# Frontiers in Retailing Spring 2024

## Final Paper

*"The retail phenomenon: from E-commerce to Brick-and-Mortar"*

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## 1. Retail Landscape: *The rise of e-commerce and other effects of the pandemic*

E-commerce, understood as buying and selling goods online, has revolutionized the way we shop. E-commerce experienced consistent growth since its beginnings, when someone sold a CD of the band Sting in 1994 for $12.48 plus shipping (McKinsey, 2023). Nevertheless, the COVID-19 pandemic boosted e-commerce as a key distribution channel in the retail industry. According to the International Trade Administration, the share of e-commerce sales in the retail industry globally went from 13.6% in 2019 to 19.5% in 2021, almost doubling its share in the span of two years. By 2025, nearly 25% of retail sales worldwide will be made online. In fact, according to eMarketer, the global e-commerce market is expected to reach $6.3 trillion in sales in 2024, up by 9% from the $5.8 trillion generated in 2023 (Forbes, 2024).

The e-commerce market's growth posed challenges for pure online direct-to-consumer (DTC) players who once enjoyed low competition. Initially, they thrived due to immature supply chains, minimal online brand presence, and advantageous digital marketing conditions. Most brands did not sell online or did a poor job in fulfilling their online orders and pure players were able to carry long tail stocks with cheaper interest rates. However, as brands embraced DTC e-commerce, competition intensified. Brands now heavily invest in loyalty programs, SEO, AdWords, and brand differentiation. With market maturity, pure online DTC players face fierce price competition, higher customer acquisition costs, and diminished margins (Valtech, 2023).

Among the various seismic changes the pandemic brought to the retail industry, one of them was the redefined purpose of physical retail spaces. The attractiveness of retail spaces shifted from spaces in which consumers fulfilled functional necessities, to spaces where consumers connect and gather novel, social, and educational experiences. The transformation of routine shopping into memorable experiences has transformed brick and mortar stores into immersive retail spaces which combine digital and physical functionality, engage with their targeted audience, include captivating visuals, and generate personalized interactions. These four elements make up the pillars of a successful retailer who delivers impactful experiences for their customers (Reality Interactive, 2022). According to Shopify, *"32% of consumers say they're likely to engage with in-store experiential moments"*, which underscores the relevance of experiential retail in brick and mortar nowadays (Shopify, 2022).

With 70% of consumers engaging in both online and physical channels for their purchases and one third of Americans making omnichannel features part of their shopping routines since COVID, omnichannel went from a "nice to have" strategy to a critical element for every brand. Hence, pure e-commerce players have lately ventured into physical retail for continued growth and customer retention. The investment for a store, when compared to significantly increasing digital customer acquisition costs, also makes the case for pure online DTC players to own a physical store. However, not all online DTC players are suited to venture in omni. It is most suited for brands whose product categories like apparel benefit from customers physically interacting with the products. This paper answers the relevant questions of who, among all pure online DTC players, should go into brick and mortar, why, and how they should do it. Finally, a list of case studies illustrate all of these answers with real-life examples.

## 2. E-commerce to Brick-and-Mortar: *Who, Why and How*

### ***Who* are the companies that should be looking to move to a brick and mortar**

Brick-and-mortar stores can be particularly advantageous for certain product categories like apparel, especially when the brand benefits from customers physically interacting with the products. It is especially true for high-end brands where product quality matters greatly and sales require personalized assistance. The in-store experience can significantly boost customer satisfaction and deepen brand-customer relationship to create memorable shopping experiences that encourage loyalty and repeat business.

Amidst a crowded e-commerce landscape, companies find differentiation and must cultivate deeper customer connections through physical retail. Meeting customers where they prefer to shop—be it online or offline—is crucial. Integrating brick-and-mortar stores into omnichannel strategies extends brand reach, particularly for established e-commerce businesses with a sizable base of loyal customers. This physical presence complements online platforms, offering click-and-collect services and streamlined exchanges. Human interactions in-store foster loyalty and boost Lifetime Value, especially during negative experiences like returns, where top-tier in-store service can reshape customer perception and drive exploration of new products.

Transitioning to brick-and-mortar stores demands substantial capital investment, often necessitating companies to reach a certain scale. However, with confident financial projections and expectations of near-term profitability, this investment can bring significant returns. Confidence in financial health signals readiness to tackle the challenges of establishing a physical retail presence. Examples of brands excelling in omnichannel strategy implementation include Warby Parker, Third Love, and Glossier.

### ***Why* should some E-commerce brands transition into Brick-and-Mortar**

**1. Business Evolution:** For some e-commerce ventures, establishing physical locations becomes essential for continued growth and evolution. For instance, Warby Parker, a successful eyewear company that initially relied on a home try-on model where customers could try up to five frames at home. Although the business model was successful, the company eventually realized its limitations (customers could only try on a limited amount of frames at home and had to handle the return) and opened brick-and-mortar stores to enhance the customer experience. By allowing customers to try on a wider range of glasses instantly and access eye-care services in-store, Warby Parker significantly improved the shopping process, leading to increased customer satisfaction and brand loyalty.

**2. Top line Growth Boost:** Transitioning to brick-and-mortar can provide a significant boost to top line growth by expanding the points of contact with customers. Having physical stores allows businesses to engage with customers in-person, providing opportunities for personalized interactions and additional sales. This multi-channel approach not only increases revenue potential but also strengthens brand presence and customer engagement.

**3. Enhanced Customer Retention:** Brick-and-mortar presence enables businesses to establish deeper connections with customers, leading to improved customer retention. In-store interactions create memorable experiences that foster brand loyalty and encourage repeat purchases. Customers who feel valued and appreciated are more likely to become brand advocates and recommend the business to others, further contributing to its long-term success.

**4. Inventory Management and Returns Handling:** Physical stores serve beyond just sales opportunities, fulfilling practical roles like inventory management and returns handling. Businesses can optimize operations, cut fulfillment expenses, and boost efficiency by using stores as inventory hubs and return points. This integrated strategy improves customer satisfaction with convenient returns and ensures ample stock to meet demand.

***Cost Benefit Analysis***

According to Gupta, Kushwaha, Bandhera, et al. (2023), these are the main benefits and challenges of any business that wants to operate in the e-commerce channel:

Benefits of e-commerce:

- Facilitates global market access for businesses, unlocking previously unreachable customer bases, at a lower cost than traditional retail.
- Enhances customer convenience, enabling purchases of a wider range of products at any time without the inconveniences of traditional retail (e.g., parking, queuing)
- Reduces operational expenses for businesses as it enables players, for example, to have lower levels of stock or pay lower rent.
- Utilizes big data and AI to gather insights into consumer behavior, facilitating personalized marketing strategies that ultimately enhance satisfaction and loyalty.
- Promotes environmental sustainability compared to traditional retail by reducing the reliance on physical stores and optimizing delivery logistics.

Challenges of e-commerce:

- Susceptibility to cyber-attacks threatens data security and erodes customer trust.
- Strain on delivery systems and infrastructure due to the escalating demand for shipping services can lead to delays and diminish the customer experience.
- Absence of physical product interaction poses challenges for customer satisfaction, particularly concerning product evaluation and the complexities of returns and refunds.

In comparing e-commerce benefits and challenges with those of brick and mortar stores, the U.S. Chamber of Commerce recognizes that customers still prefer to buy in-store. Despite the growth of e-commerce sales, these represent a minority (~20%) when compared to those of physical stores. Another benefit that the U.S. Chamber recognizes for brick and mortar stores is that, if businesses find the right real estate for themselves, these physical locations have the benefit of being closer to converting the customer. Meanwhile, online retailers are in constant competition for attention and are subject to the dominance of Amazon and Google in the online space, making small businesses pay a premium just to be noticed (U.S. Chamber of Commerce, 2019). Other benefits include increased brand visibility and awareness, increased average purchase value versus e-commerce, higher trust of consumers in the channel, and enhanced customer experience, among others.

The main challenge of a physical store is the cost. Selling online is always going to be cheaper. The U.S. Chamber of Commerce (2019) states that, according to Entrepreneur, the cost of opening a storefront ranges from $2,000 to $100,000, depending on the vertical, the size, and location of the business. Nonetheless, the added pressure to retailers of delivering impactful experiences has translated into an even higher cost of operating a physical store. In addition, physical retailers still need to operate an online store because relying solely on word of mouth and nearby foot traffic severely limits the growth potential of the business. In fact, three out of four customers are more likely to visit the store in person if they find helpful information online.

## ***How*** **Should an E-commerce Open a Brick-and-Mortar Store?**

**1. Make sure the Timing is Right:** Before transitioning to brick-and-mortar stores, e-commerce businesses should ensure several factors align. They should experience rapid growth and have confidence that opening a physical store will advance their business and reach new markets. Sufficient capital is necessary to cover initial and ongoing expenses. Moreover, they should wait for opportune moments and ideal locations to arise, considering factors like foot traffic, demographics, competition, and lease terms.

**2. Customer Analysis:** Conduct a comprehensive analysis of customer behavior, preferences, and demographics to inform the location selection and store format. Understanding the target market is crucial for designing a compelling in-store experience that resonates with customers.

**3. Forecasting:** Develop detailed forecasts and projections to assess the financial feasibility of opening brick-and-mortar stores. This includes estimating initial setup costs, ongoing operational expenses, revenue projections, and expected ROI. Financial planning ensures that the business can sustainably support the new stores and achieve profitability over time.

**4. Pilot Store Launch:** Consider launching a pilot store or pop-up as a low-risk way to test the market and gauge customer response. This allows businesses to validate their assumptions, refine their strategies, and identify potential challenges before committing to larger-scale expansion. By gathering real-time feedback and insights from the pilot store, businesses can make informed decisions about future store openings and optimize their retail strategy.

**5.Talent Training:** Brick-and-mortar stores require unique skills from employees compared to e-commerce. Customer-facing staff need strong interpersonal skills to assist customers throughout the purchasing process, and must know the brand and products well to guide customers effectively. For example, in upscale fashion brands, sales associates act as style consultants, helping customers find suitable pieces. This requires specialized training different from online customer service roles. This also means hiring and training for back-of-house roles like visual merchandisers, which e-commerce operations don't typically need.

**6. Marketing Strategy:** Invest in a comprehensive marketing and promotion strategy to generate awareness and excitement about the new brick-and-mortar stores. Utilize a mix of digital marketing, traditional advertising, social media, and local outreach to reach target customers and drive foot traffic to the stores. Creating a buzz around the store openings helps attract customers and establishes a strong foundation for long-term success.

<u>Measuring retailer success: key metrics and objectives to keep in mind</u>

Measuring success can vary based on the business model and sometimes size of the retailer. For example, if a retailer has a subscription model then clearly membership count and growth are key metrics to monitor. However, there are some metrics that all retailers share: Customer Lifetime Value (CLV) and Customer Acquisition Cost (CAC). CLV indicates the value that a customer brings to you as a retailer over his or her time as your customers, whereas CAC showcases your spend efforts to convert them to becoming your customer. Long-term, your CLV should be always higher than your CAC, some say at a 3:1 ratio. A further metric shared across retailers is customer feedback. This feedback can be either structured through recurring surveys, which would be more quantitative, or anecdotal and qualitative, by getting a feeling of what your customers are saying on social media or product reviews.

Focusing on metrics that can be of relevance particularly to pure e-commerce retailers, we need to go through the customer journey:

**<u>Awareness:</u>** Is our advertisement convincing? Are we showing it to the right customers? Are we spending on the right channels (SEO vs. socials)?

1. **Ad Click through Rate:** # of clicks / # of Views
2. **Traffic and its source**: # of visitors of your website; where they clicked on your link

**<u>Consideration:</u>** Is it easy for customers to find us, interact with us, and spot what they need?

3. **Search Engine Ranking:** browser ranking website based on relevant keyword search
4. **Average time spent on webpage:** number of seconds/minutes of a user session

**<u>Purchase:</u>** Are we meeting users' needs with our value proposition? Are the customer friction points in the purchase process? Are customers satisfied with the product?

5. **Sales conversion Rate:** # of purchases / # of total site sessions
6. **Cart abandonment Rate:** # of completed purchases / # of shopping carts created
7. **Return rate:** # of returns / # total orders

**<u>Loyalty:</u>** Are our customers enjoying our products? Would they repurchase with us? Are they promoters of our brand?

8. **Returning customer rate:** # of returning customers / # total customers
9. **NPS:** % promoters - % detractors (survey response by customers from 0-10)

As purely digital retailers are transitioning to physical stores, in order to measure the success of that transition, they need to start by establishing: what are we wishing to achieve by establishing physical presence. This may vary depending on the retailer's products. For example, Crystal Landsem shared with us that Lulus' Melrose store was primarily to drive a higher brand reputation and offer a hub to host events with influencers & build connections with partners. Retailers need to have cash flow positivity and achieve a substantial digital customer mass, in order to actually make a physical presence a "success".

Metrics for physical retail to consider include but are not limited to: 1) Traffic, 2) Sales per square foot, 3) Average transaction value, 4) Gross margin return on investment, 5) Inventory turnover. Additionally, as highlighted by Crystal Landsem, it is important to have a ROI timeline for the store and start considering metrics at a holistic level. For example what uplift has the store driven on digital performance and vice-versa how digital activations are driving foot traffic.

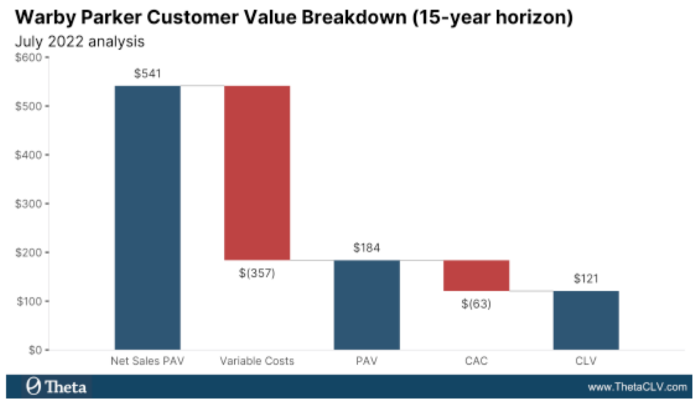
## 3. Case Studies: Warby Parker, Third Love, Glossier

**Warby Parker:** The company is an exemplar in execution of a pure digital to physical transition, seamlessly connecting the two realms and creating a cohesive brand journey for their customers. Some of the key learnings that we can derive from Warby Parker's success story are the importance of building a digital brand first, before moving to physical retail:

- **Build the core:** Warby Parker focused on disrupting the eyewear market with a differentiated business model - cutting out middlemen - therefore capturing higher margins and being in more control of the total experience. They focused on building a phenomenal customer experience with their "try-at-home", which built significant loyalty and an NPS of over 80, as discussed in class. Customer feedback was essential to their innovation and product development. Additionally, they effectively leveraged social channels to build a strong brand identity, creating a loyal and large customer base.
- **Test & Learn:** Before opening their first retail store, Warby Parker experimented with showrooms and a school bus that drove around cities selling their products. It allowed them to test demand for a physical experience and understand more about how customers want to interact with their products. The test and learn mentality also prevailed in their go-to-market strategy when deciding on store locations.They saw each opening as an opportunity to better serve a customer they did not fully understand yet.
- **In-store experience:** Warby Parker realized that it needed to provide an additional value in stores vs. online in order to drive traffic. Stores allowed human touch to interconnect with technology. They placed a strong focus on training the staff to the highest standards, to ensure a great experience and true value for customers shopping.
- **Feedback loop:** Physical stores gave Warby Parker access to more information about their customers. Setting up feedback mechanisms allowed them to optimize their in-store experience, products, and geographic locations of presence.

In terms of key performance metrics, the Cowen and Company report on Warby Parker shows that their Customer Value Breakdown even in one of the most challenging global times for physical retail was remarkable.

Figure 1 - Theta's Updated WRBY CLV Waterfall




Source: Cowen and Company, Theta

**Third Love:** This is a brand that was born digitally native in 2013, and after growing and achieving success, decided to start testing physical retail presence. ThirdLove is an example of how the retail footprint can complement e-commerce-first brands, creating an experience for customers to physically interact with the product, especially for an apparel brand where their main focus is fit and comfortability.

- **About the brand:** ThirdLove is an American lingerie company started by Dave Spector and his wife Heidi Zak. As 50% of the population wear lingerie, they felt that there was an opening for a brand that represented true women. Their value proposition is to provide comfortable yet sexy bras in a wide range of sizes, including half cups, made from premium materials and extensively wear-tested for comfort.
- **E-commerce first:** Starting as a purely e-commerce bra brand, they then launched their first retail endeavor with a pop-up store in Manhattan, in 2019. The aim was to reach customers hesitant about online bra purchases or unaware of the brand. It exceeded expectations, prompting consideration of a brick and mortar, until the pandemic intervened. Nonetheless, they demonstrated that an omnichannel approach could satisfy customer desires for in-person experiences, fostering loyalty and online repurchases.
- **First physical store:** Post-pandemic, the brand opened its first physical store in Newport Beach in 2022, following achievement of $100m yearly revenue and positive cash flow. They expanded with 10 additional stores in cities like San Francisco, Miami, D.C., and Philadelphia, alongside a presence in select Neiman Marcus department stores, aiming to enhance accessibility and align with their desired customer experience.
- **Store Experience:** In the store, customers will find more than 60 bra sizes and well-trained fit stylists ready to help them find their correct size. It also offers a full assortment with some level of inventory. For this specific product category, fit is everything, so they ensure the in-person customer journey is exceptional.
- **Learnings**: The customer data that ThirdLove gathers during physical store visits helps them not only improve the in-store experience, but also attracts new customers who find it important to try on the products before purchasing.

**Glossier:** This is a brand that started as a blog and then moved to a fully ecommerce sales platform, only to then start with owned retail stores and conquer more than 600 points of sale inside one of the biggest retailers of personal care and beauty products, Sephora.

- **From Blog to E-Commerce:** It started as a blog, where real people were sharing real information about products they have used and their experiences. Because of the blog and access to customer information, preferences and experiences, Glossier was born as a brand with products that are made through thoughtful design and from customer feedback and continuous conversation. They launched the e-commerce platform in 2014 with four products: a moisturizer, a face mist, a skin tint, and a lip balm.
- **The Start in Physical Stores:** Glossier started its physical presence with flagships in New York and Los Angeles and hosted pop-ups in cities such as Seattle, Boston, and London. In 2020, due to the pandemic, they had to close all their stores. In 2021, they opened permanent stores in Los Angeles, Seattle, New York, and London.
- **Retail Customer Experience:** The focus of their stores is on offering real-life experiences that allow customers to discover and connect with the products through the store experience. The goal of the stores is not to generate more transactions, but to create a different beauty experience.

## 4. Key Learnings

***Who* should go into brick and mortar stores?**

- For product categories like apparel, physical stores enhance customer satisfaction through product interaction, personalized service, and brand immersion, fostering loyalty and increasing lifetime value.
- Learning from Warby Parker, ThirdLove, and Glossier, successful transitions to physical retail hinge on understanding customer needs and creating meaningful in-store experiences to drive loyalty and sales growth.

***Why* should a brand go into brick and mortar?**

- Pure E-commerce players initially had low competition and high ROI, but this has evolved. Today, almost every brand has a digital platform, increasing competition, raising customer acquisition costs, and reducing brand margins. Brands now need to continually create different experiences, which can serve as a differentiating factor to grow sales.
- Brands opt to create stores for top-line growth, business evolution, and improved customer experience. Factors like target consumer preferences and location influence their decision to establish a physical presence.

***How* should they do this transition?**

- Some brands choose to test first with a pop-up store, such as Warby Parker and Third Love, while others opt to enter department stores to increase their physical presence.
- Retail stores have evolved in recent years, shifting from purely transactional spaces to more experiential ones. The focus is now on creating immersive customer experiences and fostering social connections. Consequently, retailers are rethinking the layout and design of their stores to enhance customer engagement and brand interaction.

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