

BRICKS AND CLICKS

Thaiha Nguyen, Investment Manager. Second Quarter 2019

BAILLIE GIFFORD

A photograph of a modern architectural space, likely a public building or museum. The structure features a complex, angular design with large glass panels and prominent metal beams. The glass panels are colored in shades of red, orange, and yellow. A person in a dark jacket and pants is walking across a light-colored tiled floor in the foreground. The sky is clear and blue. The overall atmosphere is bright and contemporary.

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'Observatory of Light, Work in Situ', Foundation Louis Vuitton presents a temporary work by Daniel Buren.
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BRICKS AND CLICKS

BY THAIHA NGUYEN

In the folktale of the same name, Chicken Licken causes alarm after being hit by a falling acorn, proclaiming to all that the sky is falling. While the world isn't coming to an end, it becomes a self-fulfilling prophecy when the wily fox, Foxy Loxy uses the ensuing panic to lure the birds into his den, where he quickly disposes of them. Commentators have been predicting the sky falling on bricks and mortar retailers for as long as there has been online competition. So far, they have been wrong. But are things changing?





Sears is closing 80 more stores as it teeters on the brink of liquidation.
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The year 2018 has been marked by a record loss for US retail with anticipated closure of nearly 11,000 stores owned by traditional retailers like Sears, Gap and Macy's. In the recent Thanksgiving and Black Friday sales, footfall in traditional stores fell between 5–9 per cent compared with the same days last year. At the same time, online sales surged by 26 per cent to more than \$12 billion, making it the fastest-growing day for ecommerce sales in history. That doesn't sound like an acorn falling, more like a large bell tolling.

But before we begin rushing to get our affairs in order, we should also remember that every 50 years or so, retailing undergoes this kind of disruption. It is nothing new. A century and a

half ago, the growth of big cities and railroad networks made possible the modern department store. Mass-produced automobiles came along 50 years later, and soon shopping malls lined with specialty retailers were constructed in the newly-formed suburbs and challenged the city-based department stores. The 1960s and 1970s saw the spread of discount chains – Walmart, Kmart and the like, and soon after, big-box 'category killers' such as Home Depot and Circuit City. Each wave of change didn't eliminate what came before, but it reshaped the landscape and redefined consumer expectation. Retailers that fail to adapt will die out as new ones pull traffic away from their stores and make the remaining volume less profitable.

ROLE REVERSAL

The same narrative applies to today's world. Ecommerce has changed our shopping habits, and there is no going back to a pre-internet era. Traditional bricks and mortar retailers well know that they must adapt and reinvent themselves if they are to survive. Many are pushing hard to get online to compete with the likes of Amazon. But the stakes are high: free delivery and return, and even same-day delivery are no longer a privilege, rather a 'must-have'. And because customers do not have the same opportunity to handle products before ordering them, the volume of customer returns will also be higher than for offline retailers.

However, it's not all one-way traffic in favour of digital offerings; the crossover goes both ways. Digital natives like Amazon, Warby Parker (online glasses retailer) and Rent the Runway (allows users to rent rather than buy designer labels) are heading in the opposite direction and are opening physical stores. Why so? Haven't they heard that the sky is falling on physical stores?

However, if you think about it, constant connectivity, contextual relevance and a multi-screen world are changing both online and offline shopping. As a result, digital and in-store experiences are beginning to blur. Physical stores won't necessarily go away. In fact, for the bigger brands especially, they will serve as a crucial part in their omnichannel offering. Stores no longer just fulfil a logistic function as the additional distribution centres for pick-up and return of online orders through instore click-and-collect, but are growing to become the advertising and consumer-engagement channel for brands. There will be exciting times ahead for forward-thinking retailers.

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THE BRICKS AND CLICKS MODEL

Unsurprisingly, this retail revolution is being driven by emerging technologies. It is likely that the stores of the future will look very different from those we have today, using augmented reality and digital technologies to deliver a seamless customer experience. One area which we see already taking the lead in this respect is clothing retailers and fashion brands.

One leading example is the global fashion brand, Rebecca Minkoff. The brand's flagship store in New York City features 'connected walls' – these are mirrored displays showing video and inspirational content that shoppers can touch to request the said items be delivered to the fitting rooms for them to try on. The technology automatically recognises the products through radio-frequency ID (RFID) tags, which sync with the available inventory in the store. Should a customer want a different size or style, they simply request it from the computerised mirror, and if they are not sure about the colour, can even layer different colours on their own image, until they find 'the one'. And if the customer is looking for a second opinion, the mirror can be photographed or recorded in 360-degree views to be sent to friends via email or social media. With technology, it is no longer in fairy tales that we can ask "Mirror, mirror on the wall, which is the fairest of them all?" Checkout is also effortless – customers can simply put together an order, just like online shopping, walk out of the store and wait for their pieces to be delivered home. According to Uri Minkoff, the brand's CEO co-founder, the enhanced fitting rooms have both increased the time customers spend in stores and, more importantly, boosted clothing sales by triple digits.





Another concept store of the future is from the sports brand, Adidas. With many sporting activities undertaken outdoors, it should be no surprise that customers should want to test certain garments in the weather conditions that they will be worn in. But how do you recreate cold weather, rain or snow in a shop? With the help of virtual reality, of course. Adidas is set to create a VR-enabled fitting room that can simulate winter weather, making the process of choosing the apparel for running in the cold much more exciting and relevant.

While examples like Rebecca Minkoff and Adidas are rare today, they will no doubt become ubiquitous in due course. We will increasingly see technologies, such as beacon transmitters, deployed in shops, enabling brands to use their physical stores as a targeted advertising channel. Beacons are small, Bluetooth-enabled devices that are placed around a store. They can connect

to smartphones that have the retail app installed and Bluetooth turned on. The beacons detect those smartphones, enabling retailers to send special offers, discounts and promotions to their potential customers. Retail stores such as Urban Outfitters and Macy's have already implemented this technology.

The above examples aren't as futuristic as they may seem. We will soon see more retailers adopting this new omni-channel strategy by augmenting their physical stores with digital technologies. Far from the sky falling, the skies are wide open for technology-enabled retailers. Shops aren't dying out but are evolving to serve different functions. They won't merely be a marketplace through which people trawl to locate and purchase items. Instead, they will be distribution centres, advertising channels and showrooms to engage with customers, all in one.

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THE NEXT WAVE OF DISRUPTION

Ecommerce was able to displace existing retail models because it gave customers a breadth of choice, transparency and convenience that could not be rivalled instore. However, as customers are offered ever-increasing choices, they are also likely to be overwhelmed by the options available and many will soon tire of browsing for products for the want of an effective filtering option. For example, a simple search for ‘blue skinny jeans’ results in approximately 1,000 results on Amazon Prime; 700 on ASOS and 500 on Macy’s. Who would have time to scroll their way through all of that? Not to mention that most of the time, we cannot put into words what it is we want to buy, so what is the likelihood of us being able to pick up say, the perfect ‘pastel off-shoulder silky top with flowery pattern’? We may not even know what it is we want to buy. Everyone wants to look good but may not have the time nor fashion sense to pick the most suitable items for themselves. That is why personalisation is becoming so important to retailers today.

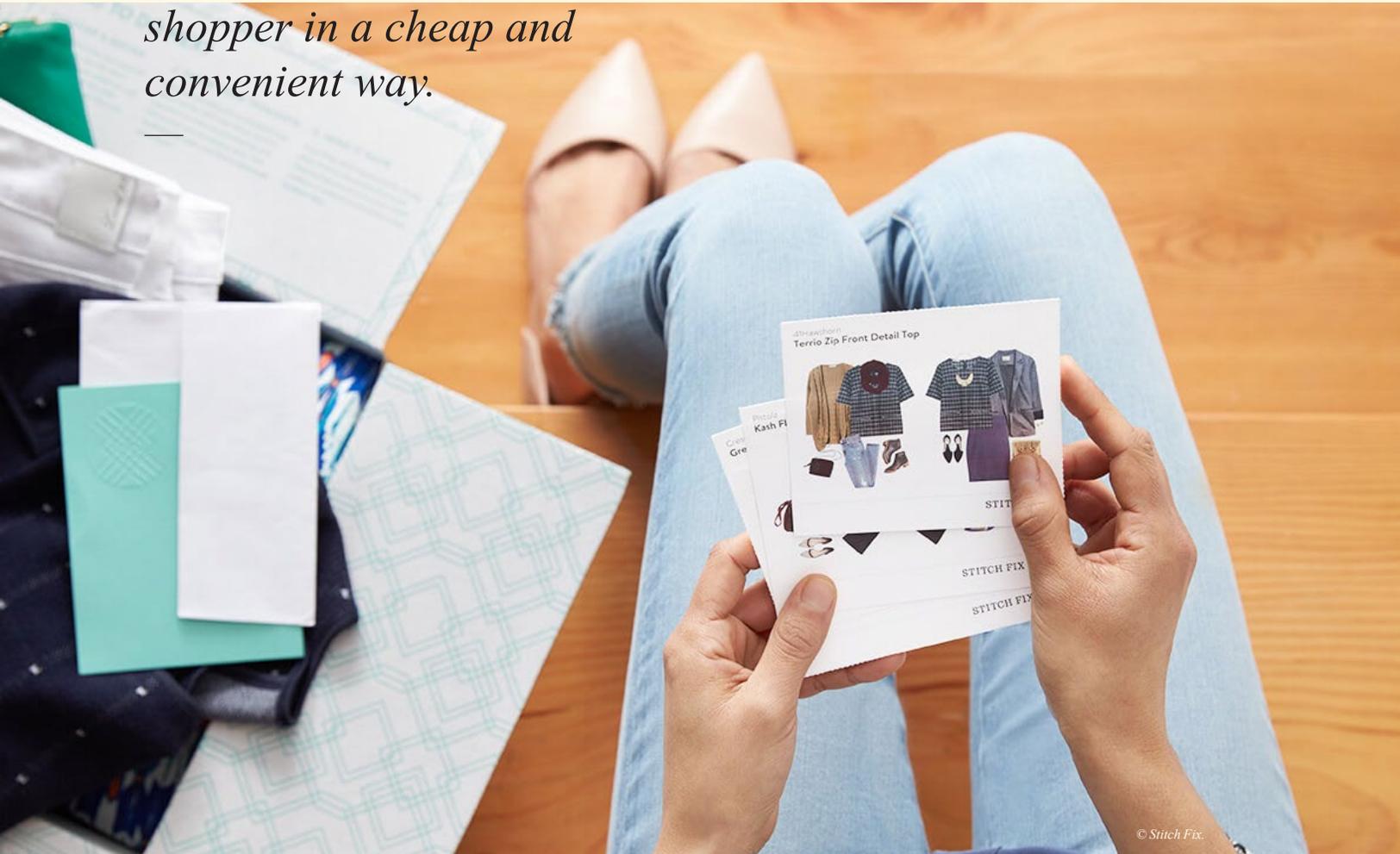
One company that is seeking to change the way we shop for clothes is Stitch Fix. It blends the human element of personal styling with proprietary algorithms. Founded in 2011 in Silicon Valley, Stitch Fix’s ambition is to remove the hassle of shopping for clothes by doing the shopping for its customers. Customers complete an online style quiz, and their preferences are passed to a personal stylist who handpicks pieces that they believe will meet the customer’s tastes, needs and budget. Combining machine learning and proprietary data algorithms with a network of thousands of human stylists means that Stitch Fix is able to offer the luxury of a personal

shopper in a cheap and convenient way. If the customer does not like an item, they return it for free. And regardless of whether they keep the selection of clothes or not, customers are encouraged to provide detailed and nuanced feedback so as to train the company’s algorithm to better reflect the client’s personal style and fit in future shopping experiences.

Another company that is trying to disrupt the fashion industry, potentially on a very large scale, is Rent the Runway. The company started out in 2009 as a rental business for occasional dresses like wedding or proms. Recognising that many customers want to look great but simply cannot afford to pay hundreds or thousands of dollars for a dress that they wear only once, renting rather than buying is a much more economical option. However, the founder, Jennifer Hyman has much bigger ambitions. She wants to offer customers a “closet in the cloud,” a subscription model that allows customers to rent everyday work clothes, instead of buying them. In the same way that we are experiencing a profound shift from ownership to access across many industries, Jennifer believes the same will happen in fashion: Rent the Runway will be the fashion equivalent of Uber in transportation, Spotify in music or WeWork in workspace. It has recently opened five physical stores and partnered with 15 WeWork locations as pick-up and drop-off points, making the renting process even more convenient for its customers.

The implications of disruptors like Stitch Fix and Rent the Runway are far more reaching than just changing the way we shop for clothes. They are potentially affecting the entire supply chain. In the

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case of Stitch Fix, it uses its unprecedented marketplace insights to inform brands of what customers like or what size and colours are missing from their collections, hence marking the age of fashion being born entirely from data. These new styles are created from a genetic algorithm. The company's genetic algorithm starts with existing styles that are randomly modified over the course of many simulated 'generations.' Over time, a sleeve style from one garment and a colour or pattern from another, for instance, evolve into a whole new shirt.

If the first wave of fast fashion pioneered by the likes of Inditex and H&M relied on quickly copying what celebrities wear on red carpets, it is likely that the second wave will be triggered by digital-natives like Stitch Fix using data and machine learning. If that happens, we would expect a shorter time from design to market, lower costs of supply chain, better responses to market trends and changing consumer tastes, leading to more efficient logistics and fulfilment.

BETTER FOR CUSTOMERS, BETTER FOR THE ENVIRONMENT

Beyond the ambition to deliver customers an endless wardrobe, Rent the Runway also wants to reduce the huge wastage of the fashion industry. Over the last decade, fast fashion has encouraged people to treat clothes as disposable items. According to the company, the average American buys 68 items of clothing each year, 80 per cent of which are seldom worn; and 20 per cent of what the \$2.4 trillion global fashion industry generates is thrown away. The impact of such consumptive shopping habits on our environment is staggering¹:

- 1.2 billion tons of greenhouse emissions are generated every year, which is more than the amount created by international flights and shipping combined
- Every second, a truckload of clothes is landfilled or burnt
- 98 million tonnes of non-renewable resources including oil, fertilisers, chemical and dyes are used each year

One of the easiest and most obvious ways to solve the problem is to increase how much use we get from individual pieces of clothing. Hence, through renting and recycling clothes, Rent the Runway hopes it can contribute to a more sustainable fashion industry.

1. Estimated by Ellen MacArthur foundation.





CONCLUSION

Fashion, like all forms of retail, has gone through many forms of disruption in the past. Nevertheless, the current upheaval seems to be having a much more profound impact, not only on consumer behaviours, but also on the broader supply chain. The current disruption, while wiping away many companies, will simultaneously create opportunities for forward-thinking adaptors and innovators. We have been following the evolution of apparel retailers for many years now and we remain excited about the next waves of innovation in technology and business models. Companies like Stitch Fix and Rent the Runway are set to consign to the past the days when we used to wander around huge department stores or even browse the internet for hours to try to find that perfect dress.

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