Retail Transformation Study

How Retail Leaders Are Redefining IT and Transforming the Customer Experience

Lee Holman, Lead Retail Analyst, IHL Group
lee@ihlservices.com

Greg Buzek, President, IHL Group
@gregbuzek
greg@ihlservices.com
CONTENTS

3 Study Highlights
6 Store Growth / IT Spend Trends
10 Leaders and IT Investment
13 Focus on Security
16 Priorities and Purchase Intentions
41 How Does One Compete in Today’s Retail Environment
Study Highlights
For 2017...

- Store counts and Remodels up 4.9% & 4.2%
- Enterprise & Store IT Spend up 4.5% & 4.7%
- POS spend up for 2017
  (25% of retailers for HW, 32% for SW)
- Cloud spend up for 2017
  (34% of all software)
- Unified Commerce gains momentum
- Retailers that only see IT as a cost center will be eliminated by Amazon and other retailers

Source: IHL Group
Segment Definitions
They are not all created equal

For purposes of this study, we identify retail segments according to the following:

- **FDC** – Food/Grocery, Drug Stores, Convenience Stores / Gas Stations, and Mass Merchant / Warehouse Clubs. 32% of the respondents.

- **GMS** – Specialty Softgoods retailers (shoes, accessories, apparel), Specialty Hardgoods retailers (DIY, consumer electronics, books, office supplies, auto parts, etc.) and Department Stores. 60% of the respondents.

- **Hospitality** – Restaurants, Lodging and Entertainment (casinos / cruise lines, theme parks, theaters, sporting arenas, museums, etc.). 8% of the respondents.
Retailers, Leading and Otherwise
They are not all created equal

Average sales growth in the study was 4.1%

For purposes of this study, we categorize retailers as:

- **Leaders** – growth of **5% or more**. 30% of study.
- **Average Retailers** – growth of between **0% and 5**. 38% of study.
- **Below-Average Retailer** – 2016 revenues were **flat or declined**. 32% of the retailer pool for this study.
Study Details

The 2017 Store Systems Study is the 14th annual collaboration of IHL Group with RIS News. Released at NRF each January, it represents the first retail tech study of the new year.
Store Count Growth
- Overall 4.9% increase
- Just below last year’s highest figure in 13 years
- Mass Merchants / Warehouse Clubs – -1.0%
- Highest growth is in Tier III (6.6%)

Remodels Growth
- Overall 4.2% increase
- Highest figure ever in the history of this study
- C-Stores up 7.0%
- Highest growth is in Tier I (5.5%)
IT Spend Growth by Retail Tier

How the largest and smallest retailers plan to increase their IT spend

Source: IHL Group
IT Spend Growth
IT Spend continues to outpace the economy

Enterprise IT Spend Growth
- Average down 2% from 2016
- 2nd lowest increase in last 5 years
- 22.8% increase over the past 5 years, which indicates a focus on getting back-end systems ready for Unified Commerce
- Biggest increases come from Grocery (6.4%) and Specialty Soft (5.8%)
- Has led Store IT Spend by 2.3% over the past 9 years

Store IT Spend Growth
- Average up 21% from 2016
- 2nd-highest increase in 9 years
- Biggest increases come from Specialty Soft (7.7%) and Food/Grocery (6.2%)
2017 Spend Growth

Planned IT Spend Growth for 2016 Leaders, Average, Below Average Performers

Source: IHL Group
Lack of IT Investment Is Costly

% of Retailers think they leave ROI “money on the table” due to their lack of IT investment

Source: IHL Group
Leaders and IT Spend
Retail Leaders vs. Average Retailers

Leaders:

- Grow Enterprise IT Spend at rate **677% faster** than Below Average Retailers and **131% faster** than Average Retailers
- Grow Store IT Spend **311% faster** than Below Average Retailers and **48% faster** than Average Retailers
- FDC Leaders are **12% less likely** to leave sales on the table due to lack of IT Investment than Average Retailers. GMS retailers are **14% less likely** to do so.
- Conclusion: Retailers that tie IT Spend only to last year’s revenues do so at their own peril. **Those that see IT as only a cost center will likely be eliminated by Amazon and other retailers.**

Source: IHL Group
Security Spend By Segment

EMV has been and continues to be a distraction and disruption

Source: IHL Group
Leaders vs Others on Security

Leaders, with the most at risk, are increasing spend faster than others.

Source: IHL Group
Leaders:

- Have increased EMV spend 26% faster than average
- Increased non-EMV security spend 21% faster than average

Source: IHL Group
Priorities and Purchase Intentions

This looks at the top priorities that retailers are focusing in terms of process and technologies for 2017 and what their purchase timeframe is going forward in key areas.
Top Retail IT Priorities

What Retailers see as the most important technologies going forward

1. Upgrading CRM Loyalty Programs - 59%
2. Single View of Customer Across Channels - 55%
3. Single Order Management Across Channels - 46%
4. Inventory Visibility - 46%
5. Lowering Supply Chain Costs - 38%
6. BI/Analytics for Store Associates - 34%
7. Mobile for Associates - 30%
8. WFM Software/Hardware - 29%
9. Empowering Store Associates - 27%
10. IT Transformation - 23%
11. Store Comms Upgrade - 23%

Source: IHL Group
Top Priorities of Leaders
Retail Leaders vs. Average Retailers

Leaders rate:

- IT Transformation **135% higher** priority
- Lowering Supply Chain Costs **145% higher**
- Associate Training / Tools **194% higher**
- Inventory Visibility **55% higher**
- Clientelling / Assisted Selling **26% higher**

*Source: IHL Group*
Software IT Spend in Cloud
Overall 34% of software budget in Cloud vs 26% in 2016

31% increase in percent of software budget in cloud

- **27%** Store Systems
- **33%** BI/Analytics
- **47%** eCom
- **46%** Sales/Marketing
- **29%** Merch
- **25%** Supply Chain
- **30%** Core ERP

Source: IHL Group
Cloud Spend by Retail Tier
Retailers plan to have this much of their Software Spend in the Cloud

<table>
<thead>
<tr>
<th>Cloud Solution</th>
<th>Tier I</th>
<th>Tier II &amp; III</th>
</tr>
</thead>
<tbody>
<tr>
<td>E-Commerce</td>
<td>39%</td>
<td>57%</td>
</tr>
<tr>
<td>Sales / Marketing</td>
<td>44%</td>
<td>49%</td>
</tr>
<tr>
<td>BI / Analytics</td>
<td>33%</td>
<td>33%</td>
</tr>
<tr>
<td>Core ERP</td>
<td>28%</td>
<td>33%</td>
</tr>
<tr>
<td>Merchandising</td>
<td>37%</td>
<td>22%</td>
</tr>
<tr>
<td>Store Systems</td>
<td>20%</td>
<td>40%</td>
</tr>
<tr>
<td>Supply Chain</td>
<td>28%</td>
<td>21%</td>
</tr>
</tbody>
</table>

Source: IHL Group

- Tier 1 Merchandising grew from 19% to 37% in 2017 (95% growth in budget)
- Tier 1 Supply Chain from 18% in 2016 to 28% in 2017 (56% budget growth)
- 1 of every 5 dollars in Store Systems now being spent on Cloud Solutions for Tier 1 (up from 13% in 2016), and 40% of Tier II and III.
Store Systems Purchase Timeframe
POS and Digital Signage

Source: IHL Group

### POS Client - Base System
- Up to Date/In Place: 27%
- Within 12 Months: 25%
- 12-24 Months: 11%
- 24-36 Months: 11%

### POS Software
- Up to Date/In Place: 20%
- Within 12 Months: 32%
- 12-24 Months: 16%
- 24-36 Months: 12%

### Digital Signage
- Up to Date/In Place: 14%
- Within 12 Months: 15%
- 12-24 Months: 22%
- 24-36 Months: 7%
Store Systems Purchase Timeframe

Mobile Technologies

<table>
<thead>
<tr>
<th>Category</th>
<th>0%</th>
<th>10%</th>
<th>20%</th>
<th>30%</th>
<th>40%</th>
<th>50%</th>
<th>60%</th>
<th>70%</th>
<th>80%</th>
<th>90%</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobile for Managers</td>
<td>25%</td>
<td>35%</td>
<td>18%</td>
<td>4%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mobile for Associates (non-POS)</td>
<td>24%</td>
<td>25%</td>
<td>18%</td>
<td>2%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mobile POS</td>
<td>22%</td>
<td>25%</td>
<td>23%</td>
<td>9%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Consumer Mobile Checkout</td>
<td>5%</td>
<td>24%</td>
<td>18%</td>
<td>7%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Source: IHL Group
For FDC retailers in 2017, their biggest targets for purchase are:

- POS Software (37% of retailers intend to purchase), up 61% from last year due in part to the EMV mandate for fuel retailers (since pushed to 2020).
- Mobile Devices for Managers (26%), flat from last year.
- Mobile POS (26%), the highest it’s been in this study, which bodes well since most of these retailers have been in a wait-and-see mode as GMS retailers pave the way.

For GMS retailers:

- Mobile Devices for Managers (36%), up 33% from 2016. These retailers continue to lead in adoption here.
- Coming in at 32% each, POS Hardware (up 33% from 2016) and POS Software (flat from last year). Specialty retailers (especially Softgoods) keep these numbers propped up due to their more rapid replacement cycle.

Source: IHL Group
Leaders are:

- 96% more likely to have Up-To-Date POS Hardware
- 96% more likely to have Up-To-Date POS Software
- 21% more likely to be using Mobile devices for Managers
- 250% more likely to be using Mobile devices for Associates
- 150% more likely to be using Mobile POS
- 160% more likely to be using Consumer Mobile Checkout

Source: IHL Group
Cross-Channel Commerce Timeframe

Source: IHL Group
Cross-Channel Commerce Timeframe

- **Check Inventory at Other Stores**
  - Up to Date/In Place: 45%
  - Within 12 Months: 16%
  - 12-24 Months: 15%
  - 24-36 Months: 4%

- **Order Online from POS**
  - Up to Date/In Place: 32%
  - Within 12 Months: 30%
  - 12-24 Months: 11%
  - 24-36 Months: 4%

- **Order Inventory at Other Stores**
  - Up to Date/In Place: 32%
  - Within 12 Months: 16%
  - 12-24 Months: 16%
  - 24-36 Months: 7%

- **Split ticket**
  - Up to Date/In Place: 24%
  - Within 12 Months: 25%
  - 12-24 Months: 18%
  - 24-36 Months: 2%

*Source: IHL Group*
Cross - Channel Adoption

For FDC retailers in 2017, their biggest plans for adoption include:

- Order Management System (33%), which serves as the central hub for all data related to products, suppliers and customers.
- Order Online from POS (32%), which provides the competitive advantage of an “endless-aisle” capability.

For GMS retailers:

- Order Online from POS (32%), which assists greatly when a specific color or size is not available in the store.
- Order Management System (19%). These retailers are much further along the adoption curve than FDC retailers, as competition (if not survival) is more dependent upon “one version of the truth” than it is for FDC retailers. This helps with:

  - Holistic Merchandise Planning Across Channels (also 19%), where one set (rather than multiple, redundant and contradictory sets) of planning resources are exploited.

Source: IHL Group
Unified Commerce Leaders
Leaders in Sales Growth vs Average Retailers

By the end of 2017, Leaders are:

★ 46% more likely to be using OMS
★ 52% more likely to be using Ship from Store
★ 58% more likely to be using Split Ticket
FDC Fulfillment Outsourcing

Here are retailers’ plans for using a 3rd party for e-commerce fulfillment

- Domestic Fulfillment:
  - Do Today: 16%
  - Within 12 Months: 16%
  - 12-24 Months: 5%

- International Fulfillment:
  - 5%

Source: IHL Group
GMS Fulfillment Outsourcing

Here are retailers’ plans for using a 3rd party for e-commerce fulfillment

**Domestic**
- Do Today: 27%
- Within 12 Months: 5%
- 12-24 Months: 22%
- 24-36 Months: 8%

**International**
- Do Today: 22%
- Within 12 Months: 8%
- 12-24 Months: 22%
- 24-36 Months: 8%

*Source: IHL Group*
Fulfillment Outsourcing by Retailer Class

This is how different classes of retailers are currently approaching fulfillment outsourcing

- **Leaders**
  - Domestic Fulfillment Outsourcing by YE2017: 41%
  - Int'l Fulfillment Outsourcing by YE2017: 12%

- **Average Retailers**
  - Domestic Fulfillment Outsourcing by YE2017: 29%
  - Int'l Fulfillment Outsourcing by YE2017: 20%

- **Below Average Retailers**
  - Domestic Fulfillment Outsourcing by YE2017: 24%
  - Int'l Fulfillment Outsourcing by YE2017: 35%

*Source: IHL Group*
Fulfillment Summary
Retail Leaders vs. Average Retailers, and GMS vs FDC

Food/Drug/Mass Leaders are:
- Outsourcing Domestic Fulfillment 41% quicker
- Outsourcing International Fulfillment 40% slower than average (not really doing it yet)

GMS Leaders are:
- Outsourcing Domestic Fulfillment 156% quicker
- Outsourcing International Fulfillment 500% quicker than Average Retailers

Source: IHL Group
Retailers with Up-to-Date POS had 2016 sales growth 213% higher than those who don’t and expect 73% higher sales growth in 2017.

Retailers doing Consumer Mobile Checkout Mobile had 80% higher sales growth in 2016 than those that don’t and expect 21% higher sales growth in 2017.

Those with Up-to-Date POS Software are prioritizing Single OMS Transaction System 40% higher.

Those who are prioritizing Empowering Store Associates are 67% more likely to be already using Mobile for Associates.

Source: IHL Group
Speaking of Innovation Spend...

Amazon’s annual spend is more than the amounts of the following retailers combined

Source: IHL Group
How Does One Truly Compete?

There are many technologies in which retailers can invest their capital. Here, we show which ones really “move the needle” when it comes to increasing sales and ability to compete. Keep in mind, a retailer does not need to defeat Amazon or Walmart, just those within their own sphere.
To Effectively Compete
Retailers must...

1. Make massive investments in Unified Commerce
2. Leverage Cloud Computing for a jumpstart
3. Take advantage of mobile
4. Create the “WOW” customer experience
These three technologies our research has found are foundational to successfully growing sales and competing effectively. Everything is built on these three technologies:

- **Single View of the Order (OMS) across channels**
- **Single View of the Customer across channels (loyalty works everywhere)**
- **Up-to-date POS that can access the order, inventory, and loyalty in real time**

Source: IHL Group and NCR Studies
Sales growth increases:

- **1.1x more** due to Marketing Cross-channel Capabilities
- **1.07x more** due to Customer Preferences in All Channels
- **1.02x more** due to Cross-channel Demand Planning
- **92% higher** due to Mobile POS
- **84% higher** due to Loyalty Profiles Available in Real Time
- **77% higher** due to Integrated marketing Across Channels
- **72% higher** due to Mobile Devices for Associates

Source: IHL Group and NCR Studies
About the Survey

Background and Demographics of the Study
Retail Segments

Respondents by Retail Segment

- Specialty Retailers: 51%
- Food, Drug, C-Stores: 24%
- Others: 25%

- 50+ retailers representing stores in 10 segments
- This is a reasonable representation of the retail landscape in North America
- The “Other” category includes Department Stores and Hospitality

Source: IHL Group
The results indicate that the respondents are those who are “in the know”, who have the necessary insight into operational plans, and who are able to provide the most up-to-date perspective available.

Source: IHL Group
Retail Revenues by Channel

**FDC Revenues by Channel**
- Bricks & Mortar: 83%
- E-Comm (non-Mobile): 7%
- E-Comm (Mobile): 3%
- Other: 7%

**GMS Revenues by Channel**
- Bricks & Mortar: 74%
- E-Comm (non-Mobile): 16%
- E-Comm (Mobile): 4%
- Other: 6%

Source: IHL Group
58% of responses came from retailers with annual revenues of > $1 Billion, who drive total IT spend as well as technology proliferation

Smaller retailers are more agile, and the US mall structure helps them grow rapidly

Source: IHL Group
IHL Group License
and Fair Use Agreement

This IHL Study includes an electronic Enterprise License and can be shared freely within the purchasing organization and wholly owned subsidiaries. We ask that this information not be shared with partners or others outside the purchasing company without authorization from IHL Group. The license does not extend to joint ventures or other partnerships. If the relationship is not a wholly owned subsidiary, then both parties would need a license.

_Practically, this implies the following:_
1. The purchasing company can use the reports worldwide internally as long as the international organizations are wholly owned subsidiaries of the purchasing company.

2. The research reports and databases cannot be distributed in whole or in part to others in the organization, partners, or customers without express written approval from IHL Group.

3. You may quote components of the data (limited use) in presentations to others in the organization or customers such as specific charts. This is limited to percentage components, not individual unit information. Unit data cannot be shared externally without express written approval from IHL Group. All references to the data in presentations should include credit to IHL Group for the data.

4. The license holder can reference qualitative quotes in printed material with written approval from IHL Group.

5. All requests requiring written approval should be submitted to ihl@ihlservices.com and will be reviewed within one business day.

For any questions regarding this policy, please contact us at 615-591-2955 or email us at ihl@ihlservices.com.
Thank You

We at IHL Group appreciate you taking the time to review this study, and we trust that regardless of whether you are a retailer or a technology vendor, you have found actionable data contained herein.

If you have questions about the methodology employed or how to participate in next year’s study, please contact us at 615-591-2955 or email us at ihl@ihlservices.com.