



Exceeding Customer Expectations Through Lean Retail Architecture

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Cisco Internet Business Solutions Group (IBSG)

Executive Summary

- A slowing economy, the ongoing housing crisis, and growing consumer debt will combine to create a challenging environment for the U.S. retail industry in 2008 and 2009.
- The Cisco Internet Business Solutions Group (IBSG) believes traditional retail growth strategies will not succeed in this environment. In addition, merely improving customer experience* or increasing customer satisfaction is not enough.
- To become a market leader, retailers must build brand loyalty by creating and maintaining brand-right,** differentiating customer experiences. These experiences must consistently exceed customers' brand expectations at every stage of the shopping lifecycle.
- Adding to the difficult macroeconomic environment are two significant challenges:
 - Conventional IT practices have created technology bottlenecks at stores and data centers, limiting retailers' ability to control costs and implement new services.
 - Today's tech-savvy consumers are demanding more from IT-enabled services than in the past, putting even more pressure on retailers to change traditional IT strategies.
- Lean Retail Architecture addresses these challenges by allowing retailers to reduce IT complexity and develop new services.
- Lean Retail Architecture can lower annual operational, maintenance, and refresh costs by 20 percent, reduce the number of data center servers by 30 percent, and double storage utilization.
- These savings allow retailers to invest in the services necessary to create brand-right, differentiating customer experiences.

Introduction

Upbeat sales forecasts by U.S. retailers will be in short supply this year. In fact, several high-profile retailers, including Bed Bath & Beyond and Rite Aid, have already cut their 2008 forecasts.¹

The reasons are clear: an ongoing financial crisis caused by subprime mortgages, a drop in home values, substantial consumer debt loads, and \$100-per-barrel oil. And while many industry observers remained hopeful about the resilience of the U.S. consumer, reality hit home when sales figures confirmed the 2007 holiday shopping season was below expectations.

As retail executives plan their strategies for 2008 and beyond, one thing is clear—competition for customers and same-store growth is going to be fierce.

Cisco IBSG believes that building brand loyalty will be the No. 1 way for retailers to win in this difficult environment.

This should come as no surprise since brand-loyal customers spend more during each store visit and make more visits across all retail channels during their lifetimes. In fact, according to the Database Marketing Institute, the longer customers patronize a retailer, the more they will spend per year, per visit, per order.³

Nevertheless, in this day of ubiquitous information and multichannel retailing, customer loyalty is hard to win and easy to lose. A recent study by Accenture suggests that shopper loyalty can be easily erased by lower-priced competition—especially if merchandise assortments and customer service provide no positive differentiation.⁴

Moreover, there is an oncoming wave of “millennials”—young adults who take today’s mobile, digital, and networked world for granted—as potential customers. This demographic group will reshape the retail industry through its size (second only to Baby Boomers in sheer numbers) and use of personal technologies such as YouTube, Facebook, smartphones, and text messaging.

The bottom line for today’s retailers is this: 2008 is not going to be easy; difficult times, however, will create opportunities for retailers willing to innovate and take calculated risks. The opportunity for retailers is to build customer brand loyalty by creating brand-right, differentiating customer experiences using a Lean Retail Architecture.

The State of Customer Experience Today

In general, customers are not happy.

Numerous independent studies have documented consumers' dissatisfaction with their shopping experiences. Capgemini's 2003 report points to a consistent set of shopper frustrations, with special emphasis on the difficulty of obtaining product and usage information.⁵

A 2005 report from Bain & Company documents the gap between what companies believe they are delivering to customers, and what customers really think. In the survey, 80 percent of companies said they provided a "superior" customer experience, while only 8 percent of customers agreed—a 10-to-1 disconnect.⁶

Accenture's 2006 report notes how quickly consumers abandon a brand when the overall experience is perceived as ordinary, and how, with all other elements being equal, price becomes the sole determining factor in retail brand selection.⁷

Implications for retailers are unmistakable:

- Dissatisfied customers "vote with their feet" and are quick to move to other brands.
- Loyalty programs may not create brand loyalty.
- The ability to provide experiences that consistently exceed expectations is essential to creating lasting brand loyalty.

The Technology, Age, and Expectation Wave

The fact that customers continue to express dissatisfaction with their shopping experiences—despite ongoing investments by retailers—is a sign that expectations are rising rapidly, driven by a series of game-changing inflection points.

Two decades ago, the retail industry witnessed the creation, growth, and widespread use of express delivery services—allowing goods to be delivered to any doorstep overnight.

In the 1990s, retailers embraced the Internet and began to provide 24-hours-a-day, seven-days-a-week online shopping. Customer expectations increased again, as Internet shoppers placed orders at home for merchandise from virtually anywhere in the world.

Both overnight delivery and e-commerce were considered remarkable at the time. Now both are viewed as basic services and necessities for conducting business.

A third inflection point is now hitting the retail industry—the widespread use of personal technology. A few facts paint the picture:⁸

- In 2006, the number of text messages sent using cell phones outnumbered people on the planet.
- Roughly 2.7 billion Google searches were conducted each month in 2006. • By 2011, researchers predict there will be 540 million broadband subscriptions worldwide, mobile phone penetration in the United States will exceed 100 percent, and nearly 80 percent of all cell phones purchased will be “converged” devices—offering telephony, text messaging, and Web services such as music, video, and interactive gaming.

This use of personal technology is most pronounced among the “millennial” generation. These 15- to 24-year-olds have grown up with mobile phones, laptop computers, and broadband Internet services, and bring with them expectations for ubiquitous access, seamless delivery of information, personal service, customized products, and speedy transactions.

Today’s Retail Store Reality

Sensitive to competitive pressures and complaints from customers about their shopping experiences, retailers have made significant investments in store-level technologies. Mobile devices, self-serve checkout stands, customer kiosks, and digital signage are just some of the solutions implemented by retailers over the last few years.

Unfortunately, many of these solutions have been “point” products deployed individually, causing stores to be overloaded with technology and creating information “silos” at the store level. These “technology bottlenecks” require expensive, hard-to-find, high-level technical employees to run and maintain the systems. The situation also limits retailers’ ability to deploy and remove applications quickly.

IHL Group, a leading U.S. advisory firm on in-store technology, reports that most North American and European retail stores have become mini data centers, operating between four and six 32-bit servers per store.⁹

Further, Forrester Research in 2007 reported that retailers spend an average of 78 percent of their annual budget on maintenance, ongoing operations, systems, and equipment (MOOSE) for the current installed base.¹⁰ Although this figure is in line with other vertical industries, retail’s traditionally low investment in technology suggests that few dollars are available for strategic IT innovation.

Reducing MOOSE

According to Forrester Research, retailers spent an average of 78 percent of their annual budget on MOOSE in 2006. This left only 22 percent of traditionally thin retail IT budgets for strategic or innovation development.¹²

A European-based hypermarket, grocery, and convenience retailer, with operations from Asia to Eastern Europe and a reputation for bold strategic moves, recently told Cisco it had reduced MOOSE to below 50 percent through the application of Lean Retail Architecture principles.

The money saved went toward new projects and the retailer's bottom line.

Store-level technology complexity has created two other issues that have become barriers to improving customer experience.

First, technology bottlenecks stretch the time it takes to launch and roll out new functionality to the stores. Time is money—especially when it comes to IT investments. It is common for retailers to spend two years deploying new technological capabilities across all stores, and another two years to train staff adequately.

Second, technology bottlenecks makes it more difficult for retail executives to make strategic decisions. At a time when fast response to trends in merchandising, store support, or staffing is essential, all too often, IT resources are stuck in the wrong place at the wrong time.

At a time when it is critical for retailers to respond, most simply cannot—creating a scenario for losing customers and lowering same-store sales.

Creating Brand-Right, Differentiating Customer Experiences that Increase Brand Loyalty

Given these trends and today's difficult retail environment, traditional strategies of merchandise assortment, price strategy, and real estate development will not be enough to drive organic growth.

After extensive conversations with senior retail executives worldwide, Cisco IBSG believes the critical path to brand loyalty—and accompanying organic growth—is through the consistent creation of brand-right, differentiating customer experiences.

What Is a Brand-Right, Differentiating Customer Experience?

A brand-right, differentiating customer experience is:

- Much more than customer satisfaction.
- A shopping experience that consistently exceeds ever-rising customer expectations, creating clear (and measurable) value.
- A shopping experience that consistently differentiates a retailer's brand from the competition.

- An experience where expectations are met or exceeded at every stage of the shopping lifecycle.
- A winning strategy (not a solution) that is as important to the business as merchandising, pricing, supply chain, and real estate.

It is important to distinguish between customer expectation and actual experience. Expectations vary according to industry segment, price point, and a brand's implied promise to customers. For example, a luxury department store carries experience expectations that are vastly different from those associated with a strip-mall retailer selling closeouts and overruns.

In addition, customers carry baseline expectations that can be expressed at different price points, and at each stage of the shopping lifecycle. These expectations are rising and will continue to accelerate because of the use of personal technology.

Benefits of Brand-Right, Differentiating Customer Experiences

Retailers that consistently provide brand-right, differentiating experiences across the shopping lifecycle will achieve the following benefits:

- Increased brand loyalty among regular shoppers, as measured by:
 - Increased revenue per visit
 - Increased traffic across all channels
 - A higher percentage of lifetime wallet share across all customers
 - Increased gross margins
- Increased market share among all shoppers, as measured by:
 - Increased traffic across all channels
- Increased conversion rate of periodic shoppers into regular shoppers, as measured by:
 - Increased traffic across all channels
 - Increased percentage of annual wallet share per customer
 - Increased gross margins

Escaping Technology Bottlenecks

As noted, technology bottlenecks caused by individual, siloed technologies at the store level have made it nearly impossible for retailers to deploy new solutions due to cost, complexity, management, and maintenance issues. This situation also inhibits retailers' ability to create brand-right, differentiated customer experiences that increase brand loyalty.

Faced with this dilemma, retailers must change the way they operate by:

- Doing more with less
- Creating more technology-enabled solutions for consumers, with lower costs and complexity

- Enabling better use of data for analysis and insight, with less risk
- Providing more customer, associate, and merchant access to information without hiring CIOs for every store
- Focusing less on maintaining old services, and more on creating new ones

The answer to escaping technology bottlenecks can be found in the growth and maturation of a high-bandwidth, high-reliability, low-cost network—the Internet.

In the consumer market, the Internet's impact has already been seen in music downloading, video sharing, real-time collaboration, and IP telephony. All of these services were considered remarkable as little as two years ago. Today, they are part of people's lives.

The enterprise market has also benefited from the Internet as bandwidth costs have declined and reliability and security have improved for business-critical use.

Cisco believes the use of network-based communication, collaboration, and enterprise applications throughout the business world will continue to accelerate. Additionally, there is a growing consensus among retail IT executives that selected enterprise applications can and should be moved to a new, centrally managed, network-dependent, industry-specific IT architecture.

We call this “Lean Retail Architecture.”

Lean Retail Architecture

Lean Retail Architecture is a guiding framework for eliminating technology bottlenecks and reducing costs and complexity in both the store and the data center. At a high level, Lean Retail Architecture delivers business-appropriate applications as services, and virtualizes and consolidates storage and data center servers.

The architecture is now possible because of improved network reliability, lower bandwidth costs, and new application-acceleration technologies that provide local-area-network-like performance over wide-area networks.

Potential benefits include:

- Reduced server and storage hardware at remote sites
- Virtualization and consolidation of data center servers and storage
- Reduced refresh costs for hardware and software licenses
- Reduced remote site management and break/fix costs
- Reduced risks associated with handling proprietary and consumer data
- Longer hardware refresh cycles
- Reduced time to capability and return on investment (ROI)
- Increased application agility (the ability to start, stop, and respond to the business)

- Increased enterprise data integrity
- Increased opportunity to buy software as a service

The bottom line is cost savings at operational and capital levels, and much more flexibility and agility. Lean Retail Architecture frees the funds required to make new investments, while providing the flexibility to make new solutions work.

Of course, the extent to which a retailer can make the shift to this “lean,” network-centric approach will depend upon local assessments of network reliability, agreements with local service providers, and assessment of backup plans for business-critical applications. Few retailers are currently willing to move all applications (especially point of sale solutions) to the network-centric model.

Cisco projects that deployment of Lean Retail Architecture can reduce annual store IT operating costs by 20 percent, cut the number of data center servers by 30 percent, and double data center storage utilization.

Leading retailers have told Cisco IBSG that their use of Lean Retail Architecture has also enabled a 40 to 50 percent reduction in MOOSE costs. This has allowed these companies to free funds for development of differentiating experiences.

Creating Differentiated Customer Experience

To build and replicate differentiated customer experiences using Lean Retail Architecture, Cisco IBSG recommends the following steps.

Business

- Analyze the expectation baseline for the customer segment and price point across all stages of the shopping lifecycle.
- Recognize that the perceived value of an experience is measured against the expectation baseline. Does the experience exceed expectations? Is a positive experience created?
 - Customers may be satisfied by an experience, but mere satisfaction will not create differentiating value. In fact, in an era of ever-increasing expectations, the satisfactory experience may be perceived as nothing more than meeting the industry norm.
- Evaluate the value delivered to current customers because of the brand-right, differentiated experience—and envision the value that you will need to deliver three years from now to maintain market leadership.
- Measure customer experience value in quantitative (time or money saved) or qualitative (trust earned, insight gained, personal service rendered) terms. Most differentiating experiences will provide both quantitative and qualitative value.

- Prepare for the inevitable evolution of customer experiences across the shopping lifecycle. What may be exceptional differentiation today (as measured by value received versus brand and segment expectation) may be little more than the baseline norm tomorrow.
- Recognize that differentiating customer experiences are built from direct customer interactions (such as self-checkout), indirect customer support (such as from well-informed and mobile associates), and enterprise efficiency (such as high availability of goods on shelf). Differentiating customer experiences are often built by a complementary combination of all three.
- Establish a brand-right, differentiating customer experience strategy. Begin by asking:
 - In which stages of the shopping lifecycle must the brand consistently exceed ever-rising expectations?
 - In which stages can the brand simply keep pace with the ever-rising norm?
 - How will the brand consistently execute (and measure and monitor) its areas of planned differentiation?

Information Technology

- Analyze current store-level IT structures. What is the MOOSE-to-innovation ratio? How much more store-level complexity can be managed?
- Analyze current requirements to add new functionality to the store. Will this require overlay networks? More servers? More and new devices?
- Analyze current data management practices. How many “views” of customer, vendor, and product data exist within the enterprise? How “clean” and reliable is your business-critical data?
- Analyze your current network. What are the terms of your service provider service-level agreements (SLAs) for resilience and reliability? What is the reliability performance overall? Per region? Per store?
- Audit your “store-touching” application suite, and evaluate each application’s potential for network-enabled, centralized management. Key criteria: business risk, levels of reliability, necessity, and cost of higher levels of reliability or back-up systems. Review opportunities to buy selected applications as a third-party service.
- Make the decision to change to the Lean Retail Architecture. Execute the change in a phased manner. Begin moving budget monies from MOOSE to strategic innovation.
- Invest your newly created innovation monies in creating customer experience differentiation, according to the market position of your brands, and at those points of the shopping lifecycle that will create the most value against customer expectations.

Getting Started

Cisco is uniquely positioned to help you develop a strategy that will enable your business to win in 2008 and beyond. To get started, Cisco IBSG recommends these next steps:

- Develop a business strategy based on the content in this paper.
- Execute a Lean Retail Architecture cost / benefit analysis. Cisco's Lean Retail Architecture analysis tool can identify and quantify opportunities to eliminate costs within existing store and data center IT operations. Your local Cisco representative can arrange for a customized and detailed review.
- Conduct a Lean Retail Architecture application audit and develop a deployment roadmap. Provided by Cisco's Advanced Services unit, these steps identify the current state of store technology and customer-facing applications, opportunities for lean retail deployment, and a roadmap for phased implementation.

“Awesome” Consumer Experiences at Every Stage of the Shopping Lifecycle

Opportunity

Become the leading retailer in India by building brand loyalty with more than 1.1 billion potential Indian customers

Challenges

Aggressive multinational competition from the world's largest retailers

Solution

A rapidly growing, locally owned, multibrand Indian retailer is building its future on two strategies: creating “awesome” experiences for its customers, and doing so with a lean, network-centric retail architecture.

So, how does this retailer create “awesome” experiences? By understanding and catering to hometown cultural differences in merchandising, promotions, advertising, and, most important, store layout. In addition, it is working to create incremental improvements at every stage of the shopping lifecycle, including awareness of product availability, checkout, and post-sale service.

With the need to grow rapidly in every channel, and the desire to provide consistently positive experiences as it grows to 4,000 stores, this Indian retailer must have maximum flexibility to create (or destroy) IT-based services for its customers and associates. To do this, the retailer has chosen to implement a lean, network-centric IT architecture across all stores and business units.

Endnotes

Sources

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Definitions

- * Customer experience—A differentiated experience that provides measurable value above a customer's brand and segment (big box, general merchandise/grocery, mall specialty, department store) expectation.
- ** Brand right—A positive customer experience that supports and extends a brand's promise (Wal-Mart = low prices; Saks = luxury).

More Information

The Cisco Internet Business Solutions Group (IBSG), the global strategic consulting arm of Cisco, helps Global Fortune 500 companies and public organizations transform the way they do business—first by designing innovative business processes, and then by integrating advanced technologies into visionary roadmaps that improve customer experience and revenue growth.

For further information about IBSG, visit <http://www.cisco.com/go/ibsg>



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