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Singapore Management University

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The retail industry faces a future where convenience and value-added services will be the deciding factors

The secret to retailing success has long been described by the phrase “Location, Location, Location”. That maxim has morphed into to “Convenience, Convenience, Convenience” with the advent of digital technology, observes **Jagdish Sheth**, Charles H. Professor of Business as Emory University, pointing to the success of Alibaba’s Singles Day sales and Amazon’s one-day delivery service.

According to Sheth’s calculations, e-commerce has grown at 23 per cent per annum between 2012 and 2019 and will reach 15 percent of total retail sector by 2020. At this rate, e-Commerce will surpass US$35 trillion by 2020.

“Hyper and supermarkets account for 35 percent of the retail direct sales with U.S. and China at the forefront – that means people buy mundane products again and again,” Sheth explained at a recent SMU Retail Centre of Excellence (RCOE) event *The future of retailing: When the artificial becomes real*. “Amazon didn’t think of this market in the beginning but these days, most people buy from Amazon primarily paper towels, toilet tissues, detergent etc.

“People are not buying consumer electronics even though you can still find them there. The percentage of sales is moving towards day-to-day necessities.”

As mass merchandise – not just day-to-day necessities but also clothes and even food – become increasingly sold online, brick-and-mortar retailers will be forced to differentiate themselves by offering a unique shopping experience. Examples include IKEA’s use of Virtual Reality and STORY, a concept store by Macy’s that reinvents its entire space every few weeks.

The ultimate winners, Sheth says, will be those who can retailers who can provide integrated value added services enabled by digital technology, such as:

- Ordering & Delivery: GrubHub, Uber Eats
- Financing & Payment: Sears, Room to Go
- Installation and maintenance: Costco services

ADAPT TO THE NEW REALITY...OR PERISH

While the trends are obvious, successful companies develop bad habits that ultimately lead to failure. The denial of new reality, Sheth explains, is top of the list.

“This is where American retailers such as Macy’s and Sears are at,” he elaborates. “When you grow up being successful in a certain way, it hard to let that go. Many companies fail because they are either unable to change or unwilling to change.”

He adds: “Most good retailers go bad either when they are unwilling or unable to adapt when their ecosystem, which includes technology, non-traditional competition and consumer lifestyles, changes rapidly.”

Legacy systems and outdated paradigms sometimes prevent companies from embracing the digital revolution, Sheth explains.

“Most of the intellectual property laws are organised around Industrial Age patent laws, especially copyright laws. There’s no way you can protect it in the Digital Age, it’s like a horse out of the barn. There’s nothing you can do.

“One solution is: If you can’t protect it, you monetise it. The answer is simple: license it, license it, license it. The traditional industrial model is “I invent, I design, I make it, I sell it, I service it.” Typical IBM, General Motors hierarchy, vertical integration.”

Citing the example of Texas Instruments, with whom Sheth worked with as a consultant, all production was abolished after he discovered that US$600 million in R&D investments had yielded US$1.4 billion in royalties. Sheth continues: “Production had labour problems, environmental problems, country of origin problems; it was too headachy for nothing. So our job was to create IP rights, we did that and we licensed it to the world.”

He also elaborates on the necessary paradigm shift with regard to cost structure:

> *“In the Industrial Age, fixed costs and variable costs come together but maximum fixed costs is only 40 percent of total costs. Marginal costs and marginal pricing theory are still valuable, as is the economies of scale.*
>
> *When we come to the digital world, true costs are fixed costs only, there is no variable cost. If I want to make one chip or a wafer, it will be about $2.6 billion today. The first chip costs $2.6 billion, the cost of separation is nothing.*
>
> *If I want to make a major operating system software, it would be billions of dollars. Upgrades are 500 million dollars or a billion. My first software copy will be a billion dollars or more, and marginal cost is zero.*
>
> *We teach in economics that marginal price, the price of the next unit you produce, must be equal to your marginal cost to maximise your profits. So if my marginal cost is zero, how should I price each additional unit? The answer is free.*
>
> *All these industrial age companies who are still stuck in the fixed costs/variable costs paradigm cannot make this transition from the electrical and mechanical age to the digital age.”*

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