Efforts to differentiate offline channels by retailers in the US, in response to the growth of online channels including Amazon

Avison Young, Consulting Division

AVISON YOUNG

Q1. What is Amazon's distribution channel strategy and growth direction?

Q2. What is the competitiveness of a successful offline retailer?

Q3. What are the main differentiating directions of offline retailers?

CANADA BEST MANAGED COMPANIES | Platinum member

Q1.

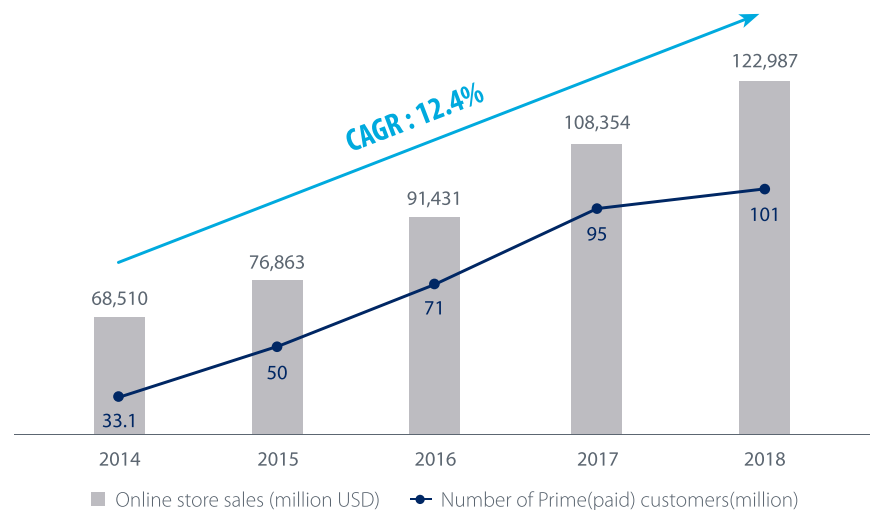What is Amazon's distribution channel strategy and growth direction?

Q1. What is Amazon's distribution channel strategy and growth direction?

Amazon has grown into a key purchasing channel dominating 50% of the US e-commerce market, by successfully converting new customers, influxed through internet searching, into paid customers.
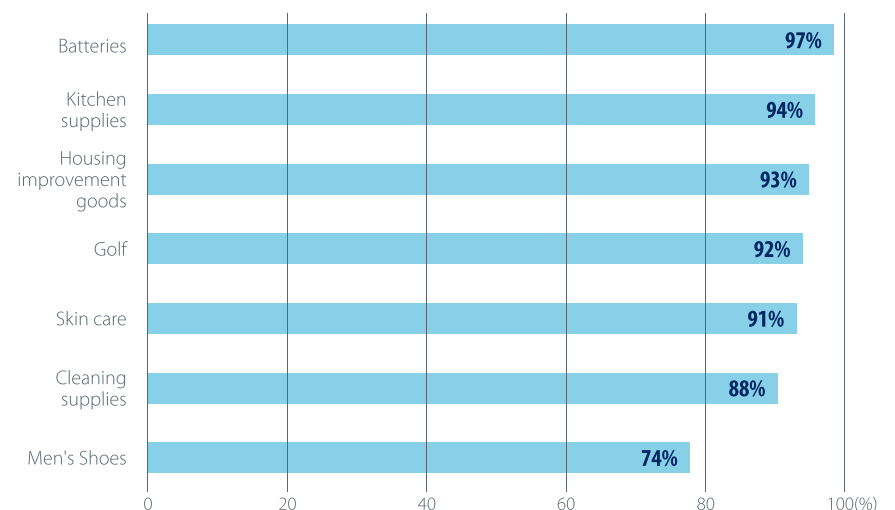
Sales share of Amazon by main major items

2016	2017	2018
38.1%	**43.5%**	**49.1%**

Growth trend of Amazon's online store business

CAGR : 12.4%

- 2014: 68,510 / 33.1
- 2015: 76,863 / 50
- 2016: 91,431 / 71
- 2017: 108,354 / 95
- 2018: 122,987 / 101

■ Online store sales (million USD) ●— Number of Prime(paid) customers(million)

(Source : Amazon, AY Analysis)

Proportion of online purchase in Amazon by major items 2018

Item	%
Batteries	97%
Kitchen supplies	94%
Housing improvement goods	93%
Golf	92%
Skin care	91%
Cleaning supplies	88%
Men's Shoes	74%

0   20   40   60   80   100(%)

Q1. What is Amazon's distribution channel strategy and growth direction?

In addition to focusing on the growth of online channel itself, Amazon is expanding customer contact point by continuously launching various offline formats, and also, expanding its goods from books to fresh foods.

Timeline

2014	Nov.2015	Feb.2017	Jan.2017	Sep.2017	late 2019
Amazon pop-up store	amazon books	WHOLE FOODS MARKET	amazon go	amazon 4-star	Launching of grocery stores

Cases of Amazon's expansion in offline channels.

Amazon pop-up store

- Stores in the form of a mini-store in shopping centers such as Kohl's.
- 87 stores are operating currently, but Amazon announced to close all of its pop-up stores to focus on new offline formats. (Mar.2019)
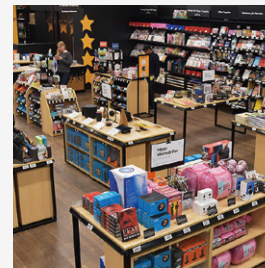

amazon go

- Unattended convenience store. (under 231sqm)
- 10 stores operating currently, planning to expand both in size and numbers up to 3,000 by 2021.

amazon books

- A store that deals books and electronics engrafted with online-based services such as membership discounts, shipping, and recommendations.
- 19 stores in operation and will expand up to 400 in the future.

amazon 4-star

- Composed of books and home & kitchen appliances which rated 4 or more on the Amazon online mall.
- 3 stores are operating currently with items curated to fit regional characteristics.

WHOLE FOODS MARKET

- A premium grocery store focused on organic products which functions as a service hub for fresh foods and also providing linked services between online-offline after acquisition.
- Operating approximately 400 stores.

Launching of grocery stores

- A grocery chain that deals with inexpensive and versatile products compared to the 'Whole Foods Market'.
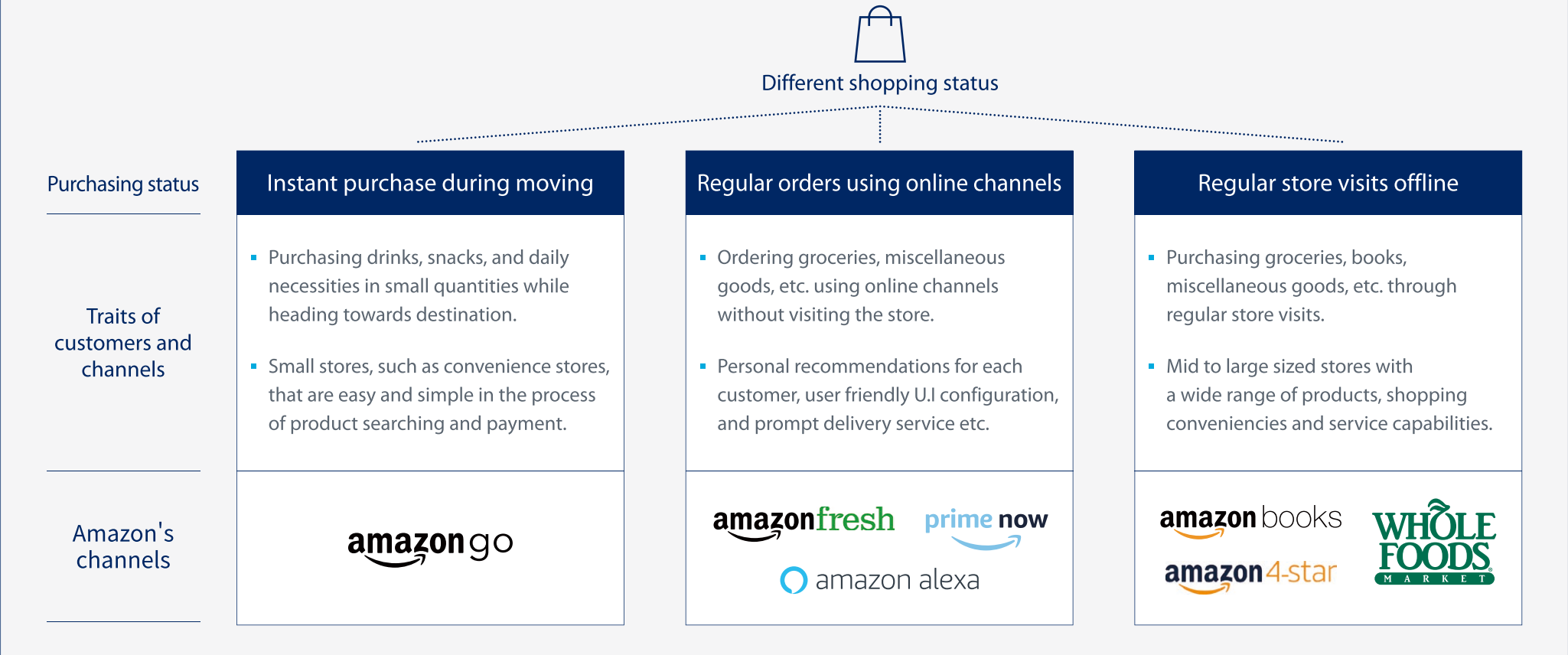- Expected to expand into the major cities of US after opening it's first store in LA.

(Source : Amazon, Press release, AY Analysis)

Q1. What is Amazon's distribution channel strategy and growth direction?

Through these offline formats, Amazon operates various customer contact points throughout online and offline, in the purpose to build a platform that can handle all purchasing situations.

On-line   customers   Off-line

Distribution channel deployment status of Amazon by purchasing conditions.

"**Amazon is expanding its online and offline channel operations,** aiming to create a shopping environment where customers can shop without the restriction of time, place and product."

Different shopping status

Purchasing status	Instant purchase during moving	Regular orders using online channels	Regular store visits offline
Traits of customers and channels	▪ Purchasing drinks, snacks, and daily necessities in small quantities while heading towards destination. ▪ Small stores, such as convenience stores, that are easy and simple in the process of product searching and payment.	▪ Ordering groceries, miscellaneous goods, etc. using online channels without visiting the store. ▪ Personal recommendations for each customer, user friendly U.I configuration, and prompt delivery service etc.	▪ Purchasing groceries, books, miscellaneous goods, etc. through regular store visits. ▪ Mid to large sized stores with a wide range of products, shopping conveniencies and service capabilities.
Amazon's channels	amazon go	amazonfresh prime now amazon alexa	amazon books amazon 4-star WHOLE FOODS MARKET

(Source : Amazon, Press release, AY Analysis)

AVISON YOUNG

Q2.

What is the competitiveness of a successful offline retailer?

CANADA BEST MANAGED COMPANIES | Platinum member

Q2. What is the competitiveness of a successful offline retailer?

Contrary to Amazon's growth, many offline retail distributors in the U.S. are facing difficult situations, due to decreased sales and accelerating customer exodus to online channels such as Amazon.

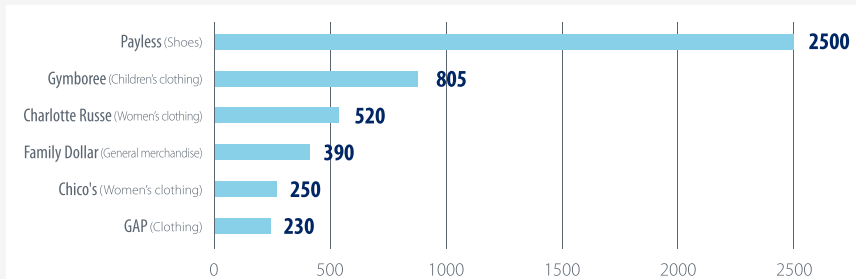### The number of closures of offline distributing channels are increasing in the US.

Outlook on increasing offline retail closures.

(Unit : No. of stores)

Year	Stores
2018	5,400
2019(E)	4,800 ... 12,000

0   2400   4800   7200   9600   12000

4,800 stores went through closure during Jan~Feb. 2019
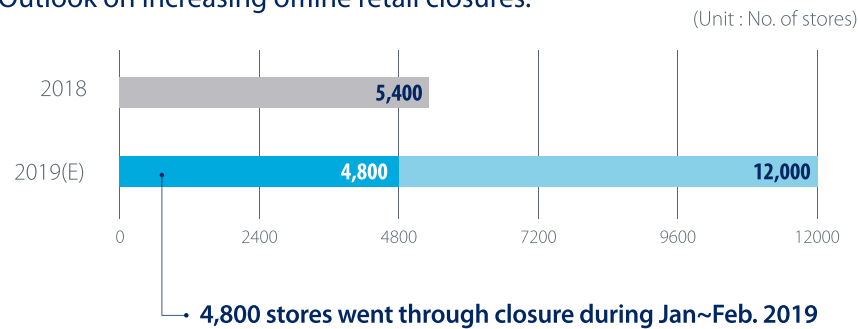
- The number of store closures during the first two months in 2019 has already reached 4,800, <u>which is 89% of that in 2018(5,400)</u>.

- The trend of closures within the US retailers is growing, since the estimated number of closures are expected to be at 12,000 in the 2019, while only about 2,260 new stores are scheduled for new openings.

- Meanwhile, not only pop brands, but also luxury brands are facing closures and vacancies due to continued decline in sales.
  : 20% of retail store spaces in the Manhattan district are suffering vacancy, including the Manhattan Fifth Avenue. (Vacancy rate increased 7% compared to 2016)

Offline closures increases due to reduced sales

Cases of brand chain store closures in the US (Mar. 2019)

Brand	Closures
Payless (Shoes)	2500
Gymboree (Children's clothing)	805
Charlotte Russe (Women's clothing)	520
Family Dollar (General merchandise)	390
Chico's (Women's clothing)	250
GAP (Clothing)	230

0   500   1000   1500   2000   2500

- In addition, the number of closures in retail chain brands, such as 'Performance Bike (bicycle brand, 102 closures)', 'Victoria's Secret(women's underwear, 53 closures)', and 'Abercrombie(clothing, 40 closures)', increased due to the competition with Amazon which resulted in sales decrease.
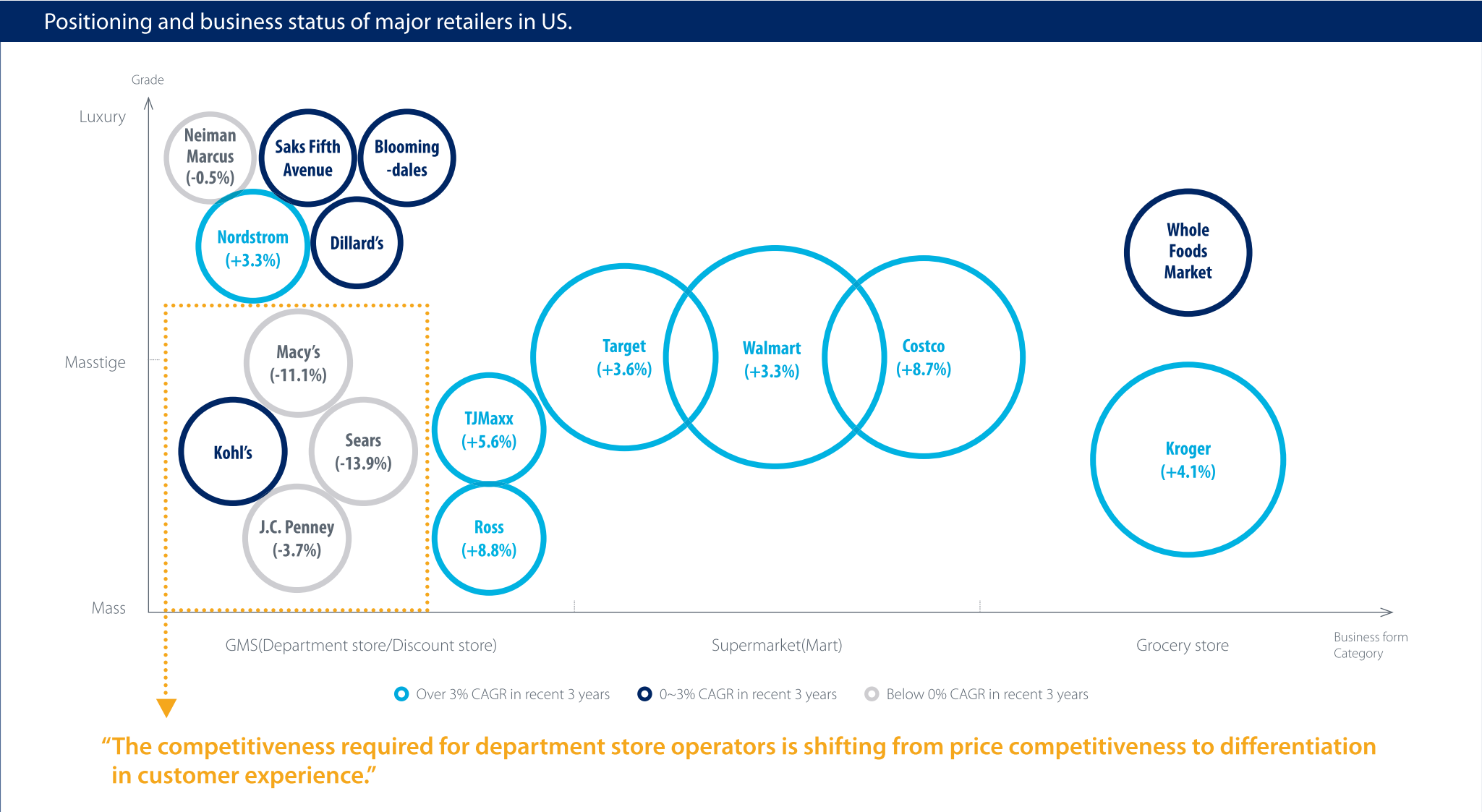
Amazon replaces the role of offline stores

- Since 2014, Amazon started launching stores such as 'Westfield' in the form of mini stores within shopping malls which grew into a core tenant.

- <u>Amazon is increasing it's offline stores in various formats such as 'The Whole Food', 'Amazon Books' and 'Amazon-Go'</u>, intensifying the competition and taking over the offline field; observable in the case where they <u>opened 'Amazon Books' at where the former 'Barnes&Noble' closed out.</u>

amazon

(Source : Coresight Research, AY Analysis)

Q2. What is the competitiveness of a successful offline retailer?

Retailers are experiencing difficulties such as decrease in sales and etc., particularly in the mid-grade department stores which are in rivalry with Amazon in the mid and low-end product categories.

Positioning and business status of major retailers in US.

Grade

Luxury

Neiman Marcus (-0.5%)

Saks Fifth Avenue

Blooming-dales

Nordstrom (+3.3%)

Dillard's

Whole Foods Market

Masstige

Macy's (-11.1%)

Target (+3.6%)

Walmart (+3.3%)

Costco (+8.7%)

Kohl's

Sears (-13.9%)

TJMaxx (+5.6%)

Kroger (+4.1%)

J.C. Penney (-3.7%)

Ross (+8.8%)

Mass

GMS(Department store/Discount store)

Supermarket(Mart)

Grocery store

Business form Category

- ⊙ Over 3% CAGR in recent 3 years
- ⊙ 0~3% CAGR in recent 3 years
- ○ Below 0% CAGR in recent 3 years

"The competitiveness required for department store operators is shifting from price competitiveness to differentiation in customer experience."

(Source : Company announcements, AY Analysis)

Q2. What is the competitiveness of a successful offline retailer?

However, department store operators who chose to focus on enhancing the advantages of offline stores by combining customer-friendly services, rather than online business and sales competition, have succeeded in improving sales.

Successful transfiguration into a customer-friendly service provider. (Nordstrom, Walmart, Kohl's) : Comparison of competitive strategies -to stand against Amazon- by offline department store operators.

NORDSTROM

Walmart

KOHL'S

Materialization of omni-channel environments via enhanced digital infrastructures
- Organically blending offline stores and online channels to increase online sales by providing an integrated shopping and service experience regardless of the customers' channel in use.

Innovation of offline stores and enhancement of shopping satisfaction
- Maximizing the benefits of offline stores by improving physical environments, along with enhancing product categories and service capabilities.

Inducing customers from other online channels
- Collaborating with Amazon to operate a refund desk within the store, providing active discount coupons, to encourage shopping.

Engrafting digital infrastructure into offline channels to enhance shopping experience and customer satisfaction which increased customer inflow

VS

Attempt to compete for sales based on price competitiveness. (Macy's, Sears, J.C. Penney)

macy's

sears

JCPenney

Internal restructuring, such as cutting out low-returning stores
- Shutting down unprofitable offline stores and internal restructuring through layoffs.
  : Sears, after closing 150 stores in 2017, has decided to close an additional 70 more, while JC Penny and Macy's closed 150 and 140 stores each respectively in 2017.

Expansion of sales channels through developing online channel
- New online channels were developed and operated separately in a multi-channel format, to compete with other online operators such as Amazon, but failed to secure new customers.
  : Disappointing features such as information no more than simple discounts, outdated U.I, and lack of merchandise compared to other online operators made customers turn away.
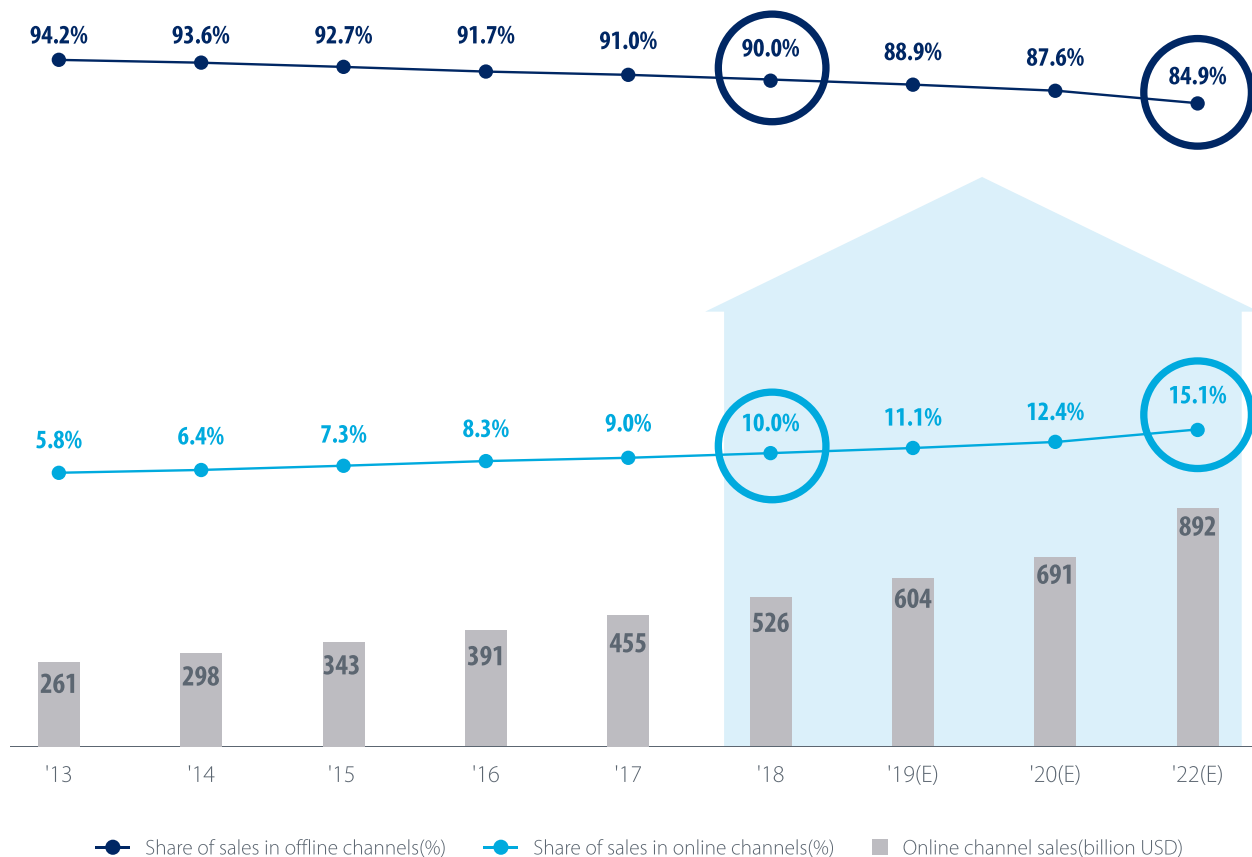
Failed to stop customer churn due to lack of price and product competitiveness in both online and offline channels compared to Amazon

Responding to the fast-growing online channels is also important, but in the end, the key seems to be shopping competitiveness in offline stores, since they account for an absolute 90% of the total sales.

Share of sales between online and offline distribution channels.

Offline channel share: 94.2% ('13), 93.6% ('14), 92.7% ('15), 91.7% ('16), 91.0% ('17), 90.0% ('18), 88.9% ('19E), 87.6% ('20E), 84.9% ('22E)

Online channel share: 5.8% ('13), 6.4% ('14), 7.3% ('15), 8.3% ('16), 9.0% ('17), 10.0% ('18), 11.1% ('19E), 12.4% ('20E), 15.1% ('22E)

Online channel sales (billion USD): 261 ('13), 298 ('14), 343 ('15), 391 ('16), 455 ('17), 526 ('18), 604 ('19E), 691 ('20E), 892 ('22E)

Legend: Share of sales in offline channels(%) — Share of sales in online channels(%) — Online channel sales(billion USD)

- **The total sales of US online channels in 2018 were $526 billion, accounting for 10% of the total sales.**

- **Online channel sales are expected to expand up to around 15% by 2022.**

- **Although countermeasures are needed to respond effectively to fast-growing online channels, but ultimately, it is essential to effectively expand the offline sales which occupies the absolute 85~90% of the total sales.**

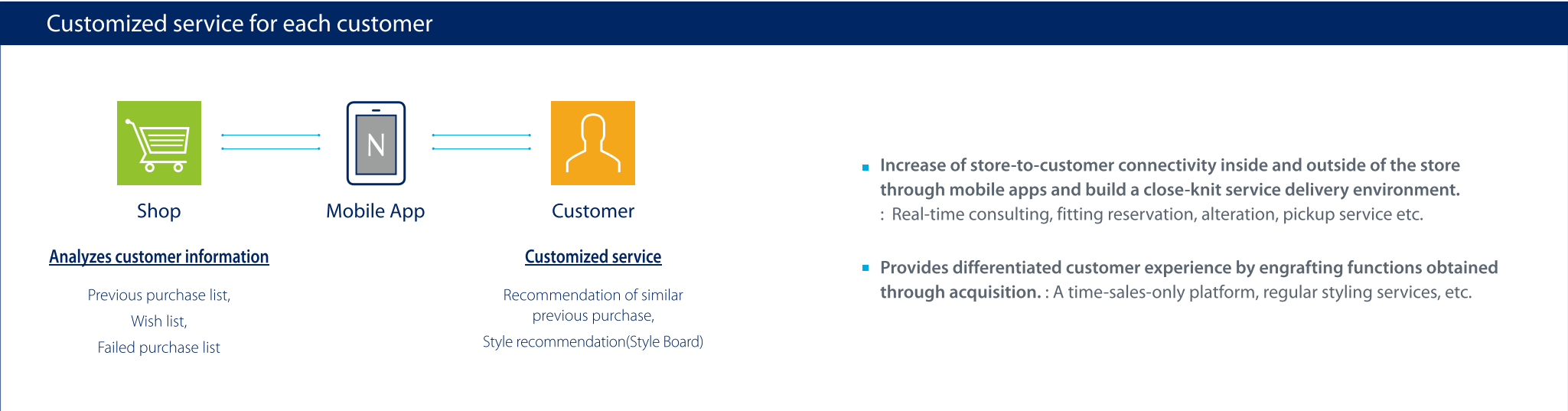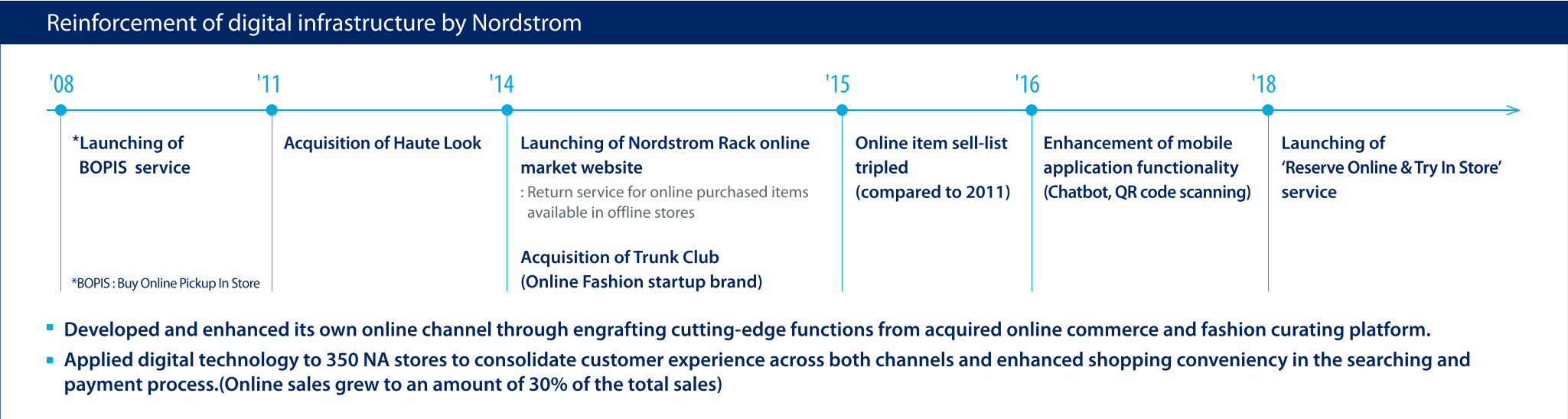(Source : eMarketer, US Retail ecommerce Sales, AY Analysis)

Q3.

What are the main differentiating directions of offline retailers?

NORDSTROM

Nordstrom intends to strengthen its digital infrastructure to provide a more integrated customer experience than Amazon through organically blending online and offline channels.

Reinforcement of digital infrastructure by Nordstrom

'08	'11	'14	'15	'16	'18
*Launching of BOPIS service	Acquisition of Haute Look	Launching of Nordstrom Rack online market website	Online item sell-list tripled (compared to 2011)	Enhancement of mobile application functionality (Chatbot, QR code scanning)	Launching of 'Reserve Online & Try In Store' service

: Return service for online purchased items available in offline stores

Acquisition of Trunk Club (Online Fashion startup brand)

*BOPIS : Buy Online Pickup In Store

- **Developed and enhanced its own online channel through engrafting cutting-edge functions from acquired online commerce and fashion curating platform.**
- **Applied digital technology to 350 NA stores to consolidate customer experience across both channels and enhanced shopping conveniency in the searching and payment process.(Online sales grew to an amount of 30% of the total sales)**

Customized service for each customer

Shop → Mobile App → Customer

Analyzes customer information

Previous purchase list,
Wish list,
Failed purchase list

Customized service

Recommendation of similar previous purchase,
Style recommendation(Style Board)

- **Increase of store-to-customer connectivity inside and outside of the store through mobile apps and build a close-knit service delivery environment.**
  : Real-time consulting, fitting reservation, alteration, pickup service etc.

- **Provides differentiated customer experience by engrafting functions obtained through acquisition.** : A time-sales-only platform, regular styling services, etc.

(Source : Company announcements, Press release, AY Analysis)

: Materialization of omni-channel environments via enhanced digital infrastructures

NORDSTROM

In fact, by launching 'Nordstrom Local', which amplifies the online shopping channel experiences through a life friendly service in offline stores, the overall channel for all sales have increased.

Launching of Nordstrom Local

- First experimental store(281sqm) opened in LA, Oct. 2017.
- **A showroom type store consisted only of fitting samples, which is 1/50 the size of existing department stores. (product inventory unprepared)**
- **Provides exclusive customer-friendly services.**
- In 2018, two additional stores opened in other regions, enhancing customer-specific personalized services.

Integrated management of channel-to-channel customer experience

Provides service through online application

- **Provides pick-up service in the store for online purchased items.**
  : Expansion of Curbside Pickup service
   (a direct delivery service by car)
- **Fittings available on store through online reservation. (Applink)**
- **Supports refunds & exchange for online purchased items at all stores.**

Life friendly services such as dress mending

- **Customized designing and repair services provided by in-shop-tailors.**
- **Custom styling services provided by professional stylists.**
  : Customers can get recommendations or connect directly
   to store staffs through Trunk Club membership
   (Online styling service).

Cases of sales increase after providing life friendly services

Stylings	~X5
*Styleboard	~X4
Dress mendings	~X3
On-store Pick-ups	~X2
Fitting reservations	~X2
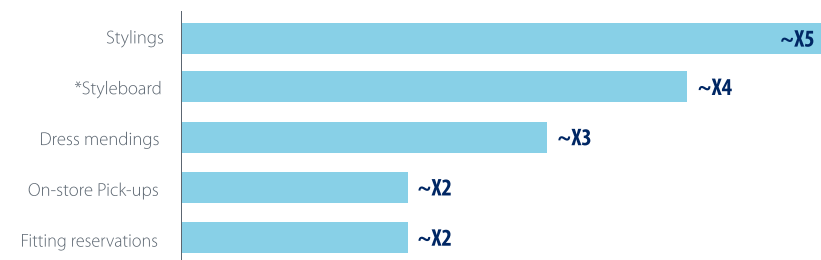
"Customers tend to increase consumption on more involving services."

*Styleboard : Online and mobile based styling & product recommendation service

(Source : Company announcements, Press release, AY Analysis)

Walmart

Walmart focused on enhancing the shopping appeal of offline channels, by improving the physical shopping environment and differentiating the categories and brand expertise from Amazon.

Enhancing the physical shopping environment of offline stores
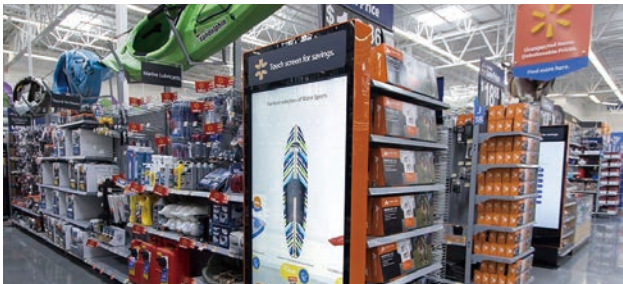
"500 stores are being remodeled every year to enhance the convenience and comfort of shopping from the traditional product-oriented display mode."
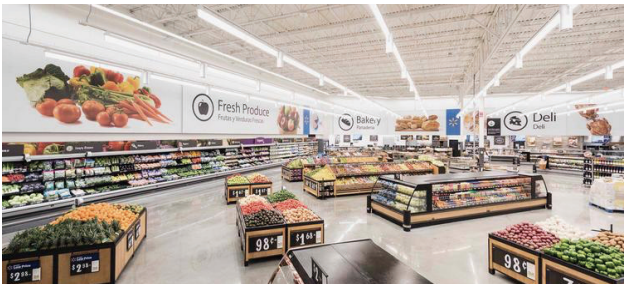
Widened shopping space, products displayed at eye-level, enhanced visibility through signboards.

Interactive display methods to induce trigger experience, reinforcement of electronics section.

Kiosks installed in each sections for instant online purchasing, to link in-store shopping and online shopping experiences.

Differentiated product categories and brand portfolios

"Strengthening category expertise and store visit elements through acquisition of popular brands favored by the Millennial Generation in the U.S."

2016	2017	2018

hayneedle — Furniture / Decorations /Outdoor livings

Feb. **Moosejaw** — Premium outdoor apparel targeting young upper-middle class

Mar. **ModCloth** — Targeting 1020 Women, Women's clothing, apparel /accessories

June. **BONOBOS** — Targeting 2030 Men, Men's clothing

Oct. **BARE NECESSITIES** — Female Lingeries

Oct. **ELOQUII** — Women's Big-size clothing
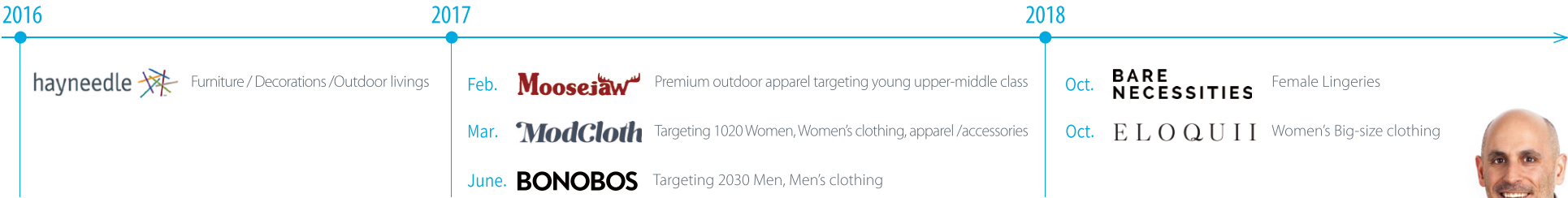
"We're trying to create a portfolio of these brands that give us proprietary content for a reason for millennial to come shop inside the Walmart ecosystem…"

Marc Lore | Walmart Ecommerce CEO

(Source : Company announcements, Press release, AY Analysis)
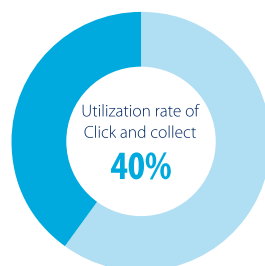
Walmart

Also, to improve the value of shopping experience gained in offline stores, the company has expanded the scope of offering pick-up services in response to customer service needs, …
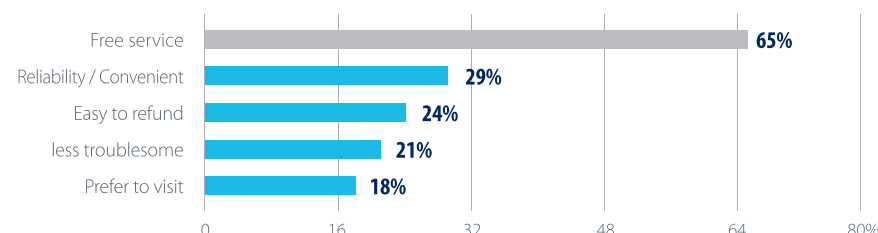
Increased need for direct receive through store visits

**Utilization rate of *Click and collect
(Online orders / pick-up services in nearby stores)**

40% of customers using the online channels collect their products from nearby stores using the Click and collect services in the US.

*Click and collect : A self pick-up service for customers to pick up their online-ordered items in nearby stores

Utilization rate of Click and collect
40%

Reasons for preference of the Click and collect service(n=1000)

Free service	**65%**
Reliability / Convenient	**29%**
Easy to refund	**24%**
less troublesome	**21%**
Prefer to visit	**18%**

0   16   32   48   64   80%

- **The Click and collect service meets better needs in ways such as more reliable, easier refund, less troubleshooting compared to the traditional delivery service, as a result, more people tend to use the pick-up service by visiting nearby stores on their way back home.**

Diversification on pick-up hubs and extend service coverage in response to customer needs

Walmart ▶ **Pickup** ▶

Drive-up & Go

Pick-up Towers inside the store

24 hour Pick-up Kiosk

Order via Online / Mobile, receive Order No. / QR Code.
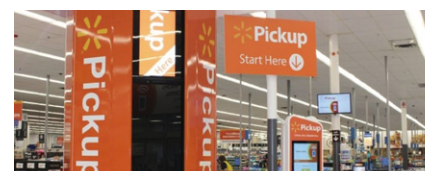
Visit nearby store to pick-up

A drive-through space that allows customers to receive ordered items without getting off the vehicle. (Since 2013)

A separate space for customers to receive or return online ordered items. (Since 2017)

A space around 132sqm, which consists of a number of kiosks operating 24 hours, where customers can receive their products within one minute.

- **As the customer's need for self pick-ups grow, Walmart diversified it's pick-up service systems & hubs and online ordering infrastructures to satisfy the customer's needs.**
- **The number of stores providing pick-up services has reached 2,100 in 2018, and is expected to expand up to 3,100 by 2020.**

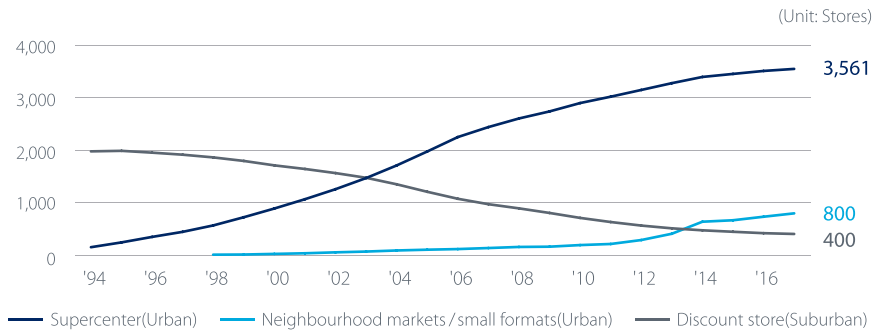(Source : iVent Retail, Nielson, AY Analysis)

Q3. What are the main differentiating directions of offline retailers?
: Enhancement of shopping satisfaction in offline channels

Walmart ☀

… and expanded the outlets of the urban store format to enhance relationships and accessibility with new target customers such as upper income brackets and Millennials, and enhanced their appeal as offline channels.

Expanded number of urban store format and customer coverage

(Unit: Stores)

4,000
3,000
2,000
1,000
0

'94 '96 '98 '00 '02 '04 '06 '08 '10 '12 '14 '16

3,561
800
400

— Supercenter(Urban) — Neighbourhood markets / small formats(Urban) — Discount store(Suburban)

"Diversified store formats and item lists in response to changes in consumer needs"
(Discount store ▶ Supercenter/Neighborhood markets)

Supercenter
- Miscellaneous & Fresh food
- Average store size 17,000m^2
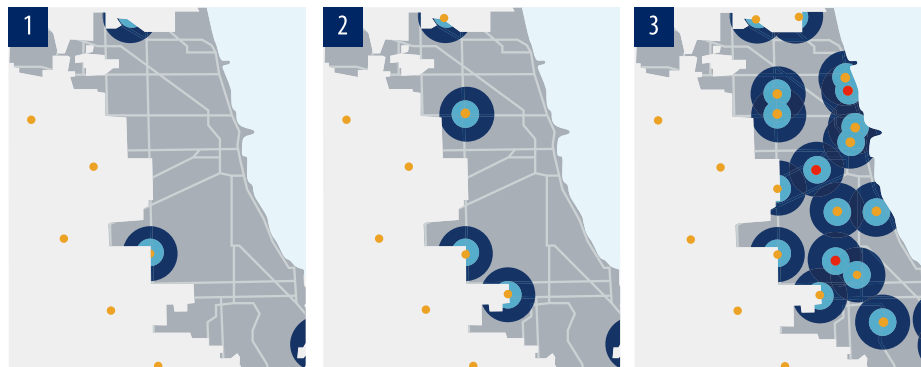
Discount store
- Miscellaneous
- Average store size 9,900m^2

Neighbourhood market
- Urban hybrid mart, number of stores increased rapidly since 2011
- 1/5 the size of supercenter (4,000m^2)
- Advanced environment and enhancement in fresh food corners

Residential ratio within the coverage range of Walmart(Chicago)

1 2 3

● Neighbourhood market

1	2005	Suburban area	Within 1mile : **1%**, Within 2miles : **4%**
2	2010	Sub-central area	Within 1mile : **3%**, Within 2miles : **15%**
3	2015	Expanded urban coverage	Within 1mile : **22%**, Within 2miles : **63%**

- **Former trend : Mega-sized discount stores to meet weekend demands.**
- **Current trend : Expanding the number of supercenters and small format marts into residential areas to induce casual visits by upperclass and millennials.**
- **Increasing accessibility and coverage of off-line channels by distributing various number of small stores within the city.**

(Source : NPR, Wal-Mart's Urban Spread, AY Analysis)

KOHL'S

Through partnership with Amazon, Kohl's successfully attracted new customers by operating a return service zone in the store, which led to a turnaround.

Successfully acquired new customers through collaboration with Amazon

**Return service operation status of Amazon**

- After a partnership contract with Amazon in 2017, Kohl's started operating 'Amazon returns reception' in 80 stores around LA and Chicago.

- In 2018, additional 21 stores started operating in other areas including Milwaukee, where exclusive parking areas and a 25% discount coupons were provided for customers using the Kohl's return service.

Effects

KOHL'S

+

amazon

- After the Amazon Return Service, visitors to Kohl's store increased 8.5%. (3Q 2018)

- 56% of the customers using the return service were either new or long term absent customers.

- Stores operating the return service attracted 43% more visitors compared to other un-operating stores.

- Recorded sales growth for 6 consecutive quarters since the second half of 2017.

amazon — Partnership — **KOHL'S**

1   Customer   2
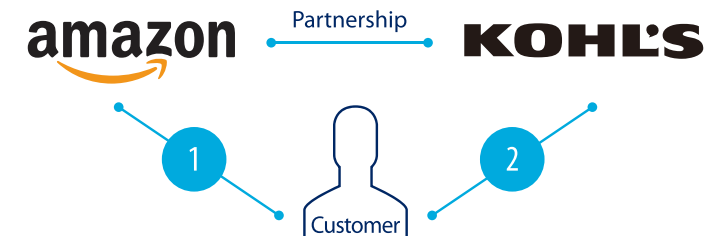
1 Request for online return

| Kohl's Dropoff application | Information of nearby Kohl's market | Packaging and application attachment | Return Code Receive QR code |

2 Return items by visiting nearby stores

| Visit store | Scan QR code & return items | KOHL'S 25 % OFF Receive discount coupon |

(Source : Gordon Haskett Research, Press release, AY Analysis)

Q3. What are the main differentiating directions of offline retailers?
: Implications

Offline channels are reconstructed from a simple objective place, only for the purpose of sales, to a service delivering space which enhances the customer satisfaction in the course of product discovery, purchase and receipt.

Strategies to Differentiate Offline Channels for retailers

"Provided extended customer service experience over Amazon by creating an integrated environment using online channels based on the advantages of offline stores"

Extended customer's shopping value and shopping experience

Convergence of online channels

- Establishing an integrated environment for all channels, by strengthening the digital infrastructure and operating new online channels.
- Enhancement in customer analysis during the purchasing phase to provide the required information to the respective channels.

Purchasements in stores

- Transforming the physical shopping experience of offline stores, such as remodeling and enhancing the ease of payment.
- Strengthening the expertise of product categories through the acquisition and collaboration of popular brands.

Providing life friendly services

- Increasing service convenience by linking online to offline stores during the payment/receive/return process.
- Expanding customized services to meet the wide range of personalized customer needs such as product recommendations, repair and styling.

Effects

- **Improves customer relationship and satisfaction which minimizes customer defections and increases the number of visiting customers**

- **Uprise in product sales, including offline and online channels**

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