Retailing: Confronting the Challenges That Face Bricks-and-Mortar Stores

Introduction by Regina Fazio Maruca

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RETAILING: CONFRONTING THE CHALLENGES THAT FACE BRICKS-AND-MORTAR STORES

New technologies can be dazzling.
But do they represent the future of retailing?
Have the fundamentals really changed?

PHOTO: CORBIS/THE PURCELL TEAM

Introduction by
Regina Fazio Maruca

What's in store for the bricks-and-mortar store? Given the current state of e-commerce – and its potential – how should senior managers of physical retail stores be thinking about priorities and directing their time, effort, and resources? Are other technological innovations being ignored – and is their potential going unrecognized – because of all the attention being paid to the mighty Net? Has on-line shopping changed the way top managers of "conventional" stores think about their products, services, and customers? Should it?

Anchored with an essay by Raymond Burke, a professor of marketing at Indiana University, this Perspectives article raises and considers a number of such questions. In addition to Burke, our participants are: Sir Richard Greenbury, the chairman of British department store Marks and Spencer; John Quelch, the dean of the London Business School; Robert A. Smith, the CEO of the Neiman Marcus Group; and Ragnar Nilsson, the chief information officer of Karstadt, Europe's largest department store chain. Together, they offer insight and, sometimes, conflicting views into such issues as the role of geography, the size and sustainability of the "plugged in" customer base, the changing relationships between retailers and their suppliers, and the Do we? How? and How Much? questions that all retailers – whether new or mature – face with regard to e-commerce.

The full impact of the Web, they agree, has yet to be entirely understood. What is becoming increasingly clear, however, is that the advent and proliferation of on-line shopping have motivated many conventional retailers to reexamine – and in some situations, reinvent – their own businesses with renewed urgency.

Regina Fazio Maruca *is a senior editor at HBR.*

Raymond Burke

In the past, life was simple. Retailers connected with their customers through their stores, through their salespeople, through the brands and packages they sold, and through direct mail and advertising in the mass media. But today, life is more complex. There are dozens of new ways to attract and engage customers – and none are more tempting than those fueled by new technologies. Indeed, even if one omits the obvious – the Web – retailers are still surrounded by technical innovations that promise to redefine the way they and manufacturers interact with customers. Consider, just as a sampling: touch screen kiosks, electronic shelf labels and signs, handheld shopping assistants, smart cards, self-scanning systems, virtual reality displays, and intelligent agents.

So if we ask the question, Will technology change the way we interface with customers in the future? the answer has got to be yes. But if we ask a slightly different question, Will all of these technologies be successful? the answer is definitely no. Some of these technologies will succeed, but many will be disappointing failures. And that's where the hard work comes in for senior managers in retailing today: Which technologies to embrace? Which to ignore? Which to spend precious resources on? When to pull the plug if success isn't measurable and immediate?

Raymond Burke is the E.W. Kelley Professor of Business Administration at Indiana University's Kelley School of Business in Bloomington.

To begin to answer these questions, it's useful to consider past successes and failures. Take the shopping cart, for example. Now you might say the shopping cart is not a retail technology. But when Sylvan Goldman introduced it in 1936, it really was revolutionary. Before that time, people did their grocery shopping only with handbaskets and were limited to purchasing what they could carry. When the shopping cart became available, people were able to buy more at one time, to stock up and visit the store less frequently.

Another success story is the universal-product-code scanner. Introduced only about 20 years ago, it has transformed the buying process in many retail stores. The UPC scanner has made checkout more convenient, improved checking accuracy, and provided us with a rich source of market research data.

Sir Richard Greenbury

Right now, opinions about the impact of the Internet on conventional bricks-and-mortar retailers, catalogs, and even door-to-door selling – are extremely different. One school of thought maintains that e-commerce will affect all retailers and all types of products, that the Internet will change the face of retailing thoroughly and permanently. Another school believes the Internet is not as much an issue for bricks-and-mortar retailers as it is for direct mail retailers, that it will prove easier for consumers to switch from catalog shopping to on-line shopping, but that most people who currently enjoy shopping face-to-face will not find the new medium particularly attractive.

I believe that the Internet has brought about a revolution in retailing. And I don't believe that anyone can predict with even a modicum of certainty how it will end. But, I would venture to say, any school of thought, like the two above, that paints the picture in black and white is off the mark. The truth is that the Internet's effect on retailing is many, many shades of gray. And that means senior managers' responses should range accordingly. Some have already felt the impact of the Net. For others, the eye of the storm is a long way off.

Sir Richard Greenbury is the chairman of Marks and Spencer, based in London.

Consider, for example, how geography affects the proliferation of on-line shopping. In the United States, the Internet has made a great splash – and with good reason. It's a big country. Consumers – even customers of one particular store – can be very spread out. It is likely that people will increasingly want to shop on-line for at least a certain range of items because of convenience.

In Britain, by contrast, I would wager that most or all of our customers live within an hour's travel of a Marks and Spencer store. The Internet just hasn't had the same impact on clothing and department store retailers here. Why switch when there's nothing onerous about the current situation? The benefits of e-commerce are simply not as immediately apparent here.

Over time, the picture will change – and that's why time is another critical consideration. As consumers become more familiar with the technology, and as they become increasingly aware that they can shop for items across ever greater distances – indeed, across borders – senior managers will have to take a hard, new look at their products and services, at their own potential for on-line sales, and at the threat of competition. Right now, not many appliances are sold over the Net. But why couldn't and wouldn't consumers prefer to buy washing machines, say, or dishwashers, from the convenience of their own homes? Once channels are established – and consumers' confidence grows – why wouldn't the picture change accordingly? Most consumers do not purchase a dishwasher and walk out of the store with it. So if they can get a dishwasher just as fast, or faster, by buying it over the Internet, and the

"The Internet hasn't changed priorities. It has simply added another layer of urgency to an already established agenda."

On the other side of the coin, consider videotex, an early home computer system with a keyboard and telephone modem that used the consumer's existing television as its monitor. Videotex was intended to be an electronic gateway to an array of information and interactive activities, including news, home shopping, advertisements, telephone directories, and banking. One such system, Viewtron, was jointly developed by Knight-Ridder and AT&T and launched in 1983. But after three years on the market, the system attracted only 15,000 customers, and Knight-Ridder pulled the plug on its $50 million investment.

Then there was interactive television. I recall a cover story on this subject in a July 1993 issue of *Business Week* whose headline proclaimed "Retailing Will Never Be the Same." Time Warner received a lot of publicity when it introduced its interactive system, the Full Service Network, in Orlando, Florida, the following year. The company also made headlines when it shut down the service in 1997, after only 30 months, 4,000 customers, and an estimated cost of $100 million.

Some in-store technologies have also failed to meet expectations. Do you remember Ted Turner's Checkout Channel? It was a network of five-inch color monitors positioned by the checkout counters in grocery stores. It ran a continuous loop of CNN programming and advertisements. Customers didn't like it and neither did the checkers. After a year in business, the Checkout Channel was available in only 840 stores. Turner Broadcasting discontinued the service in 1993 with a $16 million charge to earnings.

"Which technologies to embrace? Which to ignore? Which to spend precious resources on? When to pull the plug if success isn't measurable and immediate?"

And let's not forget VideOcart. This was a wireless system of LCD screens and computers mounted on the handlebars of shopping carts. The screens could show a map of the aisles, highlight specials, and track how customers moved through the store. VideOcart was launched in 1989 by Information Resources and was later spun off as a separate company. The spin-off filed for Chapter 11 bankruptcy protection in 1993 after installing systems in just 220 stores.

Why have so many innovations failed? From the retailer's perspective, many technologies are too expen-

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Net offers satisfactorily complete information about the product, why wouldn't they shop on-line?

Why not buy wine on-line? Or dog food? Or water? Any product

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that you don't need to look at carefully or touch is fair game. I'm not as convinced about products that require taste, feel, or other forms of face-to-face judgment. Maybe luxury clothing will never sell on-line – quite possibly, the importance of fit and feel, and the personal input of a salesperson can't be offset by even the best electronic service. But commodities like white knickers? Why not?

And when the consumer gives the nod to more products, the borders will come tumbling down. I'd love to have regular customers in the United States without having to invest in physical stores there. Imagine the marketing challenges of the truly global retailer.

But, as I said, it's too early to predict where the revolution will lead us. And no matter where it leads, senior managers should already be clear about two fundamental priorities at least. Managers in retailing today need to be obsessed both with product and with service.

Even without the Internet, the retail climate is more competitive than ever. There are too many stores. There are too many catalogs. There is too much merchandise. There are simply too many ways already for customers to allocate their increasingly spoken-for spending power.

So I want our managers – right up to the board level – to be interacting with our customers in our physical stores as never before. We must be in touch with our customers. We have to know what they're looking for, how much they're willing to pay, and (in a more immediate way than we can glean from staring at spreadsheets, sales reports, survey results, and the like) why they are – or are not – buying.

A computer screen can't convey ambiance. It can't tell you if your customers are particularly frustrated with a pothole in the parking lot or particularly pleased with the way a store looks and smells. I want our managers to concentrate on improving service – and I don't mean ensuring that the sales associates are polite. Service incorporates knowledge about the customer, the product, the weather – anything that affects what people want to buy and when they want to buy it. And I want our managers concentrating on sourcing and offering the most relevant product they can. You can't advertise your way to success with a product that is at all under par. Nor can you create a customer experience so strong it will compensate for a product that proves disappointing once it is in the consumer's home.

"The Internet just hasn't had the same impact on department store retailers in Britain as it's had in the United States."

The Internet hasn't changed priorities. It has simply added another layer of urgency to an already established agenda. Our products and our service are all we've got to build our businesses on. What on-line shopping has done is force managers to examine their priorities in newly creative ways. And that in itself opens up a whole new realm of possibility.

sive and offer too few tangible benefits. For example, to install the VideOcart system cost between $100,000 and $150,000 per store, and it took up valuable display space at the point of purchase. But evidence that it increased product sales was limited. Interactive television cost approximately $1,000 to install in each home, but it generated incremental revenues of just a few dollars per week from video-on-demand movies.

Hardware and software systems frequently require new expertise to implement, they're often incompatible with existing systems, and they quickly become obsolete. Retailers also worry that new technologies might threaten their existing businesses. For example, many conventional retailers have hesitated to embrace electronic commerce because they fear that when consumers shop on-line, they'll make fewer impulse purchases and become more price sensitive.

"Technology is just a platform for change. How we use the technology to create value for customers is what will determine the future – and that's the opportunity we must address."

From the consumer's point of view, many technologies make shopping harder rather than easier. As one shopper wrote to a columnist at the *Houston Chronicle* in June 1993:

"Dear Martin: I would like to tell you why the Checkout Channel did not work.... It must have been conceived by executives who didn't shop week in and week out....Most shoppers waiting in the checkout lines are tired, overworked parents whose minds are busy thinking of other things: how much their purchases will add up to, how they will keep track of the register display to watch for errors, and how much money they will have left when the groceries are paid for."

Customers often see little or no value in new technologies. Why should they learn to use a self-checkout system if checkers are willing to do the work for them? Why would they use a product locator kiosk when they can ask a salesperson? Consumers also worry that technology is becoming (or has already become) too intrusive. They have concerns about the privacy of their personal information and the security of their financial transactions.

To avoid costly failures, retailers need to be better prepared for the next generation of technologies that interact with customers. Here are a few lessons gleaned from recent research conducted at Indiana University's

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John Quelch

John Quelch is the dean of the London Business School.

They may not know it explicitly, but consumers weigh five factors in determining whether they will patronize a particular store. The factors are: the breadth and depth of product assortment; the price of the goods sold; service; the convenience of the shopping experience (opening hours, travel time, and parking); and ambiance.

If a consumer perceives that any given retailer's performance is superior for at least one of those factors – assuming all other factors are roughly equal – then that retailer is ahead of the game. If the consumer perceives the retailer's delivery of several factors is superior (again assuming that the others are relatively equal), there's no contest. And if the consumer thinks that a retailer cannot deliver satisfactorily on one dimension but excels on another, that retailer may win out as well. That holds true whether the competitor is physical or virtual, and so I would maintain that e-commerce has not changed the way retailers should be thinking about their priorities.

Now having said that, I'll also say that the Internet is the place to look for increasingly worthy competition. Consider that no physical store can beat Amazon.com for the breadth and depth of its assortment. Sure, the customer loses something of the experience of shopping in a bookstore, but the convenience of being able to determine from home whether a certain book is in stock is a key point of superiority. And while traditional bookstores would contend that Amazon.com's ambiance can't hold a candle to theirs – in truth Amazon does offer a sufficient substitute. The company's referral service, the fact that it offers recommendations and reviews, cancels out the inability to browse.

Too many retailers still downplay the potential impact of e-commerce. The fact is, naysayers' reactions to the Net are similar to those we heard 15 or 20 years ago from the United States when direct mail catalogs started becoming more prominent. One common preconception about direct mail was that it would work only with certain products. Another was that it was unreliable, that buying through the mail was too risky for consumers. Still another assumption was that if a retailer engaged in direct mail, catalog sales would cannibalize store sales. Do those reactions sound familiar? Well, all three proved to be myths, and – as they relate to e-commerce – all three will again, given time.

Many people, for example, said that clothing could not be sold successfully through the mail. And while it seemed at first that direct mail could succeed only if it offered a combination of low-risk branded products and inexpensive trinkets, it wasn't too long before L.L. Bean, Lands' End, and other clothiers really began to take off. We just don't know what can and will be sold over the Net. As consumers become increasing familiar with and confident in the medium, the five factors will determine that – not some preconceived notion of what's suited to on-line sales and what isn't.

As for consumer risk, think about the great vested interest that credit card companies have in ensuring the confidentiality of transactions. This early problem is well on the way to being solved. And far from cannibalizing a retailer's physical-store sales, Web sites that offer shopping will serve as an advertising mechanism. Direct mail proved to *increase* store sales, in addition to generating its own revenue. On-line shopping sites will do the same.

Customer Interface Laboratory and other academic and commercial institutions:

Lesson 1: Use technology to create an immediate, tangible benefit for the consumer. If consumers don't see how technology is going to help them, they often assume it's going to be used against them. When UPC scanners were first introduced, people reacted negatively because they believed that merchandise would no longer carry individual price tags and that shoppers might be overcharged at the register. More recently, customers have expressed concern that electronic shelf labels could be used to raise prices between the time shoppers pick up a product and the time they reach the checkout counter.

Similarly, IBM developed a video camera that could recognize a retailer's best customers as they walked into the store so that salespeople could offer outstanding personalized service. Unfortunately, shoppers felt it was an invasion of privacy. The technology is now used to recognize vegetables at the point of sale, improving the speed and accuracy of the checkout. If the benefit is not immediately apparent, make it obvious through advertising and promotional materials.

Lesson 2: Make the technology easy to use. Most computer technology is pretty complex. Take Internet shopping, for example. Each site requires consumers to navigate slightly differently; sites organize product categories in different ways, they provide different types of information about products, and they have different procedures for ordering and fulfillment. Our research has found that it takes customers an average of 20 to 30 minutes just to learn how to shop in most text-based Internet grocery-shopping systems. By contrast, it takes them only two to three minutes to learn how to

If consumers don't see how technology is going to help them, they often assume it's going to be used against them.

But for those who believe that the Internet will never account for a significant percentage of overall sales, consider the following. Even if the overall percentage of retail sales on the Internet averages just 5% across all categories, that shift will still create tremendous pressure on physical retailers, particularly in the United States. The United States has more square meters of retail space per capita than any other developed country in the world, even adjusting for purchasing power. Essentially, the United States is "overstored." Space is more readily available there, so stores tend to be larger. Increased and sustained use of on-line shopping will spawn more intense competition among physical retailers, and some stores will close.

"Many retailers are highly predictable in the way they face the dilemma of how much to bet their futures on e-commerce and how much to concentrate on traditional retailing, and therefore they're thinking defensively."

Of course, the impact of e-commerce will be felt differently, and at different times, by different retailers. Right now, the Internet is more of a transactional-sales medium than a relationship-building medium. And so retailers that market their own, very premium branded goods – that is, retailers that sell a lifestyle concept along with their particular products or services – might not be feeling the competitive pinch just yet. Personal contact with highly trained and motivated salespeople – the service factor and in part the ambiance factor – is still the critical differentiator for such businesses, and on-line experiences have yet to match that or offer a suitable counter value.

But for retailers that offer higher-value branded convenience goods, the Internet is a more immediate concern. Some retailers have fallen back on the in-store experience as a point of differentiation both from other retailers and from e-commerce competitors. It might be more prudent for them to concentrate instead on improving their value propositions – the performance of their product or service assortment relative to its price. Why? Because apart from the look of a store, it's very difficult to deliver a consistent in-store experience. In a physical store, you're employing full- and part-time workers, some of whom may have no personal interest at all in the product they're selling. For all sorts of reasons – the salesperson might be having a bad day, for example – the customer's experience is unpredictable. It is routinely easier to offer a consistent experience on-line.

Finally, for supermarkets, wholesale clubs, and retailers that offer a great assortment of mostly low-end merchandise, the Internet may pose a threat that is currently unformed but may someday be formidable. Manufacturers that today reach consumers through retailers and wholesalers may soon find it necessary to sell directly to end users. Supermarkets may think they're immune, but we know from the experiences of Peapod and Streamline that at least a small percentage of consumers are now willing to pay a premium to buy over the Internet. What if Colgate-Palmolive or Procter & Gamble began offering monthly "care packages" to consumers over the Net? There might be incremental shipping costs, but those costs might be offset by the convenience.

In addition, manufacturers might find e-commerce a good way to lock in customers to their product portfolios over time. They might launch their own frequent-buyer or reward programs. Smaller manufacturers shop in a 3-D virtual store modeled after a familiar bricks-and-mortar shop. The virtual store takes advantage of the shopper's prior knowledge to make virtual shopping more intuitive.

In-store technology can also be difficult to use. I recently watched a string of customers walk up to a "meal solution" kiosk at a supermarket and attempt to print a recipe. After repeatedly pressing the display screen, each customer walked away in frustration. Shoppers thought that they were doing something wrong. They weren't. The kiosk's printer was out of paper, but it had no way of alerting customers.

Lesson 3: Execution matters: prototype, test, and refine. Many technologies are viable concepts but fail because of poor execution. For example, the Checkout Channel repeated its broadcasts every ten minutes. That was just about the right length of time for consumers, who spend an average of eight minutes waiting in the checkout line. However, it irritated checkout staff, who had to listen to the material all day long and would often shut off the monitors.

When a Boston-area bank first tried out videoconferencing kiosks to sell financial services, customers refused to use them. The systems were located in closed booths that granted privacy but were uninviting. Simply by making the booths more open and their entrances more visible as people walked into a branch, the bank was able to substantially improve consumer acceptance.

Lesson 4: Recognize that customers' response to technology varies. It is very difficult to create one customer interface that works well for everyone. For example, Burger King tried installing video terminals in one of its restaurants to allow patrons to place their own orders. Younger customers loved them, but older people preferred to talk with human attendants.

I recently tested an on-line banking system and found that heavy users of automated teller machines gave it higher overall ratings than the "branch-wed" non-ATM customers did. However, the reverse was true when videoconferencing was added. It appeared that heavy ATM users actually disliked interacting with humans!

Lesson 5: Build systems that are compatible with the way customers make decisions. It's sad to say, but many companies developing the next generation of customer interface technologies spend more time interacting with computers than with customers. As a result, the systems are often incompatible with consumers' shopping habits.

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could engage in strategic alliances to do the same. Two-income households that are time sensitive and price insensitive have the greatest purchasing power. Retailers that consider this segment a primary source of income take note.

So given the current state of e-commerce, what should physical retailers concentrate on? The five factors – and e-commerce, both as competition and as opportunity. Many retailers are highly predictable in the way they face the dilemma of how much to bet their futures on e-commerce and how much to concentrate on traditional retailing, and therefore they're thinking defensively. They believe they must have a Web site to avoid being thought of as behind the times, but they don't really know if they need to go whole hog into the on-line world. And they're not sure how their physical stores must be to excel long term.

My best advice: don't enter e-commerce halfheartedly. If you are going in, skip the brochure site and move directly into sales. But don't even try to go on-line unless you are confident that you are thinking clearly and correctly about the five factors and about how they work for and against the consumers whom you consider to be your target market.

Robert A. Smith

How should retailers who operate primarily in physical stores be thinking about priorities? To answer that question, managers need to define what kind of a retail business they're running. Is it focused on price, assortment, or service? Does it serve high-end or low-end customers? What do customers value about it? Only when those questions are answered can a manager even begin to understand how to direct resources – no matter what's going on with technology or with the competition.

Our business model is centered on serving well our affluent clientele. We are thus oriented toward building relationships and delivering service. The quality of our goods has to be at the highest level, of course, but the key to our success has been and remains the relationship between the sales associate and the customer. Our customers are very demanding of Neiman Marcus in the physical world, and we expect them to be no less so on the Web. So any initiatives on our part – whether they take place in our stores or on the Net – must keep that same orientation and meet the same standards. For us, then, the central question is, What kind of initiatives will help us strengthen the customer relationships we have and encourage new ones to form?

If we're looking broadly at technology and specifically at the Internet, the next question might be, Can technology provide ways to communicate with customers that add value to our relationships with them? On the one hand, it's not clear that customers would be willing to spend several thousand dollars for a fine designer outfit they haven't touched or tried on. It's possible that some customers would, if they knew the brand well and trusted Neiman Marcus to deliver appropriate follow-up services and so on, but my sense is that most customers would not. On the other hand, for customers who are seeking many fashion basics, gifts, or tried-and-true products, the Internet may provide a more efficient shopping experience

Robert A. Smith is the CEO of the **Neiman Marcus Group,** based in Chestnut Hill, Massachusetts.

For example, an Internet start-up once launched a grocery-shopping system that grouped cold cereals by their main ingredients (rice, corn, or wheat, for example). Many shoppers had trouble finding their favorite brands because they didn't know the ingredients.

Lesson 6: Study the effects of technology on what people buy and on how they shop. The shopping cart altered the purchasing patterns of customers when it was introduced over 60 years ago. Today's technologies can have equally profound effects on consumers' behavior. For example, a Swedish grocery store discovered that by electronically adjusting prices according to the time of day, reducing prices in the evening, it was able to increase evening sales by 40% and double store traffic.

We have also found that consumers are more price sensitive when using text-based home-shopping systems that display lists of brands and prices than when using graphical systems that show realistic images of merchandise. Other researchers have reported that brand names become less important as the amount of detailed information about a product's attributes increases.

In some cases, technology has produced less of an effect on consumers' behavior than managers had feared. For example, a grocery retailer reported that impulse purchases were down by just 5% when customers shopped on-line. About the same amount of perishable products were purchased per order on-line as in the physical store.

Lesson 7: Coordinate all technologies that touch the customer. When a customer encounters a retailer, it shouldn't matter whether the encounter occurs via the Internet, through a catalog, by telephone, or in the physical store. The customer expects to find the same merchandise, offered at the same prices, with the same knowledgeable and courteous service.

Unfortunately, it's often the case that a retailer's operations are not well integrated across media. As a consequence, a frequent shopper may be given first-class treatment in the physical store but receive marginal service on the telephone or via the Internet. Retailers need to tap into the same product, customer, and transaction databases with all their communications media. For example, Harrah's Entertainment has built a system that recognizes high rollers whether they are on-line, on the telephone, or in any of its casinos.

Lesson 8: Revisit technologies that failed in the past. Over the years, various technologies have been introduced

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than the physical store. Our challenge will be to create a Web-based experience that exceeds our customers' already high expectations.

I do not think that a Web site with just a catalog or a list of store events alone would be particularly useful. Our customers know us and would expect more than that. Defining what *will* be useful is our challenge. That's why, at present, we do not have a commerce-enabled site.

Technological advances might someday change the way we source our goods and form partnerships with suppliers. It already has for lower-end retailers. In our case, many of our suppliers are European artisans who produce goods and manage their businesses in the old-world way. Technology hasn't really affected their businesses yet. But it will, and it may create some opportunities. Eventually, we might be hooked into more of our suppliers in ways that allow us to provide a broader or more effective assortment of goods on a timely basis.

The potential of the Internet is causing our suppliers to face up to the question of their own e-commerce potential. For retailers to prosper in a market where customers can buy directly from manufacturers, they must make sure that theirs is a value-added portion of the relationship from the customer's point of view. We'll stake our claim on providing great edited assortments, sourced throughout the world, at unsurpassed levels of service, targeting the very best clientele. We do know that customers are using new channels. We must understand and respond to our customers' desire to shift their business among stores, catalogs, and the Internet. However, in doing so, we have to create a service and systems infrastructure that fits in with the operation of our existing businesses and that encourages customers to return to our offering.

"The central question is, What kind of initiatives will help us strengthen the customer relationships we have and encourage new ones to form?"

Ultimately, technology will affect which businesses we choose to pursue through which channels. It will create new merchandising opportunities and challenges, and it will also influence how and when we remodel bricks-and-mortar stores, how and when we expand, and how and where we invest resources in new buildings.

The Web can enhance our ability to leverage our sales associates' connection with their customers in systemic ways. The challenge will be to integrate the Internet with already formidable personalized communication and service capabilities. My sense is that the Internet will someday augment our associates' knowledge of products, their connection with the company's culture, and their ability to care for their customers.

I think most executives know that e-commerce means different things to different retailers. And I think many have a pretty good idea about whether or how their particular businesses are currently suited to the Web. But the advent and proliferation of on-line shopping should serve as a wake-up call to any retailer that hasn't spent time seriously considering what brings customers to its stores, catalogs, or Web sites, and what encourages them to spend money there. The priorities for retailers remain the same as they have always been: to meet and to exceed their customers' expectations.

with much media fanfare. Then, if the actual performance failed to meet expectations, people wrote them off and shifted their attention to the next innovation. Examples include multimedia kiosks, voice recognition, artificial intelligence, virtual reality, and video telephones. However, technology continues to evolve. Performance improves and prices drop. Today, artificial intelligence is used in the selection of retail sites and to facilitate one-to-one marketing programs; voice recognition routes callers to specific store departments; virtual reality is used to test new store layouts and shelf displays; and videoconferencing assists on-line shoppers. Retailers need to revisit past technologies periodically to consider whether there are new opportunities to create value for customers.

Lesson 9: Use technology to tailor marketing programs to individual customers' requirements. Most conventional retailers design their stores, product offerings, promotions, and services for the masses. They treat all shoppers alike even though customers' needs and wants differ and so do the volume and profitability of their purchases. Treating all customers alike puts retailers at a distinct disadvantage relative to those electronic retailers that adjust their marketing programs instantly to match the needs of individual shoppers.

Advances in information technology can give conventional retailers the opportunity to overcome those problems. By setting up frequent-shopper programs and by linking customer profiles to UPC scanner data, for example, retailers can track the shopping patterns, sales volume, and profitability of their patrons. They can then mail out customer-specific fliers and promotions. When shoppers enter the store and swipe their frequent-shopper cards through a reader, a computer can print out customized shopping lists complete with recipes, coupons, and suggestions for replenishment purchases. Retailers can tailor their services in any number of ways using the available technology – if they focus on how it can help them help their customers.

Lesson 10: Build systems that leverage existing competitive advantages. For many years, people have said that a store's location was a key for its success. Now the buzz is that, in the world of electronic retailing, location doesn't matter. A consumer can do business with a merchant located across the country as easily as with one located across the street. In fact, the argument goes, having a physical store may prove to be a liability, burdening the conventional retailer with unnecessary overhead.

Ragnar Nilsson

In the early 1950s, in the United States, Austrian architect Victor Gruen conceived of the shopping mall. Gruen's design – grouping large stores away from a town's center – worked in part because of the growing popularity of the automobile (people were beginning to measure distances in terms of the time it took to drive them). It was also successful because he sensed, correctly, that consumers did not want to stop in several different places to run all their errands. Gruen's invention is arguably the first revolution in retailing.

Now we face another revolution – one that will potentially have an even greater impact on how, when, and where people shop. Has it changed how senior managers in retailing – particularly those operating bricks-and-mortar stores – should think about their priorities? Most definitely.

Certainly, some priorities remain the same. Understand your customers. Know whether they patronize your stores because of the quality of the goods you offer, the assortment, the value, the price, whatever. Constantly work to improve your service, your delivery, your supply chain, your inventory management.

But add to that list of basics another fundamental: understand whether, how, when, and how much your physical stores should be linked to, or augmented by, on-line shopping.

The Internet is here. It is increasing in popularity. And if senior managers of physical retail establishments don't come to terms with it and figure out how to make it work for them, it will in the long term work against them.

In Germany, this new fundamental priority is truly critical. The market is already intensely competitive. Consumer goods no longer occupy the top of the shopping list; they've been ousted by services (travel and other free-time activities). The cost of living has increased, and people do not have as much disposable income. Finally, the demographics in Germany are stagnant: the number of workers remains constant and so does the unemployment rate. In short, consumers are almost unmotivated to buy. In such a climate, it is important for traders – especially physical retailers – to address consumers' changing expectations more closely and also to understand the threats and opportunities presented by new technologies.

Ragnar Nilsson is the chief information officer of **Karstadt,** Europe's biggest department store chain, with headquarters in Essen, Germany.

Here at Karstadt, we began that process in 1994. Keeping all of our priorities in mind, we began to rethink how our physical stores should look and work, and to integrate various multimedia elements into our existing business. In early 1997, for example, we began to restructure our physical stores around a "theme house" concept. Essentially, we present our goods in displays depicting various situations. Everything we offer that is suited to one particular purpose is available in one thematic area. There are now six thematic areas in Karstadt stores: Fashion, Eating and Drinking, Living, Sports and Free Time, Multimedia, and Personality.

Our theory is that customers don't just want to shop for the goods they need; they want everything that goes with those goods. They want to transform simple needs into a new style, a new feeling, or a new expres-

In theory, that may be true. But in practice, it's false. The constraints of time and space still exist. Consumers can't wait for many types of products to be shipped across the country or from a different country. Some products can't be shipped at all. Customers may be reluctant to purchase on-line because the computer display is limited in its ability to convey important product information. They might prefer to shop at a local retailer because they know its reputation, location, store layout, product selection, and return policies.

Retailers can use technology to magnify rather than minimize the benefits of physical location. For example, imagine an Internet interface where customers access stores geographically rather than by URLs. A shopper views a map that shows the retail topography of the local town, highlighting stores that sell products of particular interest. He or she then selects a view showing specific brands, prices, store specials, and inventory information. A second view would highlight stores that will be open for the next hour. Such technology is already being built into the navigation systems of the next generation of American automobiles. It's one of several approaches to bringing together the best features of electronic and conventional retailing.

It's easy to be dazzled by new technologies and conclude that they represent the future of retailing. However, that conclusion would be wrong. Technology is just a platform for change. How we use the technology to create value for customers is what will determine the future – and that's the opportunity we must address.

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sion of themselves. For example, if a customer is shopping for towels, nowadays at a Karstadt they will also find matching bathrobes, electric toothbrushes, perfumed soap, and so forth. The department store of the future, we believe, must not only provide customers with goods but also offer them a whole new lifestyle.

From there, for us, it was a logical next step to extend into electronic shopping. We already had classic department stores, a mail-order company, and travel agencies. We were in a good position to embrace e-commerce. What's more, we decided that we couldn't just sit back and wait for other retailers to find success in the medium and then try to follow suit.

In that spirit, we developed and established several different multimedia elements as part of a strategy to use e-commerce in a way that fits in with our existing businesses:

- We now have a catalog on CD-ROM that customers can use to order certain types of products, like golfing equipment, from home.
- For other types of offerings, such as travel and CDs, we have a touch screen point-of-sale system, which customers can use to get information or order products not in stock.
- We've introduced Cyberb@rs cafés in 35 of our physical stores, where customers can eat, drink, and surf the Web. Interestingly, up to 20% of our Cyberb@r customers, especially younger people, are stepping into a Karstadt store for the first time.
- And we have created My-World, an on-line shopping mall offering more than 1.2 million products and services in categories ranging from books to computers to fashion to sports equipment.

With these technological elements in place, we hope to gain synergy at all levels. Consider the internal benefits, for example. The new Karstadt shopping media are linked both conceptually and logistically. We have an excellent opportunity to capture important information about our customers from all these

"Our theory is that customers don't just want to shop for the goods they need; they want everything that goes with those goods. They want to transform simple needs into a new style, a new feeling, or a new expression of themselves."

sources and use it to plan future offerings, expansions, and so forth. We can also apply our experience in one mode of business to our others. For example, as an experienced and effective partner in end-user logistics, Neckermann, Karstadt's mail-order subsidiary, was from the beginning able to make sure that My-World customers received goods on time.

Externally, customers now have a way to access products and services from any Karstadt source. For instance, with our Cyberb@rs and through My-World, customers can find and order products that might not be available in the physical Karstadt store most convenient to them. The gap between our physical stores and our mail-order business can thus be effectively closed.

Ragnar Nilsson

Certainly, many bricks-and-mortar retailers can't immediately jump in as we did. I believe that e-commerce can be a true extension of shopping in the physical world, but not all stores are currently in a position to take advantage of it.

For managers of those retail establishments, I offer the following thoughts: I daresay on-line shopping will become part of our daily lives, but it will never replace the "real" shopping experience. Customers in the physical store want the personal service and stimuli of shopping, whereas Internet customers – at least today – want to be able to shop at any hour, they want to shop quickly, and they want good prices. Those who prefer on-line shopping generally have a clear idea of what they're looking for and don't want to stroll around.

"Ultimately, technology may change the outward appearance of the playing field, but the game remains the same."

So if you are not in a position to go on-line, concentrate on identifying and improving those qualities of your business that differentiate you from the on-line experience. Think about e-commerce just as you would a new mail-order competitor. Consider your customer base even more closely than before. Are your customers likely to prefer a competitor? If so, how can you persuade them not to switch? If you suspect that they will move to the competition, is there some way you can jump-start your Internet activities? If not, is it time to reconsider your niche and your target customers?

Physical retailers must keep updating themselves in any case – that is the nature of the business. Ultimately, the fact is technology may change the outward appearance of the playing field, but the game remains the same.

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