# Want Growth? Build Online Stores

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With a sluggish economy, many traditional retailers are struggling to create meaningful growth as even modest gains in same-store sales prove challenging. However, one area of retail— e-commerce—is red-hot by comparison, and on a sustained double-digit growth trajectory. Virtually all of the major bricks-and-clicks retailers have invested heavily over the last decade to build their online channel to support and complement their existing store brands. Now is the time for them to take advantage of their investments and drive growth by aggressively introducing new brands and expanding offerings—without the usual capital expenses associated with building physical stores. This Point of View from the Cisco® Internet Business Solutions Group (IBSG) explores how traditional retailers can fuel growth through online expansion.

Investing Where the Growth Is

E-commerce continues to grow faster on a percentage basis than traditional retail. Even though e-commerce today generally is only 6 to 12 percent of a traditional retailer's total revenue, it is expected to more than double in the next five years.[1] The day when more absolute dollar growth comes from online than from physical store sales is now on the horizon.

Figure 1.   Online Versus Offline Growth Projections, 2010-2020.
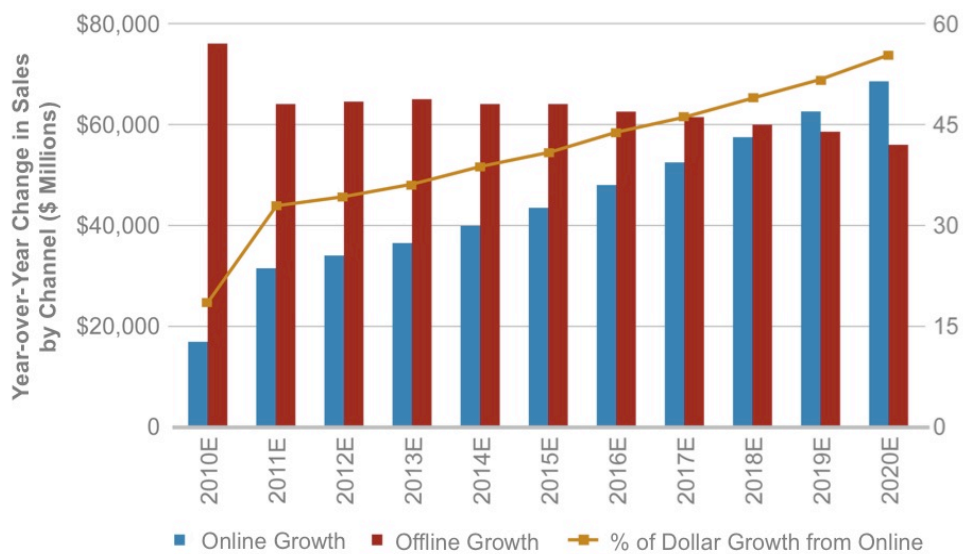
Source: Goldman Sachs Research estimates, 2010; Cisco IBSG Research & Economics Practice, 2011

Cisco Internet Business Solutions Group (IBSG)

One strategy for tapping into the online growth trend is to add new online store brands, creating growth from an expanded customer base. Retailers can tailor the online storefront, customer experience, and value proposition to new, targeted segments. This allows them to step past the usual challenges of gaining new customer segments by having to invest in new physical store space. Similarly, the capacity to add storefronts and new store merchandise is not limited by four walls.

A great example is J.C. Penney's new Growth Brands Division, an initiative designed to enable the bricks-and-clicks retailer to become more innovative, to step outside its traditional value propositions, and to pursue new customers. Two new online-only retail brands have been created: Clad and Gifting Grace. Clad focuses on men 25-54 with high-end designer menswear sold in a "digitally savvy environment." Gifting Grace targets women 30-54 with unique and memorable gifts sold through a distinctively different web experience.

Urban Outfitters is also going after a completely different market segment with BHLDN, its new online wedding dress and accessories boutique. While BHLDN may eventually include physical stores, Urban Outfitters is using online's lower barriers to entry to test the market.

With its recent acquisition of HauteLook, a "flash sales" apparel site, Nordstrom is relying on the e-commerce channel to accelerate growth (flash sales provide deeply discounted merchandise during a limited time period, and have been growing quickly as savvy consumers increasingly use the Internet to hunt for bargains). Nordstrom President Blake Nordstrom believes the acquisition "...gives Nordstrom and HauteLook shared growth opportunities as online shopping evolves." While there is strong overlap between the Nordstrom and HauteLook customer segments, this acquisition targets growth with both a new brand and new online capabilities.

Another strategy for achieving e-commerce growth is to rapidly expand the product assortment available online. Today, most bricks-and-clicks retailers have reached a point where they sell more online than they do in their stores. For large players, this is generally in the range of four to six times the number of store SKUs.[2] However, Amazon.com has raised the bar, creating a model of seemingly unlimited assortment that has made it the default search engine for many online consumers.

While traditional retailers may not choose to adopt the Amazon "marketplace" model (hosting products from other third-party retailers), it is clear that they have an opportunity to enter categories that historically have been too difficult for their store-centric model. For example, Walmart boasts an expanded online home-and-garden product assortment that challenges those of traditional home improvement retailers, allowing Walmart to sell more in less physical space. The growth opportunities with an extended assortment are new customers, greater wallet share of existing customers, and higher-margin items.

One Point of Caution

Just because you can add new brands or product assortments online doesn't mean that you should. Retailers long ago realized that success with new and greatly expanded offerings is defined by correctly identifying a customer and a need, and then creating the right value proposition (product, price, and delivery). This basic rule of retailing has not changed. Super-efficient transactional capabilities and a slick website will not overcome the wrong brand proposition.

Success Requires New Business Models

Executing an online expansion strategy requires changes to traditional retail business models. The good news is that retailers have already developed the foundational e-commerce elements, such as web platforms and customer order fulfillment, over the past decade. The challenge today turns to merging the online and store models in ways that enable rapid scaling.

The new business models require a single, integrated back end that supports distinct online retail storefronts, along with physical stores. Eliminating separate and duplicate functions such as merchandising, sourcing, and global logistics is essential to driving efficient and rapid expansion. While category and product expertise will certainly need to grow to address all cross-channel offerings, efficiencies will be gained in the acquisition and flow of product.

Figure 2.   New Approach: Single, Integrated Back End Supports Distinct Online Storefronts and Physical Stores.
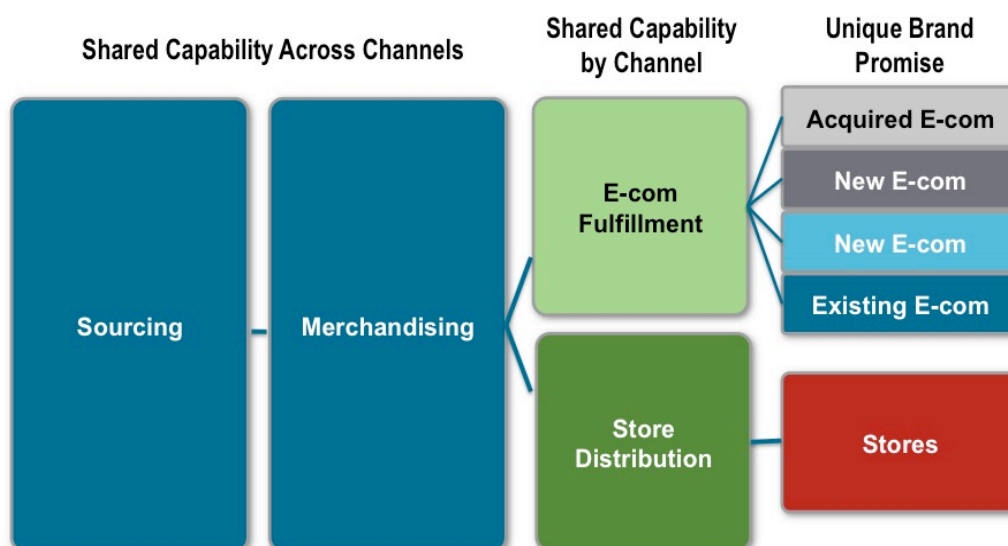
Source: Cisco IBSG, 2011

Many retailers have already eliminated this duplication and, as a result, are best positioned to rapidly expand their online portfolio. Others that have maintained separate channels face a larger effort to build the required business architecture.

The fundamental premise of this new architecture—consolidated back-end functions juxtaposed with increasingly refined and segmented customer-facing storefronts, brands, and shopping experiences—will also become increasingly important as physical and virtual channels continue to offer more cross-channel capabilities, such as "buy online and pick up in the store."

Conclusion

At Cisco IBSG, we expect that many more retailers will change their business models to tap into these new online store and extended-assortment opportunities. For many traditional retailers, these growth strategies have low barriers to entry, incorporate established core capabilities, and align with emerging consumer technology and shopping trends.

These new models also will change many long-held retail operating assumptions and practices. In addition to helping retailers achieve growth, a well-designed business architecture will be critical to transforming inventory models (deciding which inventory is available in a physical versus virtual store), real estate assets (determining store sizes and locations), and labor deployment (required labor/skills in stores, data centers, and call centers).

If you would like further assistance with architecting your retail business for online expansion and growth, please contact Paul Schottmiller (pschottm@cisco.com) or Joanne Bethlahmy (jbethlah@cisco.com) of the Cisco IBSG Global Retail Practice.

Endnotes

1. Source: Cisco IBSG, 2011.
2. Ibid.

More Information

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