BARRY BERMAN

Competing in TOUGH TIMES

BUSINESS LESSONS FROM L.L.BEAN, TRADER JOE'S, COSTCO, AND OTHER WORLD-CLASS RETAILERS

Vice President, Publisher: Tim Moore
Associate Publisher and Director of Marketing: Amy Neidlinger
Executive Editor: Jeanne Glasser
Editorial Assistant: Pamela Boland
Development Editor: Russ Hall
Operations Manager: Gina Kanouse
Senior Marketing Manager: Julie Phifer
Publicity Manager: Laura Czaja
Assistant Marketing Manager: Megan Colvin
Cover Designer: Alan Clements
Managing Editor: Kristy Hart
Project Editor: Betsy Harris
Copy Editor: Water Crest Publishing, Inc.
Proofreader: Apostrophe Editing Services
Indexer: Lisa Stumpf
Compositor: Nonie Ratcliff
Manufacturing Buyer: Dan Uhrig

© 2011 by Pearson Education, Inc.
Publishing as FT Press
Upper Saddle River, New Jersey 07458

FT Press offers excellent discounts on this book when ordered in quantity for bulk purchases or special sales. For more information, please contact U.S. Corporate and Government Sales, 1-800-382-3419, corpsales@pearsontechgroup.com. For sales outside the U.S., please contact International Sales at international@pearson.com.

Company and product names mentioned herein are the trademarks or registered trademarks of their respective owners.

All rights reserved. No part of this book may be reproduced, in any form or by any means, without permission in writing from the publisher.

Printed in the United States of America

First Printing December 2010

ISBN-10: 0-13-245919-1
ISBN-13: 978-0-13-245919-8

Pearson Education LTD.
Pearson Education Australia PTY, Limited.
Pearson Education Singapore, Pte. Ltd.
Pearson Education Asia, Ltd.
Pearson Education Canada, Ltd.
Pearson Educación de Mexico, S.A. de C.V.
Pearson Education—Japan
Pearson Education Malaysia, Pte. Ltd.

Library of Congress Cataloging-in-Publication Data
Berman, Barry.
Competing in tough times : business lessons from L.L. Bean, Trader Joe's, Costco, and other world-class retailers / Barry Berman.
p. cm.
ISBN-13: 978-0-13-245919-8 (hardback : alk. paper)
ISBN-10: 0-13-245919-1
1. Retail trade—Management. 2. Strategic planning. I. Title.
HF5429.B449 2011
658.8'7—dc22

2010031430

Contents

Preface

Competing in Tough Times: Business Lessons from L.L.Bean, Trader Joe's, Costco, and Other World-Class Retailers is the result of a two-year-long project. Through my experience as a professor with a special interest and expertise in retailing, as well as a marketing consultant, I carefully examined the overall strategies of 10 world-class retailers, looking for common principles that can be universally applied to other retail firms.

I started this project without any preconceived notions of what firms would comprise my list of world-class retailers, as well as what common principles these firms shared. I eventually identified 10 retailers based upon examining such key indicators of performance as sales per square foot, sales growth, return on equity, increase in stock market value membership retention rates for warehouse clubs, and conversion rates for web-based retailers. I also looked at retailer ratings in *Fortune's* "World's Most Admired Companies," *Fortune's* "100 Best Companies to Work For," and customer service rankings by the American Consumer Satisfaction Index, *Consumer Reports*, and *Business Week.* In evaluating retailers for inclusion in my top 10 listing, I looked for retailers that were consistent performers on these measures. Each retailer's rankings on selective indices are contained in the Appendix, "Individual and Composite Financial Performance, Customer Service, and Worker Satisfaction Metrics of the Best-Practice Retailers."

The 10 benchmark retailers are diverse in terms of retail format: supermarket (Publix, Stew Leonard's, Wegmans, and Whole Foods), extreme discount food operation (Aldi), specialty food operation (Trader Joe's), warehouse club (Costco), web-based (Amazon.com), and multichannel apparel and accessories (Nordstrom and L.L.Bean). They also vary greatly in size (from $400 million in annual revenues for Stew Leonard's to over $70 billion for Costco) and ownership organization. (Stew Leonard's, Wegmans, Trader Joe's, and Aldi are privately held, and Publix is an ESOP.)

As with the selection of the firms for inclusion as benchmark retailers, I did not start out with any perceived conclusions of common retail strategies. Instead, I began to research each company's strategies using data from annual reports (where available, as four firms are privately held), industry analyses, and articles in financial and business publications.

Despite the disparity in industry, size, and ownership format, these 10 benchmark retailers shared common strategies relating to operating at low cost (see Chapter 2, "Low-Cost Strategies I: Key Elements of a Low-Cost Provider Strategy"), providing consumers with a carefully edited selection of products (as examined in Chapter 3, "Low-Cost Strategies II: Delivering Low Costs Through Minimizing Product Proliferation"), stressing the importance of human resource management (see Chapter 4, "Differentiation Strategies I: Effective Human Resource Strategies"), focusing on consumers' service experience (see Chapter 5, "Differentiation Strategies II: Enhancing the Service Experience"), and having an aggressive private label strategy (as discussed in Chapter 6, "Differentiation Strategies III: Developing and Maintaining a Strong Private Label Program").

The strategies discussed in this book mirror Porter's low-cost differentiation model that argues that a retailer's competitively defensible position needs to be based on either of these extremes. A value orientation combines elements of each of these strategies. Chapters 2 and 3 focus on low-cost strategies, and Chapters 4, 5, and 6 describe differentiation strategies. Another integrating model that explains the success of many of these retailers is the value profit chain model. This model suggests that employee satisfaction and loyalty translates into high levels of customer service and customer loyalty, and ultimately to high profits.

I have written this book with a managerial orientation. It is in an easy-to-read decision-making format. When academic studies are often cited, they are used to document my discussion. With my academic orientation, I have heavily footnoted this book. I have also taken great care in updating all data to the most current available, as of the date of publication. To verify the accuracy of my comments, I gave executives at each of the 10 firms the opportunity to review applicable portions of the manuscript. I received responses from six firms; these comments were incorporated into the final manuscript.

Chapter 7, "Implementing Cost-, Differentiation-, and Value-Based Retail Strategies," focuses on implementing cost-, differentiation-, and value-based strategies, as the title suggests. This chapter contains a number of figures designed to help retail managers and owners more effectively utilize the principles discussed in earlier chapters.

Who Can Benefit from Reading *Competing in Tough Times: Business Lessons from L.L.Bean, Trader Joe's, Costco, and Other World-Class Retailers*?

I have aimed this book at a wide audience that includes middle to top managers at a wide variety of retailers, owners of independent retail establishments (including chains), supply chain partners who need to have a better understanding of retail practices, industry consultants, and undergraduate and graduate students with a special interest in retailing.

Introduction

The overall focus of this book deals with competitive strategies that retailers can undertake that are based on cost, differentiation, and value. In the current low-growth economic environment, any retail business store that conducts "business as usual," using the same strategies and tactics that have worked in the past, will not prosper or perhaps even survive. One way that business consultants improve a firm's performance is to study the "best practices" in the industry. It should come as little surprise to most industry observers that the "best-practice retail leaders" chosen by the author are Aldi, Amazon.com, Costco, L.L.Bean, Nordstrom, Publix, Stew Leonard's, Trader Joe's, Wegmans, and Whole Foods. In each chapter, the strategies used by these best-practice retailers are examined.

According to Michael Porter, the Harvard Business School strategy guru, there are two major competitive strategies that firms can pursue. A *low-cost strategy* argues that the retailer with the lowest cost structure benefits by charging prices that are so low, its competitors cannot match them and still earn a profit. This low-cost strategy is especially critical in this time period when a much larger than usual proportion of the market is concerned with low prices. To achieve low costs, retailers need to reduce their operating cost structure through a variety of strategies (such as self-service, more efficient use of labor, use of less-costly locations, and supply chain management initiatives), including reducing inventory carrying costs through lessening product proliferation.

The second broad strategy alternative is based on a retailer's differentiating its goods and services from competing retailers. Differentiation can be based on the quality of customer interaction and customer service, as well as through offering truly distinctive products, including private brands. The *differentiation strategy* appeals to a market segment more concerned with service quality or a product's uniqueness than its price. Retailers can also reduce direct price competition by the extent to which their products or services are differentiated from the offerings of direct and indirect competitors.

An intermediate strategy, based on value, combines elements of cost and differentiation. Value is not necessarily based on providing either the lowest costs or the highest degree of differentiation. It involves providing trade-offs of price and differentiation that are desired by the retailer's target market. *Value* is provided through offering only those services that customers either (1) absolutely require as a condition of purchasing your goods or (2) are willing to pay extra for because they view these services as meaningful. One conceptualization of value is based on four measures: results, process quality, price, and customer access costs:[1]

$$\text{Value} = \frac{\text{Results} + \text{Process Quality}}{\text{Price} + \text{Customer Access Costs}}$$

Let's briefly look at each of the four components of value. *Results* include a product's overall quality (including warranties), product convenience (precut fruits and vegetables, prehemmed slacks, easy-to-set-up computer network routers), product health (low salt, low fat, low cholesterol, product safety), and durability. The concept of results extends beyond the product concept to focus on solutions, as opposed to the basic product.

Process quality includes positive customer experiences, such as high levels of customer support, high quality of salesperson interactions, successful service recovery efforts (what the retailer will do when things go wrong), ease of finding items, short waiting lines, high in-stock positions for advertised specials, a "fun" in-store experience, and adequate parking. To an electronics store, process quality includes rewriting the manufacturer's directions to installing a wireless router, special access to the store's technical service department hotline, and bundling HDMI cables with a high-definition television router (that generally needs to be purchased separately).

Price is the final purchase cost including delivery charges and credit terms. This is the primary competitive advantage in a low-cost strategy.

In contrast to process quality that focuses on positive customer experiences, *customer access costs* include negative customer experiences. Large stores that require extensive in-store browsing, discount operations that are located in inconvenient locations, and downtown stores with insufficient parking all have high access costs. Warehouse clubs have direct dollar outlay access costs in terms of membership fees. Access costs can be measured in terms of membership fees and wasted time, as well as consumer frustration.

Value in this model can be viewed as benefits divided by costs. Benefits include results (functional aspects of a product), as well as process quality (customer service). Costs include a product's price, as well as access costs (negative customer experiences).

The Organization of This Book

Chapter 1, "The Questionable Future Facing Global Retailers," looks at the questionable future facing the retailing industry and the long-term changes in buyer behavior that have carried over from the recent recession. It also examines retail competitive strategies that focus on low cost and differentiation.

Chapters 2 and 3 focus on how retailers can effectively reduce costs to compete against Wal-Mart, limited assortment stores, warehouse stores, factory outlet stores, dollar stores, and web-based retailers that appeal to a market that is increasingly price conscious.

Chapter 2, "Low-Cost Strategies I: Key Elements of a Low-Cost Provider Strategy," concentrates on strategies that can be implemented to reduce a retailer's operating costs, whereas Chapter 3, "Low-Cost Strategies II: Delivering Low Costs Through Minimizing Product Proliferation," specifically examines cost reductions that can be accomplished through reducing product proliferation. The Appendix, "Individual and Composite Financial Performance, Customer Service, and Worker Satisfaction Metrics of the Best-Practice Retailers," at the end of this book discusses the rationale for choosing the best-practice leaders based on three criteria: financial performance, customer service, and employee satisfaction.

In contrast to these earlier chapters, Chapters 4, 5, and 6 focus on differentiation strategies utilizing human resources, customer service, and private branding. Chapter 4, "Differentiation Strategies I: Effective Human Resource Strategies," looks at the elements and benefits of an effective human resources strategy. Chapter 5, "Differentiation Strategies II: Enhancing the Service Experience," and Chapter 6, "Differentiation Strategies III: Developing and Maintaining a Strong Private Label Program," examine how a retailer can achieve differentiation through the in-store service experience and branding strategies, respectively. Chapter 7, "Implementing Cost-, Differentiation-, and Value-Based Retail Strategies," covers value-based retail strategies that combine elements of low-cost and differentiation strategies.

Endnotes

1. James L. Heskett, W. Earl Sasser, Jr., and Leonard A. Schlesinger, *The Value Profit Chain* (New York: The Free Press, 2003), p. 26.

1

The Questionable Future Facing Global Retailers

There are a number of financial ratios and other benchmarks that can be used to document the questionable future of retailing after the formal recession has ended: comparable or same-store sales data, sales per square foot, net profit as a percent of sales, increases in bankruptcies, store closings, the proportion of retailer-based credit accounts that are delinquent beyond 90 days, and so on.

The most troubling barometer of the poor health of the retail industry is data showing stagnant or declining same-store sales of many retailers. Slow or negative same or comparable sales growth directly affects a retailer's profits, stock market valuation, and capability to purchase new goods, pay current operating expenses, and raise capital. Indirectly, slow sales growth also results in increased competition as retailers seek to expand their offerings into unrelated merchandise to offset their recent sales declines. This form of increased competition is commonly referred to as *format blurring*.[1]

To illustrate the effect of low growth across a broad spectrum of retailers, *Retailer Daily* compiled comparable store data from the Securities and Exchange Commission for 26 major retailers in 2009. Comparable store sales were negative for 12 of these retailers: Target, Sears, Supervalu, Best Buy, Home Depot, Lowe's, Staples, Macy's, J.C. Penney, Kohl's, Gap, and Arby's.[2] Even more troubling, many of these retailers have faced declining same or comparable store sales for several consecutive periods. Both a decline in consumer spending, as well as a new frugality among consumers, have contributed to this slow growth.

Consumer spending is considered to be vital to the economic recovery because it accounts for about two-thirds of total economic activity. Although the U.S. economy has been growing since the middle of 2009 (after going into a recession in December 2007), the March 2010 income growth was the slowest since July 2009. According to Scott Hoyt, senior director of consumer economics for Moody's Economy.com, "The near-term outlook is still problematic. Wage income is rising only modestly. With unemployment near 10 percent, the labor market power is clearly in employers' hands, so there is little prospect for much more acceleration in wage income."[3] This unemployment rate does not include an additional 7 percent as of June 2010 that is either underemployed, that is so discouraged that they are no longer seeking employment, or that has accepted early retirement as an alternative to being laid off. What is clear to the author is that job losses associated with the recession will not be quickly restored in certain key industries, such as banking, finance, and automotive (as well as firms that service these industries). There has also been a shift in consumer mentality as to the role of savings versus spending. According to a strategist for Janney Montgomery Scott, "the broader issue here is that the credit crisis taught the consumer that borrowing is bad, savings is good."[4]

The high level of real estate foreclosures and more strict overall lending standards by banks and financial institutions has reduced consumer spending. In the first quarter of 2010, the seasonally adjusted mortgage delinquency rate was 10.06 percent on all outstanding loans. The delinquency rate includes loans that are at least one payment overdue but not in the process of foreclosure.[5] The situation is particularly poor in Nevada (with 1 of every 17 homes receiving a foreclosure filing), Arizona (with 1 in every 30 homes in foreclosure), and in Florida (with 1 in every 32 homes in foreclosure). The high number of foreclosures and underwater loans serves as a threat to the overall stability of the housing market.[6]

Much of the temporary economic recovery of the past recession has been due to the federal government's purchasing billions of dollars of mortgage-backed securities, offering tax incentives for first-time home buyers, a "cash for clunkers" auto rebate program, and other programs that have reduced foreclosures. Many of these programs are now expiring. It is questionable as to whether consumer spending activity will increase without these government incentives.[7]

A second major factor impeding growth in retail sales is the continuation of consumer caution that was originally associated with the most recent recessionary period. The authors of a *Harvard Business Review* article argued that unlike in previous recessions when consumers "greeted the return of financial stability with a buying spree," after this recession is over, "they'll continue to buy simpler offerings with the greatest value."[8] Similarly, the president of Retail Metrics, a research firm, stated that "It's [Wal-Mart] going to be a primary destination for a lot of people who may not have gone there in recent years, but who will elect to go there for the price and the value."[9]

A survey of 2,000 U.S. consumers conducted by Booz & Company suggests that only 9 percent of consumers intend to spend at pre-recession levels on household products, 10 percent on cellular phone service, 11 percent on health and beauty products, and 18 percent on apparel, clothing, and shoes as of 2011. Close to two-third of consumers (64 percent) stated that they'll shop at a different store with lower prices even if the store is less convenient.[10]

Finally, a Kantar Retail/PricewaterhouseCoopers report states that post-recession shopping will become more purposeful in nature. Rather than limiting purchases, the post-recession shopper will become more prone to seeking deals, being more open to comparison shopping, buying fewer items, shopping less often, and purchasing more private labels.[11] This report states that retailers that rely on Baby Boomers will be particularly hard hit due to their loss in wealth and the need to fund retirement.

Overall, these studies suggest that many of the competitive inroads made by web-based merchants and discounters, such as off-price chains, warehouse clubs, and dollar stores, will continue even after the recession ends. Even firms with a loyal base of customers and a clear market positioning as a "fun place to shop" like Whole Foods have had to adjust pricing strategies to deal with an increasingly value-conscious consumer base.[12]

Increased Competition Across Retail Formats

The current retail environment is characterized by increased competition across retail formats (called *format blurring*), as well as a significant increase in retail bankruptcies. This new competitive environment will be discussed separately for food and nonfood retailers.

According to two academic researchers, the sales of similar categories of merchandise across different types of retailers has resulted in format blurring.[13] Although retailers have always looked for opportunities to increase sales through selling goods and services not normally part of their line of merchandise, the pressure to pursue format blurring is much greater when retailers need to quickly increase sales levels.

Format blurring is self-perpetuating, as it generates a vicious cycle of action and reaction. A retailer that has recently lost sales to another retail format needs to quickly and aggressively seek out opportunities to offset its lost sales and profits. As an example, pharmacies need to sell greeting cards, chocolates, and cosmetics to make up for lost sales from Wal-Mart and Target that now have in-store pharmacies. Supermarkets now increasingly sell seasonal merchandise (such as barbecue grills, lawn furniture, and snow blowers) to make up for lost sales of paper towels, toilet tissues, and frozen foods to warehouse clubs. And similarly, traditional appliance retailers increasingly sell mattresses and other furniture-related items to make up for lost sales in major appliances due to increased competition from Home Depot and Lowe's.

As a result of format blurring, the broad competitive environment for grocery stores now includes supercenters, drug stores, warehouse clubs, convenience stores, dollar stores, and limited assortment stores, as well as fast-food and traditional restaurants. As Stew Leonard, Sr. aptly stated, "Anybody who sells food and has their lights on is a competitor."[14] Bill Bishop, president of Barrington-based Willard Bishop Consulting, has commented, "There is almost a game of musical chairs being played as the market share of the general purpose supermarket is reduced by all sorts of players that are taking a fraction of that business.... You can buy an awful lot of groceries at places other than grocery stores."[15]

Similarly, the competition for consumers' clothing dollars comes from a variety of retail formats, including specialty stores, department stores, mass merchants, warehouse outlets, factory outlet stores, and off-price merchants (that operate store and web-based formats). Another example of format blurring is Target's book club, which the retailer calls "Bookmarked Breakout." Unlike traditional booksellers such as Barnes & Noble that stock 200,000 titles per location, Target sells about 2,500 titles. Although Target stocks best-sellers, it also resembles independent bookstores by offering a collection of "handpicked titles from emerging authors."[16] In another example of format blurring, Best Buy is experimenting with selling patio furniture and electric scooters. According to Barry Judge, the chain's chief marketing executive, Best Buy could "eventually end up [selling] electric cars."[17]

Competition Across Retail Formats—Food-Related Products

Progressive Grocer magazine, in its *72nd Annual Report of the Grocery Industry*, stated: "...we find it difficult to argue against the overwhelming amount of data we've collected that shows the demise of the supermarket, as a format, over the past decade."[18] Support of this statement comes from several key statistics relating to supermarket market share data, as well as the increased competitive environment. The Food Marketing Institute recently reported that traditional supermarket chains (those for which food generates at least 65 percent of total sales) have lost 30 percent of the grocery market (down from 89 percent in 1988). Another forecast by TNS Retail Forward estimates that supermarkets will have zero real growth from 2008 to 2013. The 3.3 percent forecast growth during this time period will be totally offset by a 3.3 percent inflation rate.[19]

Traditional grocery stores now receive only a portion of a consumer's total purchases of foods and other items (like health and beauty aids) that in the past were purchased there in much greater quantities. An example of this trend is a family's purchase of bulk-package sizes of paper towels, toilet paper, and freezer bags at warehouse clubs; milk and eggs at a local drug store; prepared soups, breads, and coffees at specialty grocers; ready-to-serve "heat and eat" prepared fish dinners at a local fish market; and light bulbs and batteries at dollar stores. Many of these alternate channels for food and related products have established strong competitive positions in these product categories due to a combination of very low prices, unique merchandise, and one-stop shopping appeals.

A major potential threat to the traditional supermarket industry is that its overall market share will be continually eroded by price-oriented merchants at one end (such as dollar stores, warehouse stores, extreme value stores like Aldi, and Wal-Mart), by convenience-oriented merchants (such as convenience stores, supercenters, and combination stores), and by quality-oriented merchants (such as specialty independently owned food stores and chains like Whole Foods) at the other end of the spectrum.

Firms as disparate as Wal-Mart, Costco, Target, and Dollar General are now formidable competitors to traditional grocery stores. In its 2009 fiscal year, grocery items (meat, produce, deli, bakery, frozen foods, floral, dry groceries, and consumables—health and beauty aids, household chemicals, paper goods, and pet supplies) made up 51 percent of Wal-Mart's total sales.[20] Similarly, 54 percent of Costco's 2009 sales consisted of sundries (such as candy, snack foods, and tobacco), packaged foods, and fresh foods (meat, bakery, deli, and produce).[21] In its listing of the top food retailers for 2009, *Supermarket News* reported Wal-Mart as the largest food retailer; Costco was third largest.[22] Wal-Mart has been the largest U.S. food retailer since 2003, largely through growth in its supercenter format.[23]

Target is also using food as a means of improving shopping frequency and shopper convenience. Each of its SuperTarget stores has an in-store bakery, as well as a full-service deli. SuperTarget has also been a U.S. Department of Agriculture-certified produce retailer of fruits and vegetables since 2006.[24] In its 2009 fiscal year, household essentials (including pharmacy, beauty care, personal care, baby care, cleaning, and paper products) and food and pet supplies made up 39 percent of Target's sales, up from 32 percent in 2006.[25]

Dollar stores continue to expand their offerings, particularly in the perishables area. They have added coolers and freezers in many locations as a means of increasing shopper frequency, average sales per transaction, and same-store sales. Dollar General has instituted its cooler program in a majority of its 8,877 stores. Family Dollar has installed coolers in 5,600 of its 6,500-store chain as of the end of fiscal year 2008. In 2009, 70.8 percent of Dollar General's net sales consisted of packaged foods, candy, snacks and refrigerated products, health and beauty aids, home cleaning supplies, and pet supplies (up from 65.7 percent in 2006).[26] Consumables (household chemicals, paper products, candy, snacks, health and beauty aids, hardware and auto supplies, and pet foods) accounted for 64.4 percent of Family Dollar's net sales in 2009, up from 58.8 percent in 2007.[27] These are the same product categories that are sold by supermarkets.

Competition Across Retail Formats—Nonfood-Related Products

The high degree of competition among retail formats exists in virtually all sectors of retailing. Pharmacies currently face competition from in-store pharmacies at supermarkets, warehouse clubs, and mass merchants (in addition to mail-order pharmacies). Wal-Mart, Kohl's, Costco, and Target have extensive selections of housewares, clothing, electronics, jewelry, and so forth. One can purchase eyeglasses at Costco, Sears, BJ's, and J.C. Penney, as well as in chain and independent optical stores. Costco's ancillary businesses—which are made up of gas stations, pharmacies, food courts, optical, one-hour photo, hearing aids, and travel—accounted for 15 percent of Costco's total revenues in 2009.[28] In addition, 19 percent of Costco's revenues in 2009 came from *hardlines* (items such as major appliances, garden, sporting goods, patio, and furniture) and 10 percent came from *softlines* (apparel, jewelry, cameras, and small appliances). Home improvement centers like Lowe's and Home Depot now feature major appliances and carpeting and offer home installation for many of their products.

With the demise of Circuit City, retailers like Wal-Mart have upgraded their selections of electronics and high-definition televisions to more effectively compete with specialty electronics stores. According to one report, more than 25 percent of Wal-Mart's sales increase in mid-2009 has come from new shoppers, more than half of whom have household incomes of at least $50,000. Wal-Mart will work hard to keep these new shoppers because this higher-income group spends 40 percent more on their average visit than Wal-Mart's typical shopper.[29] To attract and keep this higher-income segment, Wal-Mart has begun to offer appliances from KitchenAid and Dyson and electronics from Dell, Palm, and Sony and has moved its apparel buying group to New York to become more sensitive to fashion trends.

In addition, competition from web-based retailers now covers virtually all areas of retailing (including new and used autos and real estate), as well as all price lines (from used items sold on eBay to collectibles). Forrester Research forecasts that U.S. web-based retail sales (not counting vehicles, travel, or prescription drugs) will grow to $248.7 billion in 2014, a 60 percent increase from its 2009 level.[30] Forrester projects that the fastest growth will occur in consumer electronics, apparel, accessories, and footwear.

As is the case with traditional supermarkets, the situation affecting department stores is also especially bleak. There are only 10 department store chains left with sales of at least $3 billion in the United States: luxury chains Neiman Marcus and Saks; upscale Nordstrom; mid-tier Macy's and Dillard's; value chains J.C. Penney, Kohl's, and Sears; and regional chains Bon-Ton and Belk. Mervyn's and Goody's both ended operations in 2008.

Like supermarkets, department stores have faced substantial competition at both ends of their market for apparel. There has also been significant competition for "value" shoppers from factory outlets, off-price chains, and closeout web retailers like www.smartbargains.com and www.overstock.com. European chains such as H&M, Mango, and Zara are also able to offer trendy merchandise at very low costs. According to one report, these chains have "[developed] a new category of disposable clothing."[31] And at the high end, department stores face competition from specialty stores with access to fashion designers, on-premises alterations, a well-trained sales staff, and so forth. In cosmetics, a highly profitable segment for department stores, retailers like Sephora and Ulta have been aggressive competitors of department stores. Estée Lauder has also begun to sell cosmetics online. If successful in its offerings, other cosmetics firms would undoubtedly follow suit.

Increased Number of Retail Bankruptcies

As a result of reduced sales, competition from other retail formats, and high operating costs, 26 supermarket chains filed for bankruptcy earlier in this decade. Bi-Lo and Bruno's Supermarkets have also recently filed for bankruptcy protection. In addition to these bankruptcies, a wave of consolidation has swept through the supermarket business. These include the acquisitions of Wild Oats Markets Inc. by Whole Foods, Pathmark by A&P, and Albertson's by Supervalu.

There has also been a large overall increase in retail bankruptcies in other product categories, including restaurants, electronics, furniture, and jewelry retailers. These include such major retail chains as Bennigan's, Bombay, Boscov's Department Store, Circuit City, Crabtree & Evelyn, Dial-A-Mattress, Eddie Bauer, Filene's Basement, Fortunoff's, Friedman's, Goody's Family Clothing, Gottschalks, KB Toys, Levitz Furniture, Linens 'N Things, Mervyn's, Mrs. Fields, Ritz Camera Centers, Samsonite, The Sharper Image, Steve & Barry's, The Walking Company, Whitehall Jewelers, and Wickes Furniture.

Retailers have been especially hard hit by this recession due to high fixed costs for store leases, high interest costs for store fixtures and renovation, and utilities. Unlike manufacturers, retailers cannot reduce labor costs by shutting down plants on a temporary basis or through outsourcing production to suppliers with low-cost manufacturing facilities. According to an analyst with Bernstein Research, this recession will wipe out 5 to 10 percent of all retail stores.[32] Although some retailers have closed stores as a result of bankruptcy, such as Ritz Camera, Circuit City, and Zale Corporation, others like Sears Holding Corp., Starbucks, and Talbots have shut down underperforming stores.[33] According to a report from the CoStar Group, the retail availability rate (which includes vacant locations and locations being marketed by landlords even though the existing retail tenant has not left) was 9.9 percent as of February 2010.[34]

Retailers that are number two or three in market share in their respective markets are particularly vulnerable to bankruptcy or liquidation. This is especially the case for retailers that have increased their debt in recent years when interest rates were low and credit availability was high to fund major store expansions. Retailers owned by private equity firms that were purchased during prior boom years due to their strong cash flow and property assets are also suspect.

The overall effects of the economic downturn have been felt around the world. A major global credit insurer, Euler Hermes, estimates that about 35,000 Western European retail businesses became insolvent in 2009, up 17 percent from 2008. Retailing was the second-worst-hit sector after manufacturing.[35] Among the major recent European retailer bankruptcies were Woolworths, a British chain selling toys and housewares; MFI, a British furniture retailer; The Pier, a housewares chain; and Arcandor, a German retailer whose Karstadt department stores anchor downtown shopping areas throughout Germany.

There are several major concerns with retail bankruptcies and liquidations. Unfortunately, these bankruptcies and liquidations bring down price expectations for the remaining retailers. This forces surviving retailers to reduce their prices (and profit margins) to remain competitive. Store closings also decrease the desirability of many retail locations, particularly malls, making it more difficult for the surviving stores to continue to attract customers. This is especially the case where stores rely on each other to generate store traffic or when one of a mall's major anchor tenants close. And finally, many mall developers are adversely affected. Lower rental income due to both empty stores, as well as lower percentage lease payments from existing retail tenants, may affect the maintenance of retail properties.

Retail Store Positioning and Competitive Strategy

As was discussed earlier, Michael Porter's competitive strategy theory argues that there are two major long-term competitively defensible strategies that retailers can pursue: (1) low cost and (2) differentiation. Low-cost retailers such as Aldi and Costco have succeeded by reducing product choice (this translates into savings due to faster inventory turnover, lower rental costs, and greater bargaining power with individual suppliers), use of a self-service shopping environment, and an absence of services that their consumers view as secondary in importance (such as home delivery, custom cutting of meats, no try-on rooms, and an absence of in-store displays), as well as through low rental costs (due to their ability to generate store traffic). Amazom.com is also a low-cost retailer due to its ability to minimize its inventory investment through drop shipping, the absence of physical stores, and the use of consumer ratings by shoppers and excellent photographic images that can be used by consumers as a substitute for sales assistance.

At the other end of the positioning spectrum are retailers such as L.L.Bean, Nordstrom, Trader Joe's, Wegmans, and Whole Foods. These retailers have succeeded through a differentiation strategy that combines high levels of sales assistance by a dedicated and trained staff, specialized merchandise (much of it being private label), and a shopping environment that is viewed by many consumers as exciting, entertaining, and fun.

In contrast to the cost and differentiation strategies, value strategies pursue elements of cost and differentiation strategies at the same time. Trader Joe's, for example, offers distinctive foreign foods in easy-to-prepare formats. Its products are low cost, and its stores are fun to shop due to its sampling stations (staffed by knowledgeable personnel), free coffee, and the availability of balloons and small shopping carts for children. Costco also offers low prices, as well as a differentiation strategy based on a well-developed private label program, the use of co-branding on many of its private label products, a very liberal return policy, and a treasure hunt atmosphere (due to Costco's use of an opportunistic buying strategy). Amazon.com offers low prices and an extensive selection, suggests books and other products based on a customer's recent purchases, has a simplified checkout procedure, and provides unedited product reviews from past purchasers.

According to Porter's competitive strategy theory, the least-defensible competitive strategy is being "stuck in the middle." These retailers offer no long-term benefit in terms of offering consumers low prices or a highly differentiated retail strategy. This book is offered as a guide to these "stuck-in-the-middle" retailers. The first part of dealing with a "stuck-in-the-middle" strategy is a retailer's recognizing its true positioning in the marketplace. Obviously, what is crucial is the customer's positioning of the retailer, not the retailer's idealized positioning. The second part of the change process is for the retailer to formulate short- and long-term plans to implement the recommended changes.

Recognizing the Need to Change

A central issue to be covered in this section is how a retailer can determine whether a cost, value, or differentiation strategy is most suitable. As in all forms of self-analysis, a retailer needs to honestly evaluate its strengths and weaknesses.

Here are a number of questions a retailer needs to ponder in assessing the use of low cost as a competitive advantage:

- What is the retailer's cost of goods sold as a percent of sales versus its key competitors?
- What are the retailer's operating costs as a percent of sales relative to its key competitors?

- Does the retailer have special competencies in the management of opportunistic buying (bankrupt stocks, manufacturer overruns, closeouts, broken lots, canceled orders, refurbished products, and so on)?
- Does the retailer have opportunities to significantly reduce its costs (through reducing organization hierarchies, subletting extra space, reducing product proliferation, reducing services that are regarded as unnecessary or of low value by its target market, centralizing functions, increasing labor proficiency, using self-checkouts, selling select merchandise on the Web, using drop shipping, shifting to an everyday low pricing format, and so forth)?
- Can the retailer effectively reposition empty or low-performing stores as a discount operation? Can these stores use existing store fixtures to reduce investments? Is the retailer able to effectively manage multiple formats (one of which is a low-cost operation)?

In contrast, there are a number of questions a retailer needs to ponder in assessing the use of differentiation-based strategies as a competitive strategy, as follows:

- Does the retailer's sales personnel have specialized product knowledge or skills that are especially relevant to the goods and services sold (such as "foodies" working in a grocery, sports enthusiasts working in a sporting goods store, or interior decorators working in a furniture store)?
- Is the store's atmosphere viewed as "fun," "entertaining," or "exciting" by its customers? Can the store's atmosphere easily be repositioned as "fun," "entertaining," or "exciting" through sampling stations, demonstrations, or short classes on using equipment?
- Does the retailer have special customer services or can it effectively develop services (such as need assessment, alterations, delivery, installation, troubleshooting, and repair) that can be used as a major competitive advantage?
- Does the retailer have access to unique goods through arrangements with specialized vendors, foreign sources of supply, and private label supplier contacts?

- Does the retailer have the competency and resources to successfully implement a distinctive private label program (including customer need assessment, product development, and product testing and tasting)?

The answers to the preceding questions may suggest that the retailer needs to further develop its core competencies around low cost or differentiation. Some of these questions need to be answered by a store's middle and top management, as well as its board of directors. Others require questioning shoppers via surveys or focus groups.

Formulating Short- and Long-Term Strategies to Effectively Implement Change

According to a *Harvard Business Review* article, retailers should focus their strategies around where the true "headroom" lies. The authors defined *headroom* as "market share you don't have minus market share you won't get."[36] Consumers loyal to your competitors represent market share you will not likely achieve. In contrast, a retailer is most likely to retain its most loyal customers. Headroom represents "switchers" loyal to neither you nor your competitors. The choice of a low-cost, value, or differentiation strategy also has to consider the needs and size of this switcher segment, as well as a retailer's ability to attract and maintain this group of customers.

There are many different paths to developing and implementing repositioning strategies based on low cost, value, or differentiation. These include the use of existing middle management, retaining consultants, hiring executives with specialized talents, outsourcing key tasks (such as hiring a firm with significant private label experience to develop and manage these goods), and merging or acquiring retailers that have special strengths.

There are several major caveats in repositioning for any retailer. One, a retailer may not possess the core competencies to effectively carry out the repositioned strategy. Two, consumers' perceptions about a retailer's key strengths have been formed over years and are very difficult to change. When Sears decided several years ago to sell more costly lines of clothing, its previous customers of inexpensive apparel simply switched to other retailers. To make matters worse, Sears was also unsuccessful in attracting new customers to purchase the higher-cost apparel at its stores. Generally, positioning changes need to occur slowly. This slow pace enables a retailer to communicate and reinforce its repositioned strategy over a long time period.

In pursuing a low-cost strategy, retailers need to be careful that services that a retailer's target market views as critical not be significantly reduced or eliminated. One way of reducing this risk is to use unbundled pricing. In this way, an appliance retailer can charge separate prices for an appliance, delivery, installation, and carting away of the old appliance. This unbundling strategy satisfies the needs of both the low-cost segment (which is willing to do some or all of the services) and full-service customer segments (which are looking to do none of these tasks). Unbundled pricing also enables a retailer to match the price of low-cost retailers that do not provide ancillary services. It also charges customers for only those services that they desire.

A retailer needs to be careful in formulating its differentiation strategy so that its new strategy is not based upon a niche. One way to effectively address a differentiation strategy is to use micromarketing, where stores are clustered into groupings based on their specialized markets. In this way, an appliance chain may offer compact appliances (such as 10-cubic-foot refrigerators) in its central city stores, and 23-cubic-foot refrigerators, lawn mowers, and snow blowers in its suburban and rural store units. A supermarket can utilize micromarketing by offering six-packs of lamb chops for stores in family-oriented neighborhoods and prepared single-serving portions for stores with a high proportion of single residents.

Retailers can also establish different organizational units for each major market segment. This strategy is most difficult to implement since each segment has very different needs that top management needs to recognize and appeal to. Although Aldi and Trader Joe's are both owned by the Albrecht brothers, their strategies are quite different. Aldi appeals more to the extreme value customer who is more willing than the Trader Joe's customer to forgo certain services for a lower price. The Trader Joe's customer is also much more likely to be a "foodie" who loves to experiment with exotic foreign foods, multiple coffees, teas, and olive oils. Likewise, Nordstrom and Nordstrom Rack are different retail operations in terms of their selection, pricing, store service, and store atmosphere. And Publix has a Publix Sabor division with four stores that caters to a Caribbean and South American population with a special selection of foods and all advertising and product information provided in both English and Spanish.

Many bricks-and-mortar retailers have web sites that offer a different selection of goods and services. Some retailers use the Web as a means of promoting the sale of closeouts and broken lots. Others use the Web as a means of selling distinctive merchandise that appeals to markets too small for their traditional store-based channel.

Takeaway Points

- In general, there has been an overall increase in competition from dissimilar retailer types, called "format blurring." Traditional retailers have seen significant competition as consumers increasingly shop at warehouse clubs, Wal-Mart, dollar stores, extreme value food formats like Aldi and Sav-A-Lot, office supply stores, factory outlets, and closeout-based web retailers.
- One of the major long-term changes that has carried over from this recession is the increased concern for all consumers with "value." An effective value strategy can deter the migration of consumers to other outlets. Among the strategies supermarkets need to consider in delivering value are more attractively priced private label products, warehouse "bulk" packages for selected goods (such as paper towels, facial tissue, dishwasher liquid, and detergents), the use of opportunistic buying as a strategy to offer low prices, pretesting goods for durability, and

increasing buying power through cooperative buying agreements among noncompeting retailers. Appliance stores can demonstrate value through special purchases, listing certain appliances as "Best Buys" based on features, performance, and price.

- Retailers need to make it easier for consumers to get special values. Specials should be communicated on blackboards in front of each store and can be grouped together as solutions (such as pasta, pasta sauce, ground beef, and Italian bread for a supermarket or an HDTV, a speaker system, and HDMI cables for an electronics store). Coupon offerings can be posted on a store's web site.
- Periods of low growth represent an ideal time for retailers to reexamine their operations for possible sources of additional revenues, as well as for ways to trim expenses. Some obvious areas of potential revenues that need to be examined are subletting unnecessary space to service vendors that can benefit from a store's regular customer traffic base. This can include dry cleaners, in-house bakeries, and a full-service pharmacy within a supermarket; a full-service jewelry shop, a tailor shop, and an electronics retail operation within a department store; and an electronics repair and installation facility within an electronics store. Opportunities for format blurring should also be considered. Electronics that are rapidly dropping in price, such as cellular phones, HDTVs, and netbooks, are suitable candidates.
- Periods of low growth are also an ideal time to reevaluate whether additional services should be continued or separately charged. For example, a furniture retailer may want to consider unbundling charges for delivery, installation, and carting away of one's old furniture. In this way, consumers can select and pay for specific services that they value.
- Periods of low growth generate opportunities due to weak competitors going out of business or closing underperforming stores, increased in-home food consumption (at the expense of restaurants), in-home catering, and in-home entertainment.
- Two major competitive strategies that retailers need to carefully consider are low cost and differentiation. Low-cost retailers base their overall strategy around reducing product choice,

self-service shopping environments, and an absence of services that consumers view as secondary in importance, as well as lower rental costs. Differentiation strategies are based on high levels of sales assistance, specialized merchandise, and a fun-based shopping environment. Value-based strategies combine elements of cost and differentiation by including only those services that are worth more to consumers than their cost to a retailer.

- Retailers need to examine their ability to increasingly adopt a low cost or differentiation strategy through honestly assessing their capabilities. Retailers also need to assess opportunities in the low cost and differentiation sector by examining where the true "headroom" lies. Some retailers may choose to appeal to multiple market segments through offering different overall retail strategies.

Endnotes

1. Edward J. Fox and Raj Sethuraman, "Retail Competition," in *Retailing in the 21st Century: Current and Emerging Trends*, Manfred Krafft and Murali K. Mantrala, eds. (Berlin/Heidelberg/New York: Springer, 2006).

2. www.retailerdaily.com/entry/9225/comparable-store-sales-data/, as of April 16, 2010.

3. "U.S. Consumer Spending, Income Remain Sluggish," *Industry Week* (March 29, 2010).

4. Christine Hauser, "Savings Up; Consumer Spending Flat," *Boston Globe* (May 29, 2010), p. B5.

5. Kate Berry and Sara Lepro, "Still No Peak," *American Banker* (May 20, 2010), p. 11.

6. Fred Hiers, "Foreclosures Back Up Again," *McClatchy-Tribune News* (July 16, 2010).

7. Rick Newman, "What Could Derail a Recovery," *Time* (March 2010), p. 56.

8. Paul Flatters and Michael Willmott, "Understanding the Post-Recession Consumer," *Harvard Business Review* (July–August 2009), pp. 108–109.

9. Stephanie Rosenbloom, "For Wal-Mart, a Christmas That's Made to Order," *New York Times* (Business) (November 5, 2008).

10. "Consumer 'New Frugality' May Be an Enduring Feature of Post-Recession Economy, Finds Booz & Company Survey," *Business Wire* (February 24, 2010).

11. "The New Consumer Behavior Paradigm: Permanent or Fleeting?" (Pricewaterhouse Coopers LLP and Kantar Retail), 2010.

12. Katy McLaughlin and Timothy W. Martin, "As Sales Slip, Whole Foods Tries Health Push," *Wall Street Journal* (August 5, 2009), p. B1.

13. Edward J. Fox and Raj Sethuraman, "Retail Competition," in *Retailing in the 21st Century: Current and Emerging Trends*, Manfred Krafft and Murali K. Mantrala, eds. (Berlin/Heidelberg/New York: Springer, 2006).

14. Stephen Dowdell, Meg Major, Jimmy McTaggart, and Bridget Goldschmidt, "Third Annual Outstanding Independent Awards: Family Values," *Progressive Grocer* (January 1, 2007), pp. 22–23.

15. John Schmeltzer, "Squeeze of the Supercenter: New Players Bite into the Market Share of Traditional Grocers," *Chicago Tribune* (December 24, 2007).

16. Motoko Rich, "When Big-Box Store Smiles on a Book, Sleepy Titles Can Become Best Sellers," *New York Times* (July 22, 2009), pp. C1, C5.

17. Jena McGregor, "The Hard Sell," *Business Week* (October 26, 2009), p. 45.

18. Neil Currie, "Do Supermarkets Have a Future?" *Progressive Grocer* (April 15, 2005), pp. 62–79.

19. Kelly Tackett, "Economic Forecast: Outlook to 2013: Food, Drug, Mass," (Columbus, OH: TNS Retail Forward), (November 2008), p. 4.

20. *Wal-Mart Stores Inc. 10-K for the Fiscal Year Ended January 31, 2010*, p. 6.

21. *Costco Wholesale Corporation, Form 10-K for the Fiscal Year Ended August 30, 2009*, p. 4.

22. http://supermarketnews.com/profiles/top75/2009-top-75, as of June 6, 2010.

23. Marianne Wilson, "No-Frills Shopping," *Chain Store Age* (March 2009), p. 26.

24. http://pressroom.target.com/pr/news/consumables/Super-Target/default.aspx, as of June 6, 2010.

25. *Target Corporation 10-K for the Fiscal Year Ended January 30, 2010*, p. 3.

26. *Dollar General 10-K for the Fiscal Year Ended January 29, 2010*, p. 7.

27. *Family Dollar 10-K for the Fiscal Year Ended August 29, 2009*, p. 7.

28. *Costco Wholesale Corporation Form 10-K for the Fiscal Year Ended August 31, 2009*, p. 4.

29. Matthew Boyle, "Wal-Mart's Magic Moment," *Business Week* (June 15, 2009), p. 52.

30. "U.S. Web Retail Sales to Reach $249 Billion by 2014: Study," *Reuters* (March 8, 2010), http://www.reuters.com/article/idUSTRE6274VG20100308, as of June 7, 2010.

31. Maria Halkias, "Shoppers Departing Stores—and May Not Be Back," *The Dallas Morning News* (February 20, 2009), www.dallasnews.com, as of February 23, 2009.

32. Sandra M. Jones, "2009 Predicted to Be a 'Cleansing' Period for Retailers: More Stores Expected to Close or File for Bankruptcy," *Chicago Tribune* (January 2, 2009).

33. http://retailindustry.about.com/od/statisticsresearch/a/storeclosings09.htm, as of September 10, 2010.

34. http://retailtrafficmag.com/news/store_closings_pile_up_02092010, as of September 10, 2010.

35. Mark Potter and James Davey, "Analysis—Worst Still to Come for Europe's Retailers," *Reuters News* (December 12, 2008).

36. Ken Favaro, Tim Romberger, and David Meer, "Five Rules for Retailing in a Recession," *Harvard Business Review* (April 2009), pp. 64–72.

INDEX

T

U–V

W