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RETAIL MARKETING STRATEGY REPORT

A look into the strategies of Australia's most effective online retailers and future trends of retail marketing.

AUGUST | 2021

TZU & CO.

INTRODUCTION

The COVID online retail boom is well documented, with consumers flocking to online shopping almost overnight and retailers rapidly adapting to the surge in e-commerce.

In 2020, retailers had spent more than AUD $1.7 billion on advertising and marketing. Yet despite the massive financial investment, success in the hyper-competitive online shopping space is far from guaranteed.

In this special report, marketers have an opportunity to discover the strategies of Australia's most-effective online retailers and apply those lessons to their own marketing strategy to chart new avenues for growth.

These insights provide marketers with the marketing intelligence to drive short-term and long-term growth, competitive differentiation and the white-space advantage.

All companies analysed and profiled are publicly listed. The findings are produced through a top-level analysis using a combination of publicly available sources, third-party tools, proprietary IP and desktop research. As such, the research and opinions have not been verified by any business profiled or mentioned. Businesses were reviewed based on their H1 FY 2021 performance in contrast to peers and YoY growth.

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LANDSCAPE SNAPSHOT

A SNAPSHOT OF STRATEGIC INITIATIVES

This report identifies where some of the highest-performing, customer-oriented retail businesses are focusing their marketing attention. These businesses include retailers in highly competitive, global markets where competitors' market dominance and pricing advantage could easily neutralise their marketing efforts.

Discover the strategic marketing initiatives of several leading retail businesses to stay competitive and win market share in this challenging environment.

The brands listed in this snapshot have mentioned in their publicly available reports other strategic marketing focus areas, such as leveraging first-party data, CDPs and SEO. However, it's our belief these are 'table-stakes' initiatives. All retail businesses within their competitive set would be employing the same tactics. To highlight the value of differentiation, the strategic focus areas listed here demonstrate a unique, valuable opportunity for the retailer.

BUSINESS	STRATEGIC MARKETING FOCUS
BOOKTOPIA **Online book retailer**	• Subscription services • Loyalty program • Customer support • DC: Automation/robotics and fulfillment experience
KATHMANDU **Outdoor lifestyle brand**	• Reposition the brand • Build the brand • R&D: Product innovation
BCF **Outdoor adventure clothing & equipment**	• Loyalty • Leverage locations • Exclusive range • Build brand awareness

Booktopia
Booktopia has largely been able to compete and often win against alternatives, such as Amazon, by over indexing in areas where international competitors are weaker. Namely, customer service, strategic partnership programs and delivery. These services are underpinned by a significant range of book and publication titles with high search engine coverage. The company is doubling down in these areas (including through acquisitions), and further seeking to both defend and grow their domestic market share through loyalty and subscription services. An essential move considering the volatility of its search engine-dependent growth. Its continued investment into distribution capabilities will also allow Booktopia to meet and exceed the post-purchase stage of the customer experience. This, coupled with local-based customer service, secures its position for future growth in the market, as inevitably more Australians shop for their reading material online.

Kathmandu

Kathmandu (the brand, not group) has historically relied on its bricks-and-mortar retail network, international travel and the outdoor adventure market to drive its sales and growth.

Prior to COVID, 75% of Kathmandu's revenue was derived from retail stores and only 8% online. It was seen more as a utility brand than one with an emotional connection. However, COVID was a major disruptor to the business. Kathmandu has had to find a way to both adjust and differentiate in the market. In response, the business has been in the process of replatforming to develop a DTC model and repositioning its brand to be 'all seasons' and 'any citizen of the world', not just for the adventurer. To differentiate, it's focusing on becoming a purpose-driven brand, bringing more people to the outdoors for the betterment of all. It's hoping to own the mind space and the wallets of the socially and environmentally conscious shopper – similar to Patagonia, but at a more accessible price range. We would expect the business to increase its brand investment in the year ahead to generate salience, while simultaneously maturing its digital customer experience. Additionally, the business will continue to invest in R&D. Innovating its product around its new sustainability purpose has the potential to be one of the most significant strategic moats available to the business.

BCF

BCF has been well positioned to harvest the influx of demand in the domestic travel and adventure market. Looking ahead, aside from the continued investment in its digital and omni-channel customer experience capabilities, the business is creating strategic moats in several areas. Its store network allows the business to stay closer to the customer, which is essential for bulky items. It's also leveraging the stores for their service capabilities. As novice adventurers enter the outdoor adventure market, service and support is a key need and differentiator. Furthermore, BCF is localising its product ranges to suit the behaviours and demographics of the customers surrounding the stores. Some 84% of BCF's sales are derived from its 1.77 million club members. This loyalty program primarily gives members access to cheaper prices, so although it is limited as a competitive defence strategy, it does unlock member data – an area where competitors have yet to advance.

PROFILE 1

ADOREBEAUTY

ADORE BEAUTY

ABOUT

Adore Beauty is Australia's number-one pureplay online beauty retailer.

Its vision is to help women feel more confident and fabulous every day by delivering an empowering and engaging beauty shopping experience personalised to their needs.

Our Perspective

Adore Beauty is an exemplar of a customer-oriented business that understands the importance of perceived brand value, and how it extends well beyond advertising. The business is advancing with a balance of short-term growth tactics and long-term strategic foundations. With YoY growth in NPS, brand awareness, retention and revenue over the past three years, Adore warrants merit and inclusion in our report.

Looking ahead, Adore is investing a smaller % of its marketing budget into activation media, directing the majority if it into brand value building through customer experience and value-add content. Customers share a high affinity for Adore, as seen by its 82% NPS and communities organically being built around the brand offsite on forums such as Reddit.

Marketing Strategic Focus

- Increase brand awareness & perceived brand value
- Develop vertical integration
- Drive loyalty

Once a customer experiences Adore, the value is recognised. Leveraging customer affinity to acquire new customers has been a key tactic since inception. However, to fuel faster growth and penetrate mass market, in 2020 Adore began investing its ad budget in building brand awareness through TV. This offline channel is now the key initiative in building mass-market awareness and market share. Strong brand awareness with superior brand experience is an accelerator for the business' growth and market capitalisation.

Additionally, Beauty IQ, Adore's content ecosystem, is a key pillar and differentiator. In 2020 it generated over 1.4M podcast downloads and more than 2M website content views. Owning the destination for beauty advice, education and entertainment builds a strategic moat around the company's brand. It positions Adore as the beauty business you can trust, and trust is high-yield equity in beauty retail. It's also difficult to replicate.

Lastly, Adore is looking both sideways and downwards in 2021 and beyond, exploring new categories, such as men's beauty and developing its private label products.

Key Initiative

Beauty IQ (and YouTube)

Strategic Intent: Own the destination for beauty to build perceived brand value and control the rails of beauty purchase decisions.

Beauty IQ is an ecosystem of education, entertainment and support content to help consumers feel more connected and confident in all things beauty. The three key platforms are its content hub on the Adore Beauty website, the 'uncensored' podcast series, available across all podcast platforms, and its YouTube channel (an independent, but contributing platform). The content isn't just about products (although it has integrated product shopping through its articles). The theme is about making informed beauty decisions, above and beyond commercialised beauty. Beauty IQ is a critical differentiator for Adore and acts as a farm to grow and harvest trust – the single most important currency in beauty retail.

Content spans all mediums – articles, videos and audio – so wherever a consumer is, however they prefer to access content, Adore is there. The message is that 'when you're in the Adore Beauty IQ and content network, you do don't need to go anywhere else'. Owning 'beauty', from product and perspective to inspiration and information, means Adore takes a considerable share of a consumer's weekly content consumption.

An e-commerce business and a media business

1.4 M
downloads

2.4 M
content impressions

>4.9 M
YouTube views

CY 2020

Beauty IQ serves as the ultimate owned ecosystem play – the advertising value saved by owning the communication channel mix, which reaches millions of consumers, is only matched by the additional value it adds to its brand by giving customers quality, helpful and educational content at no charge. The higher the perceived value of the brand, the higher the market cap, and the more Adore is able to invest in new market and brand growth initiatives.

Strategically, Beauty IQ creates a key differentiator and moat around its value to the market. It's creating trust, an essential currency in beauty retail. To replicate the success of the podcast alone could cost competitors millions of dollars, and there's no guarantee of effectiveness. What makes Beauty IQ unique, is that it's customer-oriented as opposed to sales-oriented. The message of each piece of content is solving the spoken and unspoken challenges beauty customers face, rather than trying sell products – that's the bi-product of generating trust and value for customers.

By channelling dollars away from the overly competitive advertising market and into producing content to distribute through its own media channel network and platforms (including its new mobile app) Adore is betting heavily on itself. And it's working. With an NPS of 85%, customer retention rates greater than 65% and YoY growth in revenue, new customers and average order sizes, Adore is proving the effectiveness in building brand value outside of advertising media.

Key Initiative

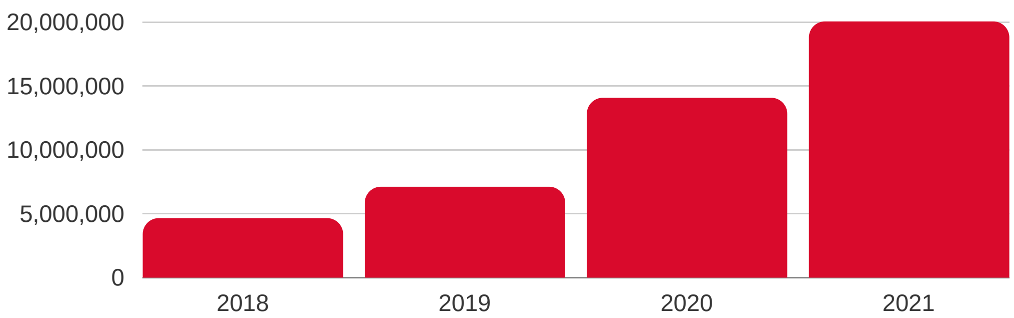
Brand Awareness

Strategic Intent: Grow market share by being better known in the market, so it can be in more consideration sets of more Australians.

Adore has increased its marketing and advertising budget, lifting from 8.7% of revenue in 2018 to 12.8% of revenue in 2020-2021. Historically, the majority of advertising investment centred on acquisition campaigns. However, as of 2020, and moving into 2021-2022, there's a shift into brand awareness. With over 80% of households shopping online in 2020, and Adore's market share less than 15% of the online beauty retail market and 4% of the total beauty and personal care market, the growth potential and market readiness gave Adore two options. One was to continue relying on the same tactics that built its market awareness: primarily word of mouth through the affinity of customers who found the brand through other customers, organic search or some acquisition campaign. The other was to move into paid mass-media brand awareness, such as TV. In 2020, they launched their first TVC supported by social media brand activity.

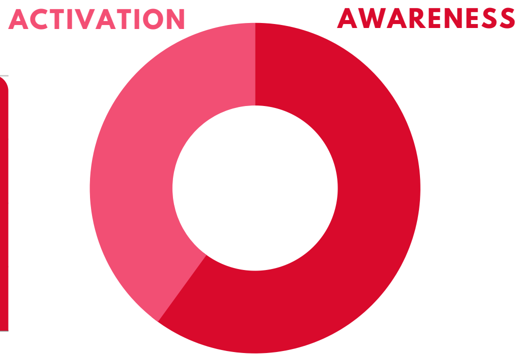
The shift in investment has proven effective. Aided awareness grew from 39% to 53% within six months of campaign activity. One of the key benefits of a stronger brand awareness is lower cost of acquisition (in the long term). Combining a mass market approach to building brand awareness, with the more targeted approach through social media, creates a compounding effect on the brand salience. Additionally, when combined with the always on acquisition communication and frequent acquisition campaigns, Adore aims to see accelerated growth over the next 12 months.

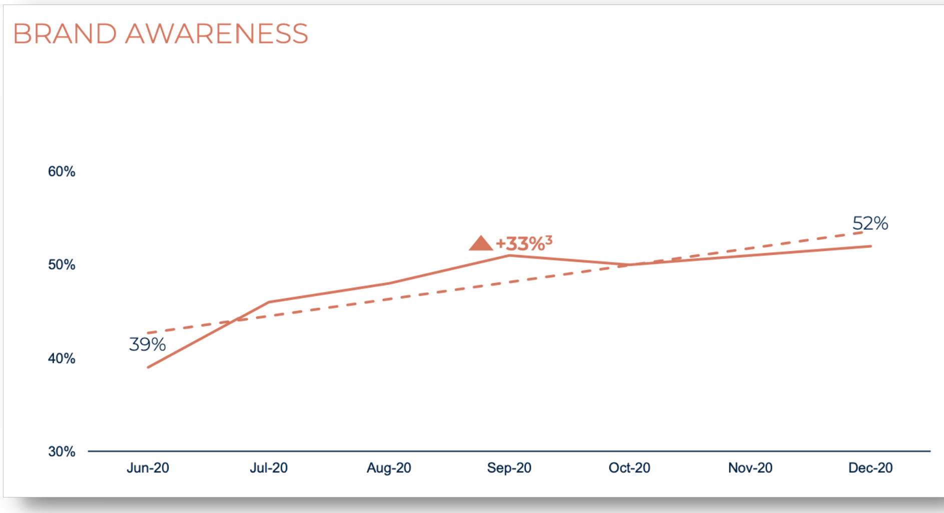
MARKETING & ADVERTISING INVESTMENT



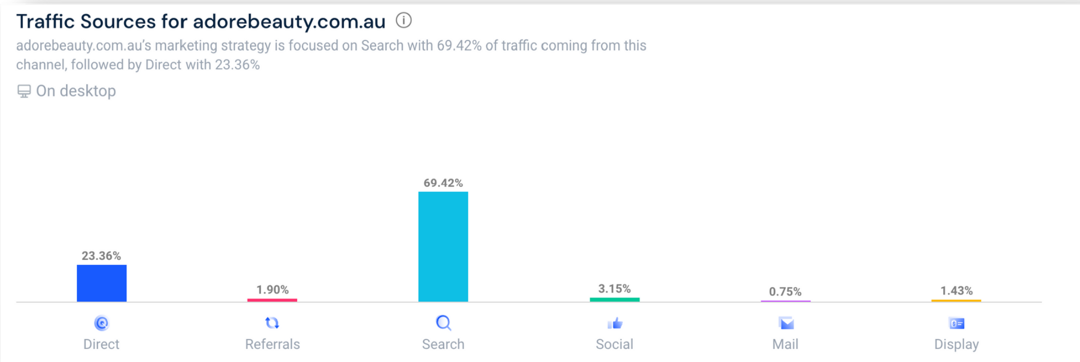
*ESTIMATES ONLY. THESE ARE BASED ON SIMILAR WEB DATA BUT ARE UNVERIFIED

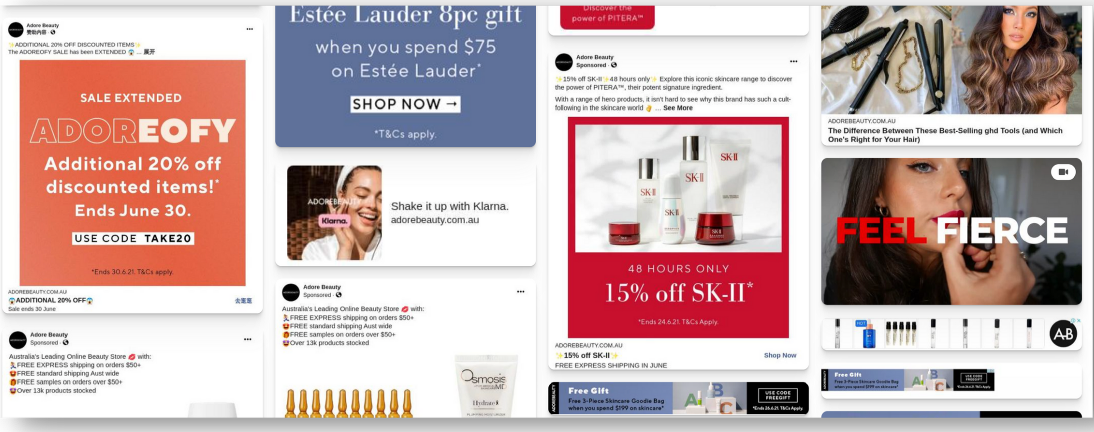
2020-2021 *ESTIMATED MEDIA RATIO





ALTHOUGH ADORE HAS INCREASED ITS BUDGET AND WHERE IT INVESTS ITS AD MEDIA MONEY, IT HASN'T STOPPED FOCUSING ON ACQUISITION. RATHER, ACQUISITION HAS BECOME MORE EFFECTIVE BECAUSE OF THE BRAND AWARENESS EFFECTS. BOTH PAID AND NON-PAID.





SOURCE: SIMILAR WEB, BIGDATR, H1 2021 ADORE BEAUTY REPORT

Key Initiative

Vertical Integration

Strategic Intent: Harvest the equity of trust built through its brand value and generate higher gross margins from private label products.

Adore has access to millions of records of customer and transactional data, and a trusted customer base. This provides the company with the quantitive and qualitative data to make informed decisions on product gaps in its target market that it can service with a private label solution.

Strategically, backwards integrating creates greater shareholder value, as well as a strong competitive differentiator, one that can now be sustainably delivered with greater logistical control through Adore's 4,000sqm warehouse. Without the data, trust, capital, brand and logistics control, vertical integration is a difficult strategy to deliver. Adore is in a prime position to execute and further separate itself from less-sophisticated and less-trusted competitors.

In December 2020, Adore piloted private label branded accessories. Additionally, in 2021 Adore began its horizontal integration, targeting the men's beauty market.

Key Initiative

Loyalty & Repeat Purchase

Strategic Intent: Increase stickiness to generate more yield per customer.

The core pillar of Adore's 65.6% customer retention rate is its obsession with customer experience. From pre-purchase, purchase to post-purchase phases, Adore has orchestrated unique and fulfilling experiences, including its signature Tim Tam packet sent with each order.

In an attempt to ring fence the company's most engaged and highest value customers, in March 2021, Adore launched its first loyalty program, Adore Society. The program rewards purchase frequency and loyalty (share of wallet) with exclusive benefits, such as free express delivery and member-only events and rewards. Most consumer-facing retailers have, or have considered, a loyalty program. Adore held off on releasing a program until it was a strategic advantage.

Level 1 $0 - $399	Level 2 $400 - $1499	Level 3 $1500+
Birthday or Anniversary $10 voucher Expires in 14 days*	Birthday or Anniversary $20 voucher Expires in 30 days*	Birthday or Anniversary $30 voucher Expires in 60 days*
Free Express Delivery minimum $50 spend	**Free** Express Delivery minimum $35 spend	**Free** Express Delivery No minimum spend
Member-only promotions	Member-only promotions	Member-only promotions
Access 'Money can't buy experiences'	**Priority Access** 'Money can't buy experiences'	**Priority Access + Invite** 'Money can't buy experiences'
Member-only competitions	Member-only competitions	Member-only competitions
	Level 2 Welcome reward	Level 3 Welcome reward
	Early access to new brand and product launches, promotions & sales	Early access to new brand and product launches, promotions & sales
		Choose when you spend your reward
		Exclusive access to limited releases

PROFILE 2

TEMPLE & WEBSTER

ABOUT

Temple & Webster is Australia’s leading pureplay furniture and homewares retailer. The company's vision is to be the first place Australians turn to when shopping for their home. Temple & Webster sells more than 200,000 products from hundreds of suppliers. It runs an innovative drop-shipping model whereby suppliers send products directly to customers, enabling faster delivery and reducing the need to hold inventory, allowing for a larger product range.

Our Perspective

In a relatively linear category, where consumers have traditionally made subjective choices influenced by the objective scales of cost, quality and convenience, Temple & Webster is highly differentiated. Drop-ship business models, although rewarding with strong gross margins, are plagued with difficulties managing the supply chain and meeting customer expectations. However, Temple & Webster has been able to overcome this issue and has been able to create an exceptional end-to-end customer experience for heavy, high-consideration products like furniture, which have typically been too much of an obstacle to eat into offline retail.

COVID-19 not only accelerated growth, it forced a market shift, creating a necessity to shop for furniture and homewares online.

Marketing Strategic Focus

- Brand Awareness
- Purchase & Post-purchase Experience
- Private Label

Temple & Webster's product range, visibility in the online purchase path and capability to meet expectations through the customer fulfillment process meant that it was well prepared for the wave, and enjoyed a first-mover advantage, which the market has rewarded. As of June 2021, Temple & Webster shares were trading on a price-earnings ratio of > 60. Harvey Norman was trading at <10. The market is valuing it more than 60 times greater than its net earnings for one year. This access to cheap capital allows it to take moonshots that its competitors can't, such as its push into artificial intelligence (AI) and augmented reality – a move that has the potential to add further value to the brand and differentiate. In the nearer term, it is doubling down on the core competencies: its range, including more private label products, and its quality of content, with an internal content studio. These differentiators add significant perceived value to the brand. Additionally, it recognised in 2019-2020 that although its intent-based performance media was effective at driving acquisition, it was limited by the brand's reach and familiarity in mass market. Subsequently, it has invested in broader mass market media such as TV and radio.

Key Initiative

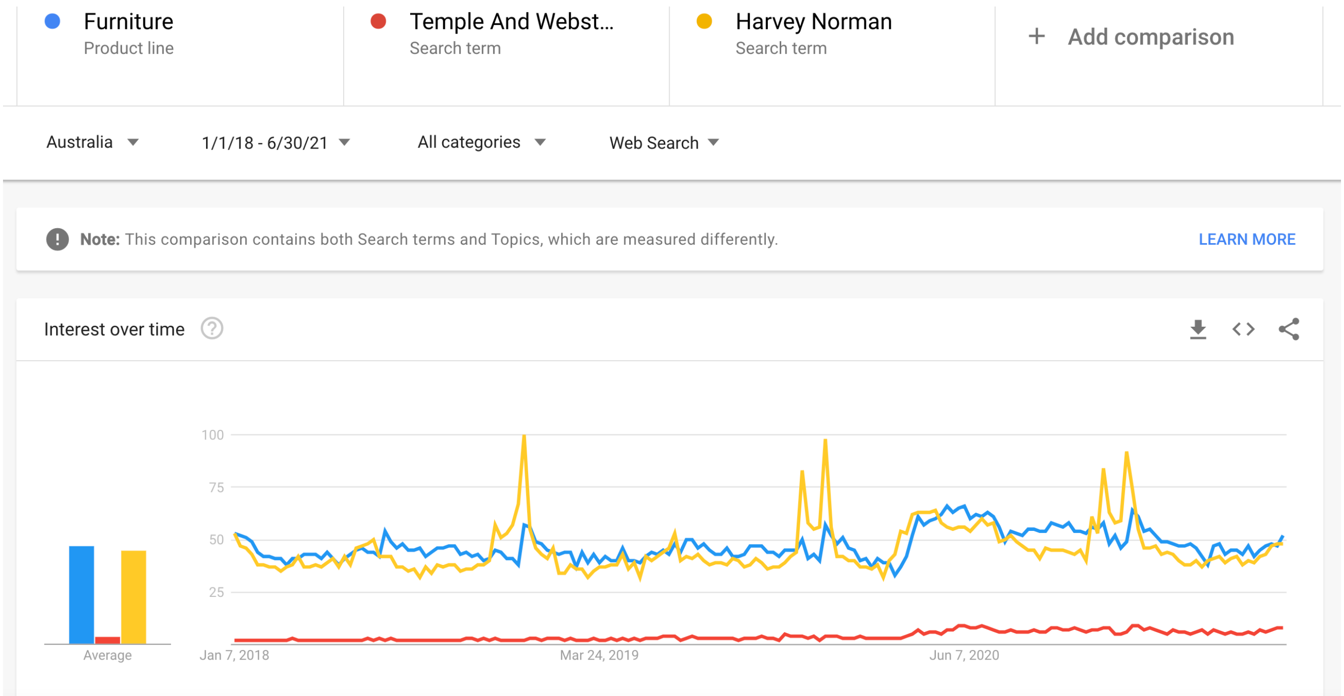
Brand Awareness

Strategic Intent: Grow market share by being better known in the market, so it can be in more consideration sets of more Australians.

Goal: Increase Brand Awareness from 55% to +80%.

Since 2018, Temple & Webster has acquired customers primarily through performance media channels with a focus on intent-based marketing. Although this approach and organic search accounts for the vast portion of its customer acquisition and media investment, its customer experience and brand awareness investment are where it sees the next step change in growth.

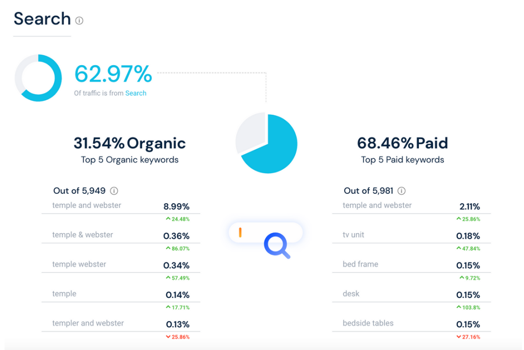
In June 2020, Temple & Webster launched its first TVC as part of its initiative to grow brand awareness in the broader ~$15B Australian furniture and homewares market. Historically, there was a stronger division between consumers who shopped for their furniture online (where the consideration set was skewed to digital-heavy players like Temple & Webster, Living Styles and Zanui) and those using online for inspiration before in-store purchase, compared to those who only browse and shop in-store. Since the pandemic, those divisions have shrunk and 8/10 Australian households now shop online. This means that Temple & Webster's competitors are no longer only those who have a strong online presence, but those with a strong offline presence (Domayne, Freedom and Harvey Norman). To take market share aware from them, Temple & Webster has to build its brand awareness in the mass market and be in the consideration set for Australian consumers who shop for furniture or homewares online.

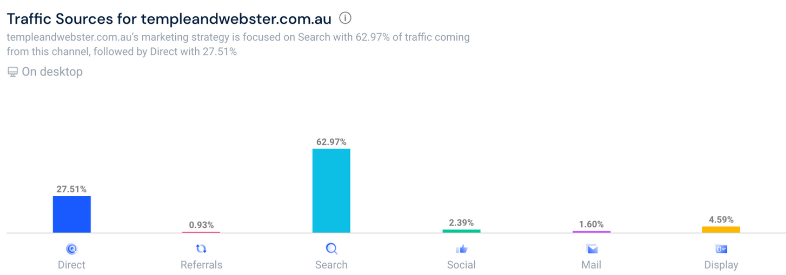


SOURCE:GOOGLE TRENDS

Building awareness is a long-term investment that yields benefits overtime. It has a compound effect with the more channels a marketer adds to the mix (although a careful view on cost effectiveness is always suggested). The benefit is not only gaining market share, but more cost-effective online conversions. In principle, the more people know your brand and trust it, the higher the likelihood they will purchase from your brand when comparing to your competitors. Therefore, the conversion rate (the percentage of those who are considering buying from you and then do buy from you) increases. Additionally, the higher a brand's awareness and perceived value, the less reliant it needs to become when competing in bottom-funnel activity. Consumers move from going to the market to find the best product (such as searching for a dining table) to the brand they know and trust to find the product (going to Temple & Webster, then searching for a dining table). This means that as a business matures in market, especially one that's grown digitally through demand harvesting, it inevitably must find a way to move to the top, wider end of the funnel to build sustainable market share. Temple & Webster has now moved into top of funnel and it's become a key strategic focus for 2021 and beyond.

The business is seeking to control its dominant online purchase path position, and at the same time capture market share from offline traditional competitors. As of 2020, Temple & Webster advertising and marketing investment was approximately 12.8% of revenue. This is the highest rate the business has applied since 2016 (usually sitting at <12%). The performance and acquisition money is scaling with the increase in market demand, but additional budget (~$1.7-$2M) has been allocated to brand building. So far the investment has proven effective, with aided brand awareness growing 25% since introduction of brand activity. In CY 2021, Temple & Webster will look to continue investing in TV, as well as radio and out of home.





SOURCE: SIMILAR WEB, BIGDATR, H1 2021 TEMPLE & WEBSTER REPORT

Key Initiative

Purchase & Post-purchase Experience

Strategic Intent: Grow perceived brand value through delivering unique and best-in-class customer experience at points of purchase and post-purchase.

The higher a consumer perceives the value being delivered to them from the brand, the more valuable the consumer becomes to that brand. Higher retention rates, more significant order values, advocacy and stronger margins are benefits of a consumer perceiving one brand as being of greater value than another.

As a retailer operating in a competitive and expensive advertising market, value cannot solely be built through promotional mechanisms. If so, price and visibility to the audience becomes the only lever for value. It's essential a retailer creates value through differentiating themselves with the products, services and experiences a customer wants and can't get from anywhere else. The 'white space' in retail exists when a consumer is looking to make a purchase and after they have made a purchase. This is where Temple & Webster excels in its competitive set.

Temple & Webster is investing in three key pillars to differentiate and grow its value in market:

1. Content Creation
2. Customer Service
3. Delivery Experience

Every retailer in the world 'does' these three things. The difference is 'how' Temple & Webster is, and plans to, execute these pillars that separates it from the market.

Content Creation

Temple & Webster has invested in a dedicated internal content studio with photographers and stylists. Setting the bar high for quality and being a trusted source for interior inspiration and guidance increases the perceived quality and value in transacting with the brand. It becomes a competitive differentiator because producing the volume of quality content is resource-intensive, making it difficult to replicate by competitors.

Customer Service
One of Temple & Webster's strongest differentiators and value-adds is its customer service. The business allocates ~3% of total revenue to customer service staff and merchants. They own the customer relationship with an in-house care team for all enquiries.

In the year ahead, it plans to innovate further in self-service customer support. The business has invested in a local and offshore AI team to help solve some of its consumers' most difficult questions and most significant friction points, such as questions like 'what will this item look like in my home?'. AI and augmented reality, if successful, would exponentially grow the brand's value. Where a human customer service representative ends, an artificial solution picks up, at scale. The business has listed AI-generated room ideas, visual search, augmented reality and AI-powered assisted help in its product backlog for release. AI and data investments could also be used to reduce bottlenecks in peak time, both in support and delivery serviceability. The value in the IP created could exponentially accelerate its differentiation in the market.

Delivery Experience
Logistics, one of the most significant challenges in online retail in Australia, is inherently more difficult for drop-ship model businesses moving bulk items of varied brands directly from suppliers. Temple & Webster has over 200,000 products on sale from hundreds of suppliers, and yet it's largely been able to create a relatively seamless delivery experience. The business model allows it to generate strong margins with lower operating costs. If Temple & Webster is able to provide an exceptional delivery experience, it's achieved the best of both worlds. This is an area that is fundamental to its ongoing strategy and where it's investing a lot of its attention.

However, the brand value becomes diminished if the business can't fulfil the customer experience through delivery. To address this risk, it has invested in improving the delivery phase. Bringing on more carriers for bulky deliveries, after hours and weekend delivery services and logistics partnerships, and data advancements for peak-hour transactions are all in the business' strategic focus for the year ahead.

Additionally, and most critical, is its strategy with third-party warehouses. In May 2021, e-commerce fulfilment provider eStore Logistics opened an exclusive fulfilment centre for Temple & Webster in Derrimut, Victoria. The exclusivity is a demonstration of the evolved relationship between Temple & Webster and eStore Logistics, one that has existed for 11 years. The continued investment in the relationship, and personalised fulfilment offering by eStore, allows it to be in strategic proximity to consumers for faster delivery times and create unique delivery experiences that become extremely cost- and effort-prohibitive to replicate. All the while allowing Temple & Webster to minimise asset costs.

Key Initiative

Vertical Integration
Strategic Intent: Backward integration and developing a broader and larger range of private label products allows Temple & Webster to fill gaps in product catalogue and increase gross margins.

As of H1 2021, Temple & Webster had a 75:25 split drop ship to private label products on offer (approximately 50,000 products). Last reported, private label products account for roughly 20% of sales for the company. Its annual reports state the business is expanding this range as a key area of focus.

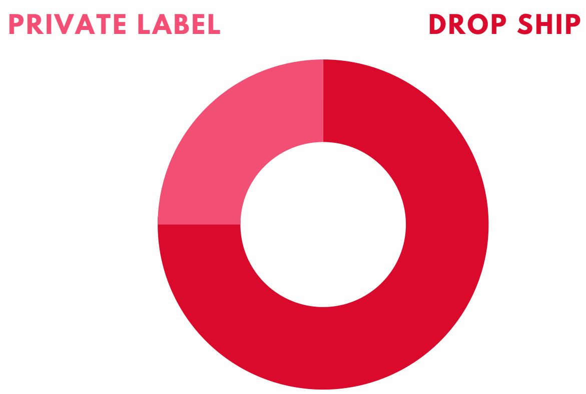
Vertical integration weaves together all of the key strategic areas we have identified in this analysis. Its data capability investment, content creation and brand building investment produce a substantial strategic differentiator in how it's able to offer private label products.

Temple & Webster has access to millions of customer, product and transactional data. Although not directly stated in public communication by Temple & Webster, it's suggested that this data could be ingested into AI capabilities, which could preference private-label products (think: recommendation engines). Additionally, with the investment in building brand and content, it could be in a stronger position to influence choice. If successful, the business could not only use data to identify what products to develop, but preference its private label products through the customer journey from inspiration to purchase.

Alternatively, it may take a more data-led, personalised approach, whereby products are promoted based on what is most likely going to convert for that customer.

Both of these hypothetical paths are possible, and inferred as a strategic tactic by the brand, and would create immense brand and shareholder value.

H1 PRODUCT RATIO



STRATEGIC INSIGHTS

When it comes to brand, platform and operational maturity, not all retail businesses are as established as the ones reviewed in this report. As a result, not all initiatives are appropriate or executable. For example, it would not be feasible for a national retailer to emulate Adore Beauty with backward integration by developing private labels without a strong degree of brand trust and equity, and the infrastructure and service processes to sustainably deliver the products. The value of this report is the insight that can be derived from an observational review and an understanding of the fundamental strategies that can apply to retail brands.

1. Customer Orientation

Amazon’s vision statement is “to be Earth’s most customer-centric company, where customers can find and discover anything they might want to buy online, and endeavour to offer its customers the lowest possible prices”. A customer-oriented company uses the customer's needs, behaviours, motivations and perceptions as its North Star. If a direction, or company decision doesn't serve the customer's needs in a superior or differential way, the choice is abandoned.

Both Temple & Webster and Adore Beauty are obsessed with their customers and their needs are priortised over other available avenues. Every business is faced with shiny objects – distractions and alternate paths they can take. For example, Adore Beauty's fanatical fan base has been asking for a loyalty program for several years. As a revenue opportunity, Adore could have acted on this sooner than it did in 2021. But Adore waited until it understood where it could add the most value to its members. Temple & Webster, as a predominately drop-ship marketplace, could increase gross margins by outsourcing or differing customer service. instead, it has decided to 'own' the customer support and enquiry function internally and has invested more into this function ever year.

Making choices led by what's best for the customer can sometimes incur short-term losses, but it pays off in the long term by way of loyalty, advocacy and the most important currency in retail – trust. When a brand becomes trusted, its advice is more likely to be followed and it builds influence. Trust is a business' best tool to improve conversion rate and grow margins. In a survey on the effect of trust on sales, 71% of people said they would rather buy from somebody they trust over somebody offering them a lower price.

The same study found customers are three times more likely to forgive a single bad experience if there's a trusted relationship, increasing retention. There's also a strong correlation between trust and advocacy. The NPS scores of Adore and Temple & Webster demonstrate they are both laser focussed on their customers. It's also why they are able to introduce private label products effectively – people want them and will buy them.

2. Build Strategic Moats

Strategic moats are defendable, high-barrier-to-entry initiatives and attributes that separate a business from its competition. They're sustainable differentiators in the market and are rewarded by the suppliers, customers and shareholders of the business.

Sonia Marciano, Professor of Management and Organizations at New York University's Stern School of Business, defines a defendable strategy according to several criteria. Here are four of those that are relevant:

1. Do the product/service attributes that attract trading partners require significant investments of time and capital? Take the attributes that makes Temple & Webster appealing to suppliers: its scale, support services and customer base. It took a lot of investment and it would require significantly more for competitors to replicate. Harvey Norman could dwarf it in these areas, but to compete with Temple & Webster online, it could cannibalise its franchisee stores by pushing its direct channel, risking a $3B business. In the case of Adore's brand advocacy, it has earned the hearts of its customers through the resources and time it's invested into building authentic relationships and superior experiences. It would be an expensive and difficult undertaking for a competitor to attempt to replicate this success. In 2021, both Adore and Temple & Webster have allocated significant budgets to building more brand awareness and brand value, increasing this attribute to market.

2. Does the company need to continually evolve or innovate to maintain its product/service advantage? And is the innovation path dependent on many components that competitors would have to match to offer an equivalent product? While competitors are transforming and replatforming, Temple & Webster is investing in moonshot innovations such as is AI and augmented reality projects that may grow the business exponentially. These solutions require the prerequiste of specific data sets, which require the volume and diversity of transactions and customer behaviours that it has developed over several years.

A competing drop-ship marketplace or any other retailer would have to succeed in several difficult areas in order to achieve the innovation success that Temple & Webster is pursuing, and it would be highly unlikely.

3. Customers perceive the relationship with the business as high stakes. Making the wrong choice subjects the buyer to risk. How much friction and risk is involved in shopping for an alternative (both as a buyer or supplier)? If a customer can swap between your shop and a competitor's with little friction or 'cost', your product or service is indifferent to the customer and your retention is volatile. However, if a customer perceives a risk in 'losing' something by shopping for an alternative, retention and yield increases. For instance, as a reseller, many of the products Adore sells can be purchased from their competitors. However, its loyalty program changes the stakes. If a customer purchases from an alternative, they risk losing loyalty points and benefits, such as free express shipping. Worth noting, the competitive response to this moat would be to demonstrate how the risk is mitigated by preferencing your company over theirs in a simple way. A great example of this is the Qantas 2020 campaign that offered to swap Velocity top-tier status for Qantas Gold Status with ease.

4.Customers benefit from a network effect. The network effect is a phenomenon whereby increased numbers of people or participants improve the value of a good or service. In effect, the more people who join the 'network' the greater the benefit for all people involved. Temple & Webster benefits as more suppliers join its platform and it attracts more customers looking for those brands and products through search engines, which in turn attracts more brand suppliers to join the service. Successfully building a flywheel model, whereby the value or experience for customers increases as more customers join or use the service, is a difficult undertaking. However, if successful, the model can accelerate exponential growth and is a defensive play, as the customers lose that value by leaving the network.

Not all business can or will meet all strategic moat elements. The more the better, but all brands should consider how they can raise the stakes and create strategic moats around the business. Marketing is intrinsically part of a company's ability to do this.

3. Find Where To Build Brand Value

The greater the perceived value of a brand, the more a brand is worth to the consumer and shareholders. This unlocks opportunities to grow margins, diversify product and service portfolios and vertically integrate with private labels.

Value in a brand isn't just built through advertising, but through all interactions with a customer. Professor Scott Galloway summaries them into three 'clock' stages: Pre-purchase, Purchase and Post-purchase.

- Pre-purchase: elements such as advertising, PR and tradeshows.
- Purchase: includes store design and shopping cart experience.
- Post-purchase: areas such as customer service.

It's common for modern marketers to over-index on both skills and investment in the pre-purchase stage – primarily advertising. It can be expensive to compete in the pre-purchase phase (going dollar for dollar trying to get your brand to stand out against other advertisers). However necessary advertising may be, it's also the most crowded space.

The retail industry will spend over $1.7B this year on advertising. Temple & Webster, for example, has grown its market cap by over 690% in three years, while spending less than $21M in advertising per year. In 2020 alone, Harvey Norman spent $380M and in three years its market cap has grown by less than 12%. Perceived value is not only built through advertising. Temple & Webster cannot outspend Harvey Norman. So, how do brands like Temple & Webster compete?

1. Knowing which media is effective for which goal. For now, Temple & Webster needs to remain dominant and present on high-intent areas like search to harvest the wave of in-market demand. Harvey Norman is less likely to compete as heavily here (in the short-term) because of its franchise model. In the long-term, Temple & Webster needs to be present and known to the broader population who are now shifting from bricks and mortar to online shopping. The genie can't be put back in the bottle. As a result, Temple & Webster is investing in traditional, trusted mass-media channels like TV to build brand awareness, which will flow downstream into its activation media.

2. Doubling down where they can win. Strategy is about making choices about what you will and will not do in order to win. A marketing leader's strategic role is to find where that winnable white space exists and decide what they will stop doing in order to have extra capacity to differentiate and grow the business. Temple & Webster has over-indexed its investment in the post-purchase stage. Its focus on customer service and logistics makes complex tasks, like orchestrating multiple items being shipped from different locations, appear simple. Playing in these areas is expensive and difficult, but critical in fulfilling the expectations of customer experience, which makes them perfect moats. In the year ahead, Temple & Webster's investment in its internal content production arm means it'll be able to produce content that follows the customer purchase path at a quality and velocity unparalleled by its competitors. It will stand out and be valued by customers for its exceptional service.

Adore has a strong post-purchase presence; however, it's the white space it has found in the pre-purchase stage that's noteworthy. Creating a content ecosystem – a destination for beauty that inspires, educates, entertains and influences – allows it to control the narrative with its customers. Adore has built a network of trusted content across several mediums to meet the customer where they're at and has, in effect, developed a media business. Its media reaches millions of Australians who care about beauty and trust Adore. This allows the business to spend less on competitive media channels to compete for the wallet of customers and actually brings the customer to its channels. Although this doesn't exclude Adore from advertising alltogether – critical market penetration requires awareness beyond its present reach – it does provide an opportunity to use its advertising budget much more selectively and effectively.

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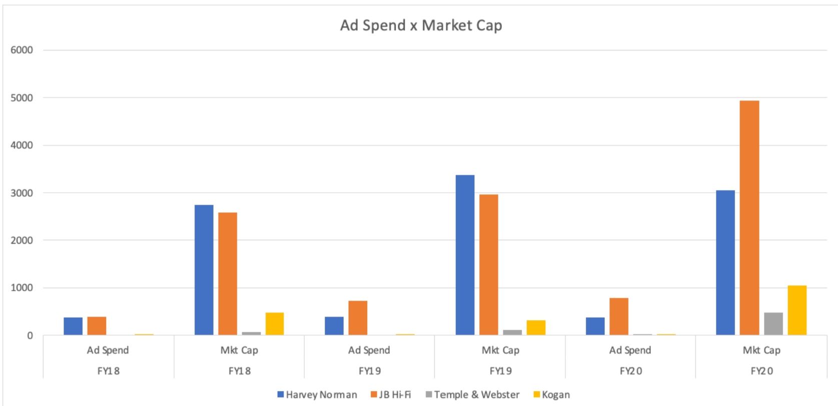
Source: Company Reports

	FY18	FY18	FY19	FY19	FY20	FY20
	Ad Spend	Mkt Cap	Ad Spend	Mkt Cap	Ad Spend	Mkt Cap
Harvey Norman	374.322	2738.0	391.044	3371	380	3044
JB Hi-Fi	395.1	2587.2	731	2969.7	786.4	4943.4
Temple & Webster	8.1	61	11.1	107	21	484
Kogan	19.9	472	18.7	313	27.6	1052



WHAT'S COMING?

In addition to the digital transformation of brick-and-mortar stores and replatforming retail, here are our predictions for the next 12 months.

1. Social Commerce Takes Off With Video

Social commerce has been in existence for a while with limited directly attributable benefit. However, that will change with the tighter integration of video and commerce through influencers and innovations like shoppable livestreams. Instagram, Snapchat, and eventually TikTok and YouTube will roll out their video social commerce products in Australia and influencers will spearhead its success.

2. Apple Grows BNPL As A Category

Nearly 50% of Australian adults have an iPhone and 7% of all Australians use Apple Pay. Apple will introduce its BNPL solution and is expected to disrupt and consolidate the industry. Retailers will need less friction to adopt it and it will simple for consumers. This should see BNPL as a category expand to a wide market, with more shoppers choosing it as an option, benefiting retail. This will force alternatives like After Pay to leverage its bilateral relationships to drive differentiation, such as its After Pay Day sales.

3. Online Goes Offline

The benefits and behaviours of e-commerce, contactless payments, online research and reviews will be designed into the bricks-and-mortar retail experience. Eventually, we expect integration of technology such as AR/VR and digital payments to be a part of the in-store experience. This limits the risks involved with physical staff presence, allowing the staff to be utilised for other areas such as service and fulfilment.

ABOUT US

Tzu & Co is a solution-agnostic marketing services and digital business consultancy. We help marketing and digital departments get unstuck, find clarity and navigate their next decision with confidence. From media performance and martech auditing to brand, CX, loyalty and growth strategies – we're not wedded to a solution or vendor. Our approach is unbiased and our success is tied to our clients'.

At Tzu & Co., you'll find an independent consultancy and implementation team. We're not a digital design, media or development agency, which means we have no vested interest in selling our clients a specific recommendation. Established in 2013, we've been solving the messy middle for some of Australia's and the world's most well-known brands as well as scale-ups and SMEs.

Our team of consultants are experienced specialists across multiple disciplines: e-commerce, marketing analytics, media and brand, market entry and growth. Solving a marketing challenge requires the right combination of data and digital expertise and marketing acumen, rarely found in one individual. Tzu & Co. provides an integrated, cross-functional service offering that harmonises the disciplines to work together.

We're the voice in the room you can trust.

F Di Marco

FABIAN DI MARCO

FOUNDER/HEAD OF STRATEGY

SOURCES

Details about company strategies and financials have been compiled from multiple investor presentations, mostly 2018, 2019, 2020 and the first-half of 2021. These include:
https://investors.booktopia.com.au/investor-centre/?page=asx-announcements
https://www.kathmanduholdings.com/
https://www.superretailgroup.com.au/investors-and-media/reports-and-publications/

Analysis of Adore and Temple & Webster's strategies, along with the strategic insights, have been developed from publicly available sources. These include:
https://www.adorebeautygroup.com.au/investor-centre/?page=asx-announcements
https://www.templeandwebstergroup.com.au/Investor-Centre/?page=investor-welcome
https://www.similarweb.com/
https://www.semrush.com/dashboard/
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