The Bay's New Groove

Is Moving Upscale in Canada's Retail Market the Right Move?

Written by Christy Chak

As the oldest company in North America, the Hudson's Bay Company has certainly had a rich history. However, the company's revenues have recently been declining due to a lack of consumer interest. In January 2006, Jerry Zucker, an American investor, purchased the company with grandiose ideas of change. Unfortunately, his sudden death four months later halted all plans until 2008, when HBC was sold to NRDC Equity Partners, a retail and real estate private equity firm.

The Canadian retail landscape has been tumultuous. Until the mid 1970s, department store chains such as Simpsons, Eaton'sand Woodward's were popular and profitable. However, by the late 1990s, only three national chains remained: Sears, the Hudson's Bay Companyand Holt Renfrew – the rest declared bankruptcy or have been acquired. New specialty retailers such as The Gap, Benetton and Club Monaco infiltrated the Canadian market, competing at the same price points as traditional department stores. These retailers have changed consumer mindsets by offering more value to consumers by selling a specific brand and lifestyle.

Mass-market discounters, such as Wal-Mart and the pending arrival of Target, restrict The Bay's ability to move down-market. Specialty stores such as Roots, Town Shoes and Future Shop limit its ability to survive in the mid-market. With Holt Renfrew as the only formidable national department store in the Canadian luxury market, The Bay chose to move upscale.

To facilitate the transition to a more upscale department store, Richard Baker, the CEO of NRDC, brought in retailing wizard Bonnie Brooks. Having worked previously at Holt Renfrew and most recently credited with the transformation of the Lane Crawford luxury retail chain in Hong Kong, Brooks is certainly qualified for the position.

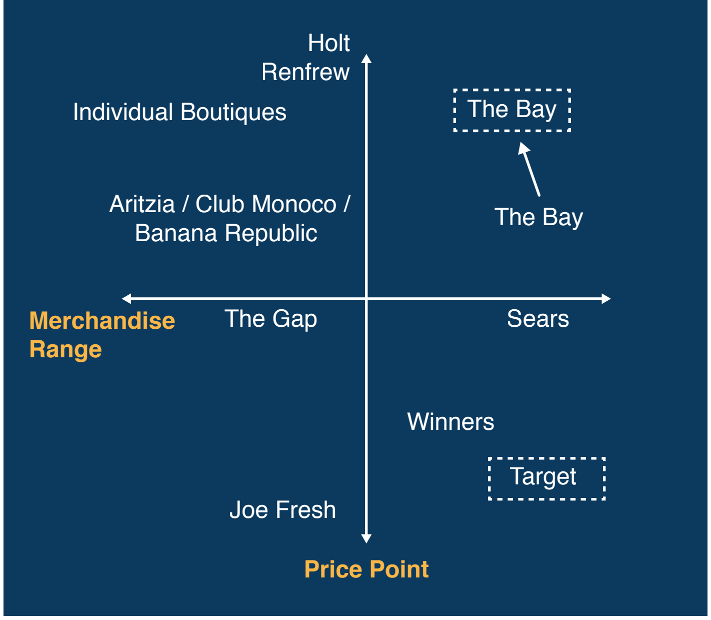
Winning the Consumer

The Bay's historical customer was the middle-class female baby boomer. This consumer group grew up during the rise of the department store and once viewed the store as a one-stop shop for all merchandise needs. Compared to specialty stores, with their frequent product turns, The Bay begins to appear old-fashioned and outdated, with high prices, mediocre product lines and poor service. The modern consumer desires a streamlined and exclusive product mix that caters to their specific interests.

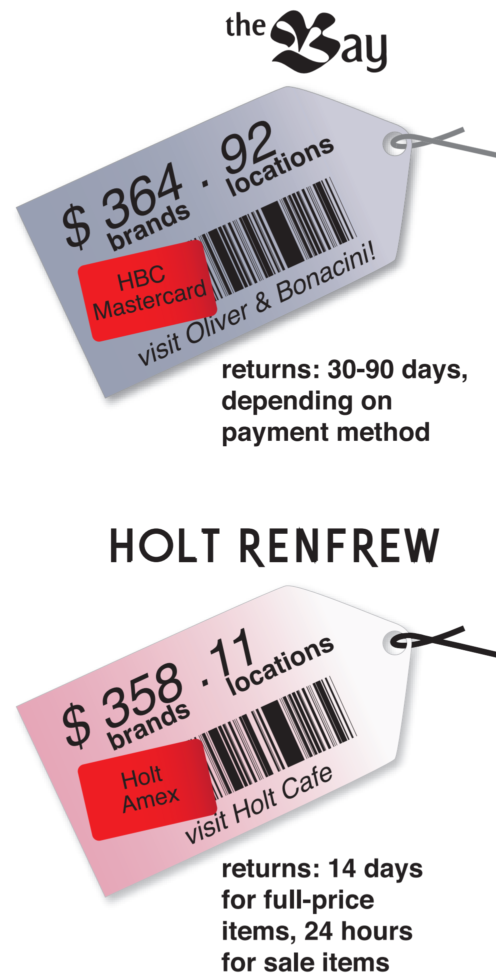
As The Bay's customers age, they are shifting their spending away from apparel towards more health and travel-related products. Brooks wishes to attract the younger, fashion-conscious audience in order to create a sustainable pipeline of consumers for the department store. According to Paco Underhill, author of The Call of the Mall, the modern woman's increasingly busy schedule dissuades her from driving to the suburban mall to idly browse through a department store. She now prefers to visit specialty stores in power-centers on her way home from work, park directly in front of the store entrance and be out within 15 minutes. The Bay must adjust to the contemporary demands of its primary customer base by narrowing its product selection and increasing convenience or risk becoming irrelevant.

Brands are important to this demographic but merely having the right products is not enough to lure them away from the specialty retailers. In a crowded marketplace, The Bay needs to differentiate itself by improving the store experience and selling a lifestyle to its customers. This goal of differentiation can be achieved by first ensuring the merchandise offered is aligned with the store's image and by enhancing the level of customer service. Department stores have traditionally been criticized for their employees' lack of product knowledge due to the sheer breadth of products. Complaints of snooty salespeople and stringent return policies also tend to be associated with luxury goods stores. An emphasis on customer service could allow The Bay to gain an edge over its Canadian competitors.

Consumer Perceptions of Canadian Apparel Retailers



Brooks' Report Card



Since her appointment in 2008, Bonnie Brooks has implemented significant changes to the department store. She responded to customer desires by securing contracts with highly-desired brands like Ralph Lauren, Topshop and Halston. Additionally, she has secured exclusive rights to many up-and-coming Canadian designers. Through these actions, Brooks provided The Bay with a more appealing assortment of merchandise and access to exclusive brands.

Brooks also commissioned a renowned design firm to renovate The St. Regis Room at the flagship Queen Street location store in Toronto. Plans are underway to renovate the remaining flagship stores in the other major cities across Canada. Recently, Brooks negotiated an agreement with Oliver & Bonacini restaurants to rebrand 24 in-store restaurants at The Bay locations across Canada, modernizing store locations to enhance the store experience.

The changes that Brooks implemented have thus far focused on increasing revenue but also significantly increased operating expenses. Although customer feedback has been generally positive, there has been no indication that the capital investment will result in a quick return to profitability, particularly since most of the changes have only been implemented at The Bay's flagship Toronto store. While Toronto is a lucrative market, there are other areas around the country where there is a demand for luxury goods, with significantly fewer competitors in the luxury segment.

Issues with the Expansion

The Bay's current strategy continues to lack focus on the core target market as it projects conflicting messages to consumers. It is apparent that Brooks first identified the niche in the upscale department and automatically expected the younger consumers who purchase in this category to arrive once new brands arrived in the store. Although Brooks culled 850 underperforming brands and introduced 250 modern, higher-end ones such as Jason Wuand Mark Fast, these brands do not necessarily appeal to the new audience. A more effective strategy would be to first recognize the primary target audience and then cater the product mix to them. Additionally, baby boomers are still a lucrative market but Brooks may be alienating this traditional core consumer in attempt to lure the younger market.

More importantly, The Bay's proposed strategy is still not sufficiently differentiated to ensure success. Since Brooks' retailing background is primarily in apparel, she has neglected the other departments at The Bay in her attempt to compete with Holt Renfrew. There are more opportunities for differentiation in those other product categories. This is also a contradiction between the stores located in urban areas and smaller regions, both in terms of the product lines offered and the overall positioning. By limiting the majority of her changes to urban centers, Brooks' efforts only affect a small portion of the potential market. The company's size hinders its ability to execute changes swiftly and given the geographical dispersion of the population, it is difficult to cater to the demands of the fashion-forward consumer even if a carefully selected line of products was offered at stores in smaller cities and towns. It would take significant time and capital to appropriately renovate all The Bay stores to convey a consistent upscale image and compete with the small luxury Canadian market. Instead of trying to fill the niche between mid-market specialty stores and Holt Renfrew, perhaps there is another gap in the market The Bay can fill.

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The (e-)Bay

In line with the evolution of shopping into an efficient and convenient task, online retail has steadily grown in Canada, with over $15 billion in purchases made in 2009. Customers have been petitioning retailers like Holt Renfrew for an online store to no avail. As a result, Canadians have been patronizing American retailers who offer a wider selection of merchandise and better prices, though the latter advantage is offset by exorbitant customs brokerages fees, duties and additional taxes. The Bay currently offers the ability to purchase cosmetics and home fashions online but not apparel, due to the concern that the merchandise will not fit or be what consumers expect (arguably the most common barrier to online shopping). However, this obstacle may prove to be The Bay's biggest competitive advantage in e-commerce. With 92 locations nationwide, compared with Holt Renfrew's 11 stores, The Bay can leverage its assets by allowing customers the flexibility of hassle-free in-store returns of online purchases to any one of its locations. Additionally, The Bay can offer a wider product range than any of its competitors, a significant advantage in online shopping, as customers can purchase multiple items and save on shipping fees. A strong Canadian online retailer that negates the extra costs and alleviates the fears of complicated returns would be welcomed by consumers.

The Bay can minimize the risk and investment required by testing out a pilot operation with manual fulfillment, eventually linking the online platform to real-time store inventory, depending on the success of the roll-out. In 2007, Nordstrom committed to investing US$450 million for full multi-channel integration of their stores, projecting online sales revenues of US$1 billion per year by 2013. Compared to The Bay's recent CAD $100-million expenditures on renovations, the cost of expanding its online presence is considerably lower and will yield significantly higher revenues. Thus, The Bay can establish itself as the first Canadian online department store, differentiating itself from its competitors and capturing new market share away from Holt Renfrew.

Concurrently renovating The Bay's flagship stores in the major cities can bring flashes of luxury to the brand, enhancing the potential for success with an e-commerce platform. As Brooks cannot seem to focus on one specific target audience, it is only through the implementation of drastic changes that The Bay can achieve sustainable profitability and continue to add to its rich history.