

JAKE SIEWERT

This is Exchanges at Goldman Sachs, where we discuss developments currently shaping markets, industries and the global economy. I'm Jake Siewert, Global Head of Corporate Communications here at the firm. And the question of today's episode is: where are retailers looking for growth? To answer that question, we're joined by Jen Davis, head of retail investment banking here at Goldman Sachs. Jen, welcome to the program.

JEN DAVIS

Thank you so much for having me, thrilled to be here.

JAKE SIEWERT

Okay, so let's set the stage. The largest single change in shopping is obviously the growth of online retail, and obviously the decline a little bit of shopping in stores. Not exactly groundbreaking,

but that shift continues to dominate and transform the industry that you're covering. So you advise CEOs of a lot of big, big retailers. How would you describe the sentiment amongst your client base?

JEN DAVIS

I mean, first and foremost, I would say that clearly ecommerce has grown quite significantly. It used to be about five percent of total retail; it's expected to be almost 17 percent by 2021. So it's grown enormously over the past six or so years. But it's important to remember that pure store-based retailing is still almost 80 percent of the overall market.

For our clients specifically, I would say that they have definitely shifted from a more defensive posture several years ago, and after waking up to that reality, and a lot of painful investment, both in terms of ecommerce capabilities, distribution and logistics, they're now taking on a much more

offensive posture and realizing that having an omnichannel model, where you have both a brick-and-mortar store base, coupled with a strong ecommerce experience, is really what you need to have for the customer journey today.

JAKE SIEWERT

So obviously we've seen a lot of the digitally-native brands grow up in the last several years; DSE I guess you might call it. But how are younger consumers driving the growth of these online-only brands?

JEN DAVIS

Yes, I think what the digitally-native brands have done is around two core themes. The first is improving the customer experience, and the second is improving the overall value proposition. And I think what the digitally-native brands have done is really disrupted that in terms of thinking through the customer experience in terms of very customized experiences overall; personalized

marketplaces and marketing overall, destination stores.

And on the value proposition, really thinking through is there private label products, is there a way to disrupt the middleman in terms of manufacturing? And so the digitally-native brands and millennials' exposure to those have really upped the ante for our core retail base, that they've had to involve their own business models in terms of needing to address those two kind of core themes.

JAKE SIEWERT

So one response amongst the kind of older retailers, or more established retail brands, is obviously acquiring some of these digitally-native brands or partnering with them. You just hosted a conference on disruptive growth in the retail industry, and all about this very topic. What value are larger, more established retailers, seeing in the

smaller high-growth brands, and what does a partnership with a traditional category offer to the start-up?

JEN DAVIS

I think about this across four areas for our retail store base today. So the first is acquiring capabilities. And a good example of that is Ulta, the beauty retailer investing in two small AR/VR technologies to offer a better store experience for their customers today in terms of trying on beauty brands. Another example of that is Lowe's, the home improvement retailer. They recently acquired the retail analytics platform of Bloomberg, which is basically ... sorry.

JEN DAVIS

So there's basically four areas that these retailers have been focused on in terms of partnering or acquiring with some of these disruptive start-up brands.

The first is acquiring capabilities. A good example of that is Ulta, the beauty retailer, who's invested or acquired in two AR/VR technology companies last fall to offer a better experience for their consumers in the store. A second example is Lowe's, which recently acquired a retail analytics platform owned by Boomerang, which basically offers improved pricing, and has a more dynamic pricing model in their stores.

The second area where these retailers are acquiring or partnering with brands is in investing in distribution, to kind of leapfrog their own in-house technologies. So examples of that are Walmart buying Jet.com a couple of years ago; Target buying Shipt in terms of delivering last-mile delivery. Yum, the fast food retailer, investing GrubHub in terms of delivery. So that's another area in terms of where the retailers are investing

today.

The third is accessing a new customer demographic that they don't typically serve. And so another example in the Walmart arena is Walmart buying Bonobos, or Eloquii, the online retailer. Another example is Nordstrom partnering with Everlane, Allbirds and Reformation. And so this is attracting a new millennial customer who maybe isn't a typical department store customer today.

And then the fourth area is really a portfolio strategy of investing in all of the above. And I think a great example of that is Foot Locker. Foot Locker has really built up a whole presence in terms of investing in start-ups. They started last year in making a minority investment in a women's athletic apparel retailer called Carbon38. They followed that up with four other investments,

including their most recent one in Goat, a digitally-native sneaker marketplace, and Rockets of Awesome.

And so I think they're thinking through all of those four areas, that's how the retailers have thought about how they're partnering or acquiring with these digital start-ups. What these brands get, what the start-ups get is kind of immediate access to scale, expertise, prowess, real estate sourcing, marketing, supply chain; a lot of bandwidth and heft that they don't necessarily have as a start-up experience all on their own.

JAKE SIEWERT

So there's also a bit of a shift back to the middle, right? So for a while, large retailers were moving aggressively in ecommerce, because they needed to, but we're also seeing some of these digitally-native brands finding some value in brick-and-mortar stores. So how are the large started



retailers and the smaller high-growth brands using physical footprint differently than they have in the past?

JEN DAVIS

Yes, so first on the typical traditional retailers, where they've been really investing is in their kind of last-mile delivery. And the buy online/pick up in store or BOPUS, as we call the acronym, in terms of those capabilities. And they do that both in terms of lowering distribution costs, and two, getting add-on sales.

And so a good example of that, going back to Lowe's, is they fulfill 70 percent of their online orders via their stores. And so that's a significant chunk of their online business today. And 30 percent of the time, when a customer comes to pick up their order, they add on an additional product. And so retailers have really been

investing a lot in that kind of buy online/pick up in store.

Another example is Walmart. Walmart's on track to offer grocery pickup in almost 3,100 stores, and they will add grocery delivery from 1,600 stores by year-end. And so really thinking about this last-mile delivery to customers today is one area that the traditional brick-and-mortar players have been thinking about, using their footprint.

The two other areas I would say the traditional players have been focused on is, one, smaller stores. And so you're seeing big box retailers thinking about more urban centers with smaller footprints, with a more localized assortment. We see that here next to Goldman's headquarters, with Target's store here in Tribeca. And they talk about opening a few dozen of those each year going forward, in more urban metro areas.

And the second area is providing services to drive traffic. And so whether it's dining services, tailoring services, grooming services with manicures/pedicures; anything to drive traffic is another area that the traditional players are focused on in terms of leveraging their footprint.

For the digitally-native brands, they are also seeing the benefit of having a brick-and-mortar and kind of omnichannel offering. And what's interesting today, you've seen dozens of stores from Warby Parker and Caspar and Bonobos and Away, the luggage company, all opening stores today. Those digitally-native brands combined are expected to open almost 850 stores over the next five years. And so I think you see this convergence between the traditional players and the digitally-native brands coming together in terms of their store footprints.

JAKE SIEWERT

So, Jen, a lot of the focus in retail is on millennials and what millennials buy and how they buy it, but obviously a huge demographic, and a relatively well-off one, are the retirees and Baby Boomers. How are retailers thinking about that demographic, and their changing tastes and habits?

JEN DAVIS

I think that's a great question. I mean, retailers recognize that that is a large and growing demographic that will continue to populate as we all age and build up that funnel. And that demographic has dollars to spend and time to spend it. And so I think not only in thinking through online investment, we're seeing retailers making investments into services.

So one example of that is Best Buy, the consumer electronics retailer, buying a company called GreatCall last year, which basically provides in-

home emergency services to senior citizens. And that's a focus for Best Buy, to try to get more of their services in their home. And so more connectivity with their customer overall. And so I think it's been an area of acute focus for a lot of retailers today.

JAKE SIEWERT

So you touched a little bit upon investing in logistics and technology. What types of retailers are more inclined to make that investment, build the in-house technology to handle logistic platforms, last-mile delivery? And where are you seeing the most M&A activity in this space?

JEN DAVIS

I think it's interesting in logistics and last-mile delivery, today over 90 percent of ecommerce orders are bought with free delivery. And so that's leveled up, from a customer perspective, that customers just expect free

delivery overall.

So I think the first area logistically that we just talked about is traditional players investing in this buy online/pick up in store capability and making sure that they can fulfill that. The second is in terms of backend speed, and where they can invest to fulfill that much quicker. And obviously Amazon has upped the ante in terms of what we all expect in terms of days.

A good example of this is Kroger, the grocer, made an investment last year in a U.K. company called Ocado that focuses on automated warehouse. They bought five percent of Ocado, and in turn entered an agreement where they would build 20 automated grocery fulfillment warehouses across the United States over the next three years. And so Kroger is trying to confront the Amazon threat in the grocery space in terms of having a very

automated fulfillment in terms of online grocery delivery. So it's been less on the pure M&A side and more on the investment and/or partnership experience overall.

I'd say more broadly, aside from just logistics, where retailers are focused today is leveraging the kind of troves of customer data and loyalty programs that they have. If you think about going to Costco and using your membership card to buy your products and purchases, they have an enormous amount of data on what you buy every month, and what you're focused on. And so using that customer data and analytics to hyper-personalize the experience, both in terms of marketing and what they're pushing out to you from a promotion standpoint, is another area that retailers are very focused on.

And I think it's interesting, in consumer survey

work, they say that 80 percent of consumers are more likely to do business with a company if they offer a personalized experience.

JAKE SIEWERT

Certainly true. I mean, I don't know Amazon thinks we've already consumed an entire pound of almonds from last week, but with four kids, maybe. Who knows? What types of retailers have been most successful at sort of using this technology to date?

JEN DAVIS

Look, I think that grocers are the ones who historically had the most data because they had the promotion cards. And so whether it's the Krogers, the Costcos, the Publix of the world, you often would swipe your card at checkout and they know, and you're coming so often, and so forth, that they have so much data. So when they print out the receipt and you're already getting a coupon for Haagen-Dazs because you just bought a pint of



Ben & Jerry's, I think that grocers have been far and away ahead of the curve in terms of that.

There's a few others in the broader retail sphere; so I mentioned Ulta earlier. Ulta's another great example of that. Almost 90 percent of their transactions are done on a loyalty program today, and so the amount of data that they have that if you've bought a Philosophy face wash, maybe we should also target you with an email promotion about a Philosophy moisturizer, and you'd like the same brand, is very powerful.

JAKE SIEWERT

So obviously in the M&A world there's not just buying, there's also sort of realignment, and a lot of companies are sort of realigning their portfolios and repositioning their brands, simplifying their portfolios, focusing sometimes on a subset of the most forward-leaning one. So how is that playing out in retail, and what does it say about brand

value and customer loyalty as these businesses evolve?

JEN DAVIS

There's been a bunch of recent examples where you're seeing companies who are focused on pruning their portfolio and focusing on their core capabilities in areas of growth.

So a good example that was announced last fall, and recently was consummated, was VF Corp, who announced that they were going to spin off their traditional denim brands, Lee and Wrangler, into a separate company called Kontoor Brands. And instead, they would hold onto kind of the remaining higher growth brands that are focused on the active outdoor and work spaces. So those include brands like Vans, Timberland, The North Face and so forth.

And for a company like the VF, they saw denim

and that denim category and the brands that they owned as slower growth, lower margin. And so for them, from a shareholder perspective, to separate the higher growth, higher margin from the lower growth, lower margin was very helpful and additive to shareholder value.

The second example of that is Gap announcing that they were going to spin off Old Navy. And so their legacy historical Gap, Banana Republic, Athleta brands, would be separate from Old Navy, which is more of a value proposition customer serving the full family overall. And so I think management teams are thinking holistically about where they can add the most value and how, from a shareholder perspective, they can deliver the most upside for their investors.

JAKE SIEWERT

So private equity's been very active in this space, as they have in a lot of industries. But some of

them have had difficulty with some big investments they made, so are the financial sponsors still finding value in legacy brands that haven't evolved as much with technology? And how are you seeing that play out?

JEN DAVIS

I think it's a great point. We've all seen the headlines of the retail bankruptcies that have happened over the past several years, whether it's Toys “R” Us, Gymboree, Mattress Firm, Payless, Claire's; for a lot of private equity players who put a lot of money to work in this sector it's been a very difficult investment strategy overall.

Where we've seen it involving, I'd say, is one, in thinking through other investments in Amazon proof, or less Amazon risk sectors? So such as high growth restaurant brands where they're still opening new concepts in stores, since it's hard to order a restaurant-delivered meal on Amazon

today.

A second area is making minority investments and smaller investments in smaller growth companies where historically we wouldn't have seen private equity players play.

The third is kind of leveraging their playbook with prior investments in terms of investing in small-scale brands that they can capitalize on international growth, where they've had a lot of expertise. Or channel growth in terms of helping a brand evolve from a wholesale to a DTC mode, and how to do that.

And then the fourth is we've seen a lot of private equity players in retail going upstream, and so not saying who's going to be the winning brand or winning retailer, but what someone upstream from them, who we can get the same benefit without

taking that end-market risk. And so a good example of that is Cornell Capital bought a company called KDC last fall, which basically manufactures the packaging for beauty brands. And so rather than picking what is the next hot beauty brands, they work with hundreds of brands, and basically provide the packaging back office supply chain and so forth for all of those brands.

JAKE SIEWERT

So as you talk about retailers moving into services, a lot of the lines are blurring, and how do you think about the lines between retail, tech, logistics? What is a retail company today?

JEN DAVIS

I think a retail company today, and it's very, very broadly defined, is anything that serves a customer with their disposable income. And so it could be your laundry detergent, it could be your apparel service, it could be your car. And so it's very broad

today.

I think there's a blurring of the lines between companies who consider themselves retail companies and companies who consider themselves technology companies. And there's a lot of overlap between the two, and so we've seen the enormous success of companies like Stitch Fix, which went public and has done phenomenally well, that uses very sophisticated data algorithms in terms of deciding what box to send you of apparel, based on your preferences, what you specified at the outset, how you've reacted to prior boxes that they've sent you.

And so they're providing apparel, which is a traditional retail service, but using technology and data to drive those decisions. And so I think across all facets of retail there's examples where the technology and convergence of logistics and data

fulfillment and so forth are coming together.

JAKE SIEWERT

So, Jen, you've been at Goldman since 2003, you're a partner now. Talk a little bit about your own journey at the firm and how you prioritize your to-do list, in a very busy life, both in and out of the office.

JEN DAVIS

I have been here for 16 years, which is staggering to me, the last ten of which have been in consumer retail. I actually started in our industrials group. It's been a really wild and fun ride overall, and I think in terms of thinking about prioritizing my never-ending to-do list, as I'm sure we all feel, it's just a massive amount of organization and ruthless productivity in terms of thinking through where can I be thoughtful about downtime, in all pockets of my life? So if it's I'm stuck in a cab, I'm stuck in an airport; last night I was on a five-hour flight where the WiFi was



broken.

JAKE SIEWERT

That sounds like heaven.

JEN DAVIS

Yes, it was wonderful. (Laughter) It was really, really wonderful. Taking advantage of all of those moments, I think, is really important. And for me, really prioritizing my family and my mental health and wellbeing is really first and foremost. And if I'm not doing that, then I can't be successful in other areas of my professional life.

JAKE SIEWERT

How have you been surprised by things, how your career's evolved here? What's been some of the bigger surprises?

JEN DAVIS

It's interesting. I think over the course of 16 years, there have been three different CEOs during my time here, and the financial crisis, changing industry groups. There's been enormous shifts on

one hand, but the one thing that hasn't changed kind of across groups, across divisions, across offices even, is our culture. And I think it's amazing to me to see how that culture and the principles of teamwork and integrity and client service really get passed down. And how we've been able to preserve that over time has been probably the biggest surprise.

JAKE SIEWERT

So you're running retail banking. But you're also a consumer; we're all consumers. So two-part question: what item would you never buy online, and what item could you now never imagine buying in a store?

JEN DAVIS

So it's a great question. It's really hard to come up with a product that I would never buy online because I would buy an appliance, I would buy jewelry; all of that online today, which traditionally bigger ticket you wouldn't think you would.

Probably the one thing I still would not is a car, because I would still want to test-drive the car. But I would do a ton of diligence and research in advance of walking into that showroom such that I could still be negotiating from a price perspective with full information availability and not asymmetry. So that's probably where I would not buy online.

And where I probably would never buy in a store again is any sort of commodity product that I don't need to look or touch. So whether it's laundry detergent or toilet paper or the moisturizer that I know that I use religiously, if I don't need to see or touch it, I will never, never need to buy it in a store again. But if I'm in a store for another reason and I want a brand discovery where I'm there already picking up something else, I will for sure add it to my cart.

JAKE SIEWERT

So let's finish up by recapping the episode's central question. In 30 seconds or less, where are retailers looking for growth?

JEN DAVIS

It's very specific to a specific retailer or brand, but for them it's going to be where's the customer demographic growing? And it's not just millennial and GenZ; there's a lot of companies focused on senior citizens and a booming Baby Boomer demographic as well. So customer growth would be one. The second would be in channel growth, and we've talked today a lot about the digitally-native brands and DTC and so how can you transition from a more wholesale-led model to controlling your own destiny on the direct-to-consumer; so that distribution angle would be the second.

And the third would be geographically. And where, especially in China and the emerging markets,

where there's mid and high-single-digit GDP growth, and a growing consumer disposable income that has dollars to spend, how do you most effectively target those markets? And what's interesting is brands tend to be much more successful in international expansion than boxes; i.e. a box that just provides other people's brands. And so I'd say it's across that customer distribution channel and geography, that retailers are focused on today.

JAKE SIEWERT

Excellent. Thank you, Jen, for joining us today.

JEN DAVIS

Thank you.

JAKE SIEWERT

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