Retailing in New Zealand.

What do retailers have to get right to be successful?

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Contents.

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Retailing in New Zealand – crossing the digital Rubicon.

The retail environment is changing rapidly. Not only do retailers have to contend with the demands of increasingly empowered customers, but they also face competition from an array of new entrants. At the same time, digital technologies are disrupting the sector, enabling retailers to better monitor and exploit changes in customer behaviour while fundamentally changing how they interact and retail products to them. To compete, retailers have to offer a compelling value proposition that is responsive to changing market dynamics.

Summary.

- The traditional retail model is changing with digital technologies disrupting retail supply chains, transforming operational processes, and revolutionising how products are marketed and sold.

- At the same time, digital technologies are empowering consumers, lowering barriers to entry, and spurring on industry rivalry within and across the retail sector.

- These trends are also evident in New Zealand, although somewhat lagging and on a much smaller scale than those in other developed markets.

- For retailers that ignore these changes, it may be business as usual for a while, but over time they are likely to lose ground to competitors that have transformed.

- Understanding customer behaviour has always been important for retailers, but that is becoming more so as the sophistication of analytical tools grows. Resulting insights from expanding data sets are being used to drive organisational change and competitive positioning.

- In a digital world where device and channel use is expanding, retailers will need to be everywhere where their customers are. With the possible exception of the corner dairy and sole trading specialist retailers, that's likely to mean a shift from single to multi- and eventually omni-channel retailing.

- Retailers also need to be able to sell the shopping experience. For some retail market segments such as clothing, furniture and electronics, that means repurposing bricks-and-mortar stores away from product distribution to "showrooming", where consumers can test products in-store before purchasing online.

- In an environment where industry rivalry is rising, improving responsiveness to customer demands will be crucial. That means a much sharper focus on how work is organised as well as on maximising operating efficiencies, including the ability to track and trace products as they move along the value chain.

- It also means a shift away from linear supply chains to more flexible supply networks, prompting a move from "off the shelf" to "on demand" product availability. To that extent, some retailers are likely to move downstream, promoting brands, taking orders, and leveraging off supply partners to deliver "on-demand" to customers.

The changing face of retailing.

The traditional role of retailers has been to purchase goods from wholesalers or manufacturers in bulk, and then sell them to end consumers, usually in smaller quantities. Together with wholesalers they form the interface between the goods-producing sectors of the economy and consumers.

Until about 10 years ago, this model had remained largely unchanged, with the most successful retailers being those that were best at sourcing desired products, shipping them and then selling them through bricks-and-mortar stores.

However, with new digital technologies coming to the fore, that model is changing, resulting in disruptions to supply chains, work organisation methods, operating processes, as well as distribution, marketing, and sales activities.

These changes are evident in New Zealand, although they typically lag those in much bigger markets, such as China, US, Europe, and the UK, and are on a much smaller scale. That reflects differences in relative market size, as well as the size and scale of retailers that exist in these countries.

In a digitally disrupted retail environment, each link of the value chain is being challenged.

Size and shape of retail in New Zealand.

New Zealand's retail sector is a big deal. In 2020, it generated turnover of about $100bn and contributed 7.8% to this country's GDP.

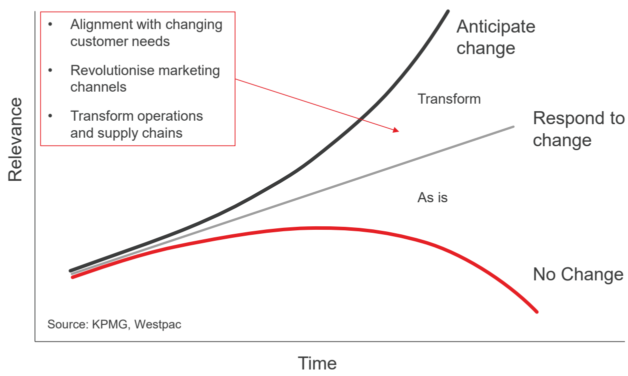
The sector is home to about 27,000 firms, employing about 220,000 staff. About 95% of these are single location outfits that employ less than 20 staff. Roughly, 14,000 of these are sole traders. At the other end of the spectrum are the 600 or so multi-location retailers that employ about 140,000 staff.

About three-quarters of all retailers in New Zealand generated an annual turnover of less than $1m in 2020, while about 94% earned less than $5m. Fewer than 100 retailers exceeded $100m in turnover and only the top 20 managed to generate more than $200m in revenues.

Critical success factors.

To prosper in this environment, retailers cannot stand still. Those that embrace the changes brought about by digital technologies are likely to be increasingly relevant to their customers and will prosper as a result. For those that ignore these changes, it may be business as usual for a while, especially for smaller specialist operators, but over time they are likely to lose ground as consumers increasingly seek out retailers that are able to leverage off digital technologies to deliver operational excellence and a superior customer experience.

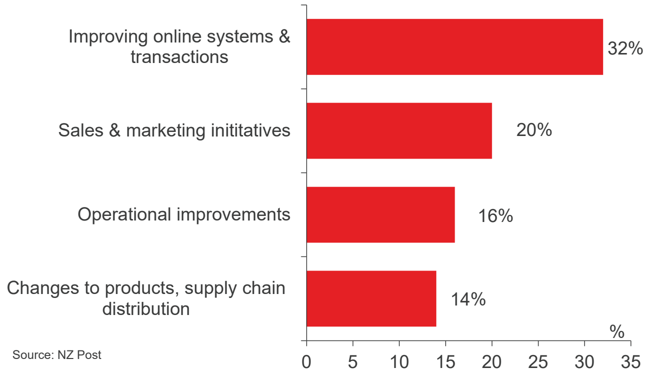
Figure 1: Strategic options for retailers



Retailers in New Zealand are already making changes in this regard, although it's not clear how transformative they are. According to a 2020 survey undertaken by NZ Post, about a third of retailers had focused on improving their existing online market channels, while a fifth had made changes to how they market and sold products to customers. Other key areas of focus include operational and supply chain improvements.

Against this backdrop, we think there are four things that retailers in New Zealand must get right to prosper in the future.

Figure 2: Major changes implemented by retailers in New Zealand during 2020



1. Understand the customer.

Understanding customer behaviour has become increasingly important as data availability has grown and the tools to analyse it have become ever more sophisticated.

Indeed, resulting customer insights are key to informing strategic, tactical, and operational decision making at all levels of the firm, covering activities such as marketing (from branding to channel strategy), sales, pricing, operations and supply chain management. Put simply, they help to drive the organisational change that ensures retailers are able to deliver the products and experiences that the customer wants.

Developing insights requires two things.

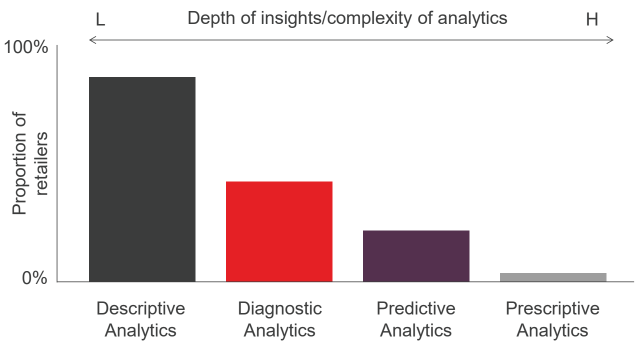
Firstly, the ability to access data. In this regard the news is good, with advances in technology resulting in more customer touch points, and by extension, more data to exploit. That includes data from in-store and online transactions, loyalty cards, customer surveys, online reviews, and email traffic. Newer sources of data might include social media chatter and that derived from query answering chat-bots powered by artificial intelligence. Not only that but the speed of access to data has also increased, with technologies such as the Internet of Things (IoT) delivering data and information on a real-time basis.

Add to that big data, which refers to the large and expanding volume of unstructured and structured data that can be mined to reveal patterns, trends, and associations relating to human behaviour and interactions.

Data provides the basis for retailers to better understand customer needs and for delivering products that align to those preferences.

The ability to access data is likely to expand further once mooted changes to customer data rights come into play. The New Zealand Government is set to introduce enabling legislation in 2022 which will allow customers to access data that firms hold on them, giving them the ability to share it with other firms, including competitors that offer a better deal. Set to be rolled out on a sector-by-sector basis, this will eventually affect the ability of retailers to use data to gain a competitive edge.

Figure 3: Take up of data analytics in New Zealand



Source: ScienceSoft, Westpac

Secondly, developing insights requires the ability to process data. And on this front, not only is the sophistication of analytical tools increasing, so too is the speed with which they are able to deliver actionable insights.

Indeed, retailers are now moving beyond simple descriptive analytics that crunch raw transaction volume data to explain the "what" of past and present performance. They are investing heavily in advanced analytics that rely on sophisticated algorithms, complex mathematics, statistics, intelligent automation, and artificial intelligence to not only explain the "what" and "why" of past and present performance, but also what will happen next.

Adoption of analytical tools in New Zealand.

Recent research from dotdigital found that retailers in the Asia-Pacific region, comprising Singapore, Australia and New Zealand, do not maximise their use of data.

Most retailers in New Zealand will use the most rudimentary form of descriptive analytics, largely based on Excel spreadsheets. That reflects a preponderance of smaller retailers and the competitive dynamics at play in particular niches.

By contrast larger retailers in New Zealand are much more likely to move beyond descriptive/diagnostic analytics, opting instead for sophisticated tools that allow them to predict demand patterns. Often regarded as a non-core competency, it is not unusual for data analytics to be outsourced to specialised consultancies.

While primarily the domain of larger global retail firms, a few are looking to go even further, investing heavily in advanced prescriptive analytics that detail what steps need to be taken to maximise benefits and minimise risk within the context of what is likely to happen next. Areas of focus include how to improve the customer's shopping experience, maximise operating and supply chain efficiencies, deliver personalised messaging and product recommendations, as well as introduce dynamic pricing.

Customer insights are a building block for gaining a competitive edge.

2. Be where the customer is.

Expand marketing channels.

Retailers need to ensure that they can deliver a shopping experience wherever and whenever the customer wants to engage. With customers using all manner of devices and different ways to interact, that means marketing products across a range of different channels.

And to some extent that is already happening. Indeed, except for the corner dairy, most retailers in New Zealand that have a physical store now are likely to have some form of online presence. That's especially so given the current Covid-19 pandemic, with accompanying lockdowns resulting in an acceleration in online shopping activity. Retailers without an online presence were sent scrambling to create one.

Expansion of marketing channels.

There are just over 10,000 firms that provide online shopping in New Zealand. In 2020, they generated sales of about $4.1bn, with a further $1.7bn coming from offshore retailers with an online presence.

There were 2.1m New Zealand online shoppers in 2020, 9% higher than in 2019, mainly because of the impact of Covid-19. That equates to an average spend of $2,500 in 2020, almost 16% higher than in 2019.

That makes New Zealand the 39th largest market for e-commerce in the world, placing it ahead of Malaysia, but just behind Portugal. However, that's small fry when compared to China, where online shopping is worth almost US$2trn a year, accounting for just over 50% of fall retail activity globally. By comparison, the US, which is the world's second largest online market, generated sales of just over $500bn in 2020.

Conversely, many online retailers, having previously benefitted from low costs of entry, have been able to add a physical presence to their web-based capabilities. That in turn has helped to blur the lines of distinction between traditional bricks-and-mortar retailers and their online counterparts.

Many of these retailers are also selling products through online marketplaces that attract huge customer traffic volumes. Marketplaces are not retailers per se, although rather confusingly several firms that run them have established their own retail capability. Instead, marketplaces provide retailers, many of whom might be new to internet shopping, with a low cost way of establishing an online presence, as well as the ability to test the market for products and services. Importantly, they also enable non-retailers to sell product in direct competition with retailers.

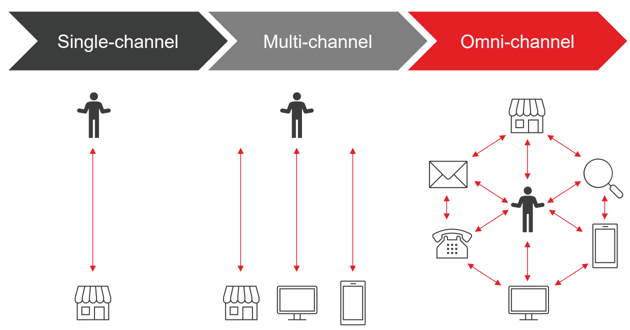
This type of platform business model already dominates many consumer-focused industries and will continue to so in the future. Indeed, marketplaces such as Amazon, eBay, and Alibaba rank among the world's largest firms. Although significantly smaller, domestic marketplaces such as TradeMe, Mighty Ape and The Market continue to see strong growth in online spend.

In addition, retailers are also tapping into social media. Indeed, by leveraging off the advertising muscle and reach of social media sites like Facebook and Youtube, bricks-and-mortar and online retailers are now able to push their products in front of millions of potential consumers rather than just having to rely on the pull of their storefronts or website offerings.

Integrate marketing channels.

Retailers are not just expanding into new channels, they are also looking to integrate them so that they can provide a convenient and seamless shopping experience to customers who interact with them across these different channels as they progress along their purchasing journey.

Figure 4: Shift to omni-channel strategy



Source: The Association of National Advertisers (US), Westpac

For example, a customer might see an advertisement for a product on social media, undertake research on that product on the internet, purchase it through a retailer's proprietary website, before returning it to a nearby physical bricks-and-mortar store because it's the wrong size.

Referred to as omni-channel retail, this approach is based on the idea that "fusing" together multiple customer touchpoints adds value that exceeds the sum of its parts. That in turn provides a point of differentiation and a potential competitive edge.

Adoption of omni-channel retail in New Zealand.

The adoption of integrated channel retailing is lagging in New Zealand. Indeed, recent research by dotdigital showed that only 14% of retailers in the APAC region, which includes New Zealand, used omni-channel marketing tactics compared to 18% globally.

This relatively low percentage reflects the large number of smaller, less well-resourced retailers that operate in New Zealand.

That said, there are several retailers in New Zealand that have omni-channel capabilities. That includes Mitre 10, The Warehouse, Country Road, Briscoes Group, Rodd & Gunn, Hallenstein Glasson, The Body Shop, and Smack Bang, a pets accessory retailer that allows its customers to generate loyalty points across different retail channels.

But not all retailers are embarking on this customer centric strategy. That's because delivering a true omni-channel retail experience requires significant investment, not only in data analytics to make sense of customer data, but also online capabilities and supporting technical infrastructure, which continues to evolve in line with digital technologies.

Savvy retailers understand that online and bricks-and-mortar are complementary channels.

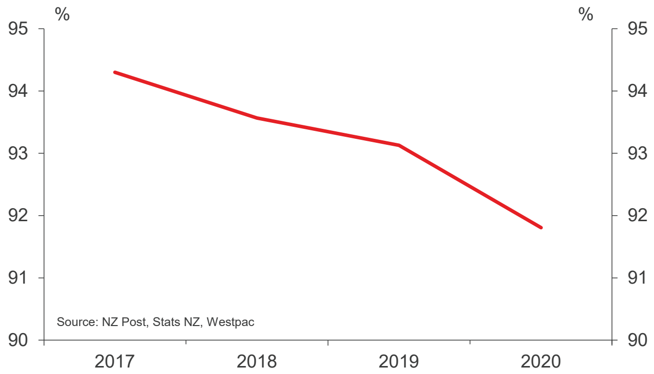
3. Deliver a superior customer experience.

Retailers need to deliver a better shopping experience than their competitors. Moving from single to multi- and more sophisticated omni-channels that deliver a seamless customer experience is clearly part of that.

But delivering a better shopping experience is also about what happens in-store.

And that's important because about 90% of retail activity in New Zealand still takes place on a face-to-face basis. That's in line with the global average of 88%, but significantly higher than in other developed markets such as the US (79%) and the UK (77%). In China, the world's largest market for e-commerce, in-store purchases still account for about 75% of retail turnover.

Figure 5: In-store spend as a proportion of total retail sales (excl. fuel & hospitality)



The dominance of bricks-and-mortar speaks to the characteristics of New Zealand's small and fragmented retail market. But it also reflects old habits. Indeed, many customers still enjoy the physical experience of trying things on and/or handing goods before they buy them. While more convenient, that's not something that online retail can compete with. Then of course there is the satisfaction of taking them home immediately and not having to wait for delivery.

A disadvantage of online shopping.

An inability to physically eye merchandise "in the flesh" may help explain why online retailers face such high product return rates. Estimates for New Zealand are hard to come by, but in the US, return rates on online shopping hover around 25% to 30% of purchases made, compared to 5% to 10% for in-store purchases.

Historically, traditional bricks-and-mortar retailers have competed on several fronts. That includes store location, the extent to which store formats are aesthetically pleasing and easy to navigate, the offering of products that reflect current trends, branding, approachable and interactive sales personnel, service quality levels, and loyalty cards.

For many retailers in New Zealand that remains the case, even as the role of the physical store within some market segments is beginning to shift away from product distribution to "showrooming", where consumers can test products in-store before purchasing online. Research undertaken by Accenture in 2020 indicated that over 60% of the world's leading consumer brands are investing in technologies that create these immersive customer experiences.

Globally that includes technologies like artificial intelligence, IoT and augmented/virtual reality (AR/VR), which are being used to deliver services such as IKEA Place, Amazon's AR View and Alibaba's Buy+. Fashion retailers such as Adidas and Asos are already using AR to allow their customers to virtually try on products and visualise how they will look in different settings. An earlier survey by Gartner in 2018 found that by 2020, 46% of retailers surveyed in Europe (including the UK), the US, Canada and China planned to deploy AR or VR to meet customer service experience requirements.

Experience-focused physical stores are rare in New Zealand. That though is likely to change as New Zealanders begin to push for a better retail experience. And indeed, there are already some exceptions. Spark's store at Commercial Bay in Auckland, for example, recently launched a new range of immersive, interactive customer experiences, effectively creating a community space for potential customers to try out and enjoy new products and services along the lines seen in major US, UK and European cities. More specifically, it has been partnering with international brands like Microsoft and Samsung to showcase their products in the flesh.

Online shopping meanwhile is going through a corresponding evolution, albeit in the opposite direction. Indeed, online websites, marketplaces and social media sites, typically able to display more products and better at providing up-to-date product and price information, are becoming less of a media channel and more a place where customers transact with retailers.

4. Improve responsiveness to customer's needs.

Maximise operational efficiencies.

Delivering a customer experience also depends on how quickly retailers are able to respond to customer demands. That means using digital technologies to minimise the time taken to fulfil orders through improvements to inventory management processes and enhancements to the ability to track products along the value chain. For retailers, a transparent supply chain with proof of product originality and traceability at its core helps reduce counterfeiting and fraudulent activity. For consumers, proof of source of origin is essential for gaining trust. That's critical in an environment where customers can post real-time comments about their retail experiences on social media.

That includes using robotics, IoT, and blockchain to automate and improve the efficiency of inventory management tasks. Notable examples include Amazon and more recently Walmart. Robots are also being used to audit stores, for example, by checking products for missing price tags and wrong price listings, as well as finding misplaced products and identifying damaged goods. In New Zealand, Mitre 10 recently announced that it is investing heavily in technology to simplify how work is organised.

These technologies are also being used to track products from the moment of production to when they leave the warehouse and arrive at the customer's doorstep. In some cases, such as food retailing, this extends further to tracking and tracing along the entire supply chain. Examples includes Starbucks, Walmart and Carrefour. The same can be said for New Zealand's biggest food retailers.

Other technologies such as 3D printing are revolutionising manufacturing, resulting in an acceleration in product development, and the increased cannibalisation of existing products. At the same time, additive manufacturing is allowing customers to play a much more active role in product manufacturing, potentially threatening the gateway role of retailers.

Maximise supply chain efficiencies.

Retailers are increasingly revamping obsolete supply chains designed for a single-channel world.

In a world where customers are interacting across a broadening range of channels as well as physical and online touch points, retailers are using data analytics to move from traditional linear forecast-led supply chains to predictive demand-driven supply chains that rely more on responsive and agile collaborative supplier networks. These retailers and suppliers operate within retail ecosystems or interconnected communities that work together to satisfy customer needs.

Technology, of course, is the key driver of change, with data captured at each point in the supply chain increasingly being shared with suppliers operating within these ecosystems, who can then source and supply the right products to customers at the right time and at their chosen point of distribution.

To meet customer expectations, insights from buying behaviour must seamlessly feed back into the supply chain, and vice versa.

These are big changes, which will have significant implications for retailing. Previously, retailers were required to provide "on-the-shelf" availability, which meant they had to hold stock for the products they were selling. But that is changing. As retailers begin to shift towards an "on-demand" availability model, that responsibility is increasingly falling on their supplier partners, who either supply to retailers who then deliver to customers, or directly to customers on the retailers' behalf.

For retailers that operate in collaborative ecosystems, this implies a fundamental change in role. The focus is shifting, and the emphasis on understanding and managing customer relationships, marketing and brand management is growing. Retailers are also focusing more on managing complex supply chain interactions, using digital technologies to track products as they move along the value chain. In essence, retailers are starting to move downstream. They are becoming marketeers, who promote brands, take orders, and leverage off their supply partners to deliver "on-demand" to customers. They manage the retail process, and as such compete on intellectual capital rather than retailing per se.

However, this move downstream also means less need to invest in warehousing and lower working capital costs associated with stock handling.

In turn, these dynamics are lowering barriers to entry into retail. But those that take advantage are not retailers in the traditional sense of the word. Instead, much like retailers who focus on "on demand" delivery, they are more about influencing buyer behaviour rather than stock management. They pose a direct threat to the incumbents, and that includes retailers who still operate on an "on-shelf" delivery model.

And the threats don't stop there. Indeed, these structural changes also create the potential for the disintermediation of retail. That includes upstream manufacturers or suppliers that have developed competencies in this new retail space, and are able to market their wares to customers in direct competition with retailers. They are different to other new entrants in one key respect – they are suppliers who have effectively forward integrated.

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