

FT Mastering Marketing Part 7: RETAILING

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The marketing function depends heavily on the presence of intermediaries between the producer and consumer. These intermediaries provide broad and convenient access to products for a wide range of customers.

In addition to serving as essential conduits for getting products to the market, intermediaries also serve as information conduits. Often, producers have little or no direct contact with end-user customers and must rely almost entirely on intermediaries for information about them. Likewise, intermediaries often play a role in directing and filtering information for end-users from producers.

Retailers are perhaps the most important type of intermediary, situated at the point of direct contact with customers. The retailing function adds value for producers and consumers in a number of ways, most of which are difficult for manufacturers to replace. These include breaking bulk (breaking caseloads into smaller quantities), providing an assortment of products so that customers can achieve one-stop shopping, creating an inventory buffer between production and consumption so that products are available when desired, and providing support services such as display, demonstration, credit, delivery, assembly, repair, and return and warranty services.

The retailing sector is huge, representing over \$2,200bn a year in revenues in the US alone (approximately 30 per cent of GDP) and employing about 25m people in that country. World-wide, it is estimated that retailing accounts for about \$7,000bn in annual revenues.

Over its long history, the retailing function has changed, often reacting to changes in consumption patterns (for example the rise in the proportion of expenditure allocated to services), demographic shifts (the migration from inner cities to suburbs) and technological forces (the introduction of toll-free calling and the widespread use of credit cards).

Today, retailing is going through another round of massive changes, the scale and scope of which are likely to exceed those that have come before. Retailing faces several major pressure points.

First, indications are that the retailing sector in most developed countries is overbuilt. In the US, for example, the square footage devoted to retailing rose by 216 per cent between 1966 and 1993 while sales (in real terms) rose by only 50 per cent.

At the same time, the amount of time spent shopping has been declining. It has been estimated that the average amount of time spent by a typical American in a shopping mall has declined from seven hours a month to about 2½ hours over the past 15 years.

This time pressure, coupled with the general sameness and predictability of much retailing, has led to a change in perception of shopping: from something regarded as fun and

entertaining to an activity that is now generally considered a tiresome burden to be dealt with as expeditiously as possible.

As a result of these factors, the retailing sector is experiencing a shakeout. The number of bankruptcies in the retail sector has been rising, reaching approximately 13,000 a year in the US.

“New-style” retailers

In contrast with conventional retailers, a number of new-style retailers (such as Wal-Mart and Carrefour) have emerged in recent years. These retailers account for much of the new wealth creation in the retailing sector while conventional retailers have been responsible for huge declines in shareholder value.

The new retailers have adopted a business philosophy and operating style that includes the following elements:

High levels of investment in information technology and the establishment of close electronic linkages with upstream partners

Rather than monitor the inventory of each item themselves, they move much of the responsibility for ensuring product availability to suppliers.

Suppliers accomplish this by monitoring sales at the point of sale (POS) on a real-time basis through computerised links. They then provide “automatic replenishment” when inventory levels run low. Payments are made through automated bank-to-bank transfers to suppliers. Purchase orders, invoices, payment notices and other paperwork are eliminated.

A more rational approach to pricing and sales promotions with an emphasis on “everyday fair pricing” (EDFP)

Rather than maintain large and predictable price variations, these retailers attempt to provide a “fair” price all the time. The objective is to assure buyers that they need not wait for a sale to get a reasonable price on the products they want to buy.

A reduction in the number of suppliers

As this occurs, the share of business for each supplier increases. Rather than rely on new suppliers to increase variety, retailers encourage existing suppliers to add greater variety and offer a fuller line of products. This enables them to better leverage existing logistical systems.

Greater market power, arising from retail concentration and intense customer loyalty.

Successful retailers have to be treated by manufacturers as customers rather than intermediaries; without their support, the manufacturer is effectively barred from serving a sizeable portion of the market.

Wal-Mart, with well over \$120bn a year in annual sales, and Toys R Us, which controls over 25 per cent of toy sales in the US, are gatekeepers to large and loyal markets of consumers that rarely shop elsewhere for certain products. Manufacturers must co-operate with these retailers or be locked out of achieving full market coverage.

Retailer-supplier partnering

Dramatic gains in distribution and marketing efficiencies can be realised when buyers and sellers work together. Partnering between retailers and manufacturers represents a major departure from their traditionally antagonistic relationship; it recognises that both are part of a

single process (which can be greatly streamlined and simplified) involved in distributing products to customers.

Inventory is pulled through the system rather than pushed down, allowing companies to provide higher levels of product availability for customers with lower average levels of inventory.

This is reflected in Black & Decker's distribution philosophy of "sell one, ship one, build one".

Partnering thus provides the advantages of vertical integration without the attendant drawbacks. It had its roots in the "quick response" movement in the clothing industry. In the grocery business, it is known as "efficient consumer response" (ECR).

A report by Kurt Salmon Associates for the Food Marketing Institute in the US estimated that ECR had the potential to reduce inventory by 41 per cent and save \$30bn a year in the US grocery industry.

Central to such partnering arrangements are the enabling technologies of bar-coded product identification and electronic data interchange (EDI) along with the re-engineering of business processes both within as well as across firms in the value chain.

These systems improve efficiencies and customer service primarily by replacing physical assets with information. They reduce the retailer's inventory while providing a supply of merchandise that is closely co-ordinated with the actual buying patterns of consumers. Resources that were earlier tied up in inventory can be deployed elsewhere - to increased advertising, new product lines or to the bottom line, for example.

The result is a win-win-win outcome. Consumers consistently find the merchandise they want in stock (often at lower prices); suppliers increase sales, lower costs and cement ties with retailers; and retailers gain increased sales and inventory turns and more satisfied customers.

These so-called "channel partnerships" have been adopted by suppliers and retailers in such diverse product categories as household goods, personal care products and home furnishings.

The impact of electronic shopping

Beyond its facilitation of retailer-supplier partnering, technology is having important impact on retailing in another way: the substitution of electronic shopping for store-based retailing.

For many time-pressured customers today, shopping on-line or via a catalogue for next-day delivery can provide greater time value than scheduling a trip to the mall.

American consumers spend \$3bn per year on items from TV shopping networks, \$10bn a year shopping over the Internet and \$60bn a year on catalogue purchases from mail-order companies such as L L Bean. While this still represents a very small portion of the retailing sector, recent growth trends indicate that electronic retailing is poised to enter the mainstream.

The World Wide Web, even in its current narrowband mode, shows the vast potential of the technology. In 1997, \$6bn worth of cars were sold over the Internet in the US while Dell Computer alone was selling at a pace of \$6m a day towards the end of the year.

America Online reported sales of \$150m in December 1997 alone, much of that in categories such as apparel that have thus far seen little shopping activity over the Internet. While electronic grocery shopping remains minutely small, Anderson Consulting projects an astounding \$85bn a year by 2007.

It is a well-established dictum of retailing that the “total shopping experience” must be considered in order to assess the relative strengths of different retail formats. Electronic shopping is typically more cost effective than store-based retailing (according to researchers, electronic shopping can lower costs by approximately 25 per cent).

However, other factors such as the number of alternatives that can be made available, the social and entertainment dimensions of shopping, the amount of information that customers need and that can be readily provided, and the type of product must also be evaluated.

In an award winning recent paper in the Journal of Marketing, Joseph Alba and his co-authors (see Further Reading) suggest that successful electronic retailers will seek competitive advantage in one or more of the following areas:

- distribution efficiency
- assortments of complementary merchandise
- collection and utilisation of customer information
- presentation of information through electronic formats
- unique merchandise.

Alba and his colleagues suggest that catalogue retailers are the most vulnerable to electronic shopping, since, while it has some of the same limitations such as delivery times, electronic shopping has the ability to provide customers with much more information than catalogues.

They also suggest that electronic shopping is ideal for retailers (such as Nieman-Marcus, Harrod’s, Gumps and Saks) with strong reputations for high-quality and unique merchandise but incomplete market coverage. By contrast, chains such as Sears, which already have extensive market coverage, have less to gain from electronic retailing.

To prevail, store-based retailers will have to emphasise merchandise that has predominantly experiential attributes (that is, it must be seen directly, touched and so on), promote the non-informational benefits (such as entertainment and the opportunity to socialise) of shopping, and treat electronic shopping as complementary to their in-store business.

The Alba paper also outlines the conditions under which manufacturers would have an incentive to disintermediate - that is, bypass retail intermediaries of any kind and deal directly with customers.

Manufacturers with strong brand names and the ability to produce complementary merchandise are most likely to consider disintermediation.

For example, Levi Strauss has very strong brand names and produces a wide range of complementary products (for example Dockers slacks and shirts) and could thus consider dealing directly with consumers. However, it (as with all manufacturers) must carefully consider the impact of doing so on its relationship with intermediaries.

In situations where the advantages of electronic shopping are very strong, store-based retailers would be ill-advised to try to counter the trend. Rather, they should devote their efforts to developing strategies to take advantage of the new opportunities offered by electronic shopping.

Retailing as entertainment, recreation and learning

A significant convergence is taking place between retailing, entertainment and recreation, and to a lesser extent, between retailing and education. Entertainment companies, such as Walt

Disney, Warner Bros., Discovery Communications, Sony and Viacom are moving into retailing in a big way while retail developers are moving rapidly to add entertainment options to their new and existing developments.

This move toward retail entertainment is rapidly gaining momentum in the US and is clearly related to the perceived threat from electronic shopping that is expected to hit conventional and price-oriented retailers hard.

Shopping as entertainment and a social experience was long an inherent part of retailing, especially in advanced economies. However, the entertainment and social aspects were seen as inherent to the shopping experience and were not explicitly emphasised.

In fact, movie theatres and other forms of entertainment in shopping malls were considered a financial drain; they took customers away from stores and generated lower sales per square foot.

In the rediscovery of the link between shopping and entertainment, there is a much more explicit focus on using entertainment as a way to differentiate the retail experience from conventional retailing and electronic retailing.

Some new retail developments incorporate nightclubs, upmarket restaurants, zoos, virtual reality rides, comedy clubs, magic shows, musical revues and large stadium-style movie theatres. Some stores have aquariums, target ranges and other experiential elements.

Retailing is also converging with learning. Customers can develop or hone expertise in new areas and parents can make their limited time with their children more meaningful.

Customers come to such stores not just to buy products or learn skills but also to browse, socialise and be with other people. They also spend more than in a traditional mall; in a Los Angeles development called CityWalk, sales are about \$500 per square foot compared with about \$203 for the average mall.

The manufacturer's perspective on retailing

From the perspective of producers, some of the key issues pertaining to retailing are: a move toward "hybrid" distribution systems in which a larger number of short channels replace a small number of long channels; the growing prominence of non-traditional retailers; and the increased pressure producers are bringing to bear on retailers to adopt technological approaches such as EDI and ECR.

Most producers in the past tended to distribute their products either indirectly (i.e., using intermediaries such as retailers) or directly (i.e., selling to end-users without the use of middlemen). Both groups are now converging toward the simultaneous use of direct and indirect distribution. The objective is to provide the greatest market coverage in the most cost-effective way possible. Thus, companies that previously sold only through indirect channels are now adding direct sales channels (e.g., IBM Direct, Xerox Direct). Airlines are adding direct channel options for end-users through their web sites. This transition is being facilitated by the rising power and falling cost of information technology, which enables companies to manage a very large number of small relationships cost effectively.

At the same time, many companies are finding that it is uneconomical for them to service smaller indirect accounts directly; they are now in the process of "outsourcing" some of their retailer customers. In some cases, some smaller retailer customers are being outsourced to larger distributors. One packaged goods company, for example, is asking some its retailers to become "master distributors" and take on smaller retailers as customers.

In making the transition to such complex hybrid marketing channels, companies are confronted with a number of areas of potential conflict with their distributors. Preventing and managing such conflict is an important factor in the success of these arrangements.

Due to greater demographic diversity in most markets as well as rising mobility, producers are now finding that traditional retailers do not adequately cover many of the locations that customers now wish to shop. Increasingly, shopping occurs in the home and in public places such as airports. Non-traditional retailers are stepping into the breach, and producers are increasingly finding that they must include these in the mix in order to achieve greater market coverage.

Finally, the search for ever-greater levels of efficiency and productivity is leading manufacturers to put pressure on retailers of all sizes to move toward integrating information technology into their operations, especially with respect to vertical information flows.

Retailing's future

The mammoth retailing sector will experience major shifts and severe dislocations in coming years.

Conventional retailers, especially those that are mid-sized, will find themselves squeezed from all sides: from larger players with better economies of scale, from smaller players with more focused selection or a greater emphasis on convenience, from electronic retailers with few physical assets but lots of informational ones, and from entertainment and education oriented players who offer a much more vibrant, lively and meaningful shopping and consumption experience.

Some of the key trends we see for retailing (in addition to the two discussed earlier – electronic shopping and the melding of retailing with entertainment and learning) include:

More polarisation in size. We expect retailers to be very large or very small; not too many will be mid-sized. As in most industries, retailing will be characterised by a small handful of giants and a large number of specialists.

More emphasis on services. In the US the share of revenues at shopping malls from services rose from 48 per cent in 1980 to 60 per cent in 1996; this trend will continue. The services that will grow will be those that cannot be delivered by electronic or other means directly to a customer's home and those that have a substantial social component to them (that is, their value is enhanced by experiencing them in groups rather than singly).

Greater focus on older customers. With the ageing of populations in most developed countries, most buyers have less need for physical products and more desire for services (including entertainment, education, travel, healthcare and financial services). Very few retail establishments currently focus on mature customers; this will change as the needs and motivations of older buyers are better understood.

More outdoor shopping centres located in downtown areas. Many existing enclosed malls are "demalling" and opening up to the outside. Newer developments are mostly clustering in downtown areas, often with active municipal involvement.

Repurposing of malls. Many malls will be converted to convention centres or be occupied by full-fledged universities. Those malls that are linked to hotels will be especially attractive for this kind of conversion. Other malls will be converted to office space.

Limited globalisation. Rather than a full-blown globalisation of the retail industry, we expect to see regional internationalisation. The primary reason is that the supply function is not

adequately globalised. Global retailers would therefore have to deal with different suppliers in different parts of the world, erasing much of their scale advantage. Retailers will find that it is preferable for them to try to dominate a particular area (because of shared costs) than to spread out thinly across the globe.

Conclusion

While retailing is changing in many ways, we can summarise the major developments in the following charts.

Historically, retailing's primary emphasis was on the transactions that resulted in the movement of merchandise. In the future, retailing will increasingly emphasise services; and transactions will be peripheral to the experiential elements of shopping and consumption.

Past retailing was based predominantly on a gravitational model, in which store locations were the primary driver of customer shopping behaviour. This mode places clear time and place constraints upon customers; transactions could only occur at the store during specified hours. In the future, such constraints would be self-defeating. Retailers must gain the ability to enable transactions to occur any time, any place.

The trend toward disintermediation is still in its early phases and massive dislocations will occur as a result of it. The trend will also give rise to major growth in support services for companies that deal directly with larger numbers of customers.

For example, growth in small package shipping will likely far exceed that in bulk shipments or the building of warehouse space.

Another important consequence of this trend is likely to be what we call "reintermediation", or the emergence of new types of intermediaries that will create and capture the value-creating opportunities that will undoubtedly be spawned by the confluence of new ways of interacting between consumers and producers.

Examples of new types of intermediaries may include rating services, automated ordering services, services based on consolidating small orders from numerous consumers into more economically viable quantities and so on. Market specialists could emerge who would orchestrate the offerings of numerous suppliers around the specialised needs of a single customer.

For today's retail intermediaries, the challenge is whether they can adapt themselves to the emerging realities in a way that ensures their continued relevance and thus prosperity. They must identify a value-adding role for themselves in the new landscape of producer-consumer relationships and create a blueprint for moving from their current business model to a new one.

Further reading

Joseph Alba, John Lynch, Barton Weitz, Chris Janiszewski, Richard Lutz, Alan Sawyer and Stacy Wood (1997), "Interactive home shopping: consumer, retailer, and manufacturer incentives to participate in electronic marketplaces," *Journal Of Marketing*, Summer.

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