Rai Technology University

ENGINEERING MINDS

Retail Strategy

Subject: RETAIL STRATEGIES **Credits: 4**

SYLLABUS

An Introduction to Retailing
Introduction; Overview; the Framework of Retailing; the Importance of Development and Applying a Retail Strategy; Theories of Retail Change.

Changing Paradigm of Retail in India
Introduction, Retailing in India: Trends & Opportunities; Traditional Retail Formats; Modern Retail Formats in India; Geographical Markets; Retailing in Rural India; Vertical Marketing System in Indian Retailing; Challenges in Retailing Business in India.

Strategic Process Planning in Retailing
Introduction; Situation Analysis; Objectives; Identification of Consumer Characteristics and Needs; Overall Strategy; Specific Activities; Control; Feedback; a Strategic Planning Template of Retail Management; Case Study.

Building and Sustaining Competitiveness: A Strategic Approach
Introduction; Methods of Developing Sustainable Competitive Advantage; Value and the Value Chain; Retailer Relationship; Technology and Relationships in Retailing; Ethical Performance and Relationships in Retailing.

Customer Relationship Management
Introduction; Relationship Marketing as New Paradigm; Customer Lifetime Value and Relationship Lifecycle; Customer Loyalty and Customer Satisfaction; Loyalty Marketing of Retailers; Case Study: Tesco. Ii

Financial Strategy
Objectives and Goals; Strategic Profit Model; Profit Margin Management Path; Asset Management Path; Setting and Measuring Performance Objectives; Types of Measures.

Pricing in Retailing
Retail Pricing: Approaches and Strategies; External Factors Affecting a Retail Price Strategy; Developing a Retail Price Strategy; Implementation of Price Strategy.

Retail Location Strategy
Introduction; the Importance of Location to Retail Companies; Types of Retail Locations; Location Assessment Techniques; Case Study: ECE Projektmanagement.

Growth Strategies
Introduction; Growth Options; Outlet Growth: Organic Growth through Outlet Multiplication, Franchising, Mergers & Acquisitions; Global Growth Opportunities.

Suggested Reading:

1. Retail Management – A Strategic Approach by Barry Berman & Joel R. Evans;
   Publisher: Prentice Hall.
2. Retail Management by Chetan Bajaj, Rajnish Tuli, & Nidhiv Srivastava,
   Publisher: Oxford University Press.
3. Retailing Management by Michael Levy, Barton A Weitz & Ajay Pandit,

Publisher: Tata McGraw- Hill Publishing Company Limited.
4. Concepts and Cases in Retail and Merchandise Management by Nancy J. Rabolt and Judy K. Miller; Publisher: Fairchild Books & Visuals, Student Edition.
5. Strategic Retail Management by David E. Bell and Walter J. Salmon, Publisher: Thomson South-Western

AN INTRODUCTION TO RETAILING

Structure

Chapter Objectives

Hello Students, The study of retailing is very important to MBA students interested in employment opportunities with large retail chains. However, with the rapid growth in organized retail level, the study of retailing has become increasingly relevant. This has led many B- schools to introduce a separate elective on retailing. Today, retailing has become one of the most popular elective courses in many B- schools.

To define retailing, consider it from various perspectives, demonstrate its impact and note its special characteristics

1. To introduce the concept of strategic planning and apply it
2. To show why the retailing concept is the foundation of a successful business, with an emphasis on the total retail experience, customer service, and relationship retailing
3. To indicate the focus and format of the text.

1.1 Introduction

Retailing is the set of business activities that adds value to the products and service sold to consumers for their personal or family use. Often people think of retailing only as the sale of products in stores, but retailing also involves the sale of services; overnight lodging in a motel, a doctor's exam, a haircut, a DVD rental, or a home - delivered Pizza. Examples of nonstore retailing include Internet sales of hot sauces, the direct sales of cosmetics by Avon, and catalog sales by L.L. Bean and Patagonia.

1.2 Overview

Retailing encompasses the business activities involved in selling goods and services to consumers for their personal, family, or household use. It includes every sale to the *final* consumer-ranging from cars to apparel to meals at restaurants to movie tickets. Retailing is the last stage in the distribution process.

Retailing today is at a fascinating crossroads. On the one hand, retail sales are at their highest point in history. Wal-Mart is now the leading company in the world in terms of sales-ahead of Exxon Mobil, General Motors, and other manufacturing giants. New technologies are improving retail productivity. There are lots of opportunities to start a new retail business-or work for an existing one-and to become a franchisee. Global retailing possibilities abound. On the other hand, retailers face numerous challenges. Many consumers are bored with shopping or do not have much time for it. Some locales have too many stores, and retailers often spur one another into frequent price cutting (and low profit margins). Customer service expectations are high at a time when more retailers offer self-service and automated systems. At the same time, some retailers remain unsure what to do with the Web; they are still grappling with the emphasis to place on image enhancement, customer information and feedback, and sales transactions.

These are the key issues that retailers must resolve: "How can we best serve our customers while earning a fair profit?" "How can we stand out in a highly competitive environment where consumers have so many choices?" "How can we grow our business while retaining a core of loyal customers?" Our point of view: Retail decision makers can best address these questions by fully understanding and applying the basic principles of retailing in a well-structured, systematic, and focused retail strategy. That is the philosophy behind *Retail Management: A Strategic Approach.*

Can retailers flourish in today's tough marketplace? You bet! Just look at your favorite restaurant, gift shop, and food store. Look at the growth of Costco, Starbucks, and Lowe's. What do they have in common? A desire to please the customer and a strong market niche. To prosper in the long term, they all need a strategic plan and a willingness to adapt, both central thrusts of this book!

1.3 The Framework of Retailing

To better appreciate retelling’s role and the range of retailing activities, let us view it from three different perspectives:

- Suppose we manage a manufacturing firm that makes vacuum cleaners. How should we sell these items? We could distribute via big chains such as Best Buy or small neighborhood appliance stores, have our own sales force visit people in their homes (as Aerus-formerly Electrolux-does), or set up our own stores (if we have the ability and resources to do so). We could sponsor TV infomercials or magazine ads, complete with a toll-free phone number.

- Suppose we have an idea for a new way to teach first graders how to use computer software for spelling and vocabulary. How should we implement this idea? We could lease a store in a strip shopping center and run ads in a local paper, rent space in a Y and rely on teacher referrals, or do mailings to parents and visit children in their homes. In each case, the service is offered "live." But there is another option: we could use an animated Web site to teach children online.

- Suppose that we, as consumers, want to buy apparel. What choices do we have? We could go to a department store or an apparel store. We could shop with a full-service retailer or a discounter. We could go to a shopping center or order from a catalog. We could look to retailers that carry a wide range of clothing (from outerwear to jeans to suits) or look to firms that specialize in one clothing category (such as leather coats). We could surf around the Web and visit retailers around the globe.

There is a tendency to think of retailing as primarily involving the sale of tangible (physical) goods. However, retailing also includes the sale of services. And this is a big part of retailing! A service may be the shopper's primary purchase (such as a haircut) or it may be part of the shopper's purchase of a good (such as furniture delivery). Retailing does not have to involve a store. Mail and phone orders, direct selling to consumers in their homes and offices, Web

transactions, and vending machine sales all fall within the scope of retailing. Retailing does not even have to include a "retailer." Manufacturers, importers, nonprofit firms, and wholesalers act as retailers when they sell to final consumers.
Let us now examine various reasons for studying retailing and its special characteristics.

1.3.1 The Impact of Retailing on the Economy

Retailing is a major part of U.S. and world commerce. Retail sales and employment are vital economic contributors, and retail trends often mirror trends in a nation's overall economy.
According to the Department of Commerce, annual U.S. retail store sales exceed $4 trillion-representing one-third of the total economy. Telephone and mail-order sales by nonstore retailers, vending machines, direct selling, and the Web generate hundreds of billions of dollars in additional yearly revenues. And personal consumption expenditures on financial, medical, legal, educational, and other services account for another several hundred billion dollars in annual retail revenues. Outside the United States, retail sales are several trillions of dollars per year.

Durable goods stores-including motor vehicles and parts dealers; furniture, home furnishings, electronics, and appliances stores; and building materials and hardware stores-make up 38 percent of U.S. retail store sales. Nondurable goods and services stores-including general merchandise stores; food and beverage stores; health and personal care stores; gasoline stations; clothing and accessories stores; sporting goods, hobby, book, and music stores; eating and drinking places; and miscellaneous retailers-together account for 62 percent of U.S. retail store sales.

1.3.2 A Retailer’s Role in a Distribution Channel

A retailer is a business that sells products and /or services to consumers for their personal or family use. Retailers are the final business in a distribution that links manufacturers to consumers. A **distribution channel** is a set of firms that facilitate the movement of products from the point of production to the point of sale to the ultimate consumer.

Manufacturers typically make products and sell them to retailers or wholesalers. When manufacturers like Ralph Lauren and Dell sell directly to consumers, they are performing both production and retailing business activities. Wholesalers buy product from manufacturers and resell these products to retailers, and retailers resell products to consumers. Wholesalers and retailers may perform many of the same functions described in later Units. But wholesalers satisfy retailers’ needs, whereas retailers direct their effort to satisfying the needs of ultimate consumers. Some retail chains like Home Depot and Office Depot, functions as both retailers and wholesalers. They’re performing retailing activities when they sell to consumers but wholesaling activities when they sell to other business, like building contractors or small business owners.

In some distribution channels, the manufacturing, wholesaling, and retailing activities are performed by independent firms, but most distribution channels have some vertical integration. **Vertical Integration** means that a firm performs more than one set of activities in the channel, such as investments by retailers in wholesaling or manufacturing. **Backward Integration** arises when a retailer performs some distribution and manufacturing activities, such as operating warehouses or designing private label merchandise. **Forward Integration** is when a manufacturer undertakes retailing activities, such as Ralph Lauren operating its own retail stores. For example, most large retailers – such as Safeway, Wal- Mart, Lowe's – engage in both wholesaling and retailing activities. They buy directly from manufacturers, have merchandise shipped to their warehouses for storage, and then distribute the merchandise to their stores.

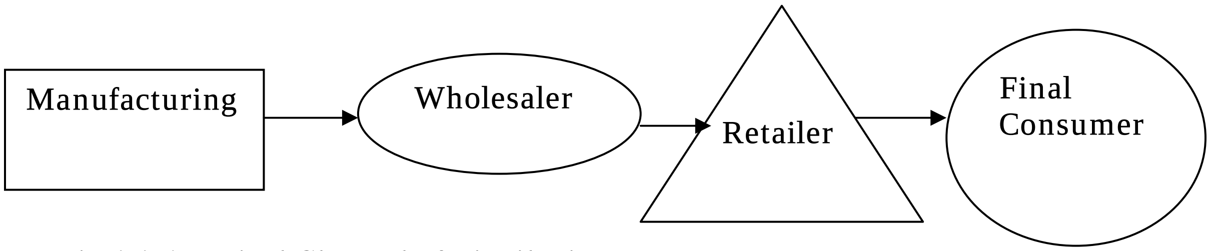


Fig 1.1 A Typical Channel of Distribution

1.3.3 The Retailer's Role in the Sorting Process

Retailers often act as the contact between manufacturers, wholesalers, and the consumer. Many manufacturers would like to make one basic type of item and sell their entire inventory to as few buyers as possible, but consumers usually want to choose from a variety of goods and services and purchase a limited quantity. Retailers collect an assortment from various sources, buy in large quantity, and sell in small amounts. This is the **sorting process**.

Another job for retailers is communicating both with customers and with manufacturers and wholesalers. Shoppers learn about the availability and characteristics of goods and services, store hours, sales, and so on from retailer ads, sales people, and displays. Manufacturers and wholesalers are informed by their retailers with regards to sales forecasts; delivery delays customer complaints, defective items, inventory turnover, and more. Many goods and services have been modified due to retailer feedback.

For small suppliers, retailers can provide assistance by transporting, storing, marking, advertising, and pre-paying for products. Small retailers may need the same type of help from their suppliers. The tasks performed by retailers affect the percentage of each sales dollar they need to cover costs and profits.

Retailers also complete transactions with customers. This means having convenient locations, filling orders promptly and accurately, and processing credit purchases. Some retailers also provide customer services such as gift wrapping, delivery, and installation. To make themselves even more appealing, many firms now engage in **multi channel retailing**, whereby a retailer sells to consumers through multiple retail formats (points of contact). Most large retailers operate both physical stores and Web sites to make shopping easier and to accommodate consumer desires. Some firms even sell to customers through retail stores, mail-order catalogs, a Web site, and a toll-free phone number.

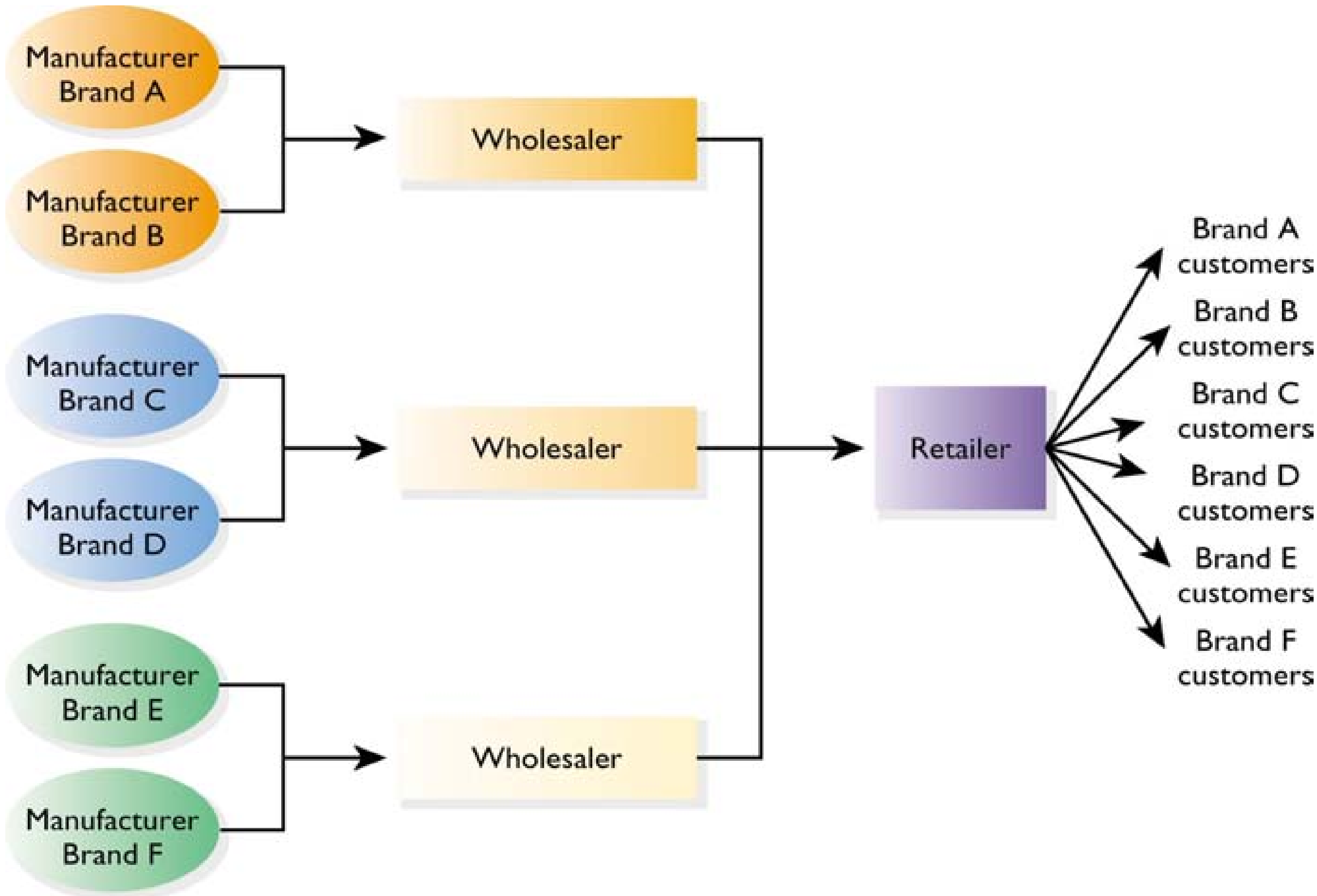


Fig1.2

1.3.4 Relationship Management among Retailers and Suppliers

Relationship among retailers and suppliers can be complex. Because retailers are part of a distribution channel, manufacturers and wholesalers must be concerned about the caliber of displays, customer service, store hours, and retailers' reliability as business partners. Retailers are also major customers of goods and services for resale, store fixtures, computers, management consulting, and insurance.

These are some issues over which retailers and suppliers have different priorities control over the distribution channel, profit allocation, the number of competing retailers handling suppliers' products, products displays, promotion support, payment terms, and operating flexibility. Due to the growth of chains, retailers have more power than ever. Unless suppliers know retailers' needs, they cannot have good rapport with them; and as long as retailers have a choice of suppliers, they will pick those that offer more.

1.3.5 Distribution types

- **Exclusive**: suppliers make agreements with one or few retailers that designate the latter as the only ones in a specified geographic area to carry certain brands or products
- **Intensive**: suppliers sell through as many retailers as possible
- **Selective:** suppliers sell through a moderate number of retailers

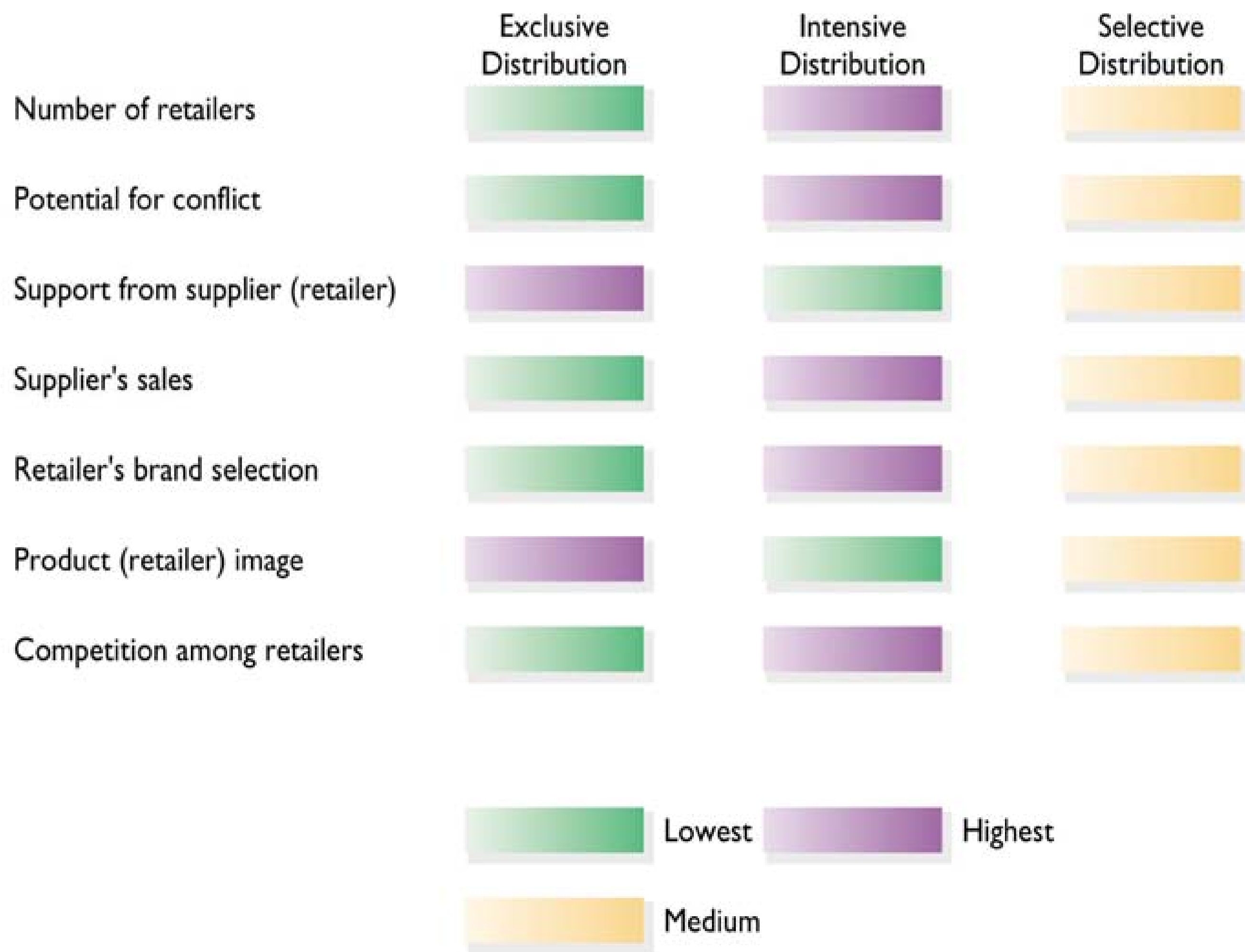


Fig 1.3 Comparing Distribution types

1.4 The Importance of Developing and Applying a Retail Strategy

A **retail strategy** is the overall plan guiding a retail firm. It influences the firm's business activities and its response to market forces, such as competition and the economy. Any retailer, regardless of size or type, should utilize these six steps in strategic planning:

1. Define the type of business in terms of the goods or service category and the company's specific orientation (such as full service or "no frills").
2. Set long-run and short-run objectives for sales and profit, market share, image, and so on.
3. Determine the customer market to target on the basis of its characteristics (such as gender and income level) and needs (such as product and brand preferences).
4. Devise an overall, long-run plan that gives general direction to the firm and its employees.

5. Implement an integrated strategy that combines such factors as store location, product assortment, pricing, and advertising and displays to achieve objectives.
6. Regularly evaluate performance and correct weaknesses or problems when observed.

To illustrate these points, the background and strategy of Target Stores—one of the world's foremost retailers – are presented. Then the retailing concept is explained and applied.

1.4.1 Aspect of Target Strategy

Throughout its existence, Target Stores has adhered to a consistent, far-sighted, customer-oriented strategy—one that has paved the way for its long term achievements:

- *Growth-oriented objected.* "Target Corporation has long been guided by principles that are designed to enhance our long term financial performance and we remain steadfastly committed to strategies that fuel consistent growth and profitable market share gains. We believe that by managing our business like this, we can continue to deliver average annual growth in earnings per share of 15 percent or more over time and generate substantial value for our shareholders."
- *Appeal to a prime market.* The firm is strong with middle-income, well educated adults, who have an average income that is about 20 percent higher than the typical Wal-Mart shopper. It is quite popular among female shoppers, parents with children under 18, and 25- to 54-years olds.
- *Distinctive company image.* Target Stores has done a superb job of positioning itself: "Pay Less + Except More. " See Figure 1.4. It is a true discount department store chain with everyday low prices. Along with Wal-Mart and Kmart, Target Stores makes up the "big three" of discounting. It has Linoleum floors, shopping carts, and a simple store layout. But Target is also perceived as an "upscale discounter." It caries products from such designers as Massimo (apparel), Isaac Mizrahi (apparel and home products), Michael Graves (home products), Liz Lang (maternity clothes), and Amy Coe (baby's nursery).
- *Focus.* The chain never loses sight of its discount store niche: "Our strategic direction at Target is clear: to continue to delight our guests with differentiated merchandising and exceptional value while we continue to invest in our technology and leverage our resources throughout our organization to enhance our performance."
- *Strong customer service for its retail category.* The firm prides itself on offering excellent customer service for a discount store. For example, at the end of many aisles, there is a red service phone so shoppers can check a price or ask a question.
- *Multiple points of contact.* Target reaches its customers through extensive advertising, stores in 47 states, a toll-free telephone service center(open 7 days a week, 17 hours per day), and a Web site.
- *Employee relations.* These are some of the awards recently won by Target: "Top 30 Companies for Executive Women" by the National Association for Female Executives, "Best for Latinas" in Latina Style magazine's "50 Best Companies for Latinas," "Top Work Place for Women" in Working Mother magazine's "100 Best Companies for Working Women," "100 Best Corporate Citizens" by Business Ethics magazine (for diversity efforts), and "Top in Training" in Training Magazine's "Training Top 100" list.
- *Innovation.* The firm "has long embraced the concepts of innovation and newness, recognizing the importance of creating unique ways to delight our guests every time they visit our stores."

- *Commitment to technology.* Target is devoted to new technologies. Consider the Target Visa card: It "has a built-in computer chip, called a smart chip. Today, you can use your Target Visa with an in home smart card reader to access exclusive offers. And soon, you'll see exciting new smart chip features popping up! The chip makes the Target Visa smart."
- *Community involvement.* Target believes in giving back. One of its popular programs is School Fundraising: "You can support your school just by shopping with your Target Visa or Target Guest Card. Target will donate an amount equal to one percent of your qualifying purchases at Target Stores or target.com to the eligible K-12 school of your choice."
- *Constantly monitoring performance.* Two years ago, Target sold off two divisions: "Both Marshal Field's and Mervyn's were saddled with declining sales and most experts believed Target would be better off getting rid of both and flying solo." Today, "Target is on its own with a lighter load and more free cash after selling the two chains for a total of $4.9 billion."

Figure 1. 4 "Pay Less + Export More" at Target

1.4.2 The Retailing Concept

Target Stores has a sincere long-term desire to please customers. In doing so, it uses a customer-centered, chain wide approach to strategy development and implementation; it is value driven; and it has clear goals. Together, these four principles form the retailing concept (depicted in Fig 1.5) which should be understood and applied by all retailers:

1. *Customer orientation.* The retailer determines the attributes and needs of its customers and endeavors to satisfy these needs to the fullest.
2. *Coordinated effort.* The retailer integrated all plans and activities to maximize efficiency.

3. *Value*-driven. The retailer offers good value to customers, whether it be upscale or discount. This means having prices appropriate for the level of products and customer service.
4. *Goal orientation.* The retailer sets goals and then uses strategy to attain them.

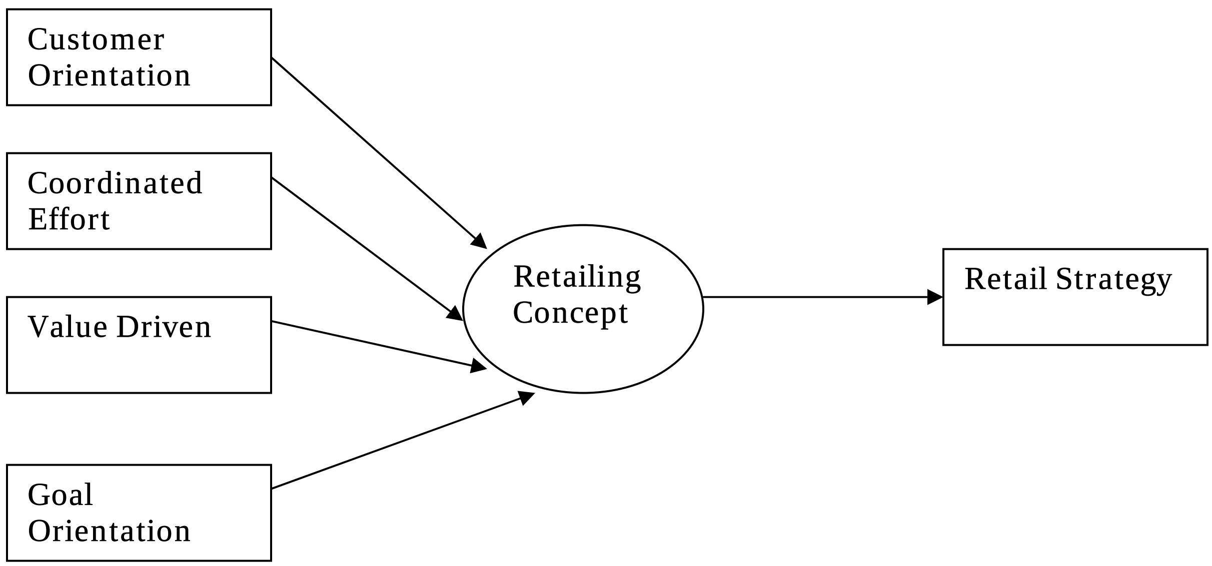


Fig 1.5 Applying the Retailing Concept

1.4.3 Customer Service

Customers Service refers to the identifiable, but sometimes intangible, activities undertaken by a retailer in conjunction with the basic goods and services it sell. It has a strong impact on the total retail experience. Among the factors comprising a customer service strategy are store hours, parking, shopper friendliness of the store layout, credit acceptance, salespeople, amenities such as gift wrapping, rest rooms, employee politeness, delivery policies, the time shoppers spend on checkout lines, and customer follow up. This list is not all inclusive, and it differs in terms of the retail strategy undertaken.

A Customer Respect Checklist

- ✓ Do we trust our customers?
- ✓ Do we stand behind what we sell? Are we easy to deal with if a customer has a problem? Are frontline workers empowered to respond properly to a problem? Do we guarantee what we sell?
- ✓ Is keeping commitments to customers – from being in stock on advertised goods to being on time for appointments – important in our company?
- ✓ Do we value customer time? Are our facilities and service systems convenient and efficient for customers to use? Do we teach employees that serving customers supersedes all other priorities, such as paperwork or stocking shelves?

- ✓ Do we communicate with customers respectfully? Are signs informative and helpful? Is advertising above reproach in truthfulness and taste? Are contact personnel professional? Do we answer and return calls promptly – with a smile in our voice? Is our voice mail caller-friendly?
- ✓ Do we treat all customers with respect, regardless of their appearance, age, race, gender, status, or size of purchase or account? Have we taken any special precautions to minimize discriminatory treatment of certain customers?
- ✓ Do we thank customers for their business? Do we say "thank you" at times other the after a purchase?
- ✓ Do we respect employees? Do employees, who are expected to respect customers, get respectful treatments themselves?

1.5 Theories of Retail Change

A number of explanations have been made about how retail organizations grow, develop, expand and succeed. Theories of retail change make sense of what has happened to retail organizations in the past, and more importantly, help retailers to foresee future scenarios for their business, and those of their competitors.

There are three main categories of theory:
_ Cyclical theories.
_ Environmental theories.
_ Conflict theory.

1.5.1 Cyclical Theories

Cyclical theories are those which trace common patterns in retail development over time and include the earliest theories of retail change. There are three primary cyclical theories:

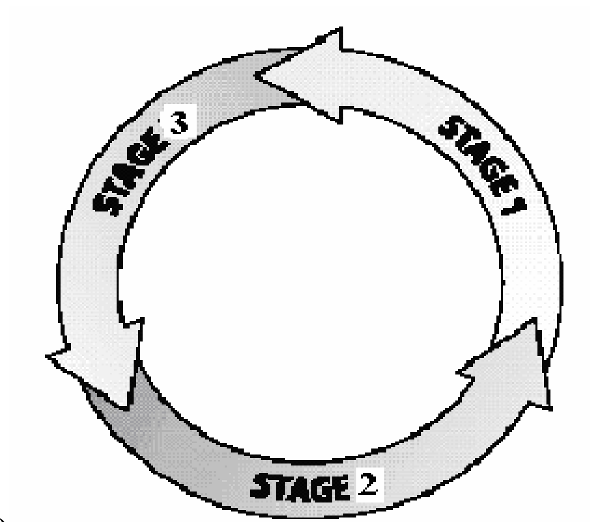
1 Wheel of Retailing.
2 Retail life cycles.
3 Retail Accordions.

1. **The wheel of retailing**

This early hypothesis (McNair, 1958) attempted to explain the evolution of retail institutions as a wheel-like progression of three phases, as illustrated in Figure1.

Wheel of retailing the theory that new retailers often enter the market-place with low prices, margins and status, and eventually emerge at the high end of the price/cost/services scales, competing with newer discount retailers. According to this theory, retail organizations enter the market with a low-cost, low-price, low-service format, using opportunistic buying and basic premises to undercut established competitors and establish them in the market. For those which succeed, there is a tendency over time to add product lines, upgrade stores and add services, which will tend to increase price levels for the merchandise. In **stage 3**, retail organizations tend to operate at the high end of the market, offering quality merchandise and service at price levels which alienate their original customers, and increase vulnerability to innovative new market entrants.

In **stage 1**, an entrepreneurial, opportunistic management style can lead to success, whether the organization be completely new to the market, or a new format brought on-stream by an existing organization. As the organization/format grows, management strength is needed in terms of leadership and organization of the growing number of staff and units. Even organizations as resolutely embedded in stage one as
Value retailers LIDL and IKEA have found it difficult to resist widening their merchandise range or adding services such as delivery. **Stage 2** is also called “*trading up*” .Retailers wishing up to expand their business and attract more customers, enhance their quantity and quality of merchandise handled, provide more services, and open outlets in more in convenient locations .This leads to an increase in operating costs and prices thus offers opportunities to new competitors to enter the market with low- price strategies.



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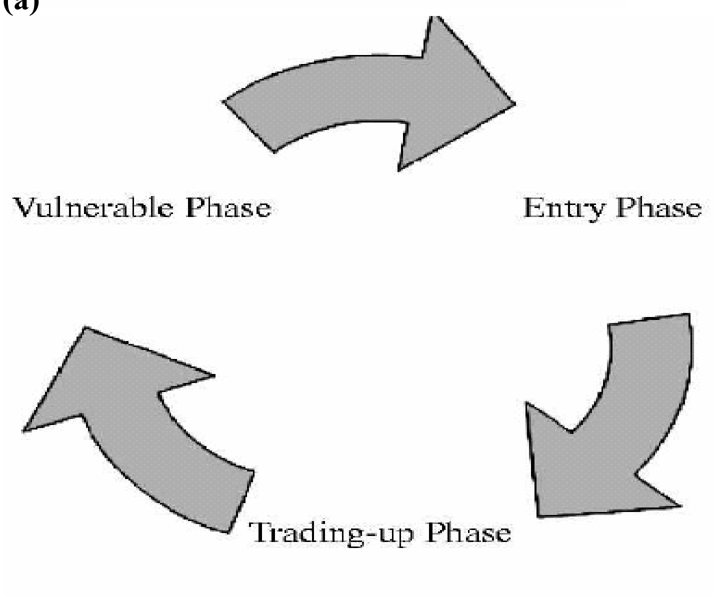


(b)
Fig 1. 6 The Wheel of Retailing

2. **Retail life cycle**

This second cyclical theory of retailing, in common with demographic and product life cycle theories, assumes that all retail organizations have a finite lifespan, during which they go through four phases of development:

_ Innovation.
_ Growth.
_ Maturity.
_ Decline.

The theory assumes that retail organizations and retail formats will move through all four phases. The time dwelt within each phase will, however, vary widely, as will the total lifespan of the organization or format.

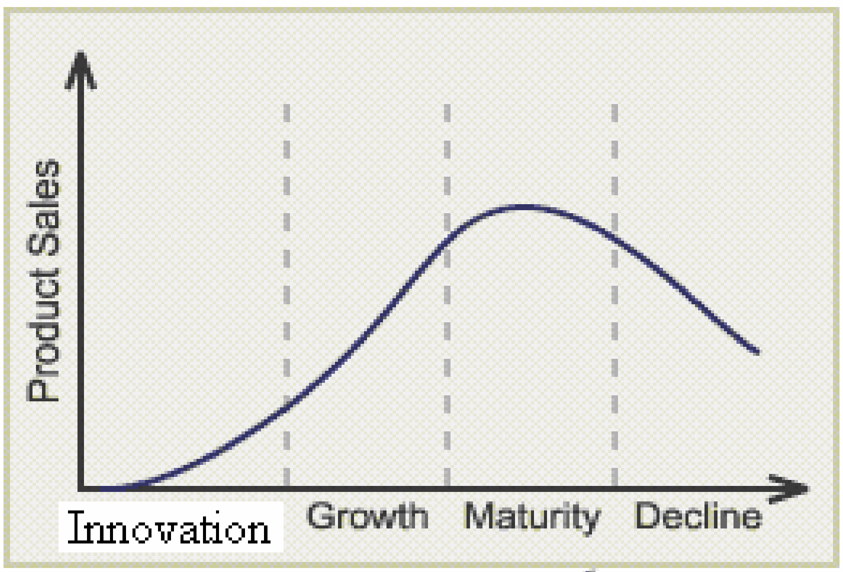


Fig 1.7

A new retail format will spend a short time, only a few years, in the innovation stage of the life cycle. Non-successful innovators will not enter the next phase, while successful innovators can take advantage of a lack of direct competitors to grow sales rapidly and develop retail unit numbers, entering the growth phase. Profits during this phase are low or non-existent due to investment in creation, infrastructure, expansion and promotion of the format. For example, Tesco.com planned for loss during its first few years of existence, investing in a national infrastructure for the online format. During format growth the number of units is expanded rapidly, often with strong centralized planning and control. Both sales and profitability growth should follow. Investment levels will remain high, both due to the high cost of expansion, and due to the cost of developing a prime market position because during this phase, the number of competitors will also grow. The retail majors, often innovators in their own right, are also quick to exploit successful ideas. For example, when the hard discount box stores began to expand rapidly in the UK during the 1980s, the grocery retail majors successfully introduced basic retailer brands at discount prices alongside their normal merchandise. The growth phase normally lasts for several years before the format is established, or mature. Maturity, on the other hand, will last indefinitely as long as the retailer is customer and competition orientated. A mature retail format will have many direct competitors and the rate of sales growth slows together with the level of profitability. In public limited companies, the delivery of continued growth to shareholders will drive growth of the format in untapped markets, through organic expansion, or through acquisition and merger activity, or the development of new, innovative activities. The maturity of some of the UK grocery majors has driven expansion in areas of the UK with development potential such as Scotland and Ireland, and in international markets, as well as investment in town centre and forecourt formats.

The decline phase, when sales growth becomes negative and profitability is very low, can also last indefinitely. The declining format will have fewer direct competitors and more indirect competitors in the growth and maturity phases of the life cycle. Organizations with declining formats require active search and investment in format innovation or acquisition/merger with organizations delivering formats in the innovation, growth or maturity phases of the cycle.

3. **Retail Accordion**

The third cyclical theory is the retail accordion, which relates retail development over time to merchandise range. This theory (However, 1943) noted that there was a tendency for retail organizations to move alternately towards specialization and diversification over time. This US-based theory is rooted in its historical pattern of retail development. The earliest stores were general stores delivering a wide merchandise range, with narrow depth of category to small, dispersed communities. As urban areas grew, they could support specialty retailers with limited product assortment but depth of category, such as shoe stores, drugstores and clothing stores. The next expansion of the accordion brought the development of department stores offering a wide merchandise range and depth of category. The latest contraction of the accordion during the 1980s and 1990s brought more concentration of merchandise range in niche retailers such as Tie Rack and category killers such as Toys 'R' Us.

It is debatable whether this theory can be applied to future development of the retail industry. Certainly, the growth of scrambled merchandising among dominant grocery retailers, particularly in hypermarkets, is developing simultaneously with restricted line formats delivered to drivers, city centre workers or home workers.

Nevertheless, it is evident at organizational level, in, for example, the expansion and retraction of store formats in Next and Arcadia during the 1980s and 1990s. It is also possible that the growth of formats in Organizations such as Toys 'R' Us, which expanded into Babies 'R' Us, Kids 'R' Us, Imaginarium and Toysrus.com, may at some future point be followed by organizational rationalization.

1.5.2 Environmental Theories

Environmental theories are concerned with the interplay between the external environment and organizational environment. The various influences of the external environment – political, legal, socio-cultural and demographic, economic and technological – on retailers change over time. Conditions can change slowly or rapidly, and only those organizations which can adapt to change and take advantage of the opportunities offered by the environment will grow, develop and thrive. A range of examples supports environmental theories. Department stores would not have existed but for developing urban neither spaces, nor would out-of-town shopping centers but for the development of the road network, suburbanization and growth of car ownership. An Organization's movement through innovation and growth to maturity depends upon successful response to changing environmental conditions.

There are two dominant environmental theories of retail change:
1 Evolution theory.
2 Institutional theory.

1. Evolution theory

The theory of retail evolution is, naturally, linked to the theory of evolution observed by Charles Darwin in the nineteenth century, the process of natural selection in which the survival of organisms is based on their ability to adapt to changing conditions. In retailing, organizations which successfully adapt to changes in the external environment are those most likely to thrive.

Davies (1998) discusses evolution theory in the context of environmental 'design spaces' which offer opportunities and threats for the retail organizations operating within them. The viability or otherwise of the 'design space' is related to:

- The size and distribution of the population;
- The need structure for goods, which is related to demographic variables such as family size and income;
- Regional income and income distribution;
- Technology;
- Government regulation;
- Social visibility of the design space.

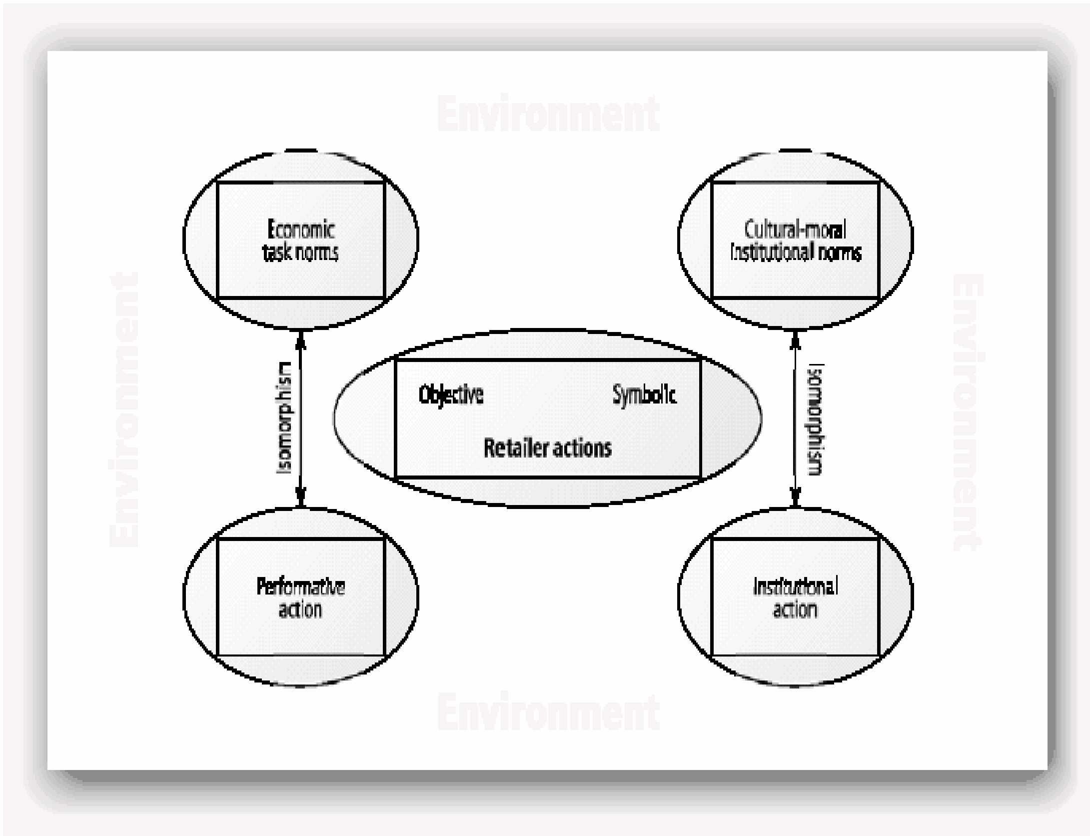
According to this 'ecological' theory, changes in the environment will cause retail change, and therefore the structure of retailing at any point in time is the result of all previous retail management decisions, together with the political, social, economic and technological environment within which retailers operate.

2. Institutional theory

Institutional theory recognizes that the organization is an organic part of its environment and that there is a degree of interdependency between them. According to this theory, the decisions and actions of a retail organization reflect the economic and cultural norms of the environment in which it exists. These norms exist at task and institutional levels.

At task level, the organization responds to its environment through actions aimed at retail performance – from a customer perspective, these are linked to retail performance-related decisions on, for example, merchandise assortment, pricing strategy, inventory and location.

At institutional level, the retailer's actions are constrained or framed according to cultural and moral norms which will influence both the internal culture of the organization and its perceived role in the society in which it exists. For example, customers may expect it to employ and promote local talent, be active in the community, and sell local products along with those which are sourced nationally or internationally.



Economic Task Norms: the economic environment in which the organization operates and within which it frames its performance objectives and actions.
Cultural-moral Institutional Norms: the organization's stakeholders create an institutional environment with cultural and moral requirements which reflect the norms of social conduct in the external socio-cultural environment.
Performative Action: performance levels and actions taken by the organization, e.g. pricing strategy, merchandising decisions.
Institutional Action: non-performance actions taken by the organization, e.g. community involvement, environmental policies.
Symbolic Actions: use of symbols such as slogans, signs and promotional literature which relate the organization's actions to its social and economic environment.
Objective Actions: actions taken to compete successfully within the economic task environment.

Fig 1.8 Institutional / environmental interaction. Source: adapted from Arnold et al.(2001).

1.5.3 Conflict Theory

Conflict theory addresses what happens when a new innovation or format challenges the status quo in a retail sector. As retail organizations adapt to each other in the competitive marketplace, new and different forms of retailing develop. This continual shift in operating forms is derived from a dialectic process which consists of action–reaction– Synthesis. As an innovator successfully enters the market through some competitive advantage (action), existing organizations will take actions designed to minimize that competitive advantage (reaction), which eventually lead to a modification of their operating methods. Meanwhile, the innovating organization will also adapt as it becomes established in the market (trading up according to wheel theory). The continual adaptation will bring the two differing types of trading closer and closer together until they are virtually indistinguishable (synthesis) (Maronick and Walker, 1974). The retail organizations which evolve deploy organizational elements (carry the memes according to ultra- Darwinist theory) of both innovative and established formats.

According to conflict theory there are four stages of response to a retail innovation:

1 Shock.
2 Defensive retreats
3 Acknowledgements.
4 Adaptations.

Initially, retailers are hostile to the threat to their established role within the industry and distribution channel. Firm size, re-seller solidarity, organizational rigidity and channel politics can all promote hostility towards the 'interloper'. In phase 2, established retail organizations will ignore or play down the possible effects of the innovation. As the threat of the innovation becomes more sustained and severe, there may be movement to block the progress of the innovation in phase 3, which, if unsuccessful, will give way to the final phase.

1.6 Review questions

1 Who are the world's major retailers?
2 What criteria were used to rank these retailers?
3 Analyze the performance of US retailers compared with those in Asia and Europe
4. Discuss the problems in undertaking such an analysis.
5 Comment upon the UK retail rankings.
6 Discuss the relative performance of the top 10 British retailers
7. Outline the key data sources for analyzing retail trends in the UK and discuss some of the problems encountered in monitoring these trends over time.

CHANGING PARADIGM OF RETAIL IN INDIA

Structure

2.1 INTRODUCTION

By the turn of the 21st century, the face of the Indian retailing industry had changed significantly. The retailing industry, which, until the early 1990's was dominated by the unorganized sector, witnessed a rapid growth in the organized sector with the entry of corporate groups such as Reliance, Tata, RPG, ITC and Bennett, Coleman & Company into the retailing market.

According to analysts, the retail industry in India is all set for the most exciting According to analysts; the retail industry in India is all set for the most exciting phase in the 21st century. Reportedly in 2004 alone about 12million sq feet space was occupied by the organized retail industry, and by the end of 2006 is expected to grow to 40 million sq feet. The overall size of the retail market in India at present is estimated at 5,88,000 crore of which, unorganized market is worth Rs 5,83,000 crore and the share of organized market is calculated at Rs. 35000 crore, and it will create 50000 jobs a year in the next 5 years.

The organized retail sector is expected to grow at a higher rate than GDP growth in the next five years driven by changing lifestyles, strong income growth and favorable demographic patterns, says KPMG report titled 'Consumer Market in India'. The structure of retailing is developing rapidly with Shopping Malls becoming increasingly common in large cities, and development plans being projected at establishing 150 new shopping malls by 2008. According to a survey the annual growth of department stores has been estimated at 24%, which is faster than overall retail, and supermarket have taken an increased share of general food and grocery trade over last two decades. The food and beverages segment is an emerging growth area. Similarly the gems and jewellery market is a key emerging area with significant potential. While Indians continue to shop with unbranded jewellery stores, the organized sector is offering branded solutions to the demand for quality and value, as consumers move away form traditional retail settings reliant on family retailers. Gemstones and jewellery represents the most significant segment of Indian retailing, accounting for a high proportion of total retail spent, and also representing a growing global retailing operations as Indian retail chains begin to expand into high value markets in the west Asia, Europe and the US. The emergence of new segments also resulted in new store formats, including hyper marts, large supermarkets (3,000 – 5,000 sq ft), mini supermarkets (1,000 – 2,000 sq ft), convenience stores (750 – 1000 sq ft) and discount/shopping/grocer. The major changes took place in food retailing, book retailing, life style retailing, coffee parlors, vending machines and beauty and health care retailing.

A.T.Kearney has estimated India's retail market at $202.6 billion, which is expected to grow at a compounded 30% over the next five years.

* In 2003-04 organized retailing, which has an annual growth rate of 8.5%, swept past the Rs200 billion mark a figure that appears quite small if one were to compare the extent of the total market.

* Organized retail at present comprises merely 2% of the total market in India.

* The share of modern retail is likely to grow from its current 2% to 15-20 % over the next decade analysts feel.

* Further the number of households earnings moiré than Rs150000 p.a to 30million today and is expected to grow to 80million by 2007.

* Additionally financial institutions are encouraging such ventures. ICICI has recently sanctioned term loans to Vivek & Co a mega retailer in Chennai to meet their expansion plans.

* Very shortly the market will also witness IPO's for some these Retail Ventures.

* No wonder a heavy weight like the reliance group is planning to do a Wal-Mart in India.

In the next couple of years India will see at least two Indian retail businesses attaining the magic figure of Rs1000 crore in sales. Several others are accepted to attain a critical mass as growth in the industry picks up momentum. This will be driven by two key factors:

1) Availability of quality real estate and mall management practices

2) Consumer preference for shopping in new environs.

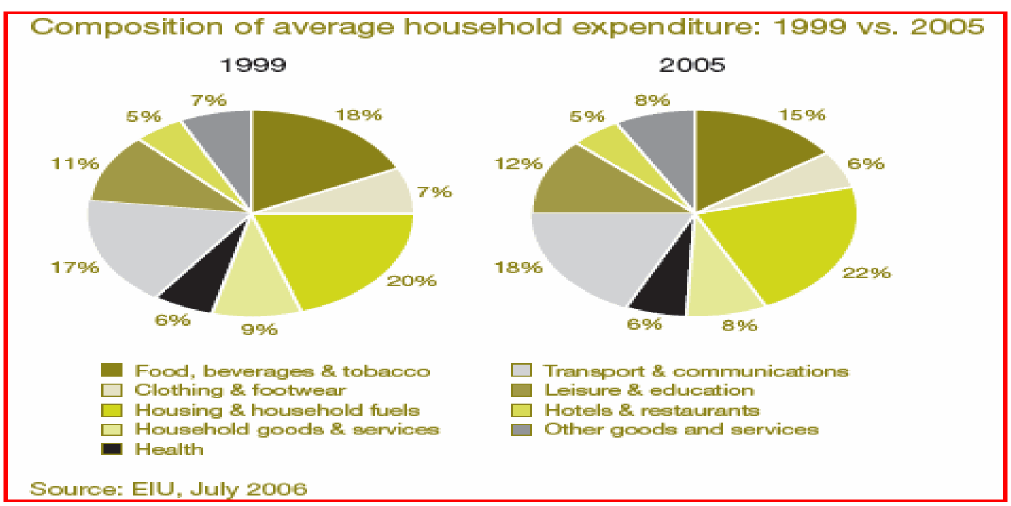


Fig 2.1

2.1.1 Food Retailing Segment:

The **Food World (FW)** supermarket chain has been one of the pioneers in organized food retailing in India. Before FW entered the food retailing market, it carried out an extensive survey in consumer attitude towards retailing. An important finding of the survey was that in terms of overall satisfaction, traditional Indian grocery stores scored 5 – 6 on a 10-point scale. FW believed that this was largely due to the absence of organized retailing and low brand proliferation. The company thus decided to offer people a pleasant shopping experience and work towards making grocery shopping less cumbersome. The main challenge for FW was to alter the existing mindset of Indians with respect to price and value and add excitement to grocery shopping.

On the basis of the above information, FW defined its objective as: "To offer the Indian housewife the freedom to choose from a wide range of products at a convenient location in a clean, bright, and functional ambience without a price penalty."

Initially, the target markets were identified as neighborhoods that had at least 4,000 households with an average monthly income of more than Rs. 4,000. For this kind of customer base, FW needed to start operations in a metropolitan city. Considering the fact that the cost of real estate was low in Southern India, FW chose Chennai, Hyderabad and Bangalore as initial locations for setting up FW stores.

FW adopted a self – service format for its stores, which typically had around 4500 sq ft of selling space. The designing of the stores was given special attention and a uniform look was adopted for all the stores. The colors red and yellow (as used in the FW logo) were used liberally while designing the stores. To give the outlets an up market look, the interiors were kept completely visible to the public by using huge glass panes for the frontage. The interiors were kept brightly lit and emphasis was given to creating a clean, pleasant ambience. All the outlets were air – conditioned and played popular music continuously. All this was done with the objective of providing an enjoyable and refreshing shopping experience to customers. The merchandise primarily comprised groceries, personal care products, kitchenware and tableware. Over the years, this list was expanded to include music, magazines and a few other product categories to cater to a wider customer base. Every item in the store was marked individually with both price and bar codes. Separate payment counters were set up for people planning to pay through credit/debit cards and for people buying only 3 – 5 items. FW also entered into alliances with the fast food major, Pizzas Corner and the satellite radio broadcasting company, World Space. While Pizza Corner sold pizzas from FW outlets. World space displayed and sold its services and products at the stores. Such tie – ups and promotional exercise have become a routine feature for FW.

2.1.2 Retailing of Lifestyle Products segment:

Shopper's Stop Limited (SSL) is the pioneer in India's organized retail revolution. SSL redefined the concept of 'shopping' by making efforts to provide the Indian consumers with an international shopping experience. In 1991, SSL set up its first outlet in Mumbai, Maharashtra, with a floor space of around 4,000 sq ft. Since then, SSL has established its stores in all major cities in India with store space ranging from 18,000 sq ft to 60,000 sq ft.

SSL stores provide a complete and in – depth range of fashion and lifestyle products and accessories to meet the lifestyle pattern of every shopper. Around 85% of SSL's merchandise is branded and it stocks more than 150 national and international brands.

Within a short period, SSL emerged as the largest single retailer for Levis, Pepe, Lee, Arrow, Zodiac, Reebok, Nike, Parker, Ray Ban, Swatch, Chambor, Revlon, Lego, Mattel and many other leading brands. The company closely monitored the movement of all brands, and if any brand failed to meet customer expectations, it was phased out. SSL also launched a range of private labels like Life, Kashish and Karrot in the premium classic, value classic and value fashion segments. A team of designers were recruited from India's premier fashion design institutes to develop private labels.

Earlier, Indian customers were used to shopping for their apparel and accessories at various shops (as no shops offered all the products at one place), which paid little or no attention to the ambience or the comfort of their customers. SSL, apart from offering a complete range of garments and accessories, included central air – conditioning, impeccably maintained trial rooms, beautiful rest rooms, play area for children, large car parking, in – store café, and other services such as alterations, goods exchanged without any questions and gift wrapping.

As a part of differentiating its product offerings from that of other major lifestyle stores such as Life Style and Globus, SSL also began conducting many events and promotion campaigns to combine entertainment with shopping. These included the 101 – day Seven Wonders of the World Festival, Surprise Sale, Salon Streets, and Men in Vogue, Great Store Robbery, Campus Stoppers and Valentine Promotion. One of the major events offered by SSL, which attracts hoards of customers, is *Parikrama* a crafts fare aimed at showcasing he diverse ethnic arts and traditions in India.

2.1.3 Coffee Parlors

Barista and Café Coffee Day:

Being a traditional tea consuming country, the average coffee consumption in India was quite low at 10 cups per person annually. However, in the late 1990s, a silent coffee revolution was sweeping urban India. Coffee drinking was increasingly becoming a statement of the young and upwardly mobile Indians. Coffee bars, an unheard concept till the mid 1990s had become big business.

There was a transition from the conventional and outdated coffee house to more sophisticated and trendy coffee bar chains like Barista, Café Coffee Day, Qwiky's and Café Nescafe. By the turn of 20th century, nontraditional coffee retailing outlets like coffee bar chains, coffee vending machines and specialty coffee powder shops succeeded in making coffee one of the most desirable beverages in urban India. The coffee parlors were an instant hit across all major metros and cities in India, as they offered an entirely new experience to customers.

Barista entered the Indian coffee retailing market in 2000 and decided to position itself as a lifestyle brand. The company targeted the premium segment youth, as it realized that it wasn't only coffee that its target segment was looking form, but also for a place to hang around comfortably, where they could be themselves and do whatever they wanted, such as reading a book, writing a letter, or simply chilling out. Hence, it recreated the ambience and experience of the typical Italian neighborhood espresso bars in India, with bright, trendy and comfortable interiors. It promoted a social and interactive environment, where one can play games like chess and scrabble, read books, listen to music, enjoy arts, surf the Net and sip an Espresso Italiano, or Iced Café Mocha. Fun posters, message boards and TV screens with music videos, all set the right mood. An open kitchen behind the bar enables one to watch the coffee actually being made.

To ensure superior quality of its product offerings, Barista used only top grade Arabica beans to make coffee and also invited brew masters from Italy to create new blends. The employee orientation program at Barista specially focused on enabling the team to understand and avoid the attitudes and behaviors in traditional restaurants that restrain customer from being himself/herself.

Since 2002, as a part of differentiating its services, Barista began offering Italian food at its outlets and also entered into tie – ups with Planet M, Crossword and Ebony to set up Espresso Corners at these places. During this period, to expand the reach of its services, the company also opened outlets in banks (ABN – Amro), movie theaters (PVR in Delhi), offices (HSBC and GE), airports and in hotels.

2.1.4 Vending Machines

Nescafe, Cadbury E-Cuba and Tata Tea:

Nestle popularized the coffee kiosk concept in India, where it offered coffee through its vending machines. Nestle installed hundreds of Nescafe kiosks at places such as shopping malls, cinema halls, food centers and office buildings. Its vending machines came in different sizes and styles to match the needs of consumers at different locations. For instance Nestlé's high capacity multitask vending machines provided snacks, drinks and confectionery items. The kiosk model enabled consumers to have hot coffee instantly, whether they were shopping or at office, just by the click of buttons. Most offices buy the Nescafe vending machines to provide their employees with free coffee.

Cadbury India, with the help of telecommunications companies – BPL Mobile and E-Cuba India, launched chocolate vending machine operated by mobile handsets in select corporate and congregation points in Mumbai.

Since 2002 the concept of vending machines to retail has picked up momentum in India. The Tata were the first in India to establish vending machines for tea, followed by HLL 'Taj Mahal' and Lipton vending machines and coca-cola international tea brand 'Georgia'vending machines. These vending machines were placed at many strategic places such as airports, railways stations, shopping malls and complexes, restaurants and food outlets.

2.1.5 Beauty and Healthcare retailing segment:

The **Shahnaz Hussian group** founded and led by Shahnaz Hussian has been one of the pioneers of organized beauty care retailing in India. The group offers exclusive salon treatment geared to individual needs as well as a number of commercial formulations for the treatment of specific problems like acne, pimples, pigmentation, dehydration, apopecia etc., it employs about 4200 people in 650 salons spread across 104 countries with a strong presence in Asia, US and the Middle east.

The group formulates and markets over 400 products for all age groups and for a variety of beauty and health problems or needs. The group sophisticated R&D units develop the products and put them through stringent quality control tests. These products are environment friendly and no testing is done on animals. All the products offered by the group are entirely natural and carry the guarantee of purity and safety.

2.2 Retailing in India: Trends and opportunities

Retailing - no marks for guessing this is the most active and attractive sector of the last decade. While the retailing industry itself has been present through history in our country, it is only the recent past that has witnessed so much dynamism. It's the latest bandwagon that has witnessed hordes of players leaping onto it. While international retail store chains have caught the fancy of many travelers abroad, the action was missing from the Indian business scene, at least till recently.

The emergence of retailing in India has more to do with the increasing purchasing power of buyers, specially post- liberalization, increase in product variety, and the increasing economies of scale, with the aid of modern supply and distribution management solutions. A definition of retailing is essential in order to be in a position to assess the impact of retailing and its future potential. The current retailing revolution has been provided an impetus from multiple sources. These `revolutionaries' include many conventional stores upgrading themselves to modern retailing, companies in competitive environments entering the market directly to ensure exclusive visibility for their products and professional chain stores coming up to meet the need of the manufacturers who do not fall into either of the above categories. Attractiveness, accessibility and affordability seem to be the key offerings of the retailing chain

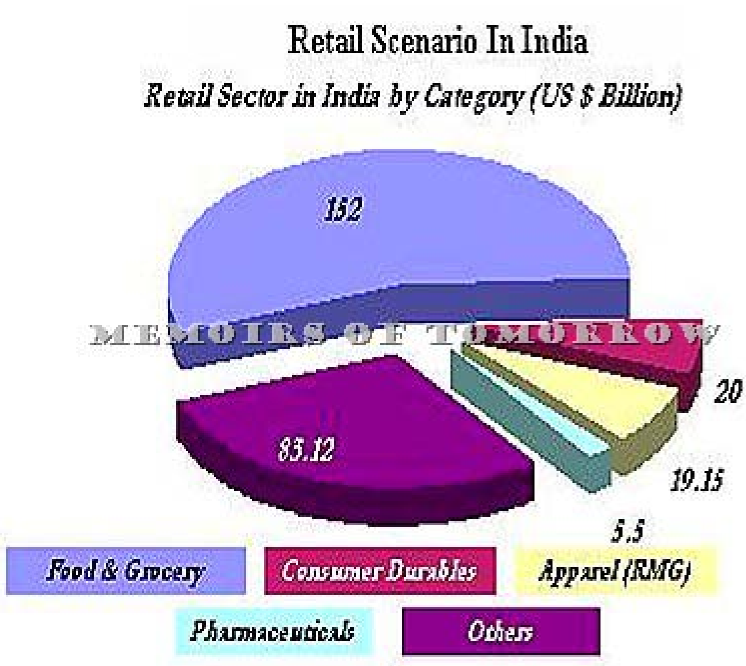


Fig 2.2

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2.2.1 The emerging sectors

Retailing, one of the largest sectors in the global economy, is going through a transition phase not only in India but the world over. For a long time, the corner grocery store was the only choice available to the consumer, especially in the urban areas. This is slowly giving way to international formats of retailing. The traditional food and grocery segment has seen the emergence of supermarkets/grocery chains (Food World, Nilgiris, and Apna Bazaar), convenience stores (ConveniO, HP Speedmart) and fast-food chains (McDonalds, Dominos).

It is the non-food segment; however that foray has been made into a variety of new sectors. These include lifestyle/fashion segments (Shoppers' Stop, Globus, Lifestyle, Westside), apparel/accessories (Pantaloon, Levis, Reebok), books/music/gifts (Archies, MusicWorld, Crosswords, Landmark), appliances and consumer durables (Viveks, Jainsons, Vasant & Co.), drugs and pharmacy (Health and Glow, Apollo).

The emergence of new sectors has been accompanied by changes in existing formats as well as the beginning of new formats:

- Hyper marts:
- Large supermarkets, typically 3,500-5,000 sq. ft.
- Mini supermarkets, typically 1,000-2,000 sq. ft.
- Convenience stores, typically 750-1,000sq. ft.
- Discount/shopping list grocer

The traditional grocers, by introducing self-service formats as well as value-added services such as credit and home delivery, have tried to redefine themselves. However, the boom in retailing has been confined primarily to the urban markets in the country. Even there, large chunks are yet to feel the impact of organized retailing. There are two primary reasons for this. First, the modern retailer is yet to feel the saturation' effect in the urban market and has, therefore, probably not looked at the other markets as seriously. Second, the modern retailing trend, despite its cost-effectiveness, has come to be identified with lifestyles.

In order to appeal to all classes of the society, retail stores would have to identify with different lifestyles. In a sense, this trend is already visible with the emergence of stores with an essentially `value for money' image. The attractiveness of the other stores actually appeals to the existing affluent class as well as those who aspire for to be part of this class. Hence, one can assume that the retailing revolution is emerging along the lines of the economic evolution of society.

2.2.2 Spread of organized retailing:

Organized retailing is spreading and making its presence felt in different parts of the country. The trend in grocery retailing, however, has been slightly different with a growth concentration in the South.

However, the Mecca of retailing is undoubtedly Chennai. What was considered a `traditional', conservative' and `cost-conscious' market, proved to be the home ground for most of the successful retail names - Food World, Music World, Health and Glow, Vitan, Subhiksha and Viveks -to name a few.

The choice of Chennai as the `retail capital' has surprised many, but a variety of factors acted in its favour. Chennai, in spite of being a rapidly growing metropolis offers reasonable real estate prices, one of the most critical elements for the industry. Chennai has been witnessing a high industrial growth and increasing presence of the MNCs, both in the IT sector as well as outside it. The industrial boom has led to the emergence of new residential areas with aggregation of professionals as well as a rapid increase in the number of `double-income' households and growth of the nouveau riche/upper middle class with increased purchasing power. This has been combined with the increasing need for touch and feels shopping (especially for the large migrant population). All the factors have acted favorably in nurturing the industry.

2.2.3 Consumer- the prime mover

A variety of factors seem to influence the growth in the retailing industry. `Consumer Pull', however, seems to be the most important driving factor behind the sustenance of the industry.

In this context***, A. F. Ferguson & Co.*** had carried out a brief survey among consumers across income segments to understand their spending pattern. An analysis of the `monthly purchase basket of the consumers surveyed indicated that the average monthly household spends on food and grocery related items varied across income segments. For instance, in the case of upper income households, the average spend was around Rs4,200 per month. As against this, the average spend in the case of a middle income household was around Rs2, 850 and lower income households Rs1,250 per month. (This is computed from a sample of 100 customers having an average family size of four.)

Based on the distribution of the more than 15 lakh households in Chennai across income segments and the average spend, a conservative estimate of the grocery retailing potential at Chennai will be around Rs.300 crores.

Besides increasing purchasing power, a variety of other factors also seem to fuel the retailing boom. With increase in double-income households and working women, there is an increasing pressure on time with very little time being available for leisure. In this scenario, consumers are seeking the convenience of one-stop shopping, whereby they could have better utility of time. They are also seeking speed and efficiency in processing, as a result. Being more aware, consumers are on the look-out for more information, better quality and hygiene as well as increased customer service. These changes in consumer behavior also augur well for the retailing industry.

However, in India there are no uniform trends with respect to consumer buying behavior. There are visible differences in the shopping pattern of consumers across income segments as shown in the table.

Organized retailing has definitely made headway in the upper class. However, even in this segment, items such as milk, fruits, vegetables and a significant portion of `through-the-month' purchases seem to be done at traditional outlets. The middle income class prefers shopping for processed food and personal care in supermarkets and fall back on traditional outlets for bulk shopping. Organized retail outlets seem to be associated with branded items/special purchases. Organized retailing does not seem to have made an impact on the lower class, except for `curiosity' shopping.

The biggest question before organized retailers therefore, is whether this really means a huge untapped potential for the organized retailers and whether the conversion in mindset going to be easy.

2.2.4 Emerging trends

The single most important evolution that took place along with the retailing revolution was the rise and fall of the dotcom companies. A sudden concept of `non-store' shopping emerged, which threatened to take away the potential of the store. More importantly, the very nature of the customer segment being addressed was almost the same. The computer-savvy individual was also a sub-segment of the `store' frequenting traffic.

Internationally, the concept of Net shopping is yet to be proven. And the poor financial performance of most of the companies offering virtual shopping has resulted in store-based retailing regaining the upper hand. Other forms of non-store shopping including various formats such as catalogue/mail order shopping, direct selling, and so on are growing rapidly. However, the size of the direct market industry is too limited to deter the retailers. For all the convenience that it offers, electronic retailing does not suit products where `look and see' attributes are of importance, as in apparel, or where the value is very high, such as jewellery, or where the performance has to be tested, as of consumer durables. The most critical issue in electronic retailing, especially in a country such as ours, relates to payments and the various security issues involved.

2.2.5 Retail management skills

It is a fact that the retailing industry is in its starting phase in our country. The benefits of organized retailing will only be felt once an equitable scale is achieved. This to a large extent depends on the store size, the walkthroughs, and bills per customer per year, average bill size and the revenue earned per sq. ft. But besides resources and bottom-line, a variety of other aspects need to be in place for tasting success. The need for qualified and trained manpower is of utmost importance. The need for specialized skills is increasingly felt in the areas of:

- Strategic management - strategizing, targeting and positioning, marketing and site selection, among others
- Merchandise management - Vendor selection, inventory management, pricing and so on
- Store management - Layout, display, customer relationship, inventory management, etc.
- Administrative Management - Human resources, finance, marketing and so on

With the need for specialized skill set, retailing has become a specialized area of knowledge and training. The RPG School of Retailing and the introduction of specialized retailing courses at various business schools, including the IIMs, stand testimony to this.

2.2.6 Technology impact

The other important aspect of retailing relates to technology. It is widely felt that the key differentiator between the successful and not so successful retailers is primarily in the area of technology. Simultaneously, it will be technology that will help the organized retailer score over the unorganized players, giving both cost and service advantages.

Retailing is a `technology-intensive' industry. It is quoted that everyday at least 500 gigabytes of data are transmitted via satellite from the 1,200 point-of-sales counters of JC Penney to its corporate headquarters. Successful retailers today work closely with their vendors to predict consumer demand, shorten lead times, reduce inventory holding and thereby, save cost. Wal-Mart pioneered the concept of building a competitive advantage through distribution and information systems in the retailing industry. They introduced two innovative logistics techniques - cross-docking and electronic data interchange.

Today, online systems link point-of-sales terminals to the main office where detailed analyses on sales by item, classification, stores or vendor are carried out online. Besides vendors, the focus of the retailing sector is to develop the link with the consumer. `Data Warehousing' is an established concept in the advanced nations. With the help of `database retailing', information on existing and potential customers is tracked. Besides knowing what was purchased and by whom, information on softer issues such as demographics and psychographics is captured.

Retailing, as discussed before, is at a nascent stage in our country. Most organized players have managed to put the front ends in place, but these are relatively easy to copy. The relatively complicated information systems and underlying technologies are in the process of being established. Most grocery retailers such as Food World have started tracking consumer purchases through CRM. The lifestyle retailers through their `affinity clubs' and `reward clubs' are establishing their processes. The traditional retailers will always continue to exist but organized retailers are working towards revamping their business to obtain strategic advantages at various levels - market, cost, knowledge and customer.

With differentiating strategies - value for money, shopping experience, variety, quality, discounts and advanced systems and technology in the back-end, change in the equilibrium with manufacturers and a thorough understanding of the consumer behavior, the ground is all set for the organized retailers. The bottom-line could look brighter, after all!

It would be important to note, however, that the retailing industry in India is still a `protected industry'. It is one of the few sectors which still have restrictions on FDI. Given the current trend in liberalization, it will not be long before the retailing sector is also thrown open to international competition. This will see a further segregation of the international retailing brands and the domestic retailers, thereby injecting much greater dynamism into the market. That will be when the real action will begin. In the second article on retailing, we uncover a model for retailers to handle the emerging scenario.

2.3 Traditional Retail Formats

Traditional retail formats refer to those formats that have long been part of the retail landscape of India. They include formats like kirana and independent stores that are typical of the unorganized retail sector across product categories and also the most administratively organized form of Indian retailing-co-operatives and government-controlled retail institutions (like the public distribution system and cottage emporiums). In terms of professional management and efficiency of integration with the value chain, the traditional retail formats are better classified under the unorganized retail sector.
There are predominantly two types of traditional retail formats, namely:

- Kirana and independent stores
- Co-operative and government-owned stores

Independent and kirana stores have emerged with the spread and density of population. Historically, they are traced to the generation of surplus in agriculture that needed to be sold to obtain other essential commodities by the producer. This was accompanied by the emergence of a trading class in India.

Co-operative stores in India are the result of the co-operative movement that can be traced to the pre-independence period. They emerged as a reaction to the feudal system and attempted to place the fruits of labour in the hands of the producer himself to make him self-reliant. The co-operative movement was strengthened after independence; yet it was largely successful in western India. Government-owned and/or-operated stores emerged after independence because of their increased role in business and their responsibility towards the socio-economically weaker sections of the society, and for preservation of handicrafts, promotion of tourism. ensuring fair prices, and distribution of essential items. In the sections that follow, the above formats are discussed in detail

2.3.1 Kirana and Independent Stores

Generally, the *kirana,* mom-and-pop, and family-owned retail stores represent the retail business in India. These are usually shops with a very small area, stocking a limited range of products, varying from region to region according to the needs of the clientele or the whims of the owners.
About 78% of these retail stores are small family-owned businesses utilizing only household labour. Even among the retail enterprises that employ hired workers, the bulk of them use less than three workers. According to ORG-MARG, a small retailer is defined as one with an average turnover between Rs 17,500 and Rs 52,500 per annum.

These are low-cost structures, mostly owner-operated, have negligible real estate and labour costs, and little or no taxes to pay. Consumer familiarity that runs from generation to generation is one big advantage enjoyed by the traditional retailing sector. The retailer to consumer ratio is very low with many such shops often located close to people's residence thus making location and convenience a major factor for their popularity. However, the retailer offers credit facilities depending on the size of his business and seeming credibility of his customer.

Branding is not the key decision criteria for a majority of customers at the traditional retail outlets, particularly in the small townships and rural India. Traditional retailer's play a significant role in the purchase decision, influencing both the product and the brand perception.

Conventionally, retailers source the merchandise from wholesalers and sell it to end-users. Manufacturers distribute goods through carrying and forwarding agents to distributors and wholesalers. The merchandise price gets inflated to a great extent by the time it reaches from the manufacturer to the end-user. The new wave of competition has had a healthy effect on traditional retailers. Many are trying to introduce self-service formats, attractive atmospherics, services such as home delivery, and even telephone-based order delivery. Many experts have referred to this as the 'boom in retailing'. However, there are three aspects of boom in retailing in India:

(a) The emergence of newer, specialized, and bigger retail formats in urban India with greater focus on 'experiential' aspects of shopping. This has been prompted by a more demanding consumer, higher disposable incomes, entry of foreign brands in the Indian market, and entry of Indian business houses in the retail sector.
(b) Deeper and wider penetration of retail network in rural India prompted by greater recognition of the potential of rural markets especially in the FMCG and consumer durables sector.
(c) Redesigning the retail mix by the traditional retailers as a sign of greater maturity of the sector and also the rub-off effect of the developments in the organized sector.

The Indian retail sector has traditionally been structured around three small retail entities-the grocer, the general store, and the chemist. The grocer stocks non-packaged, unbranded/generic commodities such as rice, flour, pulses, salt, etc. The grocery stores located in neighborhood centers or central business districts also sell branded and packaged fast moving consumer goods (FMCG's).

The general store stocks only branded and packaged FMCG's. These are generally located prominently in the neighborhood centers and residential areas. The chemist, apart from dispensing pharmaceutical products, sells branded FMCG's such as personal care products and health foods. Alongside the three retail outfits, exist a large segment of smaller, unorganized players-paan-beedi stores which stock products in sachets, batteries, confectionery, and soaps; bakeries and confectioners; fruit juice/tea stalls; ice-cream parlors; electrical, furniture, and hardware stores; and non-food boutiques. There are a large number of hawkers, carts, and stalls within the main markets or "localities and street corners, and many door-to-door sellers such as vegetable vendors.

The small independent retailers in India play a crucial role in the entire value chain. Their importance has been well acknowledged among the marketers and the customers. This is primarily because of the increase in stock keeping units (SKUs) over the past years. According to ORG-MARG's retail audit, in 1996, the number of packs more than doubled in the 57 core FMCG categories such as white toothpaste, detergent powder, and cold cream.

That apart, there have been 19 new FMCG categories (between 1990 and 1996) like branded atta, ant ageing creams, and dishwashing pastes that have introduced 1378 brands and 2579 SKUs brands and 2579 SKUs at the retail counter. This SKU proliferation ahs caused intense pressure on shell space. Marketers, therefore, have been forced to seek width in distribution rather than depth. So,

Importance of Unorganized Retail Sector in the Value Chain

The war for cigarette marketing has been reduced to a three by two feet space retail outlet. That is the size of the board on which cigarette makers an advertise at retail outlets. With the advertising ban now in effect, cigarette makers. Cigarette makers like god Frey Philips India (GPI) are rushing to forge exclusivity contracts with cigarette shops for better display of their products and fliers Market leader ITC says it already has exclusivity arrangements and will work within this before it can come up with something new and innovative later. More goodwill strategies include both GPI and ITC shipping display boards to retailers, which say that cigarettes will not be sold to people under 18.

For starters, 'Cigarettes will not be sold to persons below 18 years of age, and the panwadis who violate this will be prosecuted' (in Hindi). Now that would seem like just a clause from the Tobacco Bill. It is actually part of the point of sale (PoS) material that cigarette companies like GPI are shipping out to retail outlets as a goodwill gesture. Though the Bill says that retailers are required to carry these statutory signs. It does not say that cigarette companies are required to supply these to retailers. GPI is supplying over four lakh retail outlets with the warning sign – the beginning of the retailer's new exalted status. GPI senior vice-president (corporate affairs) says the signs are 'to help retailers comply with the new government directives which require them to display such as sign.' ITC senior executive vice president says, 'We will supply such boards to our retailers. We will also advise them on these signs and help in translating exactly as per the government directive, so that they are not harassed.' According to the government directive cigarette companies are allowed to have two boards advertising their products at retail outlets and merchandising racks.

Considering that cigarette shops are the only place now left where cigarette companies can advertise their products, the fight for space has narrowed down considerably. ITC and Godfrey Philips were the major point of sale advertisers even before the advertising ban came into effect.

GPI will also forge exclusivity contracts with retailers across the country for better display of its products and publicity boards than others. 'The retailer is now absolute king,' KSA Technopak chairman says. 'Cigarette retailers tend to gain from other means of brand promotion – glow signs, cigarette shelves and even empty cartons supplied by cigarette companies.' Source: Shiv Aroor & Sangeeta Singh, 2004, Market Dynamics: Cigarette Retailer as the New King', the financial Express, Net Edition May-04

Independent Neighborhood Stores for FMCG Products

The concept of independent neighborhood stores for FMCG products has survived and thrived due to plenty of factors such as:

- **Locational convenience**

These stores are normally located in geographical proximity to consumer's home or workplace making shopping convenient. Locational convenience of retail formats becomes very important in the Indian context because of the following reasons.

- Indians lack storage space at home and therefore makes frequent trips to nearby retailers.
- Indian consumers prefer fresh grocery rather than keeping bulk and use stale ones.
- Indian has low motorized vehicle penetration levels (48.5% in 1995-96) in comparison to bicycle. Therefore, people prefer to buy from a nearby store rather than spending on public transport to buy from the main market.

- **Value added services**

Small independent stores provide a lot of complementary service along with core offerings such as credit facility, home delivery, returns and adjustments, etc. some retailers are well aware of the preferences of consumers and even advise them on the selection of product or brand.

- **Cost involved**

These conventional retail units require very low investments initially, as most are owned by retailers or are protected tenants. These units have limited running expenses as family members provide their services to manage day to day operations.

- **Importance in value chain**

These stores have been acknowledged as the most important retail format in the value chain of FMCG companies. These outlets are used extensively not only to dispense products but also to stimulate demand. Therefore, companies generally provide POP material, banners, and refrigerators, and manage the display of their offerings effectively *Source: The Indian FMCG Sector 2002, ICRA*

Supply chain integration does not quite matter in the case of small retailer because of the small scale of his operations. Retailers normally prefer to deal directly with wholesalers with whom they are able to negotiate rates and payment terms.

Retail consolidation (consolidation of buying power) among supermarket/ hypermarket/ chain stores operators is unlikely to hurt the interest of small retailers simply because it is likely to affect manufacturers/ suppliers directly, who do not want to compromise on the retail penetration against few large volumes to a few big retailers. Small retailers are patronized by customers on account of low prices and services they offer.

Small retailers provide a wide variety of facilities to their customers, such as telephone order, credit facilities, home delivery, customization on account of offerings and packaging and specific products procured on order (in case of stock outs). More importantly, they are available next door to offer personalized service. In this way, they are able to develop a strong relationship with this customer, who, over a period of time, becomes extremely loyal.

2.3.2 Cooperatives and Government Bodies

India has a large number of retail stores run by cooperative societies and government bodies across product categories. Such initiatives were taken for various socio- economic factors, primarily, to promote industries and generate employment opportunities in rural areas.

The examples of organized retailing format in India are the Super Bazaars and the Kendriya Bhandars along with administered price public distribution system. These stores were among India's earliest endeavors into organized retailing with a user-friendly store format, large variety, and reasonable prices.

However these were characterized by average customer service, bureaucratic timings, and poor upkeep. In a similar manner, cooperative movement in various industries such as dairy products also led to the emergence of organized retail chain in leading cities of India, such as Mother Diary outlets in Delhi and Parag in Lucknow. At the same time, government established retail chains too provide effective marketing infrastructure to small scale industries engaged in handicrafts and local goods such as KVIC stores in entire India, and state emporiums in the leadings cities.

However, since the 1990s, there has been a reduction in government support for cooperatives. In 2002, there about 35,000 outlets run by cooperatives.

Some of the popular retail institutions that are controlled and managed by the co-operative or government institutions are discussed below.

Some of the popular retail institutions that are controlled and managed by the co-operative or government institutions are discussed below.

2.3.2.1 Mother Dairy, Delhi, and Fruit and Vegetable Project, Delhi

Mother Dairy, Delhi, and the Fruit and Vegetable Project, Delhi, set up by the National Dairy Development Board (NDDB) in 1974 and 1986, respectively, were merged to form Mother Dairy Fruit and Vegetable Limited (MD F & V) in April 2000.

The new company, a wholly owned subsidiary of NDDB, is involved in marketing and distribution of milk, milk, milk products, and horticulture produce. The company's dairy plant handles more than 1.3 million litres of milk daily and undertakes its marketing operations through 636 own milk ships and more than 6,500 retails outlets in and around Delhi. Ice-cream market under the brand name 'Mother Dairy' has a 41% market share in Delhi.

The company markets horticulture produce in fresh, frozen, and processed form under the brand named 'SAFAL' through a chain of 263 own fruit and vegetable shops and more than 20,000 retail outlets in various parts of the country. Fresh produce from the producers is handled at the company's modern processing facility in Delhi with an annual capacity of 120,000 MT.

A state of the art fruit processing plant, a 100% EOU, set up in 1996 at Mumbai, supplies quality products in the international market. The company's unique distribution network bulk vending booths, retail outlets, and mobile units gives it a significant competitive advantage.

2.3.2.2 Safal: Fresh Fruit and Vegetable Outlets

The fruit and vegetables unit of the National Dairy Development Board (NDDB) was set up in 1988 with the objective of ensuring a direct link between the farmers and the consumers. The aim is to ensure that the customer gets the highest quality produce. The processed products of the unit are marketed with the brand name "Safal". The Safal group acts as a link between the farmer and the consumer in the procurement process that benefits both.

The farmers get the most remunerative price and the consumers get the best produce at a reasonable price. A large and ultra modern central distribution facility has been set up to handle fresh and frozen fruits and vegetables. Initial cleaning, grading, and sorting are done, followed by cooling, to ensure its freshness till the product reaches the consumers. Specially designed modern retail outlets, the first of their kind in India, have been set up at various localities in Delhi and Mumbai, to market good quality fruit and vegetables at reasonable prices directly to the consumers.

As many as 279 specially designed modern retail outlets have been set up in and around Delhi to market fresh and frozen fruits and vegetables directly to the consumers. Each shop caters to a large number of customers and has a capacity to sell 1,600 kilos of fruit and vegetables a day. The shops are equipped with electronic machines that automatically weigh the produce and print item wise bills.

2.3.2.3 Public Distribution System in New Delhi

The public distribution system (PDS) ensures the distribution of essential items such as selected cereals, sugar, and kerosene at subsidized prices to holders of ration cards. The PDS also helps to modulate open market prices for commodities that are distributed through the system.

The Department of Food and Civil Supplies, Govt. of Delhi, manages the PDS in Delhi for regulating supply and distribution of, and trade and commerce in, essential commodities with a view to maintaining or increasing suppliers thereof, and securing their equitable distribution and availability at fair prices by enforcing the Essential Commodities Act, 1955, and various Control Orders made there under.

The main items distributed through the PDS are cereals, such as rice and wheat, and essential items, such as sugar (only for people Below poverty line) and kerosene. According to the Department of Food and Civil Supplies, there wee 3,165 PDS outlets in Delhi in March 2001. Of these, 2,818 outlets were in urban areas and 347 in rural areas. On an average, each Fair Price Shop handles 1,000 ration cards. The numbers of households in Delhi that have ration cards increased from 23.62 lakhs in 1990-91 to 36.89 lakhs in 200-2001 (Table 2.1)

Table 2.1: Important indicators of PDS – DELHI

S.No	Item	1998-99	1999-2000	2000-2001
1	No. of Cards (in '00')	3353	3599	3689
2	No. of Cereal Units (in '000')	30721	33090	33948
3	No. of Sugar Units (in '000')	17793	19345	1589
4	Fair Price Shop (in number) (i+ii)	3214	3228	3165
	(i) Urban	2811	2853	2818
	(ii) Rural	403	375	347
5.	No. of Licensed Shops of Kerosene Oil	2342	2372	2501

2.3.2.4 Central Cottage Industries Emporium

The central Cottage Industries Emporium (CCIE) is a Government of India undertaking to promote sales of artisanal goods to tourists as well as local customers. There are six stores across the country, by the same name, all keeping up the tradition of displaying and selling crafts from various regions of India.

The government runs the Central Cottage Industries Emporium, which has branches in each major city. These are well-appointed, multi storeyed complexes containing a selection of handicrafts from every corner of the country. In order to provide attractive markets in urban centers and right prices to the artisans and craftsmen, the government launched the CCIE to provide them with an alternative retail channel.

India has, over the centuries, kept its arts and crafts alive --- ivory, bras, silver, copper, gold jewellery, skills and brocades, leather goods, carpets, excellent woodwork items, precious and semiprecious stones, blue pottery, and an unending list of other goods.

The central and state governments run various cottage and handicrafts emporiums across the country. In Delhi, the Central Cottage Industries Emporium and the various state emporiums are located in Connaught Place. Cottage Emporium, as also many other such stores in the country, accept all major international credit cards. Each branch has an air freighting section where bulky purchases are delivered right at the customer's doorstep.

These emporiums retail a wide variety of product categories, which they procure from every part of India. They offer a rich variety of silk with special colours and weaves.

The heavy Kanjeevaram silks of the south, the soft and the richly brocaded ones of Beneras, the light silks from the east, the goldenhued 'muga' of Assam, 'tanchoi' from Surat, the magical tie-and-dye of Rajasthan and Gujarat, the 'ikat' or 'patola' of Orissa, and artifacts in bronze, brass, ivory, marble, or wood-statues, lamp shades, chairs, delicate filigree work on ivory and silver, marble inlaid with precious coloured stones, enamel work; 'kundan' or 'mina' jewellery of Rajasthan, silver from Orissa and pearls of Hyderabad-the entire range of rich handicraft products of India can be obtained from them. This is especially useful for the shopper in a hurry.

In New Delhi, an entire street-full of state government emporiaon the Baba Kharag Singh Marg provides the shoppers with virtually everything that is available in the country. They bring to the customers a wide selection of textiles, leather goods, art and artifacts, and the best of everything that a particular state offers. There are other emporia too like the Handloom House which sell equally good and genuine things. ,

2.4 Modern Retail Formats in India

Formats that have emerged or become popular in the 1990s are classified as modern retail formats. In terms of professional management and efficiency of integration with the value chain, these formats are classified as part of the organized retail sector in India.

2.4.1 Franchised Outlets And Company-owned Stores

Economic liberalization, competition, and foreign investment since the 1990s led to the proliferation of brands, with both foreign and Indian companies acquiring strong brand equity for their products. Hence, franchising emerged as a popular mode of retailing. Sales of franchises grew at a rapid pace of 14% per annum over the review period. In 2002, there were over 5,000 franchised outlets.

The other major retailing organization format in India is 'chain stores'. In 2002, there were about 1,800 chain stores. Among the various organizational formats, sales of chain stores grew at the fastest pace, with sales growth during the review period averaging 24% per year.

There has been a boom in organized retailing in India owing to a gradual increase in the disposable incomes of the middle-class households.

More and more new or established companies in other trades are coming into the retail business in India, contributing to the introduction of new formats like malls, supermarkets, hypermarkets, discount stores, department stores, and even changing the traditional looks of bookstores, company-owned stores, chemist shops, and furnishing stores.

For example, Bata India Ltd is one of the largest and oldest retailers in organized retail sector, with 1,600 footwear stores spread across the country, and a retail turnover of Rs 6 billion in 2001. Bata enjoyed almost a monopolistic presence in the organized footwear market until the 1980s.

However, of late, retailing has become one of the most active sectors in India for almost a decade now. It has been undergoing a metamorphosis of sorts with the entry of big organized players in a largely traditional unorganized market. However, organized retail in India does not cover more than 2% of the retail trade. Moreover, most organized retail formats have emerged in the metros and on their outskirts. Hence, they have not thrown up a major challenge to the unorganized retail formats, except for inducing a positive shift in their strategy in terms of greater focus on experiential aspects and ambience.

The emergence of organized retailing in India has been influenced by factors such as the increasing purchasing power of consumers, increased variety. of options, more brand awareness, consumer interest in quality, and the increasing economies of scale, along with the aid of modem supply and distribution management solutions.

The most interesting facet of this revolution is the non-food segment, which has given the urban consumer the power of choice while catering. To their changing needs and lifestyles. These new sectors include lifestyle and fashion retailers, such as Shoppers' Stop, Globus, LifeStyle, Westside, etc.: apparel retail, such as Wills Lifestyle and Landmark; books, music, and gift retailers, such as Archies, Music World, Crosswords, etc.; and drugs and pharmacy retailers, such as Health and Glow, Apollo. These segments have taken retail into diverse areas, offering the consumer a wide range of goods and pleasant shopping experiences.

The success of large malls such as Crossroads in Mumbai, Spencer Plaza in Chennai, and Ansal Plaza in Delhi has encouraged a number of developers to join the retail bandwagon. Malls, supermarkets, and various internationally successful formats are bringing about the retail boom in cities like Gurgaon, Mumbai, Bangalore, and Chennai. Affordability, variety, and attractiveness seem to be the key offerings of the retailing chains.

The traditional food and grocery segment has seen the emergence of supermarkets and grocery chains such as Food World, Nilgiris, and Apna Bazaar; convenience stores like Convenio and HP Speed mart are increasingly found at petrol pumps; and fast-food chains like McDonald's, Dominos, Nirulas, etc. and coffee shops such as Barista, Cafe Coffee Day etc. are expanding fast and wide.

Pubs such as Geoffrey's, and specialty eateries such as Copper Chimney and Mainland China are creating a niche for themselves and are expanding their franchise. Besides, the food and grocery sector now accounts for 14% of total organized retail, after clothing and textiles (at 36%), and watches and jewellery (at 17%). Food and grocery retail offers the biggest opportunity for growth, and even the provided levels of investment are high, says the KSA study.

2.5 Geographical Markets

There is large difference in economic prosperity levels among several states in India, linked to the wealth creation from trade, industrial, and agricultural development. There are poor districts in many states, classified according to their market potential. India has 500 districts, out of which 150 districts (category A) and next 150 districts (category B) account for 78% and 15% of the national market potential respectively. Remaining 200 districts (category C) are backward and account for only 7% of national market potential. Category C districts have 40% of the geographical share. The spread of affluent and non – affluent districts is uniform in all the four regions. However, the eastern, northern – eastern and central regions of India have the largest share of backward districts.

Did you know that India…

- is the world's second largest small car market
- is one of only three countries that makes its own supercomputers
- is the fourth largest economy in the world (measured in terms of purchasing power parity)
- is one of six countries that launches its own satellites
- 100 of the Fortune 500 have R & D facilities in India
- Has the second largest group of software developers after the U.S.
- lists 6,600 companies on the Bombay Stock Exchange; only the NYSE has more
- is the world's largest producer of milk, and second largest producer of food, including fruits and vegetables
- Sends more students to the U.S. colleges than any other country in the world. In 2007, over 84,000 Indian students enrolled in the U.S.
- Indian pharmaceutical industry is the world's second largest after China

2.6 Retailing in Rural India

2.6.1 An Overview

The Indian rural market with its vast size and demand base offers great opportunities to marketers. Two-thirds of countries consumers live in rural areas and almost half of the national income is generated here. It is only natural that rural markets form an important part of the total market of India. Our nation is classified in around 450 districts, and approximately 630000 villages, which can be sorted in different parameters such as literacy levels, accessibility, income levels, penetration, distances from nearest towns, etc.

Few Facts….

70 % of India's population lives in 627000 villages in rural areas. According to the NCAER study, there are almost twice as many 'lower middle income' households in rural areas as in the urban areas.

- At the highest income level there are 2.3 million urban households as against 1.6 million households in rural areas.
- Middle and high-income households in rural India are expected to grow from 80 million to 111 million by 2007.
- In urban India, the same is expected to grow from 46 million to 59 million. Thus, the absolute size of rural India is expected to be double that of urban India.

2.6.2 Opportunity

The above figures are a clear indication that the rural markets offer the great potential to help the India Inc which has reached the plateau of their business curve in urban India to bank upon the volume-driven growth. The Indian rural market with its vast size and demand base offers a huge opportunity that MNCs cannot afford to ignore. With 128 million households, the rural population is nearly three times the urban. As a result of the growing affluence, fuelled by good monsoons and the increase in agricultural output to 200 million tonnes from 176 million tonnes in 1991, rural India has a large consuming class with 41 per cent of India's middle-class and 58 per cent of the total disposable income. The importance of the rural market for some FMCG and durable marketers is underlined by the fact that the rural market accounts for close to 70 per cent of toilet-soap users and 38 per cent of all two-wheeler purchased. The rural market accounts for half the total market for TV sets, fans, pressure cookers, bicycles, washing soap, blades, tea, salt and toothpowder, What is more, the rural market for FMCG products is growing much faster than the urban counterpart.

2.6.3 Features of Indian Rural Markets

- **Large and Scattered market:**
  The rural market of India is large and scattered in the sense that it consists of over 63 crore consumers from 5, 70,000 villages spread throughout the country.
- **Major income from agriculture:**
  Nearly 60 % of the rural income is from agriculture. Hence rural prosperity is tied with agricultural prosperity.
- **Low standard of living:**
  The consumer in the village area do have a low standard of living because of low literacy, low per capita income, social backwardness, low savings, etc.
- **Traditional Outlook:**
  The rural consumer values old customs and tradition. They do not prefer changes.
- **Diverse socio-economic backwardness:**
  Rural consumers have diverse socio-economic backwardness. This is different in different parts of the country.
- **Infrastructure Facilities:**
  The Infrastructure Facilities like roads, warehouses, communication system, and financial facilities are inadequate in rural areas. Hence physical distribution becomes costly due to inadequate Infrastructure facilities.

The rural bazaar is booming beyond everyone's expectation. This has been primarily attributed to a spurt in the purchasing capacity of farmers now enjoying an increasing marketable surplus of farm produce. In addition, an estimated induction of Rs. 140 billion in the rural sector through the government's rural development schemes in the Seventh Plan and about Rs.300 billion in the Eighth Plan is also believed to have significantly contributed to the rapid growth in demand. The high incomes combined with low cost of living in the villages have meant more money to spend. And with the market providing those options, tastes are also changing.

2.6.4 Problems in the Booming Rural Marketing

Although the rural market does offer a vast untapped potential, it should also be recognized that it is not that easy to operate in rural market because of several problems. Rural marketing is thus a time consuming affair and requires considerable investments in terms of evolving appropriate strategies with a view to tackle the problems.

The major problems faced are:

- **Underdeveloped People and Underdeveloped Markets:**
  The number of people below poverty line has not decreased in any appreciable manner. Thus underdeveloped people and consequently underdeveloped market by and large characterize the rural markets. Vast majorities of the rural people are tradition bound, fatalistic and believe in old customs, traditions, habits, taboos and practices.

- **Lack of Proper Physical Communication Facilities:**
  Nearly fifty percent of the villages in the country do not have all weather roads. Physical communication of these villages is highly expensive. Even today most villages in the eastern parts of the country are inaccessible during the monsoon.

- **Media for Rural Communication:**
  Among the mass media at some point of time in the late 50's and 60's radio was considered to be a potential medium for communication to the rural people. Another mass media is television and cinemas. Statistics indicate that the rural areas account for hardly 2000 to 3500 mobile theatres, which is far less when compared to the number of villages.

- **Many Languages and Dialects:**
  The number of languages and dialects vary widely from state to state, region to region and probably from district to district. The messages have to be delivered in the local languages and dialects. Even though the number of recognized languages is only 16, the dialects are estimated to be around 850.

- **Dispersed Market:**
  Rural areas are scattered and it is next to impossible to ensure the availability of a brand all over the country. Seven Indian states account for 76% of the country's rural retail outlets, the total number of which is placed at around 3.7 million. Advertising in such a highly heterogeneous market, which is widely spread, is very expensive.

- **Low Per Capita Income:**
  Even though about 33-35% of gross domestic product is generated in the rural areas it is shared by 74% of the population. Hence the per capita incomes are low compared to the urban areas.

- **Low Levels of Literacy:**
  The literacy rate is low in rural areas as compared to urban areas. This again leads to problem of communication for promotion purposes. Print medium becomes ineffective and to an extent irrelevant in rural areas since its reach is poor and so is the level of literacy.

- **Prevalence of spurious brands and seasonal demand:**
  For any branded product there are a multitude of 'local variants', which are cheaper, and, therefore, more desirable to villagers.

- **Different way of thinking:**
  There is a vast difference in the lifestyles of the people. The kind of choices of brands that an urban customer enjoys is different from the choices available to the rural customer. The rural customer usually has 2 or 3 brands to choose from whereas the urban one has multiple choices. The difference is also in the way of thinking. The rural customer has a fairly simple thinking as compared to the urban counterpart.

2.7 Vertical Marketing System in Indian Retailing

A vertical marketing system consists of all the levels of independently owned business entities along a channel of distribution/value chain. Products and services are normally distributed through one of these types of vertical marketing systems: independent, moderately integrated, and fully integrated.

In an independent vertical marketing system, there are three levels of independently owned forms: manufacturers or suppliers, wholesalers or distributors, and retailers. It is the most common vertical marketing system in India, across product categories, because of large-scale unorganized operations at the retail level. It is a form of vertical marketing system in which independent entities at different levels of the value chain operate contractually to obtain the economies of scale and market impacts that could not be obtained by unilateral action.

Such a system is often used if manufacturers or retailers are small, intensive distribution is within a group, customers are widely dispersed, unit sales are high, firm resources are low, channel members want to share costs and risks, and task specialization is desirable. Under the system, the identity of the individual business entity and its autonomy to operate remain .intact. The there principal types of contract systems are franchise system, retailer sponsored cooperative, and wholesaler sponsored cooperative. Independent vertical marketing systems are prominently in use by many stationery stores, hardware gift Shop stores, grocery stores, and chemist shops

The partial integrated vertical marketing system is a form of vertical marketing system designed to control a line or classification of merchandise as opposed to an entire store's operation. The most common form of the system is when a supplier or producer and a retailer manage complete transactions and shopping, storing, and other channel functions in the absence of any independently owned intermediary (wholesaler/distributor). The vertically aligned I companies, even though in a non-ownership position, may work together to reduce the total systems cost of such activities as advertising, transportation, and data processing.

This system is most compatible if the producers and retailers are large, selective, or exclusive distribution is sought, unit sales are moderate, company resources are high, the greater channel control is desired, and existing wholesalers are too expensive or unavailable. Such integrated systems are often used by furniture stores, restaurants, computer retailers, mail-order, and direct-selling firms. This system is also adopted by the retail chains and department stores widely.

A fully integrated vertical marketing system is a form of vertical marketing system in which all or most of the functions from production to distribution are at least partially owned and controlled by a single entity. Corporate systems generally operate in manufacturing units, warehouse facilities, and retail outlets.

In simple words, a single company performs all production and distribution functions without the aid of any other firms. In the past. In this system was usually employed only by manufacturers, such as. Avon, Goodyear, and ModiCare. At Sherwin Williams, the patent manufacturer, its 2250 company-owned stores account for 57% of we firm's sales. Today, a good number of retailers are having fully integrated systems as many independent apparel stores have their own manufacturing units and retail outlets. Retail in India 185

For example, Wills Lifestyle apparel stores are owned and managed by ITC group. A fully integrated vertical marketing system can be termed as a corporate vertical system where a firm has total control over its strategy, has direct contact with final consumers, has higher retail mark-ups without raising prices (by eliminating channel members), is self-sufficient and does not rely on others, has exclusivity over products and services offered, and keeps all profits within the company.

Raymond's exclusive chain of showrooms (Formal) maximizes product visibility, enhance brand image, have exclusivity over brands, and control retail prices. However, there may be some difficulties with a fully integrated system, including heavy investment costs and a lack of expertise in both manufacturing and retailing and even distributing to other retail formats if the company is banking on a mix of _retail formats.

In India, most of the firms use a dual vertical marketing system, whereby they use more than one type of channel arrangement. Thus, Titan has a fully integrated system for its World of Titan exclusive company-owned stores, Value Mart discount stores, Time Zone (partially integrated vertical system, franchise arrangement), and independent stores approached through well-established dealer networks as a part of independent vertical marketing system).

2.8 Challenges in Retail Business in India

The retail industry in India is in a phase of transition and hence is likely to face a whole new set of challenges. For one, generating large, free cash in flows for expansion is not easy. Retail margins are already wafer-thin, compared to those in other markets like the Middle East. The management of Life Style, which runs over 200 stores there, says its net profit margins after tax in India are 4-5% compared to about 10% in the Middle East.

There are enough recent examples of chains that tried ramping up too fast too soon. Barista, Domino's and Shoppers' Stop all fell into a cash trap. So deciding the right pace of expansion is quite critical.

Most retailers are trying to increase margins. For instance, RPG group has started sourcing its fresh produce directly from the farmers. About 350 farmers in Karnataka are_doing contract farming_for RPG.

Everybody going from this. The fanners get guaranteed off take and' 46-48% of the price which the consumer pays (up from the earlier 40%). As for Food World, now sourcing half o£ its total fresh produce directly from these farmers, it can sell it 15--:-20% cheaper than the market.

Also, in apparel, it is not easy to find suppliers who can match the capacities that a fast-expanding chain like Shoppers' Stop needs. The management feels that every time customers ask why they do not have a product or a size, they end up with egg on their face. That is why store labels come in and so do international labels, which offer gross margins of 40%.

Then, there's the other bugbear: too many- department stores, too many exclusive outlets, all too close to each other. There is also a lack of sufficient differentiation. This could make it hard to build store loyalty. Besides, customers do not prefer to travel for more than 20 minutes to visit a store. So, building higher levels of traffic when catchments are shrinking is a tough challenge.

Retailers in India also face certain challenges in terms of the real estate, legal, workforce-related and certain other issues. They have an impact on the costs and efficiency of operations of the retail business.

2.8.1 Real Estate

Location is considered to be a key component of the retail strategy of any store. It also guides the direction and success of retailing industry in general. Indian retail units have to struggle on account of the shortage of real estate for new projects and even retail $pace in central business districts is out of reach for retailers due to price and high demand. Some of the new retail projects initiated by private houses are suffering on account of lack of cooperation from the local bodies in respect of security, hard infrastructure (power, roads), and public transportation facilities. In such conditions, retailers are ending up with incompatible retail property at high price. Poor state of retail estate in India can be attributed to the following factors.

- Stamp duties on transfer of property are very high and inconsistent throughout India. Stamp duties are taxes payable on every conceivable documented transaction. It is a form of revenue for a state that is why it varies from state to state.
- The Urban Land Ceiling Act and Rent Control Acts were repealed just a few years back, but it has distorted property markets in urban centers, leading to exceptionally high property prices, particularly of retail property in central business districts.
- The presence of pro-tenancy laws makes it difficult to remove a tenant or tenants. The problem is multiplied by tedious and long drawn procedures to' clear titles of ownership.
- Land use conversion is time consuming and complex, particularly in case of new shopping centers, which are coming up on out-of town agricultural land.
- Huge costs are involved in terms of time and money in legal processes for property disputes.
- City urban planning projects smaller commercial plots and this, together with rigid building and uncertain zoning laws, hinders the procurement of retail property.
- Non-residents are not allowed to own property except if they are of Indian origin. Foreign-owned Indian companies can own property for business purposes.
- Foreign investment in real estate business is prohibited except for integrated township development, wherein 100% FD I is allowed with prior government approval.

2.8.2 Work Force

The traditional independent retailers that practice child labour have come under stringent provisions of the law forbidding child labour. Therefore, dependence on adult and experienced workforce will definitely increase their cost of operations. On the other hand, the organized retailers are facing multiple challenges on this front, such as limited supply of trained workforce and labour laws hindering operations in accordance with their business requirements. The labour laws that protect store workers are not flexible enough to support the organized formats of retailing.

Some local government bodies, after a series of requests, recently extended permission to shopping centers to operate up to 9.30 p.m. on all days including national holidays. For example, the New Delhi government provided such permission to Ansal Plaza. But extended working hours stand contrary to existing labour laws. One of them is that workforce can only be employed for a specified number of hours and, therefore, to operate stores for a longer interval of time the retailers have to depend on multiple shift duties. Being subject to seasonal demand cycle (festive and end of year), these stores prefer to have part time arrangement, which is not permissible under the existing laws. This increases the store's cost of operation.

It is a fact that the retailing industry is in its starting phase in our country. The benefits of organized retailing will only e felt once an equitable scale are achieved. This, to a large extent, depends on the store size, the walkthroughs, bills per customer per year, average bill size, and the revenue earned per sq. ft. But, besides resources and bottom-line, a variety of other aspects need to be in place for tasting success. The need for qualified and trained manpower is of utmost importance. In order to survive in today's tough retail climate, companies must continually innovate ways to create stronger, more direct links with their customers. At the same time, retailers must focus on the most demanding customers who want customization, value, and service.

New store designs must assault the consumer's sense of sight, sound, taste, touch, and smell – preferably all at the same time. In this environment merchandising and specially displays are more important than ever as being on top of the mind will keep the brand growing.

What is VAT?

VAT is a multistage tax levied at each stage of the value addition chain, with a provision to allow input tax credit (ITC) on tax paid at an earlier stage, which can be appropriated against the VAT liability on subsequent sale. VAT is intended to tax every stage of sale where some value is added to raw materials, but taxpayers will receive credit for tax already paid on procurement stages. Thus, VAT will be without the problem of double taxation as prevalent in the present tax laws. Presently VAT is followed in over 160 countries. The proposed Indian model of VAT will be different from VAT as it exists in most parts of the world. In India, VAT will replace the existing state sales tax system. One of the many reasons underlying the shift to VAT is to do away with the distortions in our existing tax structure that carve up the country into a large number of small markets rather than one big common market. In the present sales tax structure, tax is not levied on all the stages of value addition or sales and distribution channel, which means the margins of distributors/ dealers/ retailers are not subject to sales tax at present. Thus, the present pricing structure needs to factor only the single point levy component of sales tax and the margins of manufacturers and dealers/ retailers, etc. are worked out accordingly. Under the VAT regime, due to multipoint levy on the price including value additions at each and every resale, the margins of either the re seller or the manufacturer would be reduced unless the ultimate price is increased.

The VAT system ensures lesser paper wok for the retail community. There will be no local statutory forms under VAT. The existing sales tax system requires dealers to maintain an account of sales and purchases, and the VAT system also requires maintenance of only such accounts. Further, the Central Sales Tax Act would be amended and there would be a single page return form common for local and central Acts. The return would be required to be filed quarterly, as is being done currently.

Important of VAT

In India, particularly the trading community has accepted and adopted loopholes in the present tax present tax system administered by the state or the centre. If VAT comes in, it will close avenues for traders and businessmen to evade paying taxes. They will also be compelled to keep proper records of their sales and purchases. Many sections hold the view that the trading community has been amongst the biggest of fenders when it comes to evading taxes. Under the VAT systems, n exemptions will be given and a tax will be levied at each stage of manufacture of a product. At each stage of value addition, the tax levied on the inputs can be claimed back from the tax authorities.

At a macro level, VAT system, if enforced properly, forms part of the fiscal consolidation strategy for the country. It could, in fact, help address the fiscal deficit problem and the revenues estimated to be collected could actually mean lowering of the fiscal deficit burden for the government. The International Monetary Fund, in its semi-annual World Economic Outlook 2003 release, expressed its concern over India's large fiscal deficit –10% of the GDP. Further, any globally accepted tax administrative system will only help India integrate better in the World Trade Organization regime.*Source: Salil Panchal and Morpheus Inc. 2003, 'What is VAT'? And why VAT' www.rediff.com April 12* In fact, the challenges of urban and rural retailing will keep marketers busy for much of this millennium.

2.9 Review questions

1. Give a brief sketch of evolution of retailing industry in India.
2. What are the different types of traditional retail formats in the Indian retail sector?
3. What is the relevance of traditional retail format in the entire value chain in the backdrop of Indian industry?
4. Discuss broadly the drivers of the emergence of the organized retailing and new retail formats in Indian retail industry.
5. Evaluate changes experienced by particular product industries (FMCG, vegetables, pharma, etc,) in the types of retail formats employed in India over the period

STRATEGIC PROCESS PLANNING IN RETAILING

Structure

Introduction

In this chapter, we cover strategic retail planning-the underpinning of outlook-in detail. As noted in Chapter 1, a retail strategy is the overall plan or framework of action that guides a retailer. Ideally, it will be at least one year long and outline the retailer's mission, goals, consumer market, overall and specific activities, and control mechanisms. Without a defined and well-integrated strategy, a firm may be unable to cope with the marketplace: "Despite the critical importance of a business plan, many entrepreneurs drag their feet when it comes to preparing one. They argue that their marketplace changes too fast for a plan to be useful or that they just don't have enough time. But just as a builder won't begin construction without a blueprint, eager business owners shouldn't rush into new ventures without a business plan.

The process of strategic retail planning has several attractive features:

- It provides a thorough analysis of the requirements for doing business for different types of retailers. .
- It outlines retailer goals.
- A firm determines how to differentiate itself from competitors and develop an offering that appeals to a group of customers.
- The legal, economic, and competitive environment is studied.
- A firm's total efforts are coordinated.
- Crises are anticipated and often avoided.

Strategic planning can be done by the owner of a firm, professional management, or a combination of the two. Even among family businesses, the majority of high-growth companies have strategic plans.

The steps in planning and enacting a retail strategy are interdependent; a firm often starts with a general plan that gets more specific as options and payoffs become clearer. In this chapter, we cover each step in developing a retail strategy, as shown in Figure 3-1. Given the importance of global retailing, a chapter appendix explores the special dimensions of strategic planning in a global retailing environment.

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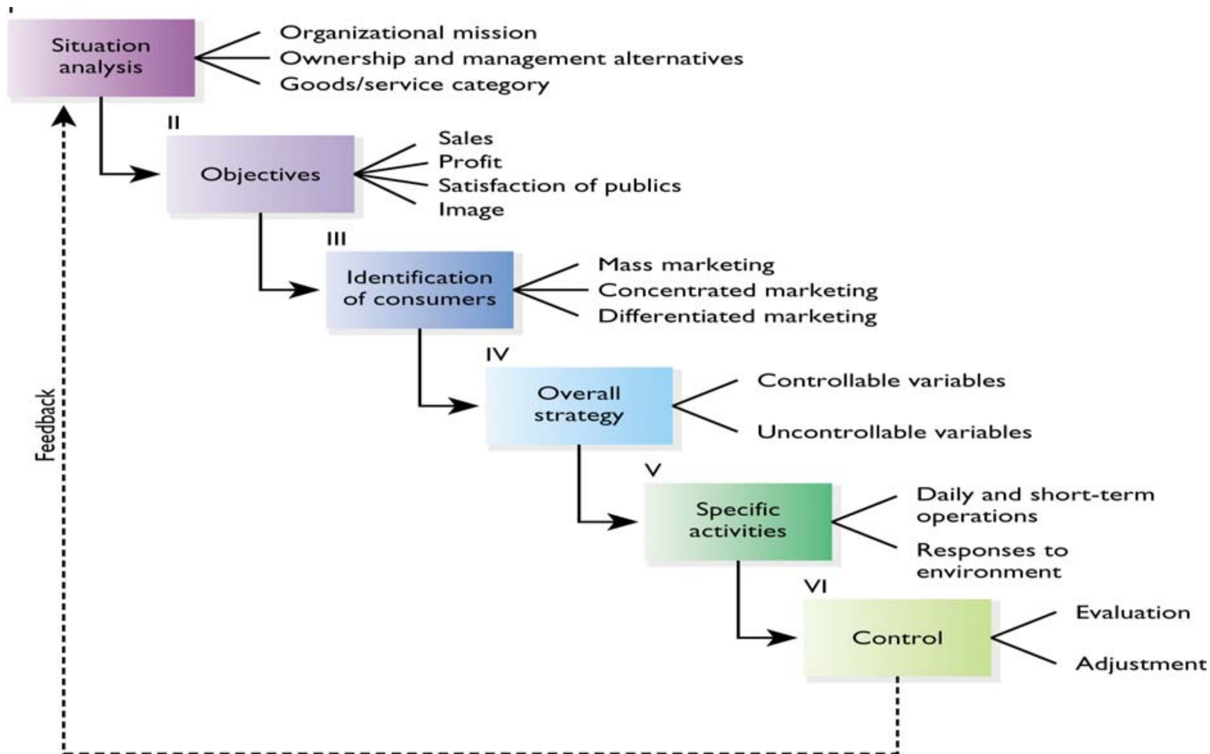

Fig 3.1 Elements of Retail Strategies

3.1 Situation Analysis

Situation analysis is a candid evaluation of the opportunities and threats facing a prospective or existing retailer. It seeks to answer two general questions: What is the firm's current status? In which direction should it be heading? Situation analysis means being guided by an organizational mission, evaluating ownership and management options, and outlining the goods/service category' to be sold.

A good strategy anticipates and adapts to both the opportunities and threats in the changing business environment. **Opportunities** are marketplace openings that exist because other retailers have not yet capitalized on them. Ikea does well because it is the pioneer firm in offering a huge selection of furniture at discount prices. Threats are environmental and marketplace factors that can adversely affect retailers if they do not react to them (and, sometimes, even if they do). Single-screen movie theaters have virtually disappeared since they have been unable to fend off the inroads made by multi-screen theaters.

A firm needs to spot trends early enough to satisfy customers and stay ahead of competitors, yet not so early that shoppers are not ready for changes or that false trends are perceived. Merchandising shifts-like stocking fad items-are more quickly enacted than changes in a firm's location, price, or promotion strategy. A new retailer can adapt to trends easier than existing firms with established images, ongoing leases, and space limitations. Small firms that prepare well can compete in a market with large retailers.

During situation analysis, especially for a new retailer or one thinking about making a major strategic change, an honest, in-depth self-assessment is vital. It is all right for a person or company to be ambitious and aggressive, but overestimating one's abilities and prospects may be harmful-if the results are entry into the wrong retail business, inadequate resources, or misjudgment of competitors.

3.2.1 Organizational Mission

An organizational mission is a retailer's commitment to a type of business and to a distinctive role in the marketplace. It is reflected in the firm's attitude toward consumers, employees, suppliers, competitors, government, and others. A clear mission lets a firm gain a customer following and distinguish it from competitors. See Figure 3-2.

One major decision is whether to base a business around the goods and services sold or around consumer needs. A person opening a hardware business must decide if, in addition to hardware products, a line of bathroom vanities should be stocked. A traditionalist might not carry vanities because they seem unconnected to the proposed business. But if the store is to be a do-it-yourself home improvement center, vanities are a logical part of the mix. That store would carry any relevant items the consumer wants.

A second major decision is whether a retailer wants a place in the market as a leader or a follower. It could seek to offer a unique strategy, such as Taco Bell becoming the first national quick-serve Mexican food chain. Or it could emulate the practices of competitors but do a better job in executing them, such as a local fast-food Mexican restaurant offering five-minute guaranteed service and a cleanliness pledge.

A third decision involves market scope. Large chains often seek a broad customer base (due to their resources and recognition). It is often best for small retailers and startups to focus on a narrower customer base, so they can compete with bigger firms that tend not to adapt strategies as well to local markets.

Although the development of an organizational mission is the first step in the planning process, the mission should be continually reviewed and adjusted to reflect changing company goals and a dynamic retail environment. Here are examples of well-conceived retail organizational missions

Fig 3.2 The Focused Organizational Mission of Frisch's Restaurants

3.2.2 Ownership and Management Alternatives

An essential aspect of situation analysis is assessing ownership and management alternatives, including whether to form a sole proprietorship, partnership, or corporation-and whether to start a new business, buy an existing business, or become a franchisee.

A **sole proprietorship** is an unincorporated retail firm owned by one person. All benefits, profits, risks, and costs accrue to that individual. It is simple to form, fully controlled by the owner, operationally flexible, easy to dissolve, and subject to single taxation by the government. It makes the owner personally liable for legal claims from suppliers, creditors, and others; and it can lead to limited capital and expertise.

A **partnership** is an unincorporated retail firm owned by two or more persons, each with a financial interest. Partners share benefits, profits, risks, and costs. Responsibility and expertise are divided among multiple principals, there is a greater capability for raising funds than with a proprietorship, the format is simpler to form than a corporation, and it is subject to single taxation by the government. Depending on the type of partnership, it, too, can make owners personally liable for legal claims, can be dissolved due to a partner's death or a disagreement, binds all partners to actions made by any individual partner acting on behalf of the firm, and usually has less ability to raise capital than a corporation.

A **corporation** is a retail firm that is formally incorporated under state law. It is a legal entity apart from individual officers (or stockholders). Funds can be raised through the sale of stock, legal claims against individuals are not usually allowed, ownership transfer is relatively easy, the firm is assured of long-term existence (if a founder leaves, retires, or dies), the use of professional managers is encouraged, and unambiguous operating authority is outlined. Depending on the type of corporation, it is subject to double taxation (company earnings and stock holders dividends.) faces more government rules, can require a complex process when established, may be viewed as impersonal, and many separate ownership from management. A closed corporation is run by a limited number of persons who control ownership; stock is not available to the public. In an open corporation, stock is widely traded and available to the public. Fig 3.3 presents a checklist to consider when starting a business.

Figure 3.3 Checklists to Consider When Starting a New Retail Business

Name of Business____
A. Self- Assessment and Business Choice ✓ Evaluate your strengths and weaknesses. ✓ Commitment paragraph: Why should you be in business for yourself? Why open new business rather than acquire an existing one or become a member of a franchise chain? ✓ Describe the type of retail business that fits your strengths and desires. What will make it unique? What will the business offer customers? How will you capitalize on the weaknesses of competitors?
B. Overall Retail Plan ✓ State your philosophy of business. ✓ Choose an ownership form (sale proprietorship, partnership, or corporation). ✓ State your long and short run goals. ✓ Analyze your customers from their point of views. ✓ Research your market size and store location. ✓ Quantify the total retail sales of your goods/service category in your trading area. ✓ Analyze your competition. ✓ Quantify your potential market share. ✓ Develop your retail strategy. Store location and operations, merchandising, pricing, and store image and promotion.
C. Financial Plan ✓ What level of funds will you need to get started and to get through the first year? Where will they come from? ✓ Determine the first year profit, return on investment, and salary that you need/want. ✓ Project monthly cash flow and profit and loss statements for the first two years. ✓ What sales will be needed to break even during the first year? What will you do if these sales are not reached?
D. Organizational Details Plan ✓ Describe your personnel plan (hats to wear), organizational plan, and policies. ✓ List the jobs you like and want to do and those you dislike, cannot do, or do not

want to do. ✓ Outline your accounting and inventory systems ✓ Note your insurance plans. ✓ Specify how day to day operations would be conducted for each aspect of your strategy. ✓ Review the risks you face and how you plan to cope with them.
NAME OF BUSINESS____
✓ Why is the seller placing the business up for sale? ✓ How much are you paying for goodwill (the cost of the business above its tangible asset value)? ✓ Have sales, inventory levels, and profit figures been confirmed by your accountant? ✓ Will the seller introduce you to his or her customers and stay on during the transition period? ✓ Will the seller sign a statement that he or she will not open a directly competing business in the same trading area for a reasonable time period? ✓ If sales are seasonal, are you purchasing the business at the right time of the year? ✓ In the purchase of the business, are you assuming existing debts of the seller? ✓ Who receives proceeds from transactions made prior to the sale of the business but not yet paid by customers? ✓ What is the length of the lease if property is rented? ✓ If property is to be purchased along with the business, has it been inspected by a professional engineer? ✓ How modern are the storefront and store fixtures? ✓ Is inventory fresh? Des it contain a full merchandise assortment? ✓ Are the advertising policy, customer service policy, and pricing policy of the past owner similar to yours? Can you continue old policies? ✓ If the business is to be part of a chain, is the new unit compatible with existing units? ✓ How much trading-area overlap is there with existing stores? ✓ Has a lawyer examined the proposed contract? ✓ What effect will owning this business have on your lifestyle and on your family relationships?

Figure 3.4 A checklist for Purchasing an Existing Retail Business

3.2.3 Goods/ Service Category

Before a prospective retail firm can fully design a strategic plan, it selects a **good/service category ----**the line of business – in which to operate. Figure 3.5 shows the diversity of goods/service categories.

Goods Establishments

Durable Goods Stores
- Automotive Group
- Furniture and appliance group
- Lumber, building, and hardware group
- Jewelry stores

Nondurable Goods
- Apparel Group
- Food Group
- General Merchandise group
- Eating and drinking place
- Gasoline service stations
- Drug and proprietary stores
- Liquor Stores

Service Establishments

Personal Services
- Laundries and dry cleaning
- Beauty/barber shops
- Photographic studios
- Health- care services

Amusement Services
- Movie Theaters
- Bowling Alleys
- Dance halls
- Golf courses
- Skating rinks
- Amusement Parks
- Coin-operated game arcades

Repair Services
- Automobile repairs
- Car washes
- Consumer electronics repairs
- Appliance repairs
- Watch and jewelry repairs

Hotel Services
- Hotels
- Motels
- Trailer parks
- Camps

Figure 3.5 Selected Kinds of Retail Goods and Service Establishments

3.2.4 Personal Abilities

Personal abilities depend on an individual's aptitude – the preference for a type of business and the potential to do well; education – formal learning about retail practices and policies; and experience – practical learning about retail practices and policies.
An individual who wants to run a business., likes to use initiative, and has the ability to react quickly to competitive developments will be suited to a different type of situation than a person who depends on other for advice and does not like to make decision. The first individual could be an independent operator, in a dynamic business such as apparel; the second might seek partners or a franchise and a stable business, such as a stationery store. Some people enjoy customer interaction; they would dislike the impersonality of self service operation. Others enjoy the impersonality of mail order or Web retailing.

3.2.5 Financial Resources

Many retail enterprises, especially new, independent ones, fail because the owners do not adequately project the financial resources needed to open and operate the firm. Table 3-1 outlines some of the typical investments for a new retail venture.

TABLE 3-1	**Some Typical Financial Investments for a New Retail Venture**
Use of Funds	**Source of Funds**
Land and building (lease or purchase)	Personal savings, bank loan, commercial finance company
Inventory	Personal savings, manufacturer credit, commercial finance company, sales revenues
Fixtures (display cases, storage facilities, signs, lighting, carpeting, etc.	Personal savings, manufacture credit, bank loan commercial finance company.
Equipment (cash register, marketing machine, office equipment, computers, etc.	Personal savings, manufacturer credit, bank loan, commercial finance company
Personnel (sales people, cashiers, stock people. Etc.	Personal savings bank loan, sales revenues
Promotion	Personal savings, sales revenues
Personal drawing account	Personal savings, life insurance loan
Miscellaneous (equipment repair, credit sales [bad debts], professional services, repayment of loans	Personal savings, manufacturer and wholesaler credit, bank credit plan, bank loan, commercial fiancé company.

TABLE 3-2 **Financial Requirements for a Used-Car Dealer**	
Total investments (first year)	
Lease (10 years, $60,000 per year)	**$ 60,000**
Beginning inventory (32 cars, average cost of $12,500)a	**400,000**
Replacement inventory (32 cars, average cost of $12,500)a	**400,000**
Fixtures and equipment (painting, paneling, carpeting, lighting, signs, heating and air-conditioning system, electronic car register, service bay)	**60,000**

Replacement parts	**75,000**
Personnel (one mechanic)	**45,000**
Promotion(brochures and newspaper advertising)	**35,000**
Drawing account (to cover owner's personal expenses for one year: all selling and operating functions except mechanical ones performed by the owner)	**40,000**
Accountant	**15,000**
Miscellaneous (loan payment, etc)	**100,000**
Profit(projected)	**40,000**
Source of funds	
	$1,270,000
Personal savings	**$300,000**
Bank loan	**426,000**
Sales revenues (based on expected sales of 32 cars, average price of $17,000	**544,000**

[a] Assumes that 32 cars are sold during the year. As each type of car is sold, a replacement is bought by the dealer and placed in inventory. At the end of the year, inventory on hand remains at 32 units.

3.2.6 Time Demands

Time demands on retail owners (or managers) differ significantly by goods or service category. They are influenced both by consumer shopping patterns and by the ability of the owner or manager to automate operations or delegate activities to other.

Many retailers must have regular weekend and evening hours to serve time pressed shoppers. Gift shops, toy stores, and others have extreme seasonal shifts in their hours. Mail order firms and those selling through the Web, which can process orders during any part of the day, have more flexible hours.

3.2 Objectives

After - situation analysis, a retailer sets objectives, the long – run and short run performance targets it hopes to attain. This helps mold a strategy and translates the organizational mission into action. A firm can pursue goals related to one or more of these areas: Sales, Profit, Satisfaction of publics, and image. Some retailers strive to achieve all the goals fully; others attend to a few and want to achieve them really well. There are array of goals for the Kroger Company.

- Increase its identical food store sales growth target
- Reduce operating and administrative costs by more than $500 million
- Further leverage its size to achieve even greater economies of scale
- Reinvest in its core business to increase sales and market share.

3.3.1 Sales

Sales objectives are related to the volume of goods and services a retailer sells. Growth, stability, and market share are the sales goals most often sought.

Some retailers set sales growth a top priority. They want to expand their business. There may be less emphasis on short run profits. The assumption is that investments in the present will yield future profits. A firm that does well often becomes interested in opening new units and enlarging revenues. However, management skills and the personal touch are sometimes lost with overly fast expansion

Stability is the goal of retailers that emphasize maintaining their sales volume, market share, price lines, and so on. Small retailers often seek stable sales that enable the owners to make a satisfactory living every year without downswings or upsurges. And certain firms develop a loyal customer following and are intent not on expanding but on continuing the approach that attracted the original consumers.

Sales objectives may be expressed in dollars and units. To reach dollar goals, a retailer can engage in a discount strategy (low prices and high unit sales), a moderate strategy (medium prices and medium unit sales), or a prestige strategy (high prices and low unit sales). In the long run, having unit sales as a performance target is vital. Dollar sales by year may be difficult to compare due to changing retail prices and inflation; unit sales are easier to compare. A firm with sales of $350,000 three years ago and $500,000 today might assume it is doing well, until unit sales are computed: 10,000 then and 8,000 now)

3.3.2 Profit

With profitability objectives, retailers seek at least a minimum profit level during a designated period, usually a year. Profit may be expressed in dollars or as a percentage of sales. For a firm with yearly sales of $5 million and total costs of $4.2 million, pre-tax dollar profit is $800,000 and profits as a percentage of sales are 16 percent. If the profit goal is equal to or less than $800,000, or 16 percent, the retailer is satisfied. If the goal is higher, the firm has not attained the minimum desired profit and is dissatisfied.

3.3.3 Image (Positioning)

An image represents how a given retailer is perceived by consumers and others. A firm may be seen as innovative or conservative, specialized or broad-based, discount-oriented or upscale. The key to a successful image is that consumers view the retailer in the manner the firm intends.

Through **positioning,** a retailer devises its strategy in a way that projects an image relative to its retail category and its competitors and that elicits a positive consumer response. A firm selling women's apparel could generally position itself as an upscale or mid-priced specialty retailer, a department store, a discount department store, or a discount specialty retailer, and it could specifically position itself with regard to other retailers carrying women's apparel.

Two opposite positioning philosophies have gained popularity in recent years: mass merchandising and niche retailing. **Mass merchandising** is a positioning approach whereby retailers offer a discount or value-oriented image, a wide and/ or deep merchandise selection, and large store facilities. Wal-Mart has a wide, deep merchandise mix whereas Sports Authority has a narrower, deeper assortment. These firms appeal to a broad customer market, attract a lot of customer traffic, and generate high stock turnover. Because mass merchants have relatively low operating costs, achieve economies in operations, and appeal to value conscious shoppers, their continuing popularity is forecast.

In **niche retailing**, retailers identify specific customer segments and deploy unique strategies to address the desires of those segments rather than the mass market. Niching creates a high level of loyalty and shields retailers from more conventional competitors. Babies "R" Us appeals to parents with very young children whereas Catherine's Stores has fashions for plus-size women. This approach will have a strong future since it lets retailers stress factors other than price and have a better focus. See Figure 3-6

Because both mass merchandising and niche retailing are popular, some observers call this the era of **bifurcated retailing**. They believe this may mean the decline of middle-of-the-market retailing. Firms that are neither competitively priced nor particularly individualistic may have difficulty competing.

Fig 3.6 Niche Retailing by American Outpost

Fig 3.7 shows a retail positioning map based on two shopping criteria:

(1) Price and service and (2) product lines offered. Our assumption: There is a link between price and service (high price equals excellent service). Upscale department stores (Neiman Marcus) offer outstanding customer service and carry several product lines. Traditional department stores (Sears) carry more electronics and other product lines than upscale stores. They have a trained sales staff to help customer. Discount department stores (Wal- Mart, Shoppers Stop, Big Bazaar etc) carry a lot of product lines and rely on self – service. Membership clubs (Costco) have a limited selection in a number of product categories. They have very low prices and plain surroundings. Upscale specialty stores (Tiffany) offer outstanding customer service and focus on

one general product category. Traditional specialty stores (Gap) have s trained sales staff to help customer and focus on one general product category. Discount specialty stores (Old Navy) rely more on self – service and focus on one general product category. Power retailers (Home Depot) offer moderate service and prices and a huge assortment within one general product category.

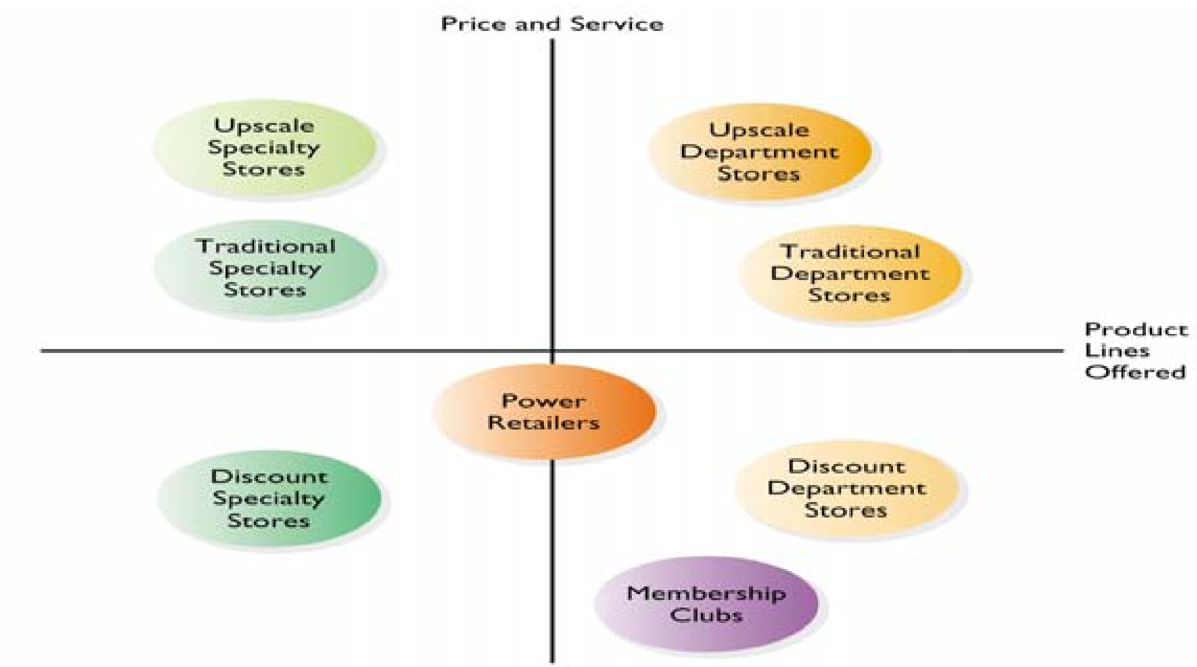

Figure 3.7 Selected Retail Positioning Strategies

3.3 Identification of Consumer Characteristics and Needs

The customer group sought by a retailer is called the **target market**. In selecting its get market, a firm may use one of three techniques: **mass marketing**, selling goods and services to a broad spectrum of consumers; **concentrated marketing**, zeroing in on one specific group; or **differentiated marketing**, aiming at two or more distinct consumer groups, with different retailing approaches for each group.

Supermarkets and drugstores define their target markets broadly. They sell a wide assortment of medium quality items at popular prices. In contrast, a small upscale men's shoe store appeals to a specific consumer group by offering a narrow, deep product assortment at above-average prices (or in other cases, below-average prices). A retailer aiming at one segment does not try to appeal to everyone.

Department stores are among the retailers seeking multiple market segments. They cater to several customer groups, with unique goods and services for each. Apparel may be sold in a number of distinctive boutiques in the store. Large chains frequently have divisions that appeal to different market segments. Darden Restaurants operates Red Lobster (seafood), Olive Garden (Italian), Smoky Bones (barbeque-style), and Bahamas Breeze (Caribbean-style) rest customers with different food preferences. After choosing the target market, a firm can detest competitive advantages and devise a strategy mix. See Table 3.3 The significance of competitive advantages- the distinct competencies a retailer relative to competitors-must not be overlooked

Strategic Implications	Mass Marketing	Concentrated Marketing	Differentiated Marketing
Retailer's Location	Near a large population base	Near a small or medium population base	Near a large population base
Goods and service mix	Wide selection of medium-quality items	Selection geared to market segment – high or low quality items	Distinct goods / services aimed at each market segment
Promotion efforts	Mass advertising	Direct mail, E-mail, subscription	Different media, and messages for each segment
Price orientation	Popular prices	High or low	High, medium, and low – depending on market segment
Strategy	One general strategy for a large homogeneous (similar) group of consumers	One specific strategy directed at a specific, limited group of customers	Multiple specific strategies, each directed at different (heterogeneous) groups of consumers

Table 3.3 Target Marketing Techniques and Their Strategic Implications

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3.4 Overall Strategy

Next, the retailer develops an in-depth overall strategy. This involves two components: the aspects of business the firm can directly affect and those to which the retailer must adapt. The former are called **controllable** variables, and the latter are called **uncontrollable** variables. See Figure 3-8. A strategy must be devised with both variables in mind. The ability of retailers to grasp and predict the effects of controllable and uncontrollable variables is greatly aided by the use of suitable data.

3.5.1 Controllable Variables

The controllable parts of a retail strategy consist of the basic categories shown, in Figure 3-8 store location, managing a business, merchandise management and pricing, and communicating with the customer. A good strategy integrates these areas. These elements are covered in depth in Chapters 6 to 11

3.5.2 Store Location

A retailer has several store location decisions to make. The initial one is whether to use a store or nonstore format. Then, for store-based retailers, a general location and a specific site are determined. Competitors, transportation access, population density, the type of neighborhood, nearness to suppliers, edge traffic, and store composition are considered in picking a location. See Fig 3.9

The terms of tenancy (such as rent and operating flexibility) are reviewed and a build, buy, or rent decision is made. The locations of multiple outlets are considered if expansion is a goal.

3.5.3 Managing a Business

Two major elements are involved in managing a business: the retail organization and human resource management, and operations management. Tasks, policies, resources, authority, responsibility, and rewards are outlined via a retail organization structure. Practices regarding employee hiring, training, compensation, and supervision are instituted through human resource management. Job descriptions and functions are communicated, along with the responsibility of all personnel and the chain of command.

Operations management oversees the tasks that satisfy customer, employee, and management goals. The financial aspects of operations involve asset management, budgeting, and resource allocation. Other elements include store format and size, personnel use, store maintenance, energy management, store security insurance, credit management, computerization and crisis management.

3.5.4 Merchandise Management and Pricing

In merchandise management, the general quality of the goods and services offering is set. Decisions are made as to the width of assortment (the number of product categories carried) and the depth of assortment (the variety of products carried in any category). Policies are set with respect to introducing new items. Criteria for buying decisions (how often, what terms, and which suppliers) are established. Forecasting, budgeting, and accounting procedures are outlined, as is the level of inventory for each type of merchandise. Finally, the retailer devises procedures to assess the success or failure of each item sold.

With regard to pricing, a retailer chooses from among several techniques; and it decides what range of prices to set, consistent with the firm's image and the quality of goods and services offered. The number of prices within each product category is determined, such as how many prices of luggage to carry. And the use of markdowns is planned in advance.

3.5.5 Communicating with the Customer

An image can be created and sustained by applying various techniques. The physical attributes, or atmosphere, of a store and its surrounding area greatly influence consumer perceptions. The impact of the storefront (the building's exterior or the home page for a Web retailer) should not be undervalued, as it is the first physical element seen by customers. Once inside, layouts and displays, floor colors, lighting, scents, music, and the land of sales personnel also contribute to a retailer's image. Customer services and community relations generate a favorable image for the retailer.

3.5.6 Uncontrollable Variable

The uncontrollable parts of a strategy consist of the factors shown in Figure3.8 consumers, competition, technology, economic conditions, seasonality, and legal, restrictions. Farsighted retailers adapt the controllable parts of their strategies to take into account elements beyond their immediate control.

3.5.7 Consumers

A skillful retailer knows it cannot alter demographic trends or lifestyle patterns, impose tastes, or "force" goods and services on people. The firm learns about its target market and forms a strategy consistent with consumer. trends and desires. It cannot sell goods or services that are beyond the price range of customers, that are not wanted, or that are not displayed advertised m the prop manner.

3.5.8 Competition

There is often little that retailers can do to limit the entry of competitors. In fact, a retailer's success may encourage the entry of new firms or cause established competitors to modify their strategies to capitalize on the popularity of a successful retailer. A major increase in competition should lead a company to re-examine its strategy, including its target market and merchandising focus, to ensure that it sustains a competitive edge. A continued willingness to satisfy customers better than any competitor is fundamental.

3.5.9 Technology

Computer systems are available for inventory control and checkout operations. There are more high-tech ways to warehouse and transport merchandise. Toll-free 800 numbers are popular for consumer ordering. And, of course, there is the Web. Nonetheless, some advancement is expensive and may be beyond the reach of small retailers. For example, although small firms might have computerized checkouts, they will probably be unable to use fully automated inventory systems. As a result, their efficiency may be less than that of larger competitors. They must adapt by providing more personalized service.

3.5.10 Economic Conditions

Economic conditions are beyond any retailer's control, no matter how large it is. Unemployment, interest rates, inflation, tax levels, and the annual gross domestic product (GDP) are just some economic factors with which a retailer copes. In outlining the controllable parts of its strategy, a retailer needs to consider forecasts about international, national, state, and local economies.

3.5.11 Seasonality

A constraint on certain retailers is their seasonality and the possibility that unpredictable weather will play havoc with sales forecasts. Retailers selling sports equipment, fresh food, travel services, and car rentals cannot control the seasonality of demand or bad weather. They can diversify offerings to carry a goods/service mix with items that are popular, in different seasons. Thus, a sporting goods retailer can emphasize ski equipment and snowmobiles in the winter, baseball and golf equipment in the spring, scuba equipment and fishing gear in the summer, and basketball and football supplies in the fall.

3.5.12 Legal Restrictions

Table 3.4shows how each controllable aspect of a retail strategy is affected by the legal Environment. Retailers that operate in more than one state are subject to federal laws and agencies. The Sherman Act and the Clayton Act deal with monopolies and restraints of trade. The Federal Trade Commission deals with unfair trade practices and consumer complaints. The Robinson-Patman Act prohibits suppliers from giving unjust merchandise discounts to large retailers that could adversely affect small ones. The Telemarketing Sales Rule protects consumers.

3.5.13 Integrating Overall Strategy

At this point, the firm has set an overall strategy. It has chosen a mission, an ownership and management style, and a goods/service category. Goals are clear. A target market has been designated and studied. Decisions have been made about store location, managing the business, merchandise management and pricing, and communications. These factors must be coordinated to have a consistent, integrated strategy and to account for uncontrollable variables (consumers, competition, technology, economy, seasonality, and legal restrictions).The firm is then ready to do the specific tasks to carry out its strategy productivity

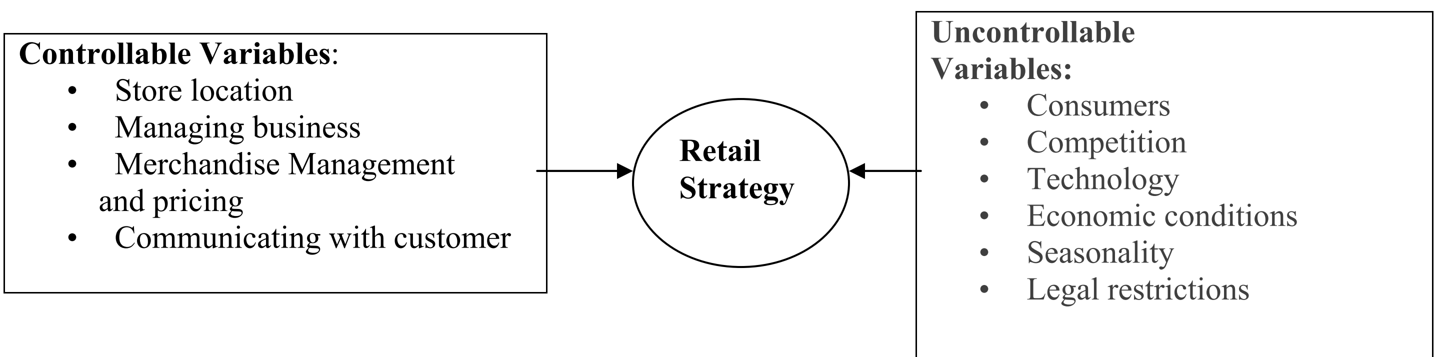

Fig 3.8 Developing an Overall Retail Strategy

Fig 3.6 The Sheraton Safari Hotel

Table 3.4 The Impact of the Legal Environment on Retailing

Controllable Factor Affected	Selected legal Constraints on Retailers
Store Location	*Zoning laws* restrict the potential choices for a location and the type of facilities constructed. *Blue laws* restrict the days and hours during which retailers may operate. *Environmental laws* limit the retail uses of certain sites. *Door-to-door (direct) selling laws* protect consumer privacy. *Local ordinances* involve fire, smoking, outside lighting, capacity, and other rules. *Leases and mortgages* require parties to abide by stipulations in tenancy documents.
Managing the Business	*Licensing provisions* mandate minimum education and/ or experience for certain personnel. *Personnel laws* involve nondiscriminatory hiring, promoting, and firing of employees. *Antitrust laws* limit large firm mergers and expansion. *Franchise agreements* require parties to abide by various legal provisions. *Business taxes* include real-estate and income taxes. *Recycling laws* mandate that retailers participate in a recycling process

	for various materials.
	Trademarks provide retailers with exclusive rights to the brand names they develop. *Merchandise restrictions* forbid some retailers from selling specified goods or services. *Product liability laws* allow retailers to be sued if they sell defective products. *Lemon laws* specify consumer rights if products, such as autos, require continuing repairs.
Merchandise Management and Pricing	*Sales taxes* are required in most states, although *tax-free days* have been introduced in some locales to encourage consumer shopping. *Unit-pricing laws* require price per unit to be displayed (most often applied to supermarkets). *Collusion laws* prohibit retailers from discussing selling prices with competitors. *Sales prices* must be a reduction from the retailer's normal selling prices. *Price discrimination laws* prohibit suppliers from offering unjustified discounts to large retailers that are unavailable to smaller ones. *Truth-in-advertising* and *-selling laws* require retailers to be honest and not omit key facts. *Truth-in-credit laws* require that shoppers be informed of all terms when buying on credit. *Telemarketing laws* protect the privacy and rights of consumers regarding telephone sales. *Bait-and-switch laws* make it illegal to lure shoppers into a store to buy low-priced items and then to aggressively try to switch them to higher-priced ones. *Inventory laws* mandate that retailers must have sufficient stock when running sales. *Labeling laws* require merchandise to be correctly labeled and displayed. *Cooling-off laws* let customers cancel completed orders, often made by in-home sales, within three days of a contract date.

"This table is broad in nature and omits a law-by-law description. Many laws are state or locally oriented and apply only to certain locations; the laws in each place differ widely. The intent here is to give the reader some understanding of the current legal environment as if affects retail management.

3.5 Specific Activities

Short-run decisions are now made and enacted for each controllable part of the strategy in Figure 3.8. These actions are known as tactics and encompass a retailer's daily and short-term operations. They must be responsive to the uncontrollable environment. Here are some tactical moves a retailer may make:

- Store location: Trading-area analysis gauges the area from which a firm draws its customers. The level of competition in a trading area is studied regularly. Relationships with nearby retailers are optimized. A chain carefully decides on the sites of new outlets. Facilities are actually built or modified.

- Managing the business: There is a clear chain of command from managers to workers. An organization structure is set into place. Personnel are hired, trained, and supervised. Asset management tracks assets and liabilities. The budget is spent properly. Operations are systemized and adjusted as required.

- Merchandise management and pricing: The assortments within departments arid the space allotted to each department require constant decision making. Innovative firms look for new merchandise and clear out slow-moving items. Purchase terms are negotiated and suppliers sought. Selling prices reflect the firm's image and target market. Price ranges offer consumers some choice. Adaptive actions are needed to respond to higher supplier prices and react to competitors' prices.

- Communicating with the customer: The storefront and display windows, store layout, and merchandise displays need regular attention. These elements help gain consumer enthusiasm, present a fresh look, introduce new products, and reflect changing seasons. Ads are placed during the proper time and in the proper media. The deployment of sales personnel varies by merchandise category and season.

3.6 Control

In the control phase, a review takes place (Step VI in Figure 3-1) as the strategy and tactics (Step IV and V) are assessed against the business mission, objectives, and target market (Step I,II and III). This procedure is called a retail audit, which is a systematic process or analyzing the performance of a retailer.

The strengths and weakness of a retailer were revealed as performance is reviewed. The aspects of a strategy that have gone well are continued; those that have gone poorly are revised, consistent with the mission, goals, and target market. The adjustments are reviewed in the firm’s next retail audit.

3.7 Feedback

During each stage in a strategy, an observant management receives signals or cues, known as feedback, as to the success or failure of that part of the strategy. Refer to Figure 3-1. Positive feedback includes high sales, no problems with the government, and low employee turnover. Negative feedback includes falling sales, government sanctions (such as fines), and high turnover.

Retail executives look for positive and negative feedback so they can determine the causes and then capitalize on opportunities or rectify problems.

3.9 Short Cases

CASE 1: BED BATH & BEYOND'S PLAN FOR GROWTH

Bed Bath & Beyond (BB&B) (www.bedbathandbeyond.com).The power retailer of domestics and home furnishings, has animal sales of $6 billion and a net income of $600 million (up a compounded rate of 28 percent and 33 percent, respectively, over the prior decade). As of this writing, BB&B has delivered 15 consecutive years of record profits. As one retailing consultant says, BB&B is viewed as "the most powerful specialty home-decor merchant in the country, much more than anyone else. They are more imaginative in creating value than anyone I know of." The firm's profitability can be explained by its increasing gross profit margins at the same time it is decreasing selling, general, and administrative (SG&A) expenses as a percent of sales. BB&B is able to increase its gross profit margins due to its excellent atmosphere, wide assortments, and deep variety within most merchandise lines. Its control over SG&A expenses is partly due to the outsourcing of its distribution centers to a third party.

BB&B anticipates growing via three ways. One, it is consistently able to secure greater sales on a year-to-year basis from comparable store sales. In a recent quarter, the chain increased comparable store sales by 11 percent.

Two, BB&B has opened hundreds. of stores over the last few years, ranging in size from 30,000 to 80,000 square feet. Since it uses a flexible real-estate strategy, BB&B is able to locate in a variety of locations. According to one expert, "Because BB&B isn't a cookie-cutter operation, it can shoehorn itself in anywhere the. Opportunities are." Furthermore, BB&B is now being allowed into large shopping centers. In the past, department store anchor tenants blocked BB&B.

T

hree, BB&B recently purchased the Christmas Tree Shops, a chain of nearly 30 stores specializing in giftware and household items. Although the Christmas. Tree Shops' name suggests that it concentrates on Christmas merchandise, the chain is positioned against Pier 1.

BB&B management (as well as many retail analysts) also attributes the chain's strong sales performance to its superior customer service. As one retail analyst states, BB&B's "management likes to tell the staff that 70 percent of customer reorders rests on their shoulders." Store-level and regional managers spend a lot of time on the sales floor to determine customer trends, as well as to help customers.

BB&B is obsessive about its consumers receiving a consistently high level of customer service whether they are in Boca Raton or New York City. A recent shopper at a suburban Long

The material in this case is drawn from Isadore Barmash, "A Hotbed of Home Decor," *Chain Store Age* (March 2005), pp. 60, 62; and *Bed Bath & Beyond* 2005 *Annual Report*.

Island store reported that a sales clerk was highly attentive. When the shopper asked the clerk where she could find a set of dishes listed on a bridal Registry the clerk immediately dropped what she was doing. The clerk then located the dishes, stood by the shopper as she decided whether to purchase the set, and even had the dishes delivered to a nearby checkout, so that the shopper could continue buying at the store. The sales clerk then met the shopper at the checkout to facilitate the transaction.

Questions

1. Explain how Bed Bath & Beyond practices the retailing concept.
2. Evaluate Bed Bath & Beyond's growth plans.
3. How can Bed Bat.1,. & Beyond increase the overall quality of its customer service?
4. Explain the concept of value from the perspective of a Bed Bath & Beyond customer.

CASE 2: NETFLIX: COMPETING IN A TOUGH MARKETIPLACE

In 1999, Netflix (www.netflix.com) introduced its online DVD rental service; this has been its major offering ever since. For a flat monthly fee, Netflix subscribers can order as many movies as they desire, up to three movies at a time, and they can keep the movie rentals for as long as they want. Unlike other services at that time, such as Blockbuster, Netflix had no due dates or no late fees. The movie rentals generally arrived the next day and titles were rarely out of stock. As of 2005, Netflix had more than 3 million subscribers; and subscriber turnover was extremely low.

According to Reed Hastings, Netflix's chief executive officer, "What you have here is a $500 million market growingl00 percent a year. And. any market that big, growing that fast, is bound to attract competitors." Wal.Mart began offering online rentals of DVDs in June 2003 and in summer 2004, Blockbuster invested. $100 million in an online rental service. In December 2004, Amazon launched an online rental service in Great Britain. Many analysts saw this move as a test for a possible entry by Amazon into the U.S. market.

Hastings sees the competitive environment as a "classic case where our competitors have size, but we have focus." Hastings believes that his firm's major asset is its subscriber base. He also feels that a new feature such as Netflix Friends, which enables users to share movie reviews with each other, is another important competitive advantage.

Of its competitors, Hastings is most concerned about Blockbuster. Netflix has 35 distribution centers (which enable it to reach more than 85 percent of its customers overnight). Blockbuster (www.blockbuster.com) has 25 centers and plans to add more. Hastings recognizes that Netflix has attacked Blockbuster's core business and that Blockbuster will strongly defend it.

*The material in this case is drawn from John Heilemann, "*Show time for Netflix,*" Business 2.0 (March 2005), pp. 36, 38; and "Wal-Mart's Film Flop," Newsday (May 20, 20OS), p. A59.*

In contrast, Hastings does not know if Amazon will invest the resources to build and maintain sufficient distribuW1ters. Competition from Amazon, however, cannot be 'issued. Unlike Blockbuster, Amazon is an Internet firm, has huge base of customers, and has a logistics infrastructure to efficiently distribute DVD rentals.

In May 2005, Wal-Mart decided to exit the online DVD business, a rare defeat for the retailing giant. Wal-Mart worked out an arrangement with Netflix that gave Wal-Mart's DVD customers the chance to continue their subscriptions with Netflix at their current price for one year. Netflix will promote Wal-Mart as a place to purchase DVDs, and Wal-Mart will publicize its arrangement with Netflix.

Many retail analysts are concerned not only with the size and retail backgrounds of Netflix's competitors but also Worry about the possibility of a price war. To stay competitive, Netflix cut the price of its basic subscription plan from t21.99 to $17.99. A few weeks later, Blockbuster cut its main plan (allowing up to three rentals at a time) by $2.50 to $14.99.

Hastings believes that a price war with Blockbuster is unlikely because a price war will cut into the profitability of Blockbuster's store operations. Netflix also has existing soft*ware* and logistics systems that give a significant cost advantage over its competitors: "Our favorite analogy is Dell, which makes money on prices that no one else in the industry can profit from."

Questions

1. Develop specific objectives for Netflix's strategic plan over the next five years.
2. What target market strategy is most appropriate for Netflix? Explain your answer.
3. Describe Netflix's competitive advantages and disadvantages relative to Blockbuster and Amazon.com.
4. Explain why retail analysts are so concerned about a price war for online DVD rentals.

CASE 3: WHAT .LOYALTY PROGRAMS WORK IN BRAZIL?

Peppers & Rogers Group Brazil (www.1tol.com.br), a subsidiary of Carlson Marketing (www.carlsonmarketing.com), recently completed a study of loyalty programs in Brazil. Fifty-three retailers with 21 million loyalty program participants (out of the 186million population for Brazil) were surveyed. Among the retailers represented were firms in the financial services, .telecommunications, travel, .transportation and healthcare industries. Peppers & Rogers focused on Brazil due to its economic growth.. Brazil’s .gross domestic product is now growing by 4 to 5 percent annually, the highest growth rate in a decade.

Six different types of loyalty programs were studied:

- Points: Members receive points, credits, miles, or other on purchases.
- Affinity: Members receive special services not available to nonmembers.
- Discount: Members receive "members only" discounts.
- Partnership: Members receive offers from other firms.
- Fee: Members are required to pay a fee to maintain their membership.
- Communications: Members can send periodic communications based upon their stated interest, past purchases, and demographics.

Here are some of the findings of the study:

- All of the retailers collected basic personal data to develop consumer profiles on loyalty program members. Eighty-seven percent kept transaction-based data to identify purchase amounts and frequency. Eighty-two percent recorded credits and redemptions. Interestingly, 76 percent of the companies restrict access of the data base to the loyalty program.
- Most firms seek to differentiate membership benefits by the value of members. Criteria include the purchase of a given good or service, the frequency of purchase, and the communication channel (for customers that furnish their E-mail address).
- Eighty-nine percent of the firms manage their own loyalty programs. The others sponsor shared programs, are partners in third-party programs, or belong to programs that use a common currency that rewards loyalty.

Retailers were asked to what degree their loyalty program attained specific program goals. The highest levels of goal attainment were associated with member satisfaction, the use of benefits by members, increased profitability, and higher sales by members. For example, two-thirds of the firms that measure trading-up indicators of success and 58 percent that monitor cross-selling indicated that they met or exceeded their goals. Firms reported much lower levels of goal attainment relative to program costs, member cancellation rates, and offering additional goods and services to members.

The study concluded that Brazil's loyalty programs have evolved from short-term means of increasing sales to longer-term customer retention strategies that provide important customer data to retailers. It also found large differences between ineffective and effective loyalty programs. Ineffective programs are thinly disguised advertising messages sent to groups of customers, while effective programs establish a meaningful dialogue between the retailer and the consumer.

Questions

1. Are the six loyalty programs outlined in the case mutually exclusive? Can a retailer have elements of multiple forms of loyalty program? Explain your answers.
2. Describe the pros and cons of restricting the program data to the loyalty program division.
3. Explain this statement: "Brazil's loyalty program has evolved. From short-term means of increasing sales to longer-term customer retention strategies that provide important customer data to retailers."
4. What material from this case can be used by a U.S. super market chain considering a loyalty program?

CASE 4: eBAY EXPANDS AROUND THE GLORE

While as recently as 2000, eBay (www.ebay.com) had virtually no international operations, by 2005, the firm had sites in 31 countries around the world ranging from Brazil to Germany and China. eBay's 2005 foreign operation generated well over $1 billion in revenues, accounting for 46 percent of eBay's trading revenues. And of eBay's 135 million registered users, about half live outside the United States. Since eBay's international sales are growing at twice the rate as .its domestic operations, its international sales will soon surpass domestic sales.

eBay has succeeded abroad because its global strategy flexible enough to adapt to co cultures, while retaining the core elements of its business model. The global strategy is based on playbook that is a bow-to manual that covers such topics as online marketing, category management, and community outreach. The playbook, which is constantly updated, consists of several hundred Web pages that summarize the collective wisdom of all of eBay's worldwide managers.

The playbook details how to drive 'traffic to the local eBay site through online ads at a country's most popular Web sites and search engines. The playbook also dictates that products, information, and chat groups be created by buyers and sellers in that country. Thus, eBay looks and feels like a particular foreign country's Web site brand. This strategy also avoids problems associated with a cookie-cutter approach to Web site planning on a global basis.

Meg Whitman, who became eBay's CEO in 1998, originally wanted to perfect eBay's concept in the United States before going abroad. However, she soon realized that many small competitors were springing up around the world. She became concerned that unless eBay went global, she would forfeit many opportunities to these small local firms or to major firms such as Amazon and Yahoo!

eBay's first foreign country was Germany, chosen in part due to the country's .40 million Internet users. eBay purchased Alando, an eBay copycat site, for $47 million in June 1999.. A German business student had started Alando four months earlier: From the start, eBay was careful to adapt its sites to a country's culture. For example, a lot of time and effort went into figuring out how to structure categories based on German customers' needs. Today, Germany is eBay's largest international site, with estimated annual total sales of $7 billion versus $20 billion for the United States.

Shortly after purchasing Alando, eBay launched its own sites in Great Britain and Australia. In 2001, eBay purchased Korea's Internet Auction Co. and Europe's iBazar (which gave eBay immediate access to Italy, the Netherlands, and Spain). eBay then purchased a minority interest in MercadoLibre, Latin America's leading auction firm. In total, eBay has invested nearly $2 billion in its international acquisitions.

Questions

1. Comment on the choice of Germany as eBay's international market
2. Evaluate the pros and cons of eBay's playbook strategy.
3. Describe the pros and cons of eBay's entering an international market by purchasing a foreign firm rather than building an operation from scratch.
4. Comment on this statement: "eBay has succeeded abroad because its global strategy is flexible enough to adapt to countries with vastly different cultures, while retaining the core elements of its business mode."

3.8 Review questions

1. Why is it necessary to develop a thorough, well- integrated retail strategy? What could happen if a firm does not develop such a strategy?
2. How would situation analysis differ for a major appliance store chain and an online major appliance retailer?
3. Draw and explain a positioning map showing the kinds of retailers selling cell phones and cell phone monthly service plans.
4. Discuss local examples of retailers applying mass marketing, concentrated marketing, and differentiated marketing.
5. How are the control and feedback phases of retail strategy planning interrelated? Give an example
6. Describe how a retailer can use fine- tuning in strategic planning.

BUILDING AND SUSTAINING COMPETITIVENESS – A STRATEGIC APPROACH

Structure

4.1 Introduction

In this Unit we will learn about what "value" really means and highlight its pivotal role in retailer's building and sustaining relationships.

The final element in a retail strategy is the retailer's approach to building a sustainable competitive advantage. Any business activity that a retailer engages in can be the basis for a competitive advantage, but some advantages are sustainable over a long period of time, whereas others can be duplicated by competitors almost immediately. It's hard for retailers to develop a long term advantage by offering broader or deeper merchandise assortments. If broader and deeper assortments attract a lot of customers, competitors will simply go out and buy the same merchandise for their stores.

Establishing a competitive advantage means that the retailer, in effect, builds a wall around its position in a retail market. When the wall is high, it will be hard for competitors outside the wall (i.e. operating in other markets or entrepreneurs) to enter the market and compete for the retailer's target customers.

Over time, all advantage will be eroded due to competitive forces, but by building high, thick walls, retailers can sustain their advantage, minimize competitive pressure, and boost profits for a longer time. Thus, establishing a sustainable competitive advantage is the key to positive long – term financial performance.

4.2 Methods of Developing Sustaining Competitive Advantage

Seven important opportunities for retailers to develop sustainable competitive advantages are as follows: (1) Customer Loyalty (2) Location (3) Human Resource Management (4) Distribution and Information systems (5) Unique Merchandise (6) Vendor Relations, and (7) Customer Service

4.2.1 Customer Loyalty

Customer Loyalty means that customers are committed to buying merchandise and services from a particular retailer. Other bases for sustainable competitive advantage discussed in this section help attract and maintain loyal customers; for instance, having dedicated employees, unique merchandise, and superior customer service all help solidify a loyal customer base. But having loyal customers is, in and of itself, an important method of sustaining an advantage over competitors.

Loyalty is more than simply liking one retailer over another. Loyalty means that customers will be reluctant to patronize competitive retailers. For example, loyal customers will continue to shop at Magazine Luiza even if a competitor opens a store nearby and provides slightly lower prices. Some ways that retailers build loyalty are by (1) developing a strong brand for the store or store brands, (2) developing clear and precise positioning strategies and (3) creating an emotional attachment with customers through loyalty programs.

Retail Branding: Stores use brands to build loyalty in much the same way that manufacturers do. A retail brand, whether it is the name of the retailer or a private label, can create an emotional tie with customers that build their trust and loyalty. People know, for instance, that when they buy the L.L. Bean brand, they can be assured that the products are "guaranteed to give 100% satisfaction in every way. Retail brands also facilitate store loyalty because they stand for a predictable level of quality that customers feel comfortable with and often seek.

Positioning: It involves the design and implementation of a retail mix to create an image of the retailer in the customer's mind relative to its competitors. Furthermore, positioning emphasizes that the image in the customer's mind (not then retail manager's mind) is critical. Retailers that are closer to an ideal point are evaluated more favorable by the customers in the segment than are retailers located farther away.

Loyalty Programs: Loyalty programs are part of an overall customer relationship management (CRM) program. These programs are prevalent in retailing, from department stores to the local pizza shop.

These programs work hand – in hand with CRM. Members of loyalty programs are identified when they buy because they use some type of loyalty card. Their purchase information then is stored in a huge database known as a **data warehouse.** From this data warehouse, analysts determine what types of merchandise and services certain groups of customers are buying. Using this information, retailers can tailor their offerings to better meet the need of their loyal customers.

4.2.2 Location

Location is the critical factor in consumer's selection of a store. For example, most people shop at the supermarket closest to where they live. A competitive advantage based on location is sustainable because it is not easily duplicated. For instance, once Walgreens has put a store at the best location at an intersection, CVS is relegated to the second – best location. Starbucks has developed a strong competitive advantage with its location selection. It conquers one area of the city at a time and then expands in the region, saturating a major market before entering a new market.

4.2.3 Human Resource Management

Retailing is a labor- intensive business, in which employees play a major role in providing services for customers and building customer loyalty. Knowledgeable and skilled employees committed to the retailer's objectives are critical assets that support the success of companies such as southwest Airlines, Whole Foods, Home Depot, and Men's Wear house.

Recruiting and retaining great employees does not come easy. Retailers gain a sustainable competitive advantage by developing programs to motivate and coordinate employee efforts, providing appropriate incentives, fostering a strong and positive organizational culture and environment and managing diversity.

4.2.4 Distribution and Information systems

All retailers strive to reduce operating costs – the costs associated with running the business – and make sure the merchandise that customers want is available. Then retailers can decide how to use the costs savings they achieve. They could offer even better service, increase the breath and depth of their merchandise assortments, or lower prices to differentiate themselves from competition.

Retailers achieve these efficiencies by developing sophisticated distribution and information systems and sharing information with vendors. For instance, merchandise sales information flows seamlessly from Wal- Mart to its Vendors, like Procter & Gamble, to facilitate quick and efficient merchandise replenishment that avoids costly stock outs. Wal- Mart has the largest data warehouse in the world, enabling the company to fine – tune its merchandise assortments on a store- by- store, category- by- category basis.

4.2.5 Unique Merchandise

It is difficult for retailers to develop a competitive advantage through merchandise because most competitors can purchase and sell the same popular national brands. But many retailers realize a sustainable competitive advantage by developing **private label brands** (also called *store brands*), which are products developed and marketed by a retailer and available only from that retailer.

4.2.6 Vendor Relations

By developing strong relations with vendors, retailers may gain exclusive rights to (1) sell merchandise in a specific region, (2) obtain special terms of purchase that are not available to competitors who lack such relationships, or (3) receive popular merchandise in short supply. Relationships with vendors, like relationships with customers, are developed over a long time and may not be easily offset by a competitor. For example, Ahold, the Holland – based food retailer, works very closely with Swiss food giant Nestle to bring its customers products that are tailored to meet their local tastes.

4.2.7 Customer Service

Retailers also can build a sustainable competitive advantage by offering excellent customer service. Offering good service consistently is difficult because customer service is provided by retail employees, and humans are less consistent than machines. The quality of service can vary from person to person and from day to day. Retailers that offer good customer service instill its importance in their employees over a long period of time through coaching and training. In this way, customer service becomes part of the retailer’s organizational culture

SUSTAINABILTY OF ADVANTAGE		
Sources of Advantage	**Less Sustainable**	**More Sustainable**
Customer Loyalty	Habitual repeat purchasing; repeat purchases because of limited competition in the local area	Building brand image with an emotional connection with customers; using databases to develop and utilize a deeper understanding of customers
Location	-	Convenient Locations
Human Resource Management	More employees	Committed, knowledgeable employees
Distribution and Information Systems	Bigger warehouses; automated warehouses	Shared systems with vendors
Unique Merchandise	More merchandise; greater assortment; lower price; higher advertising budgets; more sales promotions	Exclusive merchandise
Vendor relations	Repeat purchases from vendor due to limited alternatives	Coordination of procurement efforts; ability to get scarce merchandise
Customer Service	Hours of operation	Knowledgeable and helpful salespeople

Table 4.1 Methods of Developing Sustainable Competitive Advantage

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4.3 Value and the Value Chain

In many channels of distribution, there are several parties: manufacturer, wholesaler, retailer, and customer. These parties are most apt to be satisfied with their interactions when they have similar beliefs about the value provided and received, and they agree on the payment for that level of value.

From the perspective of the manufacturer, wholesaler, and retailer, **Value** is embodied by a series of activities and processes-a value chain-that *provides* a certain value for the consumer. It is the totality of the tangible and intangible product and customer service attributes offered to shoppers. The level of value relates to each firm's desire for a fair profit and its niche (such as discount versus upscale). Where firms may differ is in rewarding the value each provides and in allocating the activities undertaken.

From the customer's perspective, **Value** is the *perception* the shopper has of a value chain. It is the customer's view of all the benefits from a purchase (formed by the total retail experience). Value is based on the perceived benefits received versus the price paid. It varies by type of shopper. Price-oriented shoppers want low prices, service-oriented shoppers will pay more for superior customer service, and status-oriented shoppers will pay a lot to patronize prestigious stores.

Why is **"Value"** such a meaningful concept for every retailer in any kind of setting?

- Customers must always believe they get their money's worth, whether the retailer sells $20,000 Rolex watches or $40 Casio watches.
- A strong retail effort is required so that customers perceive the level of value provided in the manner the firm intends.
- Value is desired by all customers; however, it means different things to different customers.
- Consumer comparison shopping for prices is easy through ads and the World Wide Web. Thus, prices have moved closer together for different types of retailers.
- Retail differentiation is essential so a firm is not perceived as a "me too" retailer.
- A specific value/price level must be set. A retailer can offer $100 worth of benefits for a $100 item or $125 worth of benefits (through better ambience and customer service) for the same item and a $125 price. Either approach can work if properly enacted and marketed.

A retail **value chain** represents the total bundle of benefits offered to consumers through a channel of distribution. It comprises store location and parking, retailer ambience, the level of customer service, the products/brands carried, product quality, the retailer's in-stock position, shipping, prices, the retailer's image, and other elements. As a rule, consumers are concerned with the results of a value chain, not the process. Food shoppers who buy online via Peapod care only that they receive the brands ordered when desired, not about the steps needed for home delivery at the neighborhood level.

Some elements of a retail value chain are visible to shoppers, such as display windows, store hours, sales personnel, and point-of-sale equipment. Other elements are not visible, such as store location planning, credit processing, and company warehouses, and many merchandising decisions. In the latter case, various cues are surrogates for value: upscale store ambience and plentiful sales personnel for high-end retailers; shopping carts and self-service for discounters.

There are three aspects of a value-oriented retail strategy: expected, augmented, and potential. An *expected retail strategy* represents the minimum value chain elements a given customer segment (e.g., young women) expects from type *of* retailer (e.g., a mid-priced apparel retailer). In most cases, the following are expected value chain elements: store cleanliness, convenient hours, well-informed employees, timely service, and popular products in stock, parking, and return privileges. If applied poorly, expected elements cause customer dissatisfaction and relate to why shoppers avoid certain retailers.

An *augmented retail strategy* includes the extra elements in a value chain that differentiate one retailer from another. As an example, how is Sears different from Saks? The following are often augmented elements: exclusive brands, superior salespeople, loyalty programs, delivery, personal shoppers and other special services, and valet parking. Augmented features complement expected value chain elements, and they are the key to continued customer patronage with a particular retailer.

A *potential retail strategy* comprises value chain elements not yet perfected by a competing firm in the retailer's category. For example, what customer service could a new upscale apparel chain offer that no other chain offers? In many situations, the following are potential value chain elements: 24/7 store hours (an augmented strategy for supermarkets), unlimited customer return privileges, full scale product customization, instant fulfillment of rain checks through in-store orders accompanied by free delivery, and in-mall trams to make it easier for shoppers to move through enormous regional shopping centers. The first firms to capitalize on potential features gain a head start over their adversaries. Barnes & Noble and Borders accomplished this by opening the first book superstores, and Amazon.com has become a major player by opening the first online bookstore. Yet, even as pioneers, firms must excel at meeting customers' basic expectations and offering differentiated features from competitors if they are to grow.

4.3.1 Potential Pitfalls to Avoid in Planning a Value-Oriented Retail Strategy

- *Planning value with just a price perspective:* Value is tied to two factors: benefits and prices. Most discounters now accept credit cards because shoppers want to purchase with them.
- *Providing value-enhancing services that customers do not want or will not pay extra for:* Ikea knows most of its customers want to save money by assembling furniture themselves.
- *Competing in the wrong value/price segment:* Neighborhood retailers generally have a tough time competing in the low-price part of the market. They are better off providing augmented benefits and charging somewhat more than large chains.
- *Believing augmented elements alone create value:* Many retailers think that if they offer a benefit not available from competitors that they will automatically prosper. Yet, they must never lose sight of the importance of expected benefits. A movie theater with limited parking will have problems even if it features first-run movies.
- *Paying lip service to customer service:* Most firms say, and even believe, that customers are always right. Yet, they act contrary to this philosophy-by having a high turnover of salespeople, charging for returned goods that have been opened, and not giving rain checks if items are out of stock.

Table 4.2 A Value-Oriented Retailing Checklist

✓ Is value defined from a consumer perspective?
✓ Does the retailer have a clear value/ price point?
✓ Is the retailer’s value position competitively defensible?
✓ Are channel partners capable of delivering value-enhancing services?
✓ Does the retailer distinguish between expected and augmented value chain elements?
✓ Has the retailer identified meaningful potential value chain elements?
✓ Is the retailer’s value-oriented approach aimed at a distinct market segment?
✓ Is the retailer’s value-oriented approach consistent?
✓ Is the retailer’s value-oriented approach effectively communicated to the target market?

✓ Can the target market clearly identify the retailer's positioning strategy?
✓ Does the retailer's positioning strategy considers trade-offs in sales versus profits?
✓ Does the retailer set customer satisfaction goals?
✓ Does the retailer periodically measure customer satisfaction levels?
✓ Is the retailer careful to avoid the pitfalls in value-oriented retailing?
✓ Is the retailer always looking out for new opportunities that will create customer value?

4.4 Retailer Relationships

We have already introduced the concept of *relationship retailing,* whereby retailers seek to form and maintain long-term bonds with customers, rather than act as if each sales transaction is a new encounter with them. For relationship retailing to work, enduring value-driven relationships are needed with other channel members, as well as with customers. Both jobs are challenging.

4.4.1 Customer Relationships

Loyal customers are the backbone of a business. For example, besides having strong and able franchisees, nothing is more important to the well-being of a restaurant or retail franchisor than a loyal customer. In fact, nothing probably even comes close. A chain's most loyal customers are those who are "highly satisfied" and they bring with them considerably more clout to a franchisor's bottom line than customers who are just "satisfied." According to the *Harvard Business Review,* an exceptionally-satisfied customer is six times more likely to buy again as one who is merely satisfied. And only a five percent increase in customer loyalty can boost profits 25 percent to 85 percent.

In relationship retailing, there are four factors to keep in mind: the customer base, customer service, customer satisfaction, and loyalty programs and defection rates.

In relationships retailing, there are four factors to keep in mind:

a) Customer Base
b) Customer Service
c) Customer Satisfaction
d) Loyalty Programs

(a) Customer Base

Retailers must regularly analyze their customer base in terms of population and lifestyle trends, attitudes toward and reasons for shopping, the level of loyalty, and the mix of new versus loyal customers

There are various factors that influence shopping behavior. Here are some examples:

- In 1985, women bought 70 percent of men's products; today, they buy only 25 percent due to the increased shopping done by men. Women do more product research before shopping and are less apt to be influenced by ads than are men.
- On a typical mall shopping trip, women spend about 10 percent more than their male counterparts.
- Due to time constraints, consumers now spend an average of only 75 minutes

when visiting a shopping mall.

- Consumers' most important reasons to shop at a given *food store* are high quality fresh foods, good value, and healthy food alternatives.
- Consumers give *department stores* high marks for the brands and styles they carry but lower marks for prices.
- Consumers at *supercenters* and *discount department stores* tend to be households in the family life stages, often in the down- and middle-income brackets. These retailers are popular for many different product categories.

b) Customer Service

C*ustomer service* refers to the identifiable, but sometimes tangible, activities undertaken by a retailer in conjunction with the goods and services it sells. It impacts on the total retail experience. Consistent with a value chain philosophy, retailers must apply two elements of customer service: **Expected customer service** is the service level that customers want to receive from any retailer, such as basic employee courtesy. **Augmented customer service** includes the activities enhance the shopping experience and give retailers a competitive advantage.

Table 4.3 (a) Typical Customer Services

❋ Credit
❋ Delivery
❋ Alterations/ Installations
❋ Packaging/ gift wrapping
❋ Complaints/ Return handling
❋ Gift certificates
❋ Trade-ins
❋ Trial purchases
❋ Special sales
❋ Extended store hours
❋ Mail and phone orders

Table 4.4 (b) Miscellaneous Customer Services

❋ Bridal registry
❋ Interior designers
❋ Personal shoppers
❋ Ticket outlets
❋ Parking
❋ Water fountains
❋ Pay phones
❋ Baby strollers
❋ Restrooms
❋ Restaurants
❋ Baby-sitting

❋ Fitting rooms
❋ Beauty salons
❋ Fur storage
❋ Shopping bags
❋ Information

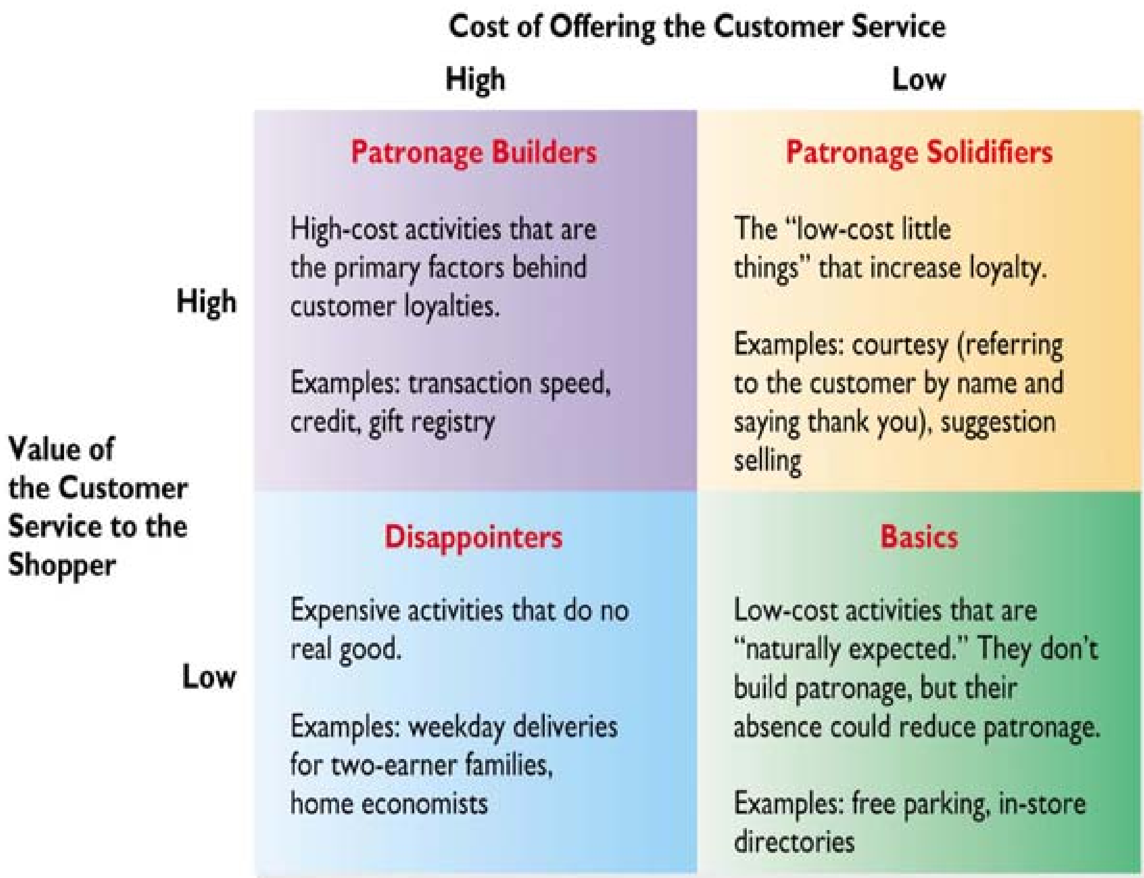


Figure Fig 4.1 Classifying Customer Services

(c) Customer Satisfaction

Customer satisfaction occurs when the value and customer service provided through a retailing experience meet or exceed consumer expectations. If the expectations of value and customer service are not met, the consumer will be dissatisfied: "Retail satisfaction consists of three categories: shopping systems satisfaction which includes availability and types of outlets; buying systems satisfaction which includes selection and actual purchasing of products; and consumer satisfaction derived from the use of the product. Dissatisfaction with any of the three aspects could lead to customer disloyalty, decrease in sales, and erosion of the market share

Figure 4.2 Turning around Weak Customer Service

Focus on Customer Concerns	Empower Frontline Employees	Show that you are listening	Express Sincere Understanding	Apologize and Rectify the Situation
"Employees must View customer Complaints as *Concerns.* This will Shift a negative Situation into one that is positive, Helpful, and Productive."	"You can often prevent customers from becoming upset if you empower frontline employees to make reasonable on – the – spot decisions."	"When a Customer voices, dissatisfaction, listen without interrupting. Then prove that you've heard him or her. That means repeating and paraphrasing."	"Upset customers need to know that you care – not just about their problem- but about their frustration. So, empathize use phrases like, 'I'd feel the same way if I were you."	"Say I'm sorry. Even when you suspect the customer is wrong, it's better to give him or her benefit of the doubt. On top of an exchange or refund, give a token of appreciation for the inconvenience."

(d) Loyalty Programs

Consumer loyalty (frequent shopper) programs reward a retailer's best customers, those with whom it wants long-lasting relationships.

Their rewards are useful and appealing, and they are attainable in a reasonable time. The programs honor shopping behavior (the greater the purchases, the greater the benefits). A database tracks behavior. There are features that are unique to particular retailers and not redeemable elsewhere. Rewards stimulate both short- and long run purchases. Customer communications are personalized. Frequent shoppers feel "specia1." Participation rules are publicized and rarely change.

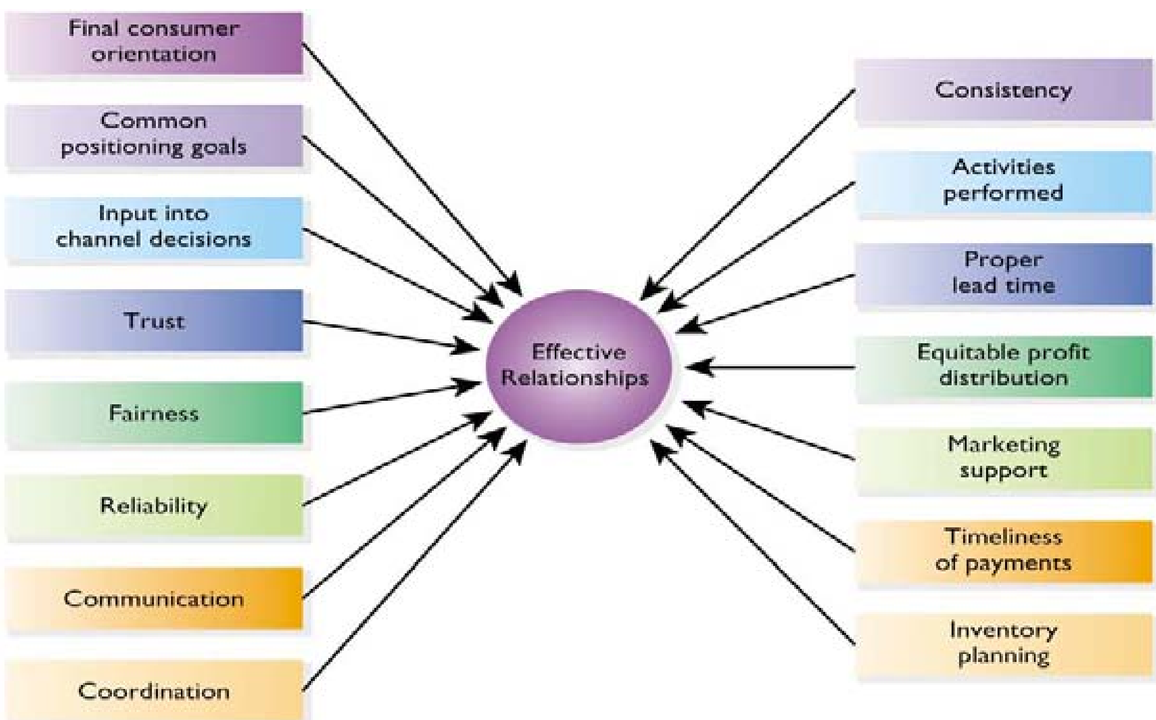
4.4.2 Channel Relationships

Within a value chain, the members of a distribution channel (manufacturers, wholesalers, and retailers) jointly represent a value delivery system, which comprises all the parties that develop, produce, deliver, and sell and service particular goods and services. The ramifications for retailers follow:

- Each channel member is dependent on the others. When consumers shop with a certain retailer, they often do so because of both the retailer and the products it carries.
- All value delivery systems activity must be enumerated and responsibility assigned for them.

- Small retailers may have to use suppliers outside the normal distribution channel to get the products they want and gain adequate supplier support. Although large retailers may be able to buy directly from manufacturers, smaller retailers may have to buy through wholesalers handling such accounts.
- A value delivery system is as good as its weakest link. No matter how well a retailer performs its activities, it will still have unhappy shoppers if suppliers deliver late or do not honor warranties.
- The nature of a given value delivery system must be related to target market expectations.
- Channel member costs and functions are influenced by each party's role. Long – term cooperation and two – way information flows foster efficiency.
- Value delivery systems are complex due to the vast product assortment of superstores, the many forms of retailing, and the use of multiple distribution channels by some manufacturers.
- Non store retailing (such as mail order, phone, and web transactions) requires a different delivery system than store retailing.
- Due to conflicting goals about profit margins, shelf space, and so on, some channel members are adversarial – to the detriment of the value delivery system and channel relationships.

Figure 4.3 Elements Contributing to Effective Channel Relationships



Top Retailers in India

Pantaloon Retail (India)
Pantaloon's managing director Kishore Biyani believes in changing the rules. When Pantaloon started the Big Bazaar discount stores in 2002, malls were not part of the shopping culture. Big Bazaar became a hit, as it combined the look and feel of Indian bazaars with aspects of modern retail like choice, convenience and quality. Headquartered in Mumbai, the Rs 3,500-crore company now operates over 5 million sq ft across 40 cities.

Shopper's Stop
A menswear store owned by K Raheja in the Mumbai suburb of Andheri in 1991 has now transformed into Shopper's Stop, with 27 departmental stores. The company entered airport retailing in a joint venture with the Nuance Group. It also launched India's largest hypermarket, Hypercity. In 2005, it bought the Crossword bookstore chain.

Lifestyle
Growing from one store in Bahrain in 1973, the NRI-led Landmark Group today operates over 5 million sq ft in the Middle East and India. The group's first Lifestyle store in India opened in Chennai in 1999. Now it has 325,000 sq ft in Chennai, Hyderabad, Bangalore, Gurgaon and Mumbai. Its first hypermarket, branded as 'Max', is expected to open soon.

Reliance Retail
Mukesh Ambani's 15,000-people Reliance Retail has opened 250 convenience stores, branded as 'Fresh', across the southern states. It is now planning to launch 30 such outlets in Mumbai. Reliance Retail plans to invest Rs 25,000 crore on hypermarkets, supermarkets and specialty stores in the next four years. The first hypermarket will be up in Ahmedabad by the end of July.

Aditya Birla Retail
The company, which will operate under the brand 'More', has selected two formats — hypermarkets and supermarkets — for its initial foray. The first store has opened in Pune. Last January, the company acquired Trinethra Super Retail, which has given it more than 5,00, 000 sq ft and a strong presence in the South. The Birlas' outlay for the business over the next three years is Rs 9,000 crore.

Bharti Retail
The world's largest retailer Wal-Mart, which prefers to go it alone outside the US, chose Sunil Mittal's Bharti Enterprises as its partner in India. The venture will start with the cash & carry (wholesale) format, which could be extended to retail operations once foreign direct investment is allowed in multi-brand retail, as is expected. The entity is yet to start operations as the formal agreement has not been inked

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4.5 Technology and Relationships in Retailing

Technology is beneficial to retailing relationships if it facilitates a better communication flow between retailers and their customers, as well as between retailers and their suppliers, and there are faster, more dependable transactions.

These two points are key in studying technology and its impact on relationships in retailing: (1) in each firm, the roles of technology and "humans" must be clear and consistent with the goals and style of that business. Although technology can facilitate customer service, it may become overloaded and break down. It is also viewed as impersonal by some consumers. New technology must be set up efficiently with minimal disruptions to suppliers, employees, and customers. (2) Shoppers expect certain operations to be in place, so they can rapidly complete credit transactions, get feedback on product availability, and so on. Firms have to deploy some advances (such as a computerized checkout system) simply to be competitive. By enacting other advances, they can be distinctive. For instance, consider the paint store with computerized paint-matching equipment for customers who want to touch up old jobs

Fig 4.4 Selected Factors Affecting Consumer Perceptions of Service Retailing

4.5.1 Electronic Banking

Electronic banking involves both the use of automatic teller machines (ATMs) the instant processing of retail purchases. It allows centralized record keeping and lets customer's complete transactions 24 hours a day, 7 days a week at bank and nonblank locations-including home or office. Besides its use in typical financial transactions (such as check cashing, deposits, withdrawals, and transfers), electronic banking is now used in retailing. Many retailers accept some form of electronic debit payment plan whereby the purchase price is immediately deducted from a consumer's bank account by computer and transferred to the retailer's account

4.5.2 Customer and Supplier Interactions

Technology is changing the nature of retailer-customer and retailer-supplier interactions. If applied well, benefits accrue to all parties. If not, there are negative ramifications. Here are several illustrations.

Retailers widely use point-of-sale scanning equipment. Why? By electronically scanning products (rather than having cashiers "ring up" each product), retailers can quickly complete transactions, amass sales data, give feedback to suppliers, place and receive orders faster, reduce costs, and adjust inventory. There is a downside to scanning: the error rate. This can upset consumers, especially if they perceive scanning to be inaccurate. Yet, according to a Federal Trade Commission (FTC) study, scanner errors in reading prices occurred only 3.4 percent of the time; and although consumers believe that most errors result in overcharges, the FTC found that overcharges and undercharges were equally likely. On way to assure consumers is to display more information at the point of purchase.

Other technological innovations are also influencing retail interactions. Here are examples:

- Many retailers think they have the answer to the problem of finding the perfect gift-the electronic gift card. They have become so popular that two thirds of u.s. adults buy or receive at least one gift card each year: "Gift cards have done more than revolutionize the practice of gift giving. They redefine how consumers shop, employers motivate, parents manage spending, and retailers boost sales. The leading occasion for gift card purchases is birthdays and, second, the winter holidays.
- Interactive electronic kiosks are gaining in use: "It's a shame to waste a minute in Honolulu, so that may be why Hilton Hotels chose that city's airport to demo its new off-site check-in kiosk. Arriving fliers can use it to get their magnetic keys, so when they get to the hotel they can go straight to their rooms. The kiosks expand the efforts of several hotel chains, including Hilton and Hyatt, which are each adding kiosks to hotel lobbies. Hilton's also reversing the deal, letting American Airlines put a kiosk in the lobby of the O'Hare Hilton."
- More retailers are using Web portals to exchange information with suppliers: "ChainDrugStore.net (www.chaindrugstore.net) is a secure online communications network connecting suppliers, wholesalers, and retailers in the retail pharmacy industry with vital information critical to business operations of each." The site "provides hundreds of companies of all sizes with new ways to build, sustain, and enhance trading relationships while increasing efficiencies and reducing costs. ChainDrugStore.net is a wholly-owned subsidiary of the National Association of Chain Drug Stores".

4.6 Ethical Performance and Relationships in Retailing

Ethical challenges fall into three interconnected categories: *Ethics* related to the retailer's moral principles and values. *Social responsibility* involves acts benefiting society. *Consumerism* entails protecting consumer rights. "Good" behavior depends not only on the retailer but also on the expectations of the community in which it does business.

4.6.1 Ethics

In dealing with their constituencies (customers, the general public, employees, suppliers, competitors, and others), retailers have a moral obligation to act ethically. Furthermore, due to the media attention paid to firms' behavior and the high expectations people have today, a failure to be ethical may lead to adverse publicity, lawsuits, the loss of customers, and a lack of self-respect among employees.

When a retailer has a sense of **ethics,** it acts in a trustworthy, fair, honest, and respectful manner with each of its constituencies. Executives must articulate to employees and channel partners which kinds of behavior are acceptable and which are not. The best way to avoid unethical acts is for firms to have written ethics codes, to distribute them to employees and channel partners, to monitor behavior, and to punish poor behavior - and for top managers to be highly ethical in their own conduct. See Figure 4.5

Most observers would agree that practices such as these are unethical (and sometimes illegal, too):

- Raising prices on scarce products after a natural disaster such as a hurricane.
- Not having adequate stock when a sale is advertised.
- Charging high prices in low income areas because consumers there do not have the transportation mobility to shop out of their neighborhoods.
- Selling alcohol and tobacco products to children.
- Having a sales person pose as a market researcher when engaged in telemarketing.
- Defaming competitors.
- Selling refurbished merchandise as new.
- Pressuring employees to push high-profit items, even if these items are not the best products.
- Selling information from a customer database.

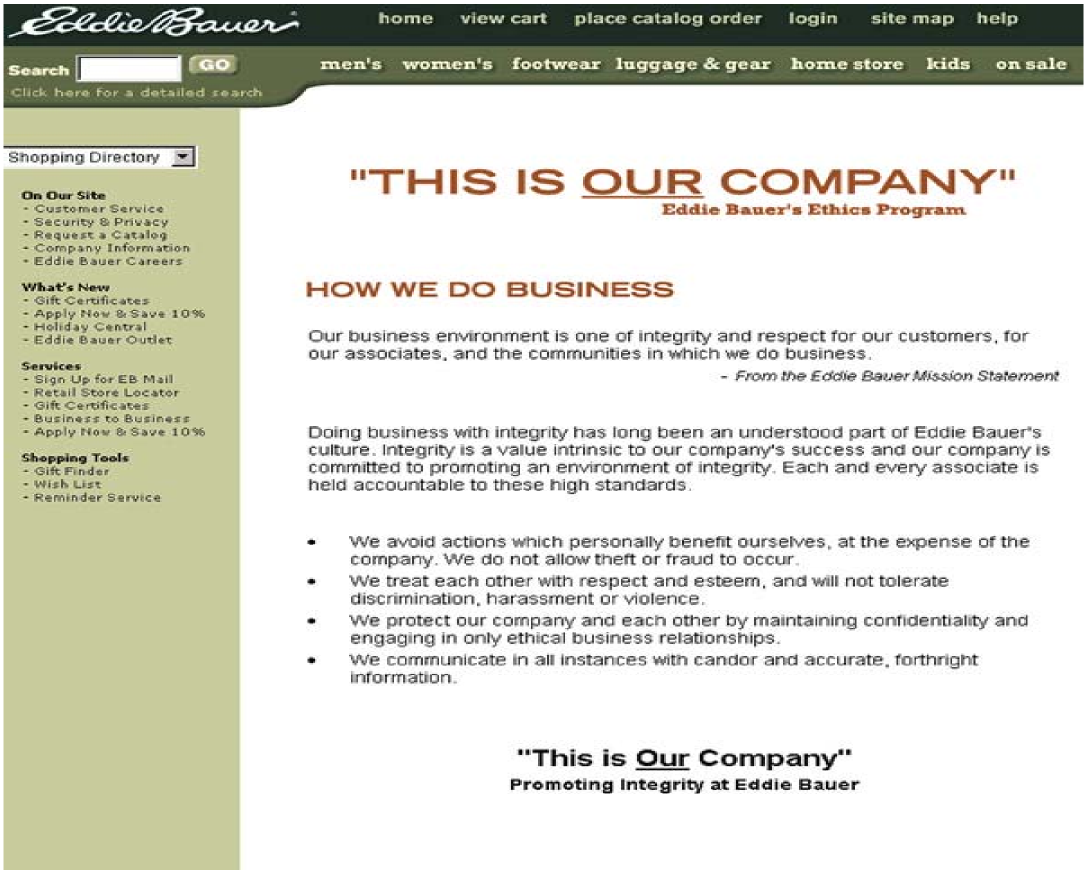

Fig 4.5 Eddie Bauer: Strong Ethical Sensibilities

4.6.2 Social Responsibility

A retailer exhibiting **social responsibility** acts in the best interests of society – as well as itself. The challenge is to balance corporate citizenship with fair level profits for stockholders, management, and employees. Some forms of social responsibility are virtually cost-free, such as having employees participate in community events or disposing of waste products in a more careful way. Some are more costly, such as making donations to charitable groups or giving away goods and services to a school. Still others mean going above and beyond the letter of law, such as having free loaner wheelchairs for persons with disabilities besides legally mandated wheelchair accessibility to retail premises.

Most retailers know socially responsible acts do not go unnoticed. Though the acts may not stimulate greater patronage for firms with weak strategies, they can be a customer inducement for those otherwise viewed as "me too" entities. It may also be possible to profit from good deeds. If a retailer donates excess inventory to a charity that cares for the ill, it can take a tax deduction equal to the cost of the goods plus one-half the difference between the cost and the retail price. To do this, a retailer must be a corporation and the charity must use the goods and not sell or trade them.

4.6.3 Consumerism

Consumerism involves the activities of government, business, and other organizations to protect people from practices infringing upon their rights as consumers. These actions recognize that consumer have basic right that should be safeguard. As President Kennedy said about 45 years ago, consumers have the *right to safety* (protection against unsafe conditions and hazardous goods and services), the *right to be informed* (protection against fraudulent, deceptive, and incomplete information, advertising, and labeling), the *right to choose* (access to a variety of goods, services, and retailers), and the *right to be heard* (consumer feedback, both positive and negative, to the firm and to government agencies).

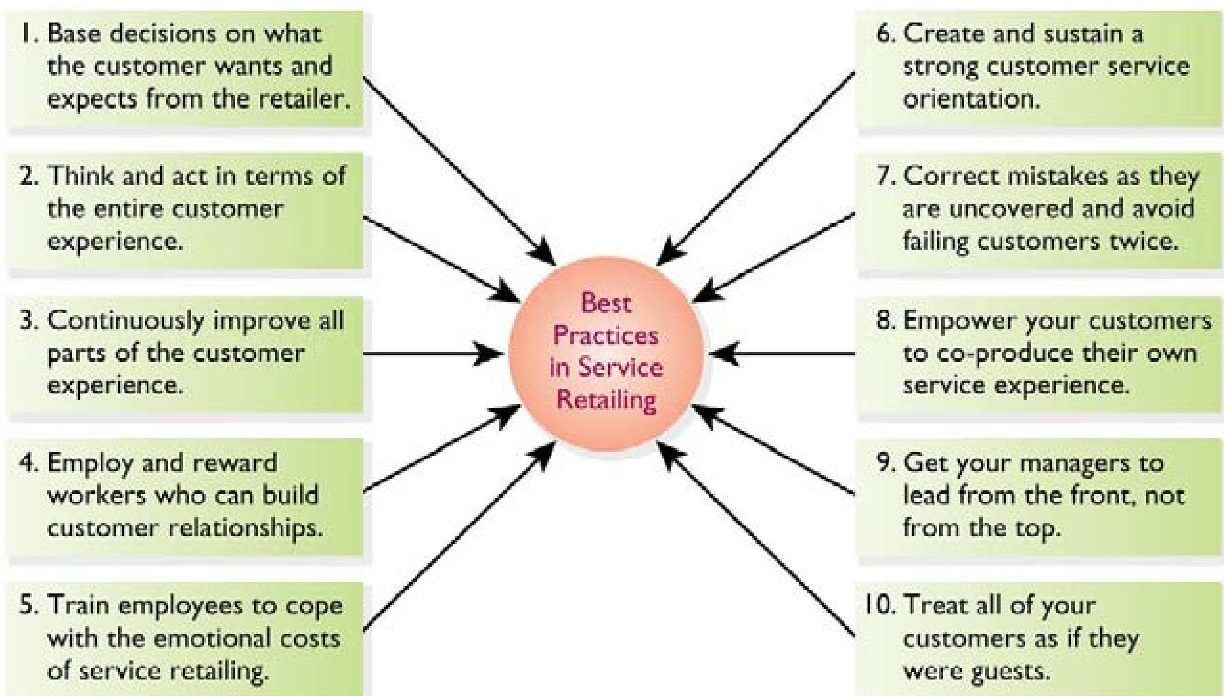

Fig 4.6 Lessons in Service Retailing

4.7 Review Questions

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1. What are the expected and augmented value chain elements for each of these retailers?
    a. Roadside dinner
    b. Resort Hotel.
    c. Local Bank

2. Why should a retailer devote special attention to its core customers? How should it do so?

4. What is the connection between customer service and employee empowerment? Is employee empowerment a good idea? Why or why not?

5. How would you measure the level of customer satisfaction with your college's bookstore?

6. Devise a consumer loyalty program for a national hardware store chain.

7. What are the unique aspects of service retailing? Give an example of each.

8. Describe three unethical, but legal, acts on the part of retailers that you have encountered. How have you reacted in each case?

CUSTOMER RELATIONSHIP MANAGEMENT

Structure

5.1 Introduction

5.2 Relationship Marketing as New Paradigm

5.3 Customer Lifetime Value and Relationship Lifecycle
- 5.3.1 Application of Customer Life Time Value
- 5.3.2 Monetary and Non Monetary Effects of Loyalty
- 5.3.3 Customer Relationship Lifecycle

5.4 Customer Loyalty and Customer Satisfaction
- 5.4.1 Customer Satisfaction

5.5 Loyalty Marketing of Retailers
- 5.5.1 Reward Accumulation Functions
- 5.5.2 Analyzing Customer Data
- 5.5.3 Using Customer Data
- 5.5.4 Loyalty Marketing on the Internet

5.6 Case Study: Tesco

5.1 Introduction

Building enduring relationships with customers has become a prime strategic objective of retail marketing. The purpose of this Chapter is to explain the new paradigm of relationship marketing and to introduce the underlying principles of customer value, the relationship lifecycle and the constructs of customer loyalty and customer satisfaction. In retailing, loyalty programmes are manifestations of customer relationship management.

5.2 Relationship Marketing as New Paradigm

Traditionally, marketing has focused on attracting new customers for a company. Today, however, companies recognize the importance of retaining current customers by forming relationships with them (Kotler et al. 2002, p. 405). This focus on relationships builds on the premise that it is less expensive to market to existing customers than to acquire new ones (Reich held/Sasser 1990). *Relationship marketing,* a term usually used synonymously with ***customer relationship management*** (CRM), involves establishing, main training and enhancing long term relationships with customers (Morgan/Hunt 1994).

With this perspective, the manager's primary task is to identify profitable and non profitable customers, focus efforts on the former and balance the cost of acquiring and retaining customers with current and potential revenue from those customers (Bechwati / Eshghi 2005, p. 88).

In retailing, advances in IT and the spread of loyalty cards have provided a means for retailers to identify a particular customer and to collect customer specific data, thus enabling individualized marketing. Compared to other industries, retailing has tremendous advantages in CRM, since it is in direct contact with the consumer (Hansiota/Rukstales 2002, p. 260).
Even though the methods proposed for CRM are very heterogeneous, some common and underlying principles have emerged (Homburg/Sieben 2005, p. 437 438):

- *Customer information*: Companies must gather reliable and detailed information on their existing and potential customers, usually stored in an IT based customer data base.
- *Individualization/segmentation*: A strong customer orientation leads to a targeted approach to individual customers or customer segments, in stead of a standardized mass market approach to retail marketing.
- *Profit orientation*: Not all customers are treated equally. Rather, they are classified and prioritized in terms of their profit potential for the company. Investment in customers is undertaken on the basis of their profit ability.
- *Customer interaction and integration*: Instead of one directional communication (such as traditional advertising), the aim is to achieve a two directional interaction with the customer, including a stronger integration in the value added process.

5.3 Customer Lifetime Value and Relationship Lifecycle

In the context of long term customer relationships, loyal customers can be seen as an nduring *asset* for the retailer (Shugan 2005, p. 191). Customers spend money on certain product categories not just once, but generally regularly (weekly, monthly, yearly) for the rest of their lives. Since the purchasing relationship might extend over many years, the future revenue stream should be discounted to arrive at the net present value of future cash flow. If a single customer spends 400 EUR on clothing each 6 months, the net pre sent value accrues to about 15,000 EUR between the ages of 15 and 75 (at a discount rate of 5 %).

Customer lifetime value (CLV), the quantified value of a customer, has become a prominent concept with the rise of CRM. CLV is the difference between what it costs to acquire, service, and retain a customer and the revenue generated by that customer over the total duration of the relationship with him (Bechwati/Eshghi 2005, p. 88). The formula for CLV in its simplest form is:

$$(1)\ CLV = \sum_{t=1}^{n} \frac{(R_t - C_t)}{(1+i)^t},$$

With $\mathbf{R}_t$ = revenue earned from a particular customer in the year t, $\mathbf{C}_t$ = customer specific cost in the year t, **i** = discount rate and n = duration of relationship. However, the most challenging aspect of estimating CLV is not applying a formula, but projecting future revenue and cost. While this was very complicated in the past, it has since become a more manageable task, because historical purchasing data for a specific customer, based on loyalty card data, is available and can form a better base for projection.

5.3.1 Application of Customer Life Time Value

CLV can be used to develop a *profile of high value customers,* which can then be applied to focus customer acquisition efforts on similar consumers. CLV can also be employed to *categorize the existing customer base* into high , medium , and low value customers, which allows a differentiation of product offers and services according to expected customer value and also provides an objective basis for directing retention efforts toward higher value customers. If, for example, handling a customer complaint costs 500 EUR and the lifetime revenue value of this customer is 5,000 EUR, it may be worth investing the money, while for a customer with a value of 300 EUR, it might not be (Bechwati/Eshghi 2005, p. 89).

5.3.2 Monetary and Non Monetary Effects of Loyalty

The monetary value of customer loyalty originates from different components. Higher commitment to a company often leads to enhanced *purchasing frequency* (i.e. more frequent store visits), *larger shopping baskets*, *lower customer price sensitivity*, and a stronger *resistance to counter offers* from competitors. Loyal customers search less for competing product and service offers.

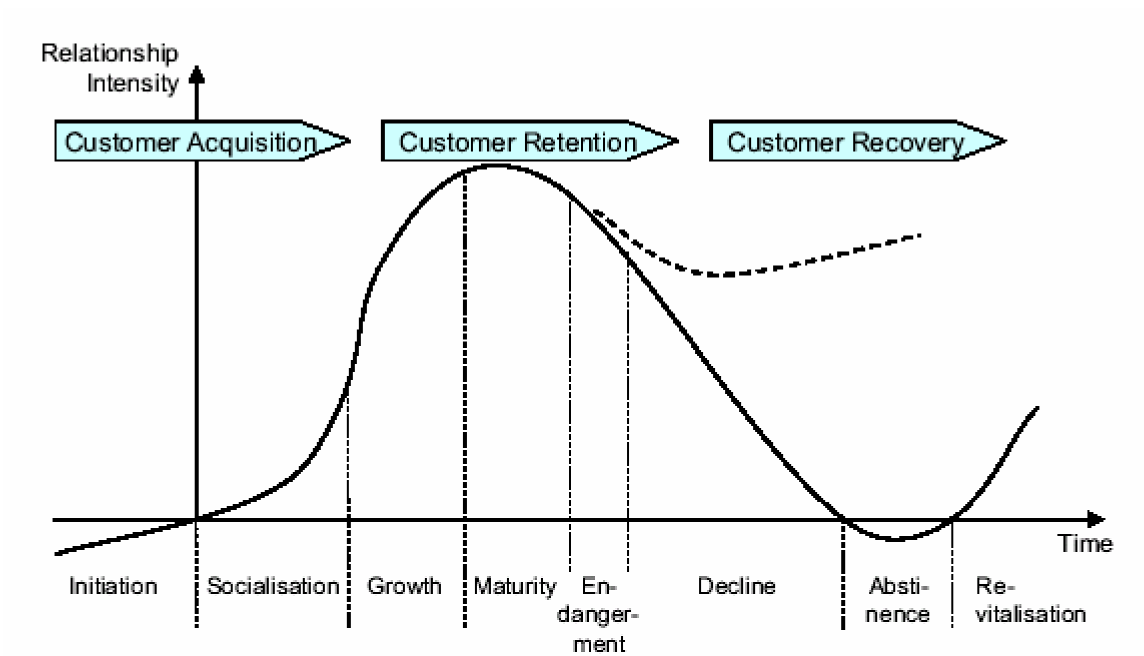
Lower marketing costs are also assumed, since targeted marketing is possible and the company acquires substantial knowledge about the consumer, making marketing more efficient. *Cross selling*, where the customer buys additional products from the company, and *up selling*, where the company manages to sell higher value products to the customer, are usually also achieved. Accordingly, the marketing focus is shifted from market share in specific product categories to increased *share of wallet* for a particular customer

(Uncles/Dowling/Hammond 2003). In addition, *non monetary benefits* also accrue. More loyal customers are expected to recommend the retailer to friends and relatives and this *word of mouth* constitutes effective and efficient marketing communication. Loyal customers also have an information *value* for the company, since they more often complain when the performance of a company deteriorates. They communicate with the retailer, thereby contributing to maintaining and enhancing the overall quality of the company

5.3.3 Customer Relationship Lifecycle

Pursuing the notion that customers are potential sources of profit over their entire lifetime, the relationship between customer and retailer can also be regarded as a lifecycle. The relationship therefore has a clear beginning, a growth stage and a maturity stage, after which a decline and a potential termination could occur (see Figure 5.1). The customer relationship lifecycle describes regularly observed patterns in the longitudinal development of customer relationships with a company. However, the model is *not deterministic*, i.e. not all stages have to occur in a relationship, the duration of stages
differ and a retailer can influence the shape of the curve, by, for example, effective counter measures in the endangerment stage.

Fig 5.1 Stages in the Customer Relationship Lifecycle



Different stages in the relationship require different marketing approaches In the early stages, the emphasis is on *customer acquisition*. In the growth stage and through maturity, the company needs to strengthen the relationship and exploit the full sales potential (*customer retention)*. In the later stages of the relationship cycle, it is important to know which customers are at risk of defecting and to employ *customer recovery* measures.

After customers are lost, it may be possible to reactivate them. Identifying the causes of such defection can help to win particular customers back, but also to avoid the same mistakes with others. Sending lost customers a special offer or calling them in order to allow them to complain about mistakes, might bring them back into the relationship. Through data analysis, defection behavior might be predicted and those customers with the highest propensity to discontinue the relationship with the retailer, targeted proactively.

5.4 Customer Loyalty and Customer Satisfaction

While loyalty has become more important as a marketing objective with CRM, there is no universally agreed definition of loyalty. Two basic approaches to conventionalize loyalty can be identified.

- Often, loyalty is defined with reference to a pattern of purchases. ***Behavioral loyalty*** is measured in terms of repeat patronage, percentage of budget allocation in a category to a store, amount of switching, or purchase likelihood.
- Many researchers argue that there must be strong commitment to a company for true loyalty to exist. Commitment refers to an emotional or psychological attachment to a company. Trust, which entails the confidence in the retailer's reliability and integrity, is often seen as closely connected to it. This ***attitudinal loyalty*** can be measured by asking consumers if they like and trust the store, whether they feel committed to it, and whether they would recommend it to others.
- Both dimensions are important for true loyalty (see Figure 5.2). ***Spurious loyalty*** refers to a situation, where repeat patronage is observed, but is not based on a strong positive attitude towards the retailer. For example, a lack of alternatives in the area can result in store patronage without having any thing to do with positive attitudes. Habitual purchasing behavior might have the same effect. Therefore, behavioral loyalty may merely reflect situational influences, but it is permanently at risk, if situational conditions change, such as rivals entering the market.
- While a positive attitude is an important objective, attitude does not necessarily correspond with behavior and ***latent loyalty*** *can* occur. Situational influences can form a barrier between attitude and behavior. For example, people can have a very positive attitude towards *Tiffany's*, but not be able to buy there. Alternatively, they may feel very positively towards *Harrods* in London, but live hundreds of miles away. Ultimately, however, retailers do not wish to foster a positive attitude of consumers, but aim at increasing their sales.
- ***True loyalty****,* the most favorable position, is signified by repeat patronage based on a strong relative attitude towards the retailer (Dick/Basu 1994, p. 102). Most definitions of loyalty now include both dimensions, i.e. behavioral loyalty corresponding with attitudinal loyalty.

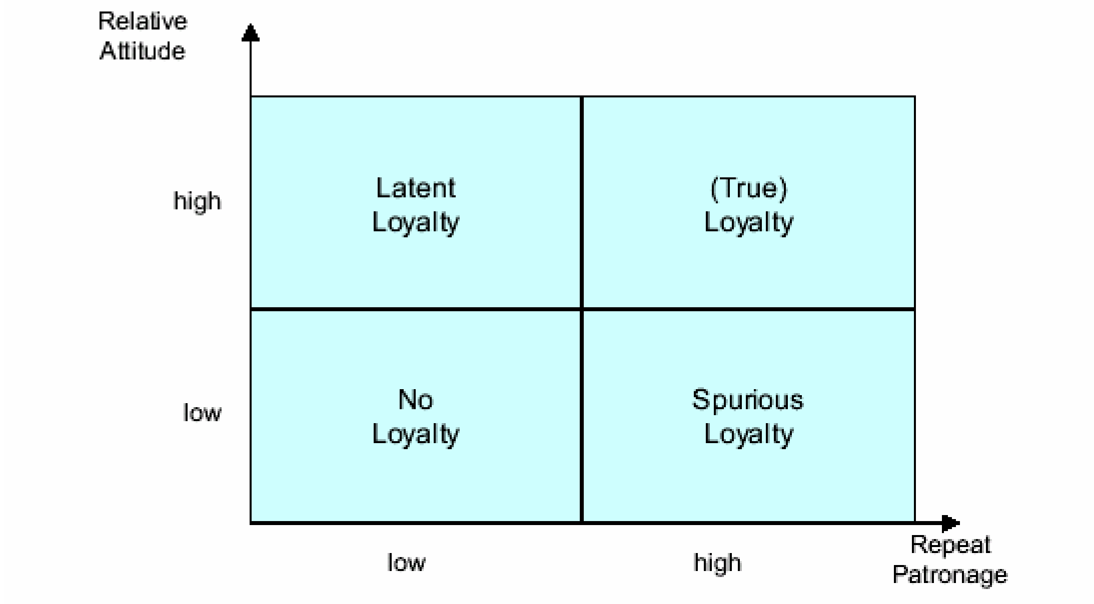


Fig 5.2 Types of Loyalty

5.4.1 Customer Satisfaction

Satisfaction is considered to be a primary prerequisite for loyalty, and loyalty is expected to rise with increasing levels of satisfaction. Satisfaction (or dissatisfaction) is a consumer's post purchase response to a product which results from a comparison of (pre purchase) expectations and perceived performance (Dick/Basu 1994, p. 104). It should be noted, though, that the association between satisfaction and loyalty is moderated by a large number of variables. If, for example, the customer is a variety seeker, or social pressure acts against purchasing at a particular store, satisfaction might only be weakly linked to loyalty. However, dissatisfaction usually leads to a substantial decline in loyalty.

A customer's satisfaction with a retailer derives from the overall evaluation of all prior experience with this retailer, and not only with respect to a specific transaction. Increasing customer satisfaction is therefore important in all stages of the customer purchasing process, while traditionally; marketing has emphasized *pre sale* and *sale activities* (Kotler et al. 2002, p. 405). With the perspective of CRM, the *post sale stage* is simultaneously a pre sale stage, since the customer is regarded as being in a continuous buying cycle. Retailers providing their customers with friendly and courteous customer service departments, fair and above regulation reactions to complaints, etc., try to enhance customer satisfaction after a purchase, with the intention of increasing the repurchase likelihood. One challenge associated with customer satisfaction, is that results derive from a comparison of performance with expectations–and expectations change over time. Consequently, constantly meeting or even exceeding customer expectations leads to increasing expectations over time. Service levels that enthused the customer when he first experienced them can become standard and form a new minimum expectation level. Thus, maintaining stable levels of customer satisfaction is only possible with steadily increasing levels of service quality.

5.5 Loyalty Marketing of Retailers

In retailing, CRM is closely connected to the *loyalty schemes* that are usually based on *loyalty cards*. Pioneers in Europe were *Tesco* in the United Kingdom (see case study *Tesco* in this Chapter) and *Albert Heijn* in Holland (Ziliani/Bellini 2004, p. 9). Many retailers now employ some form of loyalty scheme. Typically, loyalty programmes offer delayed, accumulated economic benefits to consumers on the basis of repeat purchases. Usually, this takes the form of points that can be exchanged for gifts, or vouchers. The discount value of points generally ranges between 1 and 4 % of sales. The option of giving discounts in different "currencies" (e.g. cash, stamps, miles, reward points) can also offer perceptual advantages, e.g. for the retailer's price image (Shugan 2005, p. 190; Cuthbertson/Laine 2004, p. 296). In so called *affinity programmes*, the focus is more on the emotional bond between customer and retailer. With club memberships, preferred service, newsletters, Internet chat groups, telephone help lines and other measures, two way communication is established so that customers can interact with the company and get to know it better (Rowley 2004, pp. 126 127). Most frequently, the ability to accrue benefits in the form of discounts on purchases, as well as the promotional offers connected to the loyalty programme, are the principal motivation for consumers for joining a loyalty scheme. However, emotional bonding and psychological relationship awards might also be important. *Self actualization* is considered a basic human need and loyalty programmes can provide recognition to selected customers by giving them an evaluated status and the feeling of being special. In some loyalty programmes, the sense of being a member of a community is considered more important than financial rewards (Shugan 2005, p. 190; Reinartz 2006, pp. 363 364).

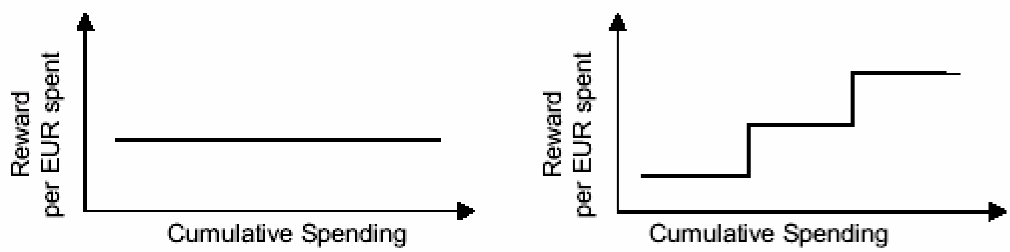


Fig 5.3 Basic Types of Reward Accumulation Functions

5.5.1 Reward Accumulation Functions

Loyalty programme rewards depend on the cumulative spending by customers at the retailer. There are two basic reward accumulation functions (see Figure 5.3). If the same share of spending is given as reward (e.g. 1 point per EUR spent), regardless of accumulated spending, this linear function might lead a consumer to distribute his spending between different retailers (without a loss for the customer). If only the *relative* rewards count as cumulative spending level increases (e.g. 1 point per EUR when spending is below 100 EUR, 3 points when spending is above 100 EUR), the programme becomes relatively more attractive for customers who spend more with one retailer and when concentrated spending at one retailer is rewarded. This supports a company strategy that aims to focus retention efforts on a small group of high value customers (Reinartz 2006, p. 365). Some times this is implemented with different types of loyalty cards, e.g. “normal” cards, gold cards, platinum cards. *Switching costs* for customers are increased, since accumulated assets can be seen as customer investment in the relationship with the retailer, which should in turn enhance loyalty. In terms of sponsorship, two types of loyalty programme exist:

- Single company loyalty programmes
- Multi partner programmes (or coalition schemes).

a) Single company loyalty programmes are run by an individual retailer. Examples are the programmes of *Boots*, *Auchan*, *Coop (Switzerland)*, *Peek & Cloppenburg*. Usually, the loyalty card carries the retail brand, and points can be accumulated at this retailer only.

b) A benefit of ***multi partner programmes*** is that customers can use their loyalty card more often, collect points faster, and qualify for certain premiums or prizes faster (Zentes/Morschett/Schramm Klein 2006, pp. 615 616). Penetration of the programme in the population is often higher than for single company programmes. Especially for retailers with a low purchasing frequency (e.g. DIY stores or consumer electronics retailers), for whom attracting customers in a proprietary programme would be difficult, participating in a coalition programme can be beneficial. While single company programmes only have data on the current customers of a particular retailer, multi partner programmes have access to far more data about shopping habits, so that the retailer can also target profitable consumers who are not yet part of his own customer basis (Cuthbertson/Laine 2004, p. 302).This facilitates analyzing customer behavior on a much broader base (within the limits of privacy regulations and customer acceptance). At the same time, the high cost of a loyalty programme can be distributed among the participating retailers. The disadvantages of a multi partner programme are that loyalty is often focused on the coalition programme, rather than any particular retailer (Cuthbertson/Laine 2004, p. 298).Also, the loyalty scheme (e.g. rewards, accumulation function) is not designed to meet a specific retailer’s strategy, but has to appeal to a group of retailers as a whole. One of the most successful multi partner programmes in Europe is the German *Payback* system with more than 30 million customer members, in which many large retail companies, such as *Real*, *OBI*, *dm drogerie markt*, *Aral*, *Apollo Optik,* participate. The British multi partner programme *Nectar* has companies such as *Sainsbury’s*, *Debenhams*, *BP* and *Hertz* as partners. In France, *S’Miles* offers bonus points for purchases with *Géant*, *Monoprix*, *Galeries Lafayette*, *Shell*, *BHV*, and others.

5.5.2 Analyzing Customer Data

In CRM, data mining techniques are used to analyze customer information. Since the results of the analysis and the forecasting of customer response can be used to develop marketing measures and the subsequent behavior of specific customers can be tracked and evaluated, a learning system can be created that studies the specific behavior of each customer and can also detect changes in behavior over time (Zentes/Morschett/Schramm Klein 2006, p. 600). An important potential advantage of CRM is that the success and the profitability of marketing measures can be evaluated in an experimental approach, by comparing the purchasing behavior of the targeted customer group with a control group, based on incremental sales or contribution margin (Hansiota /Rukstales 2002, pp. 262 263). However, up to the present, the huge amount of data collected through loyalty cards (often millions of data sets daily) results in an inadequate usage of the data, because IT capacity and methods of data analysis develop at a slower pace than data availability.

Customer segmentation is a core task of data analysis. In theory, retailers employing loyalty programmes could segment their customer base down to individual customers, but in practice, the number of segments used is generally limited to between 10 and 30. Segmentation criteria include purchasing volumes, demographic characteristics, and geographical aspects, shopping motives, attitudes and lifestyles

The options start with very simple segmentation criteria. *ABC analysis* is used to categorize customers by their annual purchases. Very often, a 20 80 rule is used that 20 % of the customers (*"A" customers*) account for about 80 % of retail sales volume. Even if the ratio is often not that extreme, it has frequently been shown that the relevance of different customers for a retailer varies considerably (Cuthbertson/Laine 2004, p. 295). While customer purchase behavior is a backwards oriented criterion, total *customer lifetime value* can serve as a very sophisticated basis for segmentation. Such customer value oriented segmentation shows what customer groups a retailer should focus on, but it does not show *how* to approach the customers. Segmentations based on such consumer behavior as shopping motives or attitudes are better suited to develop tailored marketing. Many different customer clusters have been proposed in the literature. For instance, customers can be clustered into "price oriented", "quality oriented", and "service oriented", or fashion customers into "fashion enthusiast", "style seekers", "classics" and "timids and uninvolved" (McGoldrick 2002, p. 112). The customers' stage in the family cycle (e.g. young singles, young couples, couples with young children, older, retired couples) is usually a good predictor of purchasing behavior. Based on their own customer data, retailers can, however, use a combination of methods to establish customer segments that are tailored to the retailer's specific needs.

5.5.3 Using Customer Data

Individual customer information provides insights into consumer behaviour that can be used to bring about a general change in a retailer's marketing. In such a case, the customer data is used to change macro variables of retail marketing, such as the merchandise mix, pricing, promotion, or location decisions (*micro macro approach*; Zilliani/Bellini 2004, pp. 12 13). For example, before a product is de listed due to low sales, an analysis can be conducted to determine who still buys it. If, for example, only 20 % of customers purchase the product, but those are most valuable customers in the store, keeping this product in stock is important for retaining these profitable customers (Cuthbertson/Laine 2004, p. 301).

CRM, on the other hand, focuses on *micro marketing* (or one to one marketing) which targets specific consumers or consumer segments based on knowledge of their behaviour. The retail service (such as the merchandise offered in advertising, promotions, services offered) is tailored to certain segments or (seldom) individual customers. Since the store itself is still standardised for all visitors, CRM often does not take place in the store offer, but through marketing communication with specific customers. Measures include the following

- ***Addressed direct mailings***: Customized direct mailings to customers' homes are used in almost all retailer loyalty programmes. The prime communication channel in loyalty programmes is some kind of (tailored or segmented) product catalogue, often with targeted promotions.

- ***E mail marketing***: Direct customer mailings have increased tremendously with the advent of e mail, which is used to distribute customized advertising and newsletters to customers. Distribution costs are much lower and customizing more flexible and cheaper.
- ***Instore multimedia kiosks*****:** Similar to the Internet, multimedia kiosks in retail stores can be used to communicate with each customer individually (Swoboda 1996). At electronic point of sale terminals, loyalty card holders can (among other functions) check their point account, order rewards or print out value checks with which they can pay their next purchase.
- ***Mobile marketing*****:** Some retailers already use the customers' mobile phones as communication devices, for example for providing coupons by SMS or MMS.
- ***Personal shopping assistants***: Digital shopping assistants that a customer can carry or attach to the shopping cart are still in the testing stage. Based on his loyalty card, such a device can guide the customer interactively through the shopping process in real time. Shopping lists can be displayed, the customer led to certain products, or recipes recommended, including the necessary ingredients and their location in the store.

5.5.4 Loyalty Marketing on the Internet

A higher level of CRM and one to one marketing can be employed in Internet shopping. In addition to the purchases, total purchasing behaviour can be observed with *web usage mining*. Over and above the data that can be collected with loyalty cards in store retailing, an electronic retailer can track the date and duration of each visit to his web site, the time a customer spends looking at a specific product, products viewed but not purchased, the sequence in which products were viewed or web sites browsed (Hansiota/Rukstales 2002, p. 261; Hertel/Zentes/Schramm Klein 2005, pp. 401 403). In contrast to stores, the individual data can be employed to tailor the entire retail marketing process to a specific customer, from the basic merchandise offer, prices and promotions, to the store design. The most successful example, *Amazon*, shows how individualized product recommendations are derived from connecting the profile of an individual customer (established from his purchase history) to the profiles of other customers. Demand interrelationships are detected systematically. Even the recency of purchases is considered, because purchasing behaviour can change over time. Cookies are placed or the customers log in with a password and the customer is addressed with a *personal store*.

5.6 Case Study: Tesco

Profile, History, and Status Quo

The origins of *Tesco Plc* date back to 1919, when Sir Jack Cohen started to sell groceries in a market stall in the East End of London. The name *Tesco* is derived from TES (from *TE Stock ell*, a tea supplier Jack Cohen used) and CO (Cohen). By the 1960s, the company had established its self service model and developed a reputation as a value for money retailer, according to its founder's "pile it high and sell it cheap" motto. However, during the 1970s, the company constantly lost market share to the competitors, especially *Sainsbury's*. But by 1995, *Tesco* took over *Sainsbury's* and became the United Kingdom's market leader in food retailing, thanks to constantly pursuing a more up market strategy since 1977 (Cooper/Browne/Peters 1992, p. 97). In 2005, with a market share of about 28 % in the United Kingdom, the company employs approximately 250,000 people in over 1,800 stores throughout the United Kingdom, where it operates four different store formats. Table 5.1 gives an overview of these formats.

Table 5.1 Store Formats of Tesco in the UK

Store Format	Square Feet	Number of SKUs	Location	Purpose
Express	<3,000	2,500	busy city centres/petrol stations	impulse
Metro	7,000-15,000	10,000	high streets/ large city centre shopping areas	top-up
Superstore	20,000-50,000	30,000	city suburbs	one-stop weekly shop
Extra	>60,000	50,000	city suburbs	destination shopping

The company currently operates in 12 markets outside the United Kingdom, in Europe and Asia. Over 100,000 employees work in the international operations, serving over 15 million customers and generating 7,600 million GBP sales and 370 million GBP profit. Over half of group space is now out side the United Kingdom. Currently it is the world's third largest food retailer. Table 5.2 shows the path of the company's internationalization.

Table 5.2 Internationalization of Tesco

Country	Year of Entry	Country	Year of Entry
Hungary	1994	Taiwan	2000-2005 (exit)
Poland	1995	Malaysia	2001
Czech Republic	1996	Turkey	2003
Slovakia	1996	Japan	2003
Rep. of Ireland	1997	China	2004
Thailand	1998	USA	planned for 2007
South Korea	1999		

The company pursues a long term growth strategy based on four key features (see Figure 5.4).

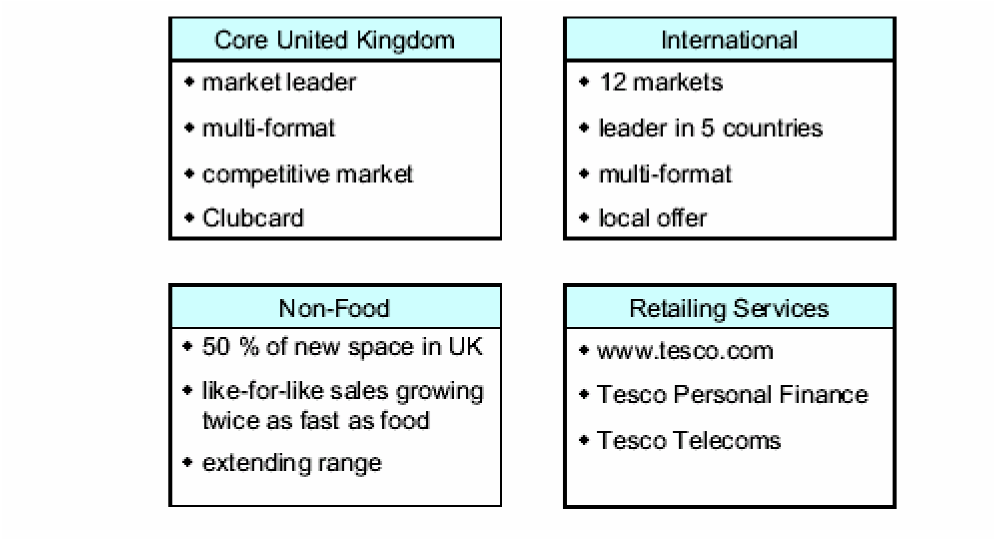


Fig 5.4 Key Features of Tesco's Growth Strategy

Tesco Club card

Market Conditions before the Introduction of Tesco Club card

Challenging Market Conditions

At the beginning of the 1990s, *Tesco* faced a number of difficult market conditions. Population growth was low and so was food market growth; the supermarket segment in the United Kingdom was already well developed and relatively saturated; getting planning permission for large Greenfield sites was becoming increasingly difficult; there were three strong competitors (*Sainsbury's*, *Asda* and *Safeway*) in the national market; *Tesco* was the no. 2 in the market with a share of 16.7 %; traditional supermarkets were challenged by the arrival of new formats such as hard discounters like *Aldi* (see case study *Aldi* in Chapter 5) (Coriolis 2004, p. 3). In order to tackle these difficulties, *Tesco* decided to implement an entirely customer focused CRM initiative based on the customer loyalty card *Tesco Clubcard*. In a saturated market like the United Kingdom, the goal of the initiative was not only to gain new customers in order to increase market share, but also to enhance existing customers' loyalty in order to secure a greater share of their total shopping basket.

Implementation

This programme was developed and implemented with the help of the agency *dunnhumby* which joined *Tesco* in their marketing efforts. In a test and learn approach, the loyalty scheme was tried out in twelve selected stores in 1994.

Focus on the Individual Customer

In February 1995, the *Tesco Clubcard* was launched nationwide. The core purpose of the CRM strategy was "to create value for customers to earn their lifetime loyalty" which is expressed in two key values "No one tries harder for customers" and "Treating people how we like to be treated" (Tesco 2006, p. 1). Thus, the *Clubcard* is more than an "average" loyalty card, and constitutes a central part of the company's philosophy. The explicit goal of *Tesco*'s CRM strategy is to reward individual customers for their loyalty (Beckett/Nayak 2005, p. 8). Consequently, the focus was shifted away from the average or typical to the individual customer. By using the individual customer as the focus, the aim was to create a modern "corner store" (Wylie 2005). This customer centric strategy is also reflected in the pivotal role of *Tesco* employees who deliver the brand promise and customer experience and thus become "brand ambassadors" (Seiler 2005, p. 21) for the company. To ensure the initiative's success, staff training, which included an educational video informing the employee's of the functioning and goal of the programme, was crucial.

Greenshield Stamps

Even though *Tesco* had been testing the loyalty scheme in a limited number of stores since 1994, the United Kingdom's first supermarket loyalty programme took the grocery industry by surprise (Rafiq 1997, p. 43). Furthermore, it was not taken seriously by many competitors. Between 1963 and 1977, *Tesco*, among other UK retailers, had used a trading stamps scheme, the Greenshield trading stamps. These stamps were given to customers when purchasing groceries or other items (in proportion to expenditure), collected in books and could be redeemed for cash or gifts (Rafiq 1997, p. 44). Thus, when *Tesco* launched the *Clubcard* in 1995, Lord Sainsbury famously dismissed the idea as nothing more than "electronic Greenshield Stamps" (Humby/Hunt/Phillips 2003, p. 65). However, *Tesco Clubcard* has proven a roaring success since its introduction, despite the cost of about 300 million GBP over the first three years, which was the equivalent of 4.5 % of *Tesco*'s sales. These costs included an update in point of sale technology, the supporting computer system needed to handle the *Clubcard* data and a call centre which established a hotline. However, due to *Clubcard*'s success, *Tesco* has covered the costs of running its loyalty programme by a sales increase "directly attributable to the promotions that have been created by Clubcard" (Humby/Hunt/Phillips 2003, p. 5). According to many experts, the key ingredient which helped *Tesco* overtake *Sainsbury's* to become the United Kingdom's leading retailer, was the implementation of the CRM strategy based on *Tesco Clubcard* (Beckett/Nayak 2005, p. 8).

Mode of Function

The *Clubcard* scheme starts like other loyalty card schemes: customers pay a joining fee and receive their own card in exchange for personal details such as name, address, date of birth, family composition, dietary requirements and product preferences. *Clubcard* holders can then present their card at the check out each time they go shopping and earn one *Clubcard* point (which is worth a penny) for every 1 GBP spent. Points can be earned either by shopping instore, at *Tesco petrol* or at *Tesco.com*. Furthermore, *Tesco* has acquired a number of so called points partners since the launch of the loyalty scheme, so *Clubcard* holders can also earn points for their *Clubcard* while shopping at (or using the services of) the following partners: *Avis* car rentals, *Powergen*, *Marriott Hotels*, *Johnsons* dry cleaner, *Nationwide Autocentre*, *National Tyres and Autocare* and *The Nutri Centre*. Loyalty schemes like *Tesco Clubcard* are described as "single operator multi partner programmes" (Rowley 2004, p. 129). Once customers have purchased items worth at least 150 GBP, they can either cash them in at the next shopping trip or redeem them for numerous offers. Each quarter, the accumulated points are transferred into vouchers and mailed to the customers, as well as additional coupons which can be redeemed for specific products (Reynolds 2004a, p. 312). Apart from spending the vouchers at a *Tesco* store or for online purchases, the customer can also transfer them into *British Airways AirMiles.* For example, a 2.50 GBP *Clubcard* voucher is worth 60 *AirMiles*. Also, vouchers can be spent on so called *Clubcard Deals* such as fun parks, museums, or restaurants. When used to order one of these *Deals*, the value of the voucher quadruples. Along with the customer's statement, the *Clubcard Magazine* is sent out four times a year. Even though delivering the vouchers and magazines by mail is more expensive for the company than e mail, *Tesco* still uses postal service because of the "bigger uplift" (Spethlift 2004, p. 34) it entails for the company. The vouchers are valid through two years, which is considered long enough for customers not to feel coerced into spending the vouchers before they want to, but also short enough so that *Tesco* does not build up excessive financial exposure, as it is the case with many airlines, where millions of

Unredeemed flyer miles accumulate as a growing liability. Since *Tesco* tries to stress the characteristics of a club, vouchers represent the club membership in dividend (Humby/Hunt/Phillips 2003, p. 76).

Currently, about 14 million British shoppers receive a statement from *Tesco* every three months (this equals about 35 % of UK homes in every mailing). The annual nominal amount of vouchers redeemed by customers is about 200 million GBP which corresponds to a redemption rate of about 20 %. This is an extraordinarily high number, compared to the industry average of about 0.5 %. This success was achieved to a great extent through a detailed analysis of the data acquired via the *Clubcard* (Spethlift 2004, pp. 33 34).

Use of Data

Customer Segments

The *Clubcard* programme is not only a loyalty card, but a comprehensive corporate philosophy and a complete business system. The data the *Clubcard* scheme provides to *Tesco* is used to drive crucial business decisions. Furthermore, it is estimated to have made *Tesco* into the "most sophisticated marketer in the world" (Spethlift 2004, p. 34). In 1995, however, the company was faced with the limitations of the IT technology at that time. Merely transmitting the data between *Tesco*'s IT department, where it was used to run the points accounting database, to *dunnhumby*, where it was analyzed for marketing and business information use, took 30 hours, using the highest bandwidth connection then available (Stone 2003, p. 186). In the first three months, the data from more than 50 million shopping trips, comprising more than 2,000 million purchased items by more than five million *Clubcard* members, was collected.

Whereas today, the capacity for taking the information from every single shopping basket processed through the check outs and analyzing it is readily available, in 1995, only 10 % of the weekly data was analysed and the findings were extrapolated to the other 90 % (Humby/Hunt/Phillips 2003, p. 97). State of the art data mining techniques were used to manage and analyze the created database. This analysis enabled *Tesco* to accurately pin point the time when purchases were made, the amount that was spent and the kind of products purchased.

Rolling Ball Method

Tesco used the data to segment its customers via the so called rolling ball method, which is based on the notion that a person's shopping basket reveals much about the person's characteristics: "You are what you eat" (Reynolds 2004a, p. 317). In order to understand why customers purchase certain products, interpreting these goods through a "psychological lens" is necessary to reveal "hidden" desires, aspirations and fears expressed in the purchase of products (Beckett/Nayak 2005, p. 9). For this purpose, about 50 products were classified by rating about 20 characteristics on a two tailed Likert scale. These product attributes included "low fat" against "high fat", "needs preparation" vs. "ready to eat" or "low price" against "high price", but also "adventurous", "exotic" or "fresh" (Humby/Hunt/Phillips 2003, pp. 153 154). This profiling method generates a map of the connotations for the goods. Since rating every product in the store by hand is an almost impossible task, 50 "obvious" products which clearly possessed the attribute or quality *Tesco* wanted to measure, such as pineapple for "exotic" or extra virgin olive oil for "adventurous", were chosen as a basis and a computer algorithm programme then took over. The next step was looking at what other items customers who purchased these products bought, discarding common items such as eggs or milk. Based on the customer's behaviour, different consumer clusters could be identified. The combination of the rated product provides information about the customer's lifestyle and thus helps segment all customers. These groupings must be large enough to be cost efficient, but "with a richness of common interest to be truly meaningful" (Spethman 2004, p. 34).

Accordingly, *Tesco* was able to segment its customers into the categories of *Finer Foods*, *Healthy*, *Traditional*, *Mainstream*, *Convenience*, and *Price Sensitive* (see Table 11.3). The company then launched store brands targeting the identified segments. Currently, these store brands account for about 45 % of the company's total assortment. The potential to use and exploit data from the *Clubcard* programme are substantial. By comparing an individual's shopping behaviour with the norm for that specific customer segment, variances can be identified. This analysis highlights not only under shopped departments, but also shows which products the individual is likely to want in the future, in order to exploit *can selling* opportunities (Beckett/Nayak 2005, p. 10).

Table 5.3 Customer Segmentation

Category	Classification	Characteristics	Store Brands
Up-Market	Finer Foods	time poor, money rich, everyday luxury items	Tesco Finest, Tesco Fair Trade
	Healthy	fruits and vegetables, weight watchers, diabetic etc.	Tesco Organic, Tesco Healthy Living, Tesco Free From
Mid-Market	Convenience	people on the go, no time or inclination for cooking	Tesco
	Traditional	time to buy and prepare meals	Tesco
Cost Conscious	Mainstream	family type meals, kids products, popular brands	Tesco Kids, Tesco
	Price Sensitive	less affluent, tend to buy cheapest or display	Tesco Value

Mass Customization

Marketing activities, and most importantly vouchers and coupons, are therefore a mixture of gifts and rewards for past and continued behaviour and also enticements for future behaviour (Reynolds 2004a, p. 315). *Tesco*'s data warehouse allows for considerable mass customization. Whereas there are *150,000 variations of the Clubcard magazine* alone, based on life stages such as young families, empty nesters, etc. (Spethmann 2004, p. 39) the complete quarterly statement, with personalised letter, vouchers and coupons, is so carefully tailored for each recipient, that *Tesco* sends out around *four million variations* (Spethmann 2004, p. 33). For example, a significantly decreased amount of grocery shopping is a strong indicator of a forthcoming holiday; *Tesco* can now send the customer coupons for sunscreen lotions. The identified 5,000 "customer needs" subgroups allow the personalized "rifle shot" approach. *Tesco* strives to make its personalized customer communication as relevant for the individual as possible. Another finding from the analysis was that in every single store, the top spending 100 customers were as valuable as the bottom 4,000. This led to the decision to run *invitation only Clubcard events* in major stores as a way of thanking the most loyal customers (Stone 2003, p. 186). A number of clubs have also been created based on *Tesco*'s unique insight into the shopping habits of its customers:

- *Food Club*
- *Baby & Toddler Club*
- *Wine Club* as well as
- *Healthy Living Club*.

These clubs are free to all *Clubcard* holders and provide benefits such as free magazines, advice, coupons and special offers. Currently, about 800,000 people have become members and voluntarily offer more personal data and preferences. The *Clubcard* data has also helped *Tesco* to identify areas where customers are positively inclined towards online shopping and launched *Tesco.com* in 1997. Today, it is the world's leading grocery internet retailer with an average of 150,000 orders per week and a leap in profit of more than 50 % from 2004 to 2005 (Tesco 2006, p. 28). Since 2006, *Clubcard* vouchers can also be used for online shopping at *Tesco.com*. Furthermore, the company has leveraged customer data obtained from its loyalty programme to diversify into non food service offers (in a *micro macro approach*):

- financial and banking services *Tesco Personal Finance* (TPF)
- *Tesco Telecoms*.

TPF is a 50/50 joint venture between *Tesco* and the *Royal Bank of Scotland* created in 1997 (Coriolis 2004, p. 28). Using information derived from *Tesco* s loyalty card programme and blending it with externally generated demographic data, the company conducted targeted research and developed profiles of customers who would be most interested in basic banking services or other options. *Tesco* found that it can acquire a financial services customer for less than half of what it costs a bank. Currently, *Tesco* offers 17 financial products and services, such as a credit card, loans, mortgages, car breakdown cover, savings, travel money, car insurance, travel insurance, life insurance or pet insurance (Tesco 2006, p. 30). Since 2001, TPF is highly profitable and currently generates over 200 million GBP in profits with almost 5 million customers (Tesco 2006, p. 6). It is also the biggest online car insurer in the United Kingdom. Since 2003, the retailer also offers a wide range of telecommunication services, such as mobile (in a 50/50 joint venture with *O2*), home phone, broadband, dial up internet access and internet phone. Around one million customers use these services (Tesco 2006, p. 6). These retailing services are a key feature of *Tesco*'s growth strategy (see Figure 5.4) and their successful implementation was achieved through *Clubcard* data. Customers can also collect *Clubcard* points from selected services, e.g. when paying with TPF Credit Card, on mobile, home phone, and broadband.

Outcome

For many experts, *Tesco Clubcard* has been the driving force behind the company's transformation from its "pile it high and sell it cheap" to a customer value strategy which helped the company to become the world's fifth largest retailer (McKelvey 2005, p. 13). Only two months after the introduction of the loyalty scheme, *Tesco* became the UK market leader. One year after the launch of the loyalty scheme, *Clubcard* holders were spending 28 % more at *Tesco* and 16 % less at *Tesco*'s arch rival *Sainsbury's*. In 1998, *Tesco* and its agency *dunnhumby* received the silver IDM Business Performance Award for the *Tesco Clubcard* campaign (Marketing Week 1998, p. 77). Currently, half of all British households are *Clubcard* holders. However, a main characteristic of the *Clubcard* loyalty scheme is its dynamic nature. As customer habits change, so do *Tesco*'s business decisions which are based on ongoing *Clubcard* data. This implies the need for constant innovations such as the *Christmas Savers Club*, which was launched in 2005 and allows customers to save their *Clubcard* vouchers to help with their Christmas shopping. Due to a decline in *Clubcard* use of two per cent at the end of 2003, *Tesco* decided to relaunch its loyalty scheme in May 2004 (Marketing Week 2005, p. 89). The company introduced smaller, personalised *Clubcards* which can be attached to a keying, making it easier for customers to remember their cards. Furthermore, the new cards have a bar code in order to provide customers with a quicker and more convenient way of collecting their points

(Tesco 2006, p. 8). Reportedly, the bar coded cards allow for quicker scanning by the check out staff; the resulting increase in productivity is supposed to be worth nine million GBP a year (Marketing Week 2005, p. 89).

Questions

1. How could data be gathered via the *Clubcard* and then be used? Give some detailed examples.
2. Do you think it is possible for *Tesco* to replicate the success of its customer loyalty programme in the home market to other countries? Discuss critically.
3. Compare *Tesco*'s *Clubcard* programme with another CRM tool such as a stamps scheme, e.g. the one *Tesco* used in the 1960s and 1970s.

FINANCIAL STRATEGY

Structure

6.1 Introduction

Financial Objectives and goals are an integral part of a retailer's market strategy. As we have examined how retailers develop their strategy and build a sustainable competitive advantage to generate a continuing streams of profits. In this chapter, we look at how financial analysis can be used to assess the retailer's market strategy- to monitor the retailer's performance, access the reasons its performance is above or below expectations, and provide insights into appropriate actions that can be taken if performance falls short of those expectations.

6.2 Objectives and Goals

The first step in the strategic planning process involves articulating the retailer's objectives and the scope of activities it plans to undertake. These objectives guide the development of the retailer's strategy, and specific performance goals determine whether the retailer's objectives are being achieved. When the goals are not being achieved, the retailer knows that it must take corrective actions. Three types of objectives that a retailer might have are (1) Financial, (2) Societal, and (3) Personal.

6.2.1 Financial Objectives

When assessing financial performance, most people focus on profits: What were the retailer's profits or profit margin (profit as a percentage of sales) last year, and what will they be this year and into the future? But the appropriate financial performance measure is not profits but rather return on investment (ROI) .Kelly Bradford set financial objectives of making a profit of at least $100,000 a year, but she really needs to consider how much she needs to invest to make the $100,000, the profit she desires from her investment.

Think of the decisions you might make when planning how to invest some money you might have. In making this investment, you want to determine the highest percentage return you can – the highest interest rate or greatest percentage increase in stock price- not the absolute amount of the return. You can always get a greater absolute return by investing more money. For example, Kelly Bradford would be delighted if she made $100,000 and only needed to invest $500,000 (a 20 percent ROI) in the business but disappointed if she had to invest $2,000,000 to make $100,000 profit (a 5 percent ROI). A commonly used measure of the return on investment is **return on assets (ROA)**, or the profit return on all the assets possessed by the firm.

6.2.2 Societal Objectives

Societal Objectives are related to broader issues about providing benefits to society – making the world a better place to live. For example, retailers might be concerned about providing employment opportunities for people in a particular area or more specifically for minorities or the handicapped. Other societal objectives might include offering people unique merchandise, such as environmentally sensitive products, providing an innovative service to improve personal health, such as weight reduction programs, or sponsoring community events.

For example, Mc Donald's value diversity among its employees and suppliers. The company ensures diversity among its corporative employees by including it in the business planning process. "As business and corporate departments put together their business plans, diversity is included in them. We have diversity business planning guidelines that we provide to the McDonald's leadership, as that they 're incorporated in the strategic planning process," explains chief diversity officer Pat Harris. McDonald's also values diversity in its supply chain and has been recognized by *Fortune* magazine as the "top purchaser from minority suppliers, spending more than $3 billion a year, or 27 percent of its total, at minority – owned firms."

Performance with respect to societal objectives is more difficult to measure than financial objectives.

6.2.3 Personal Objectives

Many retailers, particularly owners of small independent business, have important personal objectives, including self-gratification, status, and respect. For example, the owner/operator of a book store may find it rewarding to interact with others who like reading and authors that visit the store for book- signing promotions. By operating a popular store, a retailer might be recognized as a well respected business leader in the community.

Whereas societal and personal objectives are important to some retailers, financial objectives should be the primary focus of managers of publicly held retailers – retailers whose stocks are listed on and bought through a stock market.

6.3 Strategic Profit Model

The **strategic profit model**, illustrated in Fig 6.1, is a method for summarizing the factors that affect a firm's financial performance as measured by ROA. The model decomposes ROA into two components: (1) net profit margin and (2) asset turnover. The **net profit margin** is simply how much profit (after tax) a firm makes divided by its net sales. Thus, it reflects the profits generated from each of sales. If a retailer's net profit margin is 5 percent, it makes $.05 for every dollar of merchandise or services it sells.

Asset turnover is the retailer's net sales divided by its assets. This financial measure assesses the productivity of a firm's investment in its assets and indicates how many sales dollars are generated by each dollar of assets. Thus, if a retailer's asset turnover is 3.0, it generates $3 in sales for each dollar invested in the firm's assets.

The retailer's ROA is determined by multiplying the two components together:

$$\text{Net profit margin} \times \text{Asset turnover} = \text{Return on assets (ROA)}$$

$$\frac{\text{Net Profit}}{\text{Net Sales}} \times \frac{\text{Net Sales}}{\text{Total Assets}} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

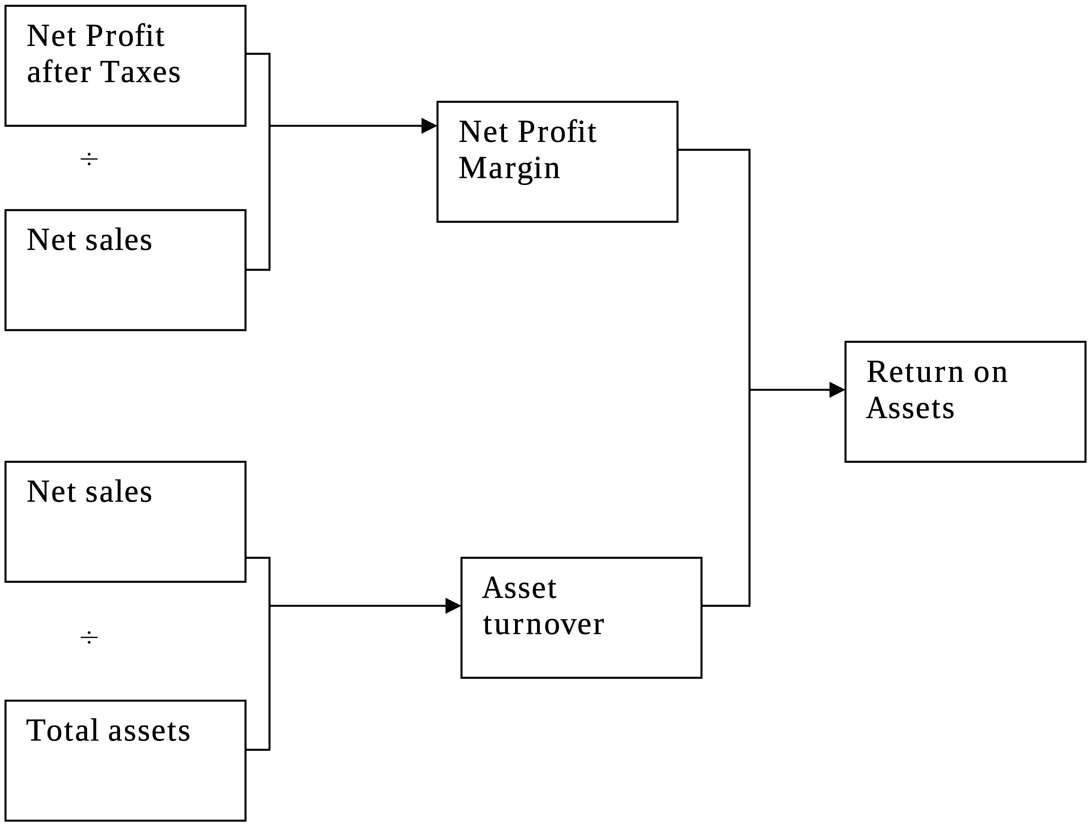


Fig 6.1 Components of the Strategic Profit Model

These two components of the strategic profit model illustrate that ROA is determined by two sets of activities, profit margin management and asset management, and that a high ROA can be achieved by various combinations of net profit margin and asset turnover.

To illustrate the different approaches for achieving a high ROA, consider the financial performance of two very different hypothetical retailers in Table 6.1. La Madeline Bakery has a net profit margin of only 1 percent and asset turnover of 10, resulting in an ROA of 10 percent. Its profit margin is low due to the highly competitive nature of its business. Consumers can buy baked goods from a wide variety of retailers, as well as from the other bakeries in the area. However, its asset turnover is relatively high, because the firm has a very low level of inventory assets. It has very little inventory because it sells everything the same day it is baked.

Table 6-1 Different Approaches for Achieving an Acceptable ROA-A Bakery and Jewelry Store

	Net Profit Margin	x	Asset Turnover =	Return on Assets
La Madeline Bakery	1%		10 times	10%
Kalame Jewelry	10%		1 time	10%

On the other hand, Kalame Jewelry Store has a net profit margin of 10 percent-ten times higher than that of the bakery. Even though it has a much higher net profit margin, the jewelry store has the same ROA because it has a very low asset turnover of 1. Kalame's asset turnover is low compared with the bakery's because Kalame has a high level of inventory; it stocks a lot of items that take many months to sell. In addition, the jewelry store offers liberal credit to customers, increasing its assets in accounts receivable.
Thus, La Madeline is achieving its 10 percent ROA by having a relatively high asset turnover-the asset management path. Kalame Jewelry Store, in contra~, achieves its same ROA with a relatively high net profit margin-the profit margin management path.

6.4 Profit Margin Management Path

Information used to examine the profit margin management path comes from the retailer's income statement, which summarizes a firm's financial performance over a period of time. For example, the income statement in a retailer's annual report provides a summary of the retailer's performance during the previous fiscal year. To capture all the sales and returns from the Christmas season, most retailers define their fiscal year as beginning on February 1 and ending January 31.

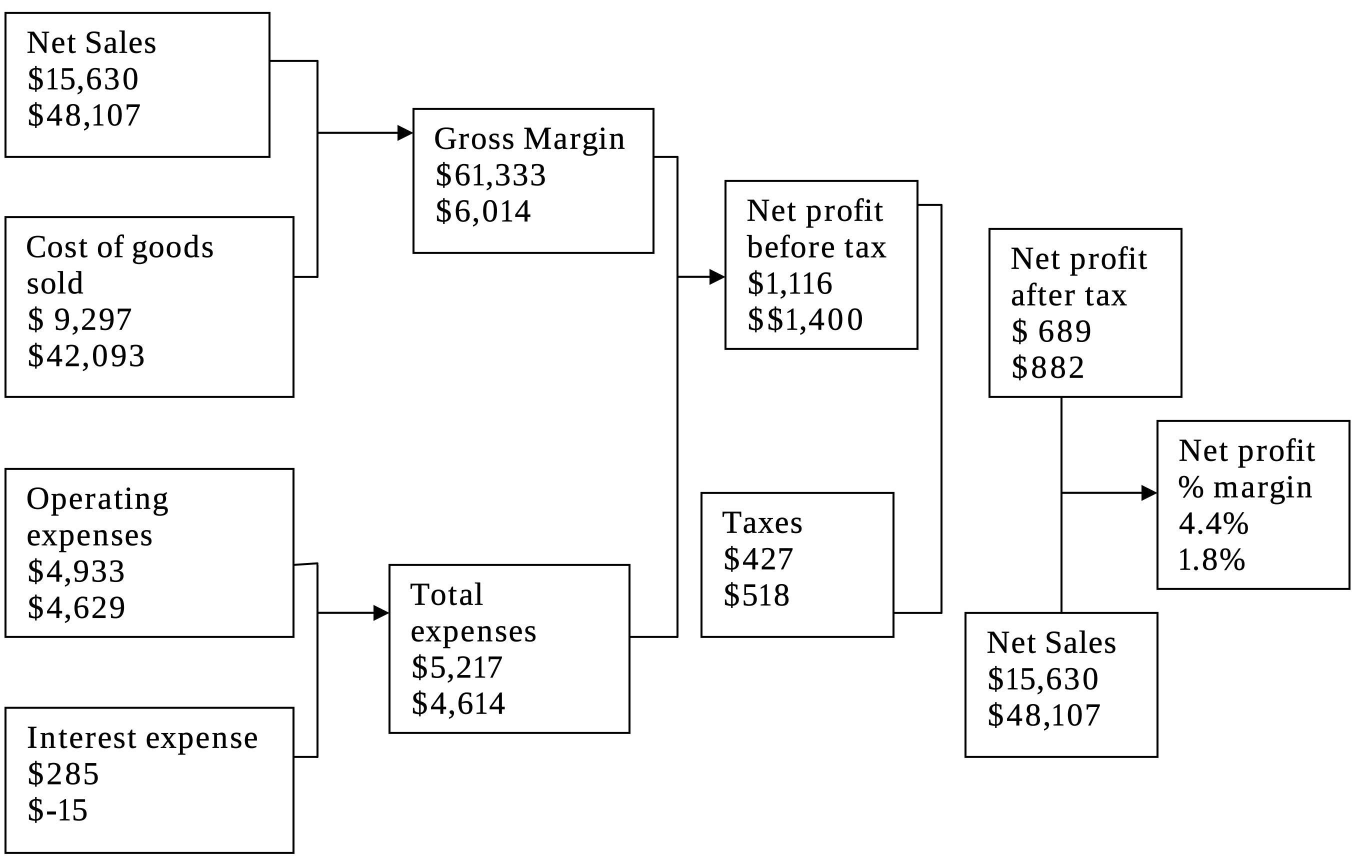
Table 6.2 shows income statements adapted from the annual reports of Federated Department Stores and Costco. The profit margin management path portion of the strategic profit model that summarizes these data appears in Fig 6.2. In the following sections, we consider each element in profit margin management path.

Net Sales The term **net sales** refers to the total revenue received by a retailer after all refunds h: been paid to customers for returned merchandise. Sales are an important measure of performance because they indicate the activity, level of the merchandising function. Costco’s net sales are more than three times greater than Federated's.
Net sales = Gross amount of sales + Promotional allowances - Customer return

Customer returns represent the value of merchandise that customers return and for which they receive a refund of cash or a credit. **Promotional allowances** are payments made by vendors to retailers in exchange for the retailer promoting the vendor's merchandise. For example, consumer package, manufacturers will frequently pays supermarket chains to stock a new product (called slotting fees) or advertise a product.

Income Statement ($ millions)	Federated Department Stores	Costco
Net sales	$15,630	$48,107
Less: Cost of goods sold	9,297	42,093
Gross margin	6,333	6,014
Less: Operating expenses	4,933	4,629
Less: Interest expenses/income	284	−15
Total expenses	5,217	4,614
Net profit, pre-tax	1,116	1,400
Less: Taxes	427	518
Net profit after taxes	689	882
Gross margin %	40.5%	12.5%
Operating expenses % of sales	31.6	9.6
Net profit % after taxes	4.4	1.8
Net profit % before interest and taxes	9.0	2.9

Table 6.2 Income Statement for Federated Department Stores and Costco



Federated Department Stores
Costco

Fig 6.2 Profit Management Path for Federated and Costco

Gross Margin

The **gross margin,** also called **gross profit,** is net sales minus the cost of the goods sold. It is an important measure in retailing because it indicates how much profit the retailer is making on merchandise sales without considering the expense associated with operating the store.

Gross margin = Net sale- Cost of goods sold

Gross margin, like other performance measures, is also expressed as a percentage of net sales so retailers can compare (1) the performance of various types of merchandise and (2) their own performance with other retailers with higher or lower levels of sales.

$$\frac{\text{Gross Margin}}{\text{Net Sales}} = \text{Gross margin \%}$$

Federated: $\frac{\$6,333}{\$15,630} = 40.5\%$

Costco: $\frac{\$6,014}{\$48,107} = 12.5\%$

Operating Expenses **Operating expenses** are costs, other than the cost of merchandise, incurred in the normal course of doing business, such as salaries for sales associates and managers, advertising, utilities, office supplies, and rent. Another major expense category, interest includes the cost of borrowing money to finance everything from inventory to the purchase of a new store location.

Like gross margin, operating expenses are expressed as a percentage of net sales to facilitate comparisons across items and departments within firms.

$$\frac{\text{Operating expenses}}{\text{Net Sales}} = \text{Operating expenses \%}$$

Federated: $\frac{\$4,933}{\$15,630} = 31.6\%$

Costco: $\frac{\$4,629}{\$48,107} = 9.6\%$

Net Profit **Net profit** (after tax) is the gross margin – operating expenses and taxes:

Net profit = Gross margin = Expenses - Taxes

It is a measure of overall performance with respect to the profit margin management path and can also be expressed before taxes. Net profit margin, like gross margin, is often expressed as a percentage of net sales:

$\frac{\text{Net profit}}{\text{Net Sales}}$ = Net profit %

Federated: $\frac{\$689}{\$15,630}$ = 4.4%

Costco: $\frac{\$882}{\$48,107}$ = 1.8%

6.5 Asset Management Path

The information used to analyze a retailer's asset management path primarily comes from the firm's balance sheet. Whereas the income statement summarizes the financial performance over a period time (usually a year or quarter), the balance sheet summarizes a retailer's financial position at a given point in time, typically at the end of its fiscal year. The information about Federated's and Costco's assets from their balance sheets is shown in Table 6-3, and the asset management path components in the strategic profit model are shown in Fig 6.3

Table 6.3 Asset Information from Federated's and Costco's Balance Sheets

	Federated Department Stores	Costco
Accounts receivable	$ 3,418	$ 335
Merchandise inventory	3,120	3,644
Cash	868	2,823
Other current assets	104	467
Total current assets	7,510	7,269
Fixed assets	7,375	7,824
Total assets	$14,885	$15,093
Inventory turnover	3.0	11.6
Asset turn over	1:1	3.2
ROA	4.6%	5.8%

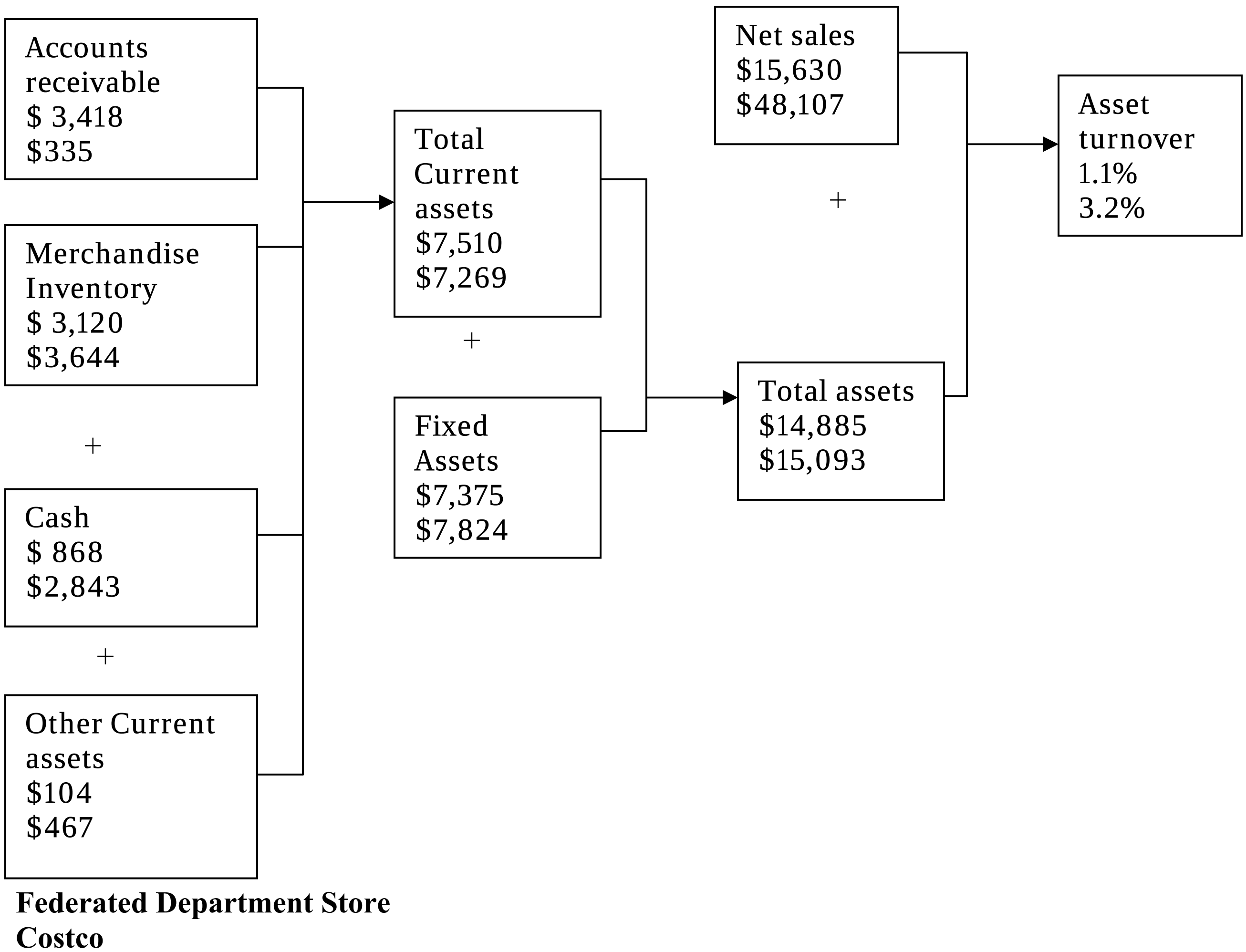


Fig 6.3 Asset Management Path for Federated and Costco

Assets are economic resources (such as inventory or store fixtures) owned or controlled by a fill There are two types of assets, current and fixed.

Current Assets By accounting definition, **current assets** are assets that can normally be converted to cash within one year. In retailing, current assets are primarily cash, accounts receivable, and merchandise inventory. **Accounts receivable** are primarily monies owed to the retailer from selling merchandise on credit to customers.

Current assets = Cash + Accounts receivable + Merchandise inventory + other current assets

Current assets are substantial for some retailers. For example, Federated has more of its assets in accounts receivable than in merchandise inventory and ten times more accounts receivable than Costco even though Costco has four times more sales. Costco's investment in accounts receivable is proportionately much smaller than Federated's because Costco's customers have a higher propensity to pay cash, whereas a significant number of Federated's customers use their Macy's or Bloomingdale's credit cards.

From a marketing perspective, the accounts receivable generated from credit sales provides an important service to customers. The retailer's ability to provide credit, particularly at low interest rates, can make the difference between making or losing a sale because paying cash for a sizable purchase like a diamond engagement ring or car may be difficult for many people. But offering this service is costly because it increases accounts receivable and thus the level of assets needed by the retailer. When merchandise is sold on credit, proceeds of the sale are tied up in accounts receivable until collection is made. The money invested in accounts receivable costs the retailer interest expense and keeps the retailer from investing the money generated by a sale elsewhere. To ease the financial burden of carrying accounts receivable, retailers use third-party credit cards, such as Visa or MasterCard, and collect from delinquent accounts quicker.

Merchandise inventory is a retailer's lifeblood. The principle benefit retailers offer customers is having the right merchandise inventory available at the right time and place. **Inventory turnover**, a ratio like gross margin, is used to evaluate how effectively-retailers utilize their investment in inventory and reflects the cost of goods sold from the income statement divided by the average inventory level from the balance sheet. Note that the inventory level reported on the balance sheet is the level on the last day of the fiscal year, not the average level. To measure the average inventory level more accurately, you would have to measure the level on each day of the year and divide by 365 or each month and divide by 12.

$$\frac{\text{Cost of goods}}{\text{Average inventory}} = \text{Inventory turnover}$$

Federated: $\frac{\$9{,}297}{\$3{,}120} = 3.0$

Costco: $\frac{\$42{,}093}{\$3{,}644} = 11.6$

Fixed Assets **Fixed assets** are those assets that require more than a year to convert to cash. In retailing, the principal fixed assets are buildings (if store property is owned rather than leased), fixtures (such as display racks), equipment (such as computers or delivery trucks), and other long-term investments such as stock in other supplier firms.

Fixed assets are more difficult to manage than current assets such as inventory. However, when a retailer remodels a store, for example, old fixtures, carpeting, and lights are removed and replaced with new ones. Thus, like inventory, these assets cycle through the store. The difference is that the process is a lot slower. The life of a fixture in a Federated store may be five years (instead of two months, as it might be for a Polo shirt), yet the concept of turnover is the same. When a retailer decides to invest in a fixed asset, it should determine how many sales dollars can be generated from that asset.

Suppose that Federated is considering the purchase of a new fixture for displaying dinnerware. It has a choice of buying an expensive antique display cabinet for $20,000 or having a simple plywood display constructed for $5,000. Using the expensive antique, it forecasts incremental sales of$50,000 in the first year, whereas the plywood display is expected to generate only $25,000. Ignoring all other assets for a moment,

$$\frac{\text{Net sales}}{\text{Fixed assets}} = \text{Fixed asset turnover}$$

Antique cabinet: $\frac{\$50{,}000}{\$20{,}000} = 2.5$

Plywood cabinet: $\frac{\$25{,}000}{\$5{,}000} = 5.0$

The antique cabinet will certainly help create an atmosphere conducive to selling expensive dinnerware. Exclusively from a marketing perspective, the antique cabinet would thus appear appropriate. But it costs much more than the plywood shelves. Clearly, by considering only asset turnover, the plywood shelves are the way to go. In the end, a combination of marketing and financial factors should be considered when making the appropriate asset purchase decision.

Asset Turnover **Asset turnover** is an overall performance measure from the asset management component in the strategic profit model.

$$\frac{\text{Net sales}}{\text{Total assets}} = \text{Asset turnover}$$

Federated: $\frac{\$15{,}630}{\$14{,}885} = 1.1$

Costco: $\frac{\$48{,}107}{\$15{,}093} = 3.2$

Return on Assets

In terms of the profit margin management path, Federated performs better than Costco, but Costco has a higher asset turnover and thus performs better on the asset management path. But overall performance, as measured by ROA, is determined by considering the effects of both paths by multiplying the net profit margin by asset turnover:

	Net profit margin	X	Asset turnover	=	Return on assets
Federated:	4.41	X	1.05	=	4.63%
Costco:	1.83	X	3.29	=	5.84%

In the end, the two firm's ROAs are fairly close. Federated has the higher net profit margin; Costco has the higher asset turnover. Return on assets is a very important performance measure, because it shows how much money the retailer is making on its investment in assets and how good that return is relative to other investments. For instance, if a retailer can achieve a 9 percent ROA by opening a new store and 10 percent by investing in a risk-free Treasury bill, the retailer should make the higher-yield, lower-risk investment.

The strategic profit model illustrates two important issues. First, retailers and investors need to consider both net profit margin and asset turnover when evaluating their financial performance. Firms can achieve high performance (high ROA) by effectively managing both net profit margins and asset turnover. Second, retailers need to consider the implications of strategic decisions on both components of the strategic profit model. For example, simply increasing prices will increase the gross margin and net profit margins (the profit margin management path). However, increasing prices will result in fewer sales, and assuming the level of assets stays the same, asset turnover will decrease. Thus profit margin increases, assets turnover decreases, and the effect on ROA depends on how much the profit margin increases compared to the decrease in asset turnover.

6.6 SETTING AND MEASURING PERFORMANCE OBJECTIVES

Setting performance objectives is a necessary component of any firm's strategic planning process. How would a retailer know how it has performed if it doesn't have specific objectives in mind to compare actual performance against? Performance objectives should include (1) a numerical index of the performance desired against which progress may be measured, (2) a time frame within which the objective is to be achieved, and (3) the resources needed to achieve the objective. For example, "earning reasonable profits" isn't a good objective. It doesn't provide specific goals that can be used to evaluate performance.

6.6.1 Top Down versus Bottom-Up Process

Setting objectives in large retail organizations entails a combination of the top-down and bottom-up approaches to planning.

Top-down **planning** means that goals are set at the top of the organization and passed down to the operating levels. In a retailing organization, top-down planning involves corporate officers developing an overall retail strategy and assessing broad economic, competitive, and consumer trends. With ills information, they develop performance objectives for the corporation. These overall objectives are men broken down into specific objectives for each buyer and merchandise category and for each region, store, and even departments within stores and the sales associates working in the departments.

The overall strategy determines the merchandise variety, assortment, and product availability, plus the store size, location, and level of customer service. Then the merchandise vice presidents decide which types of merchandise are expected to grow, stay the same, or shrink. Next, performance goals are established for each buyer and merchandise manager.

This is top-down planning is complemented by a bottom-up planning approach. **Bottom-up planning** involves lower levels in the company developing performance objectives that are aggregated up to develop overall company objectives. Buyers and store managers estimate what they can achieve, and their estimates are transmitted up the organization to the corporate executives.

Frequently there are disagreements between the goals that have trickled down from the top and those set by lower-level employees of the organization. For example, a store manager may not be able to achieve the 10 percent sales growth set for his or her region because a major employer in the area has announced plans to lay off 2,000 employees. These differences between bottom-up and top-down plans are resolved through negotiation process involving corporate executives and operating managers. If the operating managers aren't involved in the objective-Setting process, they won't accept the objectives and thus will be less motivated to achieve them.

6.6.2 Accountability

At each level of the retail organization, the business unit and its manager should be held accountable for the revenues, expenses, and contribution to ROA that they can control. Thus, expenses that affect several levels of the organization (such as the labor and capital expenses associated with operating a corporate headquarters) shouldn't be arbitrarily assigned to lower levels. In the case of a store, for example, it may be appropriate to set performance objectives based on sales, sales associate productivity, store inventory shrinkage due to employee theft and shoplifting, and energy costs. If the buyer lowers prices to get rid of merchandise and therefore profits suffer, then it's not fair to assess a store manager's performance based on the resulting decline in store profit.

Performance objectives and measures are used to pinpoint problem areas. Reasons performance may be above or below planned levels must be examined. Perhaps the managers involved in setting the objectives aren't very good at making estimates. If so, they may need to be trained in forecasting" buyers may misrepresent their business unit's ability to contribute to the firm's financial goals to larger inventory budget than is warranted and consequently earn a higher bonus. In either case, investment funds would be misallocated.

6.6.3 Performance Objectives and Measures

Many factors contribute to a retailer's overall performance, which makes it hard to find a single measure to evaluate performance. For instance, a sale is a global measure of a retail store's activity level. However, a store manager could easily increase sales by lowering prices, but the profit realized on that merchandise (gross margin) would suffer as a result. Clearly, an attempt to maximize one measure may lower another. Managers must therefore understand how their actions affect multiple performance measures. It's usually unwise to use only one measure because It rarely tells the whole story.

The measures used to evaluate retail operations vary depending on (1) the level of the organization at which the decision is made and (2) the resources the manager controls. For example, the principal resources controlled by store managers are space and money for operating expenses (such as wages for sales associates and utility payments to light and heat the store). Thus, store managers focus on performance measures like sales per square foot and employee retailers.

6.7 Types of Measures

Table 6.4 breaks down a variety of retailers' performance measures into three types: output measures, input measures, and productivity measures. **Input measures** assess the amount of resources or used by the retailer to achieve outputs such as sales. **Output measures** assess the results of a retailer's investment decisions. For example, sales revenue results from decisions about how many stores to build how much inventory to have in the stores, and how much t0 spend on advertising. A **productivity measure** (the ratio of an output to an input) determines how effectively retailers use their resource-what return they get on their investments.

6.7.1 Corporate Performance

At a corporate level, retail executive have three critical resources (inputs)- merchandise inventory, store space, and employees-that they can manage to generate sales and profits (output). Thus, effective productivity measures of the utilization of these assets are asset and inventory turnover, sales per square foot of selling space, and sales per employee.

Table 6.4Performance Objectives and Measures Used by Retailers

Level of Organization	**Output**	**Input**	**Productivity (output/input)**
Corporate (measures for entire corporation)	Net Sales, Net Profit, Growth in Sales, profits, same store sales	Square feet of store space , Number of employees, Inventory, Advertising expenditure	Return on assets Asset turnover Sales per employees Sales per square foot
Merchandise Management(measures for a merchandise category)	Net Sales, Gross Margin, Growth in sales	Inventory level, Markdowns, Advertising expenses, Cost of merchandise	Gross margin return on investment (GMROI), Inventory turnover, Advertising as a percentage of sales*, Markdown as a percentage of sales*
Store Operation (measures for a store or department within a store)	Net Sales, Gross Margin, Growth in sales	Square feet of selling areas, Expenses for utilities Number of sales associates	Net sales per square foot, Net sales per sales associate or per selling hour, Utility expenses as a percentage of sales*, Inventory shrinkage*

As we have discussed, ROA is an overall productivity measure combining the profit margin percentage asset turnover management. Another commonly used measure of overall performance is **same store sales growth**, or the growth in stores that have been open for over one year. Growth in sales can come from the sales generated per store or the number of stores. Growth in same store sales assesses the first component in sales growth and thus is an indicator of how well the retailer is doing with its core business concept. A decrease in same store sales indicates the retailer's fundamental business approach is not being well received by its customers, even if overall sales are growing because the retailer is opening more new stores.

6.7.2 Merchandise Management Measures

The critical resource (input) controlled by merchandise mangers is merchandise inventory. Merchandise managers also have the authority to set initial prices and lower prices when merchandise is not selling (take a markdown). Finally, they negotiate with vendors on the price paid for merchandise.

Inventory turnover is a productivity measure of the management of inventory; higher turnover means greater inventory management productivity. Gross margin percentage indicates the performance of merchandise managers in negotiating with vendors and buying merchandise that can generate a profit. Discounts (markdowns) as a percentage of sales are also a measure of the quality of the merchandise buying decisions. If merchandise managers have a high percentage of markdowns, they may not be buying be right merchandise or the right quantities since they weren't able to sell some of it at its original retail price. Note that gross margin and discount percentages are productivity measures, but they are typically expressed as an input divided by an output as opposed to the typical productivity measures that are outputs divided by inputs.

6.7.3 Store Operations Measures

The critical assets controlled by store managers are the use of the store space and the management of the store's employees. Thus, measures of store operations productivity include sales per square foot of selling space and sales per employee (or sales per employee per working hour, to take into account that some employees work part-time). Store management is also responsible for controlling theft by employees and customers (referred to as inventory shrinkage), store maintenance, and energy costs (lighting, heating, and air conditioning); some other productivity measures used to assess the performance of store managers are in shrinkage and energy costs as a percentage of sales.

6.8 Review Questions

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1. Why does a retailer need to use multiple performance measures to evaluate its performance?
2. What elements in the strategic model assist retailers in planning and evaluating their marketing and financial strategies?
3. Describe how a multiple – store retailer might set its annual performance objectives.
4. How is a retail strategy reflected in retailer’s financial objective?
5. Why do retailers need to evaluate their performance?
6. What measures do retailers use to assess their performance?

PRICING IN RETAIL

Structure

7.1 Retail Pricing – Approaches and Strategies

Pricing strategies affect both the margins and the positioning of a retailer. Various pricing strategies can be followed by the retailer depending on his business objectives, the influence of other external factors, and the impact of the pricing strategy on other aspects of the marketing mix.

Broadly, retailers adopt one of the three approaches in terms of pricing-discount orientation, at-the-market orientation, and upscale orientation. These approaches may be implemented using various pricing strategies. Discount orientation may take the form of every-day low-pricing strategy or high-low strategy.

Upscale orientation is reflected in premium pricing strategies. At times it takes the form of skimming prices for certain product categories to be followed by penetration prices later on. At-the-market orientation is reflected in strategies that offer average prices for most products. While a store is likely to adopt a long-term approach in terms of pricing, most retailers also adopt short-term tactical pricing tools like coupons, rebates, etc.

Hence, while stores like *Lifestyle* and Arcus reflect an upscale pricing orientation they do offer rebates and discounts at various intervals. Similarly, many retailers tend to effect price reductions to pre-empt competition or achieve greater penetration. Some stores may adopt loss-leader pricing as a tactical move to stimulate additional store traffic while retaining their basic orientation towards at-the-market pricing.

7.1.1 Pricing Approaches

There are three retail pricing approaches based on the long-term objectives of the pricing decision. They are discount orientation, upscale orientation, and at – the – market orientation.

a) Discount Orientation

Here low prices are used as the major tool for competitive advantage. The store portrays a low status image and offers fewer shopping frills. Profit margins are kept low to target price-based customers. The model works on high inventory turnover and lower operating costs. This is arguably the most common model in India because of the low per capita income and price consciousness. It is not uncommon to see affluent people buying from these low-price shops as Indians largely look for value for money. Frills can be sacrificed for some satisfactory price cuts. Roadside discount shops thrive in India where everything from clothes to perfumes is sold and the clientele is not necessarily the lower middle class. One such market is the Janpath market in New Delhi. However, with the advent of globalization, Indians are opening up and this seems to be changing.

b) Up scale Orientation

In Up scale Orientation competitive advantage is derived from the prestigious image of the store. The profit margins per unit are high, coupled with higher operating costs and lower inventory turnover. These stores usually stock distinctive product offerings and provide, high quality service, building up customer loyalty. The products stored generally go with the image of the store. It may be appropriate in situations of inelastic demand in which an organization decides to keep its prices high. The reason for such strategy might also include a growing super – premium segment of the market, overcrowding at the bottom – end of the market, or the desire to create a prestige image for the product.

c) At – the – market Orientation

A store with at – the – market orientation normally sets average prices. It offers solid service and a nice atmosphere to middle – class shoppers. Margins are average to good and it stocks moderate to above quality products. Since this model caters to the middle class, it has a huge target market. Moreover, as income increases, the price – based customers shift to these stores. Therefore, some discounts retailers also own such a store to capture customers who would shift to a higher priced store as their income rises.

7.1.2 Pricing Strategies

Following are the various pricing strategies followed by the retailer to meet his short- and long-term objectives. The adoption of these strategies is guided by the basic pricing approach of the retailer.

a) Every Day Low Pricing (EDLP)

EDLP has been popularized by large retailers like Wal-Mart, Home Depot, and Staples among others. This strategy entails continuity of retail prices below the MRP mentioned on the goods-in other words, at a level somewhere between the regular price at which the goods are sold and the deep discount price offered when a sale is held. So, low does not necessarily mean lowest. The price at a competing store where goods are on sale may be selling at lower prices.

However, in case of EDLP, these low prices are stable and not subject to a one-time sale. In India, many co-operative stores have adopted this strategy. One store that uses ED LP is Big Bazaar.

Here, goods are either sold below their normal prices, or some sales promotion scheme is available. For EDLP to work, volumes are necessary so that the store can negotiate with the manufacturers for bargain prices. The benefits of adopting an EDLP pricing strategy are given in Fig 7.1

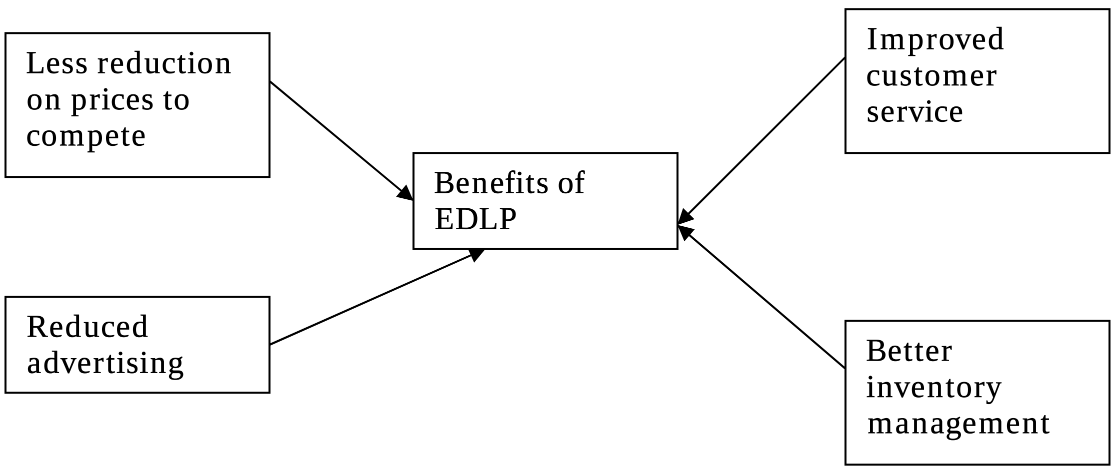


Fig 7.1 Benefits of EDLP

Do You Know!!!

Subhiksha: Essentials for a Discount Store
Subhiksha went for low real-estate costs, quick inventory turns, and informed customer buying, which have helped its meteoric growth. Subhiksha targets to become a Rs.1500-crore discount store chain by 2003. Subhiksha has three separate god owns for stocking pharmacy products, unbranded groceries, and branded FMCGs. Subhiksha has a centralized purchasing system. This eliminates multiplicity of billings, which would occur if the stores were to make independent purchases. It buys directly from distributors who sell at only a small margin above the mill prices and from 150 odd manufacturing companies. It has a fleet of 10 tempos, which supplies its stores once a day. As the discount format requires holding costs to be at a minimum, all the stores are connected through an intranet to facilitate inventory planning. Subhiksha makes spot payments against delivery, which enables it to get cash discounts. The supplier helps in inventory control and in return gets an improved cash flow.
Source: www.subhiksha.com

Some retailers have adopted a low-price guarantee policy where they guarantee that they will have the lowest possible price for a product. The guarantee usually promises to match or better any lower price found in the local market. If somebody is selling at a lower price, the retailer would refund the difference.

Benefits of EDLP: The following are the benefits of the EDLP strategy.

Less Reliance on Price Reduction to Compete: In high-low pricing, the goods that were selling for a particular retail price are sold at reduced prices during sale. This makes the customers conditioned to postpone their purchases and they buy only during sale. This is a vicious cycle as fewer items sold at normal prices means more piled up stock, which necessitates a sale to be organized. The sale keeps on getting bigger and better, reducing the average price at which goods are sold, thus hitting the bottom line.

Moreover, in high-low pricing the customers can have post-purchase dissonance once they come to know that the product they purchased at 20% discount a week back is being sold at 50% discount in the current week's sale. EDLP provides the customers with the satisfaction that they are paying a fair price for the product, and they tend to buy more frequently instead of waiting for the most beneficial sale to take place.

Reduced Advertising: Since prices are stable in EDLP, the retailer need not advertise frequently. In case *of* sale, which is held for a limited period, the retailer has to necessarily advertise so that more and more people visit the store to take advantage *of* the temporary low prices. Also, catalogues do not become obsolete since prices do not change so often.

Improved Customer Service: Stable prices also mean stable flow *of* customers in the store. In high-low pricing, the sales people generally fall short during sale time unless additional workforce is hired. In EDLP, the sales people are sufficient and, hence, are able to attend to customers properly.

Better Inventory Management: EDLP reduces the large fluctuations in demand that one experiences hi high-low pricing. So, retailers can manage their inventory with more certainty.

It must be noted here that even though EDLP may provide stability in demand and easy forecasting *of* inventory, it does not make a large difference in many cases *of* stock-outs. Goods on sale are meant to be cleared as far as possible *or* reduced to zero. So, essentially, a storeowner 'wants' to achieve the situation of a stock-out. Moreover, as these goods are sold at low profit margins, stock-outs are not of much concern as not much profit is lost. Fluctuations are also experienced in EDLP due to other factors such as festivals. In fact, demand for a majority of products is seasonal in India due to the festive season.

b) High-Low Pricing

In high-low pricing, retailers offer prices that are sometimes above their competitor's ELDP, but they use advertisements to promote frequent sales. In the past, retailers would mark down merchandise at the end of a season to clear the stock. Grocery stores would only have sales when they were overstocked. Sale is very common in garment retailing.

A sale is organized at the end of a season to serve basically two purposes. One, goods that have not managed to get sold is disposed off. Otherwise, extra handling and storage expenses have to incurred in respect *of* these goods. Moreover, there is no surety that they will get sold in the next season. Second, the sale provides an opportunity for a different target segment to visit the store. This segment is very product conscious and would compromise on design, color, etc., to buy cheaper. They also look for bargains where they are able to get a good quality product at sale prices. Nowadays, retailers also use sales to respond to increased competition and a more value conscious customer.

High-low pricing is used by stores like *Lifestyle.* Each of these strategies has its own benefits, as shown in Fig 6.2. The benefits of high – low pricing are:

Benefits of High-low Pricing The following are the benefits of high-low pricing.

Same Merchandise can he Used to Target Different Segments: The retailers use price skimming to target customers of various segments. When the merchandise is first put on display, it is sold at the maximum price. Fashion leaders and hard-to-fit customers buy at this price because they are less price-conscious or they fear that they would be unable to buy the same staff later on. Slowly, as sales in this segment are saturated, prices are lowered. More people enter the market, who are slightly more price conscious. Finally, at the end of the season, extremely price conscious customers visit the store during deep discount sales. They are not much concerned about the design or sizes and look for value buys from whatever is left over. So, the store owner is able to use the same set of goods to target various segments of the market.

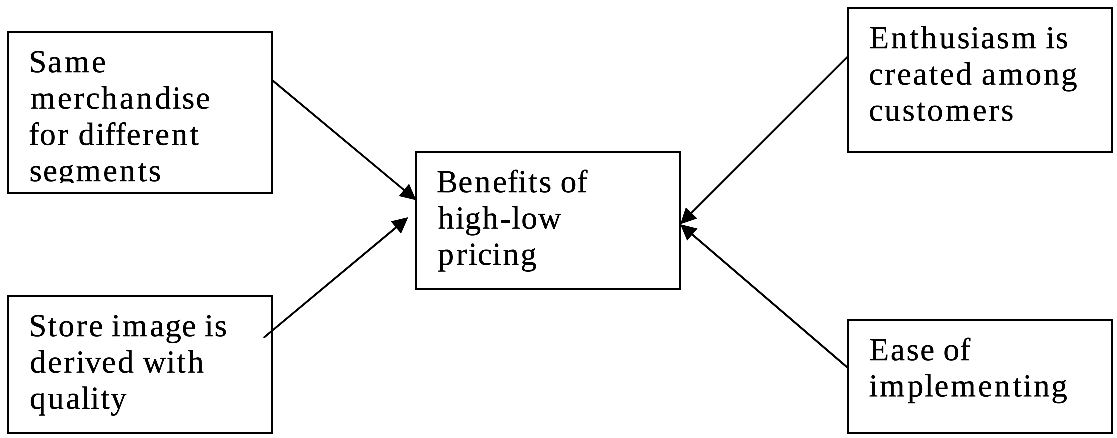
***Enthusiasm is Created Among Customers*:** A sale draws people to the store. This crowd helps in creating an atmosphere of excitement. The environment is such that people tend to purchase impulsively. During a sale, many retailers also use other supporting activities to create excitement. For example, product demonstrations or very short-term special prices. Many shoe retailers give free socks or shoe polish along with every pair of shoes purchased. This segment of customers also helps in improving the visibility of the store.

Image of Quality is Created: In an EDLP policy, the customer may assume that since prices are low throughout the year, the store must be compromising on quality or service somewhere. However, in high low pricing, even during a sale, the customer uses the original highest price as the reference. So, he or she tends to think that the merchandise stored is of high quality.

***Difficult to Implement EDLP*:** EDLP can be used primarily for known branded products so that the customer can compare the prices in the market, or, frequently purchased commodities whose prices the customers are aware of. So, EDLP cannot be implemented in every store. Moreover, implementation of EDLP requires large volumes so that the store can bargain with the suppliers for prices.

The pricing strategy of a retailer would lie along a continuum from EDLP to high-low pricing. However, retailers use other pricing practices also along with their basic strategy. In fact, very few retailers have a clear cut, simple to understand pricing strategy. It differs from time to time, product to product, and location to location. Nothing wrong about it as there are some products that are suited to EDLP and some are not.

Fig 7.2 Benefits of high – low pricing



7.2 External factors affecting retail price strategy

Several factors have an impact on a retail pricing strategy, as shown in Fig 7.3. Sometimes the factors have a minor effect. In other cases, they severely restrict a firm's pricing options.

7.2.1 The Customer and Retail Pricing

Retailers should understand the **price elasticity of demand** – the sensitivity of customers to price changes in terms of the quantities they will buy – because there is often a relationship between price and consumer purchases and perceptions. If small percentage changes in price lead to substantial percentage changes in the number of units bought, demand is *price elastic.* This occurs when the urgency to purchase is low or there are acceptable substitutes. If large percentage changes in price lead to small percentage changes in the number of units bought, demand is *price inelastic*. Then purchase urgency is high or there are no acceptable substitutes (as takes place with brand or retailer loyalty). *Unitary elasticity* occurs when percentage changes in price are directly offset by percentage changes in quantity.

Fig 7.3 Factors Affecting Retail Price Strategy

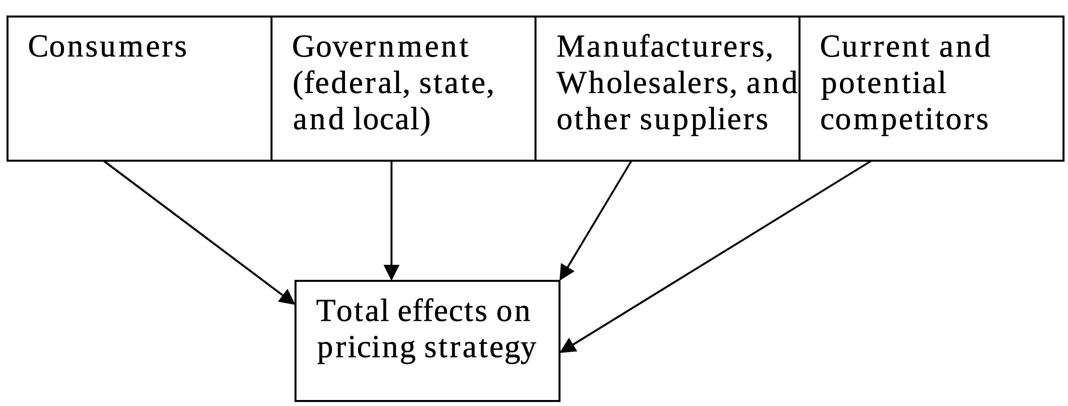


Table 7.1 A Movie Theater's Elasticity of Demand

Price	**Tickets Sold (Saturday Night)**	**Total Ticket Receipts**	**Elasticity of Demand** [a]
$ 6.00	1,000	$6,000	
			E=0.68
7.00	900	6,300	
			E = 0.79
8.00	810	6,480	
			E = 1.00
9.00	720	6,480	
			E=2.54
10.00	550	5,500	

Computation example = [(1,000 - 900)/(1,000 + 900)]1[($6.00 - *$7.00)/($6.00* + $7.00)]
= 0.68

[a] *Expressed as a positive number.*

Price elasticity is computed by dividing the percentage change in the quantity demanded by the percentage change in the price charged. Because purchases generally decline as prices go up, elasticity tends to be a negative number:

$$\text{Elasticity} = \frac{\dfrac{\text{Quantity 1 - Quantity 2}}{\text{Quantity 1 + Quantity 2}}}{\dfrac{\text{Price 1 - Price 2}}{\text{Price 1 + Price 2}}}$$

Table 7.1 shows the price elasticity for a 1,000-seat movie theater (with elasticities converted to positive numbers) that offers second-run movies. The quantity demanded (tickets sold) declines at every price from $6.00 to $10.00. Demand is inelastic from $6.00 to $7.00 and $7.00 to $8.00; ticket receipts increase since the percentage change in price is greater than the percentage change in tickets sold. Demand is unitary from $8.00 to $9.00; ticket receipts are constant since the percentage change in tickets sold exactly offsets the percentage change in price. Demand is elastic from $9.00 to $10.00; ticket receipts decline since the percentage change in tickets sold is greater than the percentage change in price.

For our movie theater example, total ticket receipts are highest at $8.00 or at $9.00. But what about total revenues? If patrons spend an average of $4.00 each at the concession stand, the best price is $6.00 (total overall revenues of $10,000). This theater is most interested in total revenues since its operating costs are the same whether there are 1,000 or 550 patrons. But typically, retailers should evaluate the costs, as well as the revenues, from serving additional customers.

In retailing, computing price elasticity is difficult. First, as with the movie theater, demand for individual events or items may be hard to predict. One week, the theater may attract 1,000 patrons to a movie, and the next week it may attract 400 patrons to a different movie. Second, many retailers carry thousands of items and cannot possibly compute elasticities for every one. As a result, they usually rely on average markup pricing, competition, tradition, and industry wide data to indicate price elasticity.

Price sensitivity varies by market segment, based on shopping orientation. After identifying potential segments, retailers determine which of them form target market:

- ***Economic consumers***-*They* perceive competing retailers as similar and shop around for the lowest possible prices. This segment has grown dramatically in recent years.
- ***Status-oriented consumers***- They perceive competing retailers as quite different. They are more interested in prestige brands and strong customer service than in price.
- ***Assortment-oriented consumers***-*They* seek retailers with a strong selection in the product categories being considered. They want fair prices.
- ***Personalizing consumers***-*They* shop where they are known and feel a bond with employees and the firm itself. These shoppers will pay slightly above average prices.
- ***Convenience-oriented consumers***-*They* shop because they must, want near stores with long hours, and may use catalogs or the Web. These people will pay higher prices for convenience. :

7.2.2 The Government and Retail Pricing

Three levels of government may affect retail pricing decisions: federal, state, and local. When laws are federal, they apply to interstate commerce. A retailer operation only within the boundaries of one state may not be restricted by some federal legislation. Major government rules relate to horizontal price fixing, vertical price fixing, price discrimination,, minimum price levels, unit pricing , item price removal, and price advertising.

a) Horizontal Price Fixing

An agreement among manufacturers, among wholesalers, or among retailers to set prices is known as **horizontal price fixing.** Such agreements are illegal under the Sherman Antitrust Act and the Federal Trade Commission Act, regardless of how "reasonable" prices may be. It is also illegal for retailers to get together regarding the use of coupons, rebate, or other price – oriented tactics.

b) Vertical Price Fixing

When manufacturers and wholesalers seek to control the retail prices of their goods and services, **Vertical price fixing** occurs. According to Consumer Goods Pricing Act, retailers in the United States cannot be forced to adhere to *minimum retail price* set by manufacturers and wholesalers. However, as a result of Supreme Court ruling, manufacturers and wholesalers are allowed to set *maximum retail prices.* This ruling "opened the door for manufacturers and wholesalers to cap the prices retailers charge for their products. It reversed a decision that barred such limits and left retailers and franchisees free to raise prices above suppliers' suggested prices. Now, manufacturers can set a maximum price as long as they show they aren't stifling competition.

There have been various legal actions in this area.

c) Price Discrimination

The **Robinson-Patman Act** bars manufacturers and wholesalers from discriminating in price or purchase terms in selling to individual retailers if these retailers are purchasing products of "like 'quality" and the effect of such discrimination is to injure competition. The intent of this act is to stop large retailers from using their power to gain discounts not justified by the cost savings achieved by suppliers due to big orders. There are exceptions that allow justifiable price discrimination when:

- ❖ Products are physically different.
- ❖ The retailers paying different prices are not competitors.
- ❖ Competition is not injured.
- ❖ Price differences are due to differences in supplier costs.
- ❖ Market conditions change-costs rise or fall, or competing suppliers shift their prices.

Discounts are not illegal, as long as suppliers follow the preceding rules, make discounts available to competing retailers on an equitable basis, and offer discounts sufficiently graduated so small retailers can also qualify. Discounts for cumulative purchases (total yearly orders) and for multi store purchases by chains may be hard to justify.

Although the Robinson-Patman Act restricts sellers more than buyers, retailers are covered under Section 2(F): "It shall be unlawful for any person engaged in commerce, in the course of such commerce, knowingly to induce or receive discrimination in price which is prohibited in this section." Thus, a retail buyer must try to get the lowest prices charged to any competitor, yet not bargain so hard that discounts cannot be justified by acceptable exceptions.

d) Minimum-Price Laws

About half the states have **minimum-price laws** that prevent retailers from selling certain items for less than their cost plus a fixed percentage to cover overhead. Besides general laws, some state rules set minimum prices for specific products. For instance, in New Jersey and Connecticut, the retail price of liquor cannot be less than the wholesale cost (including taxes and delivery charges).

Minimum-price laws protect small retailers from **predatory pricing,** in which large retailers seek to reduce competition by selling goods and services, at very low prices, thus causing small retailers to go out of business. In one widely watched case, three pharmacies in Arkansas filed a suit claiming Wal- Mart had sold selected items below cost in an attempt to reduce competition. Wal – Mart agreed it had priced some items below cost to meet or beat rivals' prices but not to harm competitors. The Arkansas Supreme Court ruled that Wal-Mart did not use predatory pricing since the three pharmacies were still profitable.

With **loss leaders**, retailers' price selected items below cost to lure more customer traffic for those retailers. Supermarkets and other retailers use loss leaders to increase overall sales and profits because people buy more than one item once in a store. However, consider this: The loss leader strategy is used primarily to attract customers to your business by introducing a bargain.

Such bargain themselves are not profitable, but hopefully this will be made up through the, other goods/services that mayor may not be related to the loss leader product. Implementing the loss leader strategy can be risky and therefore needs to be considered that it is the right approach to penetrating the market.

e) Unit Pricing

In some states, the proliferation of package sizes has led to **unit pricing** whereby some- retailers must express both the total price of an item and its price per unit of measure. Food stores are most affected by unit price rules because grocery items are more regulated than nongrocery items. There are exemptions for firms with low sales. The aim of unit pricing is to enable consumers to better compare the prices of products available in many sizes.

Retailer costs include computing per- unit prices, printing product and shelf labels, and keeping computer records. These costs are influenced by the way prices are attached to goods (by the supplier or the retailer), the number of items subject to unit pricing, the frequency of price changes, sales volume, and the number of stores in a chain.

f) Item Price Removal

The boom in computerized checkout systems has led many firms, especially supermarkets, to advocate **item price removal -** whereby prices are marked on shelves or signs and not on individual items. Scanning equipment reads pre-marked product codes and enters price data at the checkout counter.

g) Price Advertising

The FTC has guidelines pertaining to advertising price reductions, advertising prices in relation to competitors' prices, and bait-and-switch advertising.

A retailer cannot claim or imply that a price has been reduced from some former level (a suggested list price) unless the former price was one that the retailer had actually offered for a good or service on a regular basis during a reasonably substantial, recent period of time.

When a retailer says its prices are lower than competitors', it must make certain that its comparisons pertain to firms selling large quantities in the same trading area. A somewhat controversial, but legal, practice is price matching. For the most part, a retailer makes three assumptions when it "guarantees to match the lowest price of any competing retailer": (1) this guarantee gives shoppers the impression that the firm always offers low prices or else it would not make such a commitment. (2) Most shoppers will not return to a store after a purchase if they see a lower price advertised elsewhere. (3) The guarantee may exclude most deep discounters by stating they are not really competitors.

Bait-and-switch advertising is an illegal practice in which a retailer lures a customer by advertising goods and services at exceptionally low prices; once the customer contacts the retailer (by entering a .store, calling a toll-free number, or going to a Web site), he or she is told the good/service of interest is out of stock or of inferior quality. A salesperson (or Web script) tries to convince the person to buy a more costly substitute. The retailer does not intend to sell the advertised item. In deciding if a promotion uses bait-and-switch advertising, the FTC considers how many sales are made at the advertised price, whether a sales commission is paid on sale items, and total sales relative to advertising costs.

7.3 Developing a Retail Price Strategy

Figure 7.4 shows, a retail price strategy have five steps: objectives, policy, strategy, implementation, and adjustments. Pricing policies must be integrated with the total retail mix, which occurs in the second step. The process can be complex due to the often erratic nature of demand, the number of items carried, and the impact of the external factors already noted.

7.3.1 Retail Objectives and Pricing

A retailer's pricing strategy has to reflect its overall goals and be related to sales and profits. There must also be specific pricing goals to avoid such potential problems as confusing people by having too many prices, spending too much time bargaining with customers, offering frequent discounts to stimulate customer traffic, having inadequate profit margins, and placing too much emphasis on price.

Overall Objectives and Pricing

Sales goals may be stated in terms of revenues and/ or unit volume. An aggressive strategy, known as market penetration pricing, is used when a retailer seeks large revenues by setting low prices and selling many units. Profit per unit is low, but total profit is high if sales projections are reached. This approach is proper if customers are price sensitive, low prices discourage actual and potential competition, and retail costs do not raise much with volume.

With a market skimming pricing strategy, a firm sets premium prices and attracts customers less concerned with price than service, assortment, and prestige. It usually does not maximize sales but does achieve high profit per unit. It is proper if the targeted segment is price insensitive, new competitors are unlikely to enter the market, and added sales will greatly increase retail costs.

Return on investment and early recovery of cash are other possible profit based goals for retailers using a market skimming strategy. *Return on investment* is sought if a retailer wants profit to be a certain percentage of its investment, such as 20 percent of inventory investment. *Early recovery of cash* is used by retailers that may be short on funds, wish to expand, or be uncertain about the future.

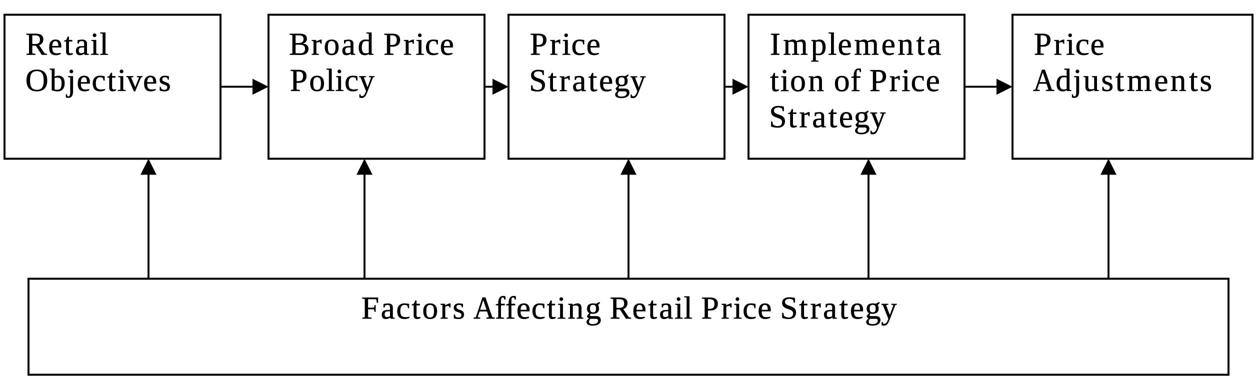


Fig 7.4 A Framework for Developing a Retail Price Strategy

7.3.2 Specific Pricing Objectives

Table 7.2 lists specific pricing goals other than sales and profits. Each retailer must determine their relative importance given its situation-and plan accordingly. Some goals may be incompatible, such as "to not encourage shoppers to be overly price-conscious" and a “we-will-not-be-undersold' philosophy."

7.3.3 Broad Price Policy

Through a broad price policy, a retailer generates an integrated price plan with short- and long-run perspectives (balancing immediate and future goals) and a consistent image (vital for chains and franchises). The retailer interrelates its price policy with the target market, the retail image, and the other elements of the retail mix. These are some of the price policies from which a firm could choose:

- ❖ No competitors will have lower prices; no competitors will have higher prices (for prestige purposes); or prices will be consistent with competitors'.
- ❖ All items will be priced independently, depending on the demand for each or the prices for all items will be interrelated to maintain an image and ensure proper markups.
- ❖ Price leadership will be exerted; competitors will be price leaders and set prices first; or prices will be set independently of competitors.
- ❖ Prices will be constant over a year or season; or prices will change if costs change.

Table 7.2 Specific Pricing Objectives from Which Retailers May Choose

- ✓ To maintain a proper image.
- ✓ To encourage shoppers not be overly price – conscious.
- ✓ To be perceived as fair by all parties (including suppliers. employees. and customers)
- ✓ To be consistent in setting prices.
- ✓ To increase customer traffic during slow periods.
- ✓ To clear out seasonal merchandise.
- ✓ To match competitors prices without starting a price war.
- ✓ To promote a “We – will not be undersold” philosophy.
- ✓ To be regarded as the price leaders in the market area by consumers.
- ✓ To provide ample customer service.
- ✓ To minimize the chance of government actions relating to price advertising and antitrust matters.
- ✓ To discourage potential competitors from entering the marketplace.
- ✓ To create and maintain customer interest.
- ✓ To encourage repeat business.

7.3.4 Pricing Strategy

In **Demand- oriented pricing,** a retailer sets prices based on consumer desires. It determines the range of prices acceptable to the target market. The Top of this range is called demand ceiling, the most people will pay for a good or service. With **cost- oriented pricing,** a retailer sets a price floor, the minimum price acceptable to the firm so that it can reach a specified profit goal. For

Competition-oriented pricing, a retailer sets its prices in accordance with competitors. The price levels of key competitors are studied and applied

a) Demand- Oriented Pricing

Retailers use Demand- oriented pricing to estimate the quantities that customers would buy at various prices. This approach studies customer interests and the psychological implications of pricing. Two aspects of psychological pricing are the price – quality association and prestige pricing.

According to the **price – quality association,** many consumers feel high prices connote high quality and low prices connote low quality. This association is especially important if competing firms or products are hard to judge on bases other than price, consumers have little experience or confidence in judging quality (as with a n w retailer), shoppers perceive large differences in quality among retailers or products, and brand names are insignificant in product choice. Though various studies have documented a price-quality relationship, research also indicates that if other quality cues, such as retailer atmospherics, customer service, and popular brands, are involved, these cues may be more important than price in a person's judgment of overall retailer or product quality.

Prestige pricing-which assumes that consumers will not buy goods and services at prices deemed too low-is based on the price-quality association. Its premise is that consumers may feel too Iowa price means poor quality and status. Some people look for prestige pricing when selecting retailers and do not patronize those with prices viewed as too low.

b) Cost-Oriented Pricing

One form of cost-oriented pricing, markup pricing, is the most widely used pricing technique. In markup pricing, a retailer sets prices by adding per-unit merchandise costs, retail operating expenses, and desired profit. The difference between merchandise costs and selling price is the **markup**. If a retailer buys a desk for $200 and sells it for $300, the extra $100 covers operating costs and profit. The markup is 33-1/3 percent at retail or 50 percent at cost. The level of the markup depends on a product's traditional markup, the supplier's suggested list price, inventory turnover, competition, rent and other overhead costs, the extent to which the product must be serviced, and the selling effort.

Markup can be computed on the basis of retail selling price or cost but are typically calculated using the retail price. Why? (1) Retail expenses, markdowns, and profit are always stated as a percentage of sales. Thus, markups expressed as a percentage of sales are more meaningful. (2) Manufacturers quote selling prices and discounts to retailers as percentage reductions from retail list prices. (3) Retail price data are more readily available than cost data. (4) Profitability seems smaller if expressed on the basis of price. This can be useful in communicating with the government, employees, and consumers.

This is how a **markup percentage** is calculated. The difference is in the denominator:

$$\text{Markup percentage (at retail)} = \frac{\text{Retail selling price - Merchandise cost}}{\text{Retail selling price}}$$

$$\text{Markup percentage (at cost)} = \frac{\text{Retail selling price - Merchandise cost}}{\text{Merchandise cost}}$$

c) Competition-Oriented Pricing

A retailer can use competitors' prices as a guide. That firm might not alter prices in reaction to changes in demand or costs unless competitors alter theirs. Similarly, it might change prices when competitors do, even if demand or costs remain the same.

As shown in Table 7.3, a competition-oriented retailer can price below, at/or above the market. A firm with a strong location, superior service, good assortments, a favorable image, and exclusive brands can set prices above competitors.

However, above-market pricing is not suitable for a retailer that has an inconvenient location, relies on self-service, is not innovative, and offers no real product distinctiveness.

Competition-oriented pricing does not require calculations of demand curves or price elasticity. The average market price is assumed to be fair for both the consumer and the retailer. Pricing at the market level does not disrupt competition and therefore does not usually lead to retaliation.

Integration of Approaches to Price Strategy

To properly integrate the three approaches, questions such as these should be addressed:

- If prices are reduced, will revenues increase greatly? (Demand orientation).
- Should different prices be charged for a product based on negotiations with customers, seasonality, and so on? (Demand orientation)
- Will a given price level allow a traditional markup to be attained? (Cost orientation)
- What price level is necessary for a product requiring special costs in purchasing, selling, or delivery? (Cost orientation)
- What price levels are competitors setting? (Competitive orientation)
- Can above-market prices be set due to a superior image? (Competitive orientation)

Table 7.3 Competition-Oriented Pricing Alternatives

Retail Mix Variable	Pricing Below at Market	Pricing at the Market	Pricing Above the Market
Location	Poor, inconvenient site, low rent	Close to competitors, no location advantage	Few strong competitors, convenient to consumers
Customer Service	Self service, little sales person support, limited displays	Moderate assistance by sales personnel	High levels of personal selling, delivery, etc
Product assortment	More emphasis on best – seller	Medium or large assortment	Small or large assortment
Atmosphere	Inexpensive fixtures, racks for merchandise	Moderate atmosphere	Attractive and pleasant décor
Innovativeness in assortments	Follower, conservative	Concentration on best- sellers	Leader
Special Services	Not available	Not available or extra fees	Included in price
Product Lines carried	Some name brands, private labels, closeouts	Selection of name brands, private labels	Exclusive name brands and private labels

7.4 Implementation of Price Strategy

Implementing a price strategy involves a variety of separate but interrelated specific decisions, in addition to those broad concepts already discussed. A checklist of selected decisions is shown in Table 7-4. In this section, the specifics of a pricing strategy are detailed.

Customary and Variable Pricing

With **customary pricing,** a retailer sets prices for goods and services and seeks to maintain them for an extended period. Examples of items with customary prices are newspapers, candy, arcade -games, vending machine items, and foods on restaurant menus. In each case, the retailer wants to establish set prices and have consumers take them for granted.

Table 7.4 A Checklist of Selected Specific Pricing Decisions

- ✓ How important is price stability? How long prices should be maintained?
- ✓ Is everyday low pricing desirable?
- ✓ Should prices change if costs and / or customer demand vary?
- ✓ Should the same prices be charged to all customers buying under the same condition?
- ✓ Should customer bargaining be permitted?
- ✓ Should odd pricing be used?
- ✓ Should leader pricing be utilized to draw customer traffic? If yes, should leader prices be above, at or below costs?
- ✓ Should consumer be offered discounts for purchasing in quantity?
- ✓ Should price lining be used to provide a price range and price points within that range?
- ✓ Should pricing practices vary by department or product line?

7.5 Review Question

1. Why is it important for retailers to understand the concept of price elasticity even if they are unable to compute it?
2. Comment on each of the following from the perspective of a small retailer:
    a) Horizontal price fixing.
    b) Vertical price fixing.
    c) Price discrimination.
    d) Minimum – price laws
    e) Unit pricing.
3. Give an example of a price strategy that integrates demand, cost and competitive criteria.
4. What are the pros and cons of everyday low pricing to a retailer? To a manufacturer?

RETAIL LOCATION STRATEGY

Structure

8.1 Introduction

Retail location is considered to be one of the most important elements in retail marketing strategy, because it is a long-term decision, associated with long-term capital commitment. Site selection is therefore associated with distinct planning processes to solve the complex location decisions. In this Chapter, the focus is on bricks-and mortar retail outlets. The different types of retail locations, the main elements of location decisions and techniques for retail site assessment will be discussed.

8.2 The Importance of Location to Retail Companies

The selection of retail store locations is one of the most significant decisions in retail marketing, because in store based retailing, good locations are key elements for attracting customers to the outlets and sometimes can even compensate for a mediocre retail strategy mix. A good location therefore can lead to strong competitive advantages, because location is considered one of the elements of the retail marketing mix that is "unique" and thus cannot be imitated by competitors. Location decisions are very complex, due to the large number of factors that have to be considered, and costs associated with, for example, the opening of new stores, can be very high. Site selection is therefore a *long term decision* that implies long term capital commitment. Once a retail site has been chosen, there is only little flexibility, because this decision usually cannot be changed easily without high losses.

Because of its *fixed nature*, location cannot be changed in the short term, contrary to other elements of the retail marketing mix such as prices, customer service, the product assortment or advertising. These latter factors can be altered if the environment (e.g. Consumer behaviour, competition) changes (Wrigley 1988).The main attention in the context of retail location strategies usually focuses on the opening of new stores. However, location decisions relate to the entire physical structure of retail outlets and are thus more comprehensive. The main types of decisions are (1) the *opening* of new stores, (2) the *extension* of floor space of existing stores, (3) the *relocation* or movement of a store from one place to another within a particular town or area where a better site is available, (4) *rationalization* decisions, e.g. the closure of individual stores, (5) *repositioning* of locations, e.g. altering of store image by changing the name or appearance, (6) *refurbishment* such as improving or updating the physical Environment of an existing outlet or (7) altering the product range and assortment "*remerchandising*") to tailor the offer more closely to local customers (Hernández/Bennison 2000). The opening of new stores comprises the most complex type of decision, because it is usually the starting point of activities in a specific geographic area. This section therefore focuses mainly on retail location decisions of this type.

8.3 Types of Retail Locations

There are three basic *types of locations* available for retail stores: solitary sites, unplanned hopping areas and planned shopping districts. Each of the basic location types is associated with specific advantages and disadvantages (see Table 8.1) according to, for example, the size of the catchments area, occupancy costs, pedestrian or vehicle customer traffic, restrictions placed on store operations or convenience of the location.

	Size (1,000 m²)	Trading Area (km)	Shopping Convenience	Pedes-trian Travel	Vehicular Traffic	Restrictions on Operations	Typical Tenants
Unplanned Areas							
Free Standing	varies	5-15	high	low	high	limited	convenience, drug stores, category killers
Urban Locations/ Central Business Districts	varies	varies	low	high	low	limited to medium	specialty stores
Planned Areas							
Neighbourhood/Community Shopping Centres	2.5-30	5-20	high	low	high	medium	supermarkets, discount stores
Power Centres	25-55	5-25	medium	medium	medium	limited	category killers
Enclosed Malls	35-100	5-40	low	high	low	high	department and specialty stores
Lifestyle Centres	15-45	5-25	medium	medium	medium	medium to high	specialty stores and restaurants
Fashion/Specialty Centres	7.5-25	5-25	medium	high	low	high	high-end fashion-oriented specialty stores
Outlet Centres	4.5-40	40-125	low	high	high	limited	off-price stores/ factory outlets
Theme/Festival Centres	7.5-25	N/A	low	high	high	highest	specialty stores and restaurants

Table 8.1 Types of Locations

Solitary Sites (Free-Standing Sites, Isolated Sites)
This type of location relates to single, free standing outlets that are *isolated* from other retailers (Gilbert 2003, p. 288). They can, for example, be positioned on roads or near other retailers or shopping centers. Such sites are used, for instance, by large store formats in food and non food retailing or for convenience shops.

Unplanned Shopping Areas
Unplanned shopping areas are retail locations with several outlets in close proximity to each other that have evolved over time. The retail mix is not the result of long range planning and for such locations, there is no centralized management (Levy/Weitz 2007, p. 188). The main kinds of unplanned shopping areas are (1) *central business districts* (traditional "downtown" areas in cities/towns), (2) *secondary business districts* in larger cities and main street or high street locations in smaller cities, (3) *neighborhood districts*, and (4) *strip* or *string* locations (locations along a street or motorway) (Berman/Evans 2007, pp. 293 294).

Planned Shopping Districts/Shopping Centers
Planned shopping areas are retail locations that have been architecturally planned to provide a unified theme for a number of outlets (Gilbert 2003, p. 288). These sites are developed deliberately and usually have some large, key retail brand stores ("anchor stores") and a number of smaller retailers to add diversity and special interest (Reynolds 1992).The basic types of shopping centers are *retail parks* that consist of a purpose built cluster of free standing retail outlets. There are (large) parking facilities and *shopping centers* that consist of single buildings which are marketed as a unified shopping destination, usually with one name and logo. The retail

mix is different from retail parks, as the range of stores is wider and often includes luxury and leisure items as well as clothing, footwear and other typical central location merchandise (Gilbert 2003, pp. 289 290).Several specific types of retail parks and shopping centers have been developed (Levy/Weitz 2007, pp. 190 191): (1) *neighborhood* or *strip/community centers* that are typically anchored by a supermarket, (2) *power centers* that consist primarily of large format retailers, (3) *shopping malls* that are enclosed, climate controlled and lighted shopping centers (regional or super regional shopping malls), (4) *lifestyle centers* that encompass an open air configuration of upscale specialty stores, entertainment and restaurants, (5) *fashion/specialty centers* that comprise mainly up market clothing shops and boutiques carrying high quality and price fashion merchandise, (6) *outlet centers* that contain manufacturers' and retailers' outlet stores or off price retailers (see Chapter 2), and (7) *theme or festival parks* that typically employ a unified theme carried by the retail outlets, their architectural design and their merchandise and can be anchored by restaurants or entertainment facilities. The main types of planned shopping areas are presented in Table 8.2

The decision as to which kind of retail location to select depends on the company's strategy. It is an integral part of the retail location decision process.

Retail Location Decision Process

Retail location decisions typically follow a systematic process that starts with a *general* assessment of geographic areas and leads to a *detailed* assessment of specific site characteristics. This process can broadly be described as a three step selection process (Brown 1992, p. 16):

- *Market selection*: The first step is the consideration of a region that has potential for a new retail outlet.
- *Area analysis*: Within the chosen region, a potentially optimal area for the store is selected.
- *Site evaluation*: In the chosen geographical area, the best available site(s) are examined in terms of all features that are relevant to potential store performance. This step concludes with a final decision as to the specific site.

Table 8.2 Planned Shopping Area Types

	Types	Examples
Intermediate Centres (10,000 – 20,000 m²) *(Centres intercommuneaux, centros intermedios, regionale Shopping-Center)* (at least one anchor, integrated)		
Locational Variants	• non-central suburban community • greenfield site, transport node	• Auchan, Torino, Italy • Cameron Toll, Edinburgh, UK
Compositional Variants	• hypermarket-anchored • specialty non-food anchored	• Euromarché • BHV, Cergy, France
Regional Shopping Centres (30,000 m²+) *(Centres commerciaux régionaux, grandes centors periféricos, überregionale Shopping-Center)* (two or more anchors)		
Locational Variants	• central area in traditional core • central area adjacent traditional core • non-central suburban growth zone • greenfield site, transport node	• Eldon Square, Newcastle, UK • La Part-Dieu, Lyon, France • CentrO, Oberhausen, Germany • Curno, Bergamo, Italy
Compositional Variants	• hypermarket-dominated • department and variety-store dominated • food, non-food and leisure anchors	• A6, Jönköping, Sweden • Lakeside, Thurrock, UK • Parquesur, Madrid, Spain
Retail Parks (5,000 – 20,000 m²) *(parques des entrepôts, parques commerciales, retail warehouse parks, Fachmarktzentren)* (not obviously anchored, not wholly integrated centres)		
Locational Variants	• non-central suburban community • greenfield site, transport node	• various • Lakeside Retail Park, UK
Compositional Variants	• large retail format tenant mix • factory outlet tenant mix • hybrid tenant mix	• Fairacres Retail Park, Abingdon, UK • Marques Avenue, Troyes, France • Fosse Park, Leicaster, UK
Specialty Centres (1,000 m²+) *(Arcades, galeries marchandes, galerias comerciales, Galerien/Passagen)* (fashion-oriented, specialty stores)		
Locational Variants	• central area in traditional core • adjacent to traditional core	• Galleria, Hamburg, Germany • Albert Dock, Liverpool, UK
Compositional Variants	• non-food specialty stores • department store conversions	• Powerscourt Centre, Dublin, Eire • Karstadt Arkaden, Mühlheim, Germany

Catchment Area

The analysis of the catchment area (*trading area, market area*) of a specific region or a specific site is of high importance in each phase of this retail location decision process. The catchment *area is* the geographic area that contains the customers of a particular site or region for a company or a group of companies for specific goods or services. Thus, it determines the potential demand at a particular site and, among other factors, influences potential sales and profitability. Usually, the catchment area is divided into three parts. The *primary trading area* is the zone in which the majority of customers are based. It encompasses 50 % to 80 % of the customers. The *secondary trading area* contains about 15 % to 25 % and the *fringe* or *tertiary trading area* includes the remaining customers that shop occasionally at a location as an alternative to local shopping (Berman/Evans 2007, pp. 270 272; Gilbert 2003, p. 280). These catchment area segments are often described in terms of the *distance* between customers' homes or work places and the area or site. Usually, either the linear distance (e.g.

concentric circles drawn around a site), the travel distance (by car or public transport) or time distance measures (by car or public transport) are used to delineate trading area segments. *Mapping techniques* are used to forecast or survey and map such store trading areas (McGoldrick 2002, p. 247). *Geographical information systems* (GIS) are important support systems for location research and trading area analysis. These are software systems that combine digitalized mapping with key locational data in order to depict trading area characteristics such as population demographics, customer purchase data, and competitor locations.

8.4 Location Assessment Techniques

The *appropriateness* of a specific site is based upon the retailer's strategy (retail formats, merchandise, pricing strategy, etc.) and is influenced by a substantial number of factors that need to be investigated. A selection of location factors is presented in Table 8.3.

Table 8.3 Selected Location Factors

Customers (potential/actual)	Accessibility	Competition	Costs
• numbers by demographics (e.g. population size, age profile, household size) • income level • disposable income per capita • employment by occupation, industry, trends • housing density • housing age/type • neighbourhood classification • home-ownership levels • building/demolition plans • main employers • spending patterns • shopping patterns • population growth, density and trends • lifestyle measures • cultural/ethnic grouping	• site visibility • pedestrian flows • pedestrian entry routes • barriers such as railway tracks, rivers • type of location zone • car ownership level • road network (conditions, driving speeds, congestion, restrictions, plans) • parking (capacity, convenience, cost, potential) • public transport (types, cost, ease of use, potential) • visibility • access for staff • access for transport and delivery	• existing retail activity (direct competitors, indirect competitors, anchor stores, cumulative attraction, compatibility) • existing retail specification (selling area, turnover estimates, department/product analysis, trade areas, age of outlets, standard of design, car parking) • saturation index • competitive potential (outlet expansion, refurbishment, vacant sites, interception, repositioning, competitor policy) • proximity of key competitors, traders, brand leaders	• purchase price • building costs • rent costs • leasing terms • site preparation • building restrictions • development concessions • rates payable • refurbishment needs • maintenance costs • security needs • staff availability • labour rates • delivery costs • insurance costs • promotional media/costs • turnover loss/other branches

In order to guide retail location decisions and to assess or forecast the potential sales or profitability of retail stores in a specific region, area or at a specific site, a number of techniques have been developed to assess the sites.

Technique/s	Subjectivity	Cost	Technical Expertise Required	Computing and Data Needs	GIS
Experience	very high	low	low	low	limited role
Checklists/Analogues/Ratios	medium	low	low	low	limited role
Multiple Regression/ Discriminant/Analysis	low	medium	high	medium	information
Gravity Modelling	low	high	very high	high	information, modelling, analysis and modelling
Expert Systems/Neural Networks	low	very high	very high	very high	information

Table 8.4 Location Planning Techniques

The techniques range from very simple to very sophisticate (see Table 8.4). Either way, most are used to identify and evaluate potential *new sites*, but they can also guide decisions on *existing locations* with respect to extensions, rationalization, repositioning, etc.

Managers' Experience

Location is a retail function which requires knowledge and expertise. In practice, managerial experience ("*retail nose*") plays an important role in assessing retail locations. For example, *rules of thumb* are often used as subjective and intuitive guidelines for site assessment. Such rules are developed from knowledge of the company (Hernández/Bennison 2000).

Location Evaluation Checklists

Checklists consist of a number of chosen variables (e.g. location factors) to be considered when evaluating retail locations. One of the first detailed checklist evaluation formats was developed by Nelson (1958). Companies select factors that they believe to influence store performance.
While some elements of such checklists are common to all types of retailers, each company is likely to have its own list with factors that reflect its particular strategy and situation (McGoldrick 2002, p. 239).

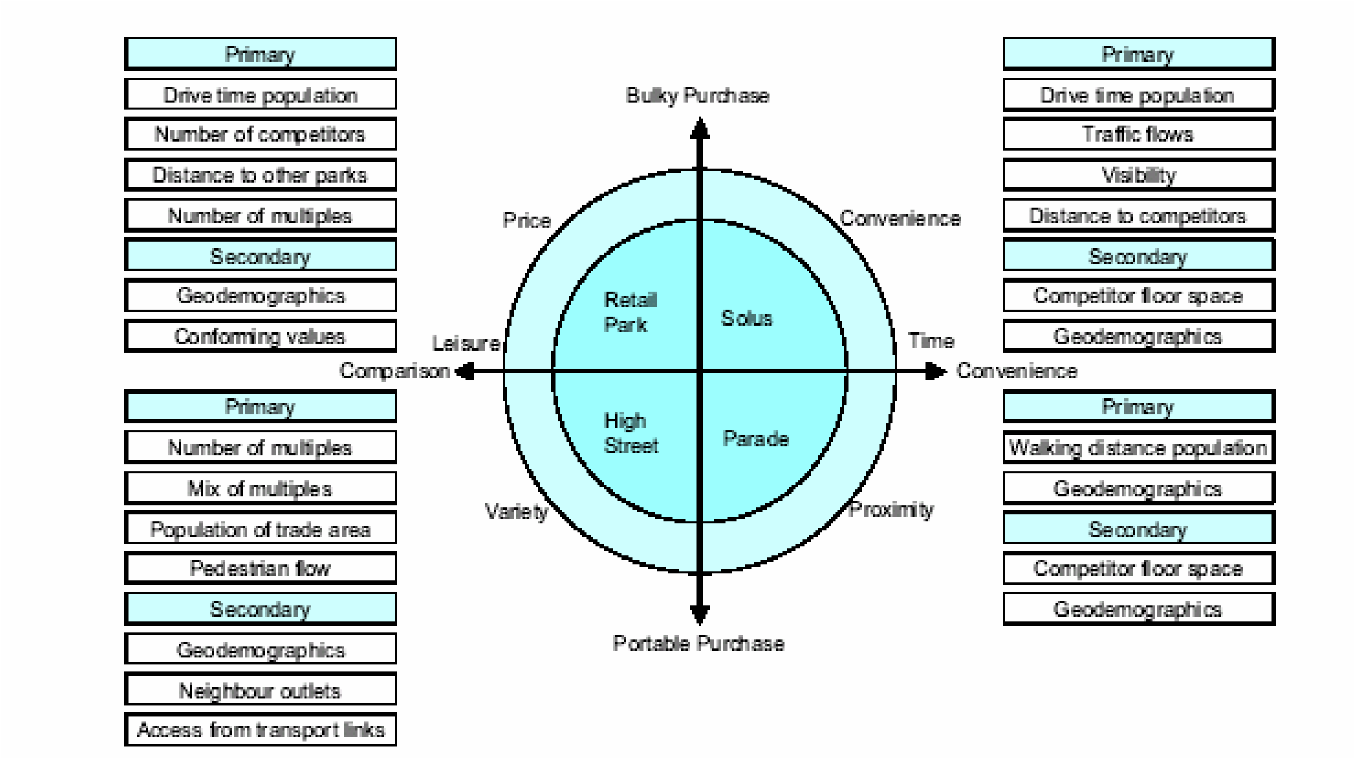


Fig 8.1 Locational Positioning

Figure 7.1 illustrates linkages between retailers' strategic positioning, typical locations and major factors that are considered to be important influences and which should be analysed in the context of site assessment.

8.4.1 Analogue Method

The principle behind the *analogue method* (Applebaum 1966) is that new store sites are compared to existing ones that have many features in common with the new store (e.g. store size, merchandise or location characteristics). The likely turnover and profitability of the new store site are estimated on the basis of sales achieved and profits earned by similar stores in existing areas. Such comparisons can be done by *extrapolating* own store data or by comparing the new site with existing competing stores (e.g. stores at the prospective location).

Multivariate Statistical Techniques

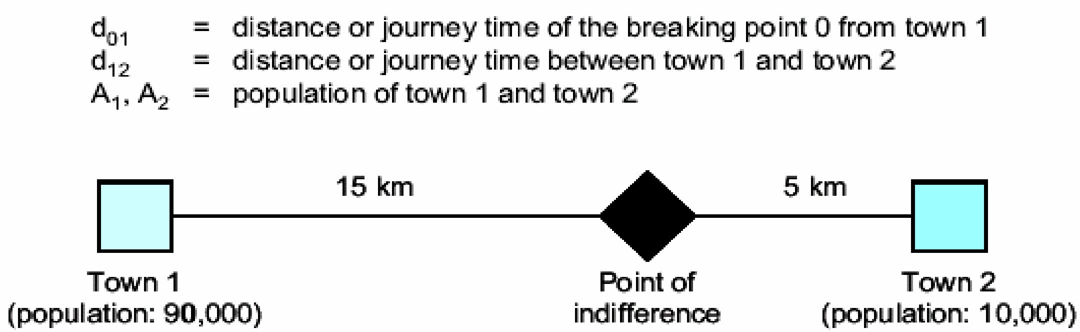
Given the increasingly complex array of data available for location analysis, multivariate statistical techniques can be used to construct models that harness the predictive power of the available predictor variables for (new) store performance (McGoldrick 2002, p. 257). Most of the important techniques are forms of *multiple regression analysis* which predict store sales and estimate market potential or potential profit. *Discriminate analysis* can be used to predict category membership. Such more sophisticated procedures can identify relationships between store sales and predictor variables such as population in the surrounding area, the spending power of the population, store accessibility, quality of transport links to sites, average distance to population or nearby competition (Moutinho/Curry/Davies 1993). These techniques provide more objective and systematic insight into the impact and importance of location attributes and are useful in screening large numbers of locations. On the other hand, they require more data than the simpler methods and a higher degree of technical expertise. *Cluster* and *factor analysis* are techniques aimed at *grouping data cases or variables* together for segmenting a portfolio of stores into similar groups (*cluster analysis*) or grouping together a range of variables that can be used to predict site profitability (*factor analysis*). The application of these procedures is particularly suited to new store format development or the segmentation of Retail networks. These techniques also require a large amount of good quality data as well as a high degree of statistical expertise and business acumen (Hernandéz/Bennison 2000).

8.4.2 Spatial Interaction Models

Spatial interaction models are also referred to as "*gravity models*", because they are based on an analogy with the physical law of gravitation. They have evolved as a major stream of development in retail location theory. The basic principle of *spatial interaction* is that the aggregate movements of shoppers are positively related to the attractiveness of a store and negatively related to the distance from the store or other deterrence factors Gravity models can be used to forecast store performance based on the simultaneous consideration of such factors as store size, store image, distance, population and distribution. One of the earliest models of this type is *Reilly's law of retail gravitation* (Reilly 1929). This law establishes a point of indifference between two towns in order to determine the catchment area of each town. This point of indifference is the *breaking point*, defined as the point up to which *one* town dominates and beyond which the *other* town dominates (see Figure 8.2). Thus, it is the point at which consumers are indifferent as to which location they use (Rogers 1992). *Fig 8.2 Reilly's Law of*

Fig 8.2 Retail Gravitation

$$d_{01} = \frac{d_{12}}{1 + \sqrt{A_2 / A_1}}$$



This model aids in the delineation of the trading area from which retailers draw customers. However, the model has many limitations (see, for example, Rogers 1992; Craig/Ghosh/McLafferty 1984). For example, the breaking point formula does not provide estimates above or below the break even point between the two towns. Also, the model cannot predict trade areas of more than two towns and the form of the function is not constant for all types of shopping trips. Retailers can offer additional competitive advantages and thus – contrary to the model assumptions – can differ in terms of location attractiveness (McGoldrick 2002, p. 261; Gilbert 2003, p. 295).

In order to overcome these limitations, *several refinements and extensions* of the model have been developed, including ***Huff's law** of shopper attraction* (Huff 1964), which is based on the utility that a shopper derives from shop ping at a particular store. It describes catchment areas on the basis of the product assortment carried at various shopping locations, travel times and the sensitivity of the kind of shopping to travel time (trip's purpose and type of product sought).

Knowledge-Based Techniques

Knowledge based techniques are the most recent models that have been developed to assess retail store locations. The most important techniques are *expert systems* or models developed based on *artificial intelligence*, such as neural networks or computer systems modeling the retail environment and shopper behaviour as "software agents" that simulate store performance at prospective locations. Such systems depend heavily on powerful computer capacities and immense data requirements and are still in the development phase.

8.5 Case Study: ECE Project management

8.5.1 Profile, History, and Status Quo

Founded in 1965 by Dr. H.C. Werner Otto, *ECE Projektmanagement GmbH & Co. KG,* a German real estate development company headquartered in Hamburg, is presently the European market leader in inner city shopping centers. In its home country of Germany, *ECE*'s market share of all shopping centers' rentable area is approximately 20.5 % (Bender 2006, p. 20). Additionally, the company also operates in the following business sectors:

- office buildings
- industrial construction
- transport related real estate
- buildings in the healthcare sector.

With respect to these business sectors, the company is organized into five operating units employing approximately 2,200 retail specialists. Table 8.5 provides an overview of the basic figures for *ECE's* other business activities.

Business Sector	Area/ Premises in m²	Tenants	Investment/ Construction Volume
Office Buildings	600,000	500	N/A
Industrial Properties	375,000	e.g. Airbus, Beiersdorf	750 million EUR
Transport Projects	N/A	e.g. railway stations Cologne, Leipzig, Hanover	400 million EUR (railway stations)

Table 8.5 Key Figures of ECE's Business Areas

ECE's business activities comprise developing, building, leasing, and managing innovative shopping centres as well as property in the other mentioned sectors. Additionally, it also revitalizes older shopping centres so as to adapt them to changing trends and consumer demand. Annual revitalization projects amount to approximately 50 million EUR.

ECE Projektmanagement is a company owned by *Otto*, the world's largest mail order operator. It was also founded by Werner Otto and generated a turnover of more than 14.5 billion EUR in the financial year 2005 with its business activities in 19 countries. *ECE* itself also has two sister companies which are active in the USA and Canada. It was Werner Otto's vision to adapt the US model of shopping centres to fit the specific needs of the largely decentralized European retail market. The first *ECE* shopping centre, the *Franken Center* in Nuremberg, Germany, which was built according to the US model of separate shops in an interconnected, covered mall, was opened in 1969 and is still run and managed by ***ECE Projektmanagement.***

Today, the company is the clear European market leader in shopping centres with 84 centres (comprising more than 2.4 million m2 in sales area) being managed as well as another 14 being currently built or planned. In 2005, more than 10 billion EUR in sales were generated by the *ECE* shopping centres and their 8,100 tenants. Some of the most prestigious centres are shown
in Figure 8.3.

Fig 8.3 Prestigious ECE Shopping Centres

Figure 8.4 shows the current geographic allocation of *ECE's* business activities, both on a national and international scale.

Fig 8.4 ECE's Centres and Projects

The initials "*ECE*" initially stood for the name of the company – *"Einkaufs Center Entwicklung"* (which translates as "shopping centre development"). However, the company, which was founded in 1965, has been active in a broader range of areas from the outset. Since the business activity in areas other than shopping centres has increased steadily and since the planning and construction of a hospital, for example, has little in common with that of shopping centres (and as the reference to shopping centres on the site board for a hospital project caused some irritation to passers by), the company was renamed "*ECE Projektmanagement*" – or *ECE* for short.

8.5.2 Success Factors

Careful Site Selection

Apart from a focus on creating an appealing and convenient customer experience, the selection of only prime locations for shopping centres was central to Otto's philosophy for *ECE* from the start. For this reason, the company conducts "extensive research on a target city" (Knutt 2003, p. 20). The following basic location factors of a potential shopping centre site are assessed critically:

- location
- catchment area
- purchasing power
- accessibility by foot, car and public transport (Schliebe 1998 p. 114).

The assessment of potential sites for a shopping centre is the first stage in project management, comprising ultimately, the development and management of a shopping centre.

ECE Projektmanagement always makes extensive use of primary statistics on the number and structure of inhabitants, other demographics, purchasing power and the centrality of the respective city. These data are easily accessible through census offices, for example (Schner mann 1998, p. 145). *ECE* always includes local civic councils and financial investors in the assessment process as soon as possible, because the latter in particular, ultimately decide whether or not a location is appropriate for constructing a shopping centre. On the other hand, local civic authorities and citizens' initiatives or action groups which oppose a potential shopping centre, can make it very difficult for the project management process to be pursued.

In terms of catchment area, *ECE* distinguishes between different zones in terms of their distance from the shopping centre, as measured in driving time by car. The distinction is made as follows:

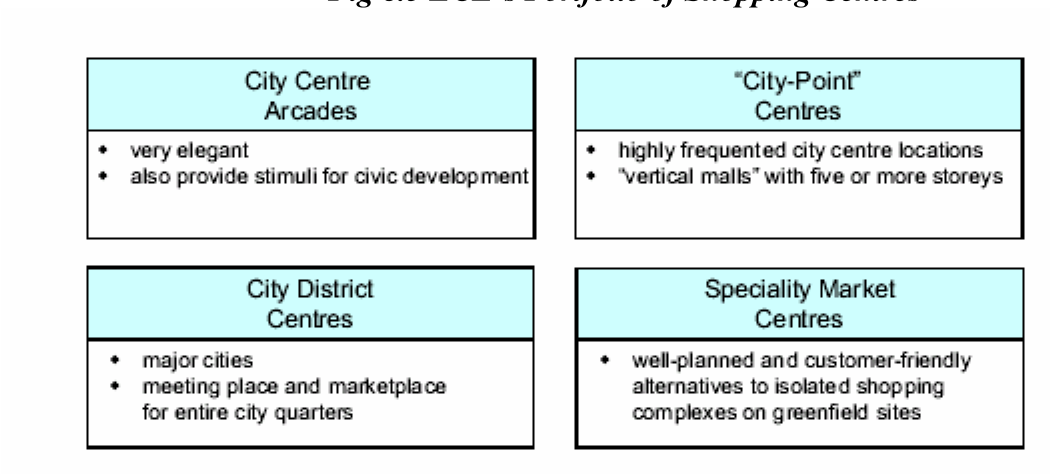
- zone I/primary catchment area: 0 5 minutes driving distance by car
- zone II/secondary catchment area: 5 15 minutes driving distance by car
- zone III/fringe/tertiary catchment area: 15 30 minutes driving distance by car
- zone IV: 30 45 minutes driving distance by car.

In order to depict the catchment area of a potential shopping centre site, the different zones are represented in concentric circles on a map, indicating the respective number of inhabitants. In this respect, *ECE Projektmanagement* uses various *geographical information systems* (GIS). Another key prerequisite for building a shopping centre is accessibility, which includes sufficient parking and landscaped entrances for pedestrians. For example, *Limbecker Platz* in Essen will be Germany's largest inner city shopping centre after its completion in 2009, with 70,000 m2 floor spaces on 3.5 storeys and approximately 200 shops. The estimated catchment area for zones I – III will comprise more than 1.7 million inhabitants and more than 2,000 parking lots will be provided.

Shopping Center Architecture

ECE only chooses locations where it can integrate its hallmark high grade and high quality architecture into the city. An example of this location factor is the *Potsdamer Platz Arkaden* in Berlin, with its 40,000 m2 of retail area which includes an *IMAX* cinema. The *Arkaden* have become a focal point of attraction and offer everything *ECE* expects "for a good location – the infrastructure is excellent, famous architects have designed the architecture so that the Potsdamer Platz has become a brand, and the Arkaden has the right size to offer a broad variety of shops and restaurants for the customers. Potsdamer Platz Arkaden is a real urban entertainment center, which attracts a lot of tourists as well" (cf. Knight 2005).In its site selection process, the company is also faced with a number of legal restrictions. Since *ECE* shopping centres are at present only built in inner-city locations and because the company has very high expectations as to the architecture of its centres, preferred locations are historical buildings and sometimes even former castles. However, there are often legal restrictions in terms of monument preservation. A current example is the shopping centre at the Schlosspark Brunswick, due to open in 2006, which caused much controversy among residents, consumers, local civic authorities, etc. (see www.schlosspark braunschweig.de). Furthermore, the Land Use Ordinance and environmental related issues have to be taken into account in the site selection process. For this purpose, *ECE* always uses external expertise to support the selection process. As *ECE* has four different kinds of shopping centres in its portfolio (see Figure 8.5), the site selection process is always tailored to the shopping centre in question.

Fig 8.5 ECE's Portfolio of Shopping Centres



Since inner city locations which meet *ECE*'s high standards and prerequisites are limited, the company began expanding into foreign markets outside Germany in 1996/1997, assessing potential markets, areas, and shopping centre sites. The *Galeria Dominikanska* in the Polish city of Wroclaw was the first *ECE* shopping centre outside Germany. Before entering a foreign market, the company analyses national economic data and key figures in great detail in order to obtain a realistic assessment of the potential market. This data includes:

- GDP real growth and GDP per capita
- domestic demand, purchasing power index
- unemployment rate and available labour, quality of available labour
- demographics, e.g. age and gender structure, level of education, or family size
- traffic connections and infrastructure
- political and legal conditions.

Another main criterion for *ECE Projektmanagement* in deciding whether or not to enter a country is the potential to become market leader. Only if there are reasonable prospects of doing so, will the company enter a foreign market. This is the case in Poland or Turkey, for example (Knutt 2003, pp. 19 20).

Staggered Rent System

The staggered rent strategy is a cornerstone of the *ECE* shopping centre concept. It is obvious that a hair salon cannot afford the same rent as a jeweler's shop, for example but a shopping centres needs both. This is where tenants profit from *ECE*'s tailored leasing policy. They pay sector dependent rents based on the financial potential of the outlet in question. The system facilitates a complementary tenant mix. By contrast, individual owners always try to demand the highest possible rent for their shop premises with the result that entire types of business disappear from inner cities. It is *ECE's* official policy and strategy to counteract this tendency by applying rent discrimination to its tenants.

Close and Long-Term Relationship with Tenants

With the help of the staggered rent system, *ECE* pursues a strategy of having an attractive and varied mix of its tenants, encompassing large anchor stores such as department stores as well as branch stores, often in the textile sector, and regional retailers which all give the respective shopping centre its unique identity, thus increasing the feeling of identity among tenants and customer acceptance. *ECE* refers to this approach, combined with the characteristic high quality architecture, as the "vibrant marketplaces" concept, which generates beneficial stimuli for the inner city, thus winning back purchasing power from, for example, category killers on Greenfield sites outside the city centres.

Tenant Structure

On average, large national chains account for 49 % of shop types in an *ECE* shopping centre; regional retailers comprise 22 % and single outlets 29 %. Figure 8.6 shows the tenancy by sector for the *Potsdamer Platz Arkaden* in Berlin as an example for the branch mix.

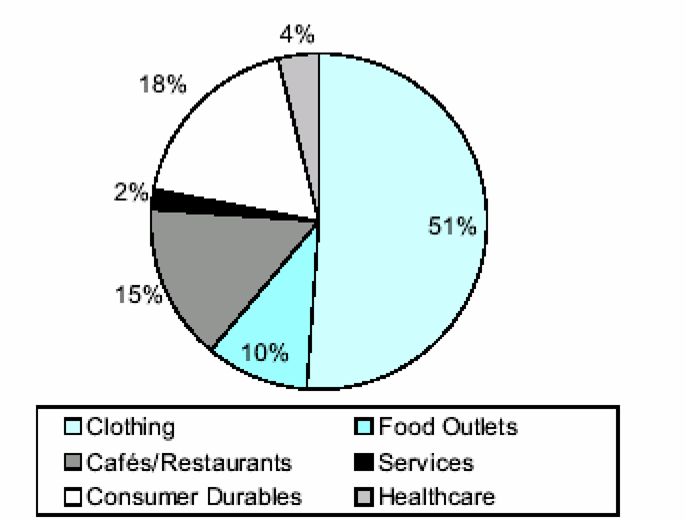


Fig 8.6 Tenancy by Sector – Potsdamer Platz Arkaden, Berlin

Because the company does not engage in outsourcing, but itself handles the entire centre planning, development, management, and leasing, it can develop closer than average relationships with its tenants, thereby gaining considerable retail know how. *ECE Projektmanagement* attaches great importance to direct and close communication with its retailers, resulting in an excellent reputation and a loyalty "bonus" on the part of the retailers. It is not unusual for the take up rate to be as high as 120 % when a new shopping centre is opened (Knutt 2003, p. 19).

8.5.3 Retail Know-How "All-In-One"

It is considered "unusual in an age of outsourcing" (Knutt 2003, p. 19) that *ECE* handles all management activities itself. The company, which sees centre manager as the "mayor" of the "town within a town", regards the following characteristics as central to its success:

- *ECE* developed the job profile of “centre manager” in Germany and now runs its own *Center Manager Academy*, an in house university, where future shopping centre managers are trained and educated.
- first rate specialists, including around 100 centre managers and 50 leasing experts
- trademark of bright, friendly, safe and clean centers
- professional management underpinned by a network of local, regional and national specialists
- high impact marketing concepts
- synergistic benefits from 84 centres under management in areas such as “bulk booking” of events, for example
- management of a tenants’ association
- media planning for a total advertising budget of around 100 million EUR
- responsibility for technical services and facilities
- operation of multi storey car parks (46 car parks under management)
- liaison with regional and civic authorities, associations, clubs and the media.

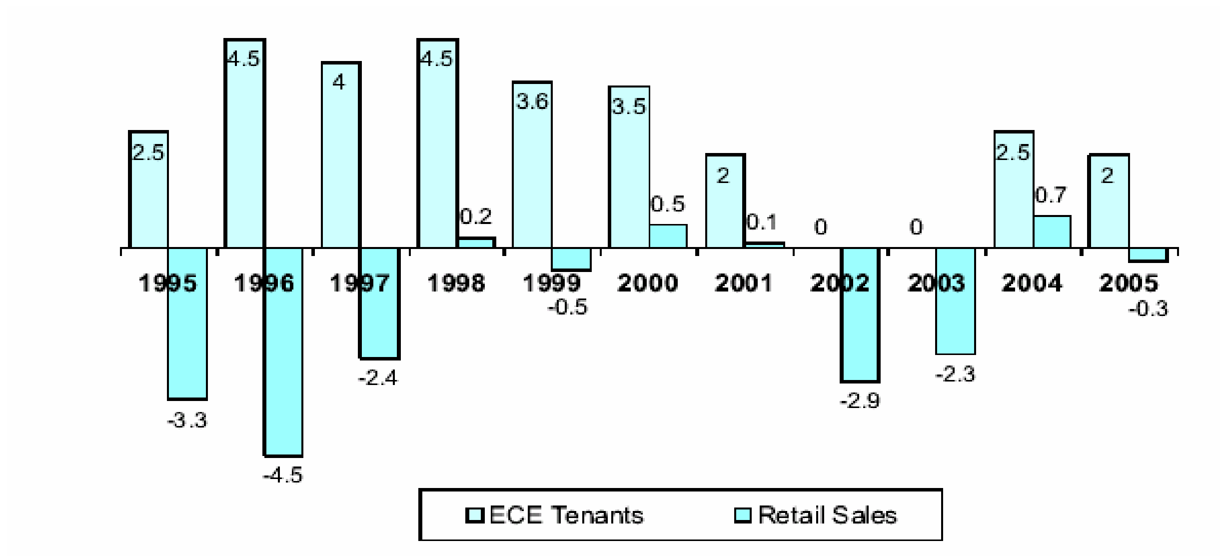


Fig 8.7 ECE Tenants’ Turnover Growth vs. Sector Trend (in %)

Over the last decade, *ECE* tenants have enjoyed a favorable sales increase compared to the general sector trend (see Figure 8.7).

8.5.4 Review Questions

1. Why is it not uncommon for citizen activist groups to protest against large shopping centers as built by *ECE*? What are the most frequently expressed fears and anxieties associated with such inner city centres?
2. What are the advantages and disadvantages of Greenfield vs. inner-city locations for different retailers?
3. Why was it attractive for *ECE* to enter Central and Eastern European countries? What are the future growth prospects in these countries and in general?

GROWTH STRATEGIES

Structure

9.1 Introduction

Growth does not usually find you. You need to find it. Or even mine for it. In today's saturated retail environment, it is harder than ever to grow the tried and true way, by rolling out more stores and more SKUs (Stock Keeping Unit).

Growth is part of a life cycle. In the maturity phase of the life cycle—where many retailers now find themselves—there is a growing need to be more imaginative, yet at the same time more systematic, in the search for growth opportunities. Planned or purposeful growth requires a framework for thinking about growth opportunities—from optimizing the business, to expanding the business, to redefining the business. It requires a superior consumer value proposition to drive economic advantage and create a growth engine. It requires a process for investigating, generating, evaluating, and initiating growth opportunities.

"A Growth strategy of the key global players' is a management report that provides a comprehensive overview of the global retail banking market including analysis of the most important financial ratios, net interest margin, cost to income ratio and return on equity."

Finding growth involves:

- ***Identifying "Green Space"***
  Existing growth patterns that we can position toward.
- ***Identifying "White Space"***
  Unmet needs of the consumer, market, channel, accounts that are not being pursued by competitors.
- ***Identifying "Red Space"***
  Internal or business model barriers that are preventing potential growth.

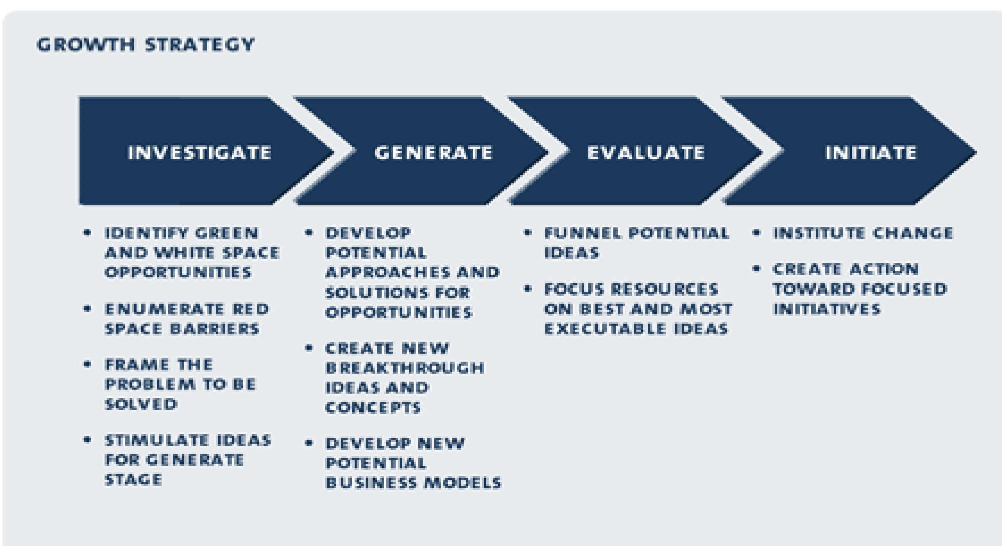


Fig 9.1 (a) A Holistic Approach to Growth Strategy Planning

Growth levers

Growth Strategy Objectives

	Geography/Location	Product/Service Offer	Target Customer	Format/Channel
Intensify	Leverage relationships with existing customers by increasing penetration of existing geographic markets	Optimize existing offer to better serve existing customers	Build/maintain loyalty/satisfaction with current customers; discover areas of untapped potential to sell more to existing customers	Enhance the shopping experience of existing customers through store modernization/ new store prototypes and/or better integration of existing channels
Extend	Reach more target customers by expanding into new geographic markets/locations with similar market characteristics	Expand existing offer to leverage relationships with existing customers and attract new customers	Target consumer sub-segments within existing customer base	Develop multiple format/channel business model to reach more target customers in more shopping situations and/or satisfy different shopping needs of same customer
Diversify	Expand into new geographic markets/locations with different market characteristics	Converge into other business sectors to create new value for new and existing customers in wholly new areas	Target new customer groups	Create new concepts to reach new customer segments

Source: Retail Forward, Inc.

Fig 9.1 (b) Retail Growth Opportunity

9.2 Growth Options

Almost all retailing activities start as independent, single outlet operations. Compared to other business sectors, such as manufacturing, entering into retailing by opening a retail store is relatively easy and does not require high capital resources. The desire to grow business and increase its value is often a fundamental objective from the very beginning. For retailers, among other benefits, sales growth provides benefits through purchasing from suppliers in large quantities and from economies of scale in operations (e.g. IT, logistics, and administration) (Ogden/Ogden 2005, p. 92).

For decades, strategic management has analysed the alternative routes to company growth. *Ansoff's matrix (*or product *market matrix)* is a well known categorization of growth strategies (see Figure 4.1). It consists of four separate strategies (Ansoff 1998)

A ***Market Penetration growth opportunity*** involves realizing growth by directing efforts toward existing customers using the retailer's present retailing format. With present products and in present markets, growth can be achieved by ***market penetration.*** Higher sales from existing markets can either be obtained by attracting current non customers, who either do not buy products in the offered categories at all or who buy them from competitors. Alternatively, the loyalty of existing customers of the retailer can be improved and the value of their shopping baskets increased. These opportunities involve either attracting consumers from its current target market who don't patronize the retailer currently or devising approaches that get current customers to visit the retailer more often or buy more merchandise on each visit.

A ***Market expansion growth opportunity*** is characterized by offering new products to existing markets. This can be done by providing the existing customer base with new product categories in the existing stores. Apparel stores expanding into selling shoes would be a good example. Considering the fact that the retailer's "products" are his stores , product development in retailing often means introducing new retail formats in existing markets. Store retailers starting to offer their products in the Internet, or supermarket retailers opening convenience stores are examples of product development.

A ***Retail format Development growth opportunity*** is an opportunity in which a retailer develops a new retail format – a format with a different retail mix – for the same target market. A current product offer can be targeted to a new customer segment, often in a new geographic area ***(market development***). For example, Barnes & Noble, a specialty book, store – based retailer, exploited a format development opportunity when it began selling books to its present target market over the Internet (www.barnesandnoble.com).Regional retailers expanding their traditional store formats to other regions or national retailers expanding to new countries attempt to increase revenue for the company with this strategy.

A ***Diversification growth opportunity*** is one in which retailer introduces a new retail format directed toward a market segment that's not currently served by the retailer. It entails offering new products to new markets. *Tesco*'s *Personal Finance*, the *Rewe* Group's activities in the travel market, and *Virgin Airlines* are examples of this strategy. Because diversification often leads retailers beyond traditional retail markets, this strategy are not discussed. In more detail in this book. It should be noted, however, that the man agreement literature warns of the dangers of diversification, when the core competence of retailers lies in other fields. *Source: Ansoff 1988, p. 109*.

Fig 9.2 Growth Opportunities

TARGET MARKETS

	Existing	***New***
RETAIL FORMAT ***Existing***	MARKET PENETRATION	MARKET EXPANSION
New	FORMAT DEVELOPMENT	DIVERSIFICATION (UNRELATED/RELATED)

9.3 Outlet Growth

An **outlet store** or **factory outlet** or "Best Saving Outlet" is a retail store in which manufacturers sell their stock directly to the public through their own branded stores. The stores can be brick and mortar or online. Traditionally, a factory outlet was a store, attached to a factory or warehouse. Often these stores are grouped together in outlet malls. The invention of the retail outlet store is often credited to Harold Alfond, founder of the Dexter Shoe Company.

Since its origination, outlets have seen variation in project size and an industry reorganization in the early 1990s which resulted in many smaller outlets going dark. As newer outlets continue their popularity, clear differences between new well designed centers and traditional retail centers is becoming harder and harder to differentiate. For example, clothing, sporting goods, electrical products, cosmetics, and toys are among the types of items sold at outlet malls.

Outlet malls first appeared in the United States as a development of the traditional factory outlet: a store attached to a factory or warehouse. An outlet mall places several such outlets under one roof in a convenient location, usually an "out-of-town" site. The out-of-town site minimizes overhead costs. And they may be legally necessary as conventional retailers may have contractual restrictions on the manufacturer on the location of the factory outlets so as to minimize competition with the traditional retailer. Therefore, factory outlets are usually located some distance from major cities.

Although Canada has its own outlet malls, American outlet malls located in border states have become tremendously popular with Canadians engaging in cross-border shopping.

Growth of factory outlet shopping centers is expected to moderate during the next few years after increasing an average of 15 to 17 percent per year between 1987 and 1995, according to a survey of retail and real estate securities analysts conducted by the International Council of Shopping Centers. The majority of analysts forecast that outlet shopping center growth will slow to 7 percent or less in number of centers.

Growth strategies for retailers can take two basic forms:

- Enhancing sales in existing retail outlets
- Enhancing sales by enlarging the outlet network.

Most retailers' statistics therefore differentiate between revenue changes in existing stores (also called *comparable store sales growth*), and changes in the scale of operations due to opening or acquiring new stores. The latter is the focus of this Chapter, because the establishment of new stores is the most important growth route for retailers. For example, *Tesco* opened more than 100 new hypermarkets in Eastern Europe between 2002 and 2006, *Kingfisher* added 27 new *B&Q* DIY stores in China in 2005, and *Fressnapf*, a German pet store retailer, was founded in 1989 and now controls a store network of about 800 stores in 11 European countries. These examples also indicate the most important options for outlet growth:

Organic growth: Most of Tesco's hypermarkets in Eastern Europe were established through *organic growth*.

***Franchising*:** Most of *Fressnapf's* growth comes from attracting new franchise partners, who open outlets under the *Fressnapf* brand.

Acquisition: *B&Q*'s sudden growth in China originated largely from the acquisition of outlets from the German DIY retail chain *OBI*.

9.3.1 Organic Growth through Outlet Multiplication

The direct establishment of own new outlets is usually the primary method for retailers to expand their businesses (Zentes/Morschett 2002, p. 173). It is also called *organic* or *internal growth*. The resulting *chain stores* operate multiple retail stores under common ownership, and usually engage in some level of centralized decision making (Berman/Evans 2007, p. 108). Large retail chain stores comprise up to several thousand stores. Opening new branches offers the advantage that the retailer's concept can be transferred to the new store right from the beginning. Location decisions, store layout and all attributes of the new store can be tailored to the existing strategy. The store managers are company employees, which enables activities to be monitored closely and decisions to be made centrally. Risk is limited as expansion is gradual. At the same time, considerable financial resources become successively tied up in the store network. The opening of branches requires substantial capital investment, which is a major constraint to growth. In many markets, organic growth is slow due to zoning restrictions, planning permission, the search for sites, including the acquisition and development of the premises, etc. This entails the risk that the critical mass is not reached fast enough and other retailers with similar concepts, but not similar constraints, expand faster. This problem particularly affects retailers that require large sites for their outlets (Zentes/Morschett 2002, pp. 173), e.g. category killers and hypermarkets (see Chapter 7), because approval for these sites is restricted in many countries. Another drawback can be seen in a loss of flexibility over time. Many chain store operations are slower to respond to changes in consumer demand and other situational factors, due to bureaucracy and a decreasing motivation of employees which is typical of larger businesses. Tailoring the assortment to the specific local needs is often easier for independent retailers than for large chain stores (Ogden/Ogden 2005, p. 93). However, modern retail information systems increasingly allow combining centralized decision making with a locally adapted marketing, including a locally adapted merchandise mix or prices.

9.3.2 Franchising

While the fast food chain *McDonald's* is the most often cited example of a franchise system, many other well known retailers also operate as franchise systems. *Benetton*, *The Body Shop*, *Fressnapf/Maxi Zoo*, *OBI*, and *7 Eleven* are Franchising is defined as a contractual agreement between two legally and financially separate companies, the franchisor and the franchisee. The franchisor, who has established a market tested business concept, enters into a relationship with a number of franchisees, typically small business owners, who are allowed to use the franchisor's brand and must operate their business according to the franchisor's specified format and processes. The franchisor provides ongoing commercial and technical assistance. In return, the franchisees typically pay an initial fee as well as fees (royalties), which aver age about 5 % of gross sales, plus some advertising fees (Inma 2005, p. 29). According to different national franchise associations, the franchising sectors in the different country markets have reached considerable sizes. In France, there are about 930 franchise systems, in Germany about

950, and in the United Kingdom about 700. On average, each franchise system has between 40 and 50 franchise outlets, but the largest often exceed 1,000. All statistics show that franchising is growing continuously (see, for an example, Fig 9.3

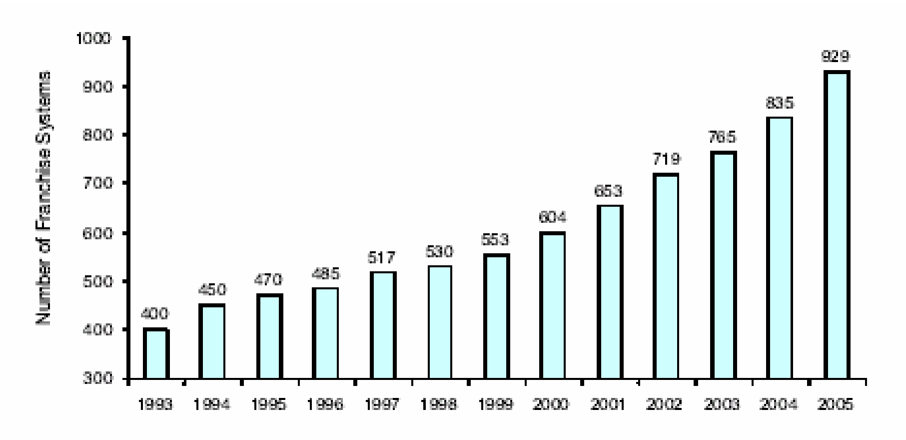


Fig 9.3 Franchising in France

9.3.3 Mergers & Acquisitions

Companies also have the option of *external growth*, that is, to expanding by acquiring resources from other companies. Expansion through mergers & acquisitions (M&A) involves the consolidation or purchasing of existing retail companies or retail outlets (Zentes/Morschett 2002, pp. 173 174). In a merger, two companies are combined and at least one of them loses its legal independence. In an acquisition, one company acquires a majority interest in another or takes over certain assets (stores) of another company. The term acquisition is often used restricted to a full takeover. The legal independence of the acquired company can remain intact (Zentes/Swoboda/Schramm Klein 2006, pp. 278 281). M&A have played a major role in structural changes in the retailing sector over the last decades and constitute a well established growth mechanism (Burt/Limmack 2001). For example, in 1999, *Carrefour* merged with *Promodès*, to form the largest European retail company and the second largest world wide. In 2004, *Wm Morrison*, which formerly had about 120 stores, com pleted the takeover of more than 200 *Safeway* stores. Major British food retail groups had made offers, but the Competition Commission had opposed the takeover by *Tesco, ASDA*, or *Sainsbury's*. In 2006, the *Metro Group* took over 85 *Wal Mart* stores in Germany, expanding its own *Real* outlet network of 330 stores by a quarter. The Austrian *XXXLutz*, the second largest furniture retailer in the world after *IKEA*, bought five furniture chains in Germany. The largest acquisition, *Mann Mobilia*, added seven stores to the company's network with a total sales space of 480.000 m2. A list of similar examples would be long. M&A allow rapid expansion by overcoming the bottleneck created by the difficulty of establishing and developing adequate retail locations, which can take years from the site selection to finally opening a store (Burt/Limmack 2001, p. 4). Within a short period of time, an acquisition makes an entire bundle of resources available to a company. Especially when *first mover advantages* are pursued in a new market, this can be a crucial success factor (Meyer 2001, p. 359). Since the customer base of the acquired retail company can often be preserved, market share is gained quickly. After an acquisition, either the integration process includes a change in the brand name of the outlets, or the original retail brand of the acquired retail outlets is retained. The latter is often the case, when the acquisition is used to expand into other retail sectors or formats. A food retailer entering the DIY market, or a supermarket company acquiring a discount chain, for example, could be well advised to keep the acquired chain's established retail brand. The acquired company s existing resources management expertise, personnel, sites, etc. focus on their established field of businesses and an objective also often pursued with an acquisition is that of exploiting the know how and dedicated assets of the acquired company. However, integration costs following an acquisition can be high. An incompatibility of company strategies, capabilities, resources, and cultures often results in an insufficient exploitation of existing potential for synergies. The takeover and associated cultural change in the acquired company may also result in a *brain drain* and the loss of significant management skills. Also, in many markets, it is difficult to find suitable takeover candidates. Successful retailers are, in most cases, not available for acquisition and less successful retailers often have retail locations, stores and premises that are not attractive enough for acquisition. Adequately evaluating the value of a retail company before an acquisition is, however, not an easy task and often, the real value and quality of the acquired company can only be assessed correctly after the acquisition (Burt/Limmack 2001, p. 4). For example, in Germany, *Wal Mart* faced the problem that the store network acquired for market entry was unfavorable, and over time, other targets for takeover were not avail able on the market. The option of further expansion through acquisition may also be limited by anti trust laws, as the example of *Safeway* in the United Kingdom illustrates. In already highly concentrated markets, the acquisition of other outlet networks by the largest players is often not approved by the authorities. In summary, acquisition is a very fast growth strategy when adequate takes over objects are available, but the associated risk is substantially higher than with organic growth.

9.4Global Growth Opportunities

International expansion is a market expansion growth opportunity that many retailers find attractive. Of the 50 largest global retailers, 37 operate in more than one country. But international expansion can risky because retailers must deal with different government regulations, cultural traditions, supply chain considerations, and languages. We first discuss the types of retailers that successfully compete globally, followed by a look at some of the pitfalls of global expansion. Then we examine the key success factors for global expansion, and finally, evaluate the strategies for entering a no domestic market.

Who Is Successful and Who Isn't?

Retailers with an offering that has universal appeal, such as distinctive merchandise or low cost, are the most successful at exploiting global markets. For example, some of the most successful global retailers are specialty store retailers with strong brand images and/or unique merchandise such as Starbucks, McDonald's, The Gap, and IKEA; category specialists such as Home Depot and Toys "R" Us that offer broad assortments and low prices, which appeal to consumers in different cultures; and discount and food retailers with low prices such as Wal-Mart, Carrefour, Royal Ahold, and Metro AG.

Category specialists and super center retailers may be particularly suited to succeed globally because of their operating efficiencies. First, these retailers are leaders in their use of technology to manage inventories, control global logistical systems, and tailor merchandise assortment to local needs. Second, retailers like Wal-Mart and Carrefour have scale economies for buying merchandise globally. Third, despite idiosyncrasies in the global environment, category specialists and super center retailers have developed unique systems and standardized formats that facilitate control over multiple stores. Fourth, at one time, U.S.-based retailers believed that consumers outside the United States who were used to high levels of personalized service would not embrace the self-service concept employed by category killers and super center retailers. However, the experience of chains such as Carrefour (France) and ALDI (Germany) has shown that consumers around the globe are willing to forgo service for lower prices.

Some U.S. retailers have a competitive advantage in global markets because American culture is emulated in many countries, particularly among young people. Due to rising prosperity and the rapidly increasing access to cable TV with American programming, fashion trends in the United States are spreading to young people in emerging countries. The global MTV generation prefers Coke to tea, athletic shoes to sandals, Chicken McNuggets to rice, and credit cards to cash. In the last few years China's major cities have sprouted American stores and restaurants, including KFC, Pizza Hut, and McDonald's. Shanghai and Beijing each have more than two dozen Starbucks, where coffee was not the drink of choice until Starbucks came to town. But these Chinese urban dwellers go there to impress a friend or because it's a symbol of a new kind of lifestyle. Although Western products and stores have gained a reputation for high quality and good service in China, in some ways, it is the American culture that many Chinese consumers want.

On the other hand, some large European and Japanese retailers offer considerably more local products and hire and train local managers, thus passing the power and authority to locals quickly. Even though Wal-Mart has a more efficient distribution system, Carrefour has competed effectively against it in Brazil and Argentina.

Do You Know!!!
The top 50 global retailers operate in an average of 9.1 countries. Eleven of the 13 retailers in the top 50 that operate in only one country are headquartered in the United States.

Keys to Success
Four characteristics of retailers that have successfully exploited international growth opportunities are: (1) a globally sustainable competitive advantage, (2) adaptability, (3) global culture, and (4) financial sources.

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Globally Sustainable Competitive Advantage Entry into nondomestic markets is most successful when the expansion opportunity is consistent with the retailer's core bases of competitive advantage. Some core competitive advantages for global retailers are shown in the following table:

Core Advantage	Global Retailer Example
Low-cost, efficient operations	Wal-Mart, Carrefour
Strong private brands	IKEA, Starbucks
Fashion reputation	The Gap, Zara, H&M
Category dominance	Office Depot, Toys "R" Us

Thus, Wal-Mart and Carrefour are successful in international markets where price plays an important role in consumer decision making and a distribution infrastructure is available to enable these firms to exploit their logistical capabilities. In contrast, The Gap and Zara are successful in international market that value fashionable merchandise.

Adaptability While successful global retailers build on their core competencies, they also recognize cultural differences and adapt their core strategy to the needs of local markets. Color preferences, the preferred cut of apparel, and sizes differ across cultures. For example, in China, white is the color of mourning and brides wear red dresses. Food probably has the greatest diversity of tastes around the world.

Selling seasons also vary across countries. The Gap's major US selling season is the back-to-school period in August; however, this is one of the slowest sales periods in Europe because most people are on vacation.. Back-to - school season in Japan occurs in April.

Store designs and layouts often need to be adjusted in different parts of the world. In the United States, for instance, discount stores are usually quite large and on one level. In other parts of the world such as Europe and parts of Asia, where space is at a premium, stores must be designed to fit a smaller space and are often housed in multiple levels. In some cultures, social norms dictate that men's and women's clothing cannot be displayed next to each other.

Cultural values and government regulations can also affect store operations. Some differences such as holidays, hours of operation, and regulations governing part-time employees and terminations are easy to identify. Other factors require a deeper understanding. For example, Latin American culture is very family oriented, so traditional U.S. work schedules would need to be adjusted so that Latin American employees could have more time with their families. Boots, a U.K. drugstore chain, has the checkout clerks in its Japanese stores standing up because it discovered that Japanese shoppers found it offensive to pay money to a seated clerk, but retailers have to provide seating for checkout clerks in Germany. Retailers in Germany also must recycle packaging materials sold in their stores.

Starbucks has been pleasantly surprised at how quickly consumers around the world have accepted the products it sells in the United States. It isn't just the lattes or cappuccinos; the Frappuccino is also extremely popular. For example, the company thought that it's US. beverages would be too sweet for the palate of many Asians-not true. People are a lot more alike than they thought.

Global Culture To be global, retailers must think globally. It is not sufficient to transplant a home-country culture and infrastructure into another country. In this regard, Carrefour is truly global. In the early years of its international expansion, it started in each country slowly, which

reduced the company's ethnocentrism. Further enriching its global perspective, Carrefour has always encouraged the rapid development of local management and retains few expatriates in its overseas operations. Carrefour's management ranks are truly international. One is just as likely to run across a Portuguese regional manager in Hong Kong as a French or Chinese one. Finally, Carrefour discourages the classic overseas "tour of duty" mentality often found in US. firms. International assignments are important in themselves, not just as stepping stones to ultimate career advancement back in France. The globalization of Carrefour's culture is perhaps most evident in the speed with which ideas flow throughout the organization.
Financial Resources Expansion into international markets requires a long-term commitment and considerable upfront planning. Retailers find it very difficult to generate short-term profits when they make the transition to global retailing

9.4.1 Entry Strategies

Four approaches that retailers can take when entering nondomestic markets are direct investment; joint venture, strategic alliance, and franchising.

Direct Investment Direct investment involves a retail firm investing in and owning a division or subsidiary that operates in a foreign country. This entry strategy requires the highest level of investment and exposes the retailer to significant risks, but it also has the highest potential returns. One advantage of direct investment is that the retailer has complete control of the operations. For example, McDonald's chose this entry strategy for the U.K. market, building a plant to produce buns when local suppliers could not meet its specifications.

Joint Venture: A joint venture is formed when the entering retailer pools its resources with a local retailer to form a new company in which ownership, control, and profits are shared. Examples of successful joint ventures include Royal Ahold (the Netherlands) and Velox Holdings (Argentina); Metro AG (Germany) and Koc Group's Migros (Turkey); Carrefour and Sabanci Holding (Turkey); Metro AG (Germany) and Marubeni (Japan); and Monsoon (United Kingdom) and Charming Shoppes (United States).

A joint venture reduces the entrant's risks. Besides sharing the financial burden, the local partner provides an understanding of the market and has access to local resources, such as vendors and real estate, many foreign countries, such as China, require joint ownership, though these restrictions may loosen as a result of World Trade Organization (WTO) negotiations. Problems with this entry approach can arise if the partners disagree or the government places restrictions on the repatriation of profits.

Strategic Alliance: A strategic alliance is a collaborative relationship between independent firms, For example, a retailer might enter an international market through direct investment but use DHL or UPS to facilitate its local logistical and warehousing activities.

Franchising: Franchising offers the lowest risk and requires the least investment. However, the entrant has limited control over the retail operations in the foreign country, potential profit is reduced, and the risk of assisting in the creation of a local domestic competitor is increased. The U.K.-based Marks & Spencer, for example, has franchised stores in 29 countries

9.5 Review Question

1. For each of three different retail growth opportunity matrix strategies, set one objective that a retailer could monitor to determine whether it has been successful with that strategy.
2. Give an example of a market penetration, a retail format development, a market expansion, and a diversification growth strategy that Best Buy might use.
3. Explain in brief about Outlet Growth.
4. Write a short note on franchising.

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