

BRICK-AND-MORTAR RETAILERS' SURVIVAL STRATEGIES AMID THE COVID-19 CRISIS

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SUMMARY

- As the shift in consumer demand towards e-commerce (EC) has taken root amid the COVID-19 crisis, brick-and-mortar retailers will need stronger survival strategies.
- The first strategy is to respond to consumer needs for infection prevention, such as by adopting cashierless checkout systems and implementing measures to reduce the amount of time customers spend in stores.
- The second strategy is to enhance the sophistication of EC initiatives by leveraging the advantage of speediness in product delivery that only brick-and-mortar retailers can provide.
- The third strategy is to expand and monetize the showroom function. Business models providing insight to this end are beginning to emerge.

The spread of COVID-19 infections has divided the retail industry, placing companies in stark contrast with each other depending on business format. Most specialty retailers, including department stores, shopping malls, and apparel shops, saw their earnings decline because they closed their stores to prevent infections, or otherwise suffered from operating restrictions. Meanwhile, other retail formats permitted to stay open in to supply consumers with daily necessities marked earnings growth. They include supermarkets, which captured demand from restaurants that had either closed or were avoided by consumers, and drugstores, which saw growth in demand for infection prevention products, e.g., masks and disinfectants (Figure 1). In addition, e-commerce (EC) transactions are increasing sharply, reflecting rapidly expanded usage by consumers who are refraining from going out. Even after retailers reopen their stores, as there are still concerns about infection, consumers will continue to avoid going out and limit person-to-person contact as much as possible for the time being, suggesting the likelihood of continued impetus for EC growth. Furthermore, the new customers who had been hesitant about using EC in the past, but decided they had little choice but to try it out with a lot of stores closed in the middle of the crisis, are also expected to contribute to further EC growth to some extent as their EC usage becomes established as part of the “new normal.” This is also the case with the EC business of brick-and-mortar retailers, as shown by the sharp growth in EC for Walmart and Target in the US market, where such expansion is outpacing growth for Amazon (Figure 2). Nonetheless, a comparison of EC against brick-and-mortar stores shows that EC still has the advantage as a sales channel, and as the economic environment deteriorates and consumption cools due to the ongoing COVID-19 crisis, brick-and-mortar retailers, especially the ones that have been slow to deploy EC services, will probably face difficulties. For brick-and-mortar retailers to survive in such a tough business environment, it will be essential for them to implement strategies aimed at withstanding the competition with EC, while also responding to consumer needs for infection prevention. This report considers possible strategies for leading retailers operating in the mature markets of advanced countries, such as general merchandisers, supermarkets, drugstores, convenience stores, and home improvement stores.

Figure 1: Change in sales for brick-and-mortar retailers (YoY, %)

Japan, US (by business format)					
	Format	January	February	March	April
Japan	Supermarket	-1.4	5.5	7.2	10.7
	Drugstore	6.3	19.1	7.6	10.4
	Home improvement	-1.5	9.7	3.5	4.0
	Apparel	-0.9	-3.5	-22.7	-53.6
	Department store	-3.1	-12.2	-33.4	-72.8
	Convenience store	0.4	2.6	-5.8	-10.6
US	Grocery store	1.5	3.9	30.9	13.2
	Department store	-3.6	-5.8	-25.1	-47.0
	Apparel	2.0	1.0	-49.8	-89.3

Europe (by major company)					
Market	Company	HQ location	Business format	% change	Period
UK	Tesco	UK	Supermarket	7.2	Jan 27-Apr 19 (12 weeks)
	Sainsbury's	UK		8.4	
	Lidl	Germany		14.8	
	Aldi	Germany		8.8	
Global	H&M	Sweden	Apparel	-57.0	Mar 1-May 6

Note: As Europe does not have statistics by business format, data for major companies have been included.

Source: Compiled by MGSSI based on data of the Ministry of Economy, Trade and Industry for Japanese drugstores, home improvement stores, and apparel companies; various industry organizations for other Japanese companies; US Census Bureau for US companies; Kantar statistical data for the UK market; and the corporate website for H&M.

Figure 2: Results for the most recent quarter for Walmart, Target, and Amazon (US\$1 million)

Walmart	Total			US business	
Feb-Apr 2020	Amount	YoY change		Amount	YoY change
Net sales	133,672	8.7%		88,743	10.5% (stores 10.0%) (EC 74.0%)
Operating income	5,224	5.6%		4,302	3.9%
Target	Total			Decrease in operating income attributable to downturn in apparel segment	
Feb-Apr 2020	Amount	YoY change			
Net sales	19,615	11.3%	(stores 10.8%) (EC 141.0%)		
Operating income	468	-58.7%			
Amazon	Total			North America	
Jan-Mar 2020	Amount	YoY change		Amount	YoY change
Net sales	75,452	26.4%		46,127	28.8%
Operating income	3,989	-9.8%		1,312	-42.6%

Source: Compiled by MGSSI based on companies' financial results

1. RESPONDING TO INFECTION PREVENTION NEEDS AND ENHANCING THE FUNCTIONALITY OF PHYSICAL STORES

At the core of retailers' strategies in the midst of the COVID-19 crisis are there the consumer needs for infection prevention. Specifically, this means limiting interpersonal contact between customers and employees as well as among customers as much as possible. One of the solutions for limiting contact between customers and employees is the so-called unmanned store, which Amazon and others are beginning to roll out. The cashierless checkout system, however, is a measure that many brick-and-mortar retailers can introduce more quickly whereas the contact frequency between cashiers and customers is rather high. In the West, the adoption of self-checkout systems has already made progress for the purpose of improving customer convenience and reducing costs, but the pace of adoption is likely to accelerate from the perspective of the COVID-19 response. It is expected that supermarkets, where a larger number of items need to be checked out, will adopt semi-self-

checkout systems, in which the cashier performs only barcode scanning of the products, and the customer uses a payment machine to make payments. Convenience stores, where fewer items are handled at the check-out counter, are more likely to adopt full self-checkout systems, in which the customer carries out all the procedures for product scanning and payment. The adoption of these systems can be expected to help reduce the risk of infection by speeding up the checkout process, as it would reduce or eliminate checkout queues, and shorten the length of time customers stay in the stores.

However, in the case of self-checkouts, multiple customers touch the same terminals and surroundings, resulting in customer-to-customer contact, albeit indirectly. As a measure to prevent such indirect contact as well, it is conceivable to introduce a payment system that will allow customers to use their smartphones. As measures for utilizing smartphones in physical stores, some leading companies are testing applications for various services other than payment, such as for providing store maps and managing shopping lists. The in-store app of US home improvement retailer The Home Depot, which is said to be especially innovative in this area, has a product search function that uses AI and image authentication technologies. For example, suppose a customer is looking for screws or other such items that have a shape or size that can easily be mistaken with another product. When a customer takes a picture with a smartphone camera and searches for an image of the product, the app displays the product number and the sales floor area where it can be found in the store. This function increases customer convenience, and is highly appraised by customers. Moreover, retailers in the West, Japan, and other countries are starting to introduce apps that notify consumers of the degree of crowdedness in their stores, with the intention of encouraging consumers who want to avoid crowds to visit stores during less crowded hours. These services leverage the use of smartphones to efficiently provide customers with information about stores and products, and because they lead to shortening the time customers spend in stores, limiting contact between customers and employees, and reducing congestion, the services are considered effective as a COVID-19 measure.

In the aspect of reducing the risk of infection, a change in store planning and development could also be explored. When deciding the store layout and product placement (shelf allocation), to date, the main objective has been to expand sales by, for example, enticing customers to browse the entire store, promoting incidental and impulse buying, and increasing per-customer spending. However, under the influence of COVID-19, shortening customers' in-store times in order to reduce the risk of infection should be prioritized to meet consumer needs, such as by placing products likely to be purchased together near each other. Also, despite the existence of digital technologies like AI, image authentication, and big data analysis that could be used for store planning and development, retailers have been hesitant about implementing them due to cost, and instead, have continued to rely on the experience and intuition of employees. It is likely that this will come under review as a part of COVID-19 countermeasures, and the introduction of these technologies could gain momentum.

Furthermore, considering that consumer behavioral patterns may change significantly owing to the effects of COVID-19, the location of stores will also come under review. In the conventional selection of store location, the generally applied method has been based on consumer movement patterns in accordance with the locations of residences, workplaces, schools, etc., and the distribution of transportation means, such as roads and railways. However, in the future, it is plausible that the movement patterns of consumers will change drastically due to the decrease in commuting frequency and the increase in activity near places of residence, as a consequence of growth in working from home and other factors. That will make it difficult to make assumptions of consumer movements based on consumers' places of residence and employment, and accessibility to transportation networks. Faced with such a situation, it will become necessary to collect and analyze data on consumer movements directly to identify new movement patterns before selecting a location.

The various measures mentioned here address consumer needs for infection prevention under the current condition that is underscored by the continuing impact of COVID-19, but many of these initiatives have also had the effect of enhancing the functionality of brick-and-mortar stores that helps improved customer convenience and stronger cost competitiveness, and should further lead to strengthening their competitiveness against EC. As such, these measures are unlikely to lose their effectiveness even in the post-COVID-19 era when the impact of the virus abates.

2. SOPHISTICATION OF EC SERVICES THAT ONLY BRICK-AND-MORTAR RETAILERS CAN PROVIDE

Even if retailers implement initiatives in response to consumer needs to avoid infections in physical stores, it will be difficult to reverse the shift in consumers' inclination towards EC as long as the risk of COVID-19 infection remains. Instead, one of the most effective strategy for brick-and-mortar retailers will be to expand and enhance EC operations. Many leading brick-and-mortar retailers have already expanded their EC services (Figure 3), and are seeing an improvement in performance as a result. In order to make further strides in that direction, it is important for those retailers to leverage the advantages unique to physical stores, and which EC does not have. Ultimately, the advantages that lie in brick-and-mortar retailers' EC operations can be boiled down to the speediness of their product delivery.

Figure 3: EC rate for major brick-and-mortar retailers (%)

	Company	Main business format	2014	2019
Japan	Aeon	Supermarket, GMS	0.2	2.3
	Seven & I	Convenience store	0.9	2.7
	Fast Retailing	Apparel	3.5	6.4
US	Walmart	GMS	2.3	6.8
	Costco	GMS	4.0	7.0
	Target	GMS	2.6	8.9
	Kroger	Supermarket	0.2	5.2
	The Home Depot	Home improvement store	6.1	10.5
	Best Buy	Consumer electronics	10.1	20.3
Europe	Tesco	Supermarket	7.0	8.7
	E.Leclerc	Supermarket	5.9	8.8
	Sainsbury's	Supermarket	5.1	14.8
	Migros	Supermarket	1.2	6.5
	Carrefour	GMS	0.9	2.4
	Auchan	GMS	3.6	5.3

Note: EC rate is based on EC sales as a percentage of total sales.

Source: Compiled by MGSSI based on Euromonitor data

First, it can be pointed out that the advantage unique to these retailers is their capabilities to offer customers the option of “click-and-collect” services, through which products ordered online can be picked up directly at a store. Under the current COVID-19 crisis, Kroger (US) and Sainsbury's (UK), which both operate supermarkets primarily in urban areas with a high risk of infection, have leveraged the unique features of click-and-collect services by employing a strategy of closing some stores to prevent infections and utilizing such facilities as so-called “dark stores” specializing in the fulfillment and delivery of online orders. In order to address consumer needs for infection prevention in the use of click-and-collect services, an important factor will be the installation of smart lockers (lockers that can be unlocked using a smartphone app) in stores to limit contact between customers and employees. Also drawing interest is the curbside pickup service that allows customers to pick up products in the parking lot of a store without entering the building. Curbside pickup has been introduced on a trial basis by Walmart (US), Target (US), and others, and is being considered for introduction by a wide range of other business formats, including shopping malls and department stores.



Walmart's curbside pickup service
(Source: Walmart's website)

Secondly, even in the case of home delivery, which is the same as standard EC, it may be possible for brick-and-mortar retailers to achieve faster delivery more efficiently than EC. This is because the distribution centers of EC are generally located in the suburbs, while the brick-and-mortar stores are located in proximity to residential areas, as the store format is premised on physical visits by customers, and they will be able to devise mechanisms for faster delivery by using those locations as bases.

However, the use of physical stores as EC distribution bases, whether for click-and-collect or home delivery, still requires the picking and packing to prepare the products ordered online. The challenge, then, is to improve the efficiency of these essential operations. It has already been confirmed that performing such work on the sales floor of the store is extremely inefficient and expensive. For this reason, a method of installing an automated small distribution center called a micro-fulfillment center (MFC) in the store is gathering attention. The US company Fabric (formerly CommonSense Robotics), which is known for its advanced MFC technology development, plans to open up to six MFCs by the end of 2020 for as yet unidentified grocery stores, indicating the spread of MFCs mainly in the US. Walmart is operating a pilot MFC at a supercenter in Salem, New Hampshire, in partnership with a company specialized in logistics robots, Alert Innovation. Walmart says the MFC will significantly reduce the lead time from order placement to completion of order preparation as compared to picking orders manually at the store.

There is no doubt that one of the most important strategies for brick-and-mortar retailers is implementing a combination of these various initiatives to leverage their speediness of delivery as a strength against specialized EC, which had, until now, been considered to have the cost advantage by not having physical stores.

3. EXPANSION AND MONETIZATION OF THE “SHOWROOM FUNCTION”

Even when brick-and-mortar retailers step up their EC services, the existence of physical stores is a prerequisite, and it is essential that the stores attract a certain volume of customers in order for those companies to maintain them. The abovementioned countermeasures to meet consumer needs for infection prevention are intended to reduce the negative aspects of shopping in physical stores during the COVID-19 crisis, but in addition to that, an important strategy is to pursue the positive aspects that attract customers to the stores. In the past, except for Walmart, Aldi (Germany), and the handful of other companies that are able to attract customers with unrivaled price competitiveness, most retailers have sought to amplify customer-drawing power by positioning their stores together with many other stores, such as in the form of shopping malls, and adjacent to restaurants and entertainment facilities, such as cinemas and game arcades. However, as interpersonal contact itself is the source of the effectiveness and added value of this approach, under the situation where infection risk remains, it is difficult to expect a great deal of customer-drawing power. As such, retailers' strategies should focus on reexamining and refining the advantages and appeal of their physical stores, which EC simply does not have.

One of the functions of physical stores that EC services do not provide is that they give customers the opportunity to actually touch the merchandise and check product quality and usability with their own eyes and hands. In addition, customers can obtain information about the products through real-time interactive communication with store employees. These are collectively referred to as the “showroom function” and are identified as the main reasons why customers take the time to visit stores. It is expected that expanding this functionality by improving methods for product display and providing free samples, along with enhancing employees' communication skills and other such measures, will increase in importance when considering the future direction of brick-and-mortar retailers. However, the spread of EC has given rise to the growing consumer behavior called “showrooming,” in which consumers visit a store to examine a product, but purchase the same item online instead at the lowest available price. This is making it difficult to reflect the showroom function in retailers' earnings. For brick-and-mortar retailers, the challenge from hereon will be not only to expand the showroom function, but also to build mechanisms to monetize such functionality. The following three cases may provide some insight on finding solutions to that end.

The first case involves motivating customers to purchase products in-store by changing the relationship with customers through other formats of business aimed at attracting customers. US supermarket Wegmans actively offers cooking classes at its stores and provides related information, such as recipes. Of course, it is difficult to attract customers by offering cooking classes when the risk of COVID-19 infection remains, but in this case, the relationship between the store and customer is not just that of a seller and buyer, but rather, becomes that of an information provider (teacher) and recipient (student) through cooking classes. Looking at the creation of

such a teacher-student relationship broadly as an approach that increases store loyalty and motivates in-store product purchases, it could have implications for the future strategies of brick-and-mortar retailers.

The second is a case where the function of communicating information to the customer, which is a part of the showroom function, is provided as a fee-based service to the product manufacturer, thereby monetizing it. Neighborhood Goods (US) operates roadside stores that are similar in format to department stores to the extent that the floor space is divided by manufacturer (brand) and each of them sells its own products within an allocated space. However, the business model is quite different from that of an ordinary retailer. Instead of earning a margin on product sales, the company charges a fee for effectively communicating the manufacturer's message and story about the product to customers, receiving the payment from the manufacturer in the form of rent for the floor space. With this business model, the company can earn revenue even if the physical stores are unable to sell the products functioning as a showroom for consumers, while the product manufacturers, for their part, can expect sales growth for their products at other stores or through their own EC sites. In this way, a win-win partnership can be built.

The third case is one where a company monetizes the customer data collected through its physical stores by selling as the information to product manufacturers. The US company b8ta (beta) operates stores offering a variety of unique and novel gadgets supplied by a number of manufacturers, including startups. AI-equipped cameras and sensors are installed in the stores to capture information on customer attributes and behaviors, such as the in-store flow of traffic, length of time a customer stops in front of a product, whether the customer picks up the product, etc. This data is then provided to the product manufacturer for a fee that is received in the form of rent for the occupied floor space. Although the flow of information is opposite to that in the second case, the common point of both models is that they incorporate a mechanism for collecting revenue from the product manufacturers.



Scene at b8ta's Hudson Yards store in New York (photographed by the author)

Both Neighborhood Goods and b8ta are extremely unique retail formats at this stage, and the product manufacturers who are their clients are mainly newly emerging D2C merchandisers who have low consumer awareness. Nevertheless, this kind of relationship can also be built with existing manufacturers who do not have a real contact point with customers. As such, the cases should provide insight for new business models to supplement the core business of brick-and-mortar retailers, especially companies with strong showroom function potential.

Within the EC domain, D2C merchandisers selling products through their own online shopping sites are beginning to emerge, mainly in the fields of apparel and health foods, and a new trend that stands out is that some of them are setting up physical stores as their operations expand. This is probably because even EC specialized companies recognize the potential advantage of having physical stores, including the showroom function, in particular. While the impacts of COVID-19 remain, will retailers be able to leverage their stores as EC distribution bases, and review, expand, and monetize the latent potential of their physical stores, such as the showroom function, while also satisfying consumer needs for infection prevention as described in this report. For brick-and-mortar retailers, a difficult period for survival is expected to persist.