

Group 6 - Redefining Department Stores

Conor Chrisom, Hadrien Markabi, Keelia Jacobs, Lorea Amatria, Thomas McInerney

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Executive Summary

Given the trend of declining sales and store closings over the past few decades, it is incumbent upon the traditional department store to take meaningful action to rebuild its customer base. We propose that this can be achieved through an enhanced store experience, deeper relationships with customers via loyalty programs, and retail-focused AI solutions with recommendations summarized below:

- Store Experience: Physical stores serve as a bridge between online and offline experiences, offering valuable services like click-and-collect and in-store returns to drive sales. Brands should incorporate technology like AI, automation, and AR to enhance the in-store experience while leveraging data analysis to optimize store location, product assortment, and inventory management.
- Loyalty Programs: Stores should consider implementing "hybrid" loyalty programs that not only combine personalized shopping experiences with tech-enhanced services but also cater to unique cultural and market differences. Additionally, brands should leverage data analytics to drive personalization and consider item-based loyalty programs to maximize lifetime value (LTV).
- AI for Retail: Brands should leverage a "test, read, and react" framework when evaluating impact of AI-solutions that can help predict LTV for marketing or reduce

eCommerce return rates. Ensure proper investment in tech infrastructure that will capture consented first-party (1P) consumer and sales data to power the best AI and empower leaders to make informed data-driven decisions.

Current State Of Department Stores

“Many who report on retail’s imminent death are overlooking the obvious — we are physical and social creatures” RH CEO, Gary Friedman.

At the dawn of the 20th century, department stores revolutionized retail by offering an extensive range of brands and products all under one roof, transforming shopping into a pleasant ritual, and turning stores into “village squares” ([source](#)). Initially, their broad and diverse customer base thrived alongside the rise of cars and globalization, with significant national and global sales. However, the emergence of discount retailers, the internet, and mobile technology shifted power towards consumers and brands. Sales in department stores have been declining since 2000 by more than 45% (Figure 1). Brands evolved into tribe

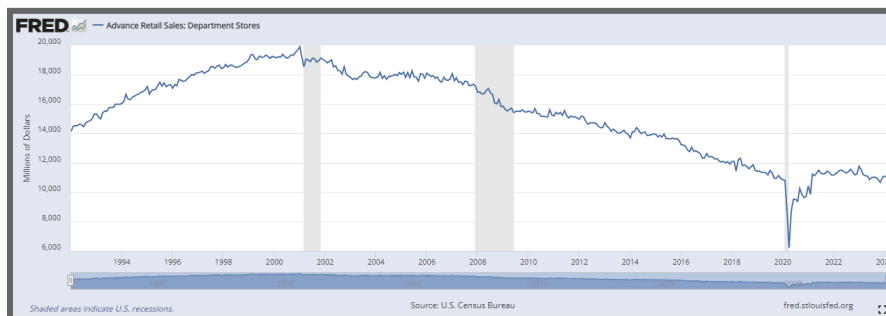


Figure 1

builders, forging communities and loyalty through unique value propositions and direct consumer engagement. This shift, coupled with the rise of e-commerce sales, reduced department stores' influence and traffic as brands started to bypass wholesalers to sell directly to consumers (Figure 2). The 2020 pandemic further challenged the sector, with major players like Century 21, Stein Mart, and Neiman Marcus filing for bankruptcy.

Today, with decreasing store traffic and lower dwell time spent in stores, department stores face a critical need to adapt. This paper explores how department stores can leverage three strategic areas—store experience, loyalty programming, and AI—to garner a larger consumer base.

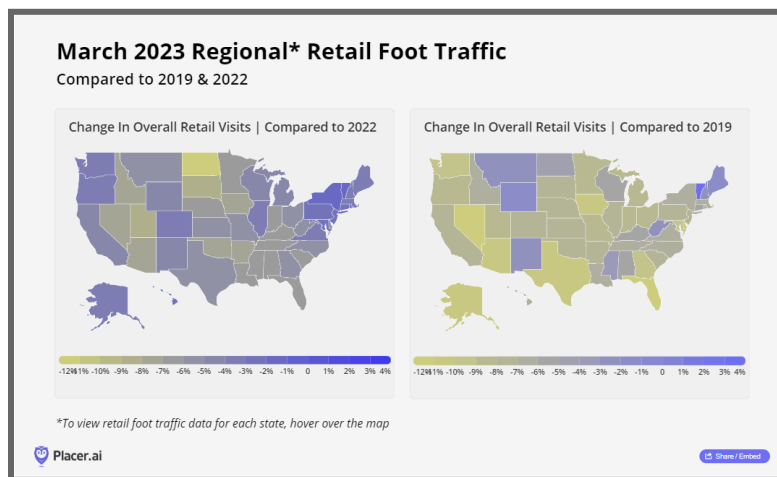


Figure 2

Data-Driven Retail Excellence: Elevating In-Store Customer Experiences

More and more, customers are interacting with businesses across various channels—both in person and online. As companies adopt an omnichannel approach, it becomes essential to meet customers where they are and provide services aligned with their preferences and needs. In this context, physical stores play a crucial role in the future network of an omnichannel player.

1.) Online-to-Offline (O2O) Services: Physical stores serve as bridges between the digital and physical worlds. Offering O2O services ensures a seamless transition for customers. For instance, click-and-collect allows customers to order online and pick up their purchases

in-store on the same day. Similarly, hassle-free in-store returns enhance the overall customer experience.

2.) Driving Sales and Integration: Department stores can significantly impact sales. They serve as touchpoints where customers can interact with products, receive personalized assistance, and make informed decisions. Integrating these experiences with online channels ensures a cohesive customer journey. Whether it's browsing in-store or making purchases online, the goal is to provide consistent service and meet customer expectations.

3). Leveraging Technology: To enhance the in-store experience, technology plays a vital role.

Consider leveraging the following technologies:

- **Automation:** Streamlining processes, such as inventory management or checkout, improves efficiency.
- **Augmented Reality (AR):** AR apps can enhance product visualization and provide interactive experiences.
- **Mobile Technologies:** Mobile apps can guide customers within the store, offer exclusive discounts, and facilitate seamless payments.
- **Data Analytics:** Collecting and analyzing data helps optimize store layouts, product assortments, and inventory management.

In addition to providing an exceptional in-store experience, the strategic location and format of physical stores significantly impact their overall effectiveness. Here's how data-driven decisions come into play:

- **Location Selection:** Choosing the right store location is crucial. Data analytics help identify optimal spots based on foot traffic, demographics, and proximity to target audiences. For instance, online sales patterns may reveal untapped areas where a physical store could thrive.

- **Assortment and Curation:** Curating the right product mix matters. By analyzing historical sales data and customer preferences, businesses fine-tune their offerings.

Loyalty & Engagement Strategies For Department Stores

As department stores strategize for the future, their approach to loyalty programs is crucial since 7 out of 10 US consumers consider loyalty programs a leading factor in sticking with a brand. Successful brands like Sephora have demonstrated the effectiveness of loyalty programs in building a dedicated consumer base by fostering a sense of community and offering exclusive benefits. These tactics can be instrumental for department stores looking to regain and retain customer engagement.

To revitalize their relevance, department stores must evolve beyond traditional point-based systems. Taking cues from brands like Neiman Marcus or Saks Fifth Avenue, or other loyalty programs that offer exclusive invitation-only events, benefits, or status levels, department stores could create personalized shopping experiences that resonate with individual consumer preferences. Utilizing data analytics helps understand shopping habits and preferences, enabling tailored recommendations and rewards that feel more intimate and valuable to the customer, increasing customer lifetime value and recurrent sales (Stourm, Valeria, et al., 2020). Moreover, integrating experiential rewards can add significant value. This could include exclusive access to events, early product releases, or unique in-store experiences, transforming department stores into lifestyle hubs rather than just shopping destinations.

Effective loyalty programs should consider customer heterogeneity and competitive dynamics to enhance customer engagement and expenditure, as demonstrated by T&T

Supermarkets. By understanding shopping behaviors and preferences, T&T developed a loyalty program that addresses the diverse needs of its customers, splitting their shopping between specialized and general items. A “hybrid” reward structure was tailored for customers who prefer different types of rewards (Asian groceries vs. Western items), which increased shopping frequency and expenditure (R. Ho et al., 2009).

Similarly, the shift to an item-based loyalty program (IBLP) highlighted that consumers respond more positively to reward point promotions than to equivalent price discounts. After the introduction of the IBLP, there was a significant change in spending behaviors among existing members and new customers, suggesting that adequate promotions under such a program are crucial to prevent alienating loyal customers and to maximize the program's potential (Jie Zhang et al., 2012).

The use of technology can further amplify the effectiveness of loyalty programs. Mobile apps that go beyond product selection and rewards, integrate augmented reality or AI-driven features can offer a more engaging way to connect with promotions and rewards, enhancing the shopping experience. Research indicates that simpler loyalty programs offering direct and immediate rewards are more effective than complex, progressive-reward systems, especially when part of a multi-vendor program like a department store (Bombaij, Nick J.F., et al., 2020).

The effectiveness of loyalty programs also varies significantly between different markets and cultural settings. Department stores should customize their loyalty strategies based on the specific characteristics of the markets in which they operate, offering more tailored rewards in diverse cultural settings driving loyalty and CLV (A. Stathopoulou et al, 2016). This strategy is

employed by Shea Jensen, President of North America, Urban Outfitters who makes sure the in-store experience from Portland Maine, to Texas, caters to local preferences.

Building on the insights from Neiman Marcus, department stores should focus on personalized marketing and exceptional customer service. Embracing omni-channel experiences and leveraging technology like AI for tailored interactions are essential. Creating memorable in-store experiences, or "retail-tainment," and engaging content can attract and retain customers. Additionally, fostering a community around the brand and offering exclusive products can deepen customer loyalty. Continuous improvement based on customer feedback ensures relevance and satisfaction. These strategies, rooted in understanding and meeting evolving customer needs, are key to building long-term relationships and operational performance in the competitive retail landscape.

AI Solutions To Transform Department Stores

Advanced Artificial Intelligence and Machine Learning adoption has the potential to transform the retail industry across myriad use cases:

- **Demand Forecasting** - machine learning algorithms analyze data, predict customer demand, and avoid over/understocking
- **Product Assortment** - analyze sales data, customer preferences, and market trends to optimize product assortment across locations ensuring a well-curated assortment that meets local needs and preferences
- **Dynamic Pricing** - AI algorithms analyze market demand, competition, and customer behavior in real time to set prices that maximize sales & profit
- **Customer Service** - reduce support costs with a more personable customer experiences via AI-enabled chatbots

- **Personalized Product Recommendations** - use AI, consumer, and sales data to predict products recommendations onsite and via marketing that will drive LTV, reduced churn, or even lower returns

For department stores, we recommend brands take a focused “test, read, and react” approach as they consider leveraging AI throughout their store and eCommerce properties. First, we recommend brands identify a clear hypothesis to test. As an example, a department store may want to design a test to understand whether its own customer and sales data can build predictive Lifetime Value (LTV) models to improve marketing ROI. These models can often be A/B tested with marketing partners such as Google or Meta to influence bid pricing, or on its own website to recommend products that will potentially drive higher LTV or increased loyalty over time. Company leaders can “read and react” to these data-driven insights and help drive a stronger consumer experience through tailored product personalization as well as increased margins through more effective marketing.

Another prominent use case for department stores is decreasing product returns rates (20-50%) as they can decrease margins and eat into profit ([source](#)). Omoda, a Dutch fashion retailer, serves as a great example of a retailer who has leveraged AI to solve this challenge. Specifically, they collected consented consumer data from their website analytics and backend transactional data, a data warehouse for model building, and deployed models using real-time cloud based infrastructure to marketing partners. The results were clear: Omoda correctly predicted whether or not any items would be returned for between 70-75% of orders by using this model, decreased returns by 5%, and increased profit margin by 14% ([source](#)).

The power of AI is largely dependent on the quality of data signals used to train models and make predictions. As such, we believe some department stores who have invested heavily in Customer Data Platforms may be at an advantage in building bespoke models based on their

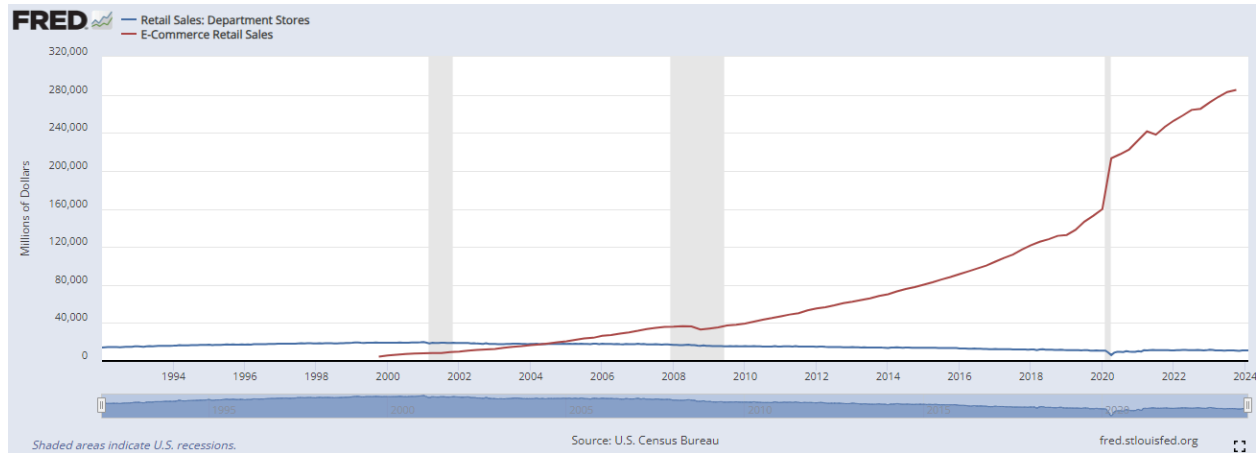
own consumer insights. Brands need to ensure organizations are structured in a way that leaders are empowered to make informed decisions with supporting data and that models don't simply sit within analytical teams. For other department stores with less 1P data, we recommend these brands start to invest in infrastructure that will allow for better data capture with an eye on privacy and maintaining trust with the consumer. Ultimately, department stores with robust, consented data along with a flexible and agile testing mindset will serve as a differentiator to help drive outsized growth.

Conclusion

As department stores strategize for the future, understanding their core competencies and customer needs will be crucial for sustainable growth. Personalization emerges as a cornerstone, offering convenience through curated assortments driven by deeper consumer insights. Adapting loyalty programs to cater to diverse needs not only enhances consumer lifetime value but also supports the broader personalization efforts. The evolving store experience, positioned as a "village square" for both physical and social interactions, gains renewed significance in an increasingly digitized world. Leveraging their assets and core competencies, department stores have opportunities to explore new revenue streams, whether through retail media networks or innovative repurposing of real estate. By embracing these strategies and remaining agile in response to market dynamics, department stores can secure their position as integral components of the modern retail landscape.

Appendix

Retail sales in department stores compared to e-commerce sales



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