Multi-Channel Retailing

Operating from physical and virtual store formats helps retailers maximize the value of their brands.

The Internet has transformed a large and growing number of retailers into "multi-channel" retailers. Initially, opening up an online distribution channel was a defensive strategy for many firms: Though skeptical about the potential for consumer acceptance of the new technology, many retailers wanted to hedge their bets in case the Internet turned out to be a significant sales channel. The fact that a transactional web site is very expensive for a retailer to set up and maintain—anywhere from $1 to $20 million per year—did not deter many from taking the plunge.

Although controversy about the size of the online market hasn't changed, the motivation for real estate-based retailers to add an online channel has: It is no longer defensive and is seen as a necessary complement to real estate-based assets. More than 60% of all online revenues in 1998 were captured by store-based retailers that had online sales channels, according to Boston Consulting Group/shop.org.[1] Yet net store growth continues to be faster for retailers with online channels than for retailers without them. While store openings are dominated by these multi-channel retailers, store closings are dominated by store retailers with no online channel. (See Figure 1.)

[1] eMarketer, *The eStats Report: eRetail, Volume II*, September 1999, p. 16.

This confirms that viewing the retail world as a tug of war between distinct sales channels, with stores, Internet and catalogs each competing for their piece of a fixed pie—is an invalid framework. Rather, the various sales channels need to be viewed as separate pillars in the promotional and sales strategy of all retailers.

The following is a brief overview of the incentives for multi-channel retailing. It suggests reasons for the continuing—perhaps strengthening—commitment of multi-channel retailers to real estate. The discussion also leads naturally to the question of whether the "pure-play" online retailers will follow in the footsteps of their catalog predecessors and become multi-channel retailers themselves. Some are already heavily involved in real estate as they build fulfilment facilities to support their online operations. It is not unthinkable that some will find that a physical storefront is as necessary a part of their strategy as a virtual storefront is to the strategy of a land-based retailer.

MULTI-CHANNEL OPPORTUNITIES

Real estate-based retailers, direct marketers and now pure-play Internet retailers all have incentives to operate multiple sales channels. These are summarized in Table 1.

Table 1

MULTI-CHANNEL OPPORTUNITIES

Opportunity	Incentive for:	To add channel:	Comments
Leverage existing brand equity	store retailers store retailers catalogers catalogers *leading* "pure-play" Internet retailers	online catalog stores online stores	Alternative for "pure-play" Internet retailers is steep ramp-up in off-line advertising and marketing expense.
Establish brand equity	second-tier Internet retailers	stores	Alternative is to ramp up marketing expense or be acquired by another retailer.
Leverage advertising/marketing expense	store retailers catalogers	online online	Store-based and catalog retailers can "piggyback" web address and other information onto existing media.
Leverage distribution and supplier networks	store retailers catalogers	online online	Delivery to customer remains a problem for both multi-channel and pure-play Internet retailers.
Access complementary demographic groups of shoppers	All	All	Store retailers access online demographic groups; online retailers obtain access to majority of consumers.
Drive cross-traffic to multiple sales channels	All	All	Shoppers can research products online and complete transactions at stores; store shoppers can purchase in-store or order online from in-store kiosks.
Leverage real estate	store retailers	online	Existing stores can be used for distribution and returns of merchandise purchased online.

Some of the incentives in Table 1 involve established retailers simply leveraging existing assets—brand recognition, distribution networks and marketing budgets—to reach more consumers. Although many of these consumers will not buy from the retailer online, they will have an opportunity to research and evaluate the retailer's product offerings and then possibly make a store visit and a purchase that would not otherwise have occurred.

ONLINE RETAILERS AND BRAND RECOGNITION

To this point there are few examples of online retailers opening store channels. (PC and peripherals retailer Gateway has opened 153 of its "Gateway Country Stores" in 39 states. These are showrooms that carry no inventory. Instead, they allow customers to test products and order while in the store.) The problem for many "pure-play" Internet retailers is that they lack brand recognition, which has led to skepticism about their survivability when they have to go head to head with established bricks-and-mortar brands coming on to the Internet. Ernst & Young reports that 82% of households with PCs consider brand recognition to be an important or very important factor in any decision to make an online purchase.[2] Yet in most categories of goods and services, a majority of consumers are unable to name a single Internet site that sells those items.[3]

Consumers find web sites mostly by word of mouth, web search mechanisms (engines and links) and traditional advertising. Store-based retailers have an advantage over pure-play Internet retailers in this respect, since they are able to cheaply leverage existing store-based marketing expenses, such as adding a web address to the bottom of a newspaper advertisement or to the store shopping bag.

Pure Internet retailers have to market to non-Internet shoppers from the ground up, since these shoppers can not be reached online. This makes it difficult and expensive to establish brand recognition—the options are a real estate-based sales or showroom channel, or merging with a larger retailer. Many will choose the latter of these options, resulting in increased concentration within merchandise segments.

STORE-BASED RETAILERS

In the case of conventional retailers, Table 1 shows that opening an online channel offers significant potential benefits, not the least of which is to drive traffic from Web site to store, and vice versa, thus possibly expanding sales in both channels. The Internet has become an important—perhaps an unparalleled—means for consumers to research products and prices. Market research firm Cyber Dialogue estimated that while 1998 online retail sales—i.e., sales ordered *and* paid for online—were $11 billion, sales ordered online and paid for offline amounted to $15 billion, and sales researched on the Internet but ordered and paid for offline were about $51 billion. Put another way, the ratio of Internet-researched purchases to Internet purchases was 5:1.[4]

The potential benefit from cross-marketing sales channels is an important reason why store-based retailers have such a strong commitment to real estate: Store expansion by retailers with an online channel is occurring at a higher rate than expansion by retailers without an online channel, although of course this is partly—though not wholly—due to the increasing number of retailers with transactional Web sites. (Figure 1). Another reason is that some store retailers, as noted above, may be able to leverage the real estate by using it for distribution and returns of online merchandise.

CATALOG RETAILERS

Most major catalog retailers are now online, raising the question of how much of current online sales are internal company transfers from one channel (catalogs) to another (Internet). Company data separating catalog and online sales are difficult to obtain, but there is enough information to suggest that the volume of transferred sales is significant. For example, Multiple Zones International—one of the top half–dozen business-to-

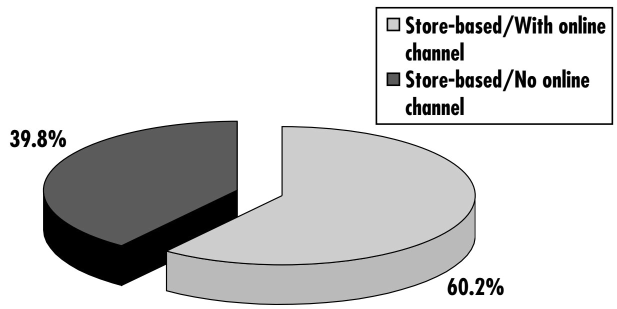
[2] Ernst & Young, *The Second Annual Ernst & Young Internet Shopping Study: The Digital Channel Continues to Gather Steam*, 1999, p. 11.

[3] eMarketer, p. 90.

[4] U.S. Department of Commerce, *The Emerging Digital Economy II*, June 1999, p. 6.

Figure 1a

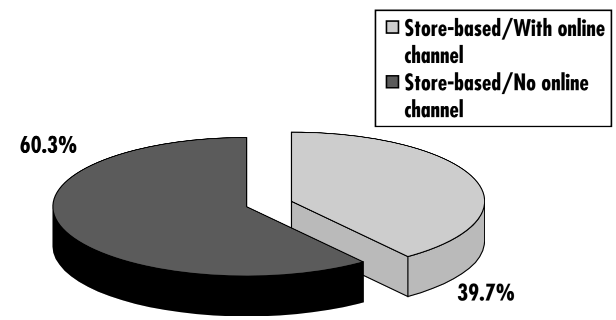
PERCENT OF ESTIMATED 1999 STORE OPENINGS ATTRIBUTABLE TO RETAILERS WITH AND WITHOUT AN ONLINE SALES CHANNEL



Source: Byrne Associates, MAX-SI Spatial Index, Store Cycle of Retailers and Developers, July 1999, p. 10.

Figure 1b

PERCENT OF ESTIMATED 1999 STORE CLOSINGS ATTRIBUTABLE TO RETAILERS WITH AND WITHOUT AN ONLINE SALES CHANNEL



Source: Byrne Associates, MAX-SI Spatial Index, Store Cycle of Retailers and Developers, July 1999, p. 10.

consumer computer catalog retailers—reportedly owes as much as 60% of its Internet orders to its own migrated catalog customers.[5] Another example is in the apparel segment, where, according to one estimate, about two-thirds of 1998 online sales originated from the following six companies: Victoria's Secret, Lands' End, Gap, J. Crew, Eddie Bauer and L.L. Bean. Of these six, five have powerful catalog operations.[6]

Most catalog companies were multi-channel retailers long before the Internet: they had other kinds of direct marketing operations and also stores. Of the top 100 catalog companies ranked by 1998 catalog sales, published by the trade publication *Catalog Age*, ICSC has identified 57 that are either exclusively or primarily business to consumer. The list is shown in Table 2.

Collectively, these 57 retailers have about 18,000 stores, with a median store count of 12.5. Many of these are catalog outlet stores that provide a channel for disposal of discontinued products, while some are full-price retail stores. Some started out primarily as catalog retailers and subsequently opened stores that are very competitive vis-a-vis their land-based rivals (e.g., Lands' End, J. Crew). Others did the reverse, starting out exclusively store-based and later supplementing these stores with catalogs (e.g., JCPenney and, more recently, Federated Department Stores).

JCPenney, at the very top of Table 2, started its catalog in 1963 and has used it to offer merchandise that expands upon—as opposed to replicating—what is available in its stores. In contrast, the recently launched *Macy's by Mail* catalog from Federated Department Stores offers a subset of what is available in the Macy's stores, targeting consumers who don't normally have access to any of those stores. Although there are divergent motivations for opening additional sales channels—store-based retailers' mailing catalogs, catalogers opening stores—the common element is extending brand awareness to tap additional markets.

This is one of the issues confronting pure-play Internet retailers: how to reach the majority of U.S. consumers who don't shop online. Unless these retailers build stores and/or invest heavily in marketing efforts (in which case they will be depending on the capital markets for funding) they will most likely be acquired by larger, more established retailers.

The key point from the foregoing discussion is that retailers need to have a stake in multiple sales channels in order to be able to maximize the value of their brands. This means that store-based, catalog and pure-play Internet retailers will (at least in the aggregate) increase their commitment to complementary channels in order to boost total company sales, rather than concentrate resources in a single channel.

[5] www.hoovers.com, accessed 9/17/99.

[6] Goldman Sachs Investment Research, *Internet Retailing*, June 1999, p. 47.

Table 2

TOP CATALOG/MAIL ORDER COMPANIES 1998

Name	Address	catalog sales ($millions)	Stores*	Merchandise
J.C. Penney Co.	www.jcpenney.net	3,929	1,148	Gen. Merch.
Office Depot	www.officedepot.com	2,699	813	Office Supplies
Fingerhut	www.fingerhut.com	1,609	0	Gen. Merch.
Spiegel	www.spiegel.com	1,394	20	Gen. Merch.
Lands' End	www.landsend.com	1,371	17	Apparel/home
Brylane	n/a	1,328	0	Apparel/home
LL Bean	www.llbean.com	1,030	22	Apparel/home
Staples	www.staples.com	825	966	Office Supplies
Intimate Brands	www.intimatebrands.com	759	1,950	Apparel/Bath&Body
PC Connection	www.pcconnection.com	732	0	Computers
Creative Computers	www.cc-inc.com	690	0	Computers
CompUSA	www.compusa.com	646	200	Computers
Hanover Direct	www.Hanoverdirect.com	546	0	Gen. Merch.
Blair Corp.	www.blair.com	507	4	Apparel/Home Goods
Multiple Zones International	www.zones.com	501	0	Computer
Cabela's	www.cabelas.com	500	5	Outdoor Sporting Goods
Oriental Trading Co.	n/a	486	0	Games, novelties.
Damark International	www1.damark.com	484	0	Gen. Merch.
Foster & Gallagher	www.gardensolutions.com	480	0	Gardening, gifts, food, children's products
Williams-Sonoma	www.williams-sonomainc.com	384	298	Home & Garden
J. Crew Group	www.jcrew.com	347	180	Apparel
Coldwater Creek	www.coldwater-creek.com	325	6	Apparel, gifts, home goods
Cornerstone Brands	n/a	320	0	Home Goods & Apparel
Northern Tool & Equipment	www.northern-online.com	313	34	Tools
Bass Pro Shops	www.basspro.com	300	6	Outdoor Sporting Goods
Neiman Marcus Group	www.neimanmarcus.com	285	33	Apparel & Home Décor
Bear Creek	www.bco.com	275	80	Food, gardening, apparel, gifts
Lillian Vernon Corp.	www.lillianvernon.com	264	15	Gifts, toys, home goods
PetSmart	www.petsmart.com	250	553	Pet supplies
Sara Lee Corp.	www.saralee.com	250	204	Hosiery, luggage, food.
Swiss Colony	www.swisscolony.com	250	1	Food and Gifts
Federated Dept. Stores	www.federated-fds.com	226	401	Apparel/Home goods
Genesis Direct	www.proteam.com	252	0	Sporting Goods
Home Depot	www.homedepot.com	225	800	Home Improvement
Omaha Steaks	www.omahasteaks.com	225	54	Food
DM Management Co.	www.dmmanagement.com	219	4	Women's Apparel
American Blind & Wallpaper Factory	www.abwf.com	216	0	Home Décor
Norm Thompson	www.nortom.com	216	2	Gen. Merch.
Walt Disney Co.	www.disney.com	210	681	Gifts & Children's Products
Ross-Simons	www.ross-simons.com	205	10	Jewelry, Tabletop, Gifts.
Dayton-Hudson	www.dhc.com	205	1,200	Gen. Merch.
Nordstrom	www.nordstrom.com	205	90	Apparel
Adolph Kiefer & Assoc.	www.kiefer.com	197	0	Swimwear
Stonington Partners	n/a	175	0	Motor Cycle parts.
Venator Group	www.venatorgroup.com	170	6,000	Athletic Shoes
Talbots	www.talbots.com	169	650	Apparel
Delia*s	www.delias.com	158	39	Teen Apparel
Golfsmith International	www.golfsmith.com	151	25	Golf Equipment
Saks	www.saksincorporated.com	149	350	Apparel & Home Décor
Sportsman's Guide	www.sportsmansguide.com	143	0	Outdoor Sporting Goods & Apparel
Knights Ltd.	www.knightsltd.com	131	4	Women's Apparel/Home Décor
Miles Kimball	www.mileskimball.com	127	1	Gifts/Home décor
Marriet Carter Gifts	n/a	125	0	Gifts and novelties
Adam & Eve	n/a	120	0	Adult Entertainment
NBTY	www.nbty.com	120	630	Vitamins
Crutchfield Corp	www.crutchfield.com	120	0	Consumer electronics.
Tiffany & Co.	www.tiffany.com	116	130	Jewelry & Gifts

*In some cases the store count is approximate.
Source: *Catalog Age* for name and catalog sales and ICSC for store count and Web addresses.

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