
THE IMPACT OF ONLINE SHOPPING

INTERVIEW WITH MILENA MILEVA

MB – Malcolm Borthwick

MM – Milena Mileva

MB Hello, and welcome. Thanks for joining us. I'm Malcolm Borthwick, managing editor of intellectual capital at Baillie Gifford.

A shopping centre in Kirkcaldy, Fife, not far away from us here in Edinburgh, sold for £310,000 earlier this year; that's less than the average price of a flat in London. It was held up as another example that online shopping is destroying bricks-and-mortar retailing. This is an easy charge to make but it's not the whole story, according to Milena Mileva, who joins us in the studio.

More on that shortly, but before we start the conversation, some important information.

Please remember that, as will all investments, your capital is at risk.

Milena, fashion, this is the main retail segment that you look at, it's also been one of the hardest hit. We've seen House of Fraser, New Look and Marks and Spencer dramatically cut costs. Nearly a quarter of all fashion spending is now online, and that's something that's commonly blamed for store closures. Do you think this is fair?

MM Yes, it's fair to an extent, I think. There's no question that technology and online shopping have had a profound impact on consumer behaviour and, as a consequence of that, it's a significant challenge to the established practices of retailers in areas from marketing, inventory management, pricing and fulfilment. However, it's a very simplistic narrative, and we need to move on from that narrative because I don't think it really shows you the full picture.



If we look beyond the present, say five, ten years from now, which is what we do as very long-term investors, things might look quite different. There'll be a lot of what are called bricks-and-mortar retailers that might thrive, that are not doomed to fail; and equally, some of these online challengers, as they're being described – people think they've got the path to everlasting glory – I think some of them might fail to live up to expectations.

So, this sort of narrative has been a case of looking at the symptoms, really, rather than the disease. There are profound changes in consumer behaviour but both physical retailers and online retailers can respond to those changes very effectively, so it's not the case of one or the other.

MB Give me some examples of how retailers are adapting to those profound changes in consumer behaviour.

MM If you look at this whole dichotomy between physical retail and online, it all comes back to the store: what is the importance of the store, what's the relevance of the store? The store can be the locus for experience, for the customer to experience the brand, to really step into a brand's world, so to speak. It can be a place where retailers build relationships with their customers.

I think, undoubtedly, there's a huge host of very mediocre retailers out there that have very undifferentiated, very dull and uninspiring store bases - people that have over-expanded and have really quite undifferentiated store bases. But equally, there are [examples of] the so-called bricks-and-mortar retailers that have always had a very, I would suggest, keen appreciation of retail theatre. [It's] this point about using the store as a very potent weapon to create loyalty in customers, to really bring them in, bring them the window to the world of the brand.

One of the ways in which some of the good ones have done it is by the use of so-called pop-up stores. These are temporary spaces which host temporary collections for the retailer, say for a couple of months, and they're a lot more than just showcasing, say, clothes.

For example, in the UK I do think one of those examples is Ted Baker. They opened one such pop-up store in London a year ago in celebration of their new collection, which is called Colour by Numbers, and if you look at it, it looks more like an art gallery; it's not really a retail store.

They host different activities in the store, things like, say, ChromaYoga. This is a type of yoga that combines light and colour techniques. They host famous bloggers to give styling advice to customers. They have walk-in nail appointments. There's a coffee shop. In other words, it's a lot more than just a place to sell clothes. It's somewhere where the customer goes and experiences



what Ted Baker wants to achieve with this collection, what are the key messages that they want customers to have. And I think that works very well.

MB The founder and chief executive of Ted Baker, Ray Kelvin, resigned earlier this year following allegations of misconduct and harassment. He's synonymous with the company's growth. Does this change your investment case for Ted Baker?

MM It's a very difficult question and one that we are debating quite a lot at the minute, as well as of course engaging with the company, in the process of this coming out. We do believe that Ted Baker is a very strong brand and is very well placed to adapt to a lot of the changes which are taking place in the retail sector and which we're talking about today. However, we also believe very strongly in the importance of [the] long-term leadership that the founder, Ray Kelvin, has had on the company and its success. We're really trying to reconcile these two different elements.

MB You mentioned earlier, Milena, the constant desire from consumers for both change and choice and this has been brought about by online shopping. How retailers manage their inventory is also important, isn't it?

MM Yes, it's crucial in fact. The days of mass inventory approach - this approach where retailers try to be everything to everyone and produce many items of the same thing - is really over. It has been exposed by the very nimble responsive business models of the online fast fashion companies, in particular. It's incapable of dealing with the insatiable appetite for change and for novelty. I think retailers that are successful are those that are responding effectively to this change, and a good example here comes, really, from the world of luxury brands.

Here in the UK, I would give Burberry as an example of a company that I think is doing interesting things. In particular, they are trialling this initiative called the B Series, which basically involves introducing new lines of product on the 17th of each month. So, you satisfy that desire for excitement and for novelty by introducing new items very frequently, but they do so in limited editions. There's a limited edition, a limited number of each of the items they're introducing, in these drop collections, these capsule collections each month, and they're giving consumer's the possibility to purchase them only for 24 hours. So, what you're doing is this very neat interplay between satisfying the desire for novelty and for excitement and for buzz, but at the same time creating this feeling of desirability, of hype. There's only limited amount of these things available, so people really want to get their hands on them and they say, "wow". It's an interesting response and a novel approach to inventory that I think other retailers can learn from.

MB And people always demand things that are scarce, don't they?

MM Indeed, exactly. It's a deliberate undersupply of product, which basically creates even further desirability in the consumer's mind.



- MB How do these artificial barriers between online and bricks-and-mortars create investment opportunities for you?
- MM It does at the minute, I think, because the valuation multiples the market is willing to attach to what people perceive as traditional bricks-and-mortar, physical retailers are very different from the ones that they're willing to attach to, say, an online-only retailer. The latter camp are on quite significant valuation multiples, whereas the former are beaten-up and unloved stocks. And whilst there might be some justification in either of those cases, I think, as I said, the story is much more subtle than what people are making it out to be.
- MB The differentiation between online and bricks-and-mortar may be not always helpful, but also quite blurred because although we see bricks-and-mortar companies going online, we're also seeing the reverse happening as well at the moment, aren't we?
- MM Yes, absolutely. It's a great point. You say about imitation being the best form of flattery, and that's exactly what's happening. There are some really successful online-only brands, people that started off as entirely digital brands. The likes of Warby Parker in the US is a great example; Allbirds, which is a sustainable trainer company, is super-hot at the minute in the US and now here in the UK. These guys started off as entirely digital brands but they are actually now opening stores, and I think that speaks to what we've been talking about. Stores are a lot more than just the place of transactional activity.
- MB Data. This is all-important, isn't it, to retailers?
- MM Hugely important. And I think one of the big weaknesses with physical retail is that there's so much data that is still generated in stores. [There are] so many customers. Most transactions, say 25%, is online in, broadly, apparel, in the UK, in this country, but the glory of that, there's still so much going on in stores. And, you're dead right, in the sense of people don't really do anything with that data. Right? But if you're more of an optimist, the interpretation you take from that is there's so much more that technology can do to make physical retailers better in that regard. It is what some people refer to as augmented retail.
- MB What's augmented retail?
- MM Partly, it speaks to this ability to really harness the customer data you have from people walking into the stores and make good things with it. There's a great example here, I think, [in] a company called Farfetch. These guys are doing interesting work in this area. Farfetch is actually an online business, it's an online platform that connects consumers that buy luxury goods with brands and luxury boutiques.



MB Is this a UK-based company?

MM It is a UK-based company, a UK-headquartered company which is listed in the United States. And it is the top ecommerce destination for luxury good in the world by traffic. I think last year it became that. But what they did do, interestingly, they actually bought a high-end boutique in London and they've come up with what they call the store of the future. And they use this physical retail store, this boutique, actually, as a testbed for some of these things we were discussing earlier on, [asking themselves] "what can we do with data"?

So, some of the stuff that they've developed around that [allows me to], for example, walk into a store of the future, something like that concept, and I'm immediately recognised. I have a universal log-in which recognises me as myself when I walk into that store. I start browsing round for clothes. Each and every clothes rack has an RF ID, a radio frequency identification chip, on it, which detects which pieces of clothing I'm picking, which pieces of clothing I'm looking at closely.

MB So it knows when you pick it up?

MM Indeed. So, it knows exactly when you're picking it up. And it does something more than that; it actually then creates a wish list, that's your wish list of the things you've looked around. And that wish list gets automatically sent into a fitting room, and there's a digital mirror in that fitting room that allows you then to start summoning the various pieces of clothing on that wish list, to change the sizes, change the colours of them, and you can try them on. And then, rather than going and queueing, to the till to pay, you can pay at any place in the store, it's a mobile payment system.

MB So you stand in front of the mirror and literally the colours are changing on the dress you're wearing?

MM Yes. You're right, some people go even further. Once augmented reality [and] these things advance from a technological point of view, yes, you would be able to see how a digital version of you looks wearing the different clothes.

But [back to] the point about the Farfetch store of the future, they refer to something called offline cookies. We know about online cookies, when we go on websites and they know what we've seen and what we've browsed, but what if we can create an offline cookie that's basically in a physical retail store? That can be quite powerful because as a sales associate in that store, you know the customer, how long the customer's been there, what they've liked, what they've tried, the things that fitted them, the things that didn't fit them, what were their preferred delivery options. You know a lot.



You actually gather a lot of that data, and what that allows you is to serve them much better. You actually can now have a lot more personalised experience as a customer than you were able to before. A sales associate sees you and knows that you've looked at a piece of clothing, a dress or shoes or whatnot, and you'll walk out of the store and, say, 90 minutes later, they send you a targeted ad through your Facebook account or Instagram account for that specific piece of clothing or that specific piece of jewellery or a bag.

That's a lot more relevant to you. It's not just the blanket advertising. They know what you really liked, what you were tempted to buy, so it's a lot more efficient for a company to actually make that bridge between the physical and the online layers.

MB And I think this bridge – I certainly find when I'm shopping – is really important from a fashion perspective, because you do want to have the touch and feel of what you're buying, which is really important to consumers.

MM Indeed, it's hugely important, yes. The Farfetch founder has this phrase that says fashion is not like music and movies, it's not downloadable. And I think that speaks to what you're saying. It's a lot more than that, and hence, I think, in fashion in particular, the sort of simple story that online will destroy everything I don't think tells you the whole truth.

MB And as a consumer, what do you look for when you're shopping for fashion?

MM I look for inspiration and individuality. I think as a consumer, people express themselves through clothes. We know that, we've always known it. And I think retailers that allow people to do that are the ones that, I think, are quite successful, personally. They speak to me.

The problem, Malcolm, is that I can't even do shopping anymore [and] forget about my investment analysis when I go into stores. I'll go into a Ted Baker store thinking I must check how the store looks. It's more with my critical hat on than my consumer, enjoying-the-experience hat on.

MB And have you ever gone into a new store and thought, actually, this is a company I should be thinking about investing in because they get the consumer experience?

MM Yes, definitely. I think it goes back to what I was saying earlier on: the stores are the window to the soul of the brand, and if they're done well, they tell you a lot about what this brand stands for and what its identity is. And if that fits with what you want, then it's a fantastic way. So, it's the retailers that are not afraid - they don't want to have all the customers; they want to have the customers that fit what they want to do.



They don't want to be everything for everyone. It's the ones that really try to get the customers that will be loyal to them because they understand what they're trying to do. These are the ones that I think are successful and will be successful. The risk is that you try to be everything to everyone, and I think that fails because consumers quite often get alienated. And the ones that you acquire end up not being very loyal to you.

MB Milena, thanks very much for joining us on the podcast.

MM Not a problem. My pleasure.

MB And many thanks to Lord of the Isles for the music – the track we've used is called Horizon Effect, which was released on Permanent Vacation. Until next time.

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