IBM Business Consulting Services

IBM Institute for Business Value

Cross-channel optimization

A strategic roadmap for multichannel retailers

In association with

Santa Clara University
Retail Management Institute

IBM® Institute for Business Value

IBM Business Consulting Services, through the IBM Institute for Business Value, develops fact-based strategic insights for senior business executives around critical industry-specific and cross-industry issues. This executive brief is based on a multiyear research study by the Retail Management Institute at Santa Clara University and the extensive client engagement experience of IBM Business Consulting Services. It is part of an ongoing commitment by IBM Business Consulting Services to provide analysis and viewpoints that help companies realize business value. You may contact the authors or send an e-mail to iibv@us.ibm.com for more information.

The Retail Management Institute, Santa Clara University

Santa Clara's Retail Management Institute represents an industry partnership committed to the advancement of retail knowledge. The Institute develops leaders capable of effectively using consumer information and technology to manage change in a dynamic and complex multichannel retail environment. The Institute's innovative undergraduate, management development and research programs are recognized globally. See www.scu.edu/rmi for more information.

Cross-channel optimization

A strategic roadmap for multichannel retailers

Executive summary

A new, superior retailing model is emerging. This model provides the retailer with powerful new capabilities based on cross-channel optimization. It is not simply about executing the same activities in multiple, separate channels. Nor does it focus simply on integrating or synchronizing channels to support cross-channel shopping.

Instead, it requires a systematic approach to exploit the strengths of one channel to complement the relative weaknesses of other channels. It involves the migration of costly activities in one channel to a lower cost basis in another. In many organizations, however, there remains a general lack of a vision or a systematic approach to achieve what this new model entails – developing multiple points of cross-channel leverage and ultimately optimizing resource allocation.

This paper makes the case for an emerging retailing model, based on a multiyear research study by the Retail Management Institute at Santa Clara University and the extensive implementation experience of IBM Business Consulting Services. The research effort was conducted with senior retail executives across a wide range of industry segments. The paper elaborates on the conceptual basis for cross-channel optimization and describes a four-stage iterative framework that retailers can use to harness its power:

Stage 1: Align fundamentals

Stage 2: Achieve proficiency

Stage 3: Leverage across channels

Stage 4: Optimize the operating model.

Further, we identify four major strategic opportunities for driving cross-channel optimization and illustrate these areas with case studies from leading retailers:

- Trend and growth mining
- Efficient marketing communications
- Improved merchandise utilization
- Enhanced customer learning.

To be successful at cross-channel optimization, retailers will need to proactively address key factors that can help (or hinder) their progress. The charge must be led from the top of the organization, treating multichannel retailing as an enterprisewide, strategic issue. Internal objectives and incentives must be aligned. The performance and costs of specific activities in each channel should be measured to identify the most promising opportunities for optimization.

Because this process involves fundamental change of the retail operating model, it will be neither easy nor quick. But companies that learn how to make the shift will build a strong platform for continued, profitable growth in revenues and market share. They will develop the capabilities for sustained market leadership in the 21st century.

The multichannel imperative

In an increasingly competitive retail marketplace, the end-to-end customer experience has become the new battleground. Success in retail today requires companies to deliver a superior, differentiated shopping experience attuned to ever-changing customer needs and preferences. A retailer's multichannel strategy is critical because of the central role its channels must play in the information-rich, seamless and tailored shopping experience customers are beginning to expect.

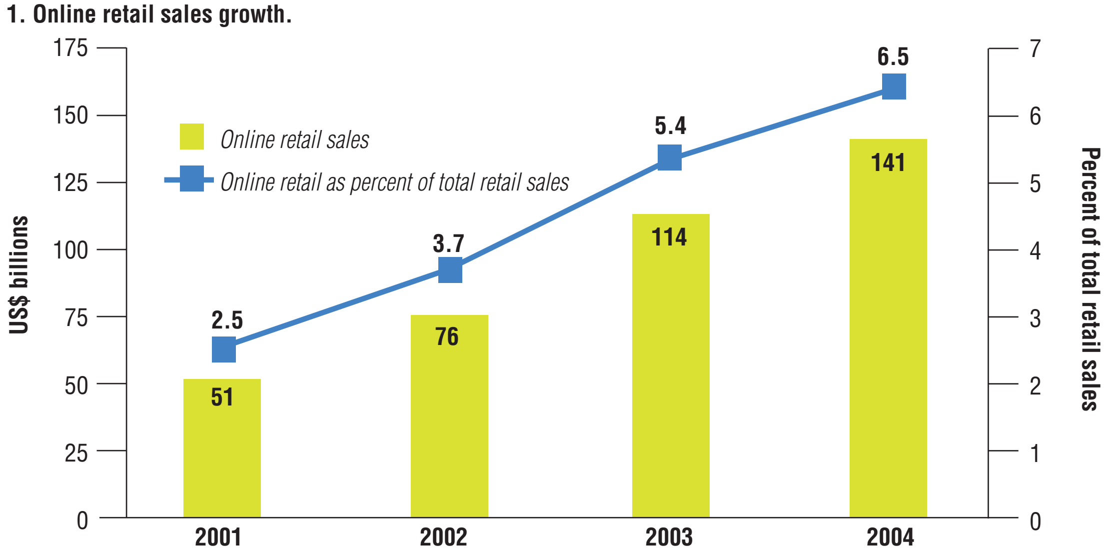
> *"Mere presence does not constitute a multichannel strategy."*
>
> *— Executive VP, Specialty Retailer*

Leading retailers today are harnessing both traditional and new channels (i.e., physical stores, the Web and catalog/direct) to provide customers with new and more flexible ways of shopping. Having recovered from the turbulence of the early dot-com era, companies are becoming more sophisticated in their e-commerce strategies. Many are even enjoying strong top- and bottom-line growth in their Web businesses. However, it would be premature to conclude that the multichannel challenge has been fully and successfully tackled. The industry remains in the early stages of a major evolutionary cycle, and significant opportunities lie ahead for companies that can identify and exploit them.

While emerging technology has been a key enabler, *multichannel evolution is fundamentally being driven by consumers*, who are demanding new ways of shopping. Recent market research reflects the reality of customer behavior patterns today (see Figures 1 and 2). While it still accounts for a small proportion of overall retail sales, e-commerce has continued to grow rapidly, averaging 40 percent annual growth over the past three years (2001-2004). And in categories such as books, toys and video games, consumer electronics, and cosmetics and fragrances, its penetration is estimated to exceed 10 percent.[1] For most retailers, Web commerce has reached critical mass and become a truly important part of the business.

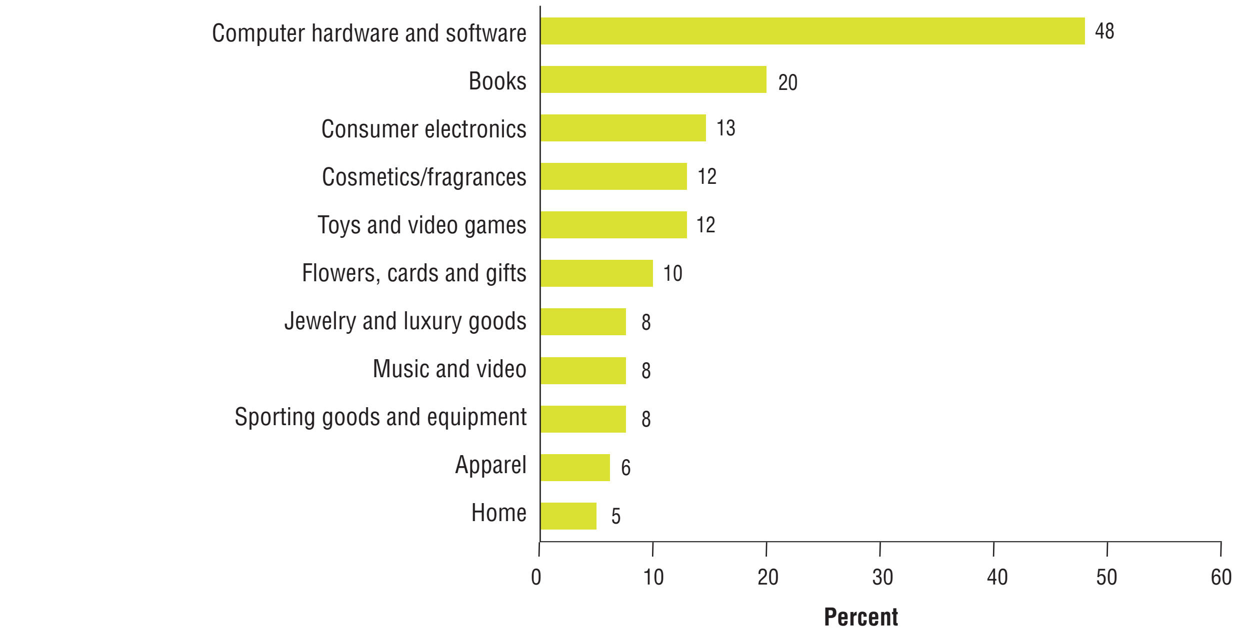
Even more importantly, customers have eagerly incorporated the use of multiple channels in their overall shopping

Figure 1. Online retail sales growth.



Source: "State of Retailing Online 8.0," Shop.org and Forrester Research, May 2005.

Figure 2. E-commerce penetration by product category (2005 estimate).



Source: "State of Retailing Online 8.0," Shop.org and Forrester Research, May 2005.

patterns. The Web has become a powerful and essential channel for customers to gather information; an estimated 20 percent or more of overall store-based sales is being influenced by the Web.[2] Cross-channel shopping has reached a level where it can no longer be ignored.

An effective multichannel strategy is therefore essential to retailers' drive to become more "customer centric." Customers view a given retailer (J.C. Penney, for example) not as three separate businesses – a department store chain, a dot-com and a catalog operation – *but as a single brand and company* that should be able to serve them in a consistent and harmonious way regardless of the channel of interaction. This is increasingly true for multibrand retailers as well.

Multichannel success is key to driving profitable growth in retail. For those facing innovative, agile competitors, the first requirement is to remain competitive and preserve market share. Over time, the benefits will come from increased customer satisfaction, improved cross-sell and upsell, and greater share of wallet. True multichannel retailing requires a new operating model, one that provides new capabilities to help increase consumer loyalty, drive revenue growth and reduce operating costs.

Reinventing the retail operating model

Today most retailers are operating in multiple channels, but the channels remain distinct and only loosely connected from both customer and internal perspectives. This situation will be a temporary, transitory phase for the industry. Retailers will move over time to deliver a truly seamless customer experience across multiple channels and touchpoints (note the distinction between these two terms – see "Channels versus touchpoints" sidebar).

This will not be a dramatic, sudden transformation. It will necessarily take place over a period of years through continuous, incremental change. Retailers will need to evolve in concert with their customers, developing and deploying new capabilities that add value both to shoppers and the business.

Multichannel retailing offers retailers the opportunity to reinvent themselves. While much attention is deservedly placed on customer-facing "front end" activities, the full multichannel opportunity includes what goes on behind the scenes. As customer shopping patterns evolve, retailers have the opportunity to reinvent their underlying operating model – to overcome the weaknesses and better exploit the strengths of any given channel. As discussed in the next section, the true benefit of multichannel retailing lies not simply in "integration," but in *cross-channel optimization*, a capability nascent, if not absent, in most retail organizations today.

Channels versus touchpoints
In this paper, these terms carry distinct meanings:

- A *channel* refers to an organizational unit in which a retailer goes to market, sells to and serves customers – for example, a store division, an e-commerce business unit or a direct/catalog division.
- In contrast, a *touchpoint* is a medium through which a retailer interacts with its customers. Examples include Web sites, the call center, store associates and the point-of-sale (POS)/cash wrap.

This distinction is especially useful given the proliferation of new touchpoints in retail today – such as self-checkout systems, price checkers, kiosks and other points of service. While today a touchpoint is usually "owned" by a given channel organization, the underlying goal of multichannel retailing is to leverage them across the entire enterprise. Eventually, the internal channel distinctions may disappear, leaving only a diverse range of touchpoints through which the retailer orchestrates a unique, compelling shopping experience.

The power of cross-channel optimization

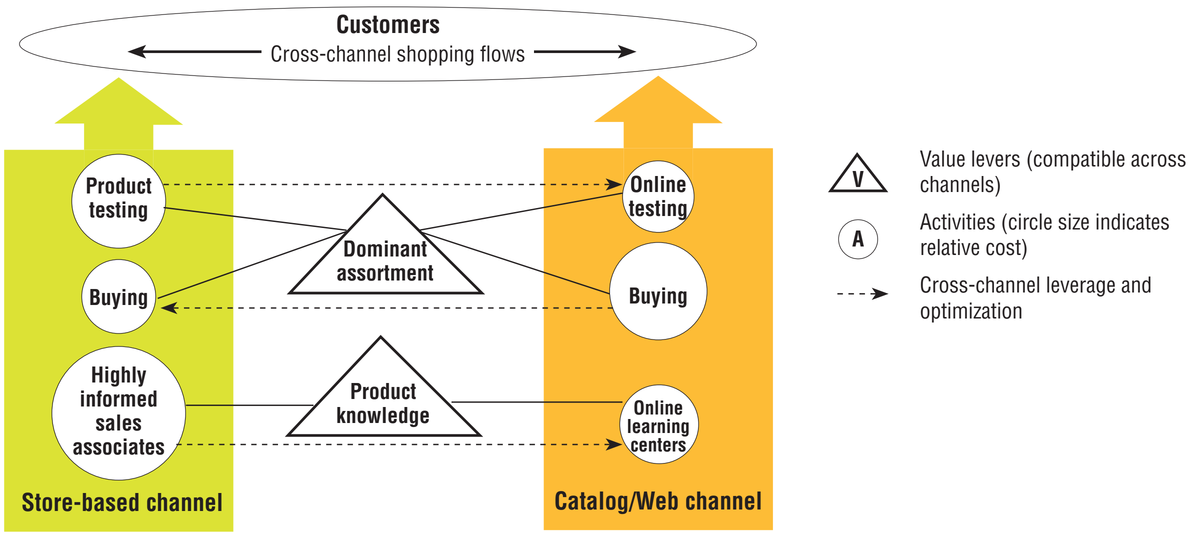
In industry publications and at conferences, considerable ink and airtime is devoted to multichannel issues. Terms such as integration, optimization, consistency and synchronization are often used in ways that result in considerable confusion. This was evident in the wide range of responses we received in the course of our research to the simple question, "What is your multichannel strategy?"

Multichannel strategies must, over time, focus on more than the performance of individual channels or simple extensions of basic customer services across channels. These strategies need to recognize the differences between such distinct objectives as *compatability*, *integration* and *optimization*.

- *Compatibility* is about whether the retailer's value proposition is presented across channels in a harmonious or congruent way from a customer perspective. It is achieved by explicitly aligning activities in each and every channel to key value levers. In the short term, key value levers might not be executed consistently across channels due to operational or technical limitations. For example, one retailer who offers promotions around bundled sets of products in the store was initially not able to present the same promotions online due to technical limitations. In this case, one of the key value levers (i.e., promotional offers) was not compatible across both channels.
- *Integration* centers on cross-channel customer shopping flows, an area that many retailers are focused on today. For example, customers might want to shop and buy online, but pick up the product in the store. Enabling cross-channel shopping flows requires *synchronization* and *integration* of the activities performed by the retailer, but does not necessarily imply a shift in where those activities are performed.
- *Cross-channel optimization* is about using the capabilities of one channel to positively change the cost structure of another channel. It involves fundamentally changing the *way* specific activities are performed, and by *whom* in the organization, to increase their effectiveness and reduce their underlying costs. Cross-channel optimization is ultimately the basis for multichannel retail success.

The deeper opportunities of cross-channel optimization are illustrated in Figure 3, depicted in the context of a general model of strategy and a supporting activity system. Triangles illustrate the retailer's key "value levers" (i.e., elements of their value proposition), and

Figure 3. Compatibility, leverage and optimization in a multichannel activity system.



Source: Dr. Dale D. Achabal and Dr. Kirthi Kalyanam, Retail Management Institute, Santa Clara University and the IBM Institute for Business Value.

circles represent the supporting "activities" (i.e., things the company does to deliver value to the customer). Activities can be associated with one or more value levers and can also be linked to each other, indicating coordination or dependencies. Activities also have costs associated with them, which are reflected in the figure by the size of the circle.

The basis for cross-channel optimization is the significant difference in the nature and costs of performing activities across channels. Prior to the Internet, most retailers worked within the limitations of a single-channel model. Even though they knew some activities were costly, it was difficult to make additional dramatic improvements in activity performance within the existing channel. Multichannel retailing provides companies not only with new channels, but also new capabilities. It allows retailers to improve the effectiveness of activities that are the basis of unique or differentiated value levers, often through the introduction of new customer services or employee tools. It also enables companies to change the cost structure of existing activities by migrating them to a different channel. For example, Figure 3 shows that some activities which are relatively costly to perform in the store-based channel, such as product testing and the customer service provided by highly informed sales associates, are being migrated to the catalog/Web channel. Conversely, many aspects of buying are much more efficiently and effectively performed in the store-based channel, and so buying activities for the catalog/Web channel are being migrated in that direction.

The big opportunities in cross-channel optimization come from using the new capabilities of emerging channels to impact the operating model of the dominant channel.

In their initial forays online, companies utilized the capabilities of their store-based operations in launching new Internet sites, for example, by exploiting the power of their brands and buying organizations. Retailers understood these points of leverage quite well, as this was about using the power of a dominant channel to improve performance in a nascent channel. However, as shown in the case studies presented later in this paper, the big opportunities for leverage and optimization are the other way around. *Going forward, the focus should be on using the new capabilities of emerging channels to impact the operating model of the dominant channel.*

Achieving cross-channel optimization: A multistage roadmap

Cross-channel optimization is complex. Retailers need a systematic approach to harness its benefits as they will not accrue to the company automatically. We have developed a multistage framework that companies can use to guide their multichannel strategies and harness the power of cross-channel optimization (see Figure 4).

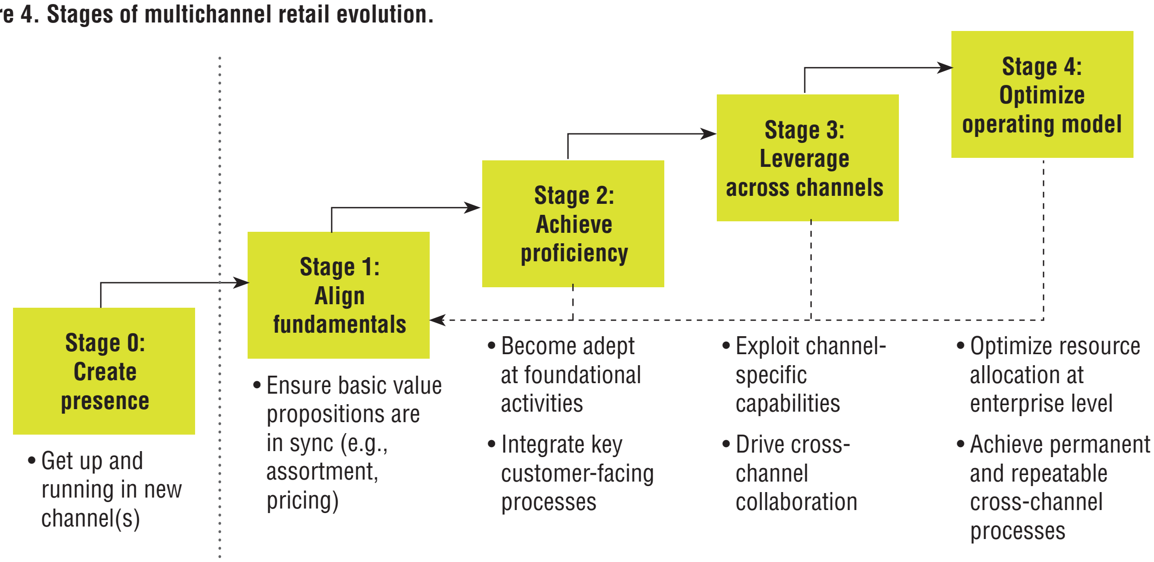
In practice, retailers will likely have a portfolio of initiatives that extend across the stages and progress through them in an iterative process that involves moving ahead, learning, rethinking earlier decisions and then again moving forward.

Stage 0: Create presence

The starting point for most retailers is simply to "get up and running" in a new channel, be it the Internet, a catalog or a new store format. For many retailers, the most recent example was going online in response to the dot-com challenge. Issues of strategic differentiation and cross-channel optimization were rarely a priority.

In this time period, the evolution of the industry also suffered because e-commerce growth did not keep pace with even the most pessimistic forecasts. Many retailers did not realize a return on their initial investments, and e-commerce quickly became a lower priority. Fortunately, the industry has now largely moved past this stage and is focused on making the most of new channels in the context of the overall enterprise.

Figure 4. Stages of multichannel retail evolution.



Source: Dr. Dale D. Achabal and Dr. Kirthi Kalyanam, Retail Management Institute, Santa Clara University and the IBM Institute for Business Value.

Stage 1: Align fundamentals

In this stage, retailers address two key questions:

1. What is our strategy to serve our target customer?
2. How is this strategy executed within and across multiple channels?

Essentially, this stage involves mapping and building out the activity system illustrated in Figure 3. With the growth of the Internet, many retailers have created activity systems to compete in this channel. The key issue is the degree of alignment and compatibility of the activity system with the retailer's overall strategy.

Alignment is important because it allows the retailer to present its value proposition in a compatible way in all channels. Compatibility, in turn, is important because it gives credibility to all channels, especially in the eyes of the customer who sees only "one retailer" brand and not distinct Internet, catalog or store-based divisions. While fundamental aspects of the brand and value proposition need to be aligned, *absolute consistency is not the goal*. For instance, while core assortments should be the same across channels, there may be differences in extended assortments that have a unique role and capability in a given channel.

To achieve compatibility, all channel organizations need to understand, agree and execute on the fundamental value levers for the retail enterprise. Lack of compatibility can lead to subpar performance, and under such circumstances, it will be hard to pursue more advanced goals such as cross-channel leverage and optimization.

As a practical matter, aligning fundamentals is not a static one-time effort. As value levers change to meet evolving consumer needs or match competitive moves, activity systems will have to be realigned. Further, as new channels and consumer touchpoints emerge, they will have to be assimilated in the context of existing value levers and activity systems.

Stage 2: Achieve proficiency

In this stage, retailers focus on achieving operational proficiency and gaining scale in the new channel(s). Proficiency and minimum operating scale are required to truly leverage the organization's existing assets, as well as those capabilities that are being acquired and deployed to support cross-channel optimization. Further, scale is required for new channels to gain sufficient credibility within the organization and earn greater management attention and resources.

There are two key aspects of achieving proficiency in the context of multichannel retailing:

- *First, retailers aim to reduce the costs of performing activities in the new channel by achieving economies of scale*. This is about going up the familiar learning curve: the lower the relative costs, the greater the difference with those in other channels and, therefore, the greater the potential benefit of cross-channel optimization.
- *Second, retailers respond to customers' emerging shopping patterns and information needs both within and across the different channels.* Examples of cross-channel shopping flows include shopping online and picking up in the store, or buying online and returning or exchanging at a store. These shopping flows challenge the different channel organizations to cooperate with each other in meeting customer needs. To date, retailers have largely focused on these types of issues, seeking to deliver new cross-channel customer services and engaging in the technology integration required to seamlessly support them.

Example cross-channel services deployed by retailers today

Customer services

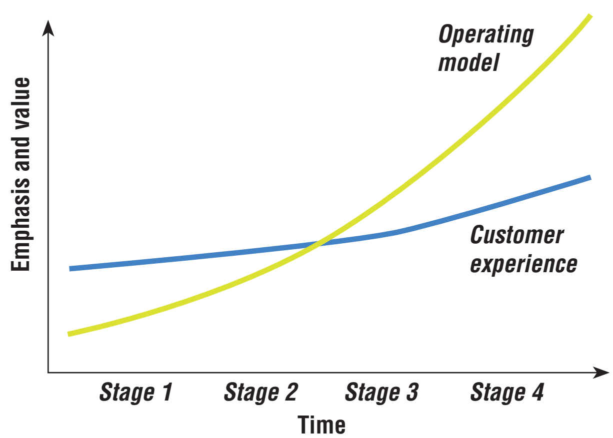
- Buy online, pick up in store
- Check store item availability online
- Cross-channel offers/promotions/gift cards
- Browse and purchase from e-commerce site while in store
- Online registration/scheduling for store events and consultations
- Multichannel gift registry
- Cross-channel returns
- Online access to account/loyalty program information.

Employee tools

- View and order from inventory in other channels/stores
- View and edit customer profiles/history from the store
- Access cross-channel customer/order information from call center.

A subtle, but important difference exists between the previous two stages and the next two. As illustrated in Figure 5, Stages 1 and 2 are primarily driven by "customer pull," focusing on the customer experience. Stages 3 and 4, in contrast, focus on achieving greater efficiency and effectiveness in the retailer's core operating model. The balance in emphasis – and source of business value – thus shifts across the stages, between customer-facing (or "front-end") activities and internally oriented (or "back-end") operations.

Figure 5. Shifting emphasis and value in multichannel strategy.



Source: Dr. Dale D. Achabal and Dr. Kirthi Kalyanam, Retail Management Institute, Santa Clara University and the IBM Institute for Business Value.

Stage 3: Create leverage across channels

In this stage, retailers seek to deploy the assets or capabilities developed in one channel into another. Consider the content and graphics developed for a catalog business: This content can be reformatted and deployed in other channels and touchpoints, such as the company's Web site and in-store kiosks. Strategies that leverage these assets across channels can help eliminate redundant activities that often unnecessarily exist or develop over time in different channels.

"You need to recognize that each channel has inherent weaknesses that are not solvable, but may not need solving because another channel compensates."

— Senior VP, Apparel Retailer

Leverage involves using the strengths of one channel to compensate for the weakness of another. Each channel has certain inherent challenges that are well known and are not solvable in that channel, but can be addressed by leveraging the unique capabilities of a different channel. Several examples follow:

- For example, the store channel has to operate physical sites, allocate inventory and manage sell-through on a store-by-store basis, while the catalog or Internet channel typically has only one central fulfillment center in which inventory is managed. Clearly, it is much more difficult to allocate and manage inventory across hundreds or thousands of locations, and this forms the root of one of the most critical problems in store-based retailing – the challenge of having the right product at the right place at the right time. "Endless aisle" kiosks that provide customers access to centralized inventory while in the store (e.g., via the retailer's Web site) help make up for the store's shortcomings and can enable the retailer to "save the sale" that would otherwise be lost due to out-of-stocks.
- Another challenge of store-based retailing is that, by and large, it is hard to personalize customer interactions consistently over time and at scale. Historically, store-based retailers relied on their sales associates to recognize and maintain continuity with individual customers, an approach that has been hard to execute given the types of labor pools that most large retailers draw from. Given the inability to engage in consistent personalized communications, such retailers have relied primarily on mass media advertising to market to customers and drive traffic to the store. However,

effective use of electronic media (e.g., e-mail or text messaging) for marketing communications can be an important step forward, helping retailers to develop the capabilities for more sophisticated "mass personalization" in the future.

- By contrast, the Internet channel suffers from the obvious weakness of subscale distribution (i.e., the need to ship directly to individual customers at comparatively high costs). To address this challenge, some retailers have experimented with various models that take advantage of store-based assets – for example, offering to ship a product ordered online to the nearest store for customer pickup and waiving the shipping fee, or using "warerooms" in the back of an existing supermarket to stage, pick and pack online grocery orders.
- At first, the Web channel also lacked the ability to deliver a "human touch" in the customer shopping experience. Customers who preferred the immediacy and ease of speaking with a sales associate were left wanting. But through new technologies like live chat and voice-over-IP, retailers are leveraging the call center capabilities built for their catalog business into the Internet channel to positively influence customer satisfaction and sales.

Stage 4: Optimize the operating model

In the final stage, retailers seek to optimize their operating models at an enterprise level. Optimization builds on leverage. The basic logic is simple: *If a capability or asset from one channel is systematically available to the other channels, the overall resources or budget devoted by the enterprise to similar or redundant activities can be appropriately adjusted.* For example, if the direct channel can drive store traffic via catalog drops, then the mass media budget of the store organization could be reduced or redirected to more productive uses.

For many organizations, however, moving to a stage where they can optimize decisions on investments and activities at an enterprise level is very difficult and takes time. As any senior executive in a store-based organization can attest, making the "comp" store sales numbers is a paramount goal that drives management actions and decision making. Few executives would relinquish control of critical resources like advertising budgets simply on the faith that the catalog or an alternative direct marketing approach will drive store traffic and sales. They will need measurable proof and assurance that it can be done in a repeatable and predictable manner.

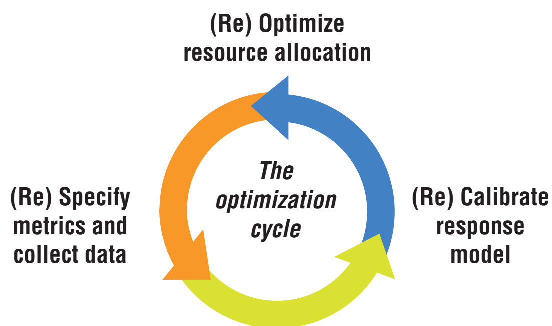
To optimize their operating model across channels, retailers can follow the three-step process illustrated in Figure 6.

1. The process begins with specifying metrics and collecting data (for example, the volume of sales coming from in-store kiosks and fulfilled through the retailer's e-commerce channel due to products that are not available in the retail store).
2. Next, these metrics and measurements are used as inputs to a response model. (Continuing the example, the *store-kiosk* sales model is calibrated to account for the propensity of customers to substitute purchases of store-based stock for online inventory.)
3. The response model is then used to adjust resource allocation. (Levels of in-store and e-commerce inventory are optimized to reflect consumer willingness to substitute.)

An optimized organization structure and the right incentive schemes, tied to the chosen metrics, are required to support this process. Retailers will need to reassess their incentive schemes so that the line executives meet cross-channel commitments. This is hard work, but there are significant rewards to those retailers that can make the transition. The fact that this is conducted at the enterprise level makes it difficult to imitate, and over time, it can become a source of competitive advantage.

In addition to challenges related to organizational structure and incentive schemes, lack of critical mass and diseconomies of scale pose hurdles to cross-channel optimization.

Figure 6. A management process for optimizing multichannel retail operations.



Source: Dr. Dale D. Achabal and Dr. Kirthi Kalyanam, Retail Management Institute, Santa Clara University and the IBM Institute for Business Value.

Building a critical mass of demand for new services in a given channel is essential. When customers decide to avail themselves of services in one channel, it creates opportunities for leveraging and optimizing activities in other channels. However, a lack of critical mass on the demand side can limit these opportunities. For example, an office supplies retailer might find that repeat buyers of printers and related supplies conduct most of their research online and do not need much help in the store. However, before the retailer can reduce their staffing levels in the printer category, the number of "self-servicing" customers has to reach a critical mass or overall customer satisfaction and sales will drop. In the short run, the retailer may have to run parallel and, in many ways, redundant activity systems to meet customer needs. This emphasizes the importance of proactive programs designed to drive rapid growth in the nascent channel in order to achieve critical mass.

Achieving critical mass in demand requires creative thinking. It involves designing customer incentives that encourage the desired action on the part of shoppers. In this regard, there are many lessons that retailers can learn from the travel industry. Airlines and hotels have offered incentives and penalties so their passengers are strongly motivated to use new channels and touchpoints (e.g., the Web or self-check-in kiosks), migrating customers from high-cost to low-cost channels.

However, a perspective of cross-channel optimization focused simply on achieving volume, profitability or satisfied consumers will not do the job. Activity migration means that activities are cut back in the original channel which might result in a loss of previously realized economies of scale. This loss of scale can occur due to any number of reasons including indivisibility of fixed costs and loss of buying power. Further, the retailer may need to run "parallel" activities for a period of time, which may be suboptimal in terms of asset productivity. Therefore, *the underlying cost structure of individual channel-based activities must be evaluated* before attempting to pursue new optimization opportunities.

Strategic cross-channel opportunities

In this section, we illustrate how a retailer's core operating model can evolve across the four stages, using case studies from our research among leading multichannel retailers. In general, we found that retailers are focused on one or more of the following strategic cross-channel opportunities (see also Figure 7):

- Trend and growth mining
- Efficient marketing communications
- Improved merchandise utilization
- Enhanced customer learning.

Trend and growth mining

This opportunity area focuses on identifying consumer trends on a continuous basis to help retailers create, test and rapidly deploy/adjust new products, assortments, brands and concepts. For example, one of the leading

U.S. consumer electronics retailers is effectively using trend and growth mining to build customer loyalty and increase market share. Company executives note that one of their points of differentiation is not simply a broad assortment, but a more subtle concept they call "merchandise authority" – which represents offering the most relevant assortment at any given time.

Following an alignment of key fundamentals, including a clear definition of their target customer and their related shopping patterns, the company focused on achieving Stage 2 proficiency by initiating a series of activities centered on building master customer files with a cross-channel view. This allowed the company to initiate and expand a series of tailored customer contact programs.

The gains from Stage 3 leverage of key activities are occurring as the company focuses on building personalized programs designed to test and evaluate new brands (and formats) for targeted customer segments. This testing can best be performed in the online channel and the knowledge then leveraged in the store-based and catalog channels. Ultimately, the company's goal is to optimize these important assessment capabilities into the company's overall merchandise planning process (Stage 4).

Figure 7. Major cross-channel optimization opportunity areas.

	Stage 1 **Align fundamentals**	**Stage 2** **Achieve proficiency**	**Stage 3** **Leverage across channels**	**Stage 4** **Optimize operating model**
Trend and growth mining	• Solidify articulation of target customer segments and related shopping patterns	• Build master customer file with cross-channel view of customers' purchase patterns • Initiate/expand tailored customer contact programs	• Build direct-to-customer capability to test/evaluate new brands and formats for targeted customer segments	• Integrate direct-to-customer assessment capabilities into merchandise planning process
Efficient marketing communications	• Maintain promotional parity on core assortment across channels • Implement consistent and compatible messaging • Build and expand customer contact files per channel	• Achieve balance between short-term ROI of marketing programs and long-term customer retention goals • Balance of customer preferences and different channel practices	• Use marketing capabilities in one channel to drive traffic in other(s)	• Reallocate marketing budget at enterprise level to increase overall ROI
Improved merchandise utilization	• Assure that core assortment meets customer expectations and is consistent across channels	• Introduce channel-specific, extended assortments • Differentiate extended assortments logically from customer perspective	• Identify where and how early sales trends can be used to improve merchandise planning and allocation decisions • Use cross-channel inventory substitution capabilities to improve customer service levels	• Optimize assortment/ inventory investment by incorporating: – Early sales trend analysis into merchandise planning and allocation process – Cross-substitution patterns to jointly optimize inventory investment and customer service
Enhanced customer learning	• Match product information delivery methods to customer learning needs • Begin to deploy basic product item information • Build product files with expanded attributes	• Develop interactive approaches to enhance shopping experience • Deploy extended, information-rich master product files and integrate third-party content	• Deploy interactive information delivery capabilities across channels • Integrate product files to include information from all channels	• Reallocate customer service associates across categories • Realign associate incentives

Source: Dr. Dale D. Achabal and Dr. Kirthi Kalyanam, Retail Management Institute, Santa Clara University and the IBM Institute for Business Value.

Efficient marketing communications

The next opportunity area involves increasing the efficiency and effectiveness of all communications activities directed at a retailer's current and prospective customers, with a goal of building the brand and increasing share of wallet. While measuring communications effectiveness in a traditional, store-based environment is itself challenging, for retailers operating multiple channels, the complexity increases significantly – even more so for multiformat, multibrand retailers.

Consider a leading U.S. multichannel retailer of home furnishings that operates multiple brands, has stores in over 40 states and distributes more than 350 million print catalogs per year. To support customer shopping across all three channels and achieve scale, the company realigned its operations to shift from a channel-centric organization to a brand-centric organization. The company has developed many linkages across its store and catalog value chains to leverage (Stage 3) and optimize (Stage 4) key value levers and activities. One of the most significant is the use of the catalog as the key advertising vehicle. According to one estimate, about 60 percent of catalog mailings are to areas where a store already exists. The catalog group uses targeted mailings and control groups to measure the precise impact on store traffic. In return, the catalog group receives a predefined percentage of store revenue as a fee for the additional mailings. This strategy provides a significant benefit to the stores organization because of the leverage that exists, allowing the internal transfer price for "advertising" to be much lower relative to the costs of comparable mass media communications typically employed by a store-based organization.

Apart from its role as an advertising vehicle, the retailer's catalog database also contributes significantly in developing new store locations. For example, purchase frequency and sales volume data are analyzed to provide a clearer picture of the market potential for a new store and the likely cannibalization impact it will have on local catalog sales. This case study is particularly interesting in that a single capability, use of the catalog as a marketing tool, enables multiple cross-channel optimization opportunities.

Improved merchandise utilization

The third opportunity area focuses on strategies that increase inventory productivity. This includes, but is not limited to, forecasting, planning and allocation of goods, the setting of in-stock levels, and inventory sharing and substitution policies across channels. Merchandise utilization offers some of the greatest opportunities for Stage 3 leverage and Stage 4 optimization in a multichannel environment.

One organization that is making considerable progress is a retailer of children's apparel and accessories in the U.S., Canada and Europe. Its core customer is a young mother who has a highly involved buying experience with this product category over a relatively short period of time. One aspect of the company's merchandising strategy is the frequent introduction of new outfits, which are all available online, but not necessarily in all stores. The tendency of this retailer's customers to buy complete "outfits" places significant restrictions on the extent to which inventory investments can be reduced in stores with lower sales potential, without creating significant customer confusion and dissatisfaction. To address this challenge, the company has leveraged the Web as an "always available" location for all stores by introducing a "save the sale" program.

Under this program, sales associates using "look books" order out-of-stock items for customers from the Web. Over time, the company hopes to further benefit from this capability by optimizing the inventory in different stores based on the volume class of the store and the willingness of their customers to accept substitute products or in-store Web ordering.

Enhanced customer learning

A fourth opportunity area refers to the value-added selling activities that enable customers to understand the products in a category and use that knowledge to match specific products to their individual preferences. For many customers, information about the product is as much a part of the consumption experience as the use of the product itself.

As an example, a major U.S. outdoor sporting equipment retailer recognized very quickly that direct Internet sales would be a growing and vibrant channel. In addition to the commerce potential, the company noticed that its customers had a natural affinity for the information on its Web site, so it expanded the site to contain more than 45,000 pages of information on products and "how to" articles. Recognizing the importance of providing its customers with access to product information wherever and however they chose, the retailer further enhanced the information using third-party content and is redeploying the content via in-store kiosks (and potentially in the future, on wireless handheld devices in its stores).

This opportunity to leverage its digital media assets led one executive to comment: *"The changes we've made, and will continue to make, are about providing the maximum amount of information a customer needs to make a purchase, at the time they need the information and in the channel they've chosen to shop."*

Optimizing its operating model in Stage 4 will require an assessment of the opportunity to reallocate customer service associates across categories and a realignment of associate incentives.

Enabling cross-channel optimization

Each retailer will have a distinct multichannel strategic roadmap based on its particular market position, target customer segments and internal capabilities. That said, the following requirements will be common to all companies as they work to create an optimized multi-channel operating model.

- *Drive multichannel strategy at a senior business executive level.* From the first stage onward, multichannel success requires alignment of value levers, strategies and metrics across different parts of the organization. Because multichannel issues inherently extend across brand, functional and channel groups, it will be very difficult for managers within these organizational silos to effect the necessary changes. Retailers need a senior executive champion for multichannel retailing that can transcend existing boundaries and politics and explicitly link the strategy to key corporate business objectives.

- *Develop deeper insight on customers' evolving needs and shopping flows.* Sources of customer insight can come from both structured research (e.g., focus groups, surveys) as well as ad hoc customer feedback collected through store-based or online mechanisms. Retailers should also seek to better leverage their store associates, who remain a powerful and under-appreciated source of insight and ideas. By explicitly defining the future customer shopping experience (e.g., through scenario and other envisioning tools), organizations can build a common vision and more easily communicate the desired end state.

  In addition, retailers can directly measure how customers are migrating across channels by tracking and analyzing their transaction history. This will help retailers better anticipate and respond to customer shifts over time. It may require aggregation of transaction data from each channel to develop a "single view of the customer" – but in doing so, the key is to define what information needs to be aggregated and how it will be used both internally (e.g., by marketing) and at the point of customer interaction (e.g., by direct or store-based sales associates).

- *Understand the costs of conducting individual activities at various levels in each channel.* How can greater economies of scale be achieved across the organization? Which capabilities should be deployed from one channel to another? Will redeployment lead to a loss in economies of scale? Assessing the relative costs of specific activities will help retailers identify the areas most likely to benefit from cross-channel leverage and optimization.

- *Prioritize investments through careful balancing of value and cost/risk.* As noted before, each retailer will likely pursue a portfolio of different multichannel initiatives across one or more of the evolutionary stages. Some initiatives will focus on "low-hanging fruit" and others on building foundational capabilities for the future. In prioritizing potential investments, retailers should take into account:
  - *Customer and competitive needs* – Which capabilities are essential to meet customer expectations? Which are competitive "table stakes"? Which will provide competitive differentiation?
  - *Operational feasibility* – To what degree can we make use of existing processes, systems and data? How large are the gaps? Is the organization ready to make the required changes in culture and/or actions? Selecting a few "quick hit" initiatives can help build momentum within the organization for more substantive and complex changes in the future.
  - *Potential economic return* – ROI should be evaluated at the subinitiative and/or service (e.g., buy online, pick-up in store) level.
  - *Opportunity for leverage* – Companies should look for areas of "critical mass" where a set of activities/ capabilities can support multiple cross-channel customer services or value levers.
- *Establish clear metrics and track results.* Companies should explicitly define metrics to assess the impact of pilot programs and help them adjust their approach accordingly. And because cross-channel leverage and optimization often involves fundamental changes in how assets, budgets and activities are managed, these metrics are also vital to demonstrate the value of these changes to the organization.
- *Foster cross-channel and cross-functional collaboration by aligning incentives.* Many of the optimization opportunities discussed in this paper involve collaboration that is both cross-channel and cross-functional. For example, using a catalog to assess sales potential for new store locations requires collaboration between the new store and the catalog marketing teams. These teams work in different organizational silos, have different mindsets and even use different vocabularies. Appropriate incentives would be required to encourage collaboration among these teams.
- *Build an open, flexible IT infrastructure that can be easily leveraged across channels and touchpoints.* To improve the ability to leverage the activity system from one channel into another, the retailer's supporting IT infrastructure should move toward a unified platform based on open standards. Due to historical factors, many retailers have used disparate technology platforms for different channels, touchpoints or business units (e.g., business-to-business versus business-to-consumer) that make future integration difficult. The prevalence of hosted or outsourced systems in the industry can further complicate matters.

  Fortunately, open standards and new technology architecture models are making it easier for companies to deploy a given set of capabilities across different parts of the business and to tie new systems together. Examples include the use of a single order capture system across multiple touchpoints (e.g., kiosk ,Web site, call center) or the development of a unified content management system that enables a "create once, store once, use everywhere" strategy. Such approaches not only help reduce the overall cost of implementation, but also support delivery of a consistent customer experience across different channels and touchpoints.

Key steps to multichannel retailing success

- Drive multichannel strategy from a senior corporate level
- Develop deeper insight on customers' evolving needs and shopping flows
- Understand the costs of individual activities in each channel
- Prioritize investments through careful balancing of value and cost/risk
- Establish clear metrics and track results
- Foster cross-channel and cross-functional collaboration by aligning incentives
- Build an open, flexible IT infrastructure.

Conclusion

Operating in multiple channels has become a permanent part of the retail landscape as retailers move down the path to true *multichannel* retailing. Companies that excel can make it easier and more enjoyable for their customers to shop, helping earn ongoing loyalty and drive greater and more profitable revenue growth for themselves.

Cross-channel optimization offers retailers a means of addressing key structural challenges and deploying new capabilities. It is anticipated that this will ultimately lead to fundamental shifts in the underlying operating models and bring increases in effectiveness, efficiency and asset productivity. However, companies that focus only on tactical or channel-specific issues will likely miss the most important areas of opportunity and struggle to overcome inherent organizational barriers.

Retailers can use the four-stage framework presented here to harness the power of cross-channel optimization. The framework is designed to allow a company to tailor the specifics to its particular market characteristics, competitive situation and existing strengths and weaknesses. In many cases, these changes will not be observable from the outside and, therefore, can become important sources of competitive advantage.

The road ahead will likely be neither short nor simple. But the potential payoff is well worth the effort. The time to begin assessing these important issues and outlining a comprehensive multichannel strategic roadmap is today.

About the authors

Dr. Dale D. Achabal is the L. J. Skaggs Professor, Director of the Retail Management Institute, and Associate Dean of the Leavey School of Business, Santa Clara University. He can be contacted at *dachabal@scu.edu*.

Melody Badgett is a Managing Consultant with the IBM Institute for Business Value. She can be contacted at *mbadgett@us.ibm.com*.

Julian Chu is a Multichannel Retailing Solutions Executive for IBM Business Consulting Services. He can be contacted at *jjchu@us.ibm.com*.

Dr. Kirthi Kalyanam is the J.C. Penney Research Professor, Director of Internet Retailing at the Retail Management Institute, and Director of eBusiness Initiatives at the Leavey School of Business, Santa Clara University. He can be contacted at *kkalyanam@scu.edu*.

Contributors

Kelly Chambliss, Partner and Multichannel Retailing Leader, IBM Business Consulting Services

Christina Trotter, Consultant, IBM Institute for Business Value

Craig W. Stevenson, Solution Manager, Distribution and Commerce, IBM Software Group

About IBM Business Consulting Services

With consultants and professional staff in more than 160 countries globally, IBM Business Consulting Services provides clients with business process and industry expertise, a deep understanding of technology solutions that address specific industry issues, and the ability to design, build, and run those solutions in a way that delivers bottom-line business growth.

References

[1] “The State of Retailing Online, 8.0.” Shop.org and Forrester Research. May 2005.

[2] Ibid.

IBM Global Services
Route 100
Somers, NY 10589
U.S.A.

G510-6186-00