Tapping into an individual’s collecting instincts is the ultimate way to build brand loyalty. Lots of brands have exploited collecting, but few have been able to sustain it over decades as the tastes of new generations of consumers have evolved. That’s why the Vera Bradley brand of colorful, provincial print handbags, fashion accessories and luggage is worth noting. The company has been able to ride the fashion waves from its original “Grandma’s” carryall for quilting and knitting projects to a fashionable Millennial’s cross-body bag for today. The Vera Bradley brand has done so by continuously reinventing its product line around the distinct stages of a woman’s life, from schoolgirl totes, backpacks and dorm accessories—including linens, day planners and lap desks—to diaper bags for young mothers, sports sacks for athletes and gym rats, luggage for the world traveler, and handbags and computer totes for the mobile professional. Vera Bradley’s homespun luxury stands in sharp contrast to the elitist luxury of Louis Vuitton or Gucci. Quite reasonably priced, most of these cloth bags offer the avid collector nearly unlimited opportunity to amass a collection worth many thousands of dollars. The luxury angle? Each bag tells a story for the collector: when she bought it and what experiences she has enjoyed while carrying that bag. Vera Bradley is also a social brand, being so distinctive and recognizable that anyone carrying VB is no stranger, just “a friend you haven’t met yet.” Many people wrongly think that collecting isn’t for the Millennial generation, but they are wrong. Their take on collecting is focused on collecting experiences and feelings that make memories, not on amassing a bunch of things to display on a shelf. Self-expressive brands like Pandora and Alex and Ani have tapped into this desire, as well.

## Value *Luxury*

Ultimately the most compelling luxury narrative for the Millennial generation is value. These younger consumers are, as a rule, intent on maximizing their return on investment when it comes to the products and services they will buy. They diligently research their purchases, tapping into social networks to find the right combination of quality, service and price. They aren’t afraid to pay a premium if they find the right match. This is why I see a bright future for bespoke footwear in this generation. Unlike Boomers, who wore \$10 Keds or \$25 Chucks, their children grew up in \$100 Air Jordans. Their sneaker wardrobes, specially crafted for each and every kind of sport and athletic endeavor, was a major capital investment. They are a perfect fit for bespoke shoe brands that offer handcrafted shoes—brands like Berluti and Tod’s, both of which are expanding into the U.S. market. They are also customers of disruptive brands like handmadebrogues.com, which offer made-to-measure shoes at around \$200 to \$300 a pair. This is affordable luxury compared to the \$675+ required to step into a pair of custom-made Tod’s Gommio Club driving shoes, or the \$1990+ for Berluti Oxfords.

For Millennials, luxury is a state of mind, not a price point or a brand logo. The luxury stories crafted for Millennials must go well beyond stated status, privilege and exclusivity—all values linked to the 1 percent who are not their role models. They want luxury that speaks to their unique values, such as luxury that is inclusive, yet individualized; luxury that is self-expressive but not self-absorbed or narcissistic; and luxury that delivers unique and meaningful experiences. **RR**



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# ORIGINS

By Marie Driscoll

## Made In Italy

“All I know is, when I see a ‘Made in Italy’ label, I want to buy it!” This is typical of comments I hear from the sophisticated fashion set I run with in NYC. Italy’s creativity, artistry, and passion speak to us viscerally on every level, from design and fabric to style and construction. ‘Made in Italy’ can even evoke visions of classical Rome, with its intelligent aesthetic, as well as *la dolce vita* – a way of life epitomized in Italian cinema of the 1950s and the ‘60s.

In the summer of 2014, London’s famed Victoria and Albert Museum hosted a comprehensive design exhibit, *The Glamour of Italian Fashion – 1945 to 2014*, which has since moved on to tour internationally. The exhibit documents a postwar Italy, eager to return to its past splendor, and the confluence of economic interests pushing for development of a national textile and clothing industry. These circumstances were amplified by an expanding film industry that influenced fashion, and ultimately the development of ready-to-wear.

Valentino’s Creative Director Pierpaolo Piccioli aptly summed up why Italian fashion has such enduring appeal, commenting, “Couture is part of our memory. It is part of our memory of being Italians, because couture is linked to craftsmanship, to the execution, to the schools of art of the 15th century. It is a typical Italian tradition that we want to perpetuate and hand down, as we strongly believe that the memory of couture is the key to face the challenges of ‘Made in Italy’s’ future.”

## Italian DNA

Let’s face it, Italians live and breathe a different level of culture and taste. Since the time of the Roman Empire, the people who live in what we now call Italy have been immersed in a design heritage spanning architecture and sculpture, road design and painting, fashion and consumer products. Romans are spoiled, living in the shadow of the Coliseum and the presence of Botticelli’s frescoes and Caravaggio’s paintings in their churches and Michelangelo’s sculptures at the Vatican. Attention to design is reflected in all they do, from the shape of pasta to the industrial design of an espresso machine or an Olivetti typewriter, to, naturally, an extraordinary bag or pair of seductive shoes.

## Traditional Constructs

A brief look at Italy’s manufacturing structure reveals that many skill sets pass down vertically through generations, combined with a horizontal division of work that depends on strong links to the local area (including local banks) and a strong reference to family ties. This familial system creates “a relationship of trust and cooperation that was first and foremost personal rather than exclusively commercial,” says Emanuela Scarpellini, Professor of Modern History at the University of Milan and visiting scholar at Stanford University and Cambridge University. This approach contrasts with the large, impersonal structure of firms. The localized model provides the flexibility and adaptability that supports manufacturing multiple design aesthetics and international brands.

According to Istat-National Institute of Statistics, in 2011 there were 130 Made in Italy industrial districts; 32 specialized in textiles and clothing; 24 in personal goods; and 17 in leather and footwear. Of the remaining districts, 38 are manufacturing sectors, 15 in food and 4 in jewelry. The others specialize in chemicals, metals and paper. Smaller firms in these districts measure success in terms of pride in their heritage and a focus on creativity and quality; growth is not the exclusive mantra. Many of the firms are family owned, providing a positive, stable environment, potentially negative family dynamics aside. These family owned firms are under-capitalized and encountering transition problems, which makes them targets for huge French luxury conglomerates seeking new growth opportunities and new brands.

## Full Disclosure

Increasingly, Italy’s premium fashion houses are foreign owned. Chinese factories, their Asian workers and upscale Chinese consumers are now intertwined with the destiny of the Italian-made. The Exane BNP Paribas/ContactLab March 2015 report, “The ‘Made in’ Controversy,” points out that 41 percent of individual leather goods operators in the Florence leather district are Chinese, up from 35 percent in 2011 and 28 percent in 2002; and 74 percent of the individual enterprises in the Florence leather district are Chinese, up from 69 percent in 2011.

Exane BNP Paribas researched 30 brands—ranging from Tiffany, Bulgari, Cartier, Bottega Veneta and Valentino to Ralph Lauren, Coach, Hugo Boss and Tory Burch,—surveying the manufacturing disclosures on their websites. Having a Made in Italy provenance denotes quality craftsmanship for both Italian and non-Italian goods. Whether a luxury brand discloses production location varies: 75 percent of high-end luxury brands and 80 percent of mega brands disclose. Interestingly, Chanel doesn’t, nor does Dolce & Gabbana. Prada discloses “Made in Prada.” Aspirational brands generally do not disclose, as disclosure of production in a third world country would not add to desirability.

According to Boston Consulting Group, 87 percent of consumers from emerging markets care about product origin, versus 71 percent of consumers in developed markets. ‘Made In’ matters

by region. For instance, around 70 percent of Chinese consumers want their watches to be Swiss; 62 percent want their perfumes and cosmetics to be French; 57 percent want their cars to be German; and 50 percent want their bags and shoes to be either Italian or French.

## Money Matters

The Italian design legacy pays off. In December 2013, Italian luxury outerwear brand Moncler went public in what was Europe's best IPO of the year. In a prime example of demand outpacing supply, the IPO was oversubscribed 31 times availability, and on its first day of trading appreciated 47 percent from the offering price, for a \$3.5 billion market capitalization on its first day as a public company. This capitalization represented 4.7 times Moncler's 2013 sales and 27.7 times its net income; on a PE (price to earnings) basis, Moncler's IPO closed more than 50 percent higher than the prevailing S&P multiple Before Moncler, Brunello Cucinelli S.p.A. (maker of \$3,195 cashmere cardigans) and Salvatore Ferragamo S.p.A. enjoyed strong demand for their IPOs, and were oversubscribed 17 times and 3.6 times, respectively.

According to Thomson Reuters, first quarter 2015 M&A activity in Italy approached the value of M&A transactions in all of 2014, as recent economic reforms have driven increased investments. At \$20.6 billion, first quarter transactions rose 260 percent year over year—compared with \$27.6 billion in 2014. Momentum is heating up in 2015, as the Italian government appears to be emerging from a three-year recession, and recent reform of the labor markets and moves to cut business taxes are making Italian businesses more appealing globally.

In its report on “2015 Global Powers of Luxury Brands,” Deloitte listed the top acquisitions in the luxury and premium goods sectors in 2013. Of the top 12, four of the acquired businesses are Italian: Loro Piana S.p.A., Pomellato S.p.A., Marcolin S.p.A. and Gianmaria Buccellati srl. The first two were acquired by French luxury houses, LVMH and Kering, respectively, and the remaining two were private equity transactions. Loro Piana fetched the highest purchase price—\$2.8 billion for an 80 percent



*“All I know is, when I see a ‘Made in Italy’ label, I want to buy it!”*



interest, or 5.48 times 2012 sales, followed by Pomellato, at 2.89 times sales. This compares with an S&P price-to-sales ratio of 1.45, and is evidence of the premium afforded to luxury Italian brands.

So what does this all mean? Given economic reforms and the bench strength of talent in Italy coupled with millions of consumers with an unrelenting desire for Italian made fashion and leather goods, we should continue to see M&A transactions with ownership of Italian brands going into international hands. The French luxury houses are good brand stewards, offering strategic, marketing and distribution know-how as well as a solid financial underpinning to their newly acquired luxury brands, while supporting creativity and nurturing growth. The portfolio approach, as the French luxury houses practice it, allows the larger mega brands within the portfolio to restrain growth in order to preserve brand value and

maintain supply/demand equilibrium as smaller brands expand to meet growing demand. Financial and nonstrategic acquirers are more mercenary, and investment returns and shorter-term objectives often supersede brand building. For example, Proctor & Gamble recently sold its 43 beauty brands to Coty, Inc. (including Gucci and Dolce & Gabbana) after years of underperformance by the P&G beauty portfolio.

Google provided a boost to the Made in Italy brand in 2014 when it teamed with the Italian Agriculture Ministry, Union of Chambers of Commerce, Ca'Foscari University and the Symbola Foundation to launch a platform bringing Made in Italy to the Web ([www.google.com/culturalinstitute/project/made-in-italy](http://www.google.com/culturalinstitute/project/made-in-italy)). Young Millennials and Generation Zers were introduced to centuries of heritage and artistic treasures as well as new practitioners that give Made in Italy its robust meaning. Country of origin will continue to matter to the growing population of aspirational luxury shoppers from developing markets, and Made in Italy products will be a core holding for investors and luxury customers. While the majority of retailers and brands are fighting in a race to the bottom where no one wins, the Italians have had a different approach for centuries. Let's hope they stick to their DNA. If they do, the power of Made in Italy will be around for another millennium. **RR**



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# GROCERY (FINALLY) GETS WITH IT

## HOW TO SATISFY CONSUMERS' GROWING HUNGER FOR ONLINE GROCERY

By Randy Burt  
& Vishwa Chandra

With the grocery industry's razor-thin margins and slow growth, online sales are not only an incredible opportunity, they also represent revolutionary change in a, traditionally, well, traditional industry.

With the grocery industry's razor-thin margins and slow growth, online sales are not only an incredible opportunity, they also represent revolutionary change in a traditionally, well, traditional industry.

And when it comes to the online grocery market, consumers are hungry for engaging, personalized and easy online grocery shopping experiences.

This year, American consumers' appetite for online grocery is finally becoming insatiable. According to a 2015 A.T. Kearney study of 1300 consumers, the number of primary grocery shoppers who bought groceries online increased from 6.8 percent in 2014 to 34 percent in 2015.

By 2019, an estimated 8 to 11 percent of grocery sales will occur online (see figure 1). What's more, shoppers making the switch to online come largely from particularly attractive segments—urban dwellers, Millennials, and those earning more than \$75,000 per year—and their online grocery spending across categories is going up.

So it's no surprise that online grocery sales are growing five to six times faster than conventional channels, with growth of 15 to 18 percent expected over the next decade. Grocers who make the right moves right now will be well positioned to capture a big share of this growth and delight consumers across channels.

### Who's Buying?

Over the past year, online grocery shopping rates have increased across all sectors, but here's a look at some of the biggest areas of growth.

All age and demographic groups are embracing online grocery. It's not shocking that 25- to 34-year-olds are the most likely to buy groceries online (37 percent), but penetration increased by more than five times in some surprising categories. For example, 25 percent of shoppers 65 and older say they bought groceries online in the past year (see figure 2).

Urban dwellers (41 percent) and people earning more than \$75,000 (22 percent) also are buying more groceries online.

The nature of the online shopping journey is driving a more diversified consumer base. Whereas mostly women shop for their families in the store, the online shopping experience often includes other members

of the family adding items to the cart.

### Shoppers are still using websites as mobile grows.

Online shoppers are increasingly using websites and apps to shop for groceries online, with some pickup in social media activity. However, among older shoppers, non-website options for online shopping (such as social media) are far less popular.

### Some old barriers remain.

Even as online grocery becomes more widespread, some of the market's long standing hurdles remain. Nearly two-thirds of respondents say they would buy more groceries online if they could guarantee the quality and freshness of products. As a result, the most popular online categories are non-perishables: personal care, beauty, packaged foods and baby food (see figure 3).

That said, even as buyers continue to express concern about the freshness of perishables, they haven't stopped buying them online. Andrew Nodes, Business Development Lead for the East Coast at Instacart says, "...customer perception versus customer action are different things. Customers believe they shouldn't be buying perishables online due to freshness, but they actually do. Perishables are among our top performing categories."

**Shoppers want value, but they will pay for convenience.** Many consumers say



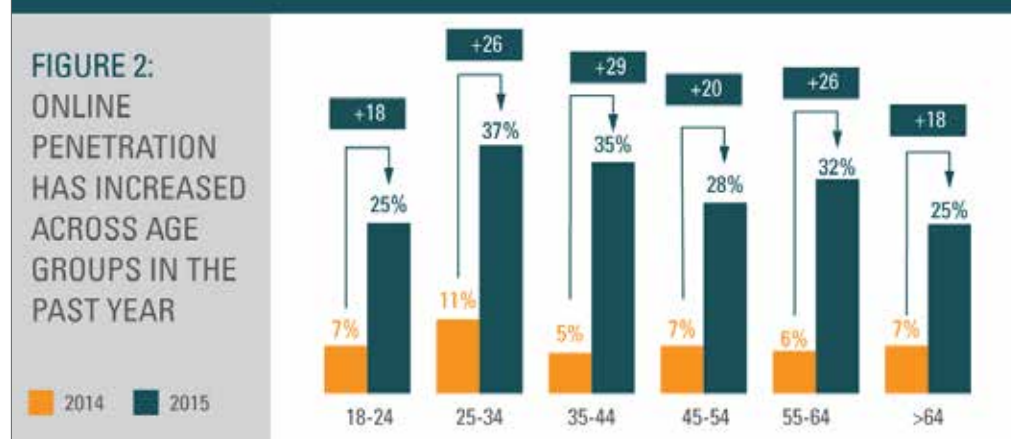
they still avoid online grocery because of a perception that costs are higher. 58 percent say that prices that better compete with those in stores and free or low-cost delivery would drive online buying (see figure 4).

Plus, respondents say they want savings—coupons (71 percent of respondents), price comparison between stores and other sites (67 percent) and loyalty programs (65 percent—see figure 5).

At the same time, they want convenience and speed. Nearly two-thirds of respondents say they would shop online more frequently if checkout was easier and they could quickly reorder items.

**Mobile apps can enhance the store experience.** Consumers say apps that enable price comparisons, the ability to search for and locate items in stores and scan for faster checkouts could increase in-store convenience and positively impact the shopping experience.

RESPONDENTS BY AGE GROUP WHO BOUGHT GROCERIES ONLINE (% respondents selecting a website as a channel that was "used," "frequently used," or "most used")



## Taking a Bite Out of the Online Opportunity

As consumers continue to adapt to technology in their lives and become more urban, online grocery is becoming easier and more appealing—for consumers and retailers. Here’s how retailers can make the most of this pivotal transition.

- Segmentation.** As in other channels and categories, leading retailers will start by identifying high-population, high-density markets, and targeting customer segments within these markets that represent the best opportunities. Thanks to online segmentation, retailers can target specific shoppers, such as new parents (with an integrated total baby offering across food and non-food) or back-to-school shoppers (including clothing, school supplies and food).

Personalizing offerings with recipe suggestions, shopping lists, customized pricing, recommendations based on purchasing history and online sampling for new products can help lure buyers to make the switch. Treating delivery as a unique channel lets retailers provide a degree of personalization and flexibility that’s unavailable via their traditional channels.

- Value proposition.** Converting consumers’ interest in online grocery shopping into increased sales depends on how quickly retailers can make features such as same-day delivery and click-and-collect a reality, and whether they can offer customers the same values and prices as they do in stores.

Third-party providers like Instacart and Google Shopping Express (and soon, most likely, Uber) are emerging to help solve the “last mile” issue, providing same-day or scheduled deliveries at minimal cost to retailers.

As they dig into click-and-collect, U.S. retailers can look to the success of many European grocers. Take Tesco, which has fulfilled more than 170 million click-and-collect orders in the UK—where 25 percent of consumers say they buy groceries online

in a given month. France also has a successful history with click-and-collect, with over 3,100 outlets.

On this side of the pond, many retailers are taking smaller first bites, with Harris-Teeter up and running at scale (around 170 locations), Peapod putting up dedicated click-and-collect locations and many traditional grocers and mass merchants rolling out click-and-collect service.

- Shopper engagement.** Engaging today’s omnichannel consumer is about much more than just using multiple traditional media such as TV, direct marketing and coupons to reach shoppers—it’s about creating a personal experience for every shopper, regardless of where or when they shop or what device they’re using.

Retailers can interact with omnichannel shoppers through personalized offers, pricing and promotional strategies tied to shopping preferences and past purchases. They can offer shoppers variety—by category and across digital touch points—and use individualized promotional offerings and merchandising strategies to increase engagement.

Some foreign retailers are already innovating in this area. Take online pure play Singaporean grocer Redmart, which sends customers reminder emails when it’s time to restock their favorite items; or Germany’s REAL hypermarkets, which gives consumers access to customized in-store coupons via its app; or Tesco’s website that prepopulates shoppers’ baskets based on in-store and online purchase history.

As ecommerce becomes the single largest source of growth in North American food retail, capturing increasingly tech-savvy consumers depends on meeting the logistical challenges of online food sales coupled with understanding customer needs and desires.

While pure play online retailers have an edge with their business flexibility and speed to market, traditional food retailers can take advantage of their biggest asset—the store—as they build out their digital capabilities and enhance their online supply chain.

FIGURE 4: NON-PERISHABLE ITEMS, PERHAPS UNSURPRISINGLY, ARE MOST POPULAR FOR ONLINE PURCHASES



FIGURE 5: SAVINGS AND CONVENIENCE ARE MOST IMPORTANT FOR DRAWING GROCERY SHOPPERS ONLINE



Ultimately, winning online grocers will balance traditional and online capabilities, segment and penetrate the most attractive market opportunities and deliver a seamless consumer proposition that meaningfully engages with shoppers.

Given the state of today’s hyper-competitive grocery market, it’s no longer a question of whether to enter online food sales, but rather how to build online capabilities that can capture customers’ trust, loyalty and wallet across channels. **RR**

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FIGURE 3: HIGHER COSTS AND THE INABILITY TO JUDGE PRODUCT FRESHNESS ARE KEEPING PEOPLE FROM GROCERY SHOPPING ONLINE





By Robert Spector

# Seattle

## America's Capital of Retail

What do Nordstrom, Starbucks, Amazon, Costco, and Recreational Equipment, Inc. (REI) have in common?

They are all world-class retailers based in Seattle.

And don't forget 103-year-old Ben Bridge Jeweler (a division of Berkshire Hathaway, with 75 stores in 11 states), 95-year-old Eddie Bauer, and ecommerce sites Blue Nile and Zulily (just acquired by QVC for \$2.6 billion). According to the most recent American Customer Satisfaction Index, Nordstrom was tops in the Department and Discount category; Amazon was the leader in the Internet category, and Costco was the pacesetter in the Specialty category.

Among Fortune Magazine's "World's Most Admired Companies," Amazon was fourth, Starbucks fifth, Nordstrom fourteenth, and Costco sixteenth. Again, each led its particular retail category. No other region had such a retail presence.

So, what's in the Puget Sound water?

Very simply, it's an approach to retail that offers customers a unique customer-centric experience (whether online or in-store) and a value proposition that is not strictly about price. On the surface, all of these companies are markedly different from one another. "When you come to Costco, you don't expect a Nordstrom experience. When you come to Starbucks, you don't expect a Costco experience," said Jeff Brotman, founder and chairman of Costco.

"Customers come to Costco because they can get the most popular versions of high-quality goods at a decent price."

### A tradition of customer service

Seattle retail is built around taking care of the customer. In Seattle's historically egalitarian culture, providing outstanding service is a noble calling. "We were raised kneeling in front of the customer—literally and figuratively," says chairman emeritus Bruce Nordstrom, who began working for the company when it sold only shoes (and who still describes himself as an "old shoe dog.") "You're down on your hands and knees, waiting on customers, which I find an appropriate position for our level of service." Nordstrom, of course, is internationally famous for its customer service, but I believe the Seattle tradition started with Frederick & Nelson, the grand dame of department stores, which opened for business in 1891—11 years before Bruce's grandfather John W. opened his little shoe store in downtown Seattle. F&N, which was sold to Marshall Field & Co. in 1929, created Frango Chocolates almost a century ago.

After going through a series of ownership changes (BATUS Retail Group, then



local investors), F&N went out of business in 1992, leaving an 850,000-square-foot hole in downtown Seattle. Six years later, Nordstrom's moved its flagship store into the renovated Frederick's building. It was as much an emotional decision as it was a business decision. "I was raised doing my back-to-school shopping with my mother at Frederick's," Bruce Nordstrom told me. "So that building has a very important place in our hearts."

The best customer service story I ever heard came from F&N: In the late 1940s, a customer named Katheryn Kavanaugh took her first trip in 20 years to her birthplace in Ireland. She shot several rolls of film of her family in County Cork. When she returned to Seattle, she brought the film to F&N to be processed. (This was the



era when department stores had lots of departments—including photography.) Somewhere along the line, the film was lost. A tearful, distraught Mrs. Kavanaugh called William Street, president of Frederick's, with her tale of woe. Street asked her to send him a list and description of the photographs she had taken. Then he cabled the list to the Marshall Field buying office in London. The London office hired a UK-based photographer from Fairchild News Service to retrace Mrs. Kavanaugh's route and duplicate the pictures she had taken of her relatives. After the developed pictures arrived safely in Seattle, F&N organized a special public ceremony, where Bill Street presented photographs to an appreciative Mrs. Kavanaugh. Now that's customer service, Seattle style.

## No-questions-asked return policies

As a New York transplant who's been in Seattle for almost four decades, I've witnessed and written about a level of expectation about customer service and politeness in Seattle that you will not find anywhere else. Customers expect retailers to be nice, knowledgeable, and helpful. They want you to be friendly, but not too friendly. This is an approach that I call "superficial intimacy." As a salesperson, I may know a lot about you: name, occupation, style, tastes, previous purchases, fluctuations in weight, etc. Nevertheless, we aren't friends. We don't go bowling together. We're affable commercial acquaintances. That's a winning approach to effective customer service.

Seattle customers also expect a money-back-no-questions-asked return policy.

Seattle customers also expect a money-back-no-questions-asked return policy.

When I interviewed Eddie Bauer himself in 1982, he told me that he was most proud of his guarantee that "Every item we sell will give you complete satisfaction or you may return it for a full refund." Eddie knew that some people would abuse this guarantee, but he felt that it was worth it to burnish the company's reputation. And he was right.

Everett, Elmer and Lloyd Nordstrom established their generous return policy in the 1930s, when they were running a two-store shoe operation. The brothers (who were admittedly mediocre salespeople themselves) dreaded having to deal with obviously outrageous or unreasonable returns. "We decided to let the clerks make the adjustments, so they would be the fair-haired boys," recalled Elmer in a privately published memoir. "We told them, 'If the customer is not pleased, she can come to us and we'll give her what she wants anyway.'"

## Seattle companies influence each other

When I asked Jeff Brotman why Seattle has so many world-class retailers, he said, "Nordstrom has set a very high bar. If you're a retailer here you have to give great customer service. If you're doing anything less, you're not doing it right. That became part of the Seattle cultural landscape, and then we rolled it out at Costco. It's not just cultural; it's really good business."

Jeff Bezos, who arrived in Seattle from New York in 1994, has often said that he wanted to make Amazon.com "the most customer-centric" company in history. He took notice of how Nordstrom was doing business. Even before he launched the website in July 1995, he made customer service his top priority because he knew that positive word-of-mouth buzz would have a greater impact on consumer perception than any kind of paid advertising. (Anyway, in 1995, he couldn't afford to spend money on advertising.) "It was seeing how successful word-of-mouth was in that first year that really led us on this path of being obsessively, compulsively, anal-retentively focused on customer service," said Bezos. Bezos also noticed that Costco, with its narrow margins, made a lot of money on its annual membership fees—\$55 for Business Membership, \$110 for Executive Membership. Costco's approach was part of Amazon's inspiration for creating Amazon Prime (initially \$79, now \$99) for free two-day delivery.



REI as a cooperative also profits from member fees. For a one-time fee of \$20, REI's two million members receive a 10 percent rebate at the end of the year.

Witnessing the rise of Amazon.com firsthand in the mid-to-late 1990s, the traditional brick-and-mortar Seattle retailers were quick to understand the power (and threat) of the internet. Unlike many other retailers in other parts of the country that took an arms-length approach to ecommerce, Seattle companies embraced this new channel. In 1996, REI, which at that time sold its outdoor-focused products through stores and mail order catalogues, assembled a team of people from every department—marketing, merchandising, information services, adventure travel, retail, real estate, accounting and public affairs—to promote buy-in to the new channel and figure out the best approach to developing it. At a time when most brick-and-mortar companies (Walmart and Barnes & Noble, among others) outsourced their websites, REI developed everything in-house.

In my 2002 book *Anytime, Anywhere: How the Best Bricks-and-Clicks Businesses Deliver Seamless Service to Their Customers*, I quote Matt Hyde, the vice president of merchandising and logistics who oversaw the building of REI.com, as saying that the internet “must be a core competency, just like service. You

Starbucks's baristas are treated as “partners.” They are well trained, and are given a pay package that includes compensation, stock, benefits and savings.

don't outsource service. Online stores are not a project; they are a business.” From the beginning, REI.com was treated “as a profit center, rather than a marketing expense, which was highly unusual at that time.” Today, almost twenty years later, REI is one of the top omnichannel retailers in the United States. The internet accounts for almost 25 percent of REI's \$2.2 billion sales; the rest is generated at the cooperative's 140 stores in 33 states.

Nordstrom's website is one of the company's roaring engines. A good number of people who work for Nordstrom.com once worked a few blocks away at Amazon.com.

Strong leadership and empowering corporate culture

Brotman, The Nordstrom brothers, Jeff Bezos, and Howard Schultz need no introduction to the retail industry or even the general public. They are acknowledged as strong, visionary leaders. Although REI CEO Jerry Stritzke is not a household name, he did build his career at Victoria's Secret and Coach. Stritzke succeeded Sally Jewel, who is the current Secretary of the Interior. Nordstrom, Starbucks, Costco and

REI all believe that the employee experience determines the customer experience. Therefore, they don't want “clerks”; they want happy, empowered employees (with product knowledge) who want to help the customer feel welcome and in the mood to make a purchase. Seattle companies generally prefer growing their own managers and executives. They are in the business of grooming people to succeed within their culture.

- At Costco, everyone starts in the warehouse, and, if he or she so chooses, an employee might one day manage a store.
- Nordstrom encourages its employees to act as if their name is on the door, and empowers them to own the customer experience.
- Starbucks's baristas are treated as “partners.” They are well trained, and are given a pay package that includes compensation, stock, benefits and savings.
- REI employees live the brand. They all participate in outdoor activities and they use and know the benefits of the products they sell.

A bias toward continuous adaptation and innovation

Every one of these companies is constantly asking itself what's next. Amazon, of course, is always reinventing itself and moving into new areas. Although Amazon is not a warm-and-fuzzy Seattle company, it is certainly the leader in adaptation and innovation. Describing what Amazon is has always been a moving target.

Nordstrom has embraced social media and has made key purchases to diversify, including Trunk Club and Haute Look. The company recently introduced TextStyle, a shopping-via-text message service that allows customers to purchase merchandise recommended by their salesperson or personal stylist through text messaging. Next opt-in leverages TextStyle by enabling a customer to use her smartphone to secure one-on-one service with a Nordstrom salesperson. Like2Buy allows customers to buy merchandise displayed on the Nordstrom Instagram page.

Starbucks is experimenting with various food selections and formats, and has made a concerted effort to enhance its digital offerings. (A footnote: Adam Brotman, chief digital officer for Starbucks, is the nephew of Jeff Brotman.)

In the end, it all comes down to the customer making a purchase. A few Christmases ago, I was in the downtown Nordstrom flagship store, where I ran into Bruce Nordstrom, who said to me with a grin: “Don't just stand there. Buy something.” **RR**



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By Mark A. Cohen

# CAUTIONARY TALES

## WHY DO RETAIL COMPANY BOARDS OF DIRECTORS APPOINT DYSFUNCTIONAL CEOS— THEN FAIL TO RECOGNIZE THEIR ERROR BEFORE IT'S TOO LATE?

All publicly held companies have a board of directors whose principal role is to act as a fiduciary on behalf of shareholders. These directors are responsible for oversight of the short-, mid- and long-term health and performance of their companies. Sensitivity to an enterprise's behavior with regard to its other constituencies—notably customers, team members and business partners—are also part of their brief. Boards of directors are typically made up of accomplished individuals chosen for their integrity, insight and capacity to provide counsel to the chief executive officer. Most individuals are former chief or senior executives. Post Sarbanes Oxley, the 2002 "Public Company Accounting Reform and Investor Protection Act," financial acumen is mission critical for all boards, especially members who chair or make up a company's audit committee. It's most curious, however, that many boards, and almost all retail company's boards, are devoid of any outside board members with any industry-specific expertise. It's as if, in the case of retail companies, boards are specifically prohibited from having any outside members with any retail experience whatsoever.

### IS THIS ACCIDENTAL?

I don't think so. The simple truth is that many retail CEOs don't want knowledgeable, inquisitive and potentially critical individuals in their midst. After all, isn't it far easier to interact with a group that may very well have no clue as to what it is witnessing and being told?

Consider first, though, how board members themselves are selected. Candidates are proffered by retained executive search firms, existing board members and sitting CEOs based upon pedigree, reputation, personal relationships or relationships based upon mutual board memberships in other companies. Without a mandate to fill board seats with members possessed of retail expertise, few if any are even considered, let alone seated. As a result, retail boards are often collections of individually impressive but collectively inadequate overseers.

Sadly, the final selection of a retail chief executive is almost always left to this outside group in the first place. With no one in the room with any retail experience, how can any board truly make a successful and informed decision with regard to the company's seniormost leadership needs? Yes, there is a widely held view by some that a successful leader in one industry can effortlessly cross over into another. This may work in some businesses. It certainly has not worked well in the retail industry. The litany of failed so-called business athletes is endless. All too often qualified and highly experienced insiders are brushed aside in favor of outsiders who, in many cases, have no credible retail qualifications to offer whatsoever. This, of course, in and of itself represents an abject failure on the part of a sitting or newly deposed CEO and his or her board to properly prepare actionable succession plans in the first place.

If a board then has no meaningful knowledge of the actual inner workings of the industry that its company is engaged in, how can it be expected to understand a job requirements document, and how can it apply that list of skills and experience to the candidates with whom it is presented? Is there something about the retail business

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that is uniquely different from other industries? Yes, there is. The ongoing creation of successful assortment, pricing and positioning strategies, execution pathways and the care and feeding of large and necessarily diverse populations of associates—all dealing in the infinitely challenging consumer space—is most definitely unique and different. The skills needed to succeed in retailing are specialized, and the elements of effective experience, judgment and common sense needed for success are without parallel.

## UNINTENDED CONSEQUENCES

The outcome of a questionable selection process is sometimes the catastrophic appointment of CEOs who, at the end of the day, do tremendous harm to the business they have been tapped to lead.

Admittedly, a process of selection can never be foolproof, regardless of who is in on it. Outside appointments—like Paul Pressler, who failed at the Gap having come from Disney, or Robert Nardelli, who failed at Home Depot after a successful career at GE, or Charles Conaway, who joined Kmart from CVS and then train-wrecked it—represent decisions on the part of boards that weren't able to properly connect the dots between their company's needs and their candidates' capabilities. Then there is the recklessness that was exhibited by the board at JCPenney in appointing Ron Johnson from Apple. Despite his apparent credibility for the work he did in concert with Steve Jobs at Apple, Johnson had never served as a CEO, had never presided over a massive turnaround and had no meaningful apparel and accessory experience. His tragic 13 months at the helm of JCPenney will, we hope, never be replicated.

THE OUTCOME OF A QUESTIONABLE SELECTION PROCESS IS SOMETIMES THE CATASTROPHIC APPOINTMENT OF CEOs WHO, AT THE END OF THE DAY, DO TREMENDOUS HARM TO THE BUSINESS THEY HAVE BEEN TAPPED TO LEAD.

Mistakes aren't limited to outside hires. Insiders, inappropriately selected, can become 'retail serial killers' as well. The Sears Roebuck board made a fatal error in selecting Alan Lacy. The Avon board did the same in its selection of Andrea Jung, as did the Target board in elevating Gregg Steinhafel. My underlying complaint, however, is not so much with the vagaries and risks of selection, but with the failure of these and other boards to recognize and deal with the crises they wrought. Unfortunately, without an experienced industry executive in the room, they remain clueless as to the degree of damage their company has sustained until it is too late.

Sometimes dysfunctional CEOs anointed by earnest but ill-prepared boards fail after periods of extraordinary success. I'm sure the board at Abercrombie and Fitch was completely smitten by Mike Jeffries's performance. After all, he personally created the brand's unique and successful brand equity and business model. But then, did anyone on that board have any idea what the ramifications of

his actions over time would be? They might have been shocked, had they understood the cliff he was driving toward. Most experienced executives in the retail industry saw it coming long before they did.

Did anyone on Target's board recognize that the store was losing its forward momentum over a period of several years? Did anyone have the insight to challenge CEO Gregg Steinhafel's completely flawed strategy to enter Canada? A retailer in the room would have readily asked meaningful questions about pricing strategies and logistics capabilities long before the company's Canadian launch. A retailer in the room would also likely have rejected a strategy to take on a massive 125-store launch all at one time.

How could the Avon board have failed to understand the ramifications of its CEO Andrea Jung's constant rounds of restructures, none of which ever resulted in any discernible improvement in the company's performance... and then, to allow the bribery scandal to remain unresolved for years on end, at a cost to the company of hundreds of millions of dollars? What were they thinking? A retailer in the room would never have tolerated any of this.

When all is said and done, whether a CEO reveals him or herself to be incompetent immediately or downstream in their term, the real failure of retail boards without actual knowledge of the retail business in general, and their retail business in particular, is unconscionable. Just as Sarbanes Oxley explicitly requires financial certification as an underlying requirement of a board's corporate governance, shouldn't industry expertise by way of board representation be required in retail, as well?

Retail businesses have always succeeded through the dedicated leadership of a few, acting in concert with, and through, the hard work of many—many, devoted, dedicated team members. Unfortunately, businesses can also be destroyed as a result of the actions of an incompetent CEO working without meaningful supervision and oversight of a knowledgeable, experienced board of directors. As an associate of a retail company without retail experience represented at the board level, you should remain alert to the behavior and performance of your CEO. A supplier to a company operating without adequate oversight should be equally careful, as should every lender or investor in that company's stock.

We all know the danger of flying aboard a plane with only a single unsupervised pilot in the cockpit. **RR**



### MARK A. COHEN

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# WHOLE FOODS' HAM HANDED MOVES

By David Merrefield

**In an unusual turn of events, the sands are shifting under Whole Foods Markets—and now it's in trouble.**

In short order, Whole Foods, the quintessential upmarket food retailer, has gone from being a Wall Street darling to a Wall Street pariah. In rough terms, Whole Foods' equity value has dropped by nearly half since winter. Even more disturbing, its comps in the first quarter were a meager 1.3 percent, or less than half of what they generally are. The last weeks of the second quarter saw comps at 0.4 percent. This indicates very serious sales slippage and suggests comps are headed for negative territory.

## What's Going On Here?

Whole Foods is now facing three major challenges, two of which have to do with price and one of which concerns its core product offer.

**1** The newest challenge to Whole Foods is one of its own making. In New York City, the Department of Consumer Affairs found a "systematic" problem with short weights, meaning consumers were paying more for product than they should. News stories about that situation spread far and wide, and are what account for most of the near-term drop in comps.

**2** The longer-term drop in comps has to do with the persistent consumer perception that Whole Foods product simply costs too much, even if it's high quality, natural and organic. This remains the case even though Whole Foods has made some real progress in lowering many price points, a fact that remains invisible to many consumers.

**3** In another pricing challenge, natural and organic product has gone almost entirely mainstream and is widely available at many supermarkets for far less. As I predicted earlier in *The Robin Report*, Whole Foods is relinquishing the product exclusivity it has long used to convince consumers to shop its stores and pay its prices. Whole Foods has since acknowledged that it was slow to recognize changing competitive dynamics.

## Curious Reactions

Some of Whole Foods' reactions to these challenges have been strangely ham handed. Whole Foods has had a longstanding problem with short weights—In 2012, the company paid a \$800,000 fine in California because of short weights. It has paid fines in other jurisdictions too.

In New York, inspectors said Whole Foods' pricing errors were the most serious they had ever encountered. In response, John Mackey, co-CEO, said Whole Foods was a "victim" of overzealous enforcement because all food stores have pricing inaccuracies and they often fall in customers' favor. He also pointed out that Whole Foods has a high percentage of random-weight items wrapped and weighed in store, which are more prone to error.

From the consumer point of view, this is cold comfort. Pricing integrity is one of the most important tasks retailers have. It simply must be done right.

Nonetheless, Whole Foods offered to give customers product for free if they noticed they were overcharged. For packaged food, that's a step in the right direction. For random-weight product, it's an empty offer. How many consumers have scales accurate enough to measure product weight and tare weight to determine what the price should be?

Even as the offer applies to packaged goods, it's a strange one because it doesn't include product that is mis-charged in customers' favor. That means Whole Foods stores will tend to be full of underpriced product.

As for Whole Foods core product offer—natural and organic—it seems clear that it is losing its footing. Many other supermarkets sell more product in that category than Whole Foods does. Costco is now the nation's largest purveyor of organic product. Kroger's private label line of organic product is doing quite well. And so it goes with nearly every other major food retailer.

Of course, the fact that many players now offer natural and organic product at lower prices hammers home the idea that Whole Foods is overpriced. But there's more: One bizarre price-related episode in California made Whole Foods an Instagram laughingstock. Whole Foods offered "asparagus water," which consisted of a bottle of water containing three asparagus stalks. It was priced at \$5.99. Whole Foods withdrew that absurd product. When customers laugh at you, it's not good news.

## The High-Price Solution?

So what is Whole Foods doing about that high-price image? In a move that looks very much like capitulation, Whole Foods intends to open something of an off-price store called "365 by Whole Foods." The idea behind the "365" store is to offer its existing line of lower-priced product along with a few other products in a smaller-than-usual space.

That move has more than a few strange aspects to it, starting with the name. The name might make a lot of sense to company insiders since "365" is the name of its private label. Maybe some consumers know that, too.

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But to many other consumers, it will seem meaningless and unrelated to the iconic Whole Foods brand.

It's also unusual because it's nearly without precedent to name a store after an existing private brand. Typically, private brands are intended to further the aims of the core banner. Possibly Whole Foods was inspired by Canadian Superstore Loblaw's "Joe Fresh" stores. Joe Fresh is Loblaw's private label affordable-fashion apparel line. The "Joe Fresh" stores gave Loblaw the means to expand the label into new territory. In contrast, 365 product is available in all Whole Foods stores, so why invite customers to go elsewhere in the same market to get it? All planned "365" stores will be in existing markets.

Finally, Let's face it: The "365" concept is no more than a knockoff of Trader Joe's. Unfortunately for Whole Foods, Trader Joe's has quite a running start and has captured the high-quality, low price territory.

However, when it comes to targeting the Trader Joe's customer, Whole Foods isn't alone. Hard discounter Aldi intends to introduce a range of organic and specialty products that are positioned against Trader Joe's. Aldi's "Simply Nature" is already its fastest growing brand. Incidentally, if Aldi creeps too

far upscale in terms of product and price, it too will enter the danger zone. Up to now, Aldi has been able to keep its core low-price discipline and image.

## The Better Way

Whole Foods' "365" project brings to mind the dilemma posed by other outlet stores. At what point do the lower prices available in an alternate venue start to erode the equity of the main store?

We'll see what happens as Whole Foods starts to roll out its first five "365" stores next year. Maybe the store will be a big winner, but it seems more likely that Whole Foods would have done better to stick to its core strategy. Considering the cost and energy that will be expended on the new store, Whole Foods could have instead made more price investments and undertaken a stepped-up marketing campaign intended to convince consumers that its prices really are more reasonable than they might think.

To be sure, changing a retailer's image is slow work, but sometimes it can be ultimately unsuccessful, as many retailers have already found out. Supermarket operator Food Lion has been working for quite a while to recapture its low-price image, and there's still work to be done.

Supermarket operator Haggen is now closing more than two dozen of the stores it just acquired because it couldn't find the right price to offer its consumers.

This is true across other retail channels, as apparel retailers such as Abercrombie & Fitch have discovered when they lost their core niche and value image.

There are many avenues to success, but sticking to one core strategy and doing it well is very often the better way to success, regardless of the retail channel. **RR**



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