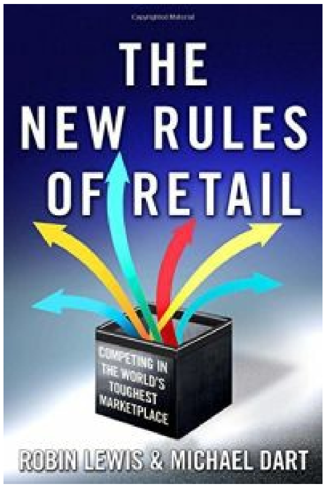

Book The New Rules of Retail

Competing in the World's Toughest Marketplace

Robin Lewis and Michael Dart
St. Martin’s Press, 2010

Recommendation

Retailing has changed dramatically: Producers and marketers no longer control what, how and if customers buy. Modern-day consumers now tell you what they want to buy, how they want to buy it and whether they’ll let you sell it to them. Retail industry consultants Robin Lewis and Michael Dart combine experience and original research in their pragmatic, useful analysis of how the industry has evolved since the rise of the Internet. They offer a clear, logically progressive discussion, with instructive observations about stores, brands and the three “new rules of retail.” Although their explanation is long on theory and examples, it’s short on specific how-tos. Nonetheless, *BooksInShort* recommends this eye-opening book – and eye-catching, too, with its great charts and diagrams – to manufacturers, marketers and retailers. Consumers, too, will relish its fascinating insights into their psyches.

Take-Aways

- The nature and the rules of the retailing industry are changing.
- The producer-driven economy of “Wave I (1850-1950)” gave way to the “marketing-driven economy” of “Wave II (1950-2000).”
- The consumer-driven economy of “Wave III” – evolving worldwide since 2000 – makes consumers the “most powerful players in commerce.”
- Producers and retailers no longer control product or brand marketing; buyers must grant sellers permission to enter their personal spaces.
- Consumers have shifted toward the experiential, the customized and the luxurious.
- Retailers seeking market share must abide by three “new rules of retail”:
- First, establish a psychologically addictive “neuroconnectivity” that makes buyers crave your brands, products and services.
- Second, implement the principles of “pre-emptive distribution” to win customer loyalty.
- Third, integrate “value-chain control” over every aspect of your business that is in contact with your customers.
- In the future, retailers’ brands will define them – and consumers will define the brands.

Summary

“Economic Tsunami”

The CEOs of 21 leading US retailers – including Neiman Marcus, Bergdorf Goodman, Home Shopping Network and Brooks Brothers – gathered in 2008 to discuss the coming recession, consumer spending and likely changes to the retail industry. Participants concurred that the recession would trigger a “true paradigm shift” in consumers’ perceptions of value and shopping behavior. Mickey Drexler, CEO of J. Crew, predicted, “Price would no longer equal value, and that value would no longer be measured by price.” The executives concluded that they had to profoundly alter their businesses to survive, let alone thrive.

> “The selling environment...is where the brand must neurologically connect with the consumer, deploying the entire imagery and DNA of the brand.”

Examining marketplace conditions and how they evolved can help you project how the “evolutionary forces” of retail will play out in your business or purchasing in the future.

“Wave I (1850-1950) – The Producer-Driven Economy”

In the late 1800s, 65% of the US's 60 million citizens lived in rural communities. Two forms of retail distribution arose: Montgomery Ward pioneered department store shopping and Sears, Roebuck & Co. led the way in mail-order catalogs. As towns became cities, larger department stores formed – Marshall Field's, Macy's, B. Altman, Wanamaker's and Hudson's, among others – and became "palaces of consumption" that dominated the retail industry.

> In Wave III, "the consumer is central and literally holds all the cards of commerce."

Wave I was:

- **"Production/retail driven"** – Producers and retailers controlled prices and product availability. Consumers had limited brand and product choices.
- **"Production chasing demand"** – Inefficient distribution hobbled manufacturers as well as sellers as they attempted to capture business from geographically shifting consumer markets.
- **"Fragmented marketing"** – Dispersed markets and lack of communication led to "sporadic, local, infrequent and inefficient" advertising, marketing and sales efforts.

"Wave II (1950-2000)" – The "Marketing-Driven Economy"

After World War II and through the late 1970s, industries benefited from investments in communication, transportation, distribution and marketing. "Mass markets" and "mass marketing" became retail buzzwords. TV ignited advertising. Shopping malls, discounters and big-box retailers (or "category-killers") proliferated. "Branding, advertising" and "segmented marketing" drove retail expansion. Designer Ralph Lauren invented the "lifestyle brand" with Polo. Bloomingdale's CEO Martin Traub let Lauren create the first-ever "shop within a shop" in his store. That elevated the in-store experience with themed shopping events.

> "The shifting balance between supply and demand, and how it drives changes in retail distribution models, is fundamental."

Wave II was:

- **"Marketing driven"** – Having met consumers' basic requirements, makers and sellers needed to create demand to continue to attract buyers.
- **Mass markets and mass marketing** – Demographic shifts and media expansion sparked new approaches to communicating with prospective consumers.
- **"Lifestyle branding"** – To lure customers from their competitors, brands had to create increasingly compelling messages.

"Wave III – The Consumer-Driven Economy"

By 2010, retailing was in the "throes of Wave III," described by Harvard professor Rosabeth Moss Kanter as "an enormous global power shift from...those who make to those who buy." Wave III shoppers access any product or service they want, while "consumer power on steroids" drives retailing in three ways.

> "The traditional definitions of 'retail' and 'wholesale' will be irrelevant in the future...and no longer meaningful to consumers."

Wave III was:

- **"More and cheaper access"** – The amount of retail space has outgrown the consumer need by far.
- **"Quicker and easier access"** – Distribution is faster and more responsive.
- **"Smarter access"** – Technological advances let consumers buy what they want on their own terms.

> "Retailers and wholesalers that successfully transform their businesses will simply all be brands [and] therefore would more appropriately be defined as brand managers."

Outsourcing production overseas changed the US economy from "one of value creation to one of value consumption." Consumers worldwide are "sated with, and turned off" to acquiring more material goods. They prefer to buy services – especially experiences – that contribute to their sense of well-being. Since 2000, five major changes in what consumers value have reshaped the marketplace:

1. **Experiences matter more than things** – Entering the stimulating atmosphere of Abercrombie & Fitch beats making a purchase in a mundane department store.
2. **The bespoke now trumps the traditional** – Specialty jeans outsell big brands like Levi's and Gap.
3. **Vendors move "from plutocracy to democracy"** – Top designer fashions now appear in mass-market outlets, for example, Vera Wang at Kohl's and Nicole Miller at JCPenney.
4. **Consumers want "new...now"** – Buyers prefer "fast-fashion" brands like Zara, which introduces novel items each week.
5. **Sellers focus on groups rather than individuals** – Retailers must engage consumers in the nonselling social networking environment.

"The New Rules of Retail"

These five changes spark three rules that retailers, wholesalers and other value chain participants must heed. Successful sellers, brands and services accommodate "profound strategic and structural shifts" that also-rans do not. Smart companies follow:

Rule 1: "Neurological Connectivity"

Create a powerfully addictive connection between the consumer and your product, brand or service. The "mere mention" of your brand should alter the consumer's physical brain chemistry by releasing dopamine and triggering an "instant desire" to buy. Customers need not know that this process occurs. Firms like Lululemon and Zara illustrate how this works. Visiting a store or buying the product produces a sensation equivalent to the fun that consumers experience when getting together with good friends. "Neuroconnectivity" creates a dynamic based on "the dopamine rush in anticipation of shopping" that drives a customer to visit a store in person or online, “the ecstasy of the actual shopping experience itself” and the pleasure of using the product or service.

> “The key objective of value-chain control is to create and control the pre-emptive distribution of a neurologically connective experience all the way through to its consumption.”

Integrate neurological connectivity into your business model “culturally, financially and relative to the entire value chain.” Factors that drive people to love retail experiences include “arousal, proximity and familiarity, similarity, novelty, kindness, accommodation and forgiveness, touch and sexuality, self-disclosure” and “commitment.”

Rule 2: “Pre-emptive Distribution”

Wave III consumers believe that sellers must “be invited or given permission” to “engage with” – rather than “talk at” – the buying public. Market segments that were once defined by demographics and consumer behavior are now communities of buyers with common interests and common concerns. Winning consumer attention and patronage requires pre-emptive distribution.

> “The successful business [is] driven by consumer demand – what consumers are actually buying, as opposed to what companies choose to push to comply with forecasting.”

Get to consumers first to win their hearts and dollars, and to gain loyalty that can sustain long-term relationships. This requires an “integrated matrix” of relevant distribution methods. Pre-emption does not depend upon a retail physical presence; retailers selling successfully online can parlay neurological connectivity into shutting down some or all their physical locations. Now is the time to tap emerging markets in developing nations. The sooner your matrix goes worldwide, the sooner you’ll create neuroconnectivity and forestall the efforts of slower-moving rivals.

Rule 3: “Value-Chain Control”

The value chain differs from the supply chain, which involves inventory, logistics and distribution. An inclusive value chain incorporates “who creates the value, where it’s created, and where and how it’s marketed.” Value-chain control is quantifiable and measurable, in a “virtuous cycle” or “virtuous loop” of three overlapping steps:

1. **“Define”** – Identify consumers’ expectations to affirm your brand’s value and guide innovation. Find a selling metaphor that captures its essence.
2. **“Develop”** – Improve your product and buyers’ perception of it. Integrate this new knowledge into back-end production and front-end marketing.
3. **“Delivery”** – Provide “pre-emptive, precise and perpetual” value to the consumer, including the neurological bond.

> “This kind of ‘word of mouth’ among friends about a movie or anything else for that matter, is worth seven times that of a recommendation from any other source. This new approach will destroy traditional media.” – Disney CEO Robert Iger

The value chain centers on uncovering consumers’ dreams, developing products or services to fulfill those dreams, and delivering the dream experience. To accomplish this, use three tools: 1) leverage the assets of the value chain, 2) make better and faster decisions about the value proposition, and 3) become more efficient and alert to shoppers’ demands. While value-chain control does not guarantee victory, an inability to achieve and exercise control will ensure failure.

“What It All Means”

Transformative change is restructuring entire industries, including retailing, which is making the transition to consumer-responsive mind-sets and other new approaches. Evident trends include:

- **“Collapse through conversion”** – Traditional retailers are letting brands control how they place, present, manage and sell their products. Companies now use multiple platforms to sell branded merchandise directly to shoppers, while retailers offer competitive, upscale private-label goods. Department stores are renting square footage to branded products that can generate higher traffic and sales, and big-box retailers are launching small, localized iterations of their giant stores,
- **“Fifty percent of retailers and brands will disappear”** – Retailers will cull underperforming products, vendors and wholesale brands for increased “control, productivity and profitability.” The words “retailer” and “wholesaler” will disappear, to be replaced by “brand managers.”
- **The Chinese will take over** – Despite differing economic histories, China and other developing countries are moving parallel with the US. China wants to satisfy growing domestic consumer demand even as it remains the “low-cost manufacturing base of the world.” China and other low-cost producer nations will seek mutually beneficial global strategies by launching or acquiring US brands, wholesalers and retailers.
- **Media-based marketing models are changing** – Producers and sellers no longer control their own brand marketing. The technological advances that let them cast a wider net are under consumers’ direct control. Customers can invite marketers into their personal lives or bar their entry. A “bottom-up economy” lets consumers use YouTube, Hulu, Facebook and other sites to participate in the creation of the products or services they want.

“The Master Model”

The fastest-growing retail channel is the branded-apparel sector that includes J. Crew, Aeropostale, Gap, and others. Branded stores outperform department stores because they achieve neurological connectivity, pre-emptive distribution and value-chain control from the start. Their aggregate master-model example is instructive and worth emulating.

> “What’s new today is cloned tomorrow.”

The largest apparel company in the United States – VF Corporation, with $8 billion in annual sales – integrates the three strategic imperatives across a range of brands, including Lee Jeans, Wrangler, Vanity Fair Intimates, Jansport and others. Other brands practicing this model include The North Face, Best Buy, Home Shopping Network, Amazon and Zappos. The ultimate brand model is Apple, “the true Master” at work.

About the Authors

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