

Fall 12-14-2018

# Is American Retail at a Historic Tipping Point?

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## Recommended Citation

Torres-Baron, Violetta, "Is American Retail at a Historic Tipping Point?" (2018). *CUNY Academic Works*.  
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# **Is American retail at a historic tipping point?**

**How some big-box retailers are turning their businesses around in the era of e-commerce**

## **The Inflection Point**

It's become a holiday tradition for Matina Lazarakis to visit Macy's "Santaland" on the eighth floor of the flagship Herald Square location with her three daughters.

"There's no feeling like shopping at Macy's during Christmas time," Lazarakis said. "And recently I've noticed that Macy's has done a 360 to better the experience at the store for shoppers."

International tourists and native New Yorkers alike rub elbows in the 13,000-square-foot winter wonderland – nested within one of the 11 floors of the largest department store in the country – overflowing with decorative lights and elaborate ornaments. It's a microcosm of what brick-and-mortar stores in the US are slowly evolving to become: an experience.

For centuries, Americans had a certain physical location in mind when they needed to buy something. When they needed to prepare dinner, they went to the supermarket. When they needed to buy a new blouse for a job interview, they went to the department store. When they needed to replace a light bulb, they went to the hardware store.

Then along came online shopping and a shift in consumer behavior that has led to a record number of store closings and retail bankruptcies, including Sears, Sports Authority, Payless Shoes, and Toys "R" Us. Last year, 26 retailers filed for bankruptcy remarkably surpassing the 20 retailers that filed in 2008 amid a recession that devastated the sector.

Yet the deeply anticipated 'retail apocalypse' of brick-and-mortar stores as a whole has not happened. About 90% of retail still happens offline and retailers from Macy's to Walmart to Target and Best Buy are learning how to reach the next generation of shoppers.

"Physical retail is not dead," said Joseph Feldman, senior managing director at Telsey Advisory Group. "Last year we bought into this notion of a retail apocalypse but this year has been a rebound off of that."

Still he warns that retailers must continue to adapt. "I would say retail in the US is at an inflection point," he said. "Traditional retailers need to change if they want to survive."

In a marketplace increasingly dominated by those that don't will be left behind.

Blockbuster, the once-leading but now obsolete movie rental business is a prime example of a company that failed at its inflection point. The company didn't embrace digital change despite an opportunity in 2005 to purchase Netflix for \$50 million, instead doubling down on its physical retail presence. Today, Blockbuster is extinct while Netflix is a media titan.

With a strong US economy, companies that make the smart decisions can be poised to at least survive.

### **In The Backdrop of Retail's Evolution: A Robust Economy**

The strength of the retail industry in the United States depends on key economic measures – all which paint a positive picture.

Median income, according to the US Census Bureau, began falling in 2007, and bottomed out in 2012. Since then, it has bounced back and as of 2016 stood at \$56,617 slightly higher than it was in 2007. This suggests consumers' wallets are fatter than they have been in recent years.

Last month, the consumer confidence hit 135.7, a historical high, according to the Index of Consumer Sentiment, which gauges how confident Americans feel about the economy.

That confidence reflects the strength of the labor and housing markets. The unemployment rate in the United States is at 3.7 percent, a multi-decade low and a far cry from the 9.9 percent rate at the peak of the recession. Likewise, the housing market has fully recovered and is at an all-time high.

Together, these indices signify strong and robust American consumers who are inclined to loosen their wallets.

### **Retail Growth: Online and brick-and-mortar**

According to the National Retail Federation, retail across all channels, including in stores, continues to grow. Online sales get all the attention with a 12.5 percent annual growth rate from 2012 to 2016. But brick-and-mortar sales have been growing too, up 1.3 percent over the same period.

"Retailers have spent the past decade investing in their digital channels and will likely spend the next decade investing in their physical stores" said Stephanie Cegielski, a vice president at the International Council of Shopping Centers. "This will not only create a positive experience for the consumer but it will create an environment that online shopping cannot provide."

Looking to the future, online sales over the next five years are projected to grow 11.7 percent annually, while growth in store sales is predicted at 1.7 percent.

## **Macy's Approach: Experimenting with a new type of brick-and-mortar**

In hopes of continuing its sustained growth, the American department store chain has invested heavily in its off-price Backstage stores, loyalty program, mobile app and website while also improving its physical stores by leveraging mobile checkouts and new shop layouts.

In its most recent earnings, Macy's reported sales at stores open for at least 12 months were up 3.3 percent, marking the fourth consecutive quarter of same-store sales growth and surpassing Wall Street expectations.

"Macy's recipe for success is a combination of e-commerce, stores, and strong mobile experience," said Jeffrey Gennette, chief executive officer.

"You really can't replace the experience of going to a store, seeing what you want to buy, feeling the material and trying it on," said Matina Lazarakis who is a member of Macy's Star Rewards program. "Plus Macy's has phenomenal sales that as a public school teacher and mother of three girls I just can't pass up."

In November, Macy's also announced it is experimenting with a new store format called "neighborhood stores" as a key strategic initiative moving forward.

"Neighborhood stores" will have a smaller footprint, fewer employees and a smaller selection. In lieu of simply closing stores, which other competitors are doing, executives explained that when Macy's stores close there's a tendency for online shopping in that particular area to decrease – a loss they are not keen to undertake.

"Based on customer insights and a deep understanding of our shoppers we know that a strong brick-and-mortar presence amplifies online sales," said Paula Price, chief financial officer.

In early 2017, Macy's shut 100 stores in an effort to cut real estate costs in low traffic areas. Macy's "neighborhood stores" will have more self-service options and an area dedicated to more self-service options.

Testing and customer analytics are crucial for big-box retailers who are in search of the appropriate mix of physical presence and e-commerce penetration.

"Macy's continues to evolve into a differentiated retailer," said Ivan Feinseth, director of research at Tigress Financial Partners. "It continues to innovate and expand its digital capabilities and there's a significant upside to that."

On the earnings conference call Macy's said it expects to reach \$1 billion in mobile sales this year.

## **Target's Approach: Expanding same-day delivery and redesigning stores**

Target has been busy upgrading its supply chain. Early last year, the Minneapolis retailer announced it would pour \$7 billion into investments to turn around its business over the next three years. A portion went into bulking up its delivery options, making it more convenient for people to shop in Target stores and online.

Late last year, the big-box retailer announced the acquisition of grocery delivery platform Shipt Inc for \$550 million in cash, assuring same-day delivery for all of its products by the end of 2019 to bait customers that have turned to online competitors.

The retailer is already making headway: it announced its delivering in two hours or less to customers near 1,400 Target stores across 160 markets. Ship-from-store sales more than doubled, executives said in the latest earnings call.

In the third-quarter earnings report, Target announced online sales soared 49 percent, outpacing the 41 percent rise in the second quarter and a 28 percent gain in the first. It also said same store sales rose 5.1 percent.

The company's Drive Up service, which allows shoppers to place orders online then pick up at a nearby store without getting out of their car is now on track to reach nearly 1,000 US stores before the end of the year. The initiative started with 50 stores 12 months ago.

"We are seeing two really positive things out of the Drive Up and Shipt efforts," said Catherine R. Smith, chief financial officer at Target. "We are seeing incremental guests making incremental trips and we're seeing customers shift what would have been a two-day free delivery into coming to our stores because they are so well located."

Providing customers ample options for shopping, delivery, and pick-up is what Target hopes will deem the retailer "the easiest place to shop in America."

Like Walmart's grocery pickup service, Drive Up is prevalent among parents with small children, where shopping can be difficult. Parents, especially those with babies, have been using Drive Up for restocking their household essentials like diapers, said Target.

This is a critical demographic for Target as the toys and baby segments are particularly strong, benefiting from the Toys "R" Us bankruptcy earlier this year.

"As other retailers continue to close stores and liquidate in the face of rapid changes in consumer preferences and shopping behaviors, our investments position Target to capture

sales and market share by serving consumers who are no longer shopping those competitors,” the company said.

### **Walmart’s Approach: Acquisitions & Groceries**

With Amazon’s explosive growth, it’s easy to lose sight of the fact that Walmart is still, by a long shot, the world’s largest retailer. Walmart wants to remind us that it isn’t going anywhere just yet.

In November, the Bentonville, Arkansas-based company reported comparable sales climbed for the 16th consecutive quarter at a 3.4 percent growth rate, stronger than the 2.9 percent expected by analysts. Walmart added it anticipates comparable sales to sustain this streak and grow “at least” 3 percent next year.

E-commerce sales during the third quarter grew 43 percent, year over year, after the second quarter’s 40 percent gain.

Walmart is an example of a traditional retailer whose efforts to scale its digital business are proving to be fruitful. The big-box retailer is now continuously demonstrating strong sales metrics while Amazon’s growing dominance of retail has forced traditional retailers to scramble and figure out a competing strategy.

The world’s largest retailer has been on an acquisition binge recently buying brands aimed at millennial shoppers who typically wouldn’t turn to Walmart. The company recently bought lingerie retailer Bare Necessities after purchasing plus-sized clothing startup Eloquii: both digitally native brands.

Walmart’s latest efforts to attract younger shoppers include its 2017 acquisitions of Modcloth and Bonobos – two other digital-first upscale fashion brands with large millennial followings. This year, Walmart also built a new mattress brand called Allswell to compete against bed-in-a-box competitors like Leesa and Casper.

“I shop online with Eloquii but never in a store front,” said Victoria Palacios. “It’s way more convenient for me to browse their selection on my phone instead of making a trip to a physical location.”

### **Best Buy’s Approach: Tailored customer service**

Best Buy is touting its tech support and advice to win shoppers. The company began a \$199/year “Total Tech Support” program in May which includes unlimited “Geek Squad” support online and in stores. Its efforts are paying off: the company reported its same-store sales grew 4.3 percent in the third quarter.

In the era of online shopping and anonymous transactions, Best Buy's strategy is to build deeper and more relationship-based experiences with customers filling a void for shoppers who want added support with repairs and installations.

To compete in the retail landscape, companies are figuring out their ways to differentiate themselves from their rivals. For the largest U.S. consumer tech retailer, an emphasis on tailored customer service is their competitive approach.

With more than 1,000 big-box stores and 125,000 employees Best Buy was once struggling with shrinking profits and little hope. The Minnesota-based retailer hired Hubert Joly as CEO in 2012 at the time when the company was in chaos as sales and the stock price were falling. Joly comes from a hospitality background having served as CEO of travel company Carlson. Much of his influence has been solidifying Best Buy's dedication to customer service as a means of increasing loyalty and reputation.

"Senior management deserves significant credit for successfully reconfiguring the company's business model, so as to compete effectively in an increasingly online and omni-channel retail landscape," Oppenheimer & Co analyst Brian Nagel said in a report.

### **But no one should forget about Amazon**

While traditional retailers are getting smart and savvy about how to win over customer loyalty, Amazon remains the most important force in retailing.

According to a survey by eMarketer, Amazon claimed 49% of the US e-commerce market this year, up 30% from one year ago. E-commerce giant eBay is second to Amazon and has only 6.6 percent of the market share.

"The reality of retail in today's age is Amazon's untouchable advantage against other retail companies" said Ivan Feinseth, chief investment officer at Tigress Financial Partners who extensively covers the retail industry. "The slice of the pie for the rest is getting smaller."

A few months ago Amazon announced it was nationally raising its minimum wage to all of its workers to \$15 per hour, bragging to its competitors — many which are barely getting by paying workers minimum wage — that it's doing well enough to offer the bump.

Just look at Walmart's CEO Doug McMillan who keeps a photo of the top 10 retailers in the United States throughout the last few decades, readily available on his cellphone, to remind him how quickly "companies come and go".

Topping the list includes names like Sears, Kmart, Super-valu, Fortune Brands, Gemco, Zayre — all of which have either gone bankrupt or have had to be acquired by a competitor.

"Businesses grow, and if they don't change enough, they decline over time," McMillan told CNBC. "Retailers do that on a bit of a faster cycle."