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2017 retail, wholesale, and distribution industry outlook

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Introduction

Many traditional retail operations continue to be disrupted by technologies that remove barriers to entry for agile players. Challenged by evolving market fragmentation, pragmatic adoption of technology can present retailers with opportunities to innovate as well as to develop new profit models.

The world of retail has entered a period of enormous transformation. With broader retail market growth at a pace of three percent annually,[1] many retailers are finding themselves in an uphill battle to profitably expand growth and market share. Global market forces combined with an ever-increasing proliferation of retail purchase channels, along with commoditization of products and pricing, have resulted in elevated expectations on the part of many consumers. While retailers may anticipate confident spending throughout 2017, preparing for uncertainty by evaluating potential risks and rewards should be part of an overall strategy as business model disruption is part of the new normal.

In order to retain customers' loyalty and win new business along with greater share of the consumers' wallets, retailers need to consider:

- Attracting purchasers into physical and online stores with improved loyalty programs and experiential engagement experiences
- Offering unique or highly differentiated product and service offerings while ensuring in-stock inventory levels
- Achieving operational excellence in addressing customer service and support requests

In order to be successful in confronting the unavoidable wave of retail evolution over the next 12 months and beyond, retailers must be able to anticipate and respond to challenges. Similar to world-class surfers, top-performing retailers are usually best able to identify the right waves, know just when to jump on the board, where to paddle and how to ride that wave to shore. Surfers that wait for the next wave to come along may miss their sales targets.

Introducing disruption as the new normal

Many of us are living in a volatile, uncertain, complex, and ambiguous world of constant disruption—and the rate of change is accelerating. Social, technological, environmental, political, and economic trends have converged to create disruptive forces that are shaping many consumers' behaviors and preferences, including how, when, and where they make purchases.

It's easy to see the disruption that has toppled many leading retailers after it occurs. Spotting disruption before it occurs is difficult. Few companies even know what to look for. Companies must be vigilant; certain risks can attack the basis of competitive advantage, and undermine performance. Moreover, retail threats in 2017 are expected to be immune to traditional risk management methods.[2]

Retailers will be expected to quickly assess their tolerance for risk versus rewards that may surface such as:

- Opportunities and threats posed by third-party vendor and partner relationships
- Impact of the Internet of Things (IoT), cloud computing, and distributed intelligence combined with ever-changing privacy or security concerns
- Use of robotics to inform enterprise-level decision making, maximize opportunity, and reduce potential risk that might occur from
  - Social robots
  - Virtual service robots
  - Cloud robotics
  - Industrial automation and IoT
  - Distributed intelligence and robotics

Agility and flexibility are apt to be required for retailers to thrive in 2017 and beyond. In the race to deliver customer value, 90-day assessment programs have given way to an accelerated pace of "fail fast, learn quickly, move forward"[3] and succeed early by delivering minimum viable products. Established players may be at greater risk of losing market share to retail disruptors who are held to different standards and better able to exploit organizational and operational agility.

Economy

Retailers can anticipate confident spending throughout 2017

Economic fundamentals for consumer spending appear to be solid going into 2017. The labor market continues to strengthen, adding an average 181,000 jobs per month in 2016.[4] Disposable personal income was up 3.4 percent in the year ending October, and average hourly earnings are starting to accelerate.[5] As the labor market tightens further, income growth is expected to edge up in the short to medium term. Income growth for consumers has come at a time of rising asset prices. House prices have crossed their pre-2008 peaks and key equity indices hit all-time highs in November.[6] This has boosted household wealth, thereby aiding consumer spending. And consumer confidence remains elevated.

The election cycle, however, has created some level of uncertainty about the economy and consumer spending in 2017. Some of the policies suggested by the new administration, such as tax cuts and infrastructure spending, could support consumer spending, but others might create potential challenges. In particular, the proposed restrictions on trade could raise prices for imported goods, reducing consumer spending power, and lead to job cuts in export sectors. Proposed policies in other areas, such as health care and housing, could also have significant impacts on consumer spending. The potential for economic policy that leads to a fall in consumer spending power, added to global economy risk from China's financial situation and Europe's political challenges, suggest some potential downside risk for consumer spending in 2017.

But expect unprecedented competition

Despite improving consumer confidence and slight rise in disposable income, holiday sales are expected to grow at a pace of 3.6 to 4 percent annually.[7] Many retailers are finding themselves in an uphill battle to win market share at a time when digital opportunities have opened the door to new retailers and business models that continue to splinter marketplaces. Subscription-based online ordering of tailored meals or home delivery of recipes packaged with ingredients required to cook a meal can capture market share from both supermarkets and restaurants. Amazon's success may be a story of fragmentation, not of concentration. Many companies are not actually competing specifically with Amazon, but with millions of tech-savvy third-party sellers who simply pay Amazon a commission in order to take advantage of their distribution platform and consumer reach. In fact, Amazon's Marketplace (54% CAGR) is growing at twice the rate of Amazon direct (30% CAGR).[8]

Nimble players may take market share from big box retailers

Some of retail's biggest competition is no longer coming from the big-box down the street, but from a large number of smaller, more nimble players who are stealing share from larger, more traditional at-scale retailers.[9] These new economics are expected to drive unprecedented volatility and competition in the marketplace throughout 2017. Additionally, increased market fragmentation is not just a digital phenomenon, as other non-traditional competitors will possibly continue to steal share as well. Several well-known non-US based apparel and cosmetics brands have built a strong foothold in the US market by connecting both the physical and online shopping experience. Businesses should consider that:

- Retail sales typically track GDP growth—so category share may be highly poachable rather than greatly expandable
- Differentiation should likely focus on product uniqueness first and customer experience second
- Expansion and growth is expected to come from emerging global markets, non-traditional channels and partnerships
- Diminishing importance of stand-alone brick and mortar stores is expected give way to experiential engagement, mobile, social network, and on-demand commerce channels
- Market share winners will possibly deliver both product uniqueness and enhanced customer experiences while reducing operating costs

Consumer mindsets

Product uniqueness can beat price, promotion, and placement

Retailers should continue to remain laser-focused on getting the basics right by providing distinctive, high-quality, and trusted products to consumers at the right price. No technology strategy, including sophisticated customer engagement (CRM) or digital marketing software, cutting edge in-store gadgets or well-designed apps and websites can act as a substitute for inaccurate merchandising decisions or poor product offerings. While providing customers with great digital and in-store experiences is important, ultimately, retailers should strive to have customers more excited about owning a specific product rather than the channel it was purchased from. In short, retailers should strive to produce, market, and deliver on their brand promise by:

- Supplying distinctive and superior products, product extensions and services
- Creating excitement, desire and demand via digital assets and distribution channels
- Remembering that nearly everyone discounts, so price, trade promotions and placement is secondary to producing exceptional products

On-demand retail can feed instant gratification

When it comes to getting the deals and products they seek, many consumers' expectations continue to increase. Offering attractive shipping, coupon or trade promotions have become the norm among many retailers looking to drive sales in a competitive marketplace. Everything from pet dental chews and baby diapers to prescription medications are available for programmed delivery via online subscription-based services. Several national supermarket and health-wellness chains offer displays where shoppers are invited to try free samples of protein shakes, tea blends or appetizers before purchasing.

Using just a few taps and swipes, many shoppers now expect products delivered to their door in record time, at a competitive cost, often with free shipping and returns. The desire for instant gratification with zero friction has altered many consumer mindsets forever—consider:

- Flash sales— capitalize on consumers' desire for instant gratification by offering dramatically lower prices for short periods of time from an online virtual location
- Pop-up stores—fuel impulse shopping by expanding traditional brands' in-store experiences at newer locations on a seasonal basis
- Virtual markets—co-located in high-traffic areas heighten the convenience of buying groceries in places customers frequent daily such subway stations, parks, and public spaces

For many traditional retailers, the introduction of technology into the shopping experience continues to shift the economic benefit of a retail transaction away from the retailer and toward the consumer.

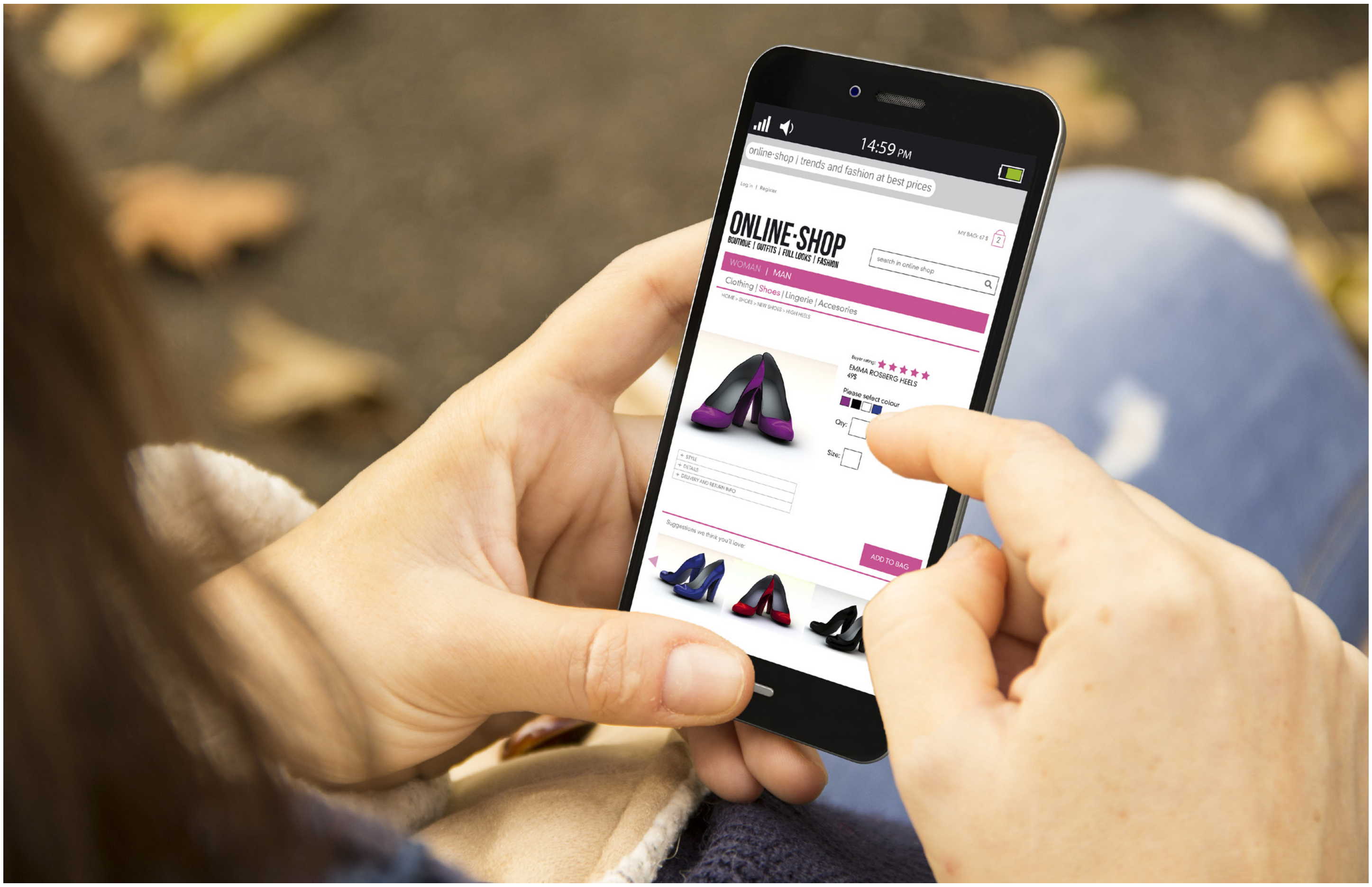
Align customer journey design processes to customer preferences

Many customers seek personalized brand interactions and engagements that retailers could supply by using the right consumer insight in the right place and at the right time. Market campaigns and trade promotions likely need to be highly relevant, in-moment, and in alignment with a customer's current lifecycle.

A global retailer of educational toys seeks to deliver personalized, targeted messages that lead shoppers on relevant journeys across every stage of the customer lifecycle from the physical store to digital and experiential gaming experiences. The company visualizes, maps, and analyzes each consumer's journey as they explore numerous age-appropriate toy brands. With this insight, Mattel means to influence the customer's journey toward paths most probable to result in purchases by intentionally designing their engagement options.[10]

When a US-based wireless provider with retail subscribers experienced rapid growth, the increase in customer service and support call volume was both costly and overwhelming. To address call volume without negatively impacting service or satisfaction levels, the company decided to perform customer journey analytics on all online support channels to determine the probability of a customer calling in for a certain support issue. Agents now proactively know what issues need to be resolved, how the subscriber tried to address the issues, and how best to deliver an improved customer experience.

After operationalizing customer journey analytics, time customers spent in the interactive voice response unit (IVR) decreased by 67 percent, which in turn had a positive impact on customer



satisfaction index (CSAT) and customer effort (CES) scores, customer retention rates and top-line revenue. With more than 1.35 million subscribers, just one-half of one percent increase in customer churn or retention is worth an estimated $1.3 billion in revenue to this telecommunications company. In addition, the company reduced call center volumes by 30 percent which saved 15 dollars per call without negatively impacting service levels.

Retailers should strongly consider evaluating the relationship-building benefits of:

- Using adaptive interaction rules and artificial intelligence (AI) to optimize the customer experience according to channel preferences
- Offering predictive or prescriptive next-best action upsell, cross-sell, and trade promotions to high-value customers most likely to purchase
- Integrating both data and contextual information prior to analysis in order to enhance customer engagement
- Supporting near-real time or in-the-moment customer engagement based upon various embedded analytical techniques such as, but not limited to; adaptive interaction, predictive next best action, contextually aware interaction, automated behavioral targeting, or prescriptive guidance
- Increasing usage of multiple customer information sources inclusive of mobile, kiosk, point of sale (POS), web, CRM, ERP, supply chain, social channels—and third-party data

Brands that successfully utilize analysis of this in-moment engagement to improve the customers' journey, reduce friction and enhance the brand experience are expected to realize tangible benefits by leveraging timely insight derived from all types of digital behavior and purchase-path history.

Enabling technology

Operational excellence should dominate technology investments

A clear focus on operational excellence combined with the consumer's appetite and comfort level for technology adoption should likely dominate retailers' investments in customer experience management tools. Defending market share in 2017 may demand that brands transition from pushing messages out to shoppers, to pulling them via engagement techniques. Designing customer centric processes from the outside in—through the lens of the customer—by targeting attributes such as relevance, selection, convenience and enjoyment serves to enhance the customer's brand experience.

Currently there are more than 500 software vendors that offer value propositions that are a theme and variation on "improving the customer experience."[11] While emerging technologies continue to offer retailers ample opportunities to differentiate themselves from their competitors—2017 is expected to be the year businesses think beyond the proliferation of technology innovation and understand what technologies shoppers are ready to adopt, and most importantly, which experiences will drive tangible value. For example, applying robotics to enterprise applications, as well as some customer service tasks, may be a way for large retailers to offset rising distribution costs. Consider envisioning how:

- Augmented reality can supply buyers with an enhanced try before you buy experience such as in gaming, virtual dressing rooms, or real estate
- AI in the form of mobile or online virtual agents, webchat and chat-bots are better able to improve customer service and support interactions
- Robotic process automation (RPA) may provide significant operational cost reductions when applied to extremely repetitive, rules-based, high volume tasks that can be optimized such as customers' informational inquiries on products, pricing, return policies, or warranty terms
- Wi-Fi signals bring the promise of geo-location based opportunities for trade promotions and other customer engagement techniques to both in-moment and in-store opportunities with greater accuracy and relevance than ever before
- Cognitive intelligence technologies may well supply greater visibility and decision support to demand and supply investments and procurement strategies combined with after sale customer experience monitoring

The promise of emerging technology has never been greater. Ever-evolving enabling technologies including AI, social commerce, the Internet of Things (IoT) and virtual reality all have the potential to transform the customer retail experience and day-to-day operations like never before. While the opportunities may seem endless, retailers should refrain from allowing the explosion of emerging shiny penny technologies to take precedence over the foundational elements of successful retailing.

Internet of Things (IoT) can fortify supply chain management

Savvy retailers may realize benefits and defray costs through revenue-split partnerships with innovative IoT technology partners. One scenario is the installation of "smart shelves" that alert store managers or suppliers in a vendor managed inventory relationship when inventory is low or out of stock. Radio-Frequency Identification (RFID) tags have been in use to track inventory throughout supply chains at many larger companies. However, now sensors that monitor the quality of perishable goods to prevent risk arising from food poisoning incidents or batch recalls for quality issues are a reality as well.

Other uses for IoT solutions and sensors include AmazonGo's recently released Just Walk Out technology—a convergence of "computer vision and deep learning machine algorithms, connected to sensor fusion technologies to track users, their movement, and actions inside the store."[12] Scheduled to open in early 2017, this physical grocery store enables shoppers to download the phone application, activate Wi-Fi, and shop, resulting in a frictionless commerce experience without lines or check-out processes. Charges are added to each customer's Amazon account and a receipt is sent. With its cashier-free store, Amazon relies on smart supermarket technology such as connected apps, cameras, sensors, and software to account for what customers purchase.[13]

Moreover, AI embedded within IoT may provide retailers with "guided intelligence" to mitigate risk proactively and address other critical issues throughout global supply chain processes. Ideally, IoT solutions may be utilized to:

- Build more intelligent "outside-in" merchandising and supply chain strategies through analysis of numerous relevant information sources—collected from both internal systems—and externally from beyond the enterprise

- Reduce operational costs and create consistent product availability to satisfy customer demands
- Record transactions of luxury or high value items such as diamonds, yachts or artwork in a block chain system in order to protect both customers and sellers from fraudulent transactions
- Get real-time universal inventory visibility necessary for optimizing collaborative planning forecasting and replenishment, vendor managed inventory, merchandising, and fulfillment processes

Consumers expected to adopt AI

While it may take a few years for technologies such as augmented reality, cognitive intelligence or machine learning to disrupt retail, a significant impact from AI may be a lot closer than some might expect.

AI is at an evolutionary tipping point and already much more embedded in our daily lives than most people think. Consumers currently encounter elements of purposely designed AI in their daily lives by using voice-activated virtual assistants such as Amazon Alexa,® Microsoft Cortana,® or Siri® voice recognition software[14] to find restaurants, provide directions, play music or make suggestions for lifestyle changes. Tech-giants Amazon, Apple Inc., Google, IBM, and Microsoft are engaged in an AI arms race, which is expected to push the technology into the market at ground-breaking speed.

For retailers in 2017 and beyond, AI also holds great promise for stream-lining business processes and improving customer service—all while reducing operating costs.

Platforms

Social networks may disrupt online

As companies continue to invest heavily into providing direct-to-customer transactions, social networks are expected to evolve from branding, customer service, and marketing channels to retail channels. Similar to Amazon's One-Click purchase button, many social networks are positioned to function as an additional commerce "front door" for shoppers by enabling them to make a purchase via one click from within their social network.

Several social networks have all incorporated their own versions of a "buy now" button into sponsored posts. For consumers, a browsing session on any of these networks can quickly transform into a shopping session or purchase with either a well-known or emerging retailer. Networks should consider continuing to incorporate third-party payment technology such as Amazon Payments,® Apple Pay® mobile payment solution,[15] and Google Wallet® to reduce customer effort within a social network purchase experience. This can enable consumers to complete the purchase and check-out process without ever leaving the social network.

Facebook Messenger recently opened the door for retailer-side commerce solutions by leveraging their chat platform to bring brands and customers closer together. For the 900 million monthly consumers[16] who use Facebook Messenger globally, reaching out to retailers to receive product updates or details on placed orders can be as easy as texting a friend. Retailers should consider leveraging these channels to drive sales by reducing friction in this direct-to-customer engagement model.

This rise in social commerce is important for two reasons. First, social networks have amassed such a sizeable audience, that even incremental participation growth in purchase sites could represent a significant shift in online retail distribution. The second is personalization. Networks such as Facebook and Instagram have access to contextual data that can be utilized to personalize offerings with a higher degree of accuracy and effectiveness than many retailers could ever hope to attain on their own.

Retail channel fragmentation and disruption may offer opportunity

Over the next 12 to 24 months, the most successful retailers may be defined by their attitude and approach to disruptive forces. New players and business models, rising customer expectations, shifts in spending, changing cultural norms and increased market fragmentation will all likely shape retail's future landscape. Many brands must make an effort to do more than react to these market forces and instead find ways to use the momentum of these changes to their advantage.

Retailing is more than brick and mortar, click and mortar, and point and click. Channel proliferation is a catalytic wake up call for retailers to envision new profit-sharing models and partnerships in order realize greater profits. Many larger category players risk market erosion unless they adapt to current and future realities. Retailers nimble enough to adapt and innovate their way through the inevitable changes ahead are expected to continue to grow and thrive in perhaps new and unexpected ways.

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