How can department stores remain competitive in a changing retail world?

Bricks-and-mortar retailers have taken a battering in recent years from weak consumer confidence, rising overheads and increasingly intense online competition. How can the old stalwart of the High Street, the department store, adjust its economic model to remain competitive?

One of the exciting things about working in retail is change. Each year brings new fashions, new propositions, new stores and new people. Despite the constant churn, department stores are durable beasts. Look down the high street in many towns and it is the department store that has been there longest, often for 100 years or more.

However, the pace of the changes in the last year, including rising costs, channel shift and fast-evolving customer habits, has pushed many department stores to the brink. Even the biggest and best-known brands have faced difficulties. House of Fraser is under new ownership; Debenhams is fighting hard to stay alive; and John Lewis has reduced staff bonuses for the first time in over 60 years.

So department stores have to reinvent the economics of their business to remain competitive and ensure they stick around for the next 100 years. At its heart, today's department store model is simple: a store needs its customers to prefer it over the alternatives as a place to spend time and money; it needs its suppliers need to choose it over other channels as a place to sell goods; and it needs both these constituencies to be big enough to pay for the building, the staff, the systems and the stock. Reinvention comes from constant rebalancing to make that equation work. In our experience, three areas stand out.

First, reinventing category roles. In any store, different departments need to pull together to make the overall economics work. Some products will drive regular footfall (perhaps fashion or gifts for customers) while others will anchor the big baskets when customers splash out. Some parts of the range will generate sales; others are the fat margin builders. Managers also need to think not just about categories but also about why and how customers are buying – shopping for the bedroom, rather than for pillows, lamps and slippers… in store and online. As the market shifts, making the economics click requires actively reformulating each element - footfall, baskets, sales, margin, new and old customers across the store – and being constantly alert to any part that is getting out of balance.

Second, behavioural experience. Retailers intuitively know that their brand and customer feelings are imperative. The fine details matter: how staff interact with shoppers; the space and layout of the store; who else is shopping; the balance of calmness and excitement. Perhaps more than any other retailer, especially those online, department stores can own and control that environment.

Behavioural economics tells us that small things add up. What is the first thing that customers see? (It's no coincidence that perfumes and pricey handbags are often on the ground floor.) Are staff free to chat or do they need to serve customers as quickly as possible? Does the store feel stuffed full of products, or is it clean and calm? Together, the details mould customer behaviour, which in turn determines the drivers of economic value - footfall, basket size, dwell time or click-through and price points. The best retailers know the sort of customer behaviour they are aiming to induce and are ruthless in creating an environment that hits that target. Intuition goes a long way, but retailers also often need a more planned approach, carefully designed experiments with results that can be measured and an understanding of how these small things add up to the total.

Third, channel shift. It's one thing to be the only department store in town, but online you are competing with stores across the globe to be the route to great products. The big choice is whether to be omnichannel or multichannel. *Omnichannel* retailers serve largely the same customers online and offline - browsing in store is a key part of the brand experience and purchase decision. Others have built a *multichannel* model with a distinctive environment that is strong enough to succeed independently both online and offline. And some retailers have been forced to admit that their strength really lies in one channel – with no real competitive advantage elsewhere.

In response to these distinct alternatives department stores are starting to operate in different ways. A true omnichannel model requires a greater focus on customer-level profitability – making money over the relationship as a whole – and less on specific product or channel KPIs, for example. But omnichannel also means accepting that location still matters – if store experience is a big generator of online sales, it will be hard to increase those sales away from your existing catchments or abroad.

Department stores have been around a long time. There will always be a place for those stores – online and offline – that bring the best of the market to customers. But there may well be fewer department stores in future. Those that are left will need to be clearer on whether they have a multichannel or omnichannel strategy. They will also have to be ultra-smart in knowing how their product categories and store environment will shape the customer behaviour on which they depend to stay competitive. So the pace of change looks set to become ever faster over the next few years as department store leadership teams make bold moves to update the fundamentals of their economic model.