The retail transformation

Cultivating choice, experience, and trust

From the Deloitte Center for the Edge
A report in the Future of the Business Landscape series

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Executive summary

TODAY'S retail landscape is changing rapidly and dramatically. Driven by the Big Shift's forces, consumers are becoming far more informed, and product choices are proliferating rapidly. Technological advances and public policy liberalization are contributing to new flows of information, knowledge, and resources. As a result, retailers face new pressures:

- Lowered barriers to market entry are bringing in many new small players and fragmenting the retail landscape.
- Online marketplaces are transcending geographic proximity and expanding market demand for highly specific offerings. Small niche players can reach consumers regardless of physical location.
- Technologies such as on-demand fulfillment are changing how and where retailers hold inventory.
- New retail models are arising out of new technologies and new ways to connect with consumers.

Amid all this change, the retail value chain is unbundling, and even remapping. Design, sales, and support are less strongly linked, with small, niche entrants drawing from a range of flexible options to execute these activities. To compete effectively, traditional retailers should reimagine how they create and capture value, thinking past omnichannel positioning to examine, and find the best uses for, their assets. Digital marketplaces with on-demand fulfillment can be incredibly well suited to providing low prices and extensive choice. Brick-and-mortar assets can serve as a stage for customized consumer experiences that go far beyond ambience to surprise and educate the consumer. Done right, these experiences can become so valuable that they inspire consumers to choose to pay for them in themselves.

Another opportunity for many large retailers is to become industry infrastructure providers. Because sourcing and procurement, inventory management, store operations, marketing, and fulfillment become more efficient as they scale, established retailers can extend these capabilities to support smaller, more fragmented niche players.

Traditional retailers can also move to transform into consumer agents—new entities that use deep understanding of consumers to help them navigate product choices.

Change is seldom easy, especially when the future is uncertain. Big changes, especially, require commitment and can attract organizational antibodies. To effectively scale new business models, established retailers should pursue "small moves, smartly made"—testing, scaling, and incorporating the most successful ideas as foundations for their evolving businesses.

Back to the future

"Looking for something? Make a request and we'll find it for you," promises Operator, a new shopping app, on its website. The service, developed by Uber cofounder Garrett Camp and former Zynga executive Robin Chan, offers a personalized, on-demand shopping experience that blends the benefits of virtual and physical retail. The Operator app responds to customers' natural-language-based questions and requests with pictures and descriptions of suggested products. The customer can buy desired products automatically using a credit card on file. Operator is now in private beta stage, with more than 85,000 signup requests.[1] A wealth of such innovative sales models are expected to emerge as the retail landscape evolves.

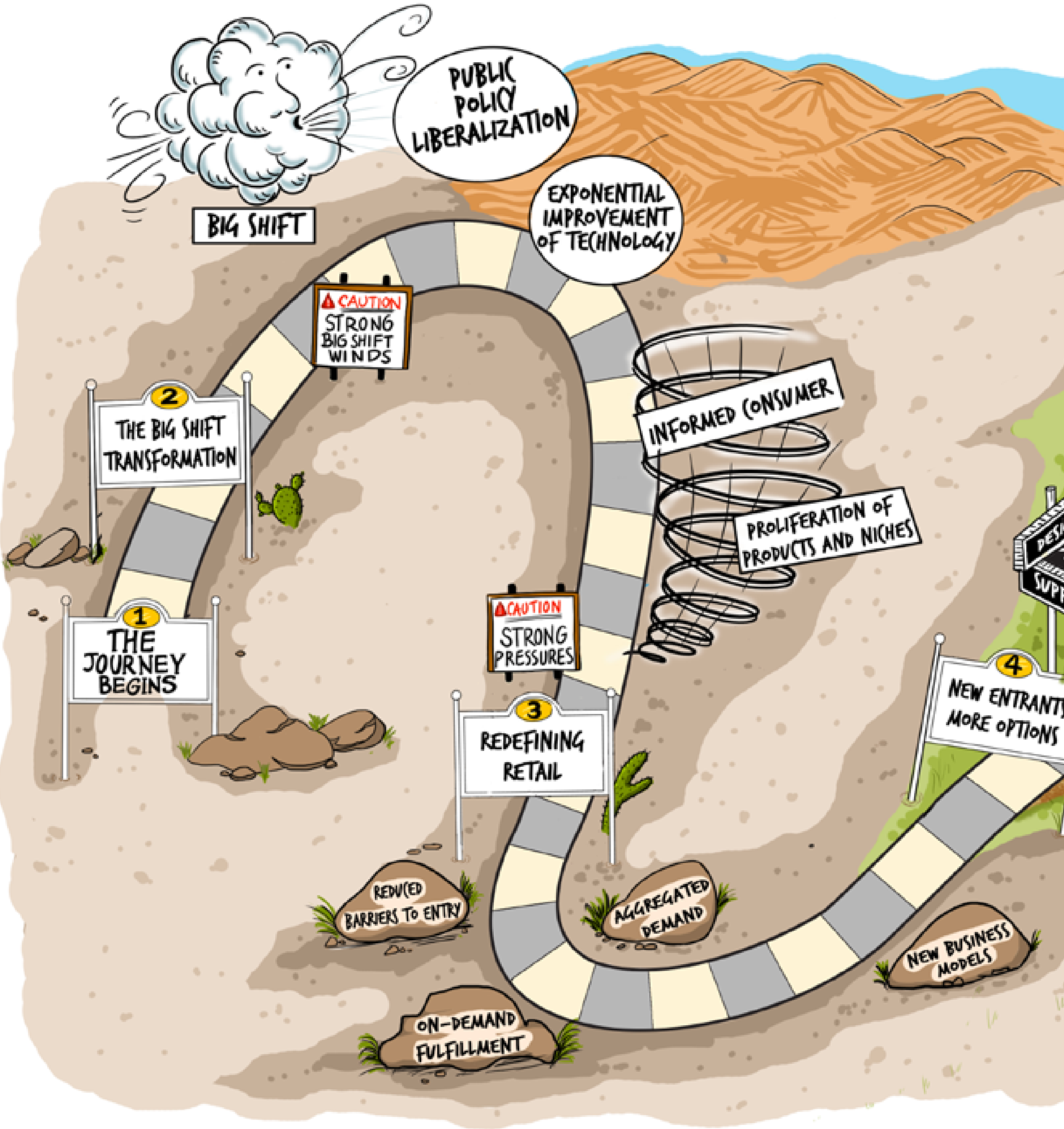
Operator is just one manifestation of what is arguably retail's most fundamental transformation in a century-long string of changes. In the early 1900s, retail was dominated by local mom-and-pop stores, each providing its community with a highly personalized shopping experience. Choices were limited by both shelf space and the amount that shoppers could carry home. The invention of the automobile increased the volume of items shoppers could carry on any one trip, contributing to the rise of larger general stores and department stores. The postwar population boom and increasing suburban sprawl, supported by TV advertising, prompted retail locations to consolidate further into indoor and open-air malls, strip malls, and mass retailers. The status quo was again disrupted in the 1970s and 80s, this time by big-box retailers. Over the next quarter century, club stores, category killers, and value players joined big-box stores to drive more and more smaller merchants out of business. Then, at the turn of the century, as Internet access became mainstream, e-commerce retailers shook up the sector yet again. The level of disruption has been significant: By 2000, seven of the eight largest US retailers in 1980 had filed for bankruptcy, been acquired, or lost their places as major industry players.[2]

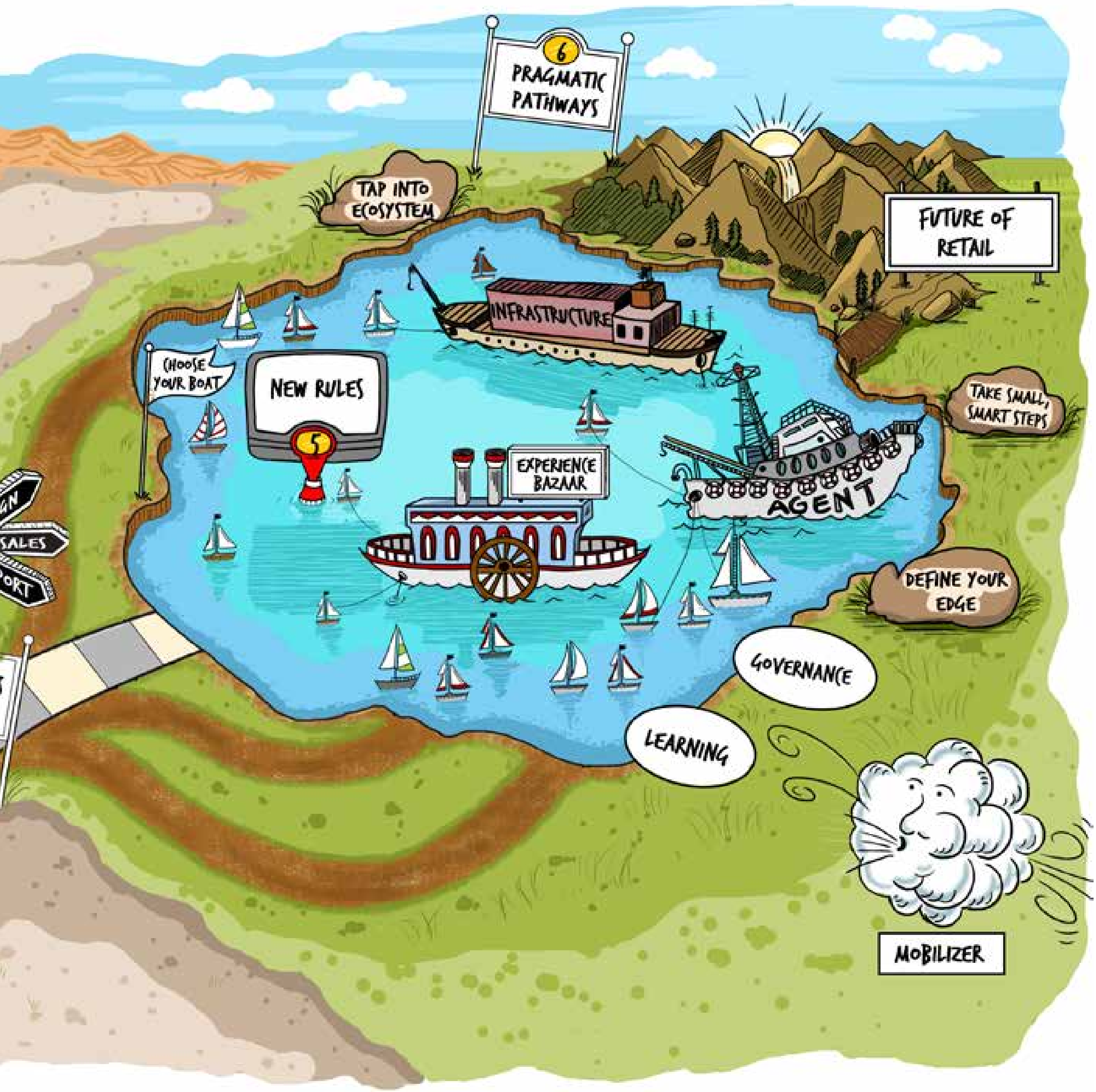
That's a lot of change for one century. But each of the transitions described above was driven by larger technological and social shifts, and each led to fundamental changes in how people shopped. And every one of them increased consumer choice while reducing consumers' total cost in terms of money, time, and opportunity.

Today, we are on the cusp of yet another transformation. Technology improvements coupled with shifts in consumer mind-set are again changing the nature of retail. Consumers have more options, and both switching costs and brand loyalty are low. To survive, many retailers are finding ways to serve individual consumers in ways tailored to their needs and desires—transforming both their value propositions and their business models. The retailers most likely to survive the current shift are those that can provide a tremendous variety of offerings while maintaining, or reviving, the personal touch of a mom-and-pop corner store.

This report explores emerging trends affecting both businesses and consumers, and considers the ways these trends are manifesting in the retail space. We will discuss possible options for established retailers in light of these changes, then describe small, smart steps these retailers can take to help position themselves well for the future landscape. Figure 1 provides a high-level view of the journey on which this report will take you.

Figure 1. The journey through the report

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PRAGMATIC PATHWAYS
TAP INTO ECOSYSTEM
FUTURE OF RETAIL
INFRASTRUCTURE
CHOOSE YOUR BOAT
NEW RULES
5
TAKE SMALL, SMART STEPS
EXPERIENCE BAZAAR
AGENT
SALES
DEFINE YOUR EDGE
GOVERNANCE
LEARNING
MOBILIZER

The Big Shift: Transforming the business landscape

BEFORE taking a deep dive into the retail sector, let's explore several large-scale dynamics shaping the broader environment in which retailers operate. Two key forces are coming together to shape today's rapidly changing retail environment: better-informed consumers and a proliferation of both products and niches.

The informed consumer

Today's consumers have more access to more information, can instantly compare prices and offerings, and can easily switch among brands and products. Moreover, information is increasingly decoupled from inventory: To learn about products, consumers no longer need to visit stores. In the Deloitte Center for the Edge Consumer Power survey, approximately 67 percent of US consumers surveyed in 2012 either agreed or strongly agreed that they have a lot more information about brands than they once had. And 70 percent of respondents agreed or strongly agreed that they have many more product choices than they had in the past.[3]

This trend is a result of the fundamental macroeconomic transformation we call the *Big Shift* (see sidebar). Exponential improvements in the cost and performance of core digital infrastructure, coupled with a general trend toward public policy liberalization, are creating an environment of constant change and disruption that is shifting the balance of power between individuals and businesses. At the same time as the Big Shift puts pressure on businesses through increased competition, it increases the power of consumers by enabling connectedness, knowledge sharing, and transparency of choice.

Proliferating products and niches

Technological improvements, combined with increased access to tools through platforms such as TechShop (the "gym for makers"), can make it easier for new product producers, including small, nimble businesses and individual craftspeople and inventors, to enter the market. Technologies such as 3D printing enable on-demand, small-batch production. And marketplaces such as Etsy, Storenvy, and eBay offer ways for these new entrants to reach targeted consumers. As figure 3 shows, the rising popularity of the maker movement, along with the growing availability of supporting infrastructures and platforms, further increases product diversity and lengthens the tail of demand.

As many aspects of production have become more accessible, near-universal Internet access has allowed shoppers in many categories to shift away from a mass-market environment to one characterized by a proliferation of accessible niche markets. Chris Anderson's 2004 *Wired* article "The long tail"

THE BIG SHIFT

The Big Shift is a set of fundamental macroeconomic trends that are reshaping the global business landscape and unleashing flows of information, people, and capital (figure 2). These trends give consumers and talent more power through access to information and lower switching costs. At the same time, competition—from both traditional and nontraditional sources—has increased. Many companies configured to operate in the scale-based, efficiency-driven models of the 20th century are now struggling to create value in the rapidly changing world of the Big Shift.

Figure 2. The Big Shift's trends

Foundational trends	The cost of computing power has decreased from $222 per million transistors in 1992 to $0.06 per million transistors in 2012.
	The cost of data storage has decreased from $569 per gigabyte of storage in 1992 to $0.03 per gigabyte in 2012.
	The cost of Internet bandwidth has decreased from $1,245 per 1,000 Mbps in 1999 to $23 per 1,000 Mbps in 2012.
	Overall trend of the Index of Economic Freedom, a compilation of 10 indicators measured by the Heritage Foundation, has been increasing since 1995.
Impact trends	Nearly 70 percent of customers agree that they have increased information and choice about brands.
	The compensation gap between the creative class and the rest of the workforce has steadily widened over the past 10 years.
	The economy wide return on assets (ROA) has declined over the last 47 years, to a quarter of its 1965 level in 2012.

Source: John Hagel, John Seely Brown, Tamara Samoylova, and Matt Frost, *2013 Shift Index metrics: The burdens of the past*, Deloitte University Press, November 11, 2013, pp. 9-27, http://dupress.com/articles/the-burdens-of-the-past/.

Graphic: Deloitte University Press | DUPress.com

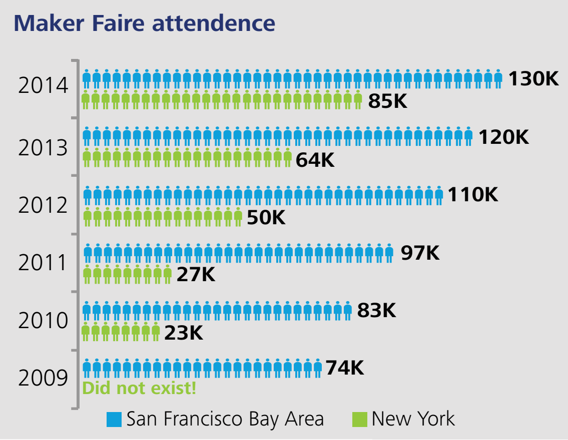
The Big Shift is measured and described through the 25-metric Shift Index, but it can be understood in terms of two fundamental drivers:

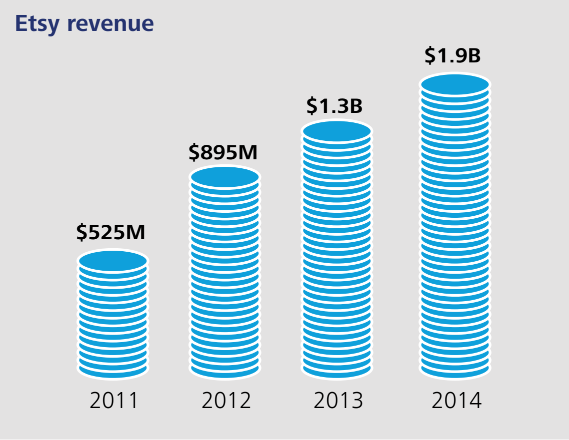
1. **Technological advances.** Exponential improvements in the cost/performance ratio of core digital technologies have led to exponential advances and innovations in other technologies that employ the digital infrastructure, blurring many traditional lines between industries and technologies.

2. **Public policy liberalization.** Over the past six decades, public policies have broadly trended toward freeing the movement of people, capital, and other resources across geographic and political boundaries, making it generally easier for individuals to start and scale businesses.[4]

The structures and regulations of specific industries have in some cases accelerated, and in others delayed, the impact of the Big Shift; however, the effects are poised to spread across the economy, in part as new businesses from other industries encroach on traditional industry territory.

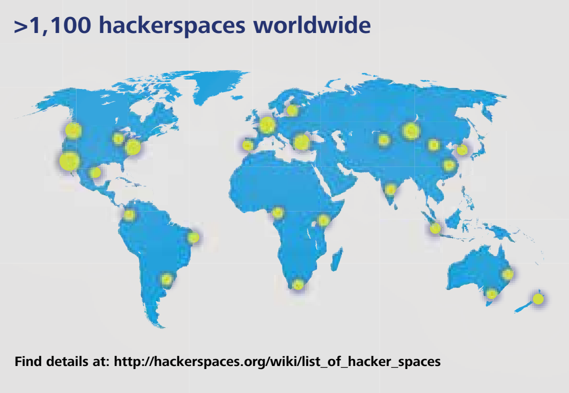
Figure 3. Maker movement overview and drivers





Kickstarter project hits

Project	Goal	Funded	# of backers
Pebble	$100K	$10.3M	69,000
Oculus rift	$250K	$2.4M	9,522
Goldieblox	$150K	$286K	5,519
Safecast	$4K	$104K	290



Sources: Top left: Maker Faire, "Maker Faire overview," *Makezine*, http://cdn.makezine.com/make/sales/Maker-Faire-Overview.pdf, accessed May 18, 2015; Kurt Wagner, "Part Disneyland, part Burning Man: Maker Faire turns 10 years old," *Re/code*, March 17, 2015, https://re-code.net/2015/05/17/part-disneyland-part-burning-man-maker-faire-turns-10-years-old-qa/, accessed May 18, 2015. Top right: Matthew Flamm, "Handmade goes big: Etsy nears $1B in sales," *Crain's New York Business*, January 18, 2013, http:www.crainsnewyork.com/arti-cle/20120128/TECHNOLOGY/1301129904, accessed May 18, 2015; Michael Brush, "The hidden problems lurking in Etsy's 'feel good' IPO," *Fiscal Times*, April 16, 2015, http://www.thefiscaltimes.com/2015/04/16/Hidden-Problems-Lurking-Etsy-s-Feel-Good-IPO, accessed May 18, 2015. Bottom left: Kickstarter, "Pressroom," http://www.kickstarter.com/press?ref=footer, accessed January 14, 2014. Bottom right: Hackerspace wiki, "List of hacker spaces," https://wiki.hackerspaces.org/List_of_Hacker_Spaces, accessed May 18, 2015.

Graphic: Deloitte University Press | DUPress.com

illustrated, and in many ways foresaw, this explosion of options: "Now, with online distribution and retail, we are entering a world of abundance."[5]

Such market fragmentation is affecting common notions of trends and taste, says former *New York Times* fashion critic Cathy Horyn. In a recent *Atlantic* article, Horyn admitted that she no longer knew what was trendy: "There is no single trend that demands our attention, much less our allegiance, as so many options are available to us at once."[6] Contrast this, say, to the ubiquity of earlier fashion trends, from Dior's New Look to the 1980s' massive shoulder pads.

Potential implications for retailers

The rise of better-informed consumers, along with product and niche proliferation, is putting pressure on traditional retail roles. Historically, retailers have served three main functions: inspiration, information, and supply. However, where once consumers may not have had a precise idea of what they wanted until they saw specific items in stores, many of today's consumers (especially younger buyers) get inspiration and information largely online—and are more likely to limit their interaction with retailers to obtaining already-selected items. A 2013 Ipsos survey ranked the Internet as the primary source of new product and brand discovery for the Millennial consumer (ages 18–34), followed by discovery through friends and family.[7]

On Instagram, for example, younger consumers share "outfits of the day," collecting "likes," inspiring each other, and often creating demand. Product review sites such as CNET, Cars.com, and Amazon can equip shoppers with information long before they enter a retail location or place an online order.

The connected consumers who use these resources and communities are actively engaged. Through reviews, research, and cocreation, they are actively shaping the brand messages of the products they consume.

At the same time, the supply role of retailers is changing. Without effective product scarcity, and with shoppers less limited to options in local stores, traditional retail models break down. Retailers with high fixed-cost structures (due to significant brick-and-mortar assets and inventory costs), which compete using only inventory at hand, are increasingly losing out to competitors with lower fixed-cost structures and extensive product assortments. Rather than stockpiling inventory, many such retailers fulfill demand only as orders are received. Business models tend to be rooted in few or no brick-and-mortar assets, combined with on-demand fulfillment strategies that help increase consumer value while decreasing total costs (in terms of both price and time). For example, Amazon operates at an approximately 15 percent price markup, compared with an average markup of 65 to 80 percent for appeal-centric retailers.[8]

In this complex and evolving environment, retailers should fundamentally reassess both their roles and the way they create value for consumers. The retailers that will be most effective in today's marketplace will likely be those that fundamentally rethink the retail experience, developing business models that blend physical, virtual, and community experiences.

Selling amid the Big Shift: Redefining retail

THE Big Shift has affected the retail sector in four main ways:

1. Reduced barriers to market entry are bringing in more small players.

2. Increased access to market demand is transcending geographic proximity.

3. On-demand fulfillment is reducing the need for retailers to hold inventory.

4. New technologies and customer relationships are opening up new ways of creating value.

Together, these changes are placing pressure on existing retailers while opening up new space in which nontraditional entrants can operate. They are also increasing opportunities across the retail landscape and reducing the level of investment needed to pursue them.

Reduced barriers to market entry are bringing in more small players

In 2008, Yokoo Gibran was a copy center employee with a passion for knitting. Early that year, she began selling her handmade knitwear on Etsy. Within a year, she was making enough to quit her day job; by December 2009, she was earning more than $140,000 a year from her Etsy sales alone. She says that her new business has "saved her life."[9]

She's not the only one. As Gibran's example demonstrates, barriers to entry have fallen drastically for both producers and sellers of consumer goods, changing the table stakes of retail and allowing in a flood of new competitors.[10] Today, it's possible to set up a retail operation in just a few hours; individuals like Gibran can become niche retail operations quickly and easily, adding a new dimension to competition.

This change is due largely to the elimination of the need to own infrastructure—a heavy investment usually recouped through scale and thus difficult for most small players to afford. Using pay-as-you-go services and free or inexpensive infrastructure provisioning (such as an Etsy "storefront" instead of a physical one, or on-demand physical pop-up space rented through Storefront), small merchants can easily enter the market. Retailers need not own or even prerent their infrastructure; instead, they can incur costs only as assets are needed, enabling efficiency at any size. As a result, the retail landscape is fragmenting. Deloitte analysis shows that the top 25 established retailers today own 2 percent less total market share than they did in 2009—a shift of $64 billion.[11]

Digital technology has made many aspects of retail operations exponentially cheaper and easier. Nearly all areas of business are affected, from digital storefront costs to back-end inventory, order management, and supply chain infrastructures. As shown in figure 2, the cost/performance ratio of core digital infrastructure (computing, data storage, and Internet bandwidth) has improved exponentially since the early 1990s, making these technologies increasingly affordable and accessible. Even the smallest retailers now have access to powerful infrastructure tools that once required large capital investment, making it easier than ever for many individuals and small entities to form retail businesses and reach markets. Today, to start selling, all a merchant needs is a credit card.[12]

Cloud services are particularly crucial here, as they enable retailers to manage back-end office operations without investing heavily in either servers or software. Instead, cloud-based programs are run and managed by a third party and accessed online, making it simple for businesses to scale their software use as needed. Demand for retail cloud services has grown rapidly and is on track to more than triple from $4.2 billion in 2011 to $15.1 billion in 2015.[13]

In addition to being less costly, technology infrastructure also tends to be easier to manage. Requiring no intensive training or dedicated IT department, many cloud platforms are fairly simple for nontechnical users to access and manage. For example, individuals with no coding knowledge can create and manage their own websites using platforms such as Wix. Six years after its founding, Wix has amassed 42 million users from 190 countries, netting revenues of $80.5 million in 2013 and $130 million in 2014.[14]

Lower barriers to entry have allowed a large number of new retailers to enter the space, eager to address fragmenting consumer niches. The result is increased competition and volatility across the sector. For example, 6 of the 10 top retailers by annual revenue in 1990 were no longer in the top 10 as of 2012.[15] In fact, Deloitte analysis reveals that the volatility of retail market share has been increasing rapidly since 2009. Moreover, the share lost is not being captured in turn by direct competitors—indicating that a significant number of new players are entering the landscape.[16] This phenomenon is notable not just for the change in the identity of the top 10 but for the questions it raises about which types of retailers and retail models are most effective in this new landscape.

Reduced barriers to entry also make it easier for manufacturers and makers to sell their products directly to consumers, bypassing traditional resellers entirely. For example, in 2014, 52 percent of US online shoppers visited brand and manufacturer websites with the intent to buy.[17] Direct consumer contact eliminates intermediate steps in the value chain, boosting profitability. Manufacturers that engage directly with consumers can also get rich and timely feedback. As more manufacturers enter the retail landscape in this way, fragmentation increases.

Increased access to market demand is transcending geographic proximity

Digital technology helps to aggregate demand beyond geographic areas. Tools such as digital platforms and social media can connect buyers and sellers across regional and even national boundaries. E-commerce enables retailers to connect with consumers from all over the world, reducing geographic constraints. Online, a seller's addressable market is effectively the world.

Stores that would not be sustainable in the physical world due to a limited number of nearby customers can thrive online by reaching niche customers worldwide. Conversely, customers once satisfied with "mainstream" options may now enjoy alternatives that they hadn't known about before. For example, in 1998, the out-of-print mountaineering memoir *Touching the Void* was recommended by Amazon to customers purchasing or viewing the bestseller *Into Thin Air,* which had kicked off a mountaineering-related reading wave.

As a result of these automated recommendations, *Touching the Void* started to outsell *Into Thin Air* two to one.[18] By revealing little-known options to customers, e-commerce has helped reshape individuals' preferences. Over half of Amazon's book sales now come from books outside its top 130,000 titles.[19]

On-demand fulfillment is reducing the need to hold inventory

The third identified impact of the Big Shift is that supply and demand have been separated, with on-demand fulfillment reducing or even eliminating the need to invest in inventory before selling. In fact, many small retailers need not invest in inventory without guarantee of purchase.

With drop-shipping, for example, retailers buy inventory only as it is sold. Retailers purchase goods from drop-shippers as consumers order them; drop-shippers then fulfill orders with white-label delivery service. Drop-shipping is a huge business: An estimated 93 percent of Facebook's $8 billion ad market, made up of over a million advertisers, is composed of retailers selling by drop-shipping.[20]

Retailers can also not only buy as they go but even stockpile orders prior to production. Crowdfunding-based presales, for example, guarantee demand before production starts. On the crowdfunding platform Kickstarter, while many projects have been prototyped and may even have small lots in production, an online campaign can provide the infusion of capital needed to scale production to meet demand or reach a bigger market while guaranteeing an initial batch of orders.

Crowdfunding also enables consumers to offer feedback, in the form of dollars, on product ideas. Such "voting with their wallets" helps retailers and even manufacturers float more ideas, pursuing only those that resonate with consumers. The crowdfunding process not only guarantees demand but also enables vendors and retailers to build a deeper understanding of their consumers. San Francisco–based custom clothing company JAKE, for example, has completed two crowdfunding campaigns in its three years of public operations, most recently for its capsule collection ROYGBIV. Backers could preorder five essential clothing pieces for men and for women from the collection (figure 4). Once the campaign closed, the company began production, reaching out to each consumer to gather size information and color preferences plus additional demographic and psychographic data.

Another on-demand retail start-up is Massdrop, where groups of enthusiasts can purchase products in batches, sometimes at more than 50 percent off the usual retail price. Unlike JAKE, Massdrop is a third-party reseller that does not manufacture its own merchandise. Once consumers sign up for Massdrop, they can browse communities focused on information and advice on retail areas of interest. Community members can also participate in group purchases at specified prices, which are activated if and when enough buyers sign up. When a group has enough buyers, Massdrop approaches the manufacturer to obtain the items. Purchase categories include high-end electronics, crafting materials and do-it-yourself tools, watches, accessories, bags, and clothing, as well as tea, collectibles such as board games and trading cards, fine pens, and more. Consumers can also vote to request items they would like to see in future drops.[21]

The Big Shift has also made it easier for product designers and retailers to manufacture to order—for example, using 3D printing technology. Indeed, while 3D printing still requires the purchase of raw materials, home use of 3D printers has created a market for 3D designs themselves. Early-stage start-up Pinshape, for example, has based its market platform on 3D printing; the company curates a selection of 3D printing designs that contributors can sell, or offer for free, through the Pinshape site.

Figure 4. ROYGBIV Indiegogo campaign

Customers can purchase the design files or order the resulting 3D prints.[22]

On-demand fulfillment is affecting luxury retail as well as mass-market retailers. New York–based Moda Operandi enables consumers to order merchandise directly from the runway—entirely bypassing the traditional high-fashion retail flow, in which a season's designs are showcased on the runway and then selected by retail buyers, who decide which stores will sell which pieces. Moda Operandi gives consumers direct access to runway fashion through a digital storefront. Its customers can preorder an item as soon as it appears on the runway, paying half up front and the remainder on receipt of the product (which can take a few months, as runway items are essentially samples). Moda Operandi's personal stylists advise customers on styles, sizes, and tailoring options. The company, which has raised $60 million in funding, reported approximately $50 million in revenue in 2014 and an average order value of almost $2,000.[23]

Tinker Tailor, meanwhile, takes on-demand fulfillment to the next level. The online luxury retailer works with fashion houses, allowing consumers to customize high-end fashion items. Customers use 3D design and visualization tools to modify designs from more than 80 designers, including Vivienne Westwood, Marchesa, Rodarte, and Giambattista Valli—shortening a skirt, modifying a neckline, or even changing fabric options to create a unique interpretation of a designer's vision. Customers can also create unique items starting with Tinker Tailor's branded designs and fabrics. The buyer signs off on a 3D image of the final product before it goes into production.[24]

New technologies and customer relationships are opening up new ways of creating value

The Big Shift's technological advances, besides shaking up the traditional retail industry, have also spawned a flood of sellers with new and different business models—for example, digitizing sample sales, selling niche Japanese barware, offering affordable personalized goods, or mail-ordering stylish yet affordable eyeglasses. While these models vary in execution, each was started by a small team that connected directly with consumers to provide an individualized experience.

Take online retailer Gilt Groupe, a market entrant whose rise was enabled by digital technology. Cofounder Kevin Ryan sought to digitize sample sales (which are traditionally used to sell excess inventory), democratizing and centralizing access to designer/luxury goods at low prices while retaining the sales' sense of urgency and exclusivity.[25] Though the idea at first seemed alien to the designers to whom Ryan pitched the idea, the site quickly took off.

Oakland-based Umami Mart, an independent retailer of Japanese kitchen goods and barware, illustrates the potential of niche retailers fueled by digital technology. Umami Mart started as a collaborative blog created by chefs and other food industry professionals. As the blog gained a following, its participants and readers began to think about importing the Japanese kitchen goods they discussed. The retail component of Umami Mart was born, spurred by online aggregation of demand.[26]

New York–based start-up Normal exemplifies the role of on-demand fulfillment. The company 3D-prints customized earbuds—in-ear headphones—based on photos taken through its iPhone® mobile app. This model has three benefits. First, the very act of manufacturing to order adds value for consumers in terms of personalization. Second, Normal need not invest in products that may not sell; by creating to order, it keeps manufacturing costs to a minimum and maintains the fungibility of its raw materials. Third, the use of 3D printing reduces the company's supply chain costs. Several competitors require professional ear molds made by audiologists; the prices of Normal's closest competitor start at $400 compared with Normal's $199.[27]

Eyewear retailer Warby Parker represents the fourth observed impact of the Big Shift: lower costs for both consumers and retailers. While traditional eyeglass retailers often sell frames for hundreds of dollars, Warby Parker offers lower-cost, equally fashionable options primarily online, with both samples and finished products shipped directly to consumers. The company recently opened a handful of brick-and-mortar locations linked to its online presence. These stores distinguish themselves from traditional eyeglass retailers with their library-inspired design and open access to the store's entire line of glasses. Customers are encouraged to browse and try on as many pairs as they want—an added value that complements the online and at-home experiences. Locations also offer eye exams onsite for a low flat fee.[28] The company states that most customers who purchase glasses in a store go on to buy a second pair online.[29] Warby Parker has raised $115 million from 16 investors over five rounds, indicating the effectiveness of its model.[30]

New entrants are increasing consumer options

AS discussed previously, more small, fragmented merchants targeting niche demands are emerging. They are enabled by concentrated players (such as digital marketplaces) that offer enabling capabilities (such as store operation) as a service, and they often operate in fragmented markets that were previously unsustainable without aggregated demand. The digital technologies that enable products to reach consumers not only tend to lengthen the tail of demand—they also make its head more shallow and less profitable over time, reducing the size of the "mass market" (see the sidebar "Factors affecting fragmentation").

Consider retail music sales. Thanks to digitization (mp3s replacing CDs) and the shift of the music market to online platforms such as the iTunes® program and YouTube, demand for "niche" music has significantly increased. As more people become interested in previously lesser-known genres and musicians, these niches loom larger in the public consciousness. The resulting diversification of what is "popular" has split sales across more albums—a trend borne out by the fact that most of the top 50 albums of all time were created in the 1970s and '80s, with *none* made after 2000.[31] Instead, the last decade has seen a fragmentation of preferences, with more people listening to more genres. This makes smaller players sustainable in a way not possible without aggregated demand enabled by digital technology.

Small, fragmented retailers can have the operations they do—flexible, highly scalable, with even international reach—precisely because of their small size and structure. For example, an eBay clothing merchant, despite having an infinitely smaller total revenue than a large, established retailer, may actually sell across more countries; its small size enables the merchant to enter markets with little brand advertising or infrastructure requirements.

Most of these fragmented players are launching without brick-and-mortar assets; they often fulfill orders on demand, enabled by technological advances and the emergence of new marketplaces and platforms. Acquiring access to brick-and-mortar retail assets remains challenging for independent niche retailers due to high, often up-front, costs. Some, however, find a way, with many using pop-up retail services such as Storefront.

Value chain impact: Fragmentation of design, sales, and support

As the retail landscape fragments, with more and more smaller retailers serving niche markets, so too do many components of the retail value chain. Of these, product design, sales, and support activities are especially vulnerable to fragmentation.

FACTORS AFFECTING FRAGMENTATION: DIFFERENT SPEEDS, SAME DESTINATION

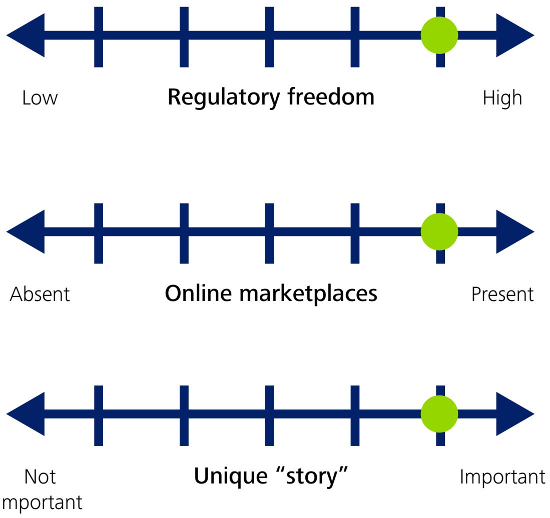
Design, sales, and support activities will fragment faster in some sectors than others. The level of regulation, the availability of online marketplaces, and the value of a unique story are some of the factors affecting a sector's rate of fragmentation (figure 5). But this doesn't mean that highly regulated mass-market goods without online marketplaces are safe. As technology continues to advance, and public policy continues its trend toward liberalization, more sectors are likely to be affected by fragmentation.

Figure 5. Factors affecting fragmentation

1. **Regulatory freedom:** Less regulated markets will fragment more quickly. For new entrants, regulations can serve as barriers to entry or commercialization.

2. **Online marketplaces:** Online marketplaces serve as platforms for new entrants, helping them access customers and enabling operations.

3. **Unique story:** The more consumers value a unique connection to a product and/or merchant, the more they will seek out niche offerings—and the more they enable fragmentation.



Graphic: Deloitte University Press | DUPress.com

Design

Enabled by the emergence of platforms and on-demand infrastructures, fragmented players can design their own goods. Individuals or small teams can design and prototype goods at open workshops such as TechShop, a "makerspace" community affiliated with the maker movement. For a monthly membership fee comparable to that of a gym, individuals and small businesses can use TechShop's equipment, which ranges from milling machines and lathes to welding equipment, 3D printers, and industrial sewing machines.[32] For example, Patrick Buckley prototyped his DODOcase, a retro-styled iPad® device cover, at TechShop in 2010. Buckley sold $4 million worth of cases in his first year in business;[33] today, his 1,000-square-foot San Francisco factory employs 25 people.[34] The DODOcase is sold online by Buckley's team and carried in J. Crew stores.[35] President Obama is often photographed with his.[36]

Designers can also use crowdsourcing platforms to presell items before they are built. For example, the GE FirstBuild online community solicits participants and equips them to identify market needs for appliances, work together for product development, and even produce prototypes at a dedicated microfactory. GE has launched this community with the idea of harnessing the huge amount of creativity that it acknowledges resides outside its organization.[37]

Sales

Using online marketplaces such as Etsy, eBay, and Storenvy, individuals and small businesses can now sell goods without extensive, expensive store infrastructure. They can also access on-demand payment infrastructures such as mobile point of sale (mPOS) devices for physical payment and embeddable application program interfaces (APIs) for online payment. mPOS devices such as those from Square and PayPal enable anyone to accept credit card payments in person. These devices, or "dongles," plug into smartphones and tablets, allowing sellers to accept credit card payments without the expense of a full POS terminal or the need for a complex POS system.

Similarly, fragmented players can accept payments online using digital payment providers such as PayPal and Stripe that offer embeddable Web-based APIs. These providers also help decrease retailers' liability by removing them from payment processing, eliminating the need to store credit card information. In 2014, PayPal alone enabled merchants worldwide to accept $125 billion in purchases.[38]

Support

Support activities, which offer a way to further engage consumers around the product experience and create relationships across the ecosystem, are poised to become more important as the retail landscape changes. Traditionally, retail support has been largely confined to onsite customer service desks and toll-free call centers. While these services are important in addressing immediate customer questions, there is also an often-untapped opportunity for further meaningful consumer engagement after (and even before) purchase. Retailers that build support ecosystems for their customers—and even those of other vendors—can derive real value from the engagement around offering advice, sharing experiences, and collaborating on additional product usage. These ecosystems can help retailers sense shifts in consumer attitude and mind-sets, enabling sellers to continuously adapt their portfolio of offerings.

SAP, while not a traditional retailer, has embraced the idea of creating a robust support community. In 2003, the multinational software company launched the SAP Developer Network, rebranded in 2007 as the SAP Community Network (SCN). This online platform attracts more than 2 million unique monthly visitors, the vast majority of whom are not SAP employees. They come to address both technical and nontechnical issues, to give and get help, and to interact through approximately 3,000 discussion forum posts and 25 blog posts each day. The resulting communally created knowledge base relies on crowdsourced content from hundreds of contributors, including participants dubbed "SAP mentors." The typical time to receive a response on SCN is 17 minutes, and more than 85 percent of presented issues are resolved.[39] SAP uses information derived from the community in product development, sales, and customer support.[40]

In the retail space, an IKEA "hacker community" has emerged to innovate and experiment with the company's furniture. Participants share ideas for product modifications, customizations, and enhancements. Such ecosystems serve not only as sources for new product ideas but also as creators and reinforcers of customer loyalty—and, for retailers, as windows into how their products meet or don't meet customer needs.

When retailers build, support, and participate in such physical and digital platforms, they can cultivate something of increasing value in a transforming economy: ecosystems where like-minded fragmented entities, including consumers and third-party players, can come together to learn from each other and help address each other's questions and challenges. The resulting experience helps form a bedrock of engagement and loyalty.

Niche players' unique stories

Fragmented niche retailers most often compete on specialization or personalization, offering unique or customized goods suited to small groups of consumers. These merchants' value propositions or personalized experiences offer a way to connect with consumers. Such merchants tend to focus not only on closing the sale but also on engaging deeply with their customers—a relationship that can evolve with consumers' changing tastes, preferences, and needs. Explains independent floral retailer Joanne Leiman, who owns FlowersFlowers in Evanston, IL, "As a small independent business owner, I don't try to 'compete' with big-box stores. Instead, I offer individualized customer service and unmatched quality that simply can't be found in a big-box chain."[41]

Retailer Mackenzi Farquer, based in Astoria, NY, says, "My customers shop Target, IKEA, Crate and Barrel, and other big-box merchants. I offer items they can't find in those stores. Plus, I'm not afraid to have the conversation with my customers on what they may have in their homes from these stores, and how the items my store carries can complement them."[42]

Similarly, Oakland-based independent retailer Umami Mart, the purveyor of Japanese kitchen goods and barware, connects with its customers through its blog, hosted by the owners with guest posts from food industry professionals. In-store events help the business further connect with customers around merchandise and blog themes.

The new rules of the game: Choices for retailers

TO remain relevant, traditional retailers should define their roles in the new landscape being driven by the Big Shift. To recap the situation: New entrants to the retail space are fragmenting the marketplace, offering more highly targeted niche products. These players help create value by using their understanding of consumers to provide high-touch, often personalized or customized, services that frequently require deep expertise and knowledge. They are enabled by digital marketplaces and supported by sophisticated virtual platforms that enable plug-and-play online operations without the limits associated with physical shelf space.

In this rapidly changing environment, where can traditional retailers find a place? Constrained by factors such as shelf space limits and fixed-cost physical assets, how can such businesses offer consumers distinguishing value?

It's not an easy fix. To rise to the challenges of this rapidly evolving landscape, large retailers should revisit the ways they approach both their online and brick-and-mortar businesses. They should then transform their physical stores, focusing not on completing transactions but on redefining experiences. Alternatively, they can look for opportunities to extend their operational and infrastructure capabilities as services—essentially becoming service providers to smaller niche players. Finally, traditional retailers can move to transform into consumer agents—new entities that use deep understanding of consumers to help them navigate product choices.

Beyond the online/offline divide

Today, many consumers care less about whether they're shopping online or at a physical store than about getting the best deal—no matter what tools they use to reach that goal. From the viewpoint of a typical consumer, a retailer should offer a seamless shopping experience across online and offline channels, integrating its virtual and physical operations so that, for instance, a shopper can return an item bought online at a store, or go to a store's website to find out if an item is in stock at the closest physical store location. Indeed, the distinction between online and offline shopping is becoming increasingly blurred, if not entirely irrelevant. For example, an Apple® retail store customer can pick up a product and pay for it with his or her Apple ID via an iPhone mobile device, leaving without ever talking with a salesperson. Is this an offline or online transaction?

The need to integrate virtual and physical operations to present a single face to the consumer may pose a challenge for many retailers. Historically, most retailers have managed their online and brick-and-mortar businesses as separate entities—sometimes going so far as to locate them in different regions and stocking them with different inventory. Often, the two businesses have distinct cultures and even separate profit and loss statements; they might also compete for internal resources. But with more consumers expecting a consistent shopping experience no matter how they choose to buy, such an approach is becoming less sustainable. To attract shoppers, retailers should move beyond the dualism of digital and physical channels and instead approach the entire business holistically, with digital and physical assets efficiently reinforcing one another to execute the company's chosen business model.

What should that business model look like? In part, retailers may want to base that decision on the extent of their physical asset base—in other words, how heavily they have invested in building and maintaining physical stores. This is because, for all the ease of going from online storefront to physical shop and back again, the economics of operating online are very different from those of operating brick-and-mortar locations. Digital storefronts with unlimited "shelf space" and the ability to leverage on-demand fulfillment can operate at relatively low cost while offering consumers more product choice than even the largest brick-and-mortar store could provide. With their low fixed-cost structure, and as consumers continue to use technology to compare prices, online operations are well suited to making money from product-based transactions—which are, of course, the retailer's traditional source of profit. Brick-and-mortar retailers that try to compete on the same grounds (price, speed, ease) in physical stores—for example, big-box electronics stores that try to match prices consumers find online—often find that such an approach simply accelerates their decline, as they cannot compete effectively on those grounds.

On the other hand, physical spaces can become catalysts for engaging consumers and even ecosystems around products and with each other—a very different business model from one based solely on product sales. Retailers with a large physical presence may therefore want to migrate toward a focus on experience, the nature of which will evolve over time. Creating individualized experiences traditionally involves investments in fixed assets and infrastructure, so existing physical assets can provide an advantage in this strategy. For example, some vertically integrated retailers such as Apple Inc. and Victoria's Secret command higher prices (and thus margins) by offering exclusive in-store experiences.

Can retailers that are not now vertically integrated pursue an experience-based strategy that captures the value of experience in their margins? Doing so may involve a fundamental shift in a company's business model. Instead of attempting to fold the value of experience into a product's sale price, retailers pursuing an experience-based strategy should focus on creating an experience so valuable that the consumer will want to pay for it in itself. It's critical to be as helpful as possible to customers, both in terms of increasing their ability to make the right purchase given individual contexts and needs, as well as in enhancing their ability to get the most value from products after purchase—and to create truly memorable and engaging experiences along the way. This kind of model does not entail inventory turns to capture value. In fact, customers may even be encouraged to purchase items elsewhere—perhaps from a smaller, more nimble retailer or a large digital marketplace. The product, in this scenario, is not the source of profit. When done effectively, experience-based selling can help boost loyalty, increase the consumer's lifetime value, and even be a source of new and innovative ideas as consumers and ecosystem partners interact and collaborate.

"Experience bazaars" that surprise and delight consumers

The idea of creating unique store experiences using aesthetics and ambience—or branded lifestyle products to communicate image—is hardly new. But historically, such experiences are essentially "push" marketing—the consumer has little to no direct say in shaping his or her experience. The experiences therefore risk becoming quickly outdated, as one season's cutting-edge brand is often next year's passing fad. Take clothing retailer Abercrombie & Fitch, whose wares went from hot look to passé in the space of a few years. The culprits: affordable, stylish "fast fashion" and a larger cultural/aesthetic shift toward personalization and unique self-expression.[43]

Today, however, retailers have an opportunity to create a completely new experience for the consumer—one that can surprise, educate, and delight consumers by inviting them to select and cocreate their own experiences. This may mean shifting business models, creating value through engagement, and cultivating an ecosystem of consumers and partners. For example, instead of selling cookware (with peripheral experiential offerings such as classes and chef-cooked dinners), a retailer might focus on creating a community of consumers who are passionate about cooking, offering a forum where members can come together and share passions and advice. Ideally, such an experience—an "experience bazaar"—could become so valuable that the retailer could charge for the experience itself, rather than the associated products. With the community in place, the retailer could suggest tools and products—either its own or competitors'—that may be purchased elsewhere. It could also partner with data aggregation platforms and personalization solutions to provide a personalized experience before, during, and after the interaction, with a focus on helping consumers get the most value from the products they have purchased. All aspects of the interaction would be rooted in deep engagement with and understanding of the consumer.

Early signs of this transition are emerging. Many physical spaces are hosting demonstrations of online merchandise that consumers want to interact with before purchase. The value of these demonstrations is rooted less in transactions in physical space and more in consumer interactions and engagement. For example, Warby Parker started as an online-only eyewear retailer and then expanded into opening physical storefronts. Google recently opened its first-ever brick-and-mortar store in London, with Android phones, Chromebook laptops, and other products on display.[44] And Amazon has debuted pop-up spaces in San Francisco, Sacramento, and New York, where consumers can experience the company's Kindle e-reader, Fire phone and tablets, and Fire TV.[45] Such spaces create a place where consumers can experience products in person, while online retailers can engage with consumers and get direct feedback. The vast majority of these companies' sales are still online—but the physical environment creates a meaningful consumer touch point.

Leading retailers are also "renting out" space in their brick-and-mortar stores, affording independent retailers appealing to the same consumer group spaces where they can showcase products and engage with consumers. Nordstrom, for example, has hosted Etsy designers and retailers in its bridal pop-ups and is collaborating with Shoes of Prey, a custom women's shoe manufacturer. Such opportunities give smaller, more fragmented sellers a chance to showcase products and engage directly with the consumer, creating tailored and engaging experiences.

Like restaurant dining and movie theaters, physical retail will not go away. But it's likely to transform greatly in both its look and the role it serves. Many consumers will continue to enjoy the social aspect of shopping and the experience of discovering new products and items. To thrive, retailers should develop new business models that embrace this enjoyment, creating spaces for consumers to explore, learn, and come together around common interests.

Incumbent retailers as infrastructure providers

As some retailers shift the focus of their physical space toward creating individual experience platforms designed to facilitate discovery, learning, and interaction, others may choose to move toward creating value in the

Figure 6. The traditional retail value chain

Graphic: Deloitte University Press | DUPress.com

business-to-business (B2B) space by providing infrastructure capabilities to other retailers.

Figure 6 shows the traditional retail value chain—the general sequence of functions needed to move a product from concept to sale and beyond. While retailers have traditionally performed many, if not most, of these functions, technological changes are beginning to break up and recombine the value chain's elements, making it newly possible for an organization to perform only a single function, or even to reorder the traditional sequence of activities.

Even as the product design and sales steps fragment, the value chain's central functions—from sourcing and procurement through fulfillment—are, as we describe below, concentrating, increasing efficiency by leveraging economies of scale and scope. Because these functions can benefit from such economies, they are likely to continue to concentrate, offering opportunities for growth to those players able to dominate the space.

Concentration refers to the emergence of a small number of large-scale players to handle an industry's infrastructure needs, each focused on a single business activity or function. These large-scale infrastructure providers are enabled by economies of scale and scope, as well as by the potential for network effects. As the retail industry undergoes concentration, especially in B2B interaction, established retailers may have the opportunity to become B2B concentrators—"scale-and-scope" operators able to provide sourcing, inventory management, store operations, marketing, and fulfillment capabilities to smaller retailers.

Sourcing and procurement

Today, emerging retailers can contract for fully managed sourcing and procurement processes once too complex for many small businesses to handle. A number of infrastructures and platforms, including purchasing cooperatives and organizations offering e-procurement tools, provide sourcing and procurement services to small retailers.

Historically, purchasing cooperatives made procurement easier and helped reduce costs by buying in bulk, then splitting the goods among multiple parties. For example, Bay Area chain Cole Hardware, an independently owned local business, purchases the majority of its inventory through the Ace Cooperative for hardware stores.[46] Today, technology enables an even greater variety of sourcing and procurement options, including drop-shipping and crowdfunding. Drop-shippers handle all sourcing and procurement for fragmented retailers, while crowdfunding facilitates presales, enabling extremely accurate demand prediction. These entities rely on the economics of scope and scale: The more transactions and participants they support, the more cost-effective each transaction is.

Inventory management and distribution

Rather than having to create or own inventory management and distribution systems, many retailers can now outsource these functions entirely or in part, hiring infrastructure providers to handle procured and produced goods and send them to stores. For example, Stitch Labs is a cloud service that can track and manage inventory and sales across multiple online storefronts. Similarly, drop-shippers fully handle inventory management, often eliminating the need for store distribution altogether.

Store operation

Retailers can also hire third-party infrastructure providers to provide storefront space and even manage back-end store operations. Store operation is the point at which retailers open up merchandise to the public; the term encompasses both online and physical stores. In the past, the need for high capital investment in physical space made retailing a generally expensive, risky proposition. Online selling supported by virtual storefront providers has removed much of the expense.

Meanwhile, many digital marketplaces are rapidly consolidating. A few key platforms, including Etsy, eBay, and Amazon, now dominate the online storefront industry. This concentration creates a virtuous cycle. The more storefronts a marketplace enables, the more likely users are to gravitate to its site, attracted by its variety; the more users come to an online marketplace, the more likely sellers are to use its digital storefront services. Today, Etsy is the biggest player in the handmade marketplace industry, with 78 percent of the worldwide market in 2012.[47] Etsy features more than 25 million sellers,[48] two-thirds of whom view their selling on that platform as full-fledged businesses.[49]

Physical real estate remains prohibitively expensive for many retailers, so most rent rather than own physical store space, usually from one of the major players controlling the majority of commercial retail real estate. San Francisco Bay Area retailers Umami Mart and Frankie & Myrrh both enjoy special deals—Umami Mart with the City of Oakland,[50] and Frankie & Myrrh with the online marketplace Storenvy (which itself received a discounted rate from the owner of its physical storefront)[51]—that enable them to lease brick-and-mortar locations. Beyond such deals, the growing popularity of "pop-up retail" enables small retailers to affordably lease space from consolidated players—space that might otherwise be vacant. Established retailers can take the store operation function to the next level by creating the "experience bazaars" discussed above.

Beyond provision of physical and digital space, other store operation functions include traffic analytics and other back-end technical and data resources designed to enhance the customer experience. These too can be provided by scale-and-scope operators, freeing small retailers from the need to own them. And they too are consolidating. For example, Google Analytics held an 85 percent share of the cloud-based analytics market as of 2012,[52] while Amazon Web Services held a 35 percent share of the infrastructure-as-a-service market in 2013, with no other competitor holding more than 7 percent.[53]

Marketing

Aggregation platforms such as social media networks can become a means for marketing. Fragmented players can use scale-and-scope operators such as Facebook to advertise to both broad and targeted audiences. While the retailers may create the ads, the aggregation platforms do the work of posting them and targeting them to the appropriate audiences—in short, the bulk of the mechanics of advertising.

Social media platforms are particularly strong examples of scale-and-scope providers, as any individual platform's value grows with the size of its user base. Used as marketing platforms, they can drive highly effective retail campaigns. For example, women's

Figure 7. The traditional retail value chain—consolidation and fragmentation

	Design (F)	Sourcing & procurement (C)	Inventory management & distribution (C)	Store operation (C)	Marketing (C)	Sales (F)	Fulfillment (C)	Support (F)
Description	Product prototyping	Purchasing or building inventory	Managing and distribution of products to be sold	Managing the point of sale	Promotion of goods for sale and/or the retailer's brand	Execution of the purchase transaction	Delivering products to consumer	Helping consumer maximize the value of products
Status	Fragmenting, as more and more individuals have access to design tools	Consolidating, via e-procurement and drop-shipping	Consolidating, via cloud services and platforms	Consolidating, via marketplaces	Consolidating, via social media and online marketing platforms	Fragmenting, as more individuals are able to establish retail operations	Consolidating, via shipping services and drop-shipping	Poised to fragment, as peer-to-peer platforms emerge to facilitate ecosystems around products
Example	GE Firstbuild	Drop-shippers	Stitch Labs	Etsy	Facebook	mPOS	UPS, Deliv, Instacart	SAP Community Network

F Fragmenting C Consolidating

Graphic: Deloitte University Press | DUPress.com

apparel retailer Nasty Gal got its start on the early social media platform Myspace. Founder Sophia Amoruso fostered a cult following, using the site to direct interested customers to buy from her eBay page; as Facebook superseded Myspace, she transitioned to that platform. Nasty Gal took no external financing until 2012, when it accepted a $50 million investment from Index Ventures and posted sales totals of nearly $130 million.[54]

Fulfillment

Infrastructure providers can also carry out fulfillment, the act of providing the customer with his or her purchase. For brick-and-mortar purchases, the term is usually synonymous with sales; in e-commerce, however, it becomes a distinct step. Fulfillment appears to be consolidating in the form of platforms or services that send goods to customers on retailers' behalf. This can take the form of drop-shipping or mailing via a national service such as USPS, FedEx, or UPS. (UPS alone holds half of the domestic US shipping market.[55]) A rising force in this area is same-day delivery services, such as those from Google, Deliv, and Instacart, that partner with retailers to fulfill remote orders. San Francisco–based Cole Hardware, for example, uses Google Shopping Express.[56] Retailers can also rent out their brick-and-mortar facilities as fulfillment centers for other players, thus becoming distribution hubs.

These examples, several of which are shown in figure 7, illustrate how players looking for growth can position themselves in specific roles in different parts of the value chain, as well as ways that the current market can reward scale and scope. By providing infrastructure, aggregating demand, and connecting retailers with consumers through marketplaces and platforms, scale-and-scope players can benefit from the retail landscape's changes—including increased fragmentation and volatility, new ways to aggregate demand, the decoupling of demand from supply, and the emergence of new retail models.

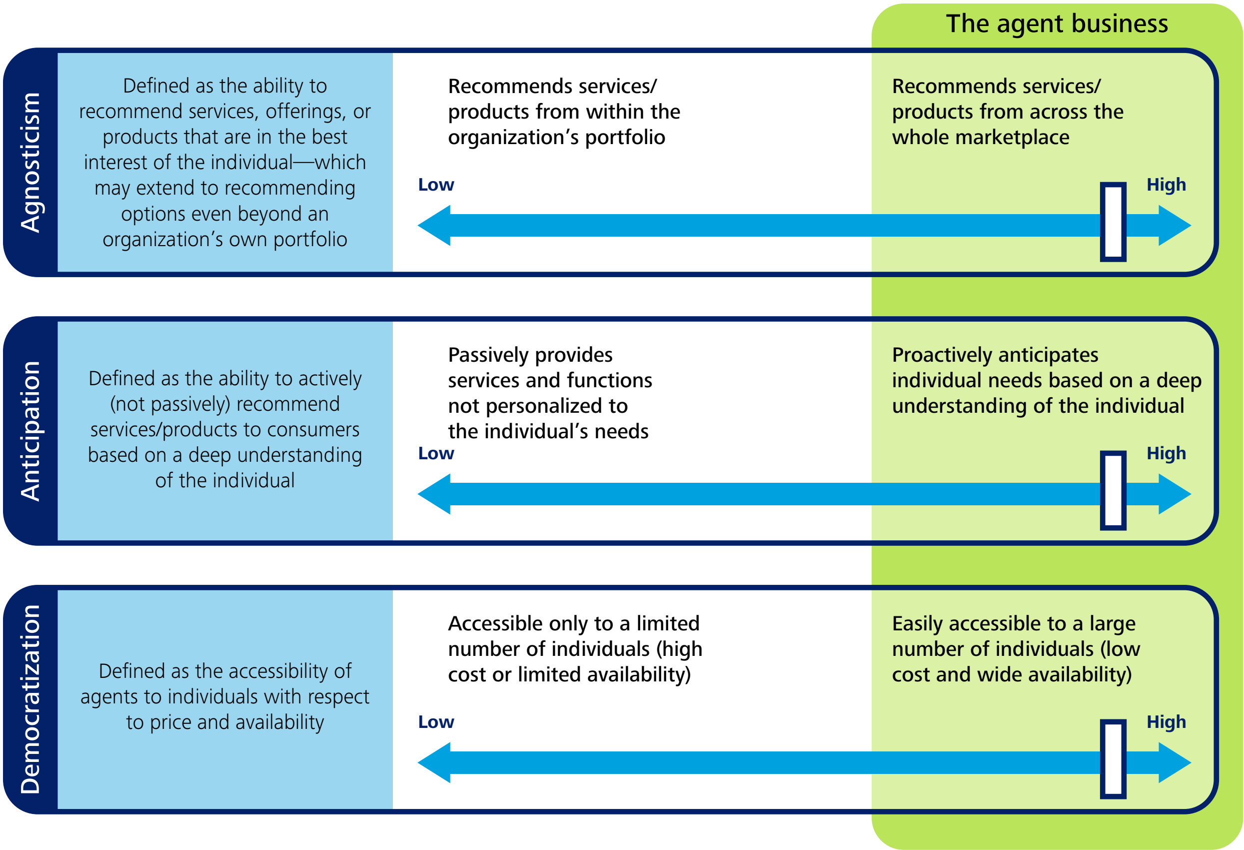
Established retailers as trusted agents

The consumer agent is not a new concept; personal shoppers and personal wealth advisors have existed for decades. However, these services have historically been accessible only to a few wealthy individuals, mainly because personalized advice is often costly and not easily scalable.[57] But recent advances in core digital technology have now made it possible to develop cost-effective personalized services that draw on data platforms, big data analytics, and machine learning. As products and niches continue to proliferate, consumers will increasingly look for trusted sources that can help them navigate multiple options and choose those that fit their needs. This role requires scale to be effective: The more consumers an agent serves, the more likely it is to recognize patterns and thus improve the quality of its advice. Large established retailers, with their access to extensive purchase-activity data for a large number of customers, have an advantage in this arena.

In today's retail environment, such retailers may take on new roles as consumer agents—entities that use their deep knowledge of individual consumers to proactively recommend the best options for each (figure 8). Effective agent business serve consumers first, focusing more on meeting consumer needs than on product sales, and tapping a broad network of curators and partners to help connect consumers to preferred niche options.

Trusted consumer agent businesses are already beginning to emerge. For example, Amazon's algorithm-based recommendation

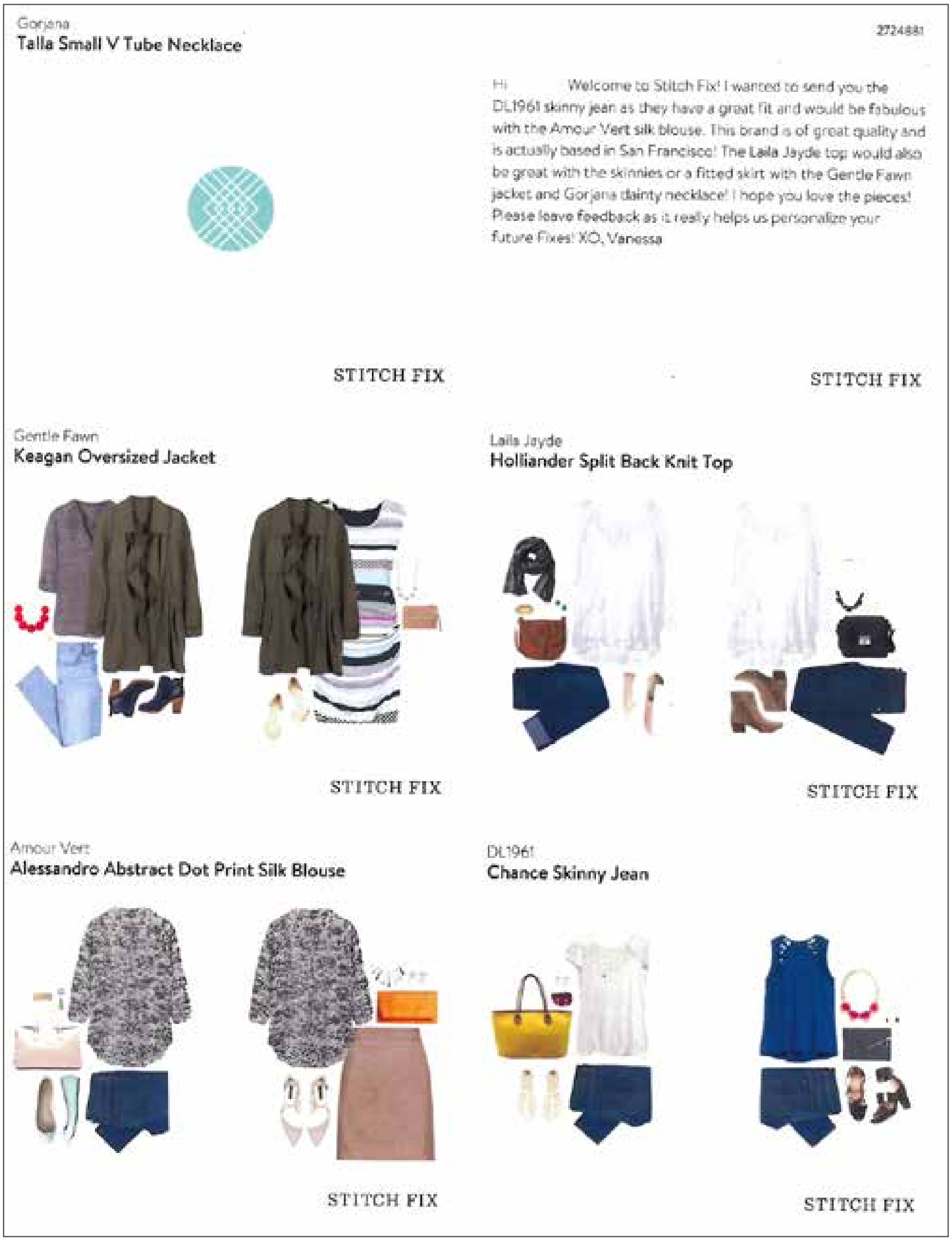
Figure 8. Characteristics of agent businesses



Graphic: Deloitte University Press | DUPress.com system uses a number of simple elements, such as items a user has purchased in the past, items in his or her virtual shopping cart, items liked or rated, and items that other customers with similar purchases have viewed and purchased. The algorithms customize the consumer experience—and Amazon's metrics demonstrate that they work. The most recent iteration of the company's recommendation engine contributed to a $3 billion, or 29 percent, quarter-over-quarter sales increase.[58]

Similarly, Stitch Fix, founded in 2011, is a personal shopping club that sends users customized boxes of clothing, on demand or by subscription. Customers are asked to fill out detailed profiles and even share Pinterest boards so that the company can assess their style preferences. Stitch Fix uses a combination of proprietary algorithms and personal stylists to curate a personalized five-piece assortment of clothing and accessories, which is shipped to the customer along with styling

Figure 9. Sample Stitch Fix customer styling card



recommendations (figure 9). The customer can keep all or none of the items in her package, paying a "styling fee" of $20 only if she purchases nothing from that box. If all the items in a box are purchased, the customer receives a 25 percent discount. Stitch Fix, which uses very limited traditional marketing, relying instead on word of mouth and social media tastemakers for promotion, is projected to bring in more than $200 million in revenue in 2015.[59]

Amazon and Stitch Fix have developed consumer agent capabilities by leveraging technology to understand consumer needs, then recommending options that address those needs. For this model to be effective, consumers must trust agents deeply—a difficult achievement when the agent recommends only its own products. Knowing this, some agent businesses will suspend reliance on inventory at hand and instead find items that best meet consumers' needs—whatever their source. As such, they will likely have limited, if any, brick-and-mortar assets, instead investing heavily in analytics capabilities and relationships with ecosystem partners. Perhaps the most sustainable business model for an agent business is to receive payments from customers for services rendered, rather than from advertising revenue or markups on products sold, which tend to undermine trust.

While change can be challenging, the good news, as we've noted, is that agent businesses are likely to be driven by powerful economies of scope and network effects. The more an agent knows about any individual customer, the more helpful it can be to that customer. Just as important, the more customers an agent interacts with, the more it can identify emerging unmet needs across customers—and the more helpful it can be to any individual customer.

Mobilizing the retail landscape

As the retail industry evolves into a landscape of niche players connected by "experience bazaars" and marketplaces, and enabled by infrastructure providers, opportunities will arise for organizations to act as mobilizers—entities that bring together elements of a rapidly shifting ecosystem to pursue shared interests and enable learning, helping to orient the industry around common goals.

Mobilizers are not a new concept. Retail associations such as the National Retail Federation provide resources that enable participating retailers to adjust and enhance performance, supporting the industry as a whole through trade shows, conferences, workshops, seminars, thoughtware, legislative lobbying, and more. However, in times of change, new movements and organizations are likely to emerge to address fragmenting consumer interests. For example, the maker movement encourages hands-on manufacturing and tinkering, while "glocalism" encourages consumers to purchase goods that, if not local, contribute to specific microeconomies (for example, purchasing items from trade co-ops in East Africa). Entities within these movements can take on the role of mobilizers. City governments promoting the purchase of locally made goods to revive their cities' manufacturing industries are acting as mobilizers, as are publications that educate individuals on movements and offer ways to get involved. To connect more deeply with their communities and understand underlying shifts in consumer behavior, retailers should pay attention to mobilizing forces in their environments.

Pragmatic pathways for transformation

THE landscape we describe in this report challenges established retailers to dramatically alter both their mind-sets and their business models. But such change can be both difficult and risky. How can retailers choose the right path when the future is uncertain?

Historically, most companies have approached major transformation as a large-scale, big-bet investment—one often driven from the top of the organization, where a large investment signals commitment. However, less than a third of such big-bet approaches to organizational change are effective.[60] This is not surprising when one considers human psychology: Changing an entire organization is difficult—and it can be intensely political. When bets are high and the environment uncertain, organizational antibodies can emerge to attack the initiative, which competes for resources and may be perceived as highly risky. It can take a long time to meet ambitious goals, and even supporters can grow impatient. As a result, many such initiatives fail to achieve their initial objectives.

Scaling edges for transformation

However, there is another approach to transformation—one that can be less risky, yet still retains the potential to transform an entire organization. This approach, which we call "scaling edges," is based on identifying a promising "edge" for the organization, then growing that edge until it becomes the business's new core. Such an approach can help make it possible for retailers to reinvent themselves while minimizing potential risks and maximizing impact.

An edge is a growth opportunity that has the potential to scale—so much so that it can catalyze change, eventually becoming effective enough to replace the core of the business. A true edge should align with larger trends disrupting the industry. Edges involve fundamentally different business models and practices from those of the core. For established retailers, potential "edges" could include becoming an "experience bazaar" for consumers, a B2B infrastructure for fragmented niche retailers, or a trusted consumer agent.

How can retailers scale an edge?

Once a retailer identifies its edge—what business it wants to be in 5–10 years from now—it should then make small, smart moves that test and grow that edge. First, the retailer should design quick prototypes—for example, pop-up events or informal collaboration agreements—and test them rapidly to get feedback. The retailer should also find individuals who are passionate about the opportunity to lead these edge projects. Here, passion is more important than experience; passionate people tend to find ways to learn new skills and capabilities.

To avoid competition for resources, edge projects should not rely on resources and IT

STEPS TO SCALING EDGES

Identify an edge to explore: Determine what business the company wants to be in 5–10 years from now—one that has a fundamentally different business model from that of the company's core.

Execute and test the edge: Establish a group to carry out the edge business model on a small scale, focusing on rapid prototyping and feedback.

Starve the edge: Fund the edge project on a shoestring, encouraging it to find creative ways to meet resource and infrastructure needs other than getting them from the business's core.

Staff for passion: Select individuals for the edge team based on interest in and affinity for the work rather than solely on experience. Passionate people tend to find ways to learn new skills and capabilities.

Define success in relative, rather than absolute, terms: Aim for the edge initiative to deliver continuously improving returns—not necessarily large returns in an absolute sense.

Scale up: Once the edge initiative gains traction, do not attempt to integrate it into the core of the company. Instead, allow the core to be pulled to the edge (figure 10).

Figure 10. Design principles: How to scale the edge?

Levers	Start How do you start?	Organize How do you mobilize the right resources and participants?	Amplify How do you use disruptive technologies to grow?	Perform How do you measure success to drive improvement?
Focus Maximize upside potential	**Focus on edges, not the core** Edge initiative: ___________	**Staff for passion before skills** Who within the firm would be most passionate about the edge initiative?	**Break dependency on core IT** What new technologies can we leverage to amplify our abilities?	**Embrace double standards** What metrics can we use to measure progress toward core goals and edge goals?
Leverage Minimize instrument required	**Look externally, not internally** What external resources, ecosystems, and partners can we leverage?	**Starve the edge** What are the minimum resources required to get started?	**Mobilize the passionate outside the firm** How do we connect with passionate talent outside our organization?	**Measure progress of the ecosystem** What specific metrics can we use to measure the health of the edge ecosystem?
Acclerate Compress lead times	**Learn faster to move faster** How can we iterate quickly to test the edge initiative?	**Reflect more to move faster** What can we do to better incorporate learnings along the way?	**Move from dating to relationships** What platforms and tools can we use to create trusted relationships with ecosystem partners?	**Focus on trajectory, not position** How can we assess the rate of learning and performance improvement within the ecosystem?

Graphic: Deloitte University Press | DUPress.com systems from the business's current core.[61] Along with testing a fundamentally new business model, retailers should tap into new sources of infrastructure and resources. Edge initiatives should also be "starved" with respect to investment from the core: They are essentially start-ups within a company, and, in general, successful start-ups are not over-funded early on.[62] To help maximize learning and leverage resources, company leaders should encourage edge teams to build deep, trust-based relationships with ecosystem players. And they should measure results without worrying too much about absolute metrics, focusing instead on trajectory.

It can be instructive to look at companies in other industries that have reinvented themselves by pursuing promising business edges. For example, financial services provider State Street shifted from consumer banking to become a B2B infrastructure provider for other financial institutions. Founded in 1792, State Street Bank started as a commercial lender. By the mid-1970s, it had developed lines of business in commercial banking, financial services, investment management, and regional banking. But market shifts were putting increasing pressure on traditional banking operations while increasing demand for scale-intensive back-office processing, a function increasingly challenging for many small banks. Noting this, the company built out its back-office capabilities, outsourcing them to other financial institutions. It also pushed aggressively into the high-tech processing of transactions related to asset management, global custody, 401(k)s, and trusteeship of debt securities based on securitized assets.[63] These initiatives grew so rapidly that State Street ultimately decided to shut down its commercial bank operations and focus exclusively on infrastructure outsourcing. Pursuing this edge has paid off for the company, which as of the first quarter of 2015 had $28.5 trillion in assets under custody and administration and $2.4 trillion under management.[64]

Retail today is at a crossroads. Incremental improvement is not enough—to be effective, most retailers will need to make a fundamental shift in both mind-set and identity. The good news: There is a path forward, but it is one that requires both conviction and courage.

Conclusion

TODAY'S retail landscape is in the midst of what is arguably its most fundamental transformation in a century-long string of changes. Multiple large-scale dynamics are shaping the broader environment in which retailers operate, putting pressure on traditional business models. To survive and thrive in this environment, established retailers should reassess how they create value, adjusting their asset mix to focus on the roles they chose to play.

When the future is uncertain, transformation can be difficult—and can be met with internal resistance. At the same time, periods of uncertainty can offer tremendous possibility for those able to choose a direction and shape the opportunity. By driving change at a business's "edges," retailers can prototype and test new business models, gather meaningful feedback, and learn and reflect with less internal tension and resistance. Small moves, smartly made, can set big things in motion.

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- What long-term opportunities are available?
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