NATIONAL CENTER FOR
THE MIDDLE MARKET

A SPECIAL REPORT BY THE NATIONAL CENTER FOR THE MIDDLE MARKET

# MIDDLE MARKET RETAIL

## How Digital Transformation Is Fueling Growth

IN COLLABORATION WITH

The Ohio State University
Fisher College of Business

SunTrust

Grant Thornton

Cisco

CBUS Retail
We Love Retail.

# About This Report

Retail isn't dying, despite what some headlines would have us believe. According to the National Retail Federation, overall U.S. retail sales have grown almost 4% annually since 2010, slightly faster than the economy as a whole. In the middle market, the retail sector has posted year-over-year growth rates well above that mark throughout 2018, making mid-sized retailers an important contributor to the industry's overall health and vitality.

To better understand the middle market retail environment and what drives its success, the National Center for the Middle Market and its partners studied a group of retailers across three categories—fast-moving consumer goods, specialty goods, and food service. We found that these retailers have not only survived the so-called retail apocalypse, they are thriving. By exploring their growth strategies and looking closely at the actions the fastest-growing middle market retailers are taking to ensure continued success in an evolving industry, we uncovered a story of digital transformation, or a willingness to invest in digital in order to boost efficiencies, increase sales, and enhance the customer experience both online and off.

### HOW THE RESEARCH WAS CONDUCTED

The National Center for the Middle Market worked with experts from CBUS Retail, The Ohio State University Fisher College of Business faculty, and its partners to survey 400 financial decision makers from middle market retail companies. The respondents were roughly evenly split between the fast-moving consumer goods, specialty goods, and food service categories. Executives responded to questions about their growth strategy, digital technology investments, supply chain, and talent challenges via a 20-minute, self-administered online survey conducted between October 8 and October 22, 2018.

# Executive Summary

In a time when headlines blare about the demise of Sears and the dominance of Amazon, it may come as a surprise to learn that there is a thriving, rapidly growing group of middle market retailers who are adopting the tools of digital transformation and reaping rewards across all areas of their businesses. Retailers in this group grew by 10.5% over the past 12 months, compared to 5.9% for the whole middle market retail segment and 8.6% for the overall middle market, as reported by the Q3 Middle Market Indicator. The retail industry overall grew by 5.2% during this same time period, according to the U.S. Census Retail Trade Survey,

Clearly, retail is alive and strong. However, to enable these levels of growth, the channels through which retailers sell are changing. E-commerce continues to grow, while catalogs continue to phase out. Malls are evolving into customer experience destinations featuring lifestyle centers and mixed-use space. It's becoming the expectation for retailers to offer an "omnichannel experience," that is, an equally appealing shopping experience online, in-store, or wherever else they engage with customers. The retailers that are doing best are leveraging technology to evolve the ways in which they operate and sell across all channels.

Middle market retailers are uniquely positioned to take advantage of the changing landscape in the industry. Their flexibility allows them to select the best technologies that will deliver the most significant impact, and they may be less hamstrung by existing investments in less productive channels. Indeed, these companies have made considerable investments in a variety of digital technologies over the past two years, allowing them to compete with multinational firms. At the same time, digital transformation has introduced new challenges. Many middle market retailers struggle to keep up with technology, develop a digitally-capable workforce, and meet the capital requirements of investment. They must also contend with new, smaller competitors and take cybersecurity more seriously.

# Fast-Growing Middle Market Retailers: An Overview

The fast-growing retailers we studied are outgrowing their peers and the middle market overall. As a group, they boast 10.5% year-over-year annual revenue growth. Those with 51 or more sales locations grew even faster (11.3% vs 9.6% for retailers with one to 10 locations). The retailers in our study expect to continue to grow at the same aggressive pace over the next 12 months. Most sell in brick and mortar stores and online (primarily via their own websites), and they expect both channels to grow over the next five years. The fastest-growing retailers are more likely to expect a greater percentage of future growth from online sales: They believe it's where the money is, and they can also lower their cost to serve by leveraging online efficiencies.

The retailers in our study fall into three categories:

## FAST-MOVING CONSUMER GOODS

This group includes retailers that offer packaged foods and beverages, toiletries, over-the-counter drugs, and other consumables. They are the most likely to say they have an aggressive growth strategy versus seeking growth at a moderate pace or optimizing performance at their current size and volume. Sales are evenly split between in-person and online channels, but future sales will come mostly from online sources.

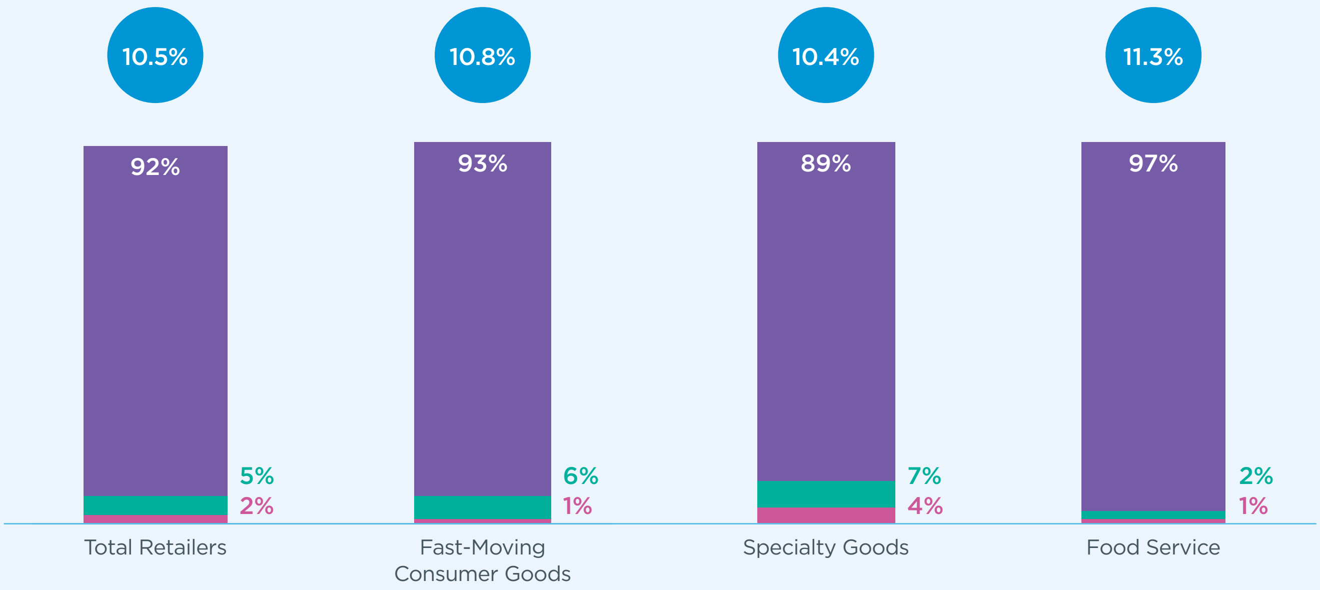
## SPECIALTY GOODS RETAILERS

These businesses sell items such as clothing, jewelry, and electronics. They are fairly evenly split between having aggressive and more moderate growth goals. Like the first group, they do half of their business online and half in person, and they anticipate maintaining that mix over the next five years. The group is most optimistic about its growth in the year ahead.

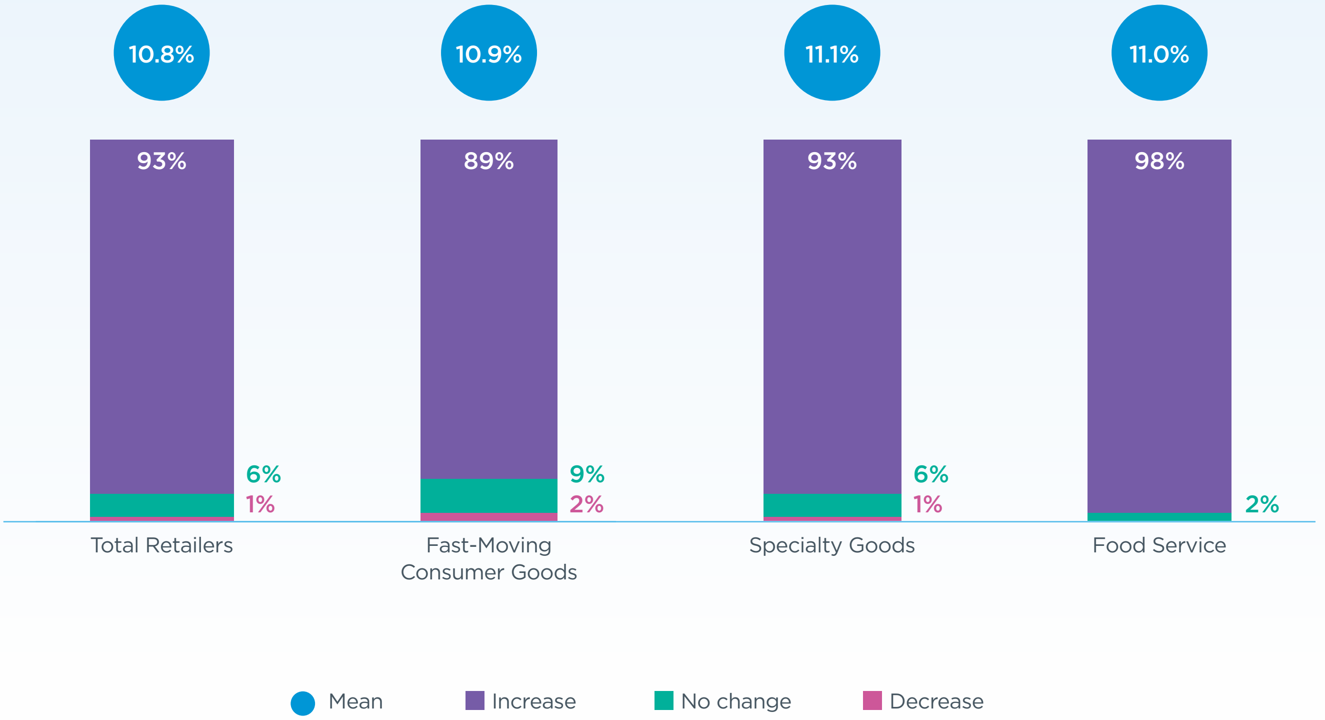
## FOOD SERVICE RETAILERS

Quick and fast-service restaurants that offer food for eating on premise or for take-out fall into this category. They experienced the fastest rate of growth of all three groups over the past year. Like Specialty Goods Retailers, they are split between aggressive and more moderate growth goals for the year ahead. Not surprisingly, this group does less business online (36.5% of sales) than the other two groups and is most likely to include companies that only offer in-person sales. However, 88% offer online options as well and nearly 40% say future growth will come equally from instore and online sales, likely by using food delivery services such as Uber Eats, Seamless, and Prime Now.

## PAST YEAR REVENUE GROWTH

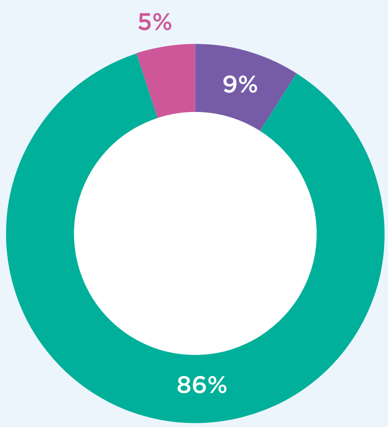



## EXPECTED COMING YEAR REVENUE GROWTH

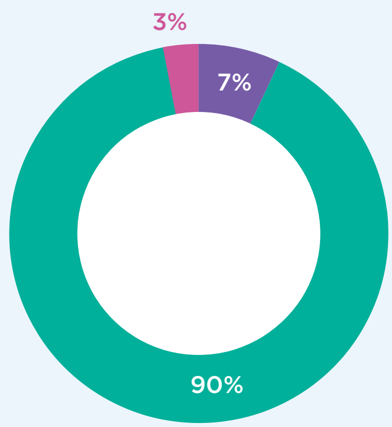


## SALES MIX BY CHANNEL

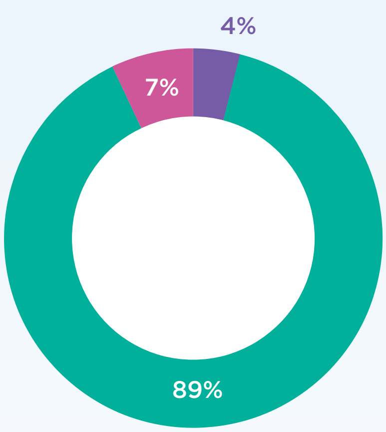
### TOTAL RETAILERS



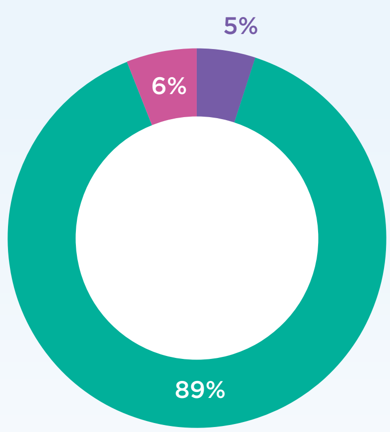

### 15%+ GROWTH RATE



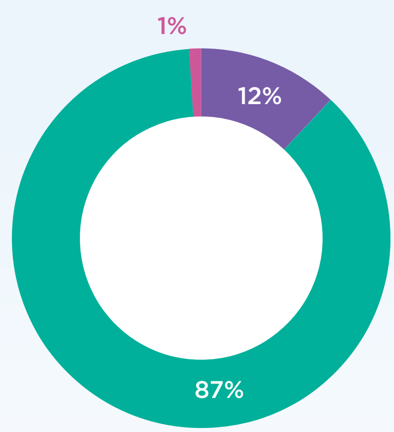

### FAST-MOVING CONSUMER GOODS




### SPECIALTY GOODS



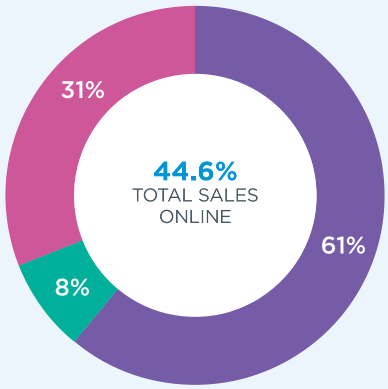

### FOOD SERVICE



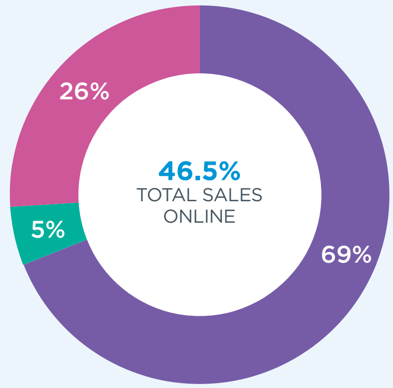

In-Person Only    Both    Online Only

## ONLINE SALES SOURCE

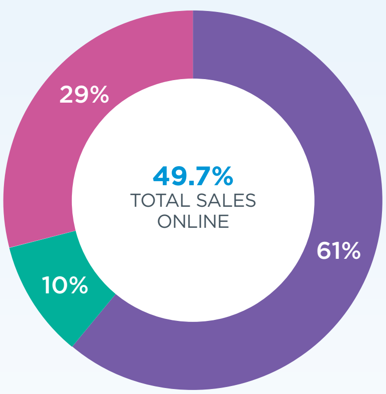
### TOTAL RETAILERS



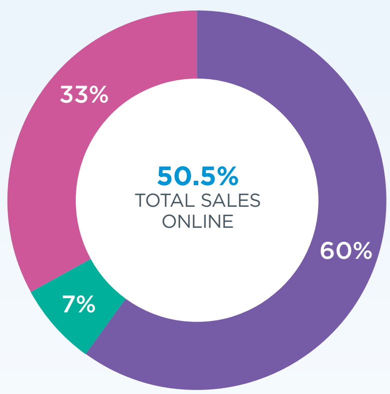

### 15%+ GROWTH RATE



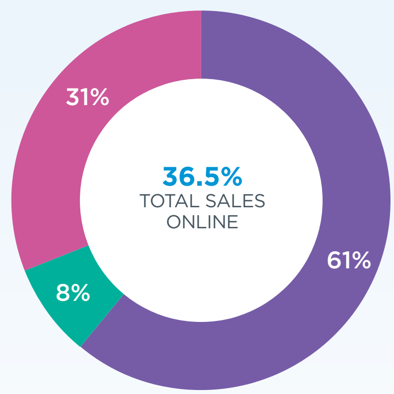

### FAST-MOVING CONSUMER GOODS




### SPECIALTY GOODS

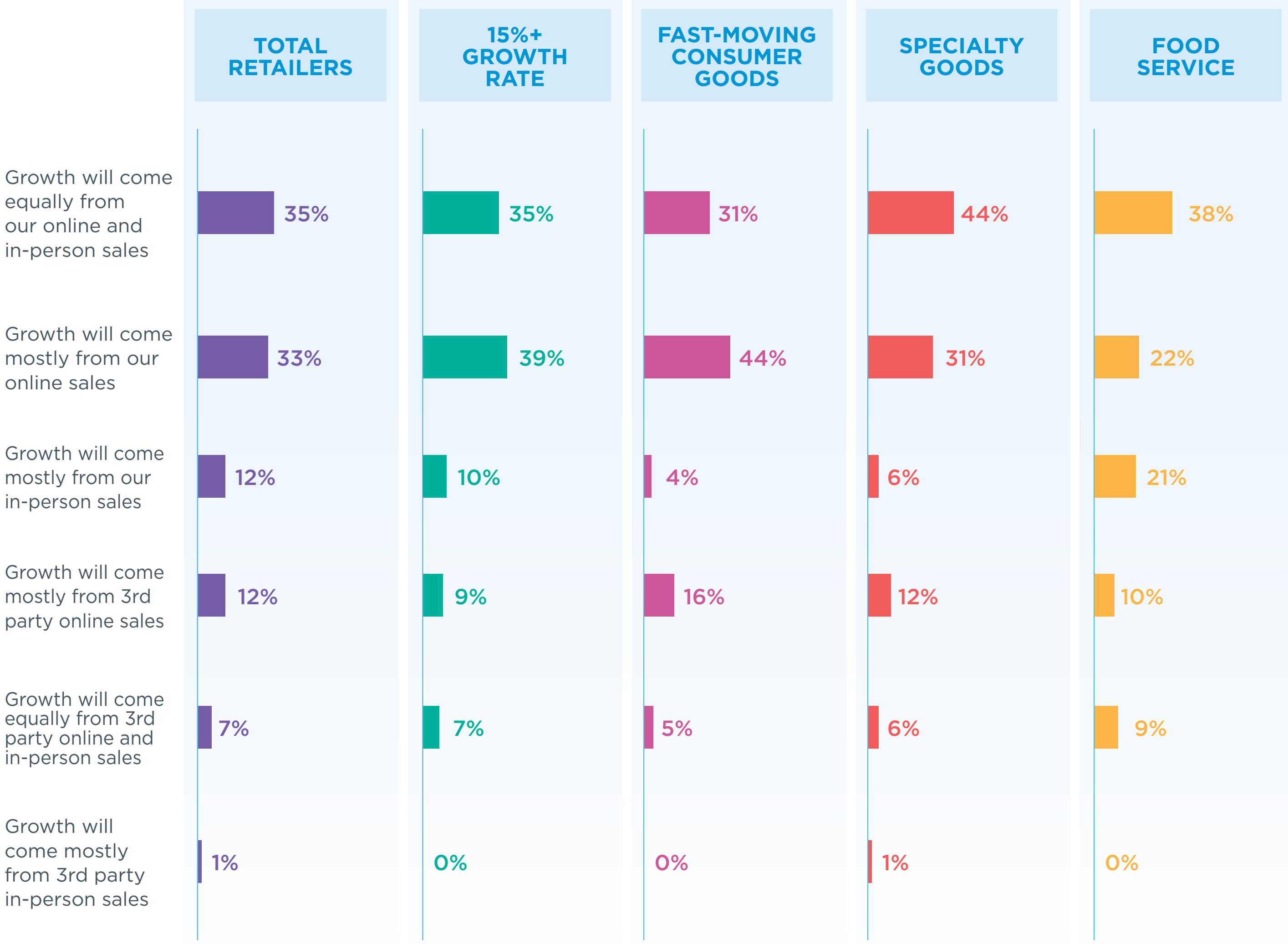



### FOOD SERVICE




Company website   3rd party website   Both

## PRIMARY SOURCES OF COMPANY GROWTH OVER NEXT 5 YEARS



INSIGHT 1

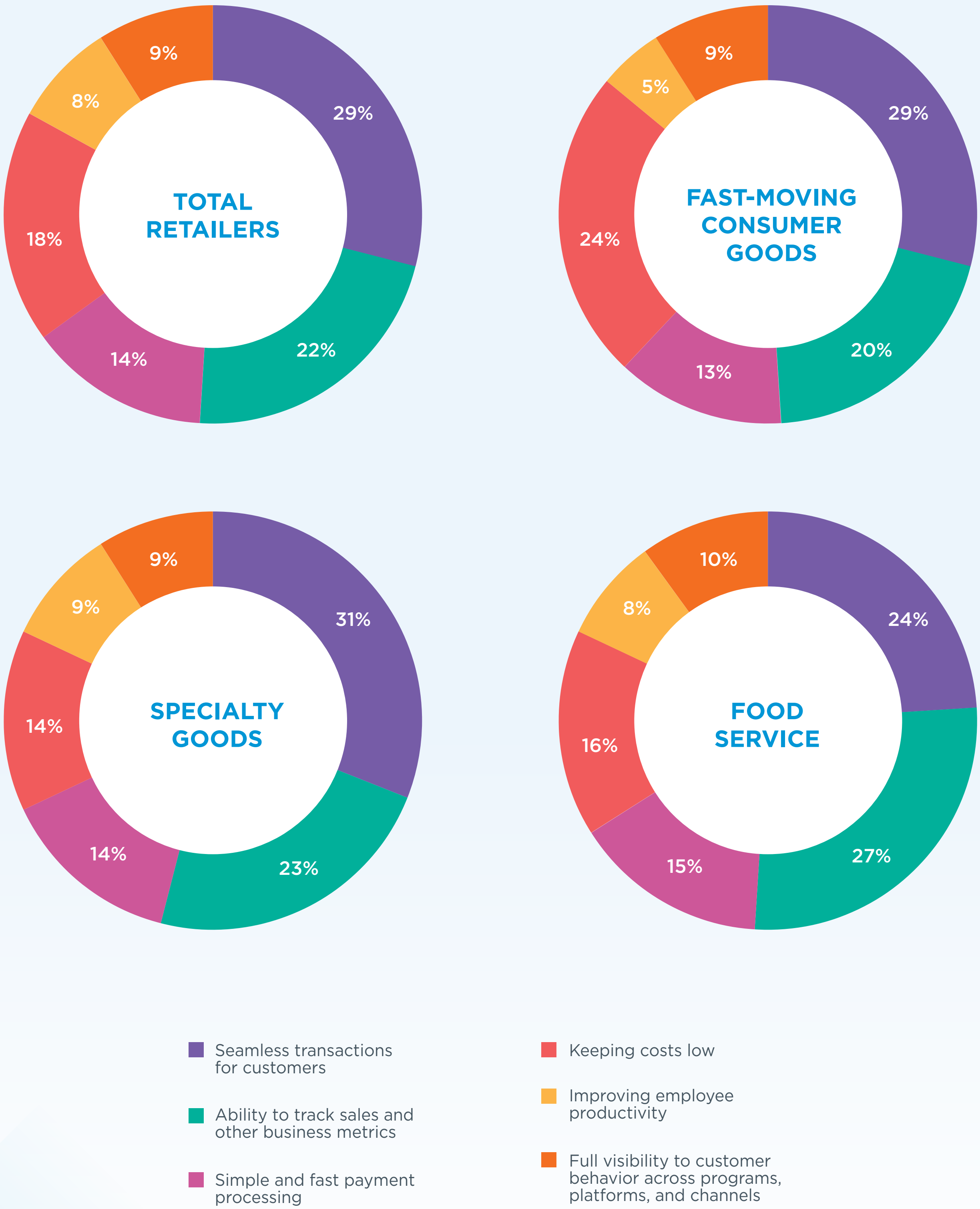
# Efficiency, sales, and customer experience drive digital transformation for thriving middle market retailers.

- *Seamless customer transactions and tracking metrics are top priorities*
- *Investment is shifting to back-office technologies for the fastest growers*
- *Food service retailers prioritize customer-facing tech and customer experience*
- *The fastest growers invest in the latest technologies in all areas of their business*

The retailers in our study leverage digital transformation to pursue three primary goals. First, they target improved efficiency by choosing and implementing technologies that will streamline operations and workflow, including the sales process, inventory allocation, shipping channels, and other facets of the supply chain. Second, they focus on driving more sales from both existing and new customers in store and online. Third, they choose technology that will lead to a seamless, enjoyable, and memorable customer experience online and off. In many ways, these goals are mutually reinforcing. By excelling in efficiency and sales, retailers may find additional resources and margin to invest more heavily in technology that improves customer experience.

When prioritizing their goals, fast-moving consumer goods and specialty goods retailers say that providing seamless transactions for customers comes first, followed by the ability to track sales and other business metrics. For food service retailers, the priority flips—tracking metrics is most important for this group.

## FIRST PRIORITY WHEN IMPLEMENTING DIGITAL TECHNOLOGY



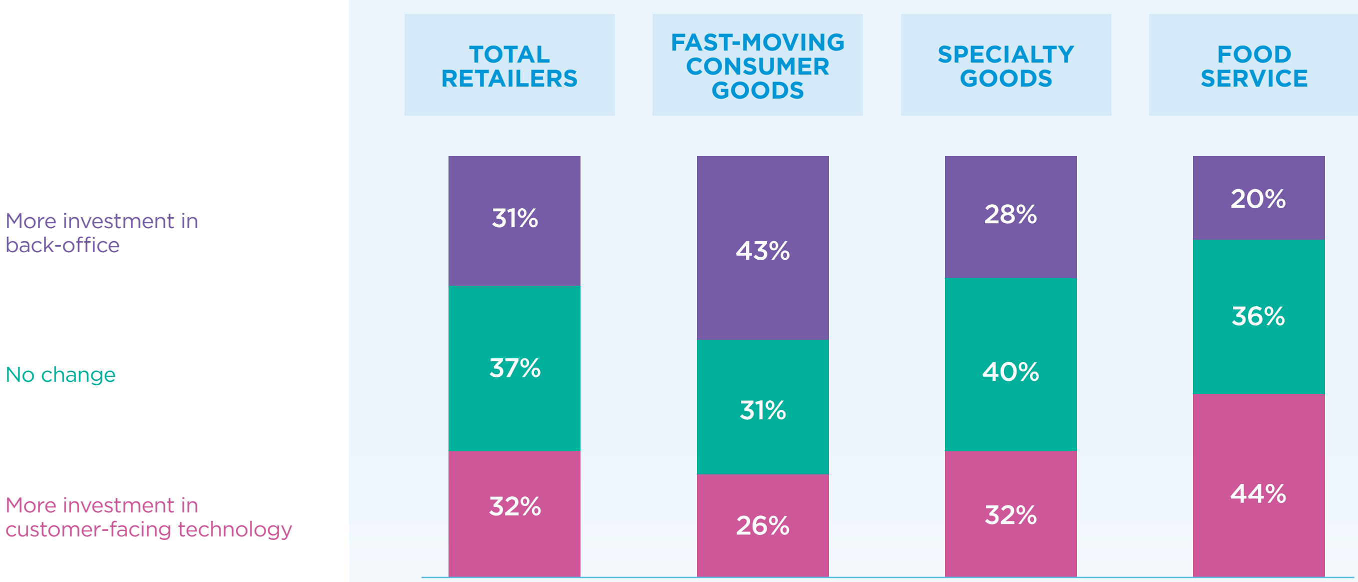
## INSIGHT 1

Retailers in all three categories currently invest slightly more in customer-facing technologies than back-office technology. Food service retailers in particular are focused on the front-end. They are adding things like in-store kiosks for ordering and technologies that enhance the dining experience. Some restaurants have installed tabletop tablets loaded with ordering apps and games. Restaurants in airports often have tablets throughout the concourse that let you order food, check your flight, play games, or surf the net. Bars and pubs that offer trivia or other games are moving to tablets to enhance the experience.

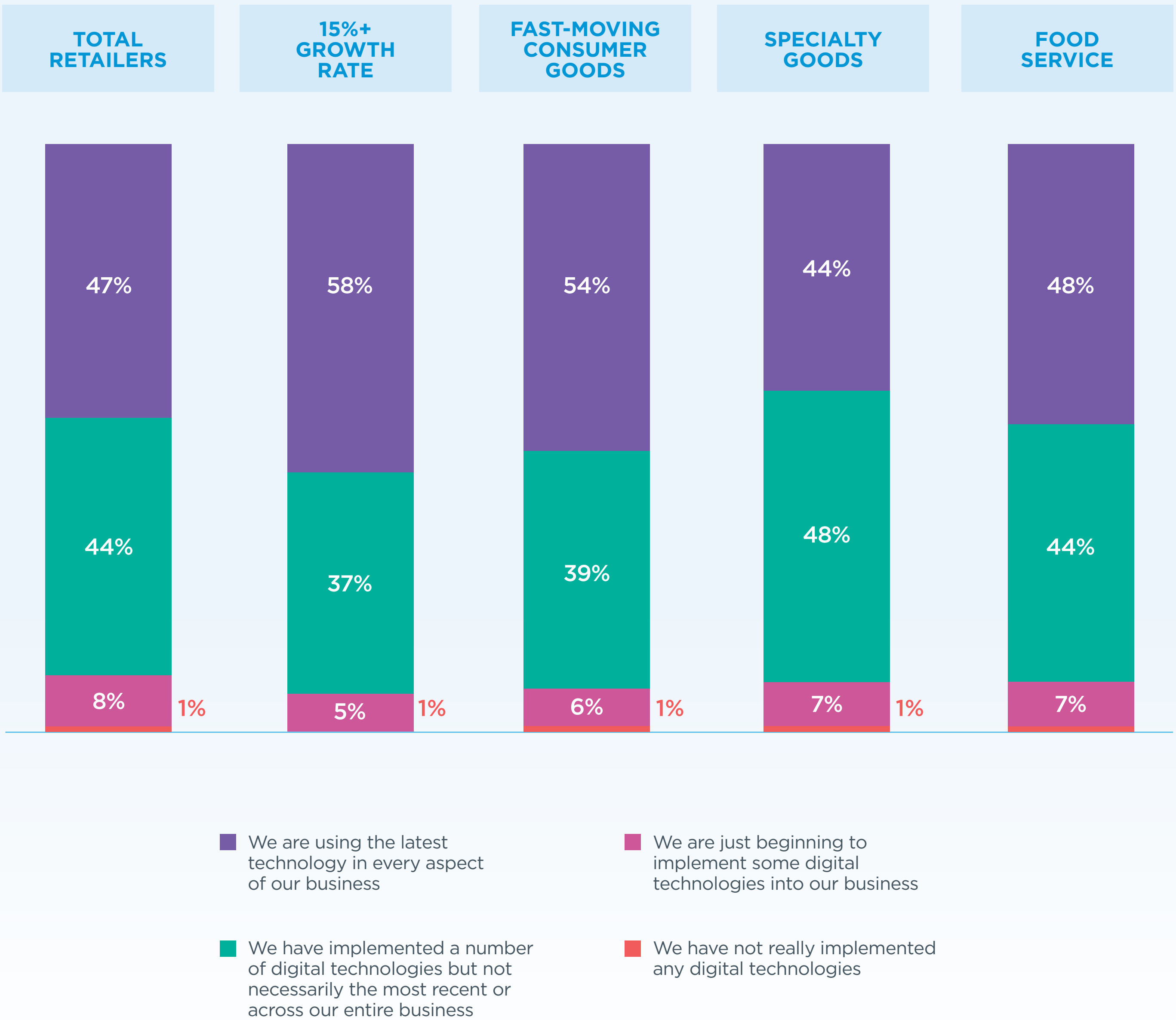
The fastest-growing companies, and fast-moving consumer goods retailers in particular, however, are starting to give more attention and dollars to back-office tech. This is presumably to better meet efficiency and metric-tracking goals.

No matter where they are investing, nearly half (47%) say they are choosing the latest and greatest technologies. Among those retailers growing at 15%+ annually, 58% say they keep up with the latest technology in every aspect of the business.

### INVESTMENT IN DIGITAL TECHNOLOGIES—CHANGE IN PAST YEAR



## HOW WELL COMPANY HAS KEPT UP AND IMPLEMENTED THE LATEST TECHNOLOGY



INSIGHT 2

# The results of digital transformation are wide reaching and they help improve the omnichannel experience.

» *Digital transformation is decidedly positive for retailers*

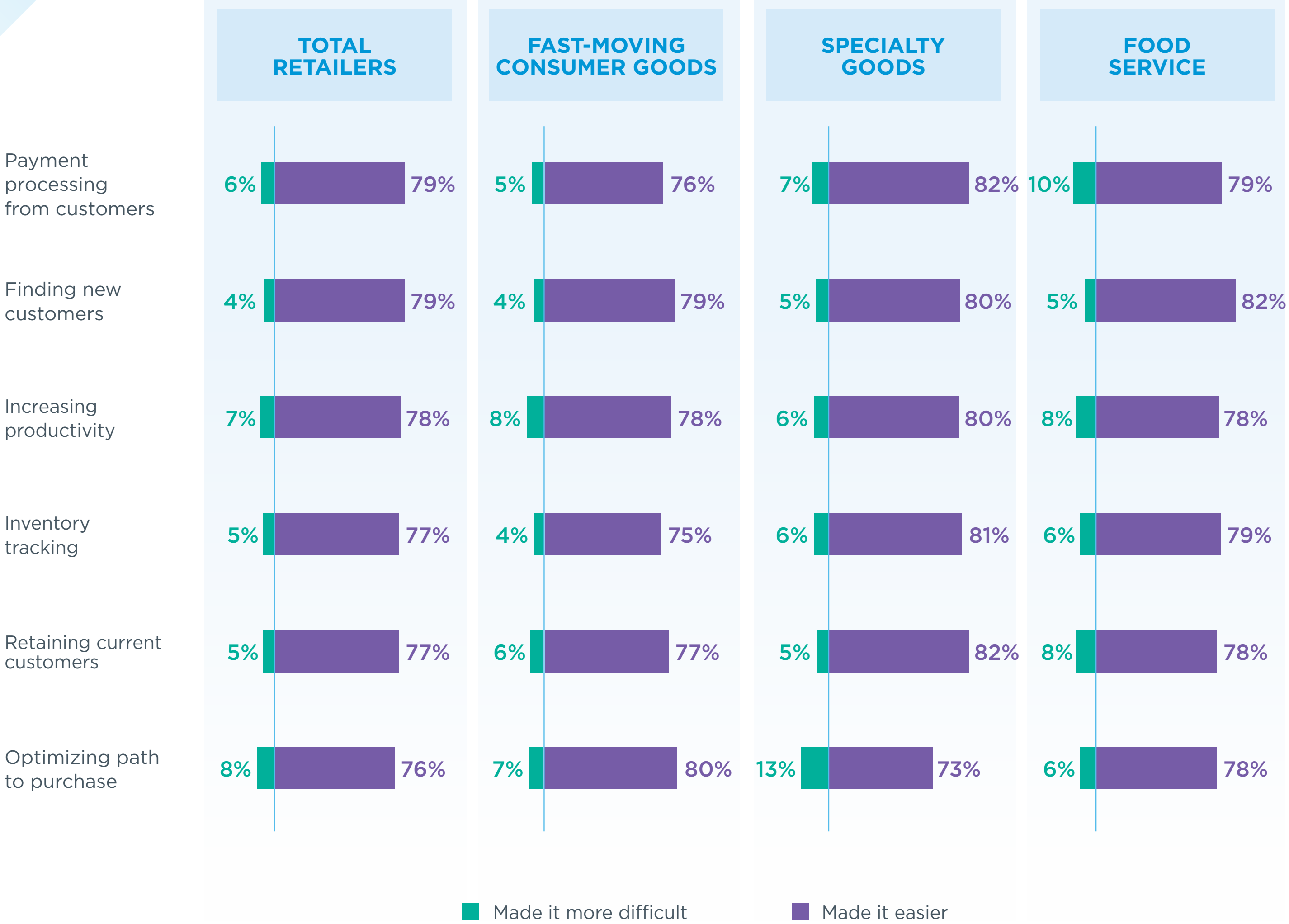
» *Online transactional and behavioral data influences in-store experience, inventory levels, staffing, and merchandise flow*

» *Fast-moving consumer goods retailers are most likely to use online and in-store technology to better understand customer behavior*

Nine out of 10 retailers in our study say the impact of digital transformation has been good for business, 54% indicate that it has been exceedingly positive. The results can be seen across all business functions, from finding and retaining customers and employees, to controlling costs and improving productivity, to tracking inventory.

Furthermore, retailers, and especially those growing at 15% or more annually, are maximizing their investment in technology to improve not only the online experience for customers, but also the in-store experience. They use online behavioral and transactional data collected from digital tools to inform what they stock and how they sell in all channels and to develop unique and effective in-store experiences for their customers.

## DIGITALIZATION'S IMPACT ON BUSINESS FUNCTIONS



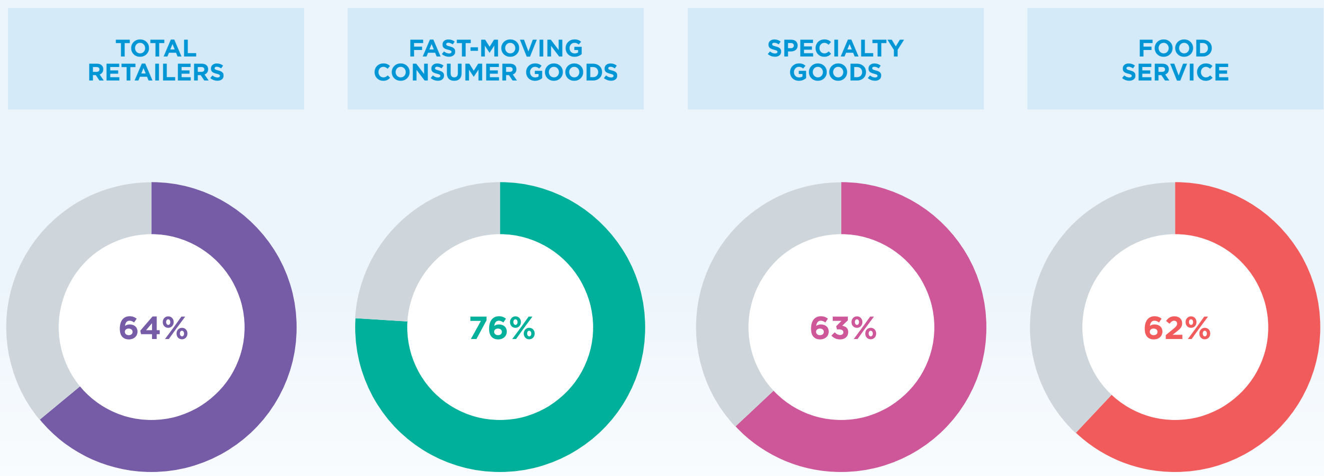
For example, some retailers are using social interests, content engagement, and demand data to inform production and inventory allocation and to identify potential issues creating barriers to purchase. Some use data to geolocate pockets of engaged customers and micro-target new stores closer to where they live and shop. Additionally, by looking at the in-store digital behavior of customers, marketers can gain insights on what's working and what's not. If customers are researching and/or ordering products online while in the store, for example, it may indicate that the store is underserving its customers or that the product is difficult to locate.

Data also informs staffing plans for many retailers and for food service retailers in particular. Managers can even use data to track employee engagement based on how and how often digital tools are being used by employees to do their jobs.

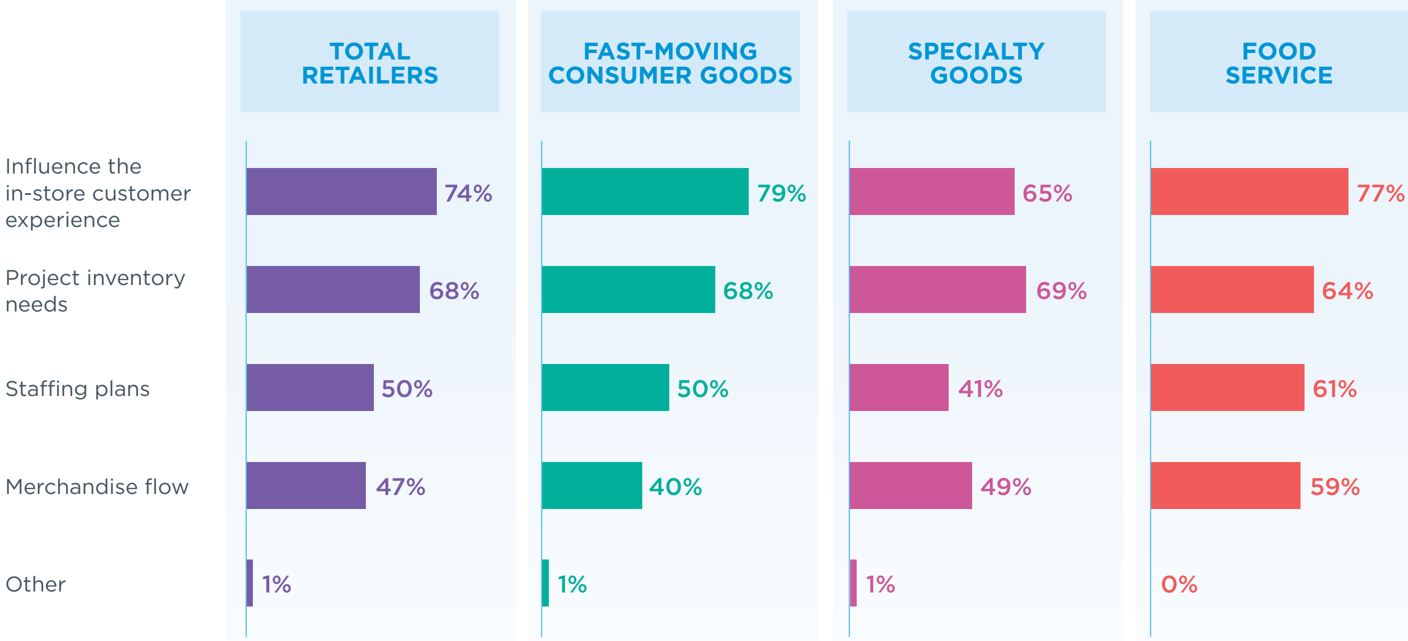
Retailers are not only leveraging technology to track online behavior. Fast-moving consumer goods retailers are using emerging in-store capabilities, such as video analytics and heat mapping, a technology that allows stores to track which areas of the sales floor receive the most traffic and even which items on a table get the most attention. These capabilities help retailers better understand customer behaviors and what helps drive sales in the store.

USE IN-STORE TECHNOLOGIES

## COMPANIES THAT USE ONLINE TRANSACTIONAL DATA




## HOW ONLINE BEHAVIORAL AND TRANSACTIONAL DATA ARE USED



INSIGHT 3

# The retail workforce is shifting from emphasizing low-wage workers to prioritizing highly-skilled talent.

» *Access to well-trained talent is the most important factor for growth*

» *Technical skills are most important in inventory positions*

» *Most high-performing retailers invest in training and development and are willing to pay competitive wages*

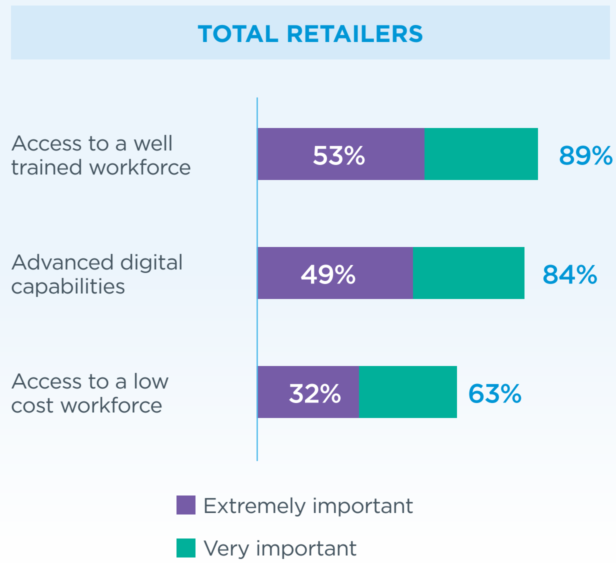
» *Few are concerned about minimum wage increases.*

Retail has long been the home of the minimum-wage worker. While this may still hold true to some extent on the sales floor, the retail workforce mix has changed as businesses have come to emphasize efficiency, customer experience, and digital transformation. Retailers are aggressively seeking skilled people, especially those with technology or computer skills, and most are willing to pay more for the right talent.

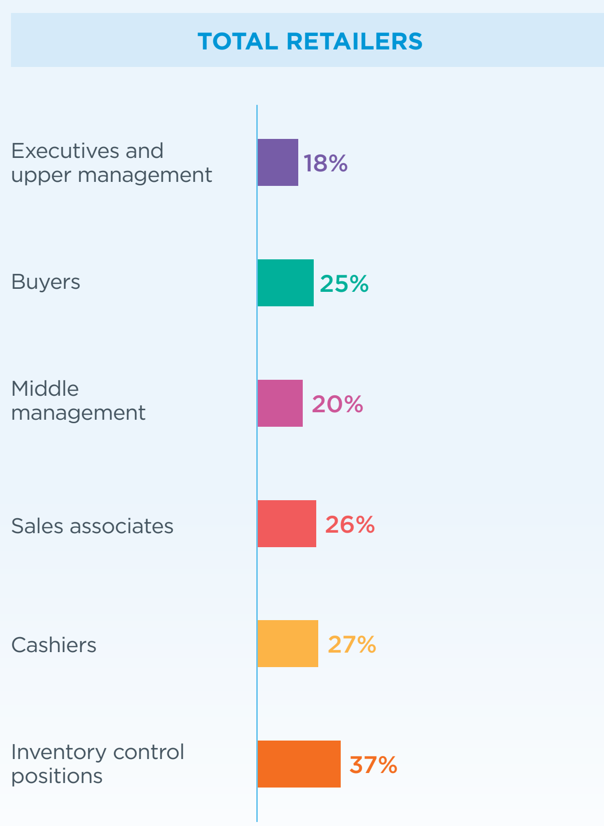
Indeed, 89% of retailers say access to a well-trained workforce is important to growth, while just 63% say access to a low-cost workforce is imperative. Specialty goods and fast-moving consumer goods retailers especially are looking for people with technology and computer skills. Our study shows that these skills are most critical in inventory control positions, and, interestingly, least important at the executive level. However, while leadership might not require expertise in technology to perform specific job functions, they need to understand its potential and value to make the proper investments and decisions within the business.

Moreover, research by the Center's partners, Brookings Institution Metropolitan Policy Program, provides further proof that technology skills are becoming increasingly important for retail occupations at all levels. Brookings' new study, *Digitalization and the American Workforce*, indicates that "digitalization"—what Brookings describes as the diffusion of digital technologies into nearly every business and workplace and pocket—has increased the retail trade industry's digital intensity score from 28 in 2002 to 41 in 2016.

## IMPORTANCE OF FACTORS FOR COMPANY GROWTH




## IMPORTANCE OF TECHNOLOGY OR COMPUTER SKILLS FOR SPECIFIC ROLES

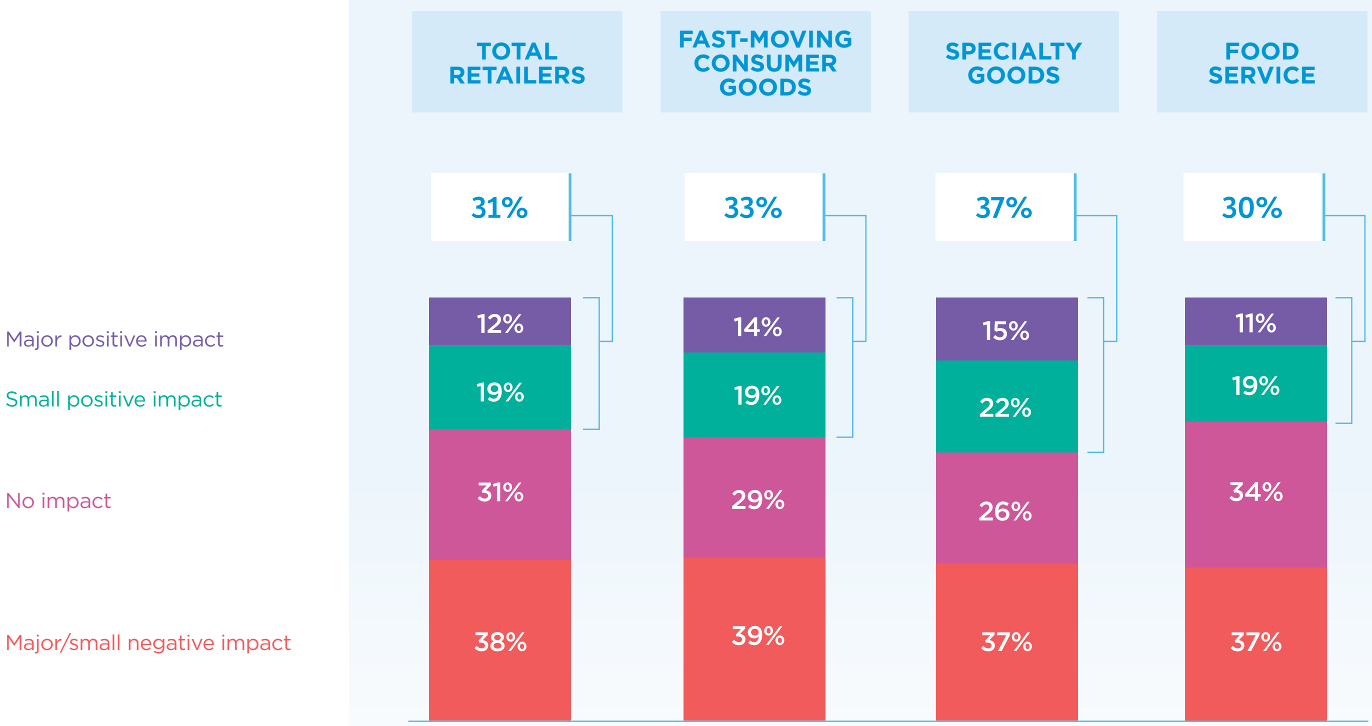


## INSIGHT 3

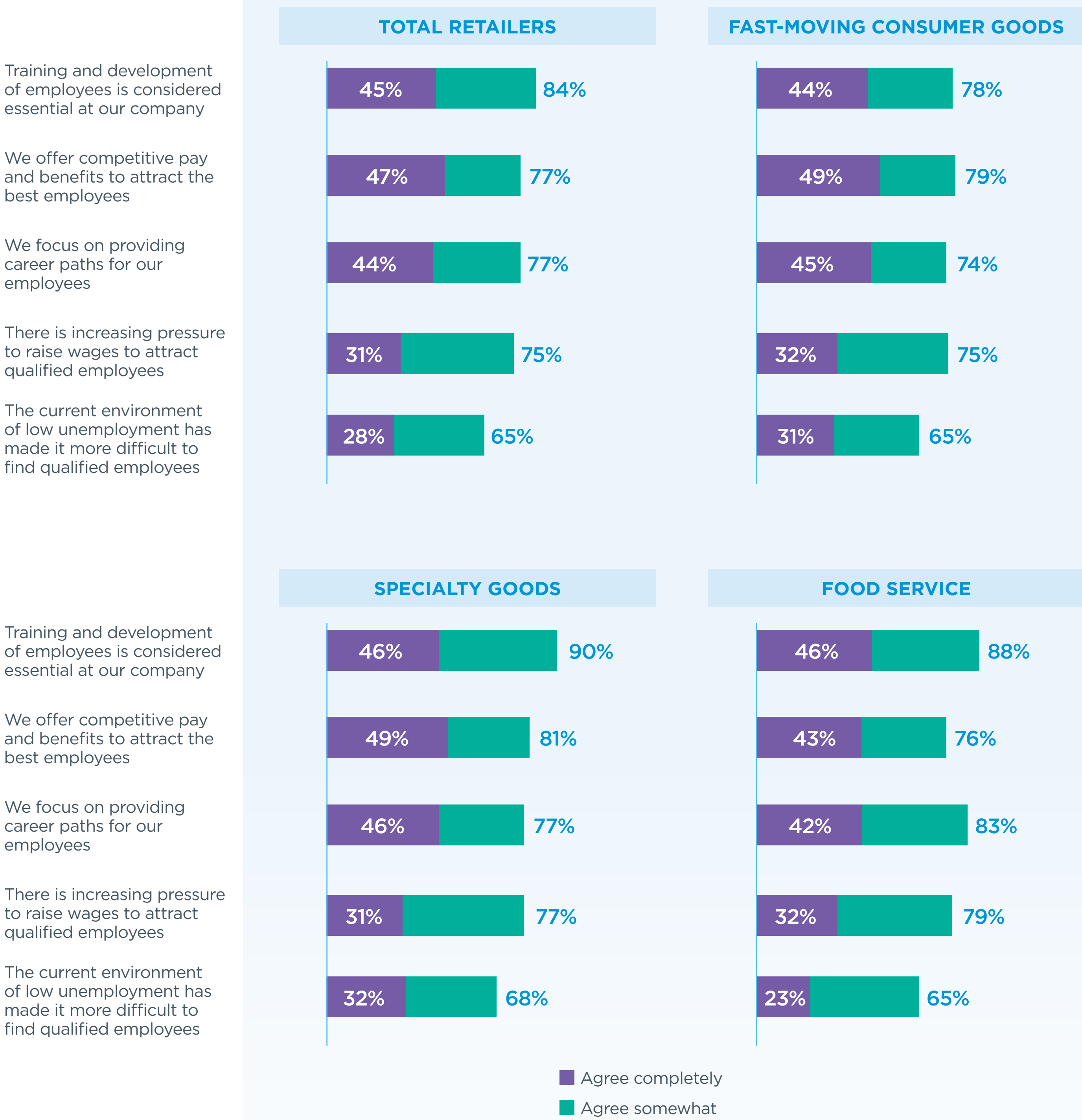
At all employment levels, retailers are committed to investing in training and developing their employees, particularly specialty goods and food service retailers. Across the categories, businesses are willing to pay competitive wages and benefits to attract and keep the right people. Among retailers growing at 15% or more annually, there is notably more pressure to raise wages to attract the best employees, and these retailers are also much more likely to offer career pathing in order to retain their workforce.

Across the board, only about a third of retailers appear to have any pressing concerns about minimum wage increases, likely because these retailers prioritize and are willing to pay for the skilled talent they need. Indeed, among specialty goods retailers, nearly four out of 10 (37%) say that an increase in minimum wage will have a positive impact on their businesses.

### IMPACT IF MINIMUM WAGE WERE TO INCREASE



## ATTITUDES ABOUT TALENT MANAGEMENT



# Digital integration of the supply chain is increasingly important.

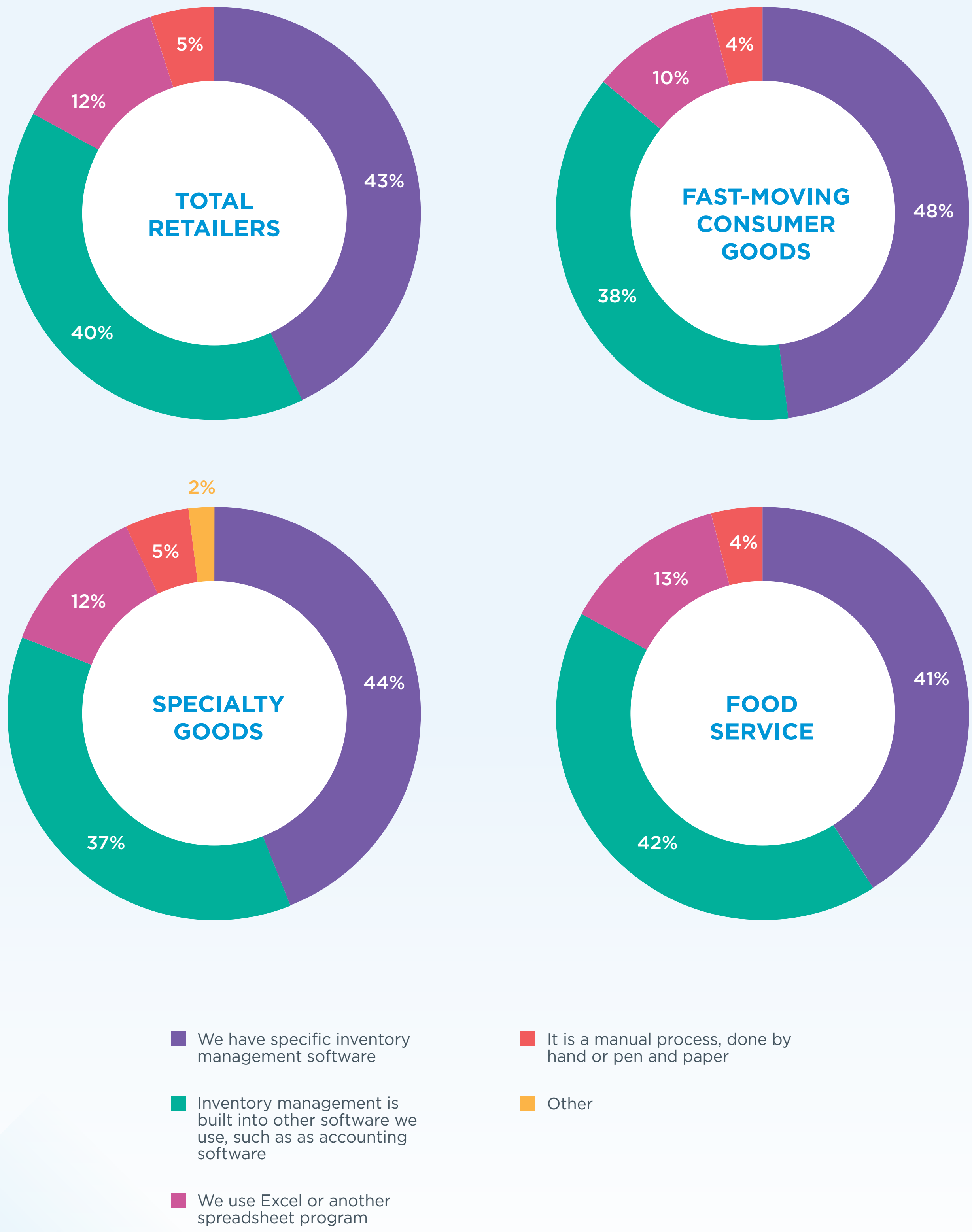
- *Supply chain is a key focus for digital transformation*
- *Most fast-growing retailers use stand-alone inventory management software*
- *Technology helps retailers better understand their inventory needs and manage the supply chain from end to end*
- *The need for increasingly sophisticated supply chain technology and skilled workers will grow*

More than four out of five (83%) of the retailers in our study say a robust supply chain is critical to growth. Nearly half (43%) say that managing inventory and the supply chain is a challenge. Retailers aim to strike the perfect balance: They never want to be out of stock when a customer comes into the store or places an online order. But they don't want to tie up working capital with excess inventory or be forced to mark down their stock to unload it.

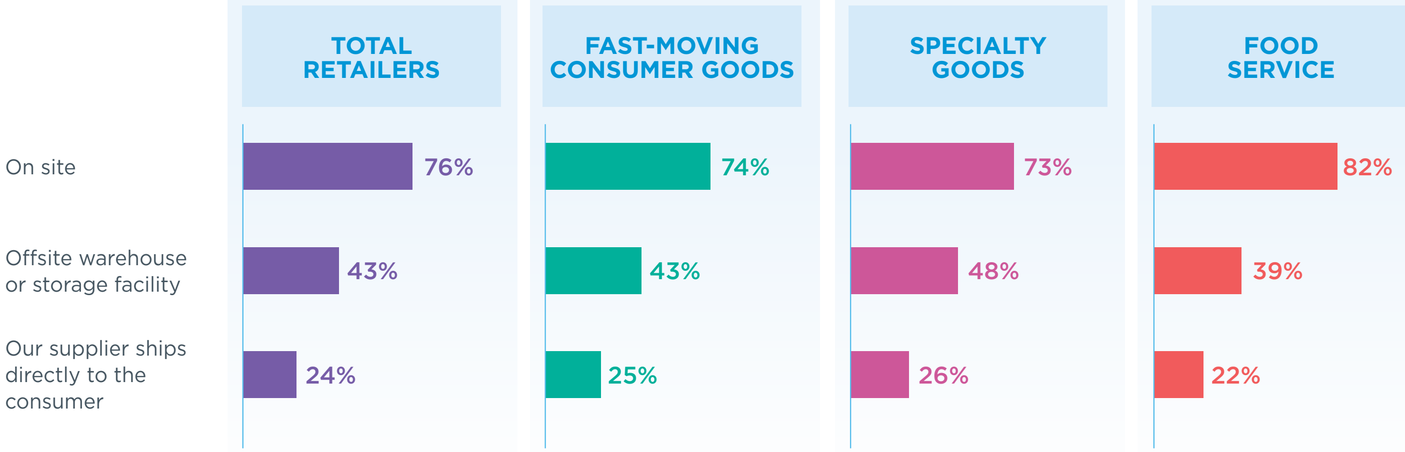
To achieve optimum inventory levels, retailers often put pressure on their suppliers to deliver faster and more efficiently. As we saw in our *Middle Market Manufacturing* study, 81% of original equipment manufacturers (OEMs), which often sell direct to retailers, say that their customers expect faster cycle time. The same study also shows that the majority of OEMs agree that digitalization of the supply chain helps make those shorter timelines possible.

Retailers are increasingly adopting new technologies to streamline the supply chain, inventory, and shipping channels. Most of the retailers in our study use either a dedicated inventory management software or a digital inventory management solution that is built into another, larger software platform, such as an accounting system. These solutions promote speed and transparency across the supply chain, which is especially important to retailers that manage multiple links, i.e. those that have multiple suppliers, store inventory in several locations, and/or use a variety of shipping partners. While the retailers we studied primarily store inventory on site, more than four out of 10 (43%) make use of offsite warehouses or storage facilities. About a quarter (24%) ship some goods direct from the supplier to the consumers. And 38% make use of third-party logistics providers (that number rises to 49% for fast-moving consumer goods companies and 41% for specialty goods retailers).

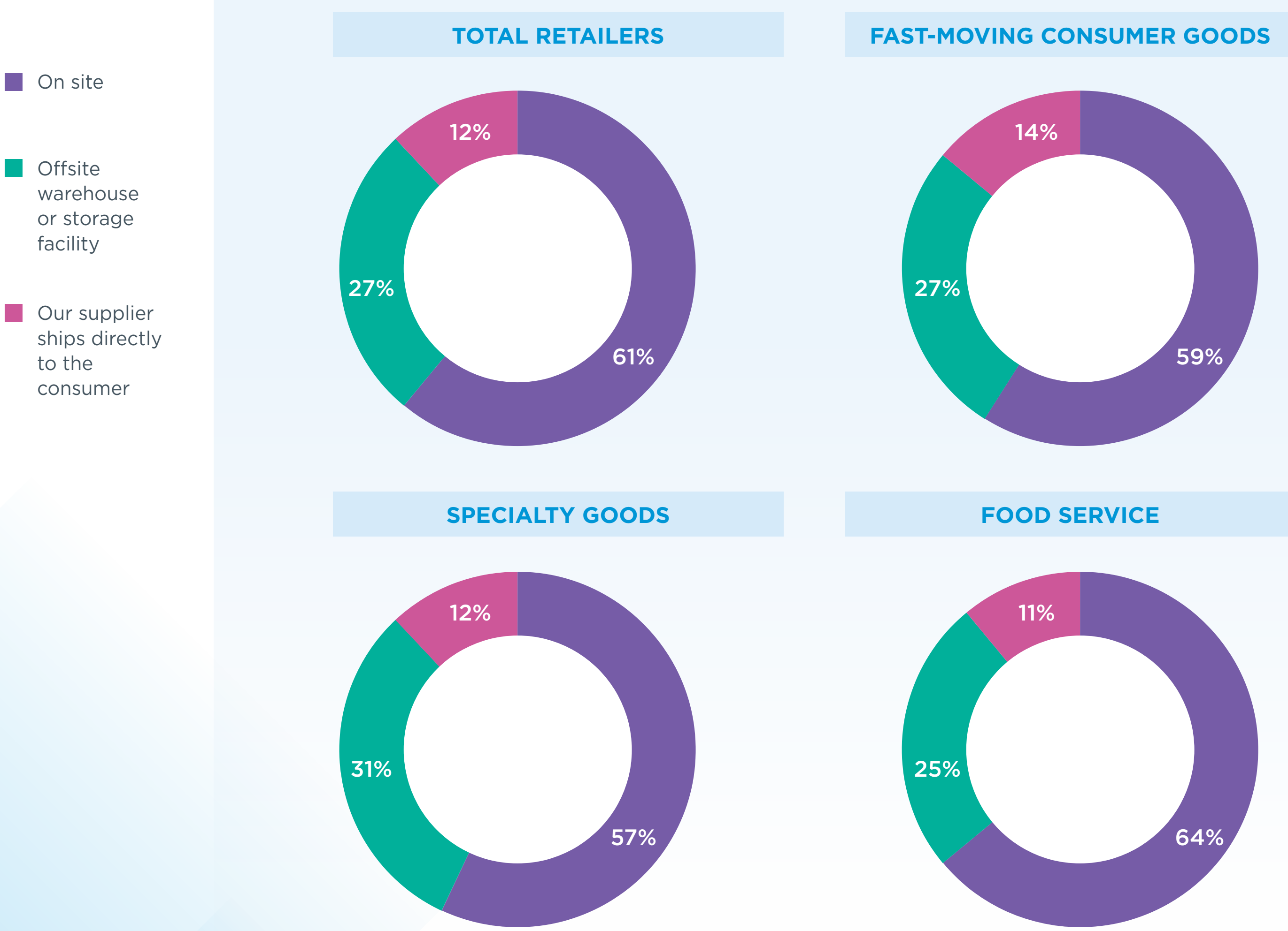
## HOW INVENTORY IS MANAGED



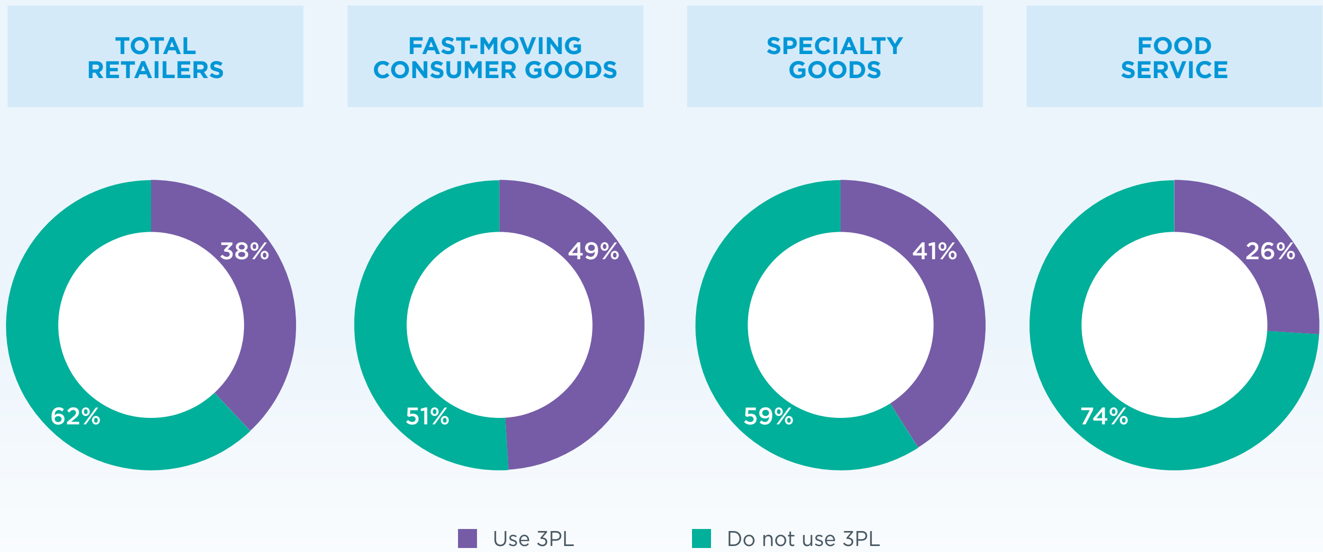
## INVENTORY STORAGE FOR ONLINE ORDER FULFILLMENT (AMONG THOSE WITH ONLINE SALES)




## INVENTORY STORAGE LOCATION MIX



## USE OF THIRD PARTY LOGISITICS SERVICES (3PL)

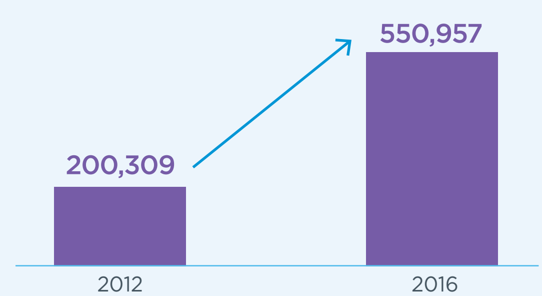



Beyond using digital solutions to help manage this supply chain complexity, many retailers, and fast-growing retailers in particular, use the online behavioral and transactional data they collect to shape inventory and supply chain decisions (see Insight #2). By becoming more digitally savvy across all areas of their businesses, retailers have better insight into what their customers want and where and how they hope to access it. They also have increased visibility into and control over the fulfillment process.

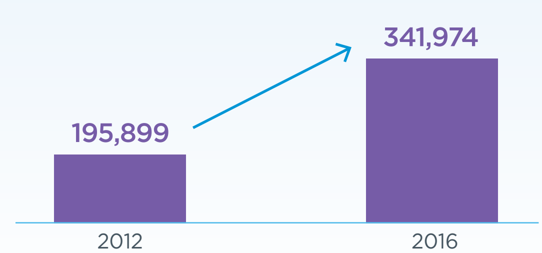
As e-commerce continues to grow for middle market retailers, they will likely need even more robust tools to manage the increasingly complex supply chain and track inventory more efficiently from end to end. Retailers will also need more people. According the National Retail Federation, total retail supply chain and logistics job openings have grown exponentially since 2012. While most retailers in our study indicate that they do not face challenges filling their inventory control positions currently, that could change as demand for people with these skill sets continues to build.

## RETAIL HIRING IS ON THE RISE IN NEW GROWTH AREAS*

### TOTAL RETAIL SUPPLY CHAIN AND LOGISTICS JOB OPENINGS




### TOTAL RETAIL ENGINEERING AND TECHNOLOGY JOB OPENINGS




*National Retail Federation, *The Future of Retail: Get the Facts,* Source: Burning Glass Labor Insight Database

# Digital transformation introduces its own set of challenges.

» *The cost of digital transformation is a challenge*

» *Most companies adopt only enough technology to keep up with competitors*

» *Digital technology opens the door for smaller companies to compete with middle market retailers*

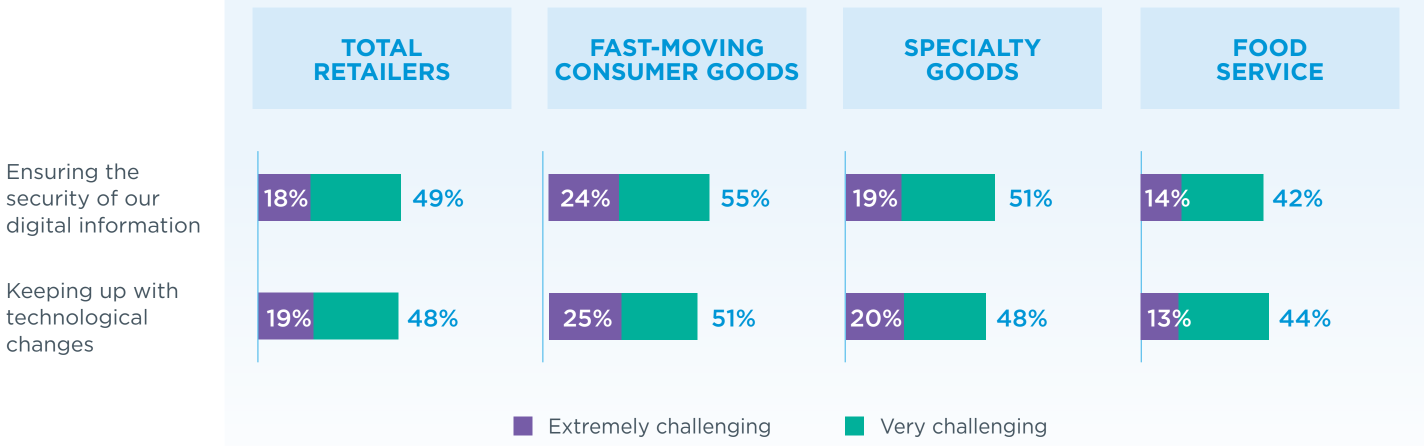
» *Cybersecurity issues and protecting digital information is a key challenge*

On one hand, the retailers in our study claim to be keeping up with the latest technologies across all areas of the business, and the impact of these investments is decidedly positive. On the other hand, 65% of retailers say they only adopt enough technology to keep up with competitors. This is true even among retailers growing at 15%+ annually.

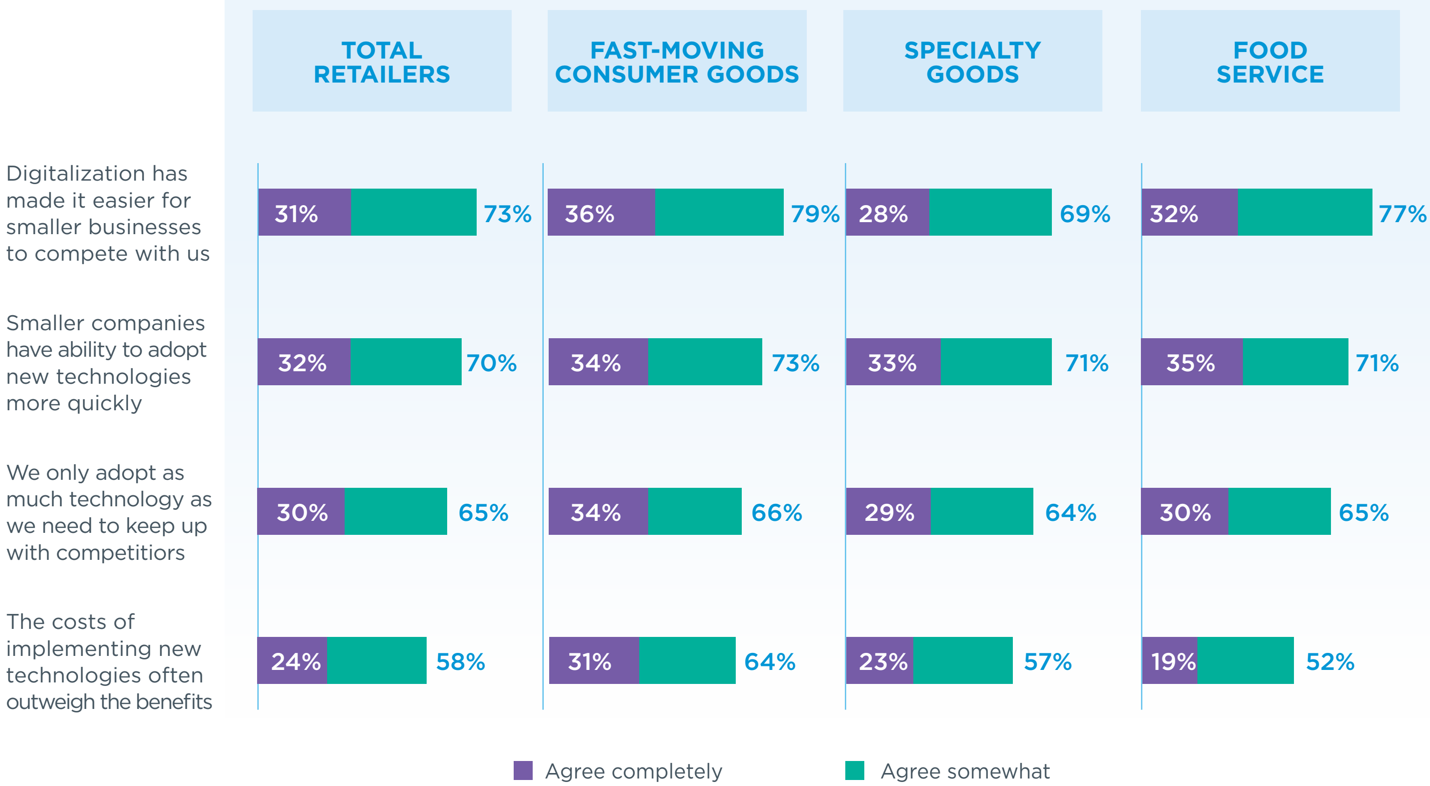
One reason they may choose to make incremental steps versus larger-scale adoptions is the price tag. Indeed, 58% of companies say the costs of implementing new technologies outweigh the benefits those technologies afford. At the same time, introducing new technology opens up new challenges for retailers to protect their digital information and the information of their customers.

Retailers are also well aware that while digital transformation allows them to compete with larger companies, it opens the door for smaller firms to more aggressively compete with them. As retailers continue to make strategic choices about the best investments for their business, they will need to continue to carefully weigh the benefits and challenges.

## BUSINESS CHALLENGES




## IMPACT OF DIGITALIZATION ON RETAIL ENVIRONMENT



# Digital Transformation: Balancing the Benefits with the Budget

Our study clearly shows that for a group of middle market retailers that is actively investing in digital technology, the results are impressive. These retailers say the impact of their investments can be felt across all areas of their businesses. And their growth proves it. They are outgrowing the overall retail sector and their middle market peers in all industries.

Yet, while many companies say they are keeping up with the latest digital technologies, the majority also claim to only be adopting as much technology as they need to keep pace with their competitors. Mid-sized retailers appear to be phasing in their digital transformation and carefully balancing the benefits it affords with the reality of their often-limited resources.

In general, middle market companies are hesitant to take on debt in order to grow. They add only what they believe they can afford, and build on their capabilities as funds allow and the market dictates. The fact that middle market companies are more flexible and agile than their larger peers may serve them well in the digital transformation arena: They can pick and choose the newest and best technologies as needed to advance specific growth goals and initiatives.

The strategy appears to be working. The growth rates indicate that middle market retailers have chosen well in terms of the digital tools they adopt. As they continue to add more and better capabilities, these digitally-savvy businesses may be poised for even greater levels of breakthrough growth as they continue to deliver the digitally-enhanced experiences and buying opportunities that entice customers to spend more both online and off.

# Are you ready for digital transformation?

As your company considers the best technologies to meet your specific digital objectives—greater efficiency, boosting sales, enhancing the customer experience, or something else—answering these questions can help you understand your own digital readiness and help you direct your digital investment for the greatest return.

» What is your consumers' omnichannel relationship with your brand? How well can you define the consumer journey?

» How current or up-to-date is your baseline consumer-facing technology? Do the systems provide a fast, easy and seamless consumer experience?

» How current is your baseline back-of-the-house technology? Are systems truly integrated? Do they provide fast and accurate data and insight that improve the employee experience?

» What talent gaps exist (employee and partner) when it comes to technology, digital expertise, and digital-first thinking?

» Evaluate your culture. How willing are your employees and leaders to adopt the latest and best technology and digital processes? What is the appetite for investment?

» Is your organization designed to deliver a truly omnichannel experience vs. a store-only or e-commerce-only experience?

NATIONAL CENTER FOR
THE MIDDLE MARKET

The National Center for the Middle Market is the leading source of knowledge, leadership, and innovative research focused on the U.S. Middle Market economy. The Center provides critical data, analysis, insights, and perspectives to help accelerate growth, increase competitiveness, and create jobs for companies, policymakers, and other key stakeholders in this sector. Stay connected to the Center by contacting middlemarketcenter@fisher.osu.edu.

THE OHIO STATE UNIVERSITY
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CBUS Retail
We Love Retail.

Driving collaboration and purposeful connection for those with a focus and a love of retail.

CBUS Retail is a non-profit association, focused on promoting Columbus, Ohio as the global retail capital for talent, collaboration and innovation. The member organization is comprised of an extraordinary group of retailers and retail service providers who meet regularly to connect, educate, collaborate and promote the retail industry. Our year-round programming includes a monthly senior executive retail advisor forum, bi-monthly "One Degree of Retail" networking events, an executive roundtable series, our annual conference featuring over 120 local and national thought leaders, and a collaborative partnership with local universities to leverage research and promote retail careers to future talent.