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The Art and Science of Retail Reinvention

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AT A GLANCE

Retail formats have short shelf lives. As long as they are still competitive, they drive up store traffic, sales, and profits. But their performance always erodes as customer needs evolve and alternative formats and channels, such as online shopping, emerge and grow. So retailers must constantly reinvent their store concepts if they are to have any chance of sustainable long-term growth.

THE MATURITY OF RETAIL FORMATS

Retailers should think through the maturity cycles of different retail formats and implement strategies based on their current format and its level of maturity.

INNOVATION, NOT "FACELIFTS"

Facelifts such as assortment changes or new signage are not sufficient. To truly innovate, retailers must adopt a structured approach to concept development.

BEST-IN-CLASS REINVENTION

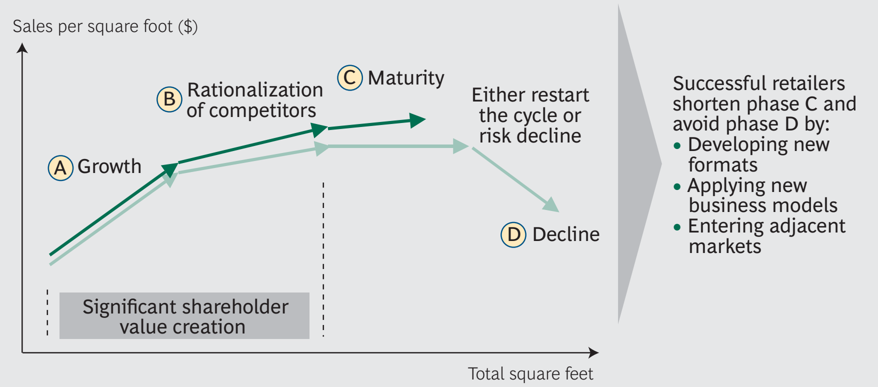
There are ten key success factors that, taken together, can result in best-in-class reinvention. These range from listening to what customers *don't* say—that is, gaining a deep understanding of core customer segments—to managing concept development in the same way that manufacturers manage R&D pipelines.

Time is not kind to retail formats. As long as they are still competitive, they drive up store traffic, sales, and profits by surpassing the competition on multiple key dimensions of the customer experience. They thrive because, among other things, they deliver a better product offering, a more attractive service model, or lower prices. But the performance of retail formats inevitably erodes because customer needs evolve over time and new alternatives—superior formats or new channels—emerge and grow. Today consumers have numerous attractive ways to purchase almost every type of product and service that they want or need. They can choose among hypermarkets, specialty retailers, hard discounters, club stores, and more.

On top of this, the face of "traditional retail" is being forever changed by the continued rise of online shopping as a viable and often superior alternative. The intensity of the online threat varies by product category—it's less severe in groceries than in consumer electronics, for example—but few would argue that online is a factor that can safely be ignored.

The result is a very dynamic and hypercompetitive retail landscape. The consequences are clear: retailers must accept that they will have to reinvent and adapt their store concepts over time if they are to have any chance of sustainable long-term growth. Thus, it is important for them to think through the maturity cycles of different retail formats and to implement appropriate strategies based on their current format and its level of maturity. (See the exhibit below.)

The Four Phases of a Retail Format's Maturity Cycle



Source: BCG analysis.

This report focuses on retail-concept reinvention: making significant improvements to an existing retail format in order to keep it current and compelling for customers. Our experience suggests that making the most of a company's current retail format and capabilities with the goal of reinvention is the best way for retailers to achieve high returns on investment. However, the ideas and success factors discussed below also apply more broadly—for example, to the development of entirely new retail concepts.

The Real Meaning of Reinventing the Retail Concept

All too frequently, retailers merely "facelift" existing concepts. Often they make minor assortment changes and layout tweaks, or they hire design firms to dress up their stores with nicer lighting and new signage. The risks of this approach soon become clear. One example: a U.S. retailer spent $120 million to brighten up the signage, shelving, flooring, and lighting in 900 stores. But the subsequent lift in market share and sales was minimal; now, only a few years later, the freshly renovated stores are being rebranded or closed.

In our experience, basic facelifts deliver no more than a 10 percent revenue gain; minimal, if any, margin improvement; and low, single-digit returns, at best, on invested capital. In contrast, true concept reinventions, when managed properly, can improve revenue by at least 20 percent, and sometimes by as much as 40 percent. They lift profit margins from previous levels. And they produce meaningful returns on capital.

In contrast to basic "facelifts," true concept reinventions can improve revenue by at least 20 percent, lift profit margins, and produce meaningful returns on capital.

To truly innovate, retailers must adopt a structured approach to concept development. The aim is to develop a format that demonstrates substantive improvement. If it does not beat both the competition and the retailer's existing format on several key dimensions, it is unlikely to deliver adequate results. So retail executives need to dive deep into the details to build a holistic view of the store and the environment in which it operates. Clear financial and operational targets must be established, along with the metrics to assess progress toward those targets. For example, are larger baskets our primary objective? Or a higher margin on each basket? Are we trying to attract new customers or sell more to our existing customers? Or both?

Success Factors in Retail-Concept Reinvention

In our experience, there are ten key success factors that, taken together, can result in best-in-class reinvention.

Listen to what customers *don't* say. Customer feedback is often misinterpreted. Typical retail research efforts easily miss the meaning behind the words or survey results. As a result, retailers often redesign their stores in ways that fail to address customers' real needs. Listening to customers also means hearing what they do *not* say and decoding weak signals to determine what they really mean.

Customers of a European hypermarket, for example, complained about the time they spent at the store. "Shopping there is such a pain!" was a typical response. "I lose time finding my way around thousands of products, and it takes 20 minutes just to check out because of the long lines." A superficial view of this feedback might steer managers toward stores with smaller footprints and fewer items. But after digging further, the retailer determined that it was not the absolute time spent in the store that mattered most to customers, it was the perceived value of that time. As it turned out, this shopper was very happy to spend 20 minutes exploring a new grocery section that offered interesting new recipes. So the retailer's challenge was to shorten the unvalued time spent in the store—such as at checkout—and to find ways to match or exceed what specialist competitors could offer in terms of making the shopping experience fun and a "good use of time."

The bedrock of any redesign is a deep understanding of core customer segments and their real needs and wants.

The bedrock of any redesign is a deep understanding of core customer segments and their real needs and wants. Questions to ask include: Who are our heavy spenders? Why do our customers pass by the competitor and walk in our door instead? How do we keep them doing this in the face of online alternatives? How many trips to the store do we want our customers to make in a week?

Redesign the entire store, not just sections. Redesigning a single section of a store may seem less daunting than reinventing the whole store concept. But changing one section will inevitably affect other sections, often in unforeseen ways. There is also a scale argument in favor of tackling the entire job at once: far more benefit will be reaped for the effort expended, and the initiative will inevitably get much more attention and investment from senior executives.

A U.S. sports chain fell into the trap of half measures by redesigning its shoe presentation in isolation from the rest of the store. The display was enlarged and other tactics deployed to increase shoe sales, such as guest visits from local and national runners. With early results showing good gains in shoe revenues but less-than-expected margin lift and a dip in sales in other parts of the store, the sports chain delayed the rollout.

In this case, the small scope of the redesign effort reduced the sense of urgency to find the right solution and determine the needed resources. As a result, the retailer failed to identify the root causes of the margin troubles and the dip in sales. Was it a layout problem or an assortment problem? Were salespeople not cross-selling? Management never found out. Momentum to roll out the concept to the rest of the chain stalled and the initiative died.

Design a core concept and prepare to adapt. Stores vary in size, shape, customer catchment area, and customer profile. How can a concept designed for an urban store work in a rural store that is larger and has very different kinds of customers and competitors? It's obviously untenable to customize concepts for every store in a chain, but neither can a concept be implemented in exactly the same way in every location. Complexity, therefore, is a significant challenge for retailers embarking on a reinvention initiative.

Retailers have to adapt their concept to different store environments, while minimizing complexity for the headquarters or central teams. One approach is to "build" a store using modular elements.

In one recent example, a leading retailer had two distinct store clusters, one urban and one rural. The urban stores faced tough competition in the home goods category, while the rural stores did not. To serve their different needs, the retailer developed Home 1 and Home 2—modular adaptations of its home-goods concept, each with its own merchandising, products and services, prices and promotions, and so on. Home 1, targeted at the urban stores, focused on a limited assortment of items in the decoration subcategory. Home 2, targeted at the rural stores, reflected the retailer's goal of becoming a destination for all home-goods subcategories; it devoted much more square footage to displaying a wide assortment in many subcategories.

The key innovation here was not the clustering of stores and the recognition that they needed different assortments; that is common in retail. What was novel was the coordinated approach across all elements of the concept—assortment, service model, pricing, layout and space allocation, and marketing. The company successfully developed a full customer offering in a coordinated manner for different types of stores. Few retailers have mastered this complex cross-functional aspect of concept reinvention.

Live in the stores. There is no substitute for direct observation. Most retailers need to spend far more time in their stores than they do in order to interpret customers' comments, identify "people issues" that may skew test results, and gauge the effectiveness of new ideas. A wide variety of approaches can be employed, including video cameras, secret shoppers, shop-alongs with customers, and customer surveys.

Successful retailers master the cross-functional aspect of concept reinvention, developing a full customer offering in a coordinated manner for different types of stores.

A drugstore chain in the western U.S., for example, was struggling with bottlenecks in prescription fulfillment. Technicians took the orders and customers were asked to come back in 20 minutes. But often the orders were not ready when the customer returned. Sometimes products were out of stock, or there were problems with the customer's insurance coverage. In testing a new process in which technicians spent more time collecting and verifying the customer's information before the customer stepped away from the counter, close observation was essential to properly interpreting results.

The team performed tests in two stores. Pharmacy A handled 200 drop-offs quite smoothly using the new process. At pharmacy B, however, the same process was said to be a "disaster." According to the technician there, "Too many things were going on. I couldn't spend 90 seconds with each customer because I was too busy. This would never work here." In fact, the problem was with incoming calls. While the drop-off technician at pharmacy B took phone calls, the technician at pharmacy A had assigned that task to someone else. When this variable was changed and the test rerun, pharmacy B was able to handle 300 drop-offs smoothly with no customer complaints.

Engage and enable your store teams. Engaging field personnel in the redesign effort both results in a better design and facilitates buy-in. The mantra here is "Develop solutions by the field, for the field." Achieving that goal requires a mix of store managers, field management, and corporate leaders.

It is particularly important to draw in the skeptics. Often these individuals recognize the problem, but they resist the changes associated with the solution. During testing, they will put obstacles, real and perceived, in the way of progress. But skeptics can often be turned into champions when they see that their opinions and observations are being woven into the redesign.

Much of the experience of retail-concept innovation, as well as the ultimate success of the new format, comes down to employee behavior. If retailers ignore this factor, the entire initiative may fail. It is important to understand why employees act the way they do, how their behavior can be changed, and what target behaviors are required if the reinvented concept is to succeed.

In one recent case, a European retailer of low- and moderately priced goods tried to boost the productivity of its cashiers by linking their bonuses to the number of items scanned per hour. In response, the cashiers began telling customers that items that could not be scanned could not be sold. This frustrated the customers, but the cashiers knew that sending someone to check prices would hurt their performance. Realizing this, the retailer changed the system so that cashiers were allowed to give away unscannable products for free. Every time they did so, an alert was sent to the area manager, who was quick to ensure that the missing barcode or price was there for future sales.

Skeptics can often be turned into champions when they see that their opinions and observations are being woven into the redesign.

Design for the middle 60 percent. The top 20 percent of store managers often do not follow "corporate" protocol but consistently deliver results. These stars are frequently skeptical of change initiatives, claiming that they are already "executing just fine." Top performers are proud of the workarounds they have fashioned, and they won't give them up easily. But it would be a mistake to design to those workarounds.

At the same time, the bottom 20 percent of store managers are likely to struggle with a redesign initiative. Many long ago abandoned established work processes and rarely see past daily fire drills. Some will be reluctant to invest time in the change initiative, complaining that they have many other issues to deal with. Designing to accommodate their behavior is also a mistake.

Retailers should design for the middle 60 percent of store managers. Often these are the managers who will most readily embrace the benefits of the reinvented concept.

"Slice and dice" test results to uncover root causes. To accurately measure impact and level of success, retailers must de-average the results they are getting and focus on the metrics that best match the concept's objectives and keys to success—for example, more traffic or larger shopping baskets. Further, they must select the appropriate number and duration of iterations for the tests they perform. A common pitfall is to be excited by an initial bump in overall sales or margin and to then roll out the new concept too quickly. It is important to measure over a long enough period to provide solid numbers. It's just as critical to have a deep understanding of the underlying metrics in order to assess what's really working and what is not.

Averaging results on a metric across stores can result in errors in interpretation. Consider the U.S. electronics retailer that realized a sales lift of 25 percent, averaged across four pilot stores. Corporate executives were excited because these numbers met the targets for the initiative, and they rushed to apply the redesign to all their stores. But they paid dearly for that decision. The de-averaged results from the four pilot stores—80 percent, 10 percent, 10 percent, and 0 percent—would have shown that the pilot had in fact succeeded in only one store, thanks to a high-performing manager.

Flawless rollout is arguably as important as the concept itself, so retailers should devote as much effort to testing rollout options as they do to testing the redesign.

This is just one example. There are many others in which retailers have seen good top-line results for a new concept but failed to understand the root causes of margin declines in some departments. Retailers must expect certain parts of any new concept to work well and others to fail miserably. It is absolutely essential to determine which is which and why, and to use those findings to root out problems before rollout.

Test varying levels of capital investment. Limiting the reinvention to high-cost store designs is a common mistake. Unless they test different levels of capital expenditure, retailers will never figure out how much they need to spend to deliver the benefits they want.

To avoid that pitfall, a European retailer tested four levels of capital expenditure, ranging from "light" (reconfigured space but the same shelving and fixtures) to expensive (a new mezzanine floor, a new ceiling, high-end lighting and carpets, and new signage). After tracking returns and figuring out which design elements mattered to customers, the retailer selected a design that fell between the high and low levels of capital expenditure to launch across the chain. For this retailer, fancy carpeting and attractive lighting made absolutely no difference to sales. Through value engineering—the use of a cheaper carpet and more mundane lighting and architecture—it was able to cut redesign costs by 40 percent and still achieve its revenue and profit goals.

Test alternative rollout options. In retail, flawless rollout is arguably as important as the concept itself. Retailers should therefore devote as much effort to testing rollout options as they do to testing the redesign. The team must make sure that the concept can be adapted to different store sizes, shapes, and customer catchment areas. And it needs to figure out how to limit operational complexity in rolling out and maintaining the new design over the long term. For example, should the redesign be rolled out district by district, according to the constraints of regional marketing spend and the management team's capacity to focus on the rollout? Or should it be scattered across the regions in order to kick-start widespread adoption? What steps are needed to create regional champions of the design?

Manage concept development like an R&D pipeline. The development of a new retail concept should never be a one-time project. Instead, retailers must actively plan for and invest in a constant cycle of innovation. Time is of the essence. It typically takes three to five years to design, test, and prepare to roll out a new design. Waiting until the current format has reached the peak of its value is likely to doom a retailer to years of sagging sales and often-futile efforts to slow the pace of decline.

The optimal approach is to create and invest in a small portfolio of refreshed concepts—much as a pharmaceutical company manages its pipeline of new drugs. Then, when the retailer has realized most of the value of the existing format in terms of sales and margins, it can make the transition to a new design before sales and margins start to drop. Effective management of the pipeline and the transition is a significant opportunity to create value. It often spells the difference between continued success and stagnation or decline.

The Importance of Process

To have the best chance of achieving a successful concept reinvention, retail business leaders should be guided by a structured, systematic, and repeatable process. BCG recommends the following four-step approach.

- *Diagnose and discover.* Develop the strategic priority and new value proposition for key customer segments; balance the need for detailed analysis with the need to move quickly.
- *Develop the concept.* Build out all elements of the new concept's value proposition—for example, the product offering, service model, pricing approach, marketing strategy, and real estate plan.
- *Develop and test prototypes.* Uncover obstacles and develop tactics to overcome them; continuously test and refine; validate across store formats, volumes, and management expertise; measure results and refine metrics; confirm financial projections.
- *Prepare for rollout.* Coordinate critical activities and resources; monitor closely to keep on track and be prepared to step in as needed; manage the buzz, both positive and negative.

Retailers must plan for a constant cycle of innovation by creating and investing in a small portfolio of refreshed concepts—much as a pharmaceutical company manages its pipeline of new drugs.

NO RETAIL FORMAT is forever. And no retail-management team can expect to get by with slapdash efforts to rework its formats. The innovation process has to be managed tightly, guided by a structured process. With the right process in place, retail executives will be much better equipped with the key metrics they need to gauge success.

So where to start? BCG urges the executive team to consider a core set of questions and use them to trigger vigorous discussion about what it will take to embed concept reinvention in the fabric of the company. (See the sidebar, "Essential Questions for the Next Strategy Meeting.")

There is no time to waste—and no time like the present to launch or reinvigorate a concept reinvention initiative. Neither is it only the chief executive's responsibility to push for the initiative; it should be a priority for the entire top management team. Far better to make retail-concept reinvention a reality in your organization as soon as possible than to discover, a year from now, that your competitors are already becoming masters at it.

ESSENTIAL QUESTIONS FOR THE NEXT STRATEGY MEETING

Here is a sample of the questions that should be on the agenda at the top management team's next strategy meeting:

- How mature is our primary format?
- What new retail concepts have we rolled out in the last five years, and how successful have they been over the long term?
- Are we crystal clear about our customers' needs, wants, and spending patterns? How granular and up-to-date are our data?
- What is in our pipeline of next-generation concepts?
- Do we know how much we're spending per year on reinvention?
- What process or framework guides our approach to reinvention?
- Who in our organization "owns" concept reinvention?
- What are our competitors doing to develop and roll out new concepts?
- Do we have established processes for testing new concepts?
- How well and how quickly are we learning from our pilots? How can we make them faster and less expensive? Do we know why past attempts have been successes or failures?
- How do we increase the number of pilots we're able to launch and run?

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