The New Retail Economy

Retailing at the Dawn of a New Millennium

PricewaterhouseCoopers LLP

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The New Retail Economy: Retailing at the Dawn of a New Millennium

In 1997, *Wired Magazine*, the bible of the new age digerati, published a cover story on the Long Boom. Complete with a smiling happy face and a forecast of 25 years of sustained and unprecedented global economic growth, the article set off a flurry of debate as to the dimensions, causes and very existence of the New Economy.

The basic premise of the New Economy was that the combination of globalization, market deregulation, and proliferating information technology had created a new, high growth, high productivity economy. The New Economy could grow faster than the old economy without worries of inflation or recession. The New Economy explained the high valuations on Wall Street, the continued strength of the economy, and the persistent lack of price inflation.

What the happy face of the New Economy fails to incorporate is the whole new set of challenges that retailers and their suppliers must face in this changed environment. It is this set of issues that we want to address in this special report on "The New Retail Economy."

Six Dimensions of The New Retail Economy

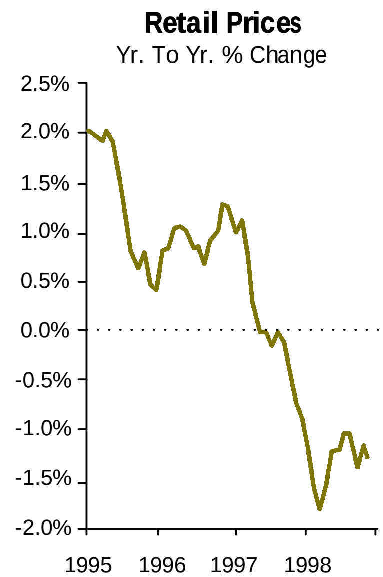
For retailers and suppliers alike, The New Retail Economy creates a dramatically different set of planning dimensions that make the skills, ideas, and success criteria of The New Retail Economy markedly different from those of the old retail economy. The internet will act as a starter crystal for the transition to The New Retail Economy. A starter crystal is often used in chemistry to get two different compounds to combine. The crystal acts as a catalyst and as a pattern for the rest of the chemicals to follow. So too the internet will pattern the successful behaviors of all businesses.

The rules that work in the internet will become the rules that work for all businesses as they organize around and outside the internet. This may very well mean that brick and mortar retailers have more to gain going forward from the internet than their newly created cyberspace counterparts. Understanding the differences and mastering the new skills they demand will be the key to retailing and consumer goods distribution success in the next millennium.

The Persistence of Deflation

From apparel to consumer electronics, gasoline to many food products, deflation is the order of the day. Cross competition, the internet, depreciating Asian currencies, and the over-investment in capacity have created a general oversupply of just about everything. That, in turn, is producing a deflationary retail environment that will persist.

Depending on their product mix, deflation is a benefit for some retailers. Where consumers are very price sensitive, as is the case in jewelry, consumer electronics, and many sporting goods categories, falling prices actually increase the size of the market. However, for



Source: U.S. Bureau of Labor Statistics

The Old Retail Economy and The New

Criteria	Old Economy	New Economy
Organization	Hierarchical	Networked
Systems Mindset	Closed	Open
Industry Structure	Consolidated	Demassified
Marketing	Mass	Interactive
Assets	Tangible	Intangible
	- Inventory	- Information
	- Real Estate	- Relationships
Capital	Financial	Knowledge
Pricing	Inflation	Deflation
Economic Model	Productivity Loop	Value Chain Management
Management	Control	Collaboration
Merchandising	Buy It Right	Customer Directed
Real Estate	Development	Redevelopment

many products, like apparel and food, falling prices do not expand the size of the market. In these cases, deflation simply produces reduced revenues.

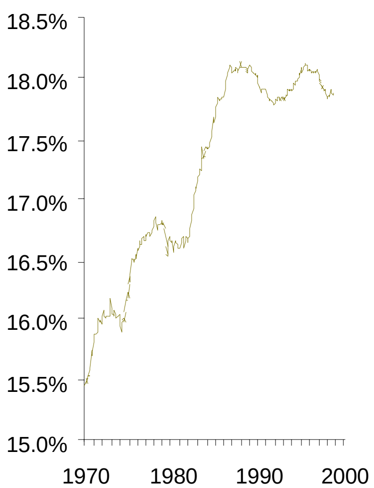
Deflation changes the economic model for retailers and their suppliers. Deflation reduces the value of inventory and real estate while increasing the burden of debt. Deflation rewards cash and makes productivity improvement the only path to profitability.

Human Capital Grows Scarce; Financial Capital Grows Abundant

The number one resource problem facing retailers and suppliers will be the scarcity of workers at all levels. Retailers in the future will be only as good as the workers they are able to recruit, train, and retain today. Retailers not only have to compete against other retailers for workers, they have to compete against other industries as well. In the past decade, retailers have fallen behind the rest of the economy in terms of employment growth. Unless the industry can reposition itself with workers as a quality work environment that provides opportunities for professional growth and enrichment, retailing will fall even further behind in attracting good workers.

Retail Employment

As a Share of Total Employment



Source: U.S. Department of Commerce

While human capital will grow scarce, financial capital will grow more abundant. Price deflation and expanding government budget surpluses will create an abundance of capital, keeping interest rates down. Good ideas will find themselves besieged with financing. Access to capital is no longer a competitive advantage.

Information Becomes Ubiquitous and Complex

Information is now the most important asset that retailers have on or off their balance sheets. It is also the most valuable product that retailers have to sell. When consumers pay a premium for a brand, they are essentially paying for information. Information goods are essentially experience goods that have high fixed and low variable costs. They are more difficult to market because the buyer needs to be assured of what he or she is buying.

The dissemination of information goods creates the need for networks. Networks have a powerful effect on the demand for information goods. When they work, they create increasing returns to scale, turning information goods into fashion goods that are either insanely great or just insane.

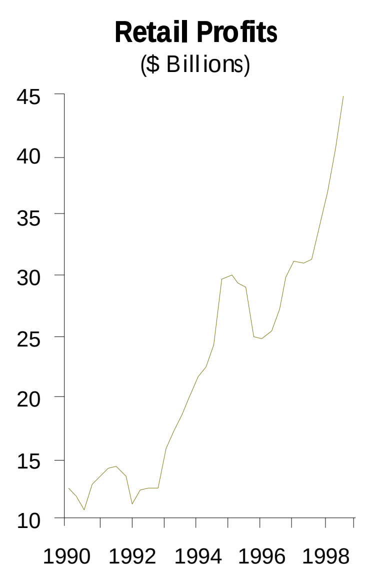
At the same time, information overload is the most serious problem that retailers and suppliers will have to address. Getting the right information to the right place in the organization at the right time to be able to make the right decision is the business challenge posed by technological change. The search for the right information solution will force all businesses into an ongoing process of restructuring and reorganization. We are all information businesses now.

The New Retail Economy exists in an environment that is dramatically more complex than the old. While the bandwidth of information coming into businesses has increased exponentially, the bandwidth of humans to assimilate that information is unchanged. Businesses that rely on technology, operate with no down time, and are global in their reach are exponentially more complex than businesses that don't do any of these things.

Complexity creates unexpected change. Where change in the past has been predictable, controllable, linear, and understandable, change is increasingly becoming unpredictable, uncontrollable, nonlinear, and incomprehensible. Complexity changes how retail organizations have to be monitored, managed, measured, merchandised, and merged.

The Appearance of New Competitors

Competition once was confined to other retailers or other suppliers offering similar goods, in a similar format, operating under a similar economic model. Competition evolved slowly over time to be competition between alternative value chains. That is no longer the case. Competitors seemingly are coming out of the woodwork. In the food area, drug stores are looking more like convenience stores. Grocery stores want to be restaurants. Numerous food offerings are appearing on the internet. Global players are getting into the game. Discount department stores are moving into grocery store categories while specialty food stores are springing up like mushrooms after an afternoon rain. What is occurring in grocery retailing will happen everywhere in retailing.



Source: U.S. Department of Commerce

The convergence of retail competition will intensify competitive pressures and renew downward pressure on prices and margins. Convergence will reinforce the consumer perception that there is an oversupply of everything. The result will be deflation of both prices and retail profitability.

At the same time, retailers are not just competing with other retailers or suppliers who are selling similar goods. They are also competing with other businesses for the attention of the consumer. Ecosystem competition, based on lifestyle, is key. Competition will be between ecosystem demand chains. No single company will dominate either a lifestyle or an ecosystem. Cooperation becomes as important as competition. Everyone competes with everything.

The Growing Importance of Place

Location, location, location has always been the watchword of the successful retailer. For the last 50 years, having the right location meant building in the suburbs. The differences between places did not matter all that much as most of these suburban places looked the same. Demographics suggest a more footloose population. Many empty nester Baby Boomers and their Echo Boom children will leave the suburbs for the city. Both generations will be freer to travel. Technology is enabling a Bedouin lifestyle.

Workers no longer have to travel to work if work can be moved digitally to the worker. The boundary between workplace and home is blurring. Commuting is often a short walk from the kitchen to the study. If workers can now choose their place of work, place will matter now more than ever. The combination of demographics, economics, and technology is shifting the venue of winning locations from the suburbs to the inner city and to smaller, high quality-of-life towns.

Suburban sprawl is becoming an important political issue. Local efforts are being made to stop or alter the character of retail development through stricter zoning laws and the purchase of open space. Neighborhood stores are growing in popularity as the desire for a pedestrian-based lifestyle grows at the expense of an auto-based world. Add the effects of the internet, and real estate strategies will undergo more change in the next few years than they have at any time in the last 50 years.

A Consumer Centric World

Retailers and suppliers alike are well practiced in muttering the mantras of consumer importance. And yet, their marketing, merchandising, advertising, and logistical practices all belie their chants of homage to the consumer. Today, the value chain is still a product-focused set of logistical relationships aimed at moving goods from the raw material state into the waiting hands of the consumer. The consumer only gets an opportunity at the very last step of the process to give a thumbs up or down to the workings of the supply chain.

The New Retail Economy will turn this product-focused logistical process on its head. The value chain of the future will be consumer-centric and consumer-driven, with marketing, merchandising, and logistics all directed by the knowledge of the consumer.

The New Retail Consumer

The New Retail Economy is, at its core, a consumer-driven economy. Any retailer or supplier that takes its eye off the changing nature of the consumer will be punished quickly and with impunity. With an oversupply of everything, capturing the attention of consumers and then holding it will be the major challenge for all retailers and their suppliers.

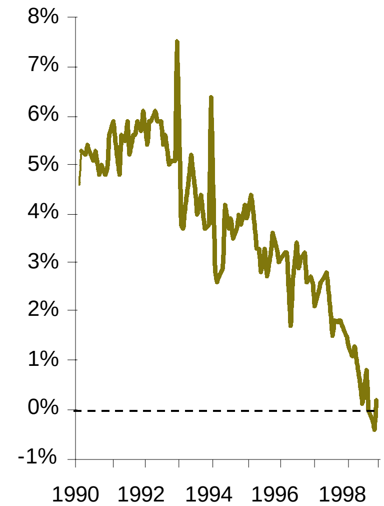
There are two large demographic growth segments that will dominate retailing over the next decade: Baby Boomers who are moving into their 50s and their children, the Echo of the Baby Boom generation, who are moving into their early 20s.

May you stay-ay-ay.....forever young.
Bob Dylan

Boomers were supposed to start saving by now. Didn't someone tell them? When you hit 40, you start worrying about old age and retirement. Ever since the Baby Boomers began entering their 40s in large numbers, the economic expectation was that they would begin saving for retirement, the savings rate would go up, and retail spending would fall. The first Boomers hit 40 in 1986, but savings continued to fall. Boomers are clearly not worried about their financial security in old age.

By the time they hit their 50s, it seemed impossible that the need to save could be put off any longer. By that age the old folks home is almost in sight. The first Boomers hit 50 in 1996. But the Boomers refused to let the party end. Not only did savings continue to fall, but the personal savings rate actually turned negative in 1998, as consumers allowed the stock market to do their saving for them.

Personal Savings
As a Percentage of Income



Source: U.S. Bureau of Economic Analysis

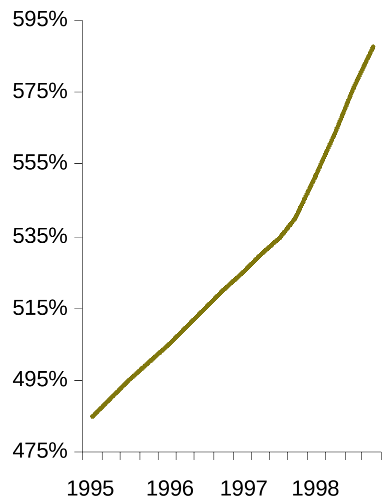
Wealth Effects Overpower Demographics

The Baby Boom generation, which has prided itself on being different from the start, is even more different as it enters middle age. Demographics may not be destiny if behavioral driven cohort effects, like not saving, overwhelm demographic effects associated with aging. The Boomers are spenders. They spend what they earn and they are clearly entering their high earning years. This is good news for retailers.

Boomers may not be saving because their parents, their homes, and the stock market did it for them. Over the next 20 years, the largest inter-generational transfer of wealth in the history of the world will take place. Many of those Boomers who have been whining about the burden of Social Security taxes will get a one-time windfall as a reward when their parents pass on to their reward. Conservative estimates have placed this transfer as low as $6 trillion. Some estimates have gone as high as $20 trillion.

Couple the boom in inheritance with a booming stock market and rising home values and you get a consumer base that is experiencing a windfall of wealth that goes well beyond the more modest gains they are experiencing in income. These gains in wealth will have an everlasting effect on consumption at retail. This newly generated wealth will power consumer spending in The New Retail Economy.

Household Wealth
As a Percentage of Income



Source: U.S. Bureau of Economic Analysis

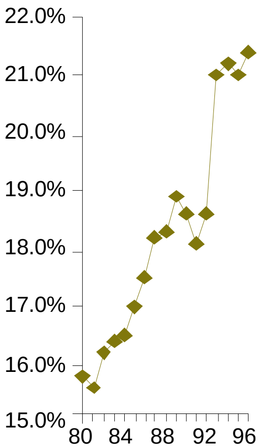
Youth at Any Age

Youth has always been a positive for retailing. Over the next decade, the growth in the number of young people will be more explosive than at any time since the 1960s when the Boomers themselves came of age. The children of the Baby Boomers will enter the job market and begin the process of household formation, giving a boost to home, auto, and apparel retailing.

At the same time, youthfulness is no longer age dependent. Boomers may be hitting middle age, but they certainly are not acting that way in their spending habits. They spend just like they did when they were younger, only now they have a lot more to spend. The combination of high spending Boomers and their high spending children, the Echo Boom, creates an ideal demographic combination for retailing.

Top 5% Tier

% Share of All Income



Source: U.S. Census Bureau

Inequality

Over the past 20 years, the United States has witnessed a growing inequality of income and wealth. The return on education has grown dramatically while the return on financial capital has grown even more spectacularly. The sharp rise in inequality creates an important and growing target for high end retailers. Over the next decade inequality will grow, driven in no small part by the tax system. More progressive income and inheritance taxes have been cut while more regressive taxes like Social Security, excise, and sales taxes have been raised.

The polarization of wealth and income has accelerated the polarization of viable market positions for retailers between high end, high quality, high priced branded retailers and low end, low price, commodity retailers. Both market segments will grow in size over the next decade, squeezing out what little is left in the middle.

Boomer Bedouins

With their children grown, Boomers will be moving more, traveling more, and staying at home less. Large suburban homes will be downsized for smaller residences that are more likely to be in urban centers. While many suburban areas will struggle, urban centers will experience a much needed renaissance in population and economic activity. Urban retailing will be a high growth segment.

No longer tied to the home in the suburbs, home for many Boomers will be where the luggage is. Retail spending will increasingly be tied not to need, but to experiences. Retailing in vacation locations will boom. Retailing that is tied together with older life experiences and hobbies, like grandparenting, gardening, cooking, reading, and traveling, will do well.

Health Maintenance

The exercise boom of the 1980s has long faded. In the past decade the average American has added 10 pounds of weight, adjusted for age. “No pain, no gain” is just not a winning slogan anymore. Health maintenance will take on greater importance to aging Boomers. It will affect their food choices and their medical decisions. It will even affect where they travel and how they vacation.

A whole new generation of pharmaceuticals aimed more at well being rather than illness is going to make its way to market in the next decade. Viagra is just the start. Anything that can give the Boomers a sense of recapturing their lost youth will do very well. Boomers have always been distrustful of authority. Remedies or regimens that promise energy and well being and enable self diagnosis will also do very well.

Listening to the Echo

While the generation gap in terms of values has closed between the Echo generation and their parents, the two generations are still very different, due in large part to the influence of technology. Where their parents grew up with television, this generation has grown up with computers and now the internet. This is a generation that is more techno-savvy than any previous generation.

Where television allows for complacency, is authoritarian, and rewards sloth, the internet requires interaction, is libertarian, and rewards curiosity. Where TV was centralized and controlled by adults, the internet is decentralized and controlled by no one. The internet is the anti-TV. Access to a world of information and media means that the members of the Echo generation will become authority figures at a very young age, first in terms of the technology, later in terms of content. Strong technology skills will translate into higher incomes, more job alternatives, and better security for this generation at an earlier age. High levels of technology literacy will make this generation a fertile target market for e-retailers.

The Internet Rules

Just as television shaped the values of the Boomer generation, the libertarian values of the internet will mold the Echo generation. Some of these values are:

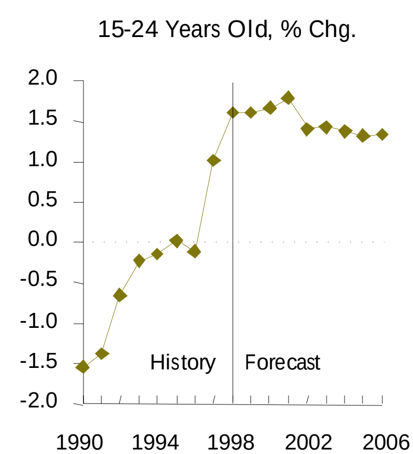
Global Orientation: Technology has made the Echo generation more networked than any previous generation and hence more global. Fashion trends, social memes, or political ideas that start in one place are quickly disseminated globally. While much of this comes from the United States, increasingly the culture of this generation will be global, with bits and pieces taken from many different places. This global connectedness also will make the Echo generation much more culturally tolerant than any previous generation.

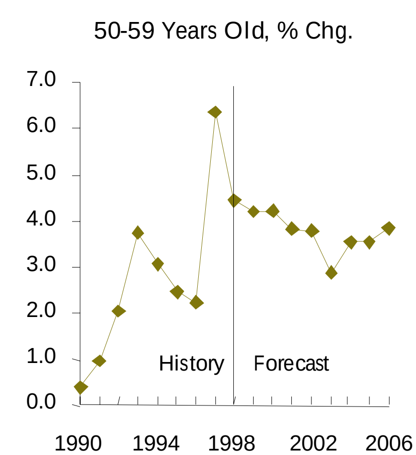
Trust and Structure: The internet is chaotic and anonymous. There is a constant need to verify and set limits. This has shown up in the desire to control access to x-rated parts of the internet. It is also showing up at colleges across the country where the Echo Boomers are working to reimpose the rules and regulations that their parents' generation threw out. This new generation wants structures they can trust in a world that has no structure. Product and advertising messages that betray trust will go nowhere with this customer.

Open and Decentralized: There are no secrets on the internet. It is an open marketplace of ideas. Many in the Echo generation have their own home pages and keep their own diaries on full display. Both of these values will work against the traditional, top down, hierarchical structure of large organizations.

Immediate and Interactive: Instant gratification is not fast enough on the internet or for this generation. The opportunity to capture the knowledge of this group is great. They want to share the ideas they have about your product but they also expect an immediate response. For retailers and suppliers who are looking to organize around the knowledge and information of their customers, this is a group that is ready to cooperate, but on their own terms.

Demographic Growth Segments





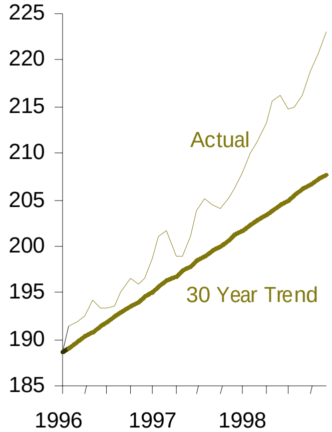
Source: U.S. Census Bureau

The New Retail Economics

The Retail Spending Boom

The fastest growing segments of consumer spending over the next decade will be in travel, entertainment, education, health care, consumer electronics and home furnishings. The New Retail Economy is a high spending one, but one where the spending is focused. This is not a rising tide that will lift all boats.

Real Monthly Retail Sales
Billions of 1992$



Source: U.S. Bureau of Census

Over the past three years, consumers have spent like there was no tomorrow. During that time, retail spending in real terms grew by more than 2.8% a year, well above the 30-year average of 1.9%. This burst of retail spending so late in a business cycle is highly unusual. The fact that much of it was durables driven makes it even more unusual. Durables usually do well at the beginning of a business cycle when there is pent up demand from the last recession. That they have done well late in a recovery is a testimony to the strength of the wealth effects that are now at work in The New Retail Economy. These wealth effects have four sources: the stock market, inheritance, housing and deflation.

The Effects of Newly Found Wealth

The increases in spending have been powered in no small part by the wealth effect generated by the 150% increase in the stock market since 1995. Capital gains in the stock market have allowed New Retail Consumers to reduce their savings from current income to less than zero. While the stock market may not deliver those kinds of returns in the future, the stock market is not the only source of wealth.

Even with a weaker stock market, inheritances will produce a sizable wealth effect over the next decade. Add to that wealth effect the additional wealth created by deflation. The flip side of deflation is an increase in consumer purchasing power. Even small decreases in prices can produce sizable increases in the total amount of real wealth held by households. Retail spending in real terms will remain above its 30-year average rate of growth for the next decade. The combination of favorable demographics, a healthy economy, and the wealth effects from financial assets, inheritances, and deflation will keep the cash register ringing for retailers.

The Virtuous Cycle

The current business cycle in the United States is the longest peace time expansion on record. The cycle before this one was the second longest. Structural shifts in the economy have clearly reduced the volatility of the business cycle and made for longer periods of expansion. Deregulation has made the economy more flexible.

New technology has improved productivity, reduced inventory, and increased the speed at which firms adapt to changes in demand. Long business expansions will make it easier for retailers to manage their inventories, plan their expansions, and take a longer term perspective in their planning. Gone is the need to catch the economy in a boom phase in order to make money. The result will be a much higher level of productivity in The New Retail Economy.

Higher Levels of Productivity

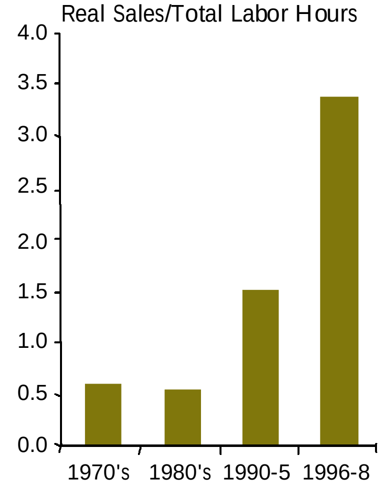
Retailing seems to have gotten on the productivity bandwagon ahead of the rest of the economy. After years of stagnation, productivity took off in the early 1990s as the positive effects of industry consolidation and the productivity loop began to have an impact.

Retailing will continue to be a high productivity industry. In a deflationary economic environment, productivity growth is the only path to higher profitability. The challenge that retailers face is in developing a new economic model that will foster future productivity growth.

Over the past decade, the productivity loop has been the source of much of the growth in productivity. Lower costs led to lower prices, which in turn led to higher unit sales volume and growing gross margin dollars. The model works well in a fragmented industry. It was one of the key factors in the industry wide move to consolidation. In a consolidated industry, however, another source of productivity growth will have to be found.

Retail Productivity Growth

Real Sales/Total Labor Hours



Source: U.S. Bureau of Economic Analysis

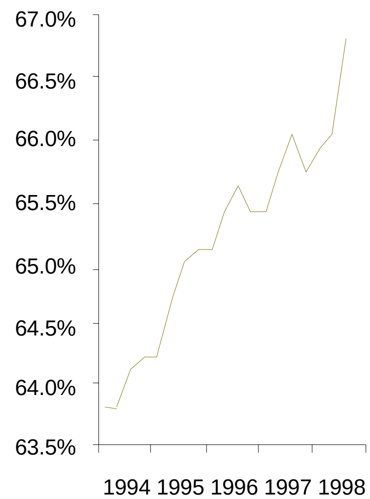
Rising Home Ownership, Stable Home Prices

While older households are downsizing and heading back into the city, younger households are moving into homeownership at earlier ages. The sharp increase in youthful homeownership in the past five years has pushed total homeownership to record high levels. The rate of homeownership also is rising sharply among ethnic and newly arrived immigrant groups.

The rising rates of homeownership will only partially offset the negative demographics for the home market. Again, polarization is the watchword. With more new market entrants, prices for entry level housing will rise. Downsizing of suburban homesteads by the Boomers will undercut prices in many higher end suburban markets. As Boomers move into urban and retirement home markets, prices will rise in these markets.

Home Ownership

Percentage of All Households



Source: U.S. Department of Commerce

The Critical Role of Deflation

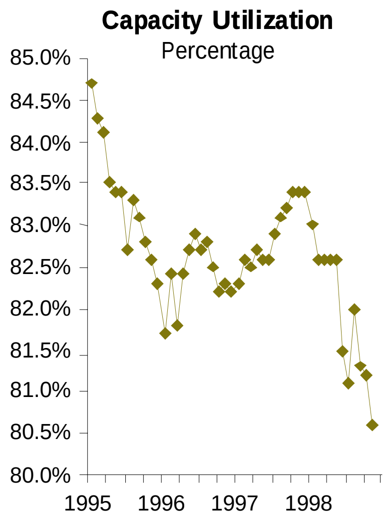
The most important change in the business environment for the economy as a whole and retailing in particular is the shift from inflation to deflation. Deflation is being driven by an oversupply of everything. From autos to PC's, from apparel to appliances, and from steel to petroleum, supply outstrips demand. If ever there was a seminal piece of evidence that the consumer is now king, it is the growing persistence and breadth of deflation.

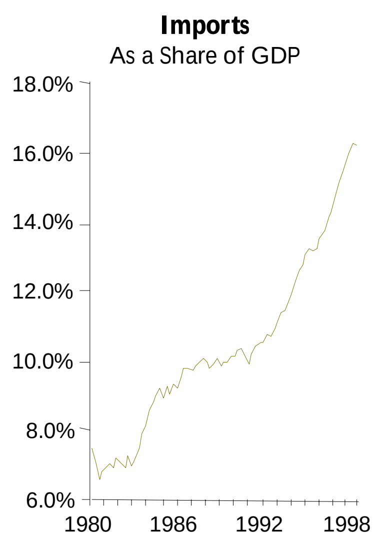
The Oversupply of Everything

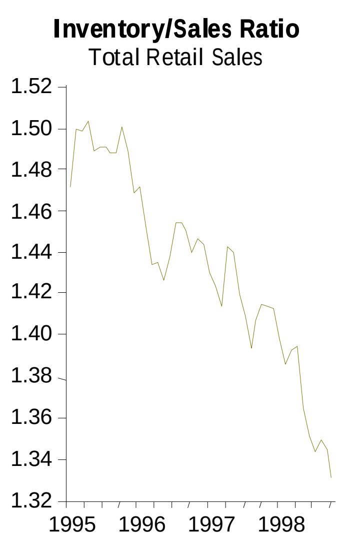
Retail deflation comes from several sources. The global economy has a very strong bias towards overproduction. The expansion of free trade is contributing to deflation by expanding the sources of global supply and reducing tariffs on many of those goods as they are traded around the world.

Excess capacity is also adding to deflation. Financial markets are in the business of pricing risk and efficiently allocating investment capital. When markets become overvalued, as they were in Asia throughout most of this decade and as they are now in the United States, they underprice risk and overstimulate investment. Excessive investment, particularly in Asia, has led to an abundance of production capacity.

Sources of Deflationary Pressure







Source: U.S. Department of Commerce

Finally, the overexpansion of retail capacity relative to consumer demand is also adding to deflationary pressures. In the past 15 years, total retail capacity has more than doubled while consumer demand has grown less than 50%.

Deflation: The Consumer Impact

Mild deflation, like mild inflation, can provide a stable environment for growth. However, a deflationary environment is dramatically different from an inflationary one. Deflation favors creditors over debtors, not a positive development in a heavily indebted economy or for a retail economy that is hooked on consumer credit as a way to drive sales. Deflationary cycles have many of the same characteristics as an inflationary cycle. When they start, most consumers and businesses assume it to be a temporary phenomenon. Like inflation, deflation tends to be self reinforcing. Where inflation creates a buy-now mentality among consumers that pushes inflation higher, deflation creates a sell-now mentality among sellers that pushes prices lower.

For some product categories, deflation is undeniably positive. For big ticket items, falling prices increase product affordability and the size of the market. For consumer electronics, autos, furniture, and home improvement, falling prices increase overall sales, accelerate inventory turns, and can give a boost to a retailer's gross margin return on inventory (GMROI). The dramatic improvement in retail inventory productivity since 1995 has been driven in part by this deflationary dynamic. For many products, from food to apparel to gasoline, lower prices will affect store choice, but it does not increase overall market demand.

Deflation: The Supplier Impact

Inflation increased the channel power of suppliers. With prices rising, suppliers were better able to allocate product among different channels in a fashion that was favorable to supplier margins and profitability. They were also able to pass on cost increases and encourage retailers to hold more inventory.

Deflation shifts power up the channel to retailers and ultimately to consumers. Deflation means that all profit gains must come from productivity and not from price increases. Deflation reduces the flexibility that suppliers have to allocate inventory among different channels and reduces the willingness of retailers to hold additional inventory. The shift to deflation has accelerated the improvement in inventory productivity throughout all of retailing. For retailers, the interest cost savings alone since 1995 from this improvement are over $2 billion a year.

Deflation: The Balance Sheet Impact

On the balance sheet, deflation reduces the value of physical assets, particularly inventory and real estate. The increased emphasis on technology introduces deflation into yet another asset category. When technology was a small share of the total asset base of a retailer, this deflation made little difference. With technology growing, it becomes much more critical.

At the same time, deflation increases the burden of debt. Deflation increases real interest rates and forces all borrowers to pay back loans with dollars that are worth more than when they were borrowed. The reduction in the value of assets and the enhancement of liabilities by deflation increases the risk of bankruptcy for all retailers.

The New Retail Business Model

Deflation can have a depressing effect on gross margins. That, however, does not mean it has a depressing effect on profitability. The past five years have been a golden era for retail profitability. During that time retail profitability has quadrupled despite falling margins. The combination of strong real gains in retail spending coupled with the positive effects of the productivity loop have pushed industry profits higher.

The Old Retail Model: The Productivity Loop

Every new retail innovation has succeeded by underpricing the cost structure of the previous retail innovation. Category dominant, big box retailing created a productivity loop of its own. This productivity loop has dramatically changed the economic model for retailing over the past decade. Supply chain management has become the common mantra. Successful retailers have used the short-term power of the productivity loop to drive down costs, lower prices, and in turn, reap higher volume and profitability. In short, retailers created value by reducing costs while giving the customer more selection at a lower price.

The drive to reduce costs by big box retailers has changed the face of retailing. It has favored the low cost operator over the higher cost service provider, sales growth over margin growth. It has produced businesses of great size without regard to quality. It has driven retail consolidation and bankruptcy, leaving a small oligopoly of retailers triumphant. And finally, it has also been one of the primary factors behind both retail sameness and retail price deflation.

While the productivity loop can work for the individual retailer, when it is applied to the entire industry, the drive to lower costs becomes, over time, a zero sum game with only the consumer the winner. The model in its current form only works for the individual retailer as long as there are similar, less efficient competitors to take market share from. The oligopolistic structure of retailing today limits the future application of the productivity loop. As a result, the industry leaders are being forced to restructure the economic model for retailing.

Where the old model rewarded cost reduction, the new model rewards sales growth. Where the old model drove sameness and consolidation, the new model is driven by innovation, information, diversity and competitive convergence. Where the old model was product driven, the new model is customer driven. Where the old model was based on decreasing returns to scale, the new model is based on increasing returns to scale. Growth in this model creates both more growth and more value for all of the stakeholders.

The New Economic Model for Retailing: Community, Communication, and Commerce

The development of supplier networks that are electronically linked together has been the key to reducing the cost and improving the efficiency of retail distribution. EDI was only the first step in this process. The shortcoming of EDI is that it is an expensive, proprietary, and closed system. Sharing information across supply chain intranets is low cost, non-proprietary, and open. Where EDI encourages retailers to limit suppliers, intranets will make it easy to expand the number of suppliers.

Wherever there is an opportunity to share information about a retailer's plans, purchases, inventory position, open to buy, past sales, or sales expectations in a way that will make individual players in a value chain more efficient, it will be done. Intranets will form around all of the traditional silo functions of the old retail model from merchandising to human resources to store operations to logistics. They will create communities and conversations within the supply chain that engage the entire supply chain.

The sharing of information on an open platform will dramatically reduce the cost of transactions while increasing the diversity of products that the supply chain is able to deliver. This winning combination of more choice at a lower cost will be the productivity driver of The New Retail Business Model.

Cultivating Community and Conversation

Half of my advertising dollars are wasted. I just don't know which half.
John Wanamaker

In The New Retail Economy, John Wanamaker would have been an optimist. Virtually all traditional advertising will be a waste. Traditionally, retailers have sought to move their products through the market by increasing consumer awareness through advertising. In The New Retail Economy, consumers ignore advertising. What traditional advertising fails to do is engage the customer.

Instead of broadcasting a one-directional message to consumers, retailers will have to engage the customer in a conversation. Over the next five years, retailers in The New Retail Economy will develop networks among their customers, not unlike what they are developing with their suppliers. By engaging the customer in a dialogue, retailers will be able to ascertain sooner and with much greater clarity what consumers want and don't want, what they like and don't like, what is important to them and what is frivolous.

The path toward higher levels of commerce lies through expanding the conversation into a community. In some cases, cultivating this community will force retailers or suppliers to give away their product for free. They will generate revenue in other ways. The free product or information hooks consumers and gives them the sense of value; the sense of community is what keeps them coming back. Technology companies have led the way, particularly when it comes to software and internet access. They give the original product away in hopes of creating a community of interest in it. They then make money off the community interest. Yahoo!, Netscape, and Linux have followed this model.

Others have focused more on the informational side of the community. Providing information from other customers about their product or service has been the approach of eBay, Garden.com, and Amazon.com. These companies have created communities at the heart of their business models. Consumers share opinions of books, offer advice about gardening techniques, and give feedback to other buyers on the reliability of different sellers. Much like neighbors talking over the back fence, the internet facilitates the sharing of product and service knowledge on a broad scale. Think of these as electronically linked customer networks, as important to a retailer as electronically linked supplier networks.

Another approach is to create the retailer as a media business. Buy.com sells product at cost hoping to make up the margin by selling advertising. FreePC takes this one step further by giving away its product in return for extensive information about its customers and the delivery of a constant stream of advertising while the product is in use.

Cellular phone companies have taken still another approach by giving away the phone and making it up on the service. The idea of giving away a product in order to drive traffic is not an alien concept to retailers. Gillette pioneered this concept in an earlier time by giving away the razor and charging for the blade. It will become increasingly important as a way of setting the standard and establishing a lifestyle relationship with the customer.

The New Retail Organization

The Restructuring of Value Chains: From Hierarchies to Networks

Traditional retail and supplier organizations were made up of functional silos. Work was organized by function: finance, marketing, store operations, merchandising. As technology permeates business, the value chains in all retail channels of distribution are being transformed in terms of power, communication, and the ability to add value.

Retailers in the New Economy will organize to create value in a different fashion by rewarding connectivity. Value will derive from relationships: relationships with suppliers, relationships with customers, relationships with other businesses, and relationships with other retailers. Relationships, however, add complexity. They also require a very different type of organizational structure from the hierarchical, functional silos of most retailers today.

Disaggregating the Value Chain

A retail business is made up of many value chains. There are a logistical chain, a real estate chain, a merchandising chain, and a human resources chain, just to mention a few. In a hierarchical structure, only a few are market facing and not all of them add value. Disaggregating these value chains will be one of the major challenges facing retailers in developing a new economic model. Within large retail organizations, corporate hierarchies will slowly give way to organizational networks that are market facing as the generators of value.

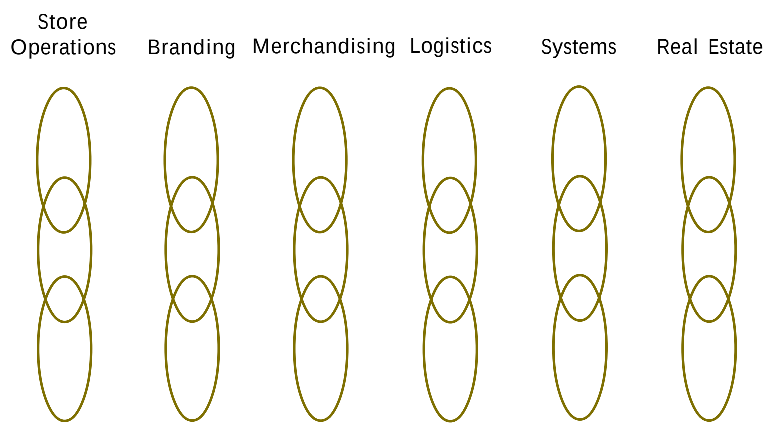
The distinction between line and staff will be lost, as all functions will be treated, measured, and rewarded as line operations. After disaggregation, value in the future will be determined by the market as opposed to determined by the organization. The downside of these networks is that they will be increasingly difficult to control and focus. Organizational and managerial style will also change. Managers will have to be coaches instead of controllers. Store associates will have to develop skills in problem solving and act as consultants to their clients instead of as salespeople.

Professional service firms have been the first firms to adopt a network model. They will be quickly followed by others. The critical challenge that arises from networks is managing the boundaries of the network. The responsibility of senior management over time will be the expansion of the network and the management of the network's boundaries.

The Old Retail Organization and the New

Criteria	Old Organization	New Organization
Value Creation	Productivity Loop	Connectivity
Organized Around	Value Chain	Knowledge Management
	Product-centric	Customer-centric
Organization Structure	Silo: Line vs. Staff	Market Facing
Management Style	Controllers	Coaches
Sales Associates	Sales People	Consultants
	Cash Collectors	Problem Solvers
Customers	Individual Transactions	Community Engagement
Information	Customer Data	Customer Feedback
Time Frame	Product Cycle	Real Time

The New Retail Model: Co-dependent Value Chains



Change Drivers

Value chain disaggregation will be driven by five forces: information technology, capital availability, human resources, markets, and the speed of change.

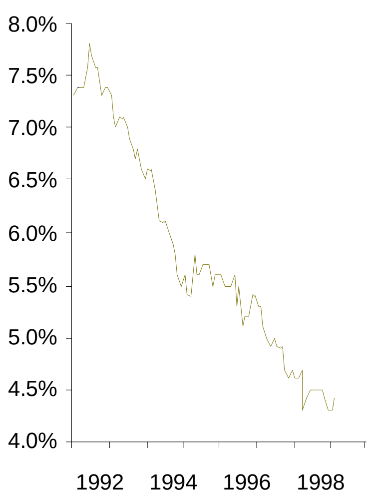
The dramatic fall in the cost and complexity of communications and information technology makes the disaggregation of the different retail chains possible. Where large, expensive systems once favored large, centralized organizations, because only they could afford them, small, cheap technology favors smaller, decentralized businesses.

Secondly, large organizations were the only ones with access to the capital needed to expand. The deregulation and decentralization of capital markets has taken away this advantage.

Third, the most qualified new workers are more interested in working for smaller companies where the opportunities for real responsibility is greater than at larger companies, where such responsibility only comes with the passage of time.

Unemployment Rate

% of Labor Force



Source: U.S. Bureau of Labor Statistics

Fourth, markets make better decisions than bureaucrats, even if they are private sector bureaucrats. Disaggregation replaces bureaucratic relationships with market ones. As transaction costs come down, the burden of bureaucracy far outweighs the costs of outsourcing.

And finally, networks are more adaptable to change. They are better able at accommodating both ambiguity and diversity. As the mean time to the next surprise decreases, the need for adaptability increases. The need for speed, flexibility and adaptability to solve multi-disciplinary problems will make networks the organizational structure of choice. Networks are not efficient, but they are effective. In a world of sudden and unexpected change, it is the adaptability of the network structure and its openness that makes it a more survivable structure in the future.

Abundance of Capital, Scarcity of Labor

For the past 50 years, retailers have operated in a business environment where there was a scarcity of capital and an abundance of labor. Since workers were easy to come by and largely interchangeable, pay levels were kept low and high levels of turnover were seen as inevitable. As the rate of unemployment falls, the quality and availability of the remaining work force deteriorates.

Hanging on to good workers will be one of the largest operational challenges facing retailers in The New Retail Economy. In a tight labor market, retailers no longer hire employees. Rather, it is the employee who is hiring the retailer. With so many other alternatives, retailing has to be made a more desirable career option. While higher salaries are important, real changes will have to be made in the areas of training and job design if retailing is to be successful at attracting the best and the brightest. Making more employees owners in the business, giving them a financial incentive to act like owners, will also be critical to success.

Innovation and the Fading Importance of Capital

The capital markets of the past 50 years were always ready to lend money to businesses that really didn't need it. For retailers with access to capital, tight capital markets acted as a welcome barrier to market entry. Innovation was limited to what other large companies, operating with similar economic models, could do.

For new start-ups it was a very different story. Raising capital was a nightmare that never seemed to end, until now. With venture capital growing dramatically, the Federal government generating a surplus, shifting capital from the public to the private sector, and foreign investment looking increasingly risky, financial capital is more available now for new start-ups than at any time in history. As a result, the financial capital needed to fund new innovations will be more available in the next five years than at any time in the past 50. The availability of investment capital will fund the rapid rollout of new concepts, further crowding the retail landscape.

Corporate Governance: The Key to Transformation

Corporate governance seeks to answer two questions: Who benefits from the good efforts of the business? Who makes the decisions that determine that outcome? Traditionally, the answer to the first question was shareholders; the answer to the second was senior management. In The New Retail Economy, the answers to both questions change.

Management, in its traditional sense of a small group of individuals who are well paid, control information, allocate resources, and make decisions, no longer makes economic sense. The role of traditional management no longer adds value in a knowledge-based, information-driven world. Every worker has to perform the functions of a senior manager. To make workers senior managers, retailers will have to make them owners. Making everyone an owner is the only path to shared values and organizational passion.

Shareholders can no longer be the sole beneficiaries of a retailer's success. Traditional shareholders will not go away. But as they compete with an ever larger pool of other capital providers, their influence will fade. In a networked world, the business is only as strong as the networks it is tied to.

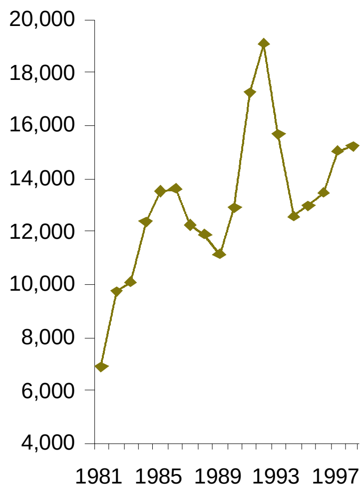
Improving the health of the networks of employees, customers, suppliers, and communities becomes the path to long term growth. Employees have to be cultivated as stakeholders to keep them from going to other business. Customers and communities have to be cultivated to gain access to the sources of knowledge and feedback they possess about the product and services of the business. They will only do that if they are made to feel they have a stake in the business.

The New Retail Competition

The goal of the monopolist is the quiet life.
John Maynard Keynes

Competitively, retailing is moving in two opposite directions at the same time: towards oligopoly and less competition and towards convergence and more competition. While the survivors of this competitive process may dearly wish for the quiet life, none will achieve it. If anything, retailing will be more competitive in the next decade, adding to both the deflationary pressures that are already in the marketplace and to the number of bankruptcies that will occur, not just in retailing, but in other businesses where retailers encroached.

Retail Bankruptcies



Source: Dun & Bradstreet

The Triumph of the Oligopolies

First it was toys. Then it was department stores and discount department stores. These competitive arenas were quickly followed by books, consumer electronics, and hardware. Eventually it will apply to all product categories. Consolidation is making the competitive structure of traditional retailing oligopolistic. In each case, bigger was always better. A few players dominate.

Most competitive arenas will support only two to three players, four at most. For those companies that do not achieve the dominant position, bankruptcy will eventually be the order of the day. The next decade will witness more bankruptcies in retailing and they will occur in businesses that once might have seemed invincible.

Existence for the surviving players will be anything but tame. Toys are a great example. So are catalog showrooms. One company dominates each segment and both are struggling as new competitors working off of completely different economic models have converged on the territory they once dominated. Convergence, the movement of non-traditional competitors onto retail turf, is the competitive threat to retail oligopolies.

Competitive Convergence

Look at grocery retailing. Consolidation is rapidly shrinking the number of players in the industry. A decade from now, there will be just a small handful of national players. And yet at the same time, new competitors are entering the market, not as grocery retailers, but as something completely different.

Discount department stores are becoming major players. Drug stores are expanding their food-related offers. Grocery stores are poaching the traditional business of restaurants by trying their hand at the prepared meal business. Convenience stores are trying to do the same. A few are even getting into fresh foods. Quick service restaurants are going upscale and supplementing their fare with more traditional grocery offerings.

Convergence is showing up in another way. Industries that had nothing to do with retailing are getting into the business and retailers are getting into other businesses. The boundaries between retailing, entertainment, telecommunications, travel, and financial services are all blurring. A full assessment of the competitive threat to any retail venture will have to take into account the movements and capabilities of non-retailers.

The Role of Standards

In the realm of technology, standards are recognized and welcomed as a way of reducing confusion, making investments in both people and capital that are interchangeable and will last beyond the next hardware or software release. The importance of standards to the retail oligopolies is going to grow. Standards will become the norm for consumer products of all types, from apparel to food to building supplies. Standards will communicate the production values of a particular product.

The Growing Importance of Place

Real estate strategies are going to have to change and change dramatically over the next decade. The combination of technology, shifting demographics, changing shopper behavior, and shifting political winds will alter the landscape of retail real estate. The importance of place is being driven by three different factors: technology, demographics, and public policy.

For the past 50 years, retailing has added greatly to the sameness of the American landscape. Malls in Minneapolis look much like those in Annapolis or Indianapolis. This sameness is going to catch up with retailers in The New Retail Economy. Place is going to take on a new importance and, with it, retailers are going to have to develop new strategies for store expansion and growth.

Technology and the Choice of Place

While still small in numbers, the fastest growing segment of the labor force today is the mobile knowledge worker who is tied through technology to a virtual organization. This shift in work mobility means that a worker literally can be anywhere. Location no longer matters. If workers can work anywhere, then increasingly they will work in places that they want to work as opposed to places where they have to work, hence the growing importance of place. Places will begin to compete for these workers as they represent high income and hence high tax revenue households. They will compete not by trying to be like every other place, but by being different.

The digitalization of work is geographically liberating people, changing their patterns of mobility and their focus on place. For many, the traditional line between work and home is blurring. Third places, places that are neither work nor home, will become important to this mobile group as a place to socialize, professionally network, and get some of the traditional back office support functions taken care of. As retailing is a real estate rooted business, this change in the pattern of movement will create new opportunities to capture customer loyalty and traffic.

Demographics, Population Movement, and Place

As the Baby Boomer generation moves into its empty nest life phase, Boomers are moving out of the suburbs and back into the city. The movement of upscale, high income households back into more urban settings has prompted a revival of inner city retailing. Given the size of the Boomer generation, many more will make the trek back into the city.

The suburbanization of America over the past 50 years has led to an increasing homogenization of communities. The movement of suburbanites back into the city will begin a slow process of reversing that trend. The boom in immigration to the United States coupled with growing ethnic identification of ethnic populations in the United States will further reinforce this trend. This diversity creates an opportunity for retailers and developers to differentiate themselves by creating retailing that reflects the diversity of different places.

Public Policy and Place

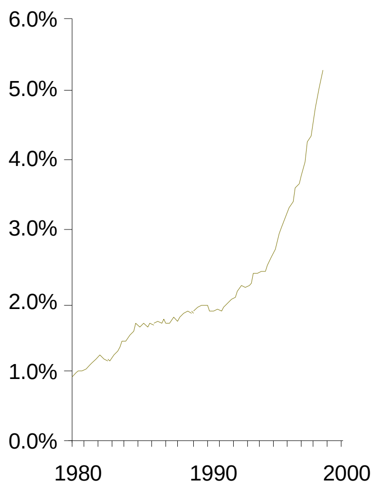
In the election of 1998, over 200 land use initiatives were on local ballots. More than 75% of them passed. The growing interest in urban sprawl has captured the attention of Vice President Gore and is now part of his "Liveability Agenda." The objective of the Gore Agenda is what is referred to as "smart growth." Smart growth is growth that goes up and not out. It favors density over sprawl. If this idea catches on, retailers will be forced to rethink their existing strategies for growth and the types of boxes in which they are planning to grow. Smart growth will force a shift from development to redevelopment, from green field projects to inner city and suburban redevelopment. Once again, place will take on renewed importance.

The New Retail Technology

Underinvestment in Information Technology

IT Investment

As a Share of the Total Economy



Source: U.S. Bureau of Economic Analysis

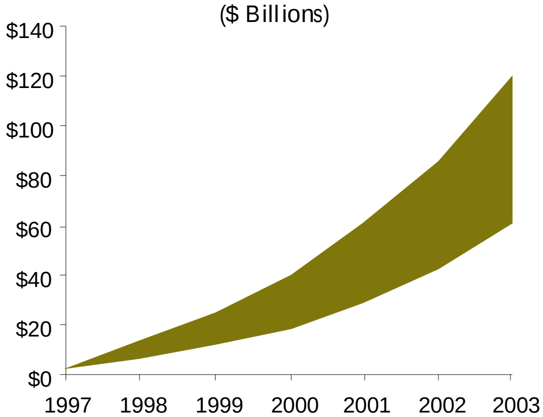
Retailers can no longer compare themselves to other retailers when it comes to expenditures on information technology, because their competition no longer lies just with other retailers. As competitive convergence accelerates, a wide variety of other business sectors from travel to health care to financial services will compete with retailers. Technology will be one of the critical dimensions of that competitive battle.

Retailers still don't get it when it comes to information technology. On average, retailers spend 1% of sales on information technology investment. The economy as a whole is spending 5.5% and that number is growing rapidly. This under-investment in information technology is putting the traditional retail industry at risk. Other industry segments will converge on retail consumers, offering them better, cheaper, more entertaining, more convenient ways of fulfilling their shopping wants.

At the same time, retailers are not getting the biggest bang for their IT buck. Instead of turning to outsourcing as a way of accelerating the implementation of new technology, retailers continue to view their approach to IT as a core competency. Less than 10% of all IT budgets are spent on outsourcing. As a result, IT in retailing is over-emphasized and under-funded, a dangerous combination that will come back to haunt the industry.

High and Low Internet Sales Estimates

($ Billions)



Source: Jupiter Communications, Forrester Research, shop.org. Yankee Group, and PricewaterhouseCoopers LLP

The Impact of the Internet

One of the places where the impact of new technology can be clearly seen is in the rapid growth of retail spending through the internet. Internet retail sales in 1998 were estimated to be between $8 and $13 billion. Over the next five years they will rise to between $60 and $120 billion.

Although the internet will remain a modest channel of distribution for retail spending overall, there are numerous product categories that lend themselves to the internet as a channel of distribution. In these categories, which include products like books, music, and consumer electronics, the loss of store-based sales will have a devastating impact on store profitability. In rare cases the internet will be the low cost provider. What's much more likely is that the internet will succeed where it can offer greater selection, more product knowledge, more personalization, and more convenience than stores.

In-store Internet

In the late 1980s, the retail industry had a technology fling with kiosks. The combination of falling hardware prices and rising labor costs seemed to make the kiosk a logical alternative to the customer service problem. Retailers' romance with kiosks was short lived. Hardware reliability problems abounded, the product or marketing uses of the kiosks were too narrow, and consumers just didn't seem to have much interest in them.

Kiosks will get a second chance as more retailers will begin to install them in their stores as a way of giving the consumer access to the internet. For many consumers, WWW actually stands for World Wide Wait. Many of the more compelling applications that retailers will want to use to attract consumers just require much more bandwidth than what the average consumer has access to. Putting the internet in the store will enable retailers to increase both the entertainment value and the communications content of their offers to consumers.

E-Business Takes Off

E-business will grow much faster and have a much bigger impact on retailing than e-retailing. The driving force behind the growth in e-business is the dramatic fall in the transaction costs associated with the sharing of information and knowledge. Everywhere along the value chain, wherever a participant may have a question that another participant can answer on a real time basis, e-business has an application. Where is my merchandise? How is a particular product selling? Where is my payment? Perhaps even, how is my competition doing?

Anywhere there is a gap between the knowledge a business needs to make an informed decision and the knowledge it actually has, there is an opportunity to provide that knowledge and add value. The challenge that every member of the value chain has is in setting the technological standards for knowledge sharing and coming to an agreement as to the information and knowledge to be shared.

The Informationalization of Everything

The under funding of retail IT investment is dangerous because it is coming at a time when the entire economy is becoming informationalized. Much of the institutional breakdown of retailing is being driven by the informationalization of the business. The informationalization of retailing is a technologically facilitated process that is transforming the critical assets of all retailers from inventory and real estate into information.

As a result, retailing is going from a business where success was based on location and merchandise to one where success depends on the unwieldy trinity of information, communication, and entertainment systems, combined with knowledge workers to create, maintain and utilize these systems.

The informationalization of retailing first transformed the cost side of retailing, increasing flexibility and reducing overhead. The focus of retail informationalization will next shift to the demand side of the business and relationship marketing. The object of relationship marketing is to capture information about the very best customers to customize the marketing message down to the individual.

From Data to Wisdom

Today, retailers spend an excessive amount of time and money on collecting and then trying to analyze data. The industry is overrun with data on sales by geography or product line. Data on consumers is now a hot area on this journey of discovery. Loyalty programs have allowed retailers to collect and analyze vast quantities of data on purchases by individuals. Some of this data has been helpful in setting in-store adjacencies. Very few retailers have actually been able to use this data to make individually crafted pitches to individual customers. Despite the vast sums of time and money spent on data, retailers have only limited results to show for their efforts. In short, the industry is up to its ears in data but has only a limited sense of what to do with it all.

The Informationalization Hierarchy: From Data to Wisdom

Data Bases

Data Bases
- Uni-functional
- Quantitative
- Operational
- Hierarchically limited
- Internally focused
- Efficiency driven
- Legacy systems
- Mainframe based

Information Bases

Information Bases
- Cross-functional
- Real time
- Quantitative
- Exception oriented
- Strategic
- ERP
- Value chain
- E-Commerce

Knowledge Bases

Knowledge Bases
- Actionable information
- Quantitative
- Qualitative
- Customer interactive
- Cumulative
- Amazon.com
- Network based

Wisdom Bases

Wisdom Bases
- Compassionate knowledge
- Adaptive
- Star Wars
- Artificial intelligence based

While the retail business will always need data, what it needs to shift its attention to is the development of both information and knowledge bases. Much of what e-commerce has to offer will be in the form of information base creation. Information is data that is nice to know. It is very often cross-functional. At the very least it has to cross at least one organizational boundary. Think of it as a reflection of organizational data sharing. What is data for one department or business is often vital information elsewhere.

Package delivery services have all set up information bases for their customers to let them check for themselves on the status of their packages. The airlines have set up automated information bases on the status of their flights. Banks offer real time account information to their customers at their ATMs. Information that customers, suppliers, or associates need on a real time basis lies at the heart of all information bases.

Creating Knowledge Bases: The Challenge of Knowledge Management

While information is always nice to have, the real challenge facing retailers is the creation of customer sourced knowledge bases. Knowledge is the difference between the information we have before the fact and the information we have after the fact. As products and services become more intertwined and complex, the value of knowledge to differentiate customer choice grows.

Any time there is a gap between the knowledge that individual consumers have to make a successful purchase and the knowledge they need, there is an opportunity to set up a consumer-to-consumer feedback loop and create value. Any time there is a gap between the perception or expectations of consumers about a product or service and the perception of that service or good by the retailer, there is an opportunity to set up a consumer to retailer feedback loop and create value.

Consumer electronics lends itself to customer recommendations of product characteristics, value and performance. Install a new bathroom and you gain a lot of knowledge. Buy a new computer and you find out all kinds of knowledge you never knew even existed. Capturing that knowledge from consumers and sharing it with other consumers both creates value and customer loyalty. Home improvement retailers can set up knowledge bases on local contractors. Consumer electronic retailers can do it for their products. Travel-related businesses can have knowledge bases on vacation sites. Drug stores can do it on health related problems and issues. Amazon.com has set up a knowledge base that allows consumers to offer their opinions of different books and authors to respond to that criticism. It is a simple way of sharing information that has been tempered by experience.

There are first mover advantages to setting the knowledge standard for a particular product or service. The more consumers who use a site, the larger the community, the greater the value and thoroughness of the information available. Once a retailer sets the standard for community in its product class, it will be a competitive advantage that will be difficult to overcome.

Wisdom is the final step on the informational chain, a step we are not likely to get to any time soon. Wisdom is knowledge that is delivered with compassion. It is the knowledge we get from parents, spouses, and good friends. The movie Star Wars showed a wisdom base in Obi-Wan Kenobi. Someday we will be able to capture the learnings of those who know us and create machines that have compassion.

Creating Value in The New Retail Economy

The Shift in the Value Chain: Creating Value in The New Retail Economy

By creating a new source of value, networks will destroy much of the old system of value creation. Just as the shift in the value curve in the 1970s due to the explosive growth in low cost overseas manufacturing capability destroyed the manufacturing-based businesses of the old Rust Belt, the disaggregation of the value chain will have an equally destructive effect on distribution-based businesses.

Asset Based Restructuring: From the Tangible to the Intangible

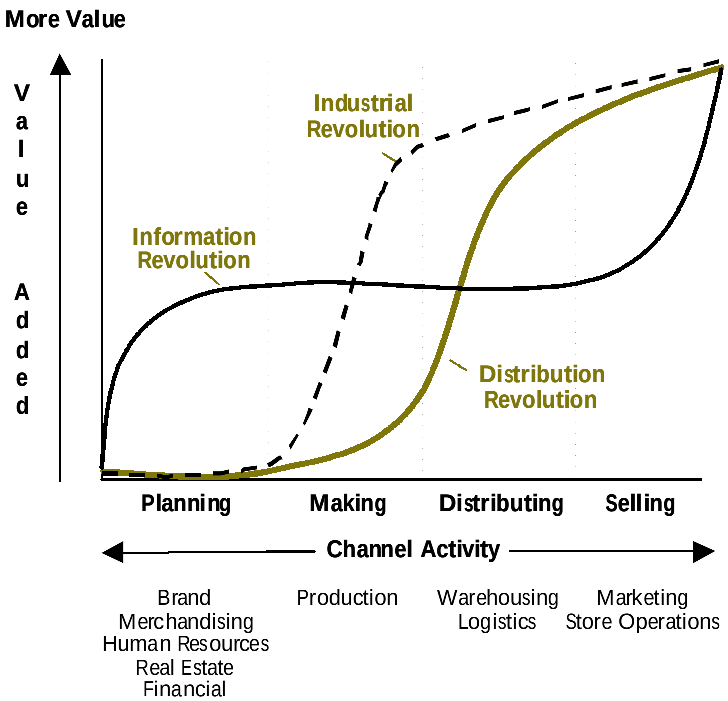
Restructuring in the past has almost always meant cutting costs, laying off workers, and cutting back operations. Restructuring in the future will mean making the transition from a business based on tangible, physical assets of inventory and real estate to one based on the intangible assets of knowledge, information, brand, culture, and relationships.

While cost cutting is always painful, asset based restructuring will prove to be even more difficult. This type of restructuring requires creativity, openness, and innovation, skills that are often in short supply in large, hierarchical organizations. While the traditional ways in which retailers have generated value will be limited, many new ways of adding value will open up.

Organizing around Real Time Information

Customers want it; the value chain needs it; the associates in your organization would be more effective if they had it. Organizing around real time information will greatly improve supply chain effectiveness and add value.

The Value Curve



Organizing around real time information is the killer application of e-business. It is a way for retailers and suppliers to dramatically reduce costs and improve the effectiveness of their business processes. The airlines have done this to inform the public about their flight schedules, reward their most frequent fliers, and price their products more effectively than any other businesses today.

Creating Communities: Organizing around Real Time Knowledge

E-mail is the current killer application of the internet. The volume of e-mail in the United States alone is measured in the trillions of messages, dwarfing the 110 billion letters sent through the U.S. Postal Service. People want to connect and the internet gives them an efficient and increasingly universal way of doing it. Communities based on lifestyles and common interests are springing up on the internet. They are a potential source of real time consumer information, knowledge, and feedback.

Capturing the knowledge of consumers and using it as feedback to direct your operations is one way to add value. Allowing consumers to tap into the knowledge of other consumers is the fastest path to solving customer problems and creating customer loyalty. eBay is doing this by allowing buyers to offer feedback on sellers. Amazon is doing this by providing a forum for literary critic wannabes. Every product that has some dimension of risk and complexity to it lends itself to this sort of treatment. It is the value added of this type of knowledge that sets up traditional channels of retailing for disintermediation through the internet.

Converging on New Markets: Leveraging Customer Relationships

One of the biggest untapped assets that retailers have is the myriad of relationships they have with their customers. These relationships can be transported into other businesses and other product categories. The supercenters are doing this today by moving their customers into food. Nordstrom's is trying financial services. Opportunities abound in travel, entertainment, and health care, where the real growth in the economy will occur in the coming years.

Setting the Standard

Setting and controlling a standard is about as close as a business can get to a license to print money. IBM did it in the 1960s, Microsoft in the 1990s. The frenzy over the internet is in some ways a mad scramble to set a standard in a particular product category. Once set, standards endure. Global product standards in a wide variety of product categories will emerge in the next decade. Setting those standards will have a big impact on who wins and who loses in each of those product categories.

Brand It

In some ways, brands are just another way of thinking about standards. Great brands, like great standards, endure. Both endure because they communicate something of meaning and value to the consumer. Dominant brands will be the ones that the standard setters target. Sweat shop activists go after the largest brands, not the smallest. The largest brands have the most visibility, the most to lose, and the biggest market clout.

The value of a brand is the degree to which it captures and holds customer attention. As more and more things vie for customer attention as time passes, creating new brands will grow more difficult. As a result, existing strong brands will only grow in value.

Buying It: Driving Consolidation

The highest risk path to creating value is by trying to buy it. Most mergers today disappoint. All too many are outright financial failures. Mergers are risky because their success depends on bringing together the intangible characteristics of the merging organizations. Culture, business relationships, and organizational knowledge make or break a merger. Unfortunately it is very difficult to conduct a due diligence on these factors. While the CEOs of merging companies will talk about synergies, the real risk of all mergers is the loss of focus that the two independent companies once had.

Cracking the Service Dilemma

Retail service is an oxymoron, a contradiction in terms that hurts retail profitability and the image of retailers in the minds of prospective employees. Why work in an environment where you are paid poorly, receive no benefits, and are abused by both management and customers alike? The level of expectation for retail service is so low that even a modicum of good service will be recognized by the customer and responded to favorably with more patronage and more loyalty. The service dilemma is an organizational problem. It requires a change in organizational philosophy, measurement, and reward.

The Strategic Challenge of The New Retail Economy

The Strategic Challenge: Balancing Focus, Synergy, and Adaptability

In restructuring to meet the challenges of The New Retail Economy, many retailers will find themselves in the dilemma of trying to balance the need for focus with the allure of synergy. Each of the many and varied opportunities for alliances with other retailers, suppliers, and competitors will each have its own synergy. While hierarchical organizations struggled to create synergy among the many different departments and business centers, they have the advantage of focus. Networked organizations can manage many more relationships; they have the advantage of synergy. The successful retailer will need both.

Glasnost and Perestroika

Ironically, the last leader of socialist Russia, Michael Gorbechev, was the prophet of The New Economy. Before anyone else, he was urging the moribund Soviet economy towards Glasnost and Perestroika, openness and restructuring. Those are the very same characteristics that all retailers will have to embrace to be successful in The New Retail Economy.

Openness: Open standards, open technology, open systems, and open communications are all winners. Openness encourages trust and collaboration. Both are keys to success in working with suppliers and customers.

Restructuring: Partnerships, assets, value chains, organizations. The willingness to be in a state of near constancy of change is one of the big challenges of The New Retail Economy. Stasis is death.

And finally, a child's curiosity is needed to be in constant search for the new, for the innovative, for the creative. Without curiosity, the benefits of openness, in general, and the efforts of restructuring, in particular, will be lost.

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