Introduction

The emergence and tremendous growth of the new economy has unleashed powerful forces that are reshaping the retail industry at an unprecedented rate. Everything from customer relationships to branding to supply chain management is impacted by this revolution. Given the dynamics at work in the new economy, retailers are struggling to strike a balance between maintaining operational excellence and implementing necessary changes.

The current transformation of the retail industry is accelerating rapidly due to the formation of new businesses not encumbered by the limitations of traditional organizational and structural models. Electronic, or virtual, stores are an excellent example. These merchants can reinvent their value propositions within weeks, work outside traditional pricing and profit margins, and offer customers complete access to competitors’ prices and product information. This kind of competition completely changes how the industry does business, reducing a traditional retailer’s ability to influence purchasing behavior by presenting customers with less reason to visit a local store and upending the traditional value proposition offered to consumers.

Over the next few years, retail executives who understand the macro and micro dimensions of this revolution will be the most successful in implementing the fundamental changes necessary to remain competitive. This shift is already under way, as many retailers are making significant investments in time, money and intellectual capital to adapt to the changing environment. An IBM study indicates that 42 percent of business executives agree the Web will mean fundamental changes over the next two years to their business model. Keys to a business’s successful transformation include understanding its position in the marketplace, reevaluating business models to accommodate new customer demands and opportunities and defining a real-world roadmap of change. It also requires establishing a nonlinear strategy, overcoming operational challenges and building on core opportunities.
e-business momentum and evolution in the retail industry

IBM takes a broad view of the retail industry’s progression toward e-business. IBM research suggests that the evolution of e-business is proceeding in four waves, assuming non-e-business retail is wave 0. In wave I, businesses use the Internet to improve their current value-chain activities and structures, creating a multichannel model. In wave II, operational efficiency increases with the development of an integrated multichannel model. In wave III, even greater operational efficiency is achieved through increased collaboration with trading partners in a vertically integrated, customer-centric multichannel model. Lastly, in wave IV, retailers will rethink their existing infrastructures, evaluate networked models and explore horizontal partnerships to concentrate on strategic capabilities. By 2005, we expect pioneering retailers will be structurally, organizationally and competitively more dynamic, innovative and, ultimately, more profitable.
In today’s marketplace, the majority of retailers are moving between wave 0 to I and II, initiating multichannel models and integrating new channels with existing infrastructures. The expectation is that this activity will continue at an accelerated pace, while a handful of early adopters will explore new means of vertical and possibly horizontal collaboration.

As retailers become e-business savvy and seek to maintain their individual market position and to maintain or increase their competitive edge, IBM anticipates a convergence of business-to-customer and business-to-business models. Specifically, we expect those retailers who understand the changing business-to-consumer model to leverage its lessons and collaborate with trading partners in the emerging business-to-business marketplace. Eventually, retailers will make a more substantial exploration of horizontal partnerships. A few e-business pioneers already have found that customers are willing to engage with multiple product and service providers for greater convenience and economies of scale.

Finally, IBM anticipates an increase in new retail entities that will structurally bypass the traditional models and generate completely new e-marketplace business models. As retailers graduate from one set of challenges to another and move through the waves of evolution, a few businesses are dramatically changing how value is created for the customer. An example of this is in the bookstore segment, where Amazon.com has significantly changed the way customers and booksellers interact.

**Restructuring retail with a nonlinear business approach**

For a retailer to achieve true e-business transformation, its executives will need to think differently about how their business works, the roles and responsibilities of managers and employees, and the competitive value their company provides. They must first recognize the limitations inherent in their business model and then quickly transition from traditional, linear thinking—which views the new economy as merely an "evolution" of the traditional business model—to a broader perspective, which may require a revised value proposition, enhanced technological capabilities and a "revolution" of the traditional business model.
Retailer inertia and other barriers to success

Despite the revolutionary advances the retail industry has made toward e-business, some of the world’s largest and most powerful retailers are implementing strategies that may prove ineffective in this new marketplace. In a number of segments, new store openings are planned at a greater than 5 percent increase, although overall revenue performance may not justify the investment. Companies are reinvesting in their stores and attempting to work more closely with trading partners, but these strategies are still linear in nature and conform to traditional models. This poses a problem—and a challenge—for retailers.

Recent studies predict that by 2005 the retail industry’s e-commerce revenue will make up 4 percent of its total revenue, compared to 1.8 percent in 2000. Given this dramatic forecast, it is critical that retailers move beyond traditional thinking and explore a more robust and comprehensive approach toward embracing the new economy. As they pursue this goal, retailers face a fundamental problem: traditional retail processes, organizational models, technologies and skills do not promote nonlinear action, limiting executives’ ability to transform their businesses no matter how creative their strategies. The difficulties executives face in each of these areas are described below in detail.

Subprocess complexities

When IBM works with a retailer to optimize allocation from a single to a multichannel business model, often the infrastructure—both its processes and technologies—has not evolved and even prohibits best-of-breed execution. Consider the case of price management. For physical-based channels (that is, stores and catalogs), pricing is based on a series of factors, including store, location, product, brand and historical activity. With the advent of the Internet and consumer agents, retailers need to establish individual or microlevel pricing for small groups of customers. This challenge is compounded by the fact that this pricing might be dynamically set, based on a number of transaction hurdles or customer criteria. Merchants who once planned for markdown dollars now have to rethink their end-to-end pricing strategies and the implications for the brand and business across channels.
**Organizational complications**

Complicating the operational difficulties of positioning nonlinear strategic growth, the organizational model itself hampers progress. The traditional models for merchandising, marketing, distribution, store operations and the like do not operate at the speed of the new economy. In preparing for a vertically integrated multichannel model or for horizontal partnerships, the organization will need to change its strategic decision-making process. For many organizations, this is accomplished through formal planning and budgeting, conducted with owners of strategic initiatives.

To succeed in the future, companies must execute policy more efficiently, and individuals and designated managers must be empowered to attack competitive challenges quickly. The roles and responsibilities of top management should be aligned to position the organization to move quickly and to set the pace in its market segment. This shift in roles and responsibilities will require some retailers to develop new positions within their companies for directing independent, strategic decisions. Other retailers will identify individuals from the current teams as the decision makers.

**Technological intricacies**

Additionally, the technology supporting the current operational model can present an obstacle. A number of the largest investments made by retailers in technology over the last ten years have entailed complex, packaged applications. In most cases, these solutions have been deployed with some level of customization, making it difficult to adopt new changes quickly and to update the solution or the underlying technology. As a result, although software providers are rapidly changing their applications to be fundamental components of the new technical environment—enabling both vertically as well as horizontally integrated models—much of their customer base cannot reap the benefits.
Five key principles offering retailers opportunities for change

To organize the process of evolving a retail business into a fully vertical and horizontal collaborative model, IBM has identified five key principles for promoting new ways of thinking among retail executives. Focusing on these principles will help executives strike a balance between strategic challenges and core fundamentals of the retail business.

- **Access**—Meeting customers and suppliers anytime and anywhere
- **Visibility**—Reacting to customers’ and suppliers’ ability to see, measure and value performance
- **Service**—Expanding services and enhancing value propositions to offset the commoditization of products
- **Brand**—Managing the transition from “push” branding to “pull” branding and ultimately to “full-ownership” branding
- **Experience**—Interpreting “lifestyles” by redefining and deploying new and better experiences for customers.

IBM research indicates that these principles can be used to judge the viability of a proposed initiative and to provide an intelligent and practical set of value-based criteria for proceeding with migration to a new economy model.

Access—Leveraging key points of interaction

In the last few years, technology has empowered consumers to engage in commerce ubiquitously. As a result, retailers must own or participate in key points of customer interaction, such as mobile devices, to remain competitive. A retailer can accomplish this by becoming either a primary owner or content provider.

*Primary owner*—Retailers who can invest the capital should consider distributing “consumer agency” tools, such as handheld personal digital assistants for consumers to engage in all commerce. The retailers who make this investment generally will have increased control over the types of goods and services offered to consumers. Ownership of this point of contact will not only increase revenue from additional participants but also significantly enhance the retailer’s ability to manage the intelligence gained from these tools.
Content provider—For those retailers who are unable to make the capital investment necessary to be the primary owner or are in a segment where a primary owner has already been established, positioning for strategic content is critical for long-term viability. The rapid evolution of the voice portal model (cellular telephones serving as demand-side market makers) is a prime example of how point of access will change the way a consumer researches and shops. Based on a consumer’s input, cell phones will eventually be able to provide customized information about a product, deliver its nearest location and price, and perhaps even assist in the negotiation. Establishing a presence in such an environment will be critical to either selling the product or directing the consumer toward a particular end.

Regardless of how the retailer elects to enable access for the customer, the content and experience must reinforce the retailer’s unique brand identity. For example, REI has integrated its view of each customer across all channels (store, kiosk, online). This enables REI to communicate and open a personal dialog with each consumer regardless of their preferred means of shopping. On the Internet, The GapKids and eToys showcased a concept known as elastic retailing during the 1999 holiday season. Elastic retailing is the ability of merchants to “stretch” into adjacent categories by affiliating with complementary retailers to provide advice, recommendations and products. The GapKids and eToys partnership enabled each to entrench their respective brands across an additional access point and build a value proposition that matched with their customers’ lifestyles and mind-sets.

The critical factor to successfully providing access lies in the identification and understanding of the customers’ computer and Internet savvy and accommodating the ways in which they want to communicate. Not every customer can or wants to engage through a dedicated point of access, but for those who have an interest, the tool used to provide access must be adaptable to the user’s skill level and present content that will make the experience satisfying.

Visibility—Expanding operational awareness
Businesses that have enabled their customers to interact seamlessly across channels increase their customers’ awareness of the company’s operational strengths and weaknesses. With this visibility, customers can make more informed decisions regarding capabilities and performance. All of these new insights can impact brand perception and, in turn, customer loyalty.
IBM believes that over the next two to three years retailers must significantly improve inventory management to keep up with the accelerated speed by which consumers order products, as well as enhance fulfillment and channel management in preparation for individual customer pricing and, ultimately, a dynamic, customer-centric model. Although visibility will have varying degrees of impact by segment, it, in total, will create a new means to disintermediate consumers from retailers. Retailers who are unable to link processes and enable the same experience regardless of channel will probably lose significant economic value as new and current businesses evolve.

**Service—Reinventing incremental competitive value**

Expanded product offerings, increased brand selection, competitive pricing and greater access to information have made the traditional product sales model difficult to maintain and less competitive. To compensate for the commoditization of products, retailers must identify new and improved service offerings and value propositions. Specifically, retailers should rethink and reengage the labor force to provide a wider range and higher quality of service offerings, and endeavor to enrich and unify the buying experience through technology, process and innovative solutions across all channels.

For one national hard-goods retailer, superior customer service is the key value proposition. As the company has embraced technology and the Internet, management has focused on deploying new technologies and expanding channels to reinforce this proposition.

In addition to redefining the value proposition, a company can modify and improve the product offering itself to make it more valuable to consumers by:

- Increasing or redefining product selection and expanding categories
- Coupling products with value-added services such as gift wrapping and product customization
- Offering higher-quality products from select manufacturers
- Discouraging comparison-shopping based on price by focusing on lifestyle differentiation and other target marketing.
Brand—Creating a powerful, competitive advantage

In today’s marketplace, it is critical that companies begin to position themselves and reestablish their brands, keeping in mind that the customer’s impression of a company is influenced by its performance across multiple channels. A company’s success in reshaping its brand identity depends on how well it shifts from defining the “push” branding through the use of traditional print media and blanket marketing to controlling the “pull” branding through electronic media, direct access and targeted marketing.

Reshaping brand identity

**Push**
- Examples
  - Printed media
  - Indirect access
  - Blanket marketing

**Pull**
- Examples
  - Electronic media
  - Direct access
  - Targeted marketing

**Own**
- Examples
  - Pervasive media
  - Realtime access
  - Personalized marketing

**Drivers/enablers**
- User acceptance of technology
- Call center technology

**Drivers/enablers**
- Telecommunications, entertainment, retail merger
- Access and visibility
Full ownership of the brand can be accomplished only through successful implementation of the first three primary principles:

- Understanding the customers’ talents and providing customers with greater access to information, products and services allow businesses to own the point of interaction.

- Providing visibility into how well the company performs will serve as a positive reflection on its services.

- The expansion of value and service through new channels helps to redefine the brand to meet customers’ rising expectations.

Since power brands will continue to play an important role in defining supplier and retail relationships, companies should:

- Strike a balance between brand and marketing execution across multiple channels.

- Create complementary alignments with traditionally noncompetitive partners to expand services and abilities.

- Capitalize on the consumer’s desire to connect with a familiar name in a changing and sometimes confusing marketplace.
Experience—Building loyalty
As universal access and competitive pricing transform many products into commodities, the shopping experience will become a key competitive differentiator. Yet technology has made it difficult to present the same experience across multiple channels. Logistically, the retail experience should:

- Extend to customers the opportunity to define their own experience using unique, personalized tools
- Reflect a consistently customized experience across all channels
- Provide realtime responses to individual customer needs across multiple channels, based on their profile.

Shaping the experience
Retailers who understand and invest in personalizing and optimizing the customer’s shopping experience can enjoy both higher sales and customer retention. This investment may be difficult, and in the short term some retailers will take a tactical approach, collecting customer information across channels, but they will miss the larger issue—the need to improve responsiveness to customer changes, optimize control over customer interaction and enhance the customer’s overall experience.

**Obstacles and opportunities**

The major catalyst to a successful e-business transformation lies in a company’s ability to think dynamically about an ever-changing industry and implement a nonlinear approach. Consider a variety of factors, such as:

- Is the company working with suppliers and partners as efficiently as possible over the Internet?
- Are there steps in the value chain that should be removed or added?
- Has the company found the most profitable spot within the chain?
- Can buyers and suppliers be united to streamline processes, enhance productivity and reduce costs?

With this new mind-set, retailers can use the five principles as a guide to conquer the operational changes needed to make their e-business transformation a reality.

Besides clearly identifying the major barriers to success and five key principles offering opportunity for change, IBM has identified five critical success factors that will help retailers thrive in the new economy.

- Senior management must be sincerely committed to the strategic, policy and operating levels of transformation.
Barriers to success

- Failure to build a cohesive vision; too focused on technology
- Inability to escape from current operating procedures and cultural barriers due to inertia or lack of power
- Failure to build trust or take a collaborative approach with partners
- Nondedicated staff: change is implemented on an ad hoc basis by both business and technical staff
- Lengthy lag time to market
- Implementing a too ambitious first phase—companies should start simple, grow fast and plan for success
- Unwillingness to adopt generally accepted collaboration standards and networked models and to align business processes and systems accordingly.

Corporate planning must include new economy dynamics as an essential component, building and integrating related principles and technology into the company’s business processes.

Flexible technology infrastructures should be developed to allow for rapid response to change.

Generally accepted standards should be adopted for communications, data interchange and system development so that processes and systems can be aligned accordingly.

Community members (that is, suppliers and divisions) must be able to adopt common business practices as the community grows and develops.
Summary
Executives agree that beyond 2005 a vertically and horizontally integrated multichannel business model will become standard in the retail industry, yet few have clearly defined new economy business plans or strategies to compete in this rapidly developing environment. IBM research suggests that a nonlinear perspective using the five key principles will enable retail companies to take the steps critical to shaping their success. In effect, management now has the tools to act within a well-defined and tested blueprint, as opposed to reacting on instinct and traditional business values that may no longer be appropriate. Retail executives must now:

• Reevaluate and redesign the value chain to update offerings and adopt more creative value propositions.

• Look beyond the current business model toward a more collaborative approach to pave the way for groundbreaking multichannel opportunities and new revenue streams.

• Fully capitalize on technologies that can establish better operational efficiencies, enhance customer relationship avenues and reshape brand identity.

True e-business transformation will occur only when an innovative and nonlinear strategy is established, operational challenges are addressed and core opportunities are embraced.
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For more information about a new economy vision in the retail industry, e-mail Mike Matacunas, Worldwide Distribution Sector Leader, eBusiness Innovation Institute, at insights@us.ibm.com, or visit:

ibm.com/services/insights