Economist: Why Both Bricks and Clicks Matter Most at Retail

By Arthur Zaczkiewicz

With 17 days and two weekends left until Christmas, the retail industry is near thepeak of the holiday shopping season.

So far, sales have been weaker than expected and the pace of promotions has ticked up. Meanwhile, online sales are increasing, and retailers are leveraging omnichannel strategies to maximize sales. Here, Andrew Nelson, chief economist, U.S.A. at Colliers International, discusses holiday sales and e-commerce trends as well as why physical stores matter.

WWD: What conditions should retailers expect this holiday season?

Andrew Nelson: Deloitte is expecting seasonal sales growth of 3.5 to 4 percent this year, ahead of inflation but below the 5.2 percent growth of last year. However, the nation's malls and department stores won't see as much growth. A disproportionate share of holiday sales will go to discount stores, far away from the fancier shopping centers — no matter how full the parking lots seem.

WWD: How will e-commerce affect the brick-and-mortar stores?

A.N.: That's the bigger story — shoppers are continuing to migrate to online shopping. Retailers and especially the shopping center industry are trying to convince themselves that the shift to e-commerce is slowing. Newspapers and industry publications also trumpet this wishful thinking. But shopping trends are showing otherwise. Just look at your teenager or even your parents — they already started their holiday shopping on their phones and tablets from the comfort of their living rooms.

What folks in the physical retailing world like to highlight is that year-over-year sales growth in e-commerce is slower now than it was a decade ago, when online shopping was still in its infancy. And that's true: In the middle of the last decade, e-commerce was growing almost 25 percent annually. Now the average growth rate has slowed to about 15 percent per year. Lower inflation accounts for some of the difference, but there's no doubt that the real growth rate is lower now than it was before the recession.

But guess what: in-store growth has slowed even more on a relative basis. The annual in-store sales growth rate is now down 53 percent from before the recession, compared to 38 percent for online sales. Thus, online sales are growing even faster compared to in-store sales than they were previously — growing 5.4 times faster now compared to 4.2 times faster before.

WWD: How is e-commerce growth shaping up for the future?

A.N.: Of course, e-commerce cannot sustain even this lower growth rate indefinitely; at these rates, e-commerce would surpass total retail sales in 25 years — logically impossible. So, yes, measured in this narrow way, online growth has slowed.

But the more important metric is how quickly e-commerce is capturing market share from physical stores. Online sales now account for 7.9 percent of total retail sales excluding autos, and this market share has been gaining momentum since the recession, especially recently. In the three years prior to the recession (2005 to 2007), the online market share rose an average of 45 basis points per year. That is, the online market share was about 0.5 percentage points higher each year. This growth has surged by two-thirds during the last three years to an average of 76 basis points per year — and to an annualized rate of more than 100 basis points in 2015. So the market-share growth curve is still increasing.

WWD: Why is e-commerce growing so fast?

A.N.: Several reasons. First, shoppers are already used to shopping online for some key products like books and electronics, and now they're expanding the range of products and services. Plus, they're increasingly comfortable shopping with mobile too, which opens up lots more opportunities for e-commerce. Second, online retailers are making electronic shopping better and more convenient, while new payment options by Apple, Google, Square and others are making mobile shopping ever easier to transact.

Lastly, although some brick-and-mortar retailers clearly get it, overall the physical retailing world has been too slow and too timid in recognizing the e-commerce threat and in adapting their business models to fight it. For example, while some leading chains say they'll match credible online prices, in reality shoppers usually find better deals online — one of the top reasons consumers say they shop electronically.

WWD: So e-commerce will keep stealing sales from stores?

A.N.: Clearly, online sales cannot continue to grab market share trend indefinitely at this rate for the same reason that e-commerce could not continue to grow forever at double-digit rates: online shopping soon would be larger than all retail sales. Again, logically impossible. Yet there is no reason to suspect retailing is anywhere near an inflection point of declining online growth. With still less than 10 percent of all sales, e-commerce still has plenty of room for more growth. And mobile shopping is really just getting started and has the potential to fuel even greater growth given the increasing ubiquity of smartphones.

WWD: What does this mean for holiday sales?

A.N.: The online share is higher for holiday shopping than for the rest of the year because people buy more higher-ticket items online than they do convenience goods like groceries. Already Cyber Monday is starting to challenge Black Friday for sales supremacy, just 10 years after online retailers banded together to create this new shopping event. ShopperTrak estimates that sales in stores on Black Friday fell from $11.6 billion in 2014 to $10.4 billion this year. Meanwhile, Adobe reported that Cyber Monday shopping this year reached $3.0 billion, up 16 percent over 2014, in addition to another $2.7 billion in online sales on Black Friday. But I think the most interesting statistic of Thanksgiving weekend is that slightly more people shopped online on Black Friday than went to stores, according to the National Retail Federation. Amazing.

WWD: Does this spell the end for malls and brick-and-mortar retailers?

A.N.: Certainly not. You hear this claim a lot, but it's really a straw man argument. No one can seriously argue that physical retailing is going to disappear anytime soon — or even in the foreseeable future. Remember, physical stores still capture more than 90 percent of all retail sales, and the shifts to online, while significant, are still relatively gradual — especially when you have sophisticated retailers like Macy's, Nordstrom and Wal-Mart, that understand the threat and are investing heavily to develop winning omnichannel strategies and more appealing in-store experiences.

But malls and retailers living in the past, or who pretend that the e-commerce tide is ebbing, are ultimately going to be swept away by the rising tide. In the last few weeks, we've seen all the department stores and many mall-based specialty chains report falling sales and downgraded forecasts for the all-important holiday season that are make-or-break for retailing.

It's not for lack of overall retail sales. Even if growing more slowly, retail sales are now at new record levels. And it's not because more stores are splitting the sales. The size of the retail stock has barely budged since the recession. Instead, it's the sales leakage to online shopping. And it's showing no signs of slowing. Unfortunately, brick-and-mortar retailers should prepare for another disappointing holiday season at the mall.