

[Title Card] Trends and Challenges in the Retail Industry

[Host] *The Middle Market Indicator Survey showed a decrease in revenue and employment growth for the retail industry, with low projections for the next 12 months. This outlook has offered the opportunity for creativity, as the industry continues to adapt to online competition with brick-and-mortar stores. Ryan Fischer, Senior Vice President, Restaurant and Retail Industry Manager with SunTrust Bank, offers more insight into the trends and challenges facing the retail industry.*

[Ryan] While we've seen a decline in month-to-month revenue growth, I do think it's important to note that we've also seen a strong year-over-year revenue growth in the first half of 2017, and expectations for the year continue to be in that 3-4% range. And that's a nice rebound from what we saw in 2015 and 2016.

I think what's really changing is where people are spending their money. In 2017, the biggest winners have really been online retail, off-price or discount retailers, building materials and furnitures and home furnishings. Apparel and home good shoppers, on the other hand, are really finding great deals and increasing name brands at off-price retail and through ecommerce while shifting those sales away from the department stores and traditional brick-and-mortar retailers.

I think consumer spending remains fairly resilient, and there's hope that continued wage growth in the back half of the year will lead to higher spending in the back half of 2017 and into the holiday season.

[Host] *The good news for brick-and-mortar retailers is that ecommerce is still less than 10 percent of overall retail revenue. Still, in order to compete with ecommerce, one of the biggest trends in the retail industry is for brick-and-mortar stores to emphasize customization, offering a unique experience to customers.*

[Ryan] Retailers can differentiate themselves by providing that custom product or service as well as unique shopping experience that can't be replicated online or at home. And today's consumer really has a wealth of options at their fingertips, so attracting that consumer to your stores is vital to your survival.

Creating that unique experience has really been done recently through a lot of investment and store remodeling and design, investing in the employee training and improving systems. All really designed at improving the ambiance and shopping experience for consumers. That leads to unique opportunities for retailers to differentiate themselves based on their product mix. So they aren't just competing on price and value, but actually higher margin custom products.

[Host] *Traditional malls are one sector of the retail industry looking to create unique experiences for customers. Ryan shares how some traditional retailers have started to adapt.*

[Ryan] First, you've got anchor tenants like Nordstrom that have really been evolving on their own by building out an off-price sister chain, Nordstrom Rack, to help fuel growth. And they're now even testing a smaller high-service model that doesn't even stock clothes. Instead, they'll have a team of personal stylists that will retrieve clothes from other stores in the area for customers to try on or pull together looks for customers on

their own style board app. In addition, they're going to offer manicures. They've got a bar that sells coffee and alcohol and also there's pick up for online orders. So they're providing a high-end service model, but with supplementary existing store networks.

[Host] *Another major way malls are looking to bring in customers is through restaurants that can put their own spin on creating a unique atmosphere, often combining traditional dining with various forms of entertainment.*

[Ryan] As traffic continues to decline at the malls, mall owners are really looking at chef-driven independent restaurants as well as entertainment venues. These are the Dave & Buster's of the world that have been a long leader in 'eatertainment.' Eatertainment is that combination of dining and entertainment in one package. So you've got a full-service restaurant and bar coupled with some sort of entertainment venue.

Eatertainment options are also driving changes to the drinking places side of the equation, where you're seeing emerging brands, such as Topgolf or Punch Bowl Social, boutique bowling alleys, and other bar and grill concepts adding spaces for shuffleboard, bocce, cornhole and other kinds of games to really differentiate and keep people longer to increase that average check.

A further evolution coming to a mall near you may be a smaller amusement park venue, containing not just arcade and midway games, but also amusement rides typically seen at the state fair as well as even proprietary rides that will really draw traffic from far and wide.

[Host] *For many established brands, however, making the shift to a more customized atmosphere can be a fine needle to thread.*

[Ryan] We're seeing tremendous capital investment in remodeling restaurants by mature brands. But that spending for the most part has proven ineffective at helping to maintain sales and traffic, but not increasing it. New independence in emerging micro chains, on the other hand, are really gaining a larger share of the increased sales in the industry.

Young people especially are looking for unique experience, and that's a dangerous proposition for large mature concepts. There are larger chains out there that continue to grow and succeed, such as a Texas Roadhouse, that have been able to create a high energy, fun atmosphere or even a Chick-Fil-A that has separated themselves from the QSR pack with healthier menu items and a service model that frankly is the envy of the industry.

[Host] *As online retailers continue to expand and innovate through technological advances and strategic acquisitions, retailers and restaurants are increasingly tasked with adapting in order to remain competitive.*

[Ryan]

Amazon buying Whole Foods is really a game-changer. Being able to deliver high-end ingredients as well as prepared meals to your home is really a scary thought for the restaurant industry and other food retailers alike. Restaurants will try to counter that by increasing delivery and takeout from their stores, but that has its own inherent problems.

A lot of food product doesn't travel well, or worse, the food can get cold because of a third-party delivery service that you use that took too much time. And all of that can really damage the brand.

Another major risk of delivering takeout is taking the sales out of your dining room. You risk losing talented servers and management to someplace that can turn more tables and the staff can earn more money, and no one really likes to eat in an empty restaurant. You know, the energy and the vibe of a busy restaurant has a significant impact on a customer's overall enjoyment of the experience.

For new stores, this can help them in reducing the square footage of dining rooms needed and potentially lower the development cost going forward, but it's difficult for an existing store to really benefit from that. The other really major difficulty there is finding drivers and the resulting rising cost of delivery charges as more and more restaurant operators enter the fray of delivery sales.

Reaching customers through social media and driving sales through online or mobile apps will be increasingly critical to restaurants' operating success.

[Host] Thanks, Ryan. To learn what business leaders from all industries across the U.S. recently told the National Center for the Middle Market about revenue and employment trends, visit the [SunTrust Middle Market Banking Page](#).