J.C. WILLIAMS GROUP

Small Retailers Can Win Big with a Multi-channel Strategy:

Small and Mid-sized Retailers are Increasing Sales and Improving Efficiencies using Multi-channel on Demand Software

November 2005

By Rena Granofsky and Lisa Hutcheson

J.C. Williams Group Limited Website www.jcwg.com
17 Dundonald St., 3rd Floor, Toronto, Ontario M4Y 1K3 Tel: (416) 921-4181 Fax: (416)921-4184 info@jcwg.com
Chicago Office: 350 West Hubbard Street, Suite 240, Chicago, Illinois, 60610 Tel: (312)673-1254 Fax: (312)822-9162

1.0 Executive Summary

The world of retail is changing at warp-speed and survival for the small and mid-sized retailer (SMB) becomes more difficult everyday. Competition is everywhere. Domestic competitors up the ante, retailers in other sectors broaden their category mix, and European retailers appear on every corner. The Internet offers a solution: retailers can build revenues and thrive by adding new channels to their sales mix.

SMB retailers that initially competed in a single channel are realizing the benefits of multi-channel retailing in terms of both new sources of revenue and customer loyalty. But adding channels also brings complexity. How do you integrate sales and customer information, allocate the right inventory to each channel, avoid costly excessive labor, and deliver a seamless experience to the demanding customer?

A new simplified approach is emerging to help SMB retailers add channels: the centralized multi-channel on-demand solution. It provides a single view of activity across all channels and enables retailers to share risk and accountability with their technology suppliers. And it significantly reduces labor requirements resulting in far more profit.

West coast-based electronics e-tailer Unity Electronics increased sales by 50% with this new approach, reduced labor, and increased customer satisfaction. And Texas-based BMP Designs, a purveyor of automotive after-market high performance and replacement parts, increased its revenues by 200% and dramatically decreased its system maintenance costs.

Each of these retailers proves that multi-channel retailing is not only viable for SMB retailers, it is the way of the future.

Table of Contents

Table of Figures

2.0 Multi-channel Magic

The online channel is by far the fastest growing channel. According to a recent study by Forrester Research, 2004 U.S. online retail sales grew to $141B, an increase of 24% from 2003, whereas total retail sales grew only 8%.[i] Online sales accounted for 6.5% of total retail sales in 2004, and retailers with stores claim 38% of online customers are new to their entire business.[ii] So by extrapolation, this new channel can add significant new revenues to any brick and mortar retailer.

Additional revenues within the online channel tell only part of the story. Each of the channels also significantly influences purchases in other channels, as shown in Figure 1 below. Confirming this, the same study states that retailers with stores find that 20% of offline purchases are influenced by the Web.[iii]

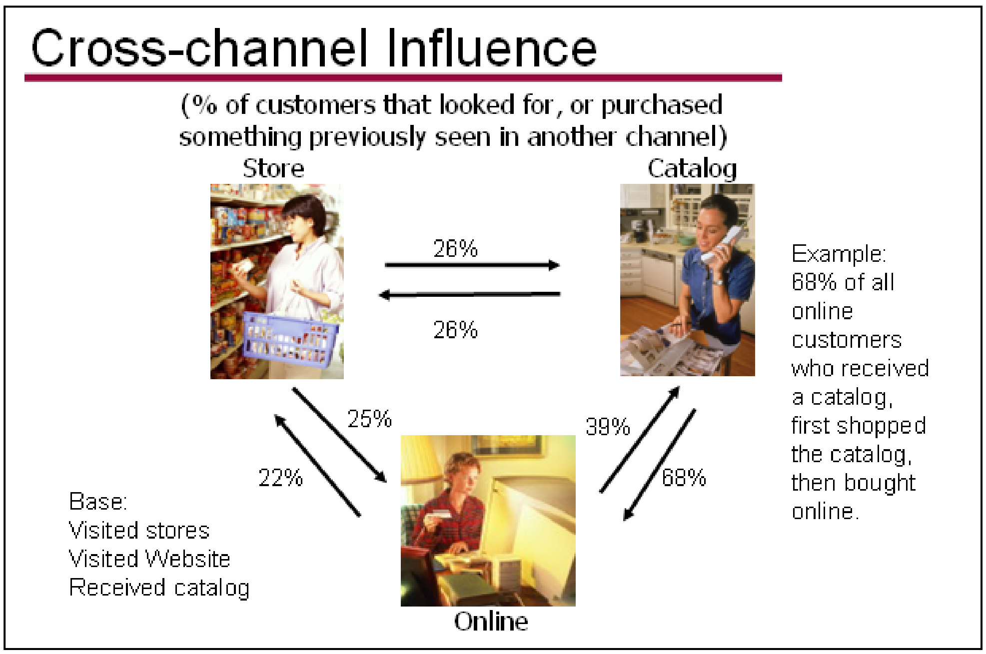

Figure 1: Cross-channel Influence

Research also tells us that customers who shop multiple channels from the same retailer spend more on each transaction, and more often, as shown in Figure 2 below. Multi-channel customers are the most valuable, proving the need for a consistent experience across all channels.

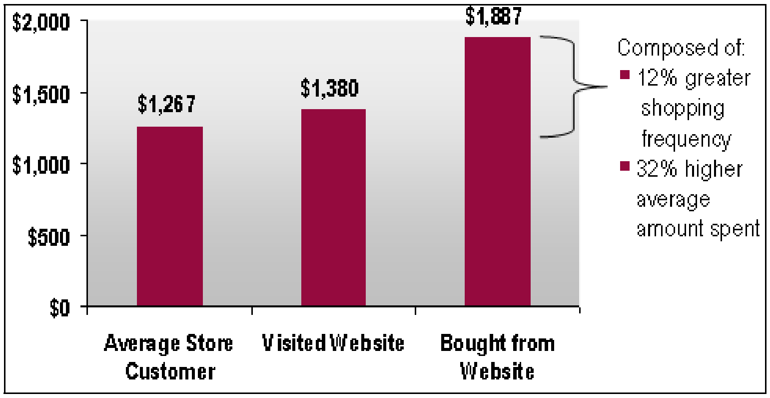

Figure 2: Multi-channel Shoppers
Source: the Multi-channel Retail Report, J.C. Williams Group, BizRate.com, Shop.org

Online channels are available beyond the retailer's online store. The Internet has enabled previously unthinkable business models, each a viable new channel on its own; for example, retailers sell their products on eBay, in affiliation with other better known Websites like Amazon.com, through links from price comparison sites and through liquidators like Overstock.com.

Each of these channels provides the opportunity for additional revenues, often through new customers. But they also add complexity. So how can an SMB retailer effectively expand into these channels and reap the benefits? The answer lies in a centralized multi-channel solution.

3.0 The Need for a Centralized Multi-channel Solution

Many SMB retailers operate their businesses on accounting systems. These systems track sales and inventory; however, they offer limited retail management tools such as to balance inventory and manage promotional campaigns. As the retailer grows, the company typically adds various software solutions to meet the needs of the moment. The result is a set of disparate systems that impede growth and reduce operational efficiencies: the chaos of multiple applications.

One can only imagine the headaches that ensue by adding yet another set of software to manage an additional channel. For example, to get started in the online channel, retailers may set up their online store on Yahoo! The approach seems simple: Yahoo! hosts the online store and provides applications to handle the product catalog, orders, and checkout. It seems quick and easy, but is it?

A new approach has emerged to address the situation: On-demand Multi-Channel Software

The challenge lies in the back-end management. The Yahoo! product catalog is stand-alone and not integrated with the other channels. It is difficult to keep product and price information in all channels in sync, to allocate inventory by channel, or analyze performance. Costly labor must be allocated specifically to this channel, to keep it in sync with the other channels and manage inventory and customer queries.

Packaged multi-channel retail management software solutions offer an alternative approach. Most of these packages focus on the brick and mortar channel, with interfaces to mail order and online stores. These are just beginning to emerge, and offer a centralized database over all channels. Each new channel is set up as a separate store and retailers use inventory management tools to track performance, balance inventories, and track customer activity across all channels.

However, a few solutions also cater to the online and mail order channels, with full handling of customer orders and fulfillment. Some also enable integration with eBay and other online marketplaces.

Leading solutions also offer integration with standard shipping software like UPS and FedEx so customers can track delivery of their orders and reduce calls to customer service desks. They might also provide online e-mail campaign management, so retailers can minimize costly promotional mailings to customers across all channels.

For many retailers, multi-channel packaged software offers a very viable approach. However, for the typical SMB retailer, the solution remains expensive and complex. As technology continues to evolve, the retailer must support ever-changing technologies, hardware, software, and so on.

A new approach has emerged to address the situation: on-demand multi-channel software.

4.0 SaS: Hosted On-demand Retail Management Software

The Software-as-Services (SaS) model is attracting companies that are looking for new ways to increase revenues while reducing costs. The approach provides access to business functionality remotely as a service with costs that are aligned with usage, minimal upfront expenses, and rapid deployment. It provides shared accountability with the vendor community. The Gartner Group declared SaS as one of the top five technologies for 2005.[iv]

It works like this: the vendor hosts the application remotely and users connect to it from anywhere through an Internet browser. In the case of the SMB retailer, the president, merchandisers, customer service, warehouse staff and everyone else in the business would be able to connect to the retail management application in real time through their web-browser. The same goes for the stores: each register is connected in real time.

The technology vendor sets up the system quicker than any retailer can. He then maintains the system and ensures that it is always available. It is the responsibility of the vendor, not the retailer, to keep up with ever-changing technologies (for example, hardware and operating systems) and hire technical personnel with the right skill sets. The retailer focuses on his core business and builds revenues.

There are many other advantages to this approach. Imagine how easy it can be to open a new store! Rather than relying on store or IT staff to maintain and upgrade each point-of-sale terminal, terminals simply need to be plugged in to power and the internet and are ready to go. Management is then able to track store performance and make changes from anywhere they have internet access, all in real- time. So setting up new brick and mortar stores is relatively quick and easy.

Software upgrades are also much easier. There is no need to roll out applications to all stores and deal with issues when they don't work. Instead, the application is updated in one spot, on the hosted server, and is then immediately available to everyone.

IBM is a leader in the SaS market. Since the program launched in 2002, the IBM SaS (Software-as-Services) initiative has connected SMB with leading independent software vendors, and developed a showcase of retail solutions specifically for the SMB retailer.

We interviewed two retailers that have implemented this model and realized the benefits of this solution. Both retailers have experienced phenomenal revenue growth while improving operational efficiencies and reducing expenses.

4.1 BMP Designs

BMP Designs specializes in after-market high performance and replacement parts for fine automobiles. The company's multi-channel operation spans three brands (BMP, PROMINI, and Supersprint); each with its own Website, catalog, call center, and walk-in store.

Like many SMB retailers, BMP had stand-alone software applications for accounting, inventory, its Website, catalog, and shipping. Casey Swenson of BMP Designs explains, "Everything was a neat product on its own but wasn't tightly integrated." The company relied on three separate sets of (duplicate) information to feed the catalog, Website, and call center. It recognized that it needed an integrated solution to automate, integrate, and streamline business processes.

The company implemented the SaS-based CORE*S*ense retail automation solution and with one central database, cut the system maintenance costs in half.

Customer service is much better too. With his old system, the customer would call and explain an issue. The next time he called, he would have to re-explain the issue to the next customer service representative. But with full tracking on a centralized system, all activity related to the customer order is accessible including every e-mail, notes on conversations, order processing, and shipping.

Once an order is shipped, the software generates a reference number customers can use to track packages during shipment. This feature empowers customers and eliminates calls to the customer service desk.

The company also uses the system to drive promotional e-mail campaigns once or twice per month. Although sales of the advertised items are not necessarily impacted, Swenson estimates that overall sales increase approximately 33%. The campaigning reminds customers to visit the sites.

The results are impressive. E-commerce sales have grown 200% in the 18 months since the implementation. Swenson concludes, "The system was probably paid off within the first three months."

4.2 Unity Electronics

Unity Electronics sells computers and consumer electronics with a focus on end-of-life inventory and refurbished goods. It began as a Yahoo! store. Today, it has its own Web store and call center, as well as presence on other e-commerce sites: Amazon.com, Overstock.com, Yahoo!, and eBay. It also drives traffic to its online store through several price engine sites like Pricegrabber.com and Shopping.com.

President Russell Hedgpeth explains that the company chose the CORE*S*ense solution because it had the most integrated product that could tackle all the channels it was using in one package. It also offered all the components of what they considered retailing and e-commerce in one package.

Hedgpeth tells us that order throughput increased by 50% right "out of the gate." They started with 30 to 50 transactions per day and now handle 300 to 500. Hedgpeth boasts, "Processing orders is ten times faster."

Without the new system, Unity projects that it would have increased its labor by 50%. Hedgpeth explains, "We would have had to throw 10 to 15 [people] at the problem to get where we are today. Today we're at 20 on the payroll, and not 35; that's huge."

With over five million visitors to its site each month, Hedgpeth concludes, "It's so clear that the solution pays for itself in time, savings, and efficiencies."

5.0 Multi-channel On demand Solution Delivers Higher Profits

With the SaS model, SMB retailers can quickly realize the dramatic benefits of an enterprise retail solution on an SMB budget. The following ROI model compares the profit of three $2 million brick and mortar retailers, each implementing a different solution to handle a new online store: a multi-channel package, a stand-alone (Yahoo!) store, and a multi-channel on demand (SaS) model.

		Y1	Y2	Y3	Y4	Y5	Total
	Revenue						
	Current In-Store Sales (SS)	2,000,000	2,200,000	2,400,000	2,600,000	2,800,000	12,000,000
	# of users/registers	8	9	10	11	12	
incremental	Web impact (x5%)	100,000	110,000	120,000	130,000	140,000	600,000
incremental	Web channel (SS x7%)	140,000	154,000	168,000	182,000	196,000	840,000
	Total incremental revenues	240,000	264,000	288,000	312,000	336,000	1,440,000
incremental	**Multi-Channel Packaged Solution**						
	Set up	30,000	0	0	0	0	30,000
(1% of 5 yr.Plan)	Hardware & Software	40,000	40,000	40,000	0	0	120,000
	Maintenance (15% of software)	9,000	9,000	9,000	9,000	9,000	45,000
	Labor ($40K/5% add'l sales)	96,000	105,600	115,200	124,800	134,400	576,000
	Total incremental costs	175,000	154,600	164,200	133,800	143,400	771,000
	Incremental Profit - Package	65,000	109,400	123,800	178,200	192,600	**$669,000**
	Yahoo Store: Stand-alone						
	Set up	50	0	0	0	0	50
	Hosting & License (% revenue)	2,580	2,790	3,000	3,210	3,420	15,000
	Labor ($40K/5% add'l sales)	96,000	105,600	115,200	124,800	134,400	576,000
	Total incremental costs	98,630	108,390	118,200	128,010	137,820	591,050
	Incremental Profit - Yahoo	141,370	155,610	169,800	183,990	198,180	**$848,950**
incremental	**Multi-Channel On demand Solution**						
	Set up	9,000	0	0	0		9,000
	Hardware (POS only)	8,000					8,000
	Hosting & License	14,400	15,600	16,800	18,000	19,200	84,000
	Labor	0	0	0	0	0	0
	Total incremental costs	31,400	15,600	16,800	18,000	19,200	101,000
	Incremental Profit -Hosted	208,600	248,400	271,200	294,000	316,800	**$1,339,000**

Figure 3: Comparative ROI Model for $2M Retailer

5.1 Incremental Revenues

We assume each retailer grows its sales in brick and mortar stores 10% per year. Given the impact of the channels on each other, presented in Section 2.0, we estimate the online channel will generate an additional 5% in additional brick and mortar sales. And we estimate the online store will generate Web sales equal to 7% of brick and mortar sales. Total incremental sales therefore stem from both online sales and incremental brick and mortar sales.

The potential for incremental revenue is huge: by adding the online channel, each of these $2M retailers will increase revenues by $1.44 million over a five year period. But which approach provides the most profit and overall benefit?

5.2 Multi-channel Packaged Solution

With four stores in the greater Detroit area, KOOL HATS offers the alternative to branded baseball caps: no-logo designs. The retailer has been assured by its customers that its hats are so cool, they will easily sell online. Recognizing the complexity of handling multiple channels, the President searches for a single packaged solution to handle its brick and mortar stores and online channel.

Like most retailers, he budgets 1%–2% of his projected revenue over five years on a new system. Projected revenues are $12M, so he finds and implements a solution at $120,000 including hardware and software. He spends $30,000 up front on training and implementation and amortizes the cost of the system over three years. He pays 15% per year on the original cost of the software for maintenance (support and upgrades).

For each 5% increase in sales, he adds personnel to support the stores and handle hardware and software upgrades; he pays $40,000 per year on average for each additional resource. Total incremental costs for the system over five years is $771,000, leaving a profit of $669,000.

5.3 Stand-alone – Yahoo! Store

SOX Plus has four stores in Chicago, each offering a wide variety of hosiery and accessories. They have exclusive rights to a hot line of accessories and believe they could cater to a much larger audience online. The president's advisor recommends they set up their online store quickly and easily on Yahoo!

It seems like a bargain. The set-up fee is only $50, and then Yahoo! charges $40 per month plus 1.5% on each transaction. It appears they can't lose: they only need to pay Yahoo! as they sell.

However, they quickly learn about the complexities on the back end. The Yahoo! store is not integrated with their inventory systems, so they need to hire additional personnel to maintain the products and prices in the online store and handle customer issues. They hire a new resource for each additional 5% of sales, at an average cost of $40,000 per year.

Total incremental costs are $591,050, leaving a profit of $848,950. It is important to note that these costs are incremental to the costs of maintaining existing systems to support the bricks and mortar channel.

5.4 Multi-channel On-demand Solution

Terrific Toys operates four stores across the Midwest, and is the exclusive distributor for some of the newest toys from around the globe. The president is certain the company can launch an online store with great success. However, Terrific Toys has a very small IT department and limited IT expertise.

The president learns of the SaS model through a business associate, and selects a hosted on-demand retail management software solution to manage both their brick and mortar and online stores. The supplier charges a setup fee of $9,000, much more than Yahoo! but far less than a typical packaged multi-channel software solution. In addition, the only hardware costs are for the one-time purchase of POS hardware, at approximately $2,000 for each register.

The company pays monthly hosting and software license fees, with maintenance and upgrades included. As revenues increase, there is no need to add any labor to maintain the hardware and software; this is all handled by the technology vendor. They can also begin selling excess inventory on eBay and explore other channels that would expand their customer reach for minimal additional cost or effort.

Total incremental costs over five years are $92,500, leaving an impressive profit of $1,339,000.

5.5 Profit Comparison

As we see in the charts in Figure 4, the hosted multi-channel on-demand solution yields the highest profit for the $2M retailer. The same applies to the $8M and $20M retailer.

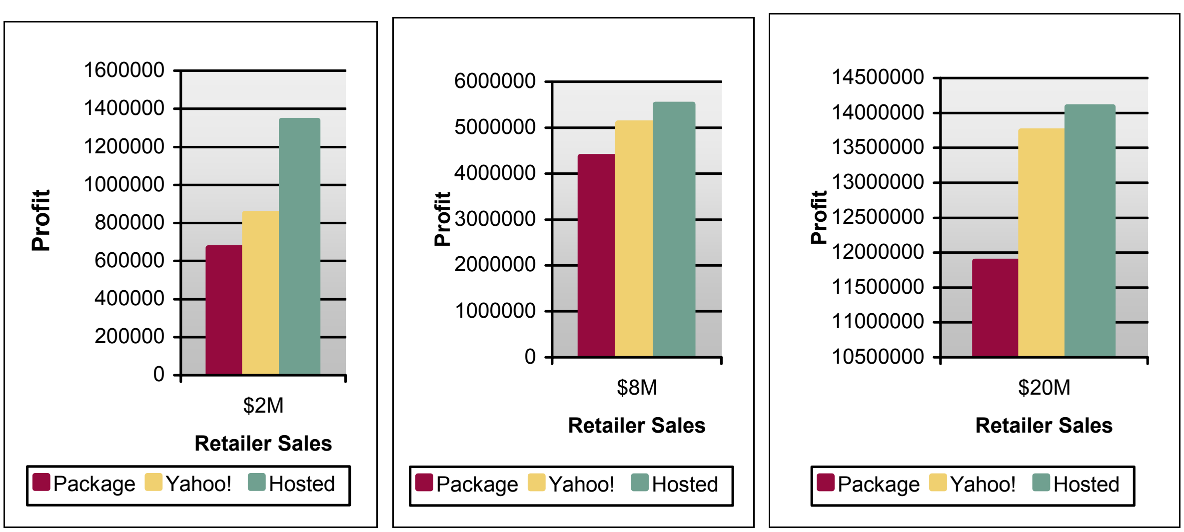

Figure 4: Incremental Profit Comparison over Five Years for $2M, $8M, and $20M Retailers

6.0 A Bright Future for Both Multi-channel and SaS

Multi-channel retailing is here to stay, and the online channel is a key component for all sizes of retailers. However, it is imperative that all channels be seamlessly integrated with one another. Otherwise retailers risk being mired in inefficient processes, with costly excessive labor that will limit the benefits of true multi-channel retailing.

SMB single channel retailers can go multi-channel with the hosted on-demand model, and share risks and rewards with their technology suppliers. Retailers who wait risk being left behind.

J.C. Williams Group is a leading North American retail consulting firm specializing in research, strategy, branding and marketing, merchandising and operations, multi-channel operations, technology, and human capital management.

Our Sponsors:

CORESense Retail Redefined **CORESense** delivers On-Demand Multi-Channel Retail Management Software to the small and mid-sized business market. Retailers increase revenue and decrease operating costs across Multi-Channel Management, Order Fulfillment, Inventory and Supplier Management and Customer Relationship Management.

As a pioneer in the Software as Services (SaS) movement, CORESense was built from the ground up to be delivered over the web so retailers realize the benefits of an enterprise system at a SMB price. CORESense is an IBM Premier Software as Services Partner. CORESense is located in Saratoga Springs, New York. For more information, contact CORESense, Inc. at www.coresense.com or 1-866-229-2804.

IBM

IBM and IBM Business Partners deliver a complete portfolio of affordable retail solutions, technology and services based upon years of retail experience with our customers. Today, IBM works with over 7,500 retailers of all sizes worldwide. We are the premier supplier of POS terminals with approximately 2 million systems installed in more than 100,000 stores. Visit us our partners at the IBM Software as Service Showcase: www.coresense.com/ibm.

---

[i] U.S. Census Bureau, Department of Commerce, U.S. Census and Forrester Research Report, The State of Retailing Online 8.0, a Shop.org study by Forrester Research, May 24, 2005.

[ii] Ibid.

[iii] The State of Retailing Online 8.0, a Shop.org study by Forrester Research, May 2005.

[iv] K.B. Chandrasekhar, Why SaaS is Making a Comeback, March 2005, www.cioupdate.com.