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Strategic Retail Management

Text and International Cases

3rd Edition

Springer Gabler

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Preface

The economic importance of retailing is constantly increasing, as can be seen from the development of many countries across Europe, America and Asia. In highly developed countries, retailers are taking an increased leadership role in every distribution channel. Expansion strategies, retail branding strategies, innovative solutions for supply chain management and many other developments all reflect this trend. Transformation countries such as those in Central and Eastern Europe and emerging countries such as China or Brazil are also seeing fundamental changes in retailing structures, which may lead to comparable developments.

Internationalisation has also led to profound changes. Formerly local or national retailers are increasingly developing into global players with worldwide operations.

Book Concept and Overview

This book is devoted to the dynamic development of retailing. The core focus is on various strategy concepts adopted by retailing companies and their implementation in practice. This is not a traditional textbook or collection of case studies; it aims to demonstrate the complex and manifold questions of retail management in the form of twenty lessons, where each lesson provides a thematic overview of key issues and illustrates them via a comprehensive case study. The examples are all internationally known retail companies, to facilitate an understanding of what is involved in strategic retail management and illustrate best practices.

The book is divided into four main parts. Part I (Chapters 1–6) introduces „Functions, Formats and Players in Retailing“. Part II (Chapters 7–10) deals with growth, internationalisation, retail branding and sustainability strategies as fundamental aspects of „Strategic Marketing in Retailing“. Part III (Chapters 11–16) focuses on the „Marketing Mix in Retailing“, discussing store location, merchandise and category management, pricing, marketing communication, instore marketing and customer relationship management. Finally, Part IV (Chapters 17–20), „Buying, Logistics and Performance Measurement“, deals with retail purchasing strategies and concepts, the modern concepts of physical distribution and IT-based supply chain management and methods of performance monitoring and controlling.

Teaching and Learning

The book is targeted primarily at students in their third and fourth academic years (undergraduate and graduate level) in the fields of Business Administration/Marketing/Management at institutions such as universities, academies and business schools. Practitioners in the consumer goods industry and retailing companies who want to acquire concise and practice-oriented information on current retail topics will also benefit.

The book can also be used in education as a basis for working with case studies. The case studies are integrated in such a way that they provide additional content and specific applications of the individual lessons. Thus, they form part of the main topic, but also lead to suggested discussion subjects and questions in order to deepen the understanding of the topic. Instructors are provided with additional resources. For each case study, draft solutions are provided via the publisher's webpage (www.gabler.de).

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und Hanna Schramm-Klein

Introduction

Retailing is one of the world's largest industries. It is in a permanent state of change, and the pace of this change has been accelerating over the past decade. From a marketing perspective, retailers are closer to consumers than manufacturers. Retailers are the final stage in the marketing chain and the contact point between consumers and manufactured products. Where retailing previously prioritised buying decisions and product assortment, it now follows a more strategic approach to management and marketing and is seizing the opportunity to be consumer-oriented, engage in personal contact with customers, gather information on consumer behaviour and exploit insights into consumer behaviour and preferences. What was once a simple way to do business has been transformed into a highly sophisticated form of management and marketing.

Retailing involves those companies that are engaged primarily in the activity of purchasing products from other organisations with the intent to resell those goods to private households, generally without transformation, and rendering services incidental to the sale of merchandise. The retailing process is the final step in the distribution of merchandise.

A number of developments are responsible for the dynamic change in modern retail management. In most developed countries, retailing has experienced a dramatic increase in the scale of operations and market concentration. **Large-scale retail chains** have appeared and taken market share from independently owned small shops. These retail chains first developed into regional groups and then into nationally and even internationally active retail operations. In the past decade, mergers and acquisitions between already large players have accelerated this development. Many retailers now have massive turnovers, very large numbers of employees and extensive store networks. The world's largest retailer, *Walmart*, achieves an annual turnover of more than 485 billion EUR, higher than the GDP of many countries, and employs about 2.2 million people. *Carrefour*, the world's third largest retailer and the second largest in Europe, operates more than 10,000 stores worldwide.

At the same time, many retailers have developed into international multichannel retailers, that is, they operate in many countries and offer their customers' different retail formats. For example, the French retailer *Carrefour* is now a multi-format group that uses hypermarkets, supermarkets, convenience stores, hard discounters and other formats to sell its assortment to customers in over 30 countries. More than half of its turnover is earned outside its home market. The German *Metro Group* employs food superstores (*Real*), consumer electronics category killers (*Media Markt* and *Saturn*), cash and carry wholesale stores (*Metro C&C*) and other formats and earns about sixty percent of its turnover in markets outside Germany. *Tesco* has expanded rapidly into Eastern European and Asian markets and, in addition to several store-based formats, operates a successful e-commerce channel, *Tesco.com*. While the rise of e-commerce in retailing was initially overestimated during the first dotcom boom, it has nonetheless developed slowly but surely and *Tesco* now achieves sales of almost 3.5 billion EUR through its online channel.

In most country markets, retailing is a highly concentrated industry. According to the market research company *Planet Retail*, the top five food retailers account for more than 70 % of the market in the UK, Germany and France. Consequently, one of the most influential developments has been a **shift in power** within the distribution channel over recent decades. The power of individual retail organisations is growing; they are now comparable to and in many cases even larger than many manufacturers, even global brand manufacturers such as *Procter & Gamble*, *Sony* or *Nestlé*. Thus, today's manufacturers often depend on a few large retailers for a substantial share of their global turnover. Along with this increasing size, retail marketing budgets, IT budgets and budgets for top managers have also increased. The increased sophistication of retail management, combined with the better availability of customer data, has also contributed to the power shift. Retailing is currently one of the leading industries when it comes to adopting new technologies. Retailer **POS data** has become more valuable, because IT systems have facilitated data collection at checkout. In addition, as retailers have grown from regional to national chains they have been able to accumulate knowledge about consumer trends and changes in product sales, etc., which has enhanced their relevance as gatekeepers for products *en route* to the customer. Customer-specific data, now increasingly gathered via **loyalty cards**, adds to this knowledge.

Where manufacturer brands once used to be all-important, the past few years have seen the power of **retail brands** challenging suppliers' positions. Retailers have started to embrace the concept of **strategic marketing**; they use strategic planning and position themselves relative to their competitors. Thus, retailers' enormous buying volumes are just one source of their power base – albeit certainly the most important.

Retailers are **intermediaries** in the distribution channel. However, while retailing has long been considered a somewhat passive link in the value chain between manufacturer and consumer, retailers now use their positions to become the **dominant player in the distribution channel**. They develop their own marketing concepts and assume **marketing leadership** in their vertical relationships with manufacturers. Retailers have also developed their own logistics concepts and created central warehouses. Accordingly, where manufacturers traditionally fulfilled large parts of the logistics function, retailers today also strive towards **logistics leadership** in the distribution channel.

Our aim with this book is to cover the most important aspects of retail management with a comprehensive approach that is simultaneously concise and innovative. We discuss twenty different retail management topics by first giving a thematic overview that covers the key issues and explains the most important concepts before illustrating them via extended case studies. The case studies use internationally known companies that can be considered best practice cases for the various strategies discussed.

Part I introduces retailers' functions (Chapter 1) before discussing retail formats and players. A **retail format** is a specific configuration of the retail marketing mix (e. g., store size, typical location, merchandise, price and service offered) and often forms the core of a retail strategy. Different formats are described for food and general merchandise retailing and we discuss which are currently gaining market share and which are declining. For example, category killers such as *IKEA*, *Media Markt* and *Leroy Merlin* have seen tremendous growth over the past few decades. And hard discounters, such as *Aldi*, are some of the most aggressively growing retail formats in food retailing worldwide (Chapters 2 and 3). **E-commerce** has grown into a substantial business in general merchandise retailing. Many pure Internet players, such as *Amazon*, *Ebay* or *Zalando*, have reached considerable size (Chapter 4). At the same time, more and more stationary retailers are embracing online shopping, offering it as part of a **cross-channel** approach (Chapter 5). At the same time, new players are competing with existing retailers. The most important trend here is the emergence of manufacturers as competitors. Manufacturers increasingly operate in vertical marketing systems, trying to control distribution of their products through contractual or even equity-based vertical strategies. In addition, vertically integrated players that are simultaneously retailers and manufacturers, such as *IKEA*, *Zara* or *H&M*, have captured major market shares in many retail sectors (Chapter 6).

Part II discusses the most important aspects of strategic retail marketing. Dynamic growth is one of the most important developments in retailing in recent decades and has provided the foundation for many subsequent changes. This growth is achieved through various **growth strategies**, such as outlet multiplication, acquisitions and franchising (Chapter 7). In addition, since many industrial countries are characterised by stagnating retail markets, this growth is increasingly achieved by entering foreign markets. **Internationalisation** is a complex process, since local environments in host countries often differ considerably from the home market (Chapter 8). Growth, whether nationally or internationally, can only be achieved via a sustainable competitive advantage, and retailers are now increasingly trying to develop a clear **positioning** for their companies relative to their competitors. One important component of this marketing strategy is creating a strong **retail brand**, with clear and distinct associations in the consumer's mind that promote customer loyalty (Chapter 9). In implementing their business strategies, however, retailers have to guarantee corporate social responsibility (Chapter 10) and therefore most engage in activities such as ethical sourcing, corporate philanthropy, cause-related marketing or socially responsible employment. While corporate social responsibility initiatives often have legal, regulatory or ethical motives, customers are increasingly evaluating retailers' behaviour.

Retailers have more options for strategic retail marketing in their **marketing mix** than manufacturers, because they are in direct contact with the final consumers, who visit their stores and interact directly with them. Part III examines this marketing mix and takes an in-depth look at a number of retail marketing mix instruments. **Store location** is a dominant determinant of retailing success, because it is a key factor in attracting customers to outlets and cannot be changed in the short-term (Chapter 11). Within their stores, retailers offer their customers a **merchandise** assortment, and one of retailers' primary functions is to select an appropriate breadth and depth for their assortment and specific products (e. g., manufacturer brands or **store brands**) and to tailor their offer to target customers. One new concept is **category management**, which aims to implement a more strategic and holistic approach to merchandising (Chapter 12). Closely related to the assortment is the **pricing policy**. Since consumers spend a large share of their incomes on retailing, pricing is extremely relevant to decisions over which retailer to patronise and retailers have many strategic and tactical options here to influence purchasing behaviour (Chapter 13). **Marketing communication** is another important element of the retail marketing mix, involving all instruments and activities to communicate with the customer (Chapter 14). Retailers have long applied traditional communication strategies, mainly above-the-line communication heavily focused on price promotions. But today below-the-line communication plays an important role, with special events, sponsoring and especially interactive media such as social media.

Many buying decisions are made at the point-of-sale, so professional **instore marketing** can increase sales substantially. Store layout and design can support customer orientation within stores and create a positive store atmosphere (Chapter 15). **Customer relationship management** (CRM), which primarily focuses on establishing enduring relationships with customers, is a relatively new part of the retail marketing mix. One key manifestation of CRM in retailing is loyalty programmes. The loyalty cards most consumers carry are gateways to very different approaches and methods of collecting data and tailoring marketing to individual customers (Chapter 16).

While Parts I – III focus on aspects of retailing that are at least partly visible to the customer, Part IV deals with the **back-end and internal processes** needed to offer products to consumers. Retailers need to buy the merchandise they offer, relying on various supply sources to do so, from global manufacturers of branded goods to external buying organisations in foreign markets and store brand manufacturers. Relationships with suppliers and new concepts such as **efficient consumer response** have emerged, but these **buying strategies** must be closely adapted to the specific supply situation (Chapter 17). Products must be transported along the supply chain – from the factory to the store shelf. **Physical logistics** is increasingly a core competency for retailers, who need to establish the necessary infrastructure and coordinate **product flows** within the **supply chain** (Chapter 18). These product flows depend in turn on **information flows**. A product sale should trigger a warehouse order, which in turn triggers a supplier order. The exact process depends on knowing what products are in stock at the various stages of the supply chain and forecasting consumer demand, etc. To enhance supply chain efficiency, different **collaborative techniques** for efficient stock replenishment have been developed, based on new enabling technologies (Chapter 19). Finally, intense competition in retailing, combined with the price pressure to which most retailers are exposed, makes it necessary to both perform well and constantly improve the effectiveness and efficiency of strategies and processes. Adequate **monitoring** of financial and operational performance is crucial, and retailers have developed sophisticated systems for evaluating the profitability of their store networks, supply chain efficiency and financial performance. New techniques like value-based management have been quickly embraced by retailers (Chapter 20).

This short overview of the different fields of strategic management in retailing shows that the world of retailing has become complex and challenging. The following twenty chapters cover the most important topics and provide an insight into the main developments and concepts. The case studies provide an understanding of how these concepts are implemented by successful retail companies around the world.

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Part I

Functions, Formats and Players in Retailing

Retail Functions

1

Abstract

This chapter explains the tasks of retailers within the distribution channel and recent trends surrounding these functions. This serves to demonstrate the complexity of retailers' activities and explain their general role as intermediaries between suppliers and final customers.

1.1 Introduction

Retailing refers to the process of purchasing products from other organisations with the intent of reselling them to the final customer, generally without transformation, and rendering services incidental to the sale of merchandise. However, this is a rather static and traditional definition. While traditional retail functions still dominate, retailers have developed into sophisticated and complex companies that often coordinate or even own value chains from the production stages right through to customer sales.

The retailing process itself is the final step in the distribution of merchandise. As with all services, it produces an intangible outcome. While the added value of a production company is obvious, it is – at least initially – less evident what value a retailer creates. Therefore, marketing and retail researchers have long tried to explain what added value retailers provide.

Butler (1917, p. 14) gave an early justification for the existence of retailers: "The middleman is the outstanding figure in modern marketing not because he has consciously set out to make a place for himself, nor because consumers have blindly permitted him to come between them and the manufacturers of the things they buy. It is because he has been forced

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into existence, on the one hand, by the necessities of specialised and large scale industry and, on the other hand, by the necessities of consumers equally specialised in their activities and constantly demanding more and more in the way of services which the distant manufacturer must usually rely upon the middleman to give."

A simple explanation for the potential advantage of using intermediaries (such as retailers) in a distribution channel is given by the **Baligh-Richartz effect** (Baligh and Richartz 1964). This effect is based on the fact that integrating an intermediary into the distribution channel (between suppliers and consumers) helps **reduce the number of necessary contacts** between the different actors in the system, where contacts include visits, payments, etc. If *m* different manufacturers (e. g., one for meat, one for bread, one for detergents, etc.) sell to *n* different households, the number of necessary contacts is m * n. Using just a single intermediary in this channel reduces the number of contacts to m + n.

In more recent economic analyses, **transaction cost theory** has often been used to explain the use of independent intermediaries in a value chain. This theory explains the existence of firms in general and the level of vertical integration with differing transaction costs in particular (Williamson 1985). From the transaction cost perspective, suppliers use intermediaries if the transaction cost of dealing with an independent retail channel is lower than the internal cost of coordinating these transactions internally. Transaction costs include, e. g., search and information costs, bargaining costs, monitoring costs and enforcement costs. Asset specificity, uncertainty and frequency of transactions influence these costs. Asset specificity refers to, e. g., the specific knowledge needed to sell a product or specific logistics infrastructure or specific equipment that may be required. As an example, for highly complex products, the cost of transferring the necessary specific product knowledge from the manufacturer to an independent retailer may be so high that a vertically integrated solution (i. e., direct selling) could be optimal. A more general case of asset specificity is the brand reputation that a manufacturer may have established and of which intermediaries may take advantage. In this case, verticalisation may also be beneficial (see Chap. 6). However, in many cases, for normal products, asset specificity is low and using independent intermediaries leads to lower transaction costs.

1.2 Traditional Retail Functions

1.2.1 Catalogues of Functions

To answer the fundamental question of why retailers exist, instead of, in the extreme case, every manufacturer selling their products and services to all the final customers who want to buy these products directly, different lists or catalogues of retail functions (or "distribution service outputs") have been proposed (Butler 1917; Alderson 1954; Sundhoff 1965; Bucklin 1966; Coughlan et al. 2006; Waterschoot et al. 2010; Zentes et al. 2012, pp. 57–59). The following explanation does not follow any of these specifically; instead, a list of functions is derived that retailers usually perform in the value chain between producers and consumers as a synthesis of the abovementioned sources.

1.2.2 Creating an Assortment

One of the benefits a retailer provides in the value chain is goods sorting. This creates value, because manufacturers typically produce a large quantity of a limited variety of goods, whereas consumers usually demand only a limited quantity of a wide variety of goods (Coughlan et al. 2006, p. 6).

Retailers provide the customer with an assortment of products and services, thereby offering **variety** (Bucklin 1966; Waterschoot et al. 2010; Varley 2014, p. 7). They offer the customer a selection of products (the merchandise mix or product range), which they preselect from a very broad array of products offered by existing manufacturers and bring into association with each other (see Chap. 12). For example, an average supermarket offers a choice of about 10,000–15,000 items (so-called SKUs, see Chap. 12) from over 500 different suppliers. Home improvement stores may offer 40,000–60,000 items. *Amazon* offers millions of different products in its online shop and on its marketplace. Thus, while manufacturers can specialise in producing a very limited product range, retailers make a broad product range available for the consumer. This lets consumers

- choose between different products in a single category (e. g., between different power drills in a home improvement store) and
- combine their purchases and buy items across several product categories in the same store (e. g., buy a power drill and a screwdriver), fulfilling the increasing need for "one-stop-shopping".

In a way, creating an assortment is also a marketing function, since it facilitates the consumer's search process. For example, instead of selecting between printers from many different manufacturers by searching for them in different locations, a retailer's product range helps the consumer manage the product complexity, choose between preselected printer brands and models and easily compare them in a single store.

Chap. 6 will present manufacturers' emerging verticalisation strategies. Some manufacturers, such as *Dell*, *Apple*, *Esprit* or, in a few cases, even manufacturers of fast-moving consumer goods such as *Nespresso*, operate stores dedicated to their branded products. But this is clearly not an option for most manufacturers, as consumers prefer to shop for several products in a single location, and most manufacturers would be overlooked by consumers if retailers did not present their products.

1.2.3 Breaking Bulk

In addition, retailers offer customers different **lot sizes** than manufacturers usually prefer to ship (Bucklin 1966). To reduce transportation costs and transaction costs, manufacturers usually have the necessary infrastructure and systems to ship full truckloads, pallets or at least cases of products, while consumers only want to buy single packages of a product. Thus, retailers buy products in large quantities, then break down these large shipments ("break bulk") to offer quantities that fit typical consumption patterns.

It is noteworthy that the term for this institution ("**re-tailor**" vs. **"wholesaler**" in English, "commerce de détail" vs. "commerce de gros" in French, "Einzelhandel" vs. "Großhandel" in German) often refers to precisely this function, relative to the wholesale level.

1.2.4 Bridging Space and Time

The system joining manufacturers and consumers usually has geographic and temporal gaps that must be overcome. Closing these gaps is a further function of retailers.

Bridging Space

Manufacturers usually produce a specific product in a central location, while final consumption takes places in households across the country. Retailers help carry out this **spatial decentralisation** (Waterschoot et al. 2010, p. 6) by offering products in stores that are close to the customer. Large retailers have broad **market coverage** with a network of stores, so the consumer can easily reach one.

The added value retailers provide to this logistical function has drastically increased over time (see Chap. 18 and 19). Initially, the main advantage conferred was that of an intermediary, meaning the manufacturer's logistics chain did not have to extend to every single household, only to a specific retail store. In the past, it was common for stores to either receive direct deliveries from manufacturers or for small retailers to buy their products at wholesale markets, which also helped bridge a geographical gap.

However, with retailers setting up their own distribution centres, they now take responsibility for an even larger part of the journey from the production facility to the consumer. Modern retail logistics concepts even involve picking up products at manufacturing sites directly, meaning the full function of bridging space is handled by the retailer. In the interplay with manufacturers, retailers now often try to obtain **logistics leadership**.

Furthermore, in recent years, retailers are increasingly going one step further downstream. With the increasing use of online retailing, retailers manage the delivery of products to individual households (as catalogue retailers have long done), thereby bridging the final part of the supply chain. Sometimes they do so with their own truck fleet; sometimes the delivery is still carried out by logistics service providers and merely coordinated by the retailer.

Bridging Time

Consumers want to be able to buy (and consume) products when they wish, while production is often carried out in batches or at least not immediately before purchase. This temporal gap is overcome by retailers **holding inventory**. As a part of the logistics process, retailers stock products in their warehouses and on their store shelves. This makes products available to the consumer when they want them.

Here retailers expend a lot of effort on minimising the inventory in the supply chain while still ensuring products remain in stock in their stores.

1.2.5 Creating Demand

A further function of retailers is creating demand. This includes market analysis, evaluating and identifying consumer needs and providing this information to suppliers (or using this information to build adequate product ranges), etc.

Furthermore, retailers **present goods** to the consumer in their stores, mostly on shelves but often also in other display forms (see Chap. 15). For example, electronic devices such as home cinemas can be tested by the consumer, along with TVs, speakers, certain lights and so on. Or clothing collections can be displayed on mannequins. These measures increase demand and would be difficult for manufacturers to carry out without stores. However, online shops can also present products to create demand, provide customer-specific advice and set specific prices which stimulate the customer to buy products.

Retailers often have knowledgeable salespeople who can give advice to help customers choose. Brick-and-mortar retailers and online shops both carry out promotional activities and conduct many other activities to stimulate demand.

In more academic terms, a part of this function is sometimes labelled “informational market decentralization” (Bucklin 1966; Waterschoot et al. 2010), since it includes transferring knowledge about products, trends and technologies from the specific product manufacturer to the customer.

1.2.6 Carrying out Transactions

Every purchase transaction involves ordering, pricing and paying for goods and services (Sundhoff 1965; Coughlan et al. 2006). Retailers carry out these functions and typically reduce costs here through standardisation and routines. Products are offered in a physical or online store for a particular price (including price labels which help avoid price negotiations for every single purchase). Products are paid for at a (physical or virtual) checkout, where the purchasing contract is closed and product possession transfers from the retailer to the consumer.

However, full routinisation is not always possible. Certain cases still involve intensive negotiations in the purchasing process, e. g., in car or furniture retailing. Products may need to be tailored to the specific customer; prices may need to be fixed individually, etc. This is also part of the retail function.

For higher priced non-food items (such as furniture, cars or home appliances), it is also common for consumers to have the option to pay later or in instalments. Providing this option stimulates demand. For a manufacturer, being far from the consumer can make it difficult to provide this option, as evaluating a customer's creditworthiness can be difficult and sometimes costly. Thus, this **financing function** is often carried out (or at least coordinated) by the retailer.

1.2.7 Product-related Services

Even though the definition of retailing states that products are resold to the final customer "generally without transformation", retailers in certain sectors have long been involved in the final step of the production process, mainly final assembly. For example, retailers of expensive bicycles often assemble customised bikes for specific customers (Waterschoot et al. 2010, p. 20), while furniture retailers assemble kitchens in customers' homes.

While the delivery of goods to households has been discussed as part of the "bridging space" function, the installation, setup, maintenance and repair of products are additional functions. Indeed, the provision of such **customer services** by retailers is rising drastically. This can be observed, for example, with computer retailers, who not only deliver the computer to the customer's home but also physically set it up, configure it, install software, connect it to peripheral devices and the Internet, transfer data from old computers and so on. Another example is home improvement retailers, where the trend has moved from **"do it yourself"** to **"do it for me"**, and retailers now often provide the customer with craftspeople who assemble the product bought at the retailer. In food retailing, ready-to-cook and ready-to-eat products are prepared by the retailer for takeaway.

This function, however, still involves products which are bought from a manufacturer and resold by the retailer to a consumer. The services related to these products are often a means to differentiate the retailer's offer from that of a competitor by **complementing the product** with value-added services. A further integration of the retailer within the production function will be discussed in the next section.

1.2.8 Efficiency Benefits of Intermediaries

One criticism of catalogues of retail functions is that they merely reflect the functions currently carried out by retailers without justifying their existence. While the functions show different activities that must usually be performed in the system between manufacturers and consumers, they do not necessarily need to be performed by a retailer. This leads to two considerations:

- Nowadays, retailers usually make many of these activities part of their domain. However, they often only manage the process, and the execution itself is carried out via **outsourcing**. For example, the transport function for distributing products to a store network increasingly falls under the domain of the retailer rather than the manufacturer, but retailers often use **third-party logistics service providers** to carry out the transport. Most online retailers ensure goods delivery to customers' homes, but they usually execute this via parcel services such as *DHL* or *UPS*.
- Manufacturers may carry out these functions themselves. This happens when manufacturers are verticalised (Chap. 6). However, if the manufacturer decides to eliminate the retailer as a middleman ("disintermediation"), these functions still need to be performed. Considering retail functions shows that eliminating the middleman does not eliminate the costs of intermediary functions.

From an economic perspective, retailers remain viable participants in the distribution channel as long as they can perform certain distributive functions more efficiently or effectively than other institutions in the channel. It is likely that different value-added functions (e. g., manufacturing, logistics and store operations) have **different optimal output levels** (Rosenbloom 2012; 2007), in which case vertical disintegration, where companies specialise in particular activities, can reduce overall production costs.

- Compared with internalised manufacturer activity, retailers can more easily achieve **economies of scale** for activities with high fixed costs (Rosenbloom 2007), e. g., providing a store, warehouses or a transport fleet.
- Furthermore, **economies of scope** are achieved because offering heterogeneous products from different manufacturers **smoothes the demand function**. A manufacturer of skiing equipment, for example, will often experience strong demand for a few months but no sales for the rest of the year. This leads to inefficient use of logistics capacity (such as warehouses) and in-store selling space (and salespeople, etc.). Idle costs will be incurred for the majority of the year. But if a sporting goods retailer takes over the functions, bundling products from summer sports manufacturers and winter sports manufacturers in their stores, they will reduce costs through steady use of the selling space and logistics infrastructure. Thus, a retailer can more easily compensate for demand fluctuations and generally employ capacity in a smoother, more cost-efficient way.
- Finally, bundling products from many different manufacturers into a product range can help reduce transaction costs for consumers (particularly search costs).

1.2.9 Flows in the Value Chain

Instead of catalogues of retail functions, other authors have focused on different channel flows that need to be performed between manufacturers and the consumer (see, e. g., Coughlan et al. 2006, pp. 10–13; Rosenbloom and Larsen Andras 2008). Usually, the literature mentions eight flows that have to be created and managed to link buyers and sellers:

1. Ownership
2. Physical possession of the product
3. Promotion
4. Negotiation
5. Financing
6. Risk
7. Ordering
8. Payment.

Ultimately, however, these flows can be associated with the retail functions listed above, so channel flows are simply another perspective on the same phenomenon.

1.3 Emerging Retailer Functions

The increasing power of retailers relative to manufacturers has led to more of the value chain being controlled by retailers. This partly applies to traditional retail functions in which retailers have taken over additional activities, e. g., in logistics. But it also applies to newly emergent functions traditionally not carried out by retailers. Retailers are increasingly using **backward integration** and partly or fully taking over the production function, a traditional domain of manufacturers.

In recent years, researchers have highlighted the changing value-added systems in the consumer goods sector (e. g., Zentes and Bastian 2010; Hertel et al. 2011; Olsson et al. 2013). These changes come as a result of the increasing relevance of store brands (see Chap. 12) and the rise of vertical retailers as new competitors (see Chap. 6). The reasons for backward integration are at least three-fold:

- First, it helps the retailer to differentiate itself from its competition if the company is involved in product development processes, since the company's offer then becomes unique.
- Second, coordinating the value chain helps the retailer ensure product quality and product supply, which may be crucial in the event of general supply shortages.
- Third, it helps the retailer acquire more of the profit margin in the value chain.

Coordinating the Value Chain

While retailers still hold a largely passive function for manufacturing brands, with product marketing mainly carried out by the manufacturer itself, this is different for **store brands** (see Chap. 12). Here, retailers are involved in R&D activities, mainly for product development, including design, packaging and so on. Quality standards are fixed and monitored by the retailer, including the necessary qualities of raw materials. In addition to selecting from different manufacturers' product ranges, the retailer actively coordinates the value chain.

Product specifications are developed by the retailer and the producer (often a specialised private label manufacturer), which is often merely a **contract manufacturer** that provides production capacity for the retailer. The retailer holds the rights to the product, product technology, recipes or construction plans and brand. Beyond coordinating production, the retailer also has to market these products entirely on its own, i. e., advertising and other marketing functions for these products are carried out by the retailer as well.

Examples of far-reaching value-added activities in the production process, in particular the development and design of store brands, include the sporting goods retailer *Decathlon* and the vertical fashion company *Zara*. For *IKEA*, insourcing the design function that was previously performed by manufacturers or independent design companies helped improve manufacturing and transport efficiency (Olsson et al. 2013, p. 1137).

Production Processes

Instead of merely coordinating production processes, some retailers go one step further and own the production companies as well. *IKEA* uses **contract manufacturing** but also owns factories around the world. This is sometimes also the case in food retailing; for example, the German market leader *EDEKA* owns more than 20 meat factories and more than ten regional bakeries. *Coop* in Switzerland owns a majority stake in Switzerland's largest meat and sausage manufacturer *Bell* as well as in many other production companies. *Migros*, a Swiss retailer that strongly focuses on store brands, owns *M-Industry,* which achieved sales of more than 6 billion CHF in 2014. *M-Industry* is a group of production companies with about 20 companies in Switzerland and further production sites in the USA, Canada, Germany and other countries. Its 12,000 employees produce a product range of about 20,000 different articles. From chocolate production to meat production, mineral waters, cheese, detergents and other product categories, *Migros* produces a large proportion of the products on its shelves. As well as being a supplier to the *Migros* stores, *M-Industry* is explicitly seen as a growth pillar for *Migros*, with the share of sales to external customers, particularly in other countries, expected to rise in the coming years.

Closed Loop Supply Chains

In recent decades, increasing importance has been attached to environmental protection and sustainable strategies (see Chap. 10). One consequence of this development is that supply chains are no longer just unidirectional, from the manufacturer to the consumer: **reverse processes** have become more relevant.

Closed loop supply chains try to close the product flows into a full circle with the aim of reducing waste. Instead of disposing of products at the end of their lifecycles, sustainable waste management reduces waste by collecting used products (and packaging material), separating (and in some cases disassembling) them, recovering the valuable parts (which can be the entire product, or components or material) and eventually reusing them through recycling or remanufacturing.

Retailers are taking over responsibility for this process. In many countries, retailers have to take back packaging material. They also have to take back used products or do so voluntarily as a customer service. From trading in used refrigerators or computers or returning used ink cartridges, returning cardboard boxes or bringing back empty glass or PET bottles, consumers can increasingly dispose of used products and packaging at their retailers. Together with manufacturers and third-party service providers, retailers are increasingly coordinating the accompanying reverse logistics processes.

1.4 Convergence between Manufacturers and Retailers

Today's retailers go far beyond their traditional distribution function and are establishing their own product development and production competence. This leads to an interesting phenomenon where the distinction between manufacturers and retailers is becoming blurred, and the characteristics of institutions at both ends of the value chain are converging.

Companies like *Migros*, *Decathlon* or *B&Q* are traditionally seen as retailers, even though their control over the production function is constantly increasing. On the other hand, companies such as *Apple*, *Boss* or *Montblanc* are traditionally categorised as manufacturers, even though they have made huge strides in integrating the retail function into their own systems and opening stores or at least controlling stores and other retail channels (see Chap. 6). The extreme cases are so-called verticals such as *Zara*, *H&M*, *IKEA*, *Dell* or *Nespresso,* where a vertically integrated exclusive system from manufacturing to retailing has emerged.

1.5 Conclusion and Outlook

Retailers add value to products and services by providing a number of retail functions. While these functions mostly do not create a tangible output and are thus not evident to everybody, they are still necessary in the value chain between manufacturers and consumers.

Retailers, as **specialists in distribution,** have a number of advantages in providing these functions more effectively and efficiently than other institutions, e. g., they can often achieve economies of scale and economies of scope in the distribution function. But with increasing size and sophistication, retailers have started to use their position as gatekeepers to the customer to acquire a growing share of the value chain and increasingly take over functions traditionally carried out by manufacturers.

Given the takeover of production functions by retailers and of retailing functions by manufacturers, both types of institutions are, in a way, converging. These developments clearly indicate that the classic conceptualisations of retail functions are not comprehensive enough to describe and analyse many modern retailers. It has therefore been proposed to revise and broaden them (Waterschoot et al. 2010).

Further Reading

- Coughlan, A., Anderson E., Stern, L. & El-Ansary, A. (2006). *Marketing Channels* (7th edn.). Upper Saddle River/NJ: Prentice Hall.
- Rosenbloom, B. (2012). *Marketing Channels: A Management View* (8th edn.). Mason/OH: Cengage Learning.

1.6 Case Study: Tesco

1.6.1 Profile, History and Status Quo

Tesco[1] is the fifth largest retailer in the world and the UK grocery market leader by a considerable margin (see Fig. 1.1). *Tesco* has seen impressive growth in recent decades, although the company has recently come under increasing competitive pressure, both at home and in some foreign markets.

The origins of *Tesco Plc* date back to 1919, when Sir Jack Cohen started to sell groceries from a market stall in London's East End. The name *Tesco* is derived from TES (from *TE Stockell*, a tea supplier Jack Cohen used) and CO (Cohen). By the 1960s, the company had established its self-service model and had developed a reputation as a value-for-money retailer, following its founder's "pile it high and sell it cheap" motto. During the 1970s, the company consistently lost market share to competitors, especially *Sainsbury's*. However, by 1995, *Tesco* surpassed *Sainsbury's* again to become the UK's market leader in food retailing, a position it has retained ever since.

In the mid-1990s, *Tesco*'s international expansion began. The company first entered Hungary in 1995, and in 1996, it entered other Eastern European countries, the Czech Republic and Slovakia. Shortly afterwards, *Tesco* entered Thailand (1998) and South Korea (1999). In the early 2000s, *Tesco* entered Taiwan (2000), Malaysia (2002), Japan (2004) and China (2004). The company then expanded into the USA (2007), Turkey (2003) and India (2014). However, not all its internationalisation efforts were successful. The business in Taiwan was never successful and was sold to *Carrefour* in 2005. In 2013, *Tesco* withdrew from its troublesome business in the USA, where it had operated about 200 *Fresh & Easy*

[1] Sources used for this case study include the websites http://www.tescoplc.com, various annual and interim reports, investor relations presentations and the explicitly cited sources.

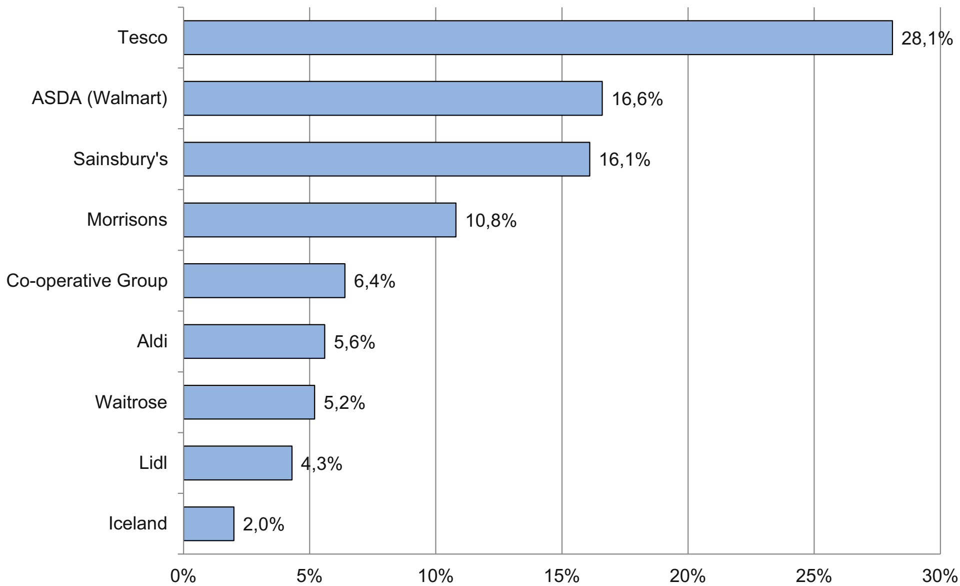

Fig. 1.1 Market shares in the UK grocery market (July–October 2015). (Kantar Worldpanel, cited from Statista 2015, p. 9)

supermarkets. *Tesco* also left Japan in 2013. And in China, where *Tesco* had ambitious plans, the company scaled back and sold a majority stake in its operations to a Chinese company.

In 2014, *Tesco* had global sales (incl. VAT) of 69.7 billion GBP, employing about 500,000 people in retail operations in 12 countries. But, as with most international retailers, the majority of Tesco's business comes from its home market. Therefore, this case study focuses on the UK. With sales (incl. VAT) of 48.2 billion GBP, almost 70 % of *Tesco's* sales come from the UK, where the company operates about 3500 stores in different formats, employing more than 300,000 people.

Even though it is the undisputed market leader in the UK with about 30 % market share, *Tesco* has been in a crisis for the past few years. Operating profit has fallen and like-for-like sales are down. The German discount chains *Aldi* and *Lidl*, who were not very successful in their first decade of operations in the UK, have recently gained acceptance among the British population, with resultant strong growth and aggressive expansion.

1.6.2 Tesco's Store Network

Tesco distributes products to customers throughout the UK via a number of different store formats (see Chap. 2 and 3) that cater to the needs of customers in different purchasing situations. All formats obviously help bridge the physical distance between supplier production sites and customers' homes, and they also help bridge the time between production and

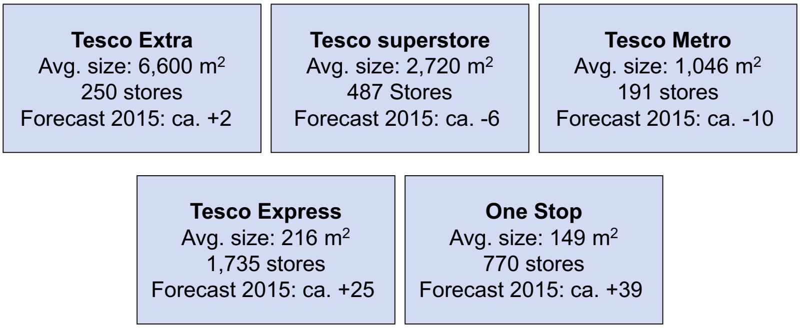

Fig. 1.2 *Tesco's* main UK store formats as of February 2015. (Tesco 2015, pp. 39–40)

purchasing. However, the different store formats do so in very different ways. Specifically, *Tesco* uses the following formats (see Fig. 1.2):

- ***Tesco* superstores** are large supermarkets with a focus on groceries but also certain non-food products. Their average size is about 2700 m^2. *Tesco* currently operates 487 of these stores but plans to reduce this number in the coming years. Usually, *Tesco* superstores are just labelled "*Tesco*". With 34 % of *Tesco's* overall floor space in the UK, superstores are a very important format. As with supermarkets in general, *Tesco* superstores are generally close to customers' homes and their merchandise mix is aimed at customers coming frequently to buy daily supplies.
- ***Tesco Extra*** stores are basically hypermarkets, mostly located out of town, with a broad range of groceries but also a high share of non-food products. Their average size is about 6600 m^2. *Tesco* has 250 of these stores and plans to keep their number relatively stable. With 42 % of overall floor space of *Tesco* in the UK, they are the most relevant store format (for this indicator). As is typical for hypermarkets, these stores are usually not frequented by customers for their daily shopping. Travel distances are farther (with "only" about 250 stores across the UK), but customers buy more at each shopping trip, stocking up their supplies for a week or two. *Tesco* plans major changes for the *Tesco Extra* format, because the stores are larger than new customer trends require. Therefore, selling space is being reduced and the released areas are being used as a type of shopping centre where, for example, *Tesco's* own clothing store brand F+F will have its own separate stores and other retail companies will be able to set up as tenants. Restaurants will be integrated and more space given to preparing fresh food, etc.
- ***Tesco Metro*** stores are inner-city supermarkets with a focus on groceries. They bridge the gap to the customer very successfully, with locations in cities and in particular on the UK's high streets. Their average size is 1046 m^2. With only 191 stores, *Tesco Metro* makes up only 5 % of *Tesco*'s overall floor space in the UK. In addition, *Tesco* plans to reduce this number in the coming years.

- ***Tesco Express*** stores are convenience stores with an average floor space of 216 m^2. This has been a growth format over the last decade, appealing to the growing demand for customer convenience. They focus on providing food products and prepared food. Margins are high due to this assortment, and market research has shown that prices in a *Tesco Express* are on average around 11 % higher than those for identical items in larger *Tesco* stores (Daily Mail 2013). *Tesco* already has 1735 of these stores and continues to open new locations. They already make up about 10 % of total floor space and there is clear expansion intent. This shows a trend towards fulfilling the "bridging space" function even better in the future, because customers have been observed to shop more frequently and invest less time in their shopping trips. Therefore, *Tesco Express's* inner-city locations along customer traffic flows, in train stations, petrol stations, business districts, etc., fulfil this customer need very well. They also provide a strong convenience store assortment of prepared food for lunches, etc.
- ***One Stop*** comprises small neighbourhood stores of only 149 m^2 on average. The chain is operated as a separate business with its own assortment. *Tesco* has 770 of these stores, which are often not known to be part of *Tesco* because they are not branded as such. A small number are operated by franchise partners and this number is expected to grow. Prices are higher than in typical *Tesco* stores. The *One Stop* format has seen great success due to its convenience, even in recent years, when *Tesco* in general has shrunk. Growth rates have been between 9 and 10 %, partially due to outlet growth. Therefore, *Tesco* intends to open more, with about 40 new *One Stop* stores due to open during 2015.

In recent years, *Tesco* has repeatedly mentioned that it sees its footprint of large stores (more than 70 % of *Tesco*'s floor space is *Tesco Metro* and *Tesco* superstores) as a burden, because the consumer trend is towards shopping online and shopping in smaller stores. In early 2015, the company announced the **closure of 43 stores** throughout the UK. While this was widely reported, it is, in fact, only about 1 % of its total store number. Still, the changes the company is making in its large stores, the move towards smaller stores and the increasing relevance of *Tesco*'s online retail site ***Tesco.com*** are a reaction to consumer trends. These changes are evidence of the problem of overstoring in the UK, with too much sales space to maintain sufficient productivity.

On a positive note, *Tesco* has been a global pioneer in online grocery shopping. It started its online shop 20 years ago (in 1994), and today it is the global market leader for online grocery shopping. This market is very important in the UK, which is the most important online market in the world. Compared to other countries, a very high share of UK retail is online. Even in grocery retailing, where most other countries do not see the relevance of online shopping, the UK online share in 2014 was about 7 %, according to the retail institute IGD. The market is estimated to be around 8 billion GPB today; *Tesco* has a market share of about 40 % in this market and it achieves impressive growth figures of more than 10 % annually.

From a retail function perspective, online shopping is a new paradigm for grocery retailers. In the past, retailers bridged the gap from suppliers to stores, before the consumer took over the last part of the supply chain. With online grocery stores, *Tesco* offers to take over the troublesome last mile. With frozen food, ambient food, etc., this is a cost-intensive challenge. *Tesco* does this either by picking products from its existing store base and then delivering them to customers' homes or by picking products in so called "dark stores", dedicated to online order picking.

In addition, new options for consumers have emerged. Beyond just "store-based retailing" or "online retailing", *Tesco* increasingly offers cross-channel solutions (see Chap. 5). With "**Click+Collect**", *Tesco* allows customers to order their merchandise online and pick it up at a collection point (usually located adjacent to a *Tesco* store). While home delivery imposes a delivery fee of usually over 5 GBP, Click+Collect is free. In the UK, *Tesco* has 1750 Click+Collect collection points for general merchandise and over 260 grocery drive-throughs.

1.6.3 Tesco's Supply Chain

With its store network, online deliveries and the Click+Collect service, *Tesco* offers products to consumers where and when they need them. But the previous section describes only the final stage in this supply chain. To move products from manufacturing plants or farms to the store requires a complex logistics network of distribution centres (DCs). Previously, suppliers often delivered directly to stores. But retailers are increasingly developing their own logistics networks and have taken over large parts of this supply chain (see Chap. 18). *Tesco* has been one of the pioneers here. Initially, centralised warehouses were established, but later a more differentiated network of warehouses and distribution centres was established for different product groups. This network is continuously being optimised.

Tesco operates one of the largest distribution networks in the UK, delivering about 10 million cases per day to its stores (IGD 2011). About a decade ago, it had approximately 35–40 DCs in the UK and Ireland, but this number was reduced to 28 in recent years. Until 2006, each DC conducted separate planning. But this has since changed, with *Tesco* first grouping DCs into regional hubs and later centralising distribution planning to increase efficiency and ensure optimal asset utilisation.

Tesco's DCs handle different types of merchandise according to their logistical requirements, e. g.:

- **Ambient groceries** (such as cans of soup or beverages) see daily deliveries to all stores. However, some ambient items, like tobacco products, are still delivered directly to stores by suppliers.
- **Temperature controlled** groceries (e. g., chilled food like dairy products or frozen food like pizzas) are also delivered daily to all stores across the UK.
- **General merchandise products** (e. g., health and beauty supplies, electrical goods, etc.) are delivered to stores less frequently.
- **Clothing** is delivered to stores via different transport chains. A single DC in Daventry stocks all *F+F* clothing store brand products and delivers to stores throughout the UK.

While there are very few warehouses which stock frozen food and general merchandise, the groceries network is more extensive. The intention is to keep the DC network sufficiently close to the stores to reduce transport kilometres. **Consolidating the transport** of frozen food products and general merchandise products into the grocery product delivery network makes transport more efficient and reduces the number of trucks coming to the stores. Products from local suppliers or global deliveries enter *Tesco's* logistics network at the DCs, and from there *Tesco* distributes these goods to its stores.

1.6.4 Tesco's Assortment

A retailer must offer its customers an assortment of products. *Tesco* offers its customers a broad range of all different food categories and – particularly in its larger stores – also a broad range of general merchandise products, including electronics and clothing. In total, across its different formats, *Tesco* offers **90,000 different products** (SKUs). A recent UK study identified how superstores offer broad product assortments compared to discount stores (The Guardian Online 2015):

- **Ketchup**: *Tesco* offers 28 options, from its store brand to *GranoVita* organic tomato ketchup. *Aldi* only has one option: its store brand.
- **Dishwasher tablets**: *Tesco* offers 26 options, from *Tesco Everyday Value* dishwasher tablets to *Finish Quantum Powerball* tablets in apple and lime. Aldi has three options: its store brand in different pack sizes.
- **Rice**: *Tesco* offers 98 options, from *Tilda* steamed wholegrain basmati to *Yutaka* sushi rice. *Aldi* has six options, all store brands.
- **Coffee**: *Tesco* offers 283 options, from *Nescafé* to *Taylors of Harrogate Lazy Sunday* coffee beans. *Aldi* has 20 options: 5 types of *Nescafé* and 15 SKUs from its store brand.

While providing an assortment is clearly an important task, the question is what the optimal assortment is and what the optimal selection is for customers. While a supermarket customer clearly wants choice, too much choice can be confusing and delay purchase decisions. Furthermore, a broad product range is linked to high costs. While a broad range is a differentiation factor for superstores, it must not be too broad. Another reason why *Tesco*'s range has grown substantially over recent years is so-called **slotting fees**. Retailers like *Tesco* demand payments from their suppliers to put products on their shelves. With the increasing profit pressure on *Tesco* over the last years, listing new products has been a way to generate short-term income to improve profit and loss statements.

Dave Lewis, *Tesco*'s new CEO, has targeted reducing the assortment as another way to improve *Tesco's* cost situation without sacrificing customer satisfaction. Cutting out unnecessary products from *Tesco*'s product range will help cut prices, make shopping easier for customers, improve product shelf availability and make ordering and refilling shelves much less costly (The Guardian Online 2015). Therefore, *Tesco* has recently announced it will **reduce its as-**

sortment by almost 30 % of its SKUs. Instead of its current 90,000 SKUs, it has hired the Boston Consulting Group to decide which products will be eliminated. The final number of SKUs is expected to range between 65,000 and 70,000 (The Guardian Online 2015).

1.6.5 Store Brands

Compared to other countries, store brands in the UK have one of the highest market shares. Market leader *Tesco* strongly contributes to these figures. It is estimated that about 45 % of *Tesco's* sales come from its diverse store brand portfolio. In developing this store brand portfolio, *Tesco* has long been a role model for retailers around the world. For example, the company was the first to seriously launch a premium store brand ("*Tesco Finest*"), after which the premium store brands of many other retailers in Europe are modelled. *Tesco's* most relevant store brands are (see also Chap. 12):

- ***Tesco***: The standard store brand, which occupies a similar quality and price level to many manufacturers' brands and which covers very different types of food products. *Tesco* offers a choice of over 10,000 products with the *Tesco* brand.
- ***Tesco Everyday Value***: This is *Tesco's* budget store brand, offerings sufficient quality at very low prices, particularly for basic products.
- ***Tesco Finest***: This is *Tesco*'s flagship and premium store brand, which claims to be "best quality food", using specialist ingredients or recipes inspired by restaurants or celebrity chefs. The brand was launched in 1998, and while most other retailers' premium store brands see limited sales, *Tesco Finest* achieves more than 1.5 billion GBP in sales per year.
- ***Tesco Organic***: This is a product range for organic food, from fresh fruits and vegetables to organic ingredients in other food products, etc.
- ***F+F***: This is *Tesco's* store brand for clothing products. It sees sales of more than 1 billion GBP per year. As well as being sold in *Tesco* food stores, *Tesco* has also started to devote separate selling spaces to the brand (still within *Tesco* stores) to provide a more shop-like atmosphere.

Other store brands include *Tesco Free From*, *Tesco Healthy Living* and *Tesco Goodness*. In terms of traditional retail functions, this broad array of store brands allows *Tesco* to perform functions traditionally carried out by manufacturers. While *Tesco* brand products are still produced by independent suppliers, *Tesco* itself designs the products, plans the recipes, defines quality standards, etc. *Tesco* has developed its own food manufacturing standards that set requirements for suppliers of its store brands.

Sourcing the assortment

Retailers provide customers access to an assortment of products that they would otherwise have to source themselves. Retailers perform this sourcing globally, as the example of *Tesco* shows (The Telegraph Online 2009). While many of *Tesco's* grocery products are sourced within the UK (except, obviously, fruits, spices and other products that do not grow there), most of its non-food products come from Asia. About 60 % of all clothing and 40 % of other non-food products sold in *Tesco*'s UK stores are procured via a *Tesco* sourcing office located in Hong Kong. *Tesco International Sourcing* uses more than 800 suppliers, mostly in China, with about 1000 factories. Together, every day about 200 containers full of clothing, TV sets, barbecues and other products are shipped from Hong Kong harbour to *Tesco*, mainly for sale in the UK (The Telegraph Online 2009).

Marketplace partners on Tesco.com
Tesco uses another measure on its online platform to expand the assortment it offers to its (online) customers. Similar to strategies by other large online retailers like *Amazon* or *Zalando*, *Tesco.com* allows third-party sellers to use its platform. This marketplace was introduced in 2012 and the number of partners has strongly increased since 2013.

1.6.6 Creating Demand

As well as placing an assortment in its stores, *Tesco* also contributes to creating demand for those products. For example, according to the market research company *Nielsen*, *Tesco* is the fifth largest spender on advertising in the UK consumer goods sector, behind only the consumer good giants *Procter & Gamble* and *Unilever*. Spending about 120 million GBP a year via different media (brochures, TV, radio, etc.), using the different methods described in Chap. 14, *Tesco* advertises its services and specific products to its customers. In addition, *Tesco* runs thousands of promotions each day, using many of the different promotion methods described in Chap. 13 to sell products from its diverse suppliers.

In 1995, *Tesco* launched a very strong loyalty scheme, the ***Tesco Clubcard***. This is one of the most effective loyalty schemes in the world, and it has been described in a number of case studies (see Zentes et al. 2011, pp. 309–317). With this loyalty card, *Tesco* tracks customers' individual purchasing behaviour, segments customers, uses strong direct marketing measures and offers customers precisely the right marketing measures (e. g., price discounts, special offers, etc.) to influence them to buy products from its range. In general, *Tesco* applies all the methods that loyalty programmes have been observed to use (see Chap. 16) and it has very early developed powerful data mining techniques and innovative methods to profile customers and link their profiles to the products they may be interested in.

1.6.7 Services

In addition to selling products, *Tesco* provides a number of services. For example, it obviously has sales staff to help customers in store. As part of *Tesco's* current restructuring measures, **customer satisfaction** with service and staff helpfulness is monitored. A number of initiatives have been established to improve service. *Tesco* has increased staff numbers (investing in additional working hours for sales employees) and better aligned working hours to customer traffic (i. e., moving sales employees' working hours to busy times) via an improved staffing system. *Tesco* has also improved work processes to increase efficiency and free employees from unnecessary work so they are available for customers. With these measures, customer satisfaction with service has greatly improved over the last two years.

Tesco also sells products – both in store and online – that need home delivery, like large domestic appliances. *Tesco* provides delivery and installation services. Furthermore, *Tesco* has introduced **product recycling**, which customers can purchase as an additional service. Here, the *Tesco* delivery team will remove the old appliance when they deliver the new one.

In addition to product-related services, in recent decades *Tesco* has diversified its business into additional services. This diversification was intended to exploit the existing customer base. *Tesco* diversified into banking services in 1997 and later into the telecommunications market with *Tesco Mobile*, a mobile phone provider. *Tesco Bank* provides a range of financial services, including credit cards, insurance, etc. It has synergy effects with *Tesco's* core business, as customers can be provided – e. g., via the *Tesco Clubcard* – targeted offers for financial services. Furthermore, *Clubcard* points are awarded for *Tesco Bank* business. Recently, *Tesco* decided to sell its stake in *Tesco Mobile* as part of its effort to pin off non-core businesses.

1.6.8 Summary and Outlook

As well as fulfilling all the standard retailer functions, *Tesco* goes well beyond. For example, *Tesco* will deliver food and non-food items to customers' homes, and it offers the Click+Collect cross-channel services. It has a very efficient supply chain linking its suppliers' production sites to its stores. And it has a broad base of stores throughout the UK. As well as buying products from brand manufacturers, a large portion of *Tesco's* assortment is store brands, for which *Tesco* designs the products, develops recipes, searches for manufacturing options and coordinates the full value chain.

However, *Tesco* also shows how quickly the customer requirements for these different functions can change, and how quickly a retail success story can turn into a **crisis**. Discounters have suddenly become dangerous competitors – even though *Aldi* and *Lidl* have been in the UK since the early 1990s and never previously posed a threat. *Tesco*'s store network, which until recently was seen as a huge asset, is now perceived to be a burden, because too many of its stores are very large *Tesco Extra* and *Tesco* superstores. Re-structuring these stores to reduce their size and fill the remaining space with useful features is a huge challenge.

Globally, it has become clear that customer requirements for fulfilling retail functions are strongly heterogeneous (see Chap. 8). Store formats and products that worked very well in the UK (and in a number of other European and Asian countries) were not well received in the USA or in Japan, to name only two examples. *Tesco* withdrew from these markets, a sign that the same functions have to be fulfilled in different ways for different customers around the world.

Questions

1. Using the catalogue of retail functions, describe *Tesco's* activities in terms of these functions.
2. Imagine if *Tesco* developed a strategy of building its own factories and further broadening its own brand range. What would this mean for its relationship with manufacturers such as *Nestlé, Unilever or Kellogg's*? Explain.
3. Assume a manufacturer such as *Tefal* (cookware, e. g., frying pans) decided to sell directly to the final customer. Considering the functions currently executed by retailers such as *Tesco,* what would *Tefal* have to do?

▶ Consider Chap. 6 on manufacturers' vertical strategies.

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Store-based Retailing – Food and Near-food

2

Abstract

Retailers have various ways of meeting customer needs through the organisation and design of their retail outlets. This chapter describes the different types of retail institutions that represent different types of retail strategies for selling goods and services in the food and near-food sector.

2.1 Types of Retail Institutions

From a managerial point of view, understanding the different types of **retail institutions** is important because they have a competitive impact on the retail business. Several types of retail institutions mirror retailer business operations. Thus, each type represents a specific retailing strategy.

Several systems of retail classification have been developed by government institutions to collect and analyse business data more effectively. One of the first classification systems was the **Standard Industrial Classification** (SIC) code, which was developed for the *US Census Bureau* in 1930 and uses special codes (sets of numbers) to identify types of retailers. This served as the basis for the further development of international classification systems such as the UN's **International Standard Industrial Classification of all Economic Activities** (ISIC), the NAICS (**North American Industrial Classification System**) or the NACE (**Nomenclature statistique des Activités économiques dans la Communauté Européenne**) in the European Union (see Fig. 2.1)

Under these classification schemes, retailers are assigned hierarchical codes based on the types of products and services they sell. However, retailers selling the same category

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G - Wholesale and retail trade; repair of motor vehicles and motorcycles G47 - Retail trade, except of motor vehicles and motorcycles	
G47.1 -	**Retail sale in non-specialised stores**
G47.1.1 -	Retail sale in non-specialised stores with food, beverages or tobacco predominating
G47.1.9 -	Other retail sale in non-specialised stores
G47.2 -	**Retail sale of food, beverages and tobacco in specialised stores**
G47.2.1 -	Retail sale of fruit and vegetables in specialised stores
G47.2.2 -	Retail sale of meat and meat products in specialised stores
G47.2.3 -	Retail sale of fish, crustaceans and molluscs in specialised stores
G47.2.4 -	Retail sale of bread, cakes, flour confectionery and sugar confectionery in specialised stores
G47.2.5 -	Retail sale of beverages in specialised stores
G47.2.6 -	Retail sale of tobacco products in specialised stores
G47.2.9 -	Other retail sale of food in specialised stores
G47.3 -	**Retail sale of automotive fuel in specialised stores**
G47.3.0 -	Retail sale of automotive fuel in specialised stores
G47.4 -	**Retail sale of information and communication equipment in specialised stores**
G47.4.1 -	Retail sale of computers, peripheral units and software in specialised stores
G47.4.2 -	Retail sale of telecommunications equipment in specialised stores
G47.4.3 -	Retail sale of audio and video equipment in specialised stores
G47.5 -	**Retail sale of other household equipment in specialised stores**
G47.5.1 -	Retail sale of textiles in specialised stores
G47.5.2 -	Retail sale of hardware, paints and glass in specialised stores
G47.5.3 -	Retail sale of carpets, rugs, wall and floor coverings in specialised stores
G47.5.4 -	Retail sale of electrical household appliances in specialised stores
G47.5.9 -	Retail sale of furniture, lighting equipment and other household articles in specialised stores
G47.6 -	**Retail sale of cultural and recreation goods in specialised stores**
G47.6.1 -	Retail sale of books in specialised stores
G47.6.2 -	Retail sale of newspapers and stationery in specialised stores
	G47.6.3 - Retail sale of music and video recordings in specialised stores
G47.6.4 -	Retail sale of sporting equipment in specialised stores
G47.6.5 -	Retail sale of games and toys in specialised stores
G47.7 -	**Retail sale of other goods in specialised stores**
G47.7.1 -	Retail sale of clothing in specialised stores
G47.7.2 -	Retail sale of footwear and leather goods in specialised stores
G47.7.3 -	Dispensing chemist in specialised stores
G47.7.4 -	Retail sale of medical and orthopaedic goods in specialised stores
G47.7.5 -	Retail sale of cosmetic and toilet articles in specialised stores
G47.7.6 -	Retail sale of flowers, plants, seeds, fertilisers, pet animals and pet food in specialised stores
G47.7.7 -	Retail sale of watches and jewellery in specialised stores
G47.7.8 -	Other retail sale of new goods in specialised stores
G47.7.9 -	Retail sale of second-hand goods in stores
G47.8 -	**Retail sale via stalls and markets**
G47.8.1 -	Retail sale via stalls and markets of food, beverages and tobacco products
G47.8.2 -	Retail sale via stalls and markets of textiles, clothing and footwear
G47.8.9 -	Retail sale via stalls and markets of other goods
G47.9 -	**Retail trade not in stores, stalls or markets**
G47.9.1 -	Retail sale via mail order houses or via Internet
G47.9.9 -	Other retail sale not in stores, stalls or markets

Fig. 2.1 NACE codes – examples. (Eurostat 2015)

of merchandise are not necessarily direct competitors. These classification schemes, therefore, are mainly used for data collection and statistical analysis to provide insight into the development of the various retail institutions at a national or international level. For retail managers, the more strategic aspects of the different types of retail institutions are crucial. Therefore, classifying retail institutions based on the characteristics of the strategies they employ to sell goods and services is important for **strategy development** and competitive analysis. These types of retail institutions are referred to as **retail formats**. Retail formats are specific configurations of retail marketing mix that are maintained consistently over time (e. g., type of store design and atmosphere, merchandise offered, services provided, pricing policy, type of location, approach to advertising and promotion, etc.).

2.2 Theories of Retail Evolution

2.2.1 Overview

There are a number of theories to explain the present structure of the retail industry and predict the future development of current and new retail formats. In this context, the **wheel of retailing** and the **retail lifecycle** are two particularly important theories.

2.2.2 The Wheel of Retailing

The **wheel of retailing** (McNair 1931) is a well-established framework for explaining developments in retail institutions. The theory suggests that retail institutions go through cycles during their development (see Fig. 2.2). The theory is that as low-end retailers upgrade their strategies to increase sales and profit margins, new forms of low-price (discount) retailers take their place in the market.

The **wheel of retailing** describes institutional changes that occur when new competitors enter the market. In its initial form, the wheel of retailing consists of a three stage cycle (McNair and May 1978; Brown 1988; Berman and Evans 2013, pp. 143–145):

- According to the wheel theory, retail innovators often appear as low-price operators. Thus, the cycle begins with retail institutions starting off with **low prices** and **low service levels**.
- The second phase is **trading up**. Retailers who wish to expand their business and attract more customers enhance the quantity and quality of merchandise they handle, provide more services and open outlets in more convenient locations. This leads to an increase in operating costs and prices and thus offers opportunities for new competitors to enter the market with low-price strategies.
- The third phase sees **increased competition** for services of all kinds and a convergence of retailers' marketing mixes as they mature. They become vulnerable to new competitors entering the market with low prices.

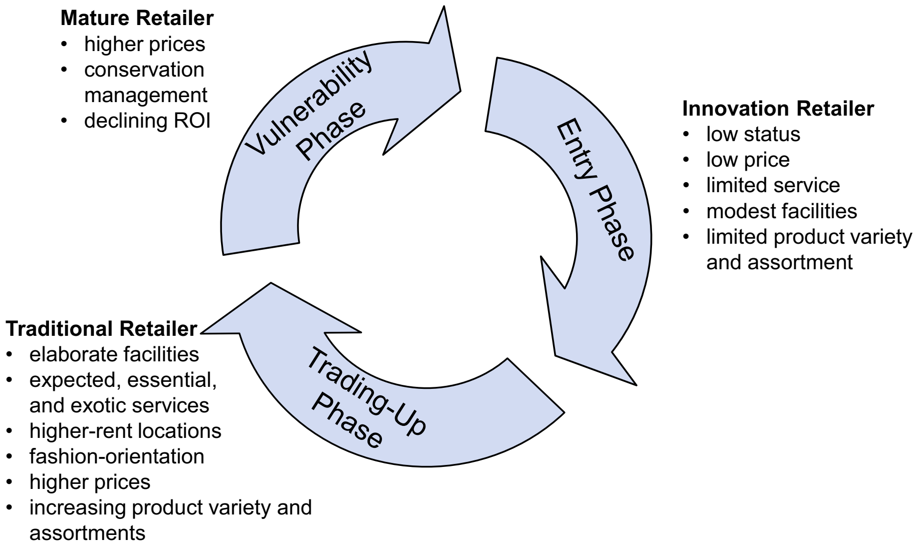


Fig. 2.2 The wheel of retailing

The wheel of retailing describes a circular retail format development process of alternating trading up and dissolution of retail formats due to a competitive environment, characterised by innovators entering the market as low-price competitors.

2.2.3 The Retail Lifecycle

The retail lifecycle is a succession of identifiable stages that a retail format goes through over time (Berman and Evans 2013, pp. 146–148):

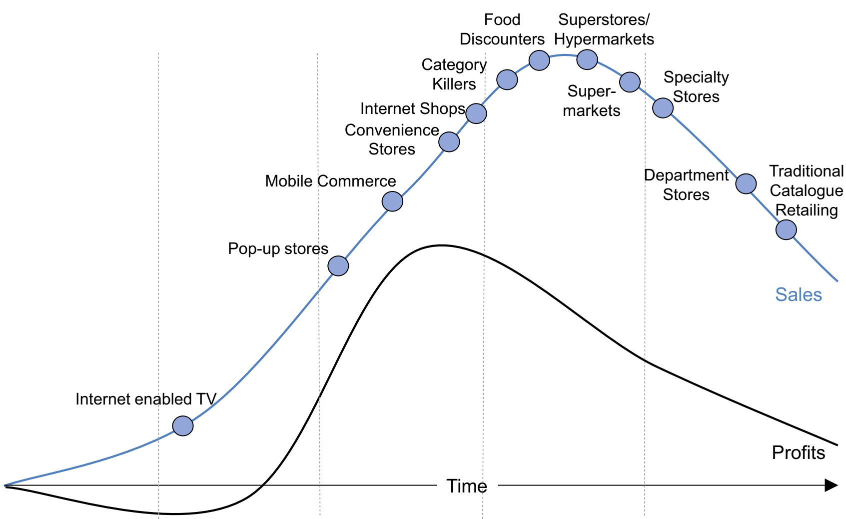
- In the **development stage**, the new format is introduced to the market. It is different from existing retail institutions' strategies, as at least one element of the marketing mix is altered in the new format.
- In the **introduction phase**, sales and profits are low, but growing. Costs and risks are high because long-term success is not assured at this stage.
- The **growth phase** is characterised by the rapid growth of both sales and profits. Existing companies expand their markets and new competitors employing the same retail format enter the market. Towards the end of this stage, growth acceleration begins to decline and cost pressures may emerge.
- The next stage is **maturity** of the retail format, brought on by market saturation, which in turn is caused by a high number of firms using this retail format and competition from new formats. Sales growth declines and profit margins may have to be

reduced to stimulate sales. Once maturity is reached, the main goal is to prevent the business from declining and to sustain profits for as long as possible.

- In the final stage, **decline**, sales volumes decline and prices and profitability shrink. Companies can try to avoid decline by **repositioning** their retail format, but many companies abandon the format altogether and introduce new formats to keep their customers or attract new ones.

Fig. 2.3 illustrates the characteristics of these five stages and indicates the stages which current retail formats have reached in Western or developed countries, including the United Kingdom, France, the United States or Germany.

In the context of the retail lifecycle, **store erosion** (Berger 1977) is defined as a reduction in a retail company's appeal and ability to attract customers over time because of changes in the company's internal and external conditions. In a **dynamic environment**, new retailing formats that meet new customer needs render existing retail formats obsolete. In order to avoid decline and survive, retail companies must adapt to changing marketplace conditions and **reposition** their retailing concepts.



	Development	Introduction	Growth	Maturity	Decline
Sales	low/growing		rapid acceleration	high, levelling off	dropping
Profitability	negative to break even		high yield	high/declining	low to break even
Positioning	concept innovation		special needs	broad market	niche
Competition	none		limited	extensive/ saturation	intensive/ consolidated

Fig. 2.3 The retail lifecycle. (Adapted from Berman and Evans 2013, p. 146; Zentes et al. 2005, p. 34)

2.3 Store Formats in Food and Near-food Retailing

2.3.1 Overview

Over the past few decades, food retailing has undergone substantial changes. **New competitors from general merchandise retailing** have entered the market by expanding their assortments and selling **food** and **near-food articles** (i. e., articles of daily use such as health and beauty aids, cosmetics and hygiene products). But, in most cases, traditional food retailers also carry merchandise outside their traditional lines of food and near-food items (i. e., general merchandise) and offer other kinds of services. These developments indicate that it is difficult to precisely allocate retail institutions to either food or general merchandise retail formats. This section will present the formats of superettes, conventional supermarkets, superstores, combination stores, hypermarkets and supercentres, convenience stores, food discounters, drugstores and warehouse clubs. Table 2.1 provides an overview of the characteristics of the most important retail formats.

Food retailing store density is relatively high in most countries.

Fig. 2.4 presents the density of retail stores of different sizes in European countries. While larger store formats are growing more relevant, stores below 1000 m^2 dominate in all country markets by store numbers. These play an important role in proximity retailing, among others.

2.3.2 Superettes

Superettes, **minimarkets** or **minimarts** are very small store formats (smaller than 400 m^2) that offer a limited assortment of food and related items of daily and short-term requirements. These formats have been under pressure for a while, even though these were once the traditional neighbourhood store format for food retailing. However, they remain important in some markets, such as the Asia-Pacific region.

Because of its long trend of dwindling market share, many retailers in Western markets have written off **superettes** and streamlined their store chains. However, thanks to the efforts of retail chains such as *EDEKA* or *REWE*, which have supermarkets but also operate superettes, this retail format is experiencing a resurgence. These retailers have changed the positioning of their small store formats by using trading-up strategies in their retail marketing mix. This strategy of positioning superettes as a form of neighbourhood-oriented proximity retailing – not to be mistaken with convenience stores – in **neighbourhood locations** or in cities, with modern in-store designs, revamped assortment strategies and usually lower prices, has made this store format relevant again.

Because one of the main problems with superettes in the past was store productivity, many retailers have also changed the **ownership structure**. In most cases, they now operate their superettes as franchise systems or voluntary chains to guarantee their profitability (see Chap. 7).

Table 2.1 Selected characteristics of store-based formats in food retailing. (Adapted from Berman and Evans 2013, p. 150; Levy et al. 2014, p. 42)

	Superettes	Conventional Supermarket	Superstore	Hypermarket	Convenience Store	Hard Discounter
Size (m^2)	100–399	400–1000	1000–5000	5000–30,000	200–400	500–1500
SKUs	20,000	20,000–30,000	30,000–40,000	40,000–150,000	1000–3000	700–1500
Merchandise	Small to medium breadth and depth of assortment; average quality; manufacturer and store brands	Extensive breadth and depth of assortment; average quality; manufacturer and store brands	Full assortment of supermarket items, plus health and beauty aids and general merchandise	Extensive breadth and depth of assortment; full selection of supermarket and drugstore items, and general merchandise	Medium breadth and low depth of assortment, average quality	Medium breadth and low depth, heavy use of store brands (up to 90 %)
Percentage Food	90 %	75–90 %	60–80 %	60–70 %	90 %	80–90 %
Prices	Average/competitive	Average/competitive	Competitive	Competitive	Average to above average/high	Very low
Atmosphere and Services	Average	Average/good	Average	Average	Average	Low
Location	City or neighbourhood	City or neighbourhood	Community shopping centre or isolated sites	Community shopping centre or isolated sites	Neighbourhood, city or highly frequented sites	Neighbourhood, traffic-oriented
Promotion	Little to moderate	Use of newspapers, flyers, coupons	Heavy use of newspapers, flyers, coupons	Heavy use of newspapers, flyers, coupons	Little to moderate	Heavy use of newspapers and flyers

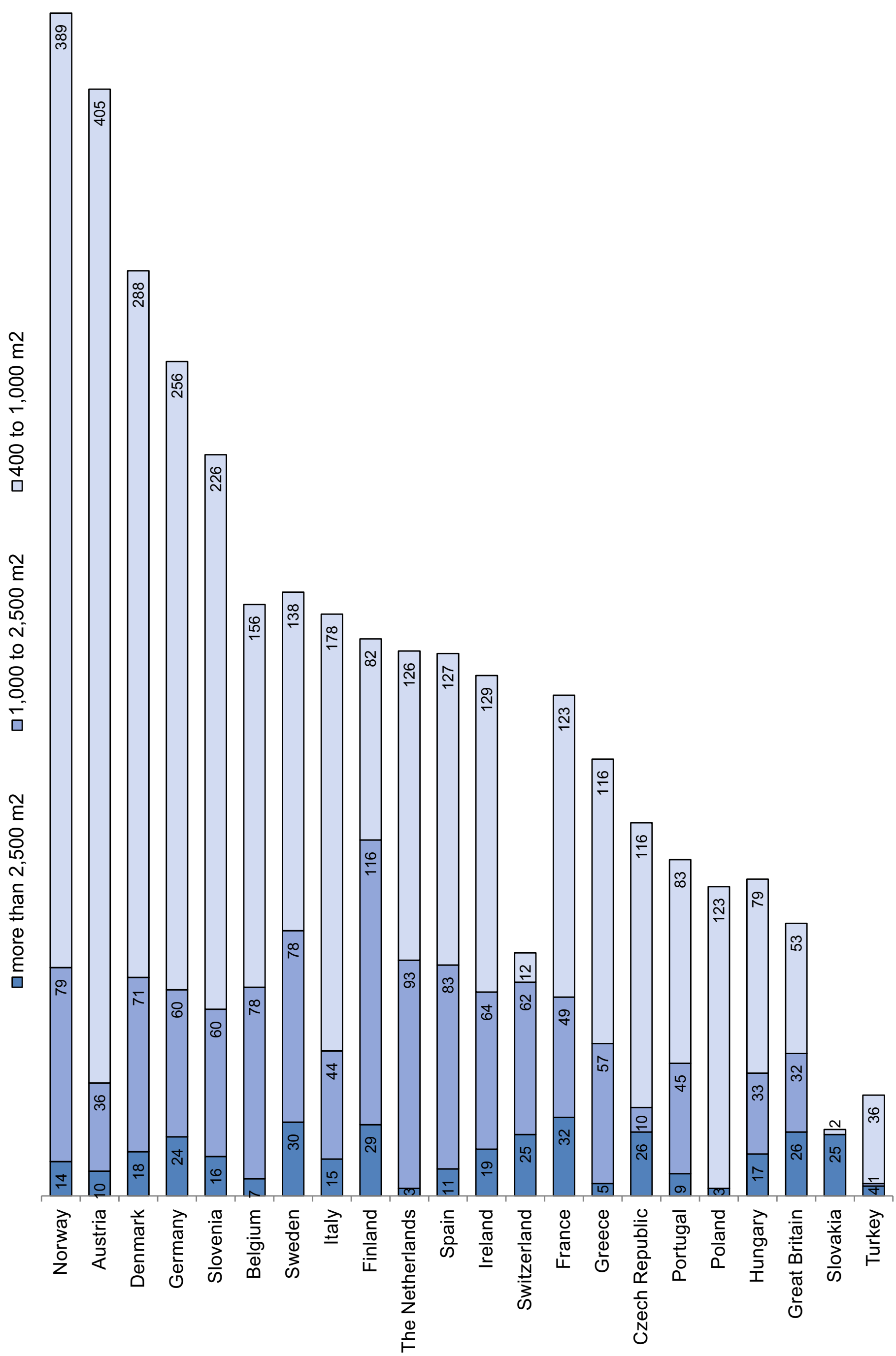


Fig. 2.4 Number of stores per 1 million inhabitants in Europe in 2013. (Nielsen 2014)

2.3.3 Conventional Supermarkets

Conventional supermarkets are self-service stores that carry a wide range of **food items** (mainly groceries, meat and produce), including fresh food (e. g., fruits and vegetables) and related items. The share of general merchandise offered in this retail format is limited to between 10 and 25 %, including, for example, health and beauty aids and products (Berman and Evans 2013, p. 152).

Supermarkets are usually located in city or neighbourhood locations with sizes between approximately 400 and 1000 m². Important players that use this format include *Sainsbury's*, *EDEKA*, *REWE*, *Ahold* or *Intermarché* in Europe and *Kroger* and *Albertson's* in the USA.

This has traditionally been the main retail format for grocery shopping and has accounted for the majority of sales in food retailing for several decades. However, it faces **intense competition** from new formats offering more convenient shopping facilities, more product lines and more varied assortments or lower prices as a result of lower operating costs (Levy et al. 2014, pp. 42–43).

Companies such as *REWE* or *EDEKA* have successfully **repositioned** their supermarkets and thus improved their competitive positions by emphasising freshness and high quality assortments, introducing medium- to high-level store brands and improving store atmosphere in order to provide a better **in-store shopping experience**.

2.3.4 Superstores

Food-based **superstores** are larger and more diversified than conventional supermarkets. Their size varies between 1000 and 5000 m², with expanded services such as a deli, bakery, seafood counter and general merchandise sections (Berman and Evans 2013, pp. 152–153). They are **"true" food stores** with a share of general merchandise ranging from approximately 20 to 40 %, but also offer consumers expanded **one-stop shopping** possibilities.

Combination stores, as they are sometimes known, are a similar store concept. They tend to be larger than superstores (up to 9500 m²) and offer a higher share of general merchandise (from 25 to 50 % of sales). These stores combine food and general merchandise, thus offering a higher level of one-stop shopping for consumers than superstores (Berman and Evans 2013, p. 153).

This combination of food and general merchandise in superstores and combination stores yields operating efficiencies and cost savings, mainly because non-food items tend to have higher margins. Superstores and combination stores usually follow either a **high-low pricing strategy** (HiLo), which means that they are very promotion-oriented (e. g., intensive advertising or distribution of flyers), or an **everyday low-price strategy** (EDLP) using few promotions and selling their merchandise at fixed low prices (see Chap. 13). Superstores and combination stores can be located in city or neighbourhood locations as well as in isolated sites or in shopping centres and oriented towards customers travelling by car. Important players that operate superstores or combination stores include *Intermarché*, *REWE, Tesco* or *Albertson's*.

2.3.5 Large Retail Formats

Over the past few decades, large retail formats have gained market share in grocery retailing. These large-scale retail formats are also referred to as "big-box retailers".

While this trend has developed similarly worldwide, specific formats have developed in different countries. **Hypermarkets**, which originated in France, are the largest of these. Their size ranges from 9000 to 30,000 m² (e. g., *Carrefour* and *Auchan*). The German **"SB-Warenhäuser"** (e. g., *Metro's Real* format or *EDEKA's Marktkauft* format) tend to be smaller, with sizes starting at 5000 m². While these European formats have a larger share of food items, ranging from 60 to 70 %, in the USA **supercentres** (e. g., *Walmart, Kmart, Target*) range from 14,000 to 21,000 m² and carry a broader assortment of general merchandise. Thus, the share of general merchandise is higher, ranging between 60 and 70 % (Levy et al. 2014, p. 45).

These large retail formats usually follow an aggressive, promotion-oriented **low-price strategy**. The stores are generally located in isolated sites or found near to or integrated into shopping centres. The architecture is usually cost-oriented, with a simple store design and **function-oriented** store atmosphere. As these large retail formats offer a broad assortment of food and general merchandise and thus provide **one-stop-shopping** opportunities, customers usually buy more. These store formats have a greater market area than smaller store formats (e. g., supermarkets), meaning customers are willing to drive further. These stores, therefore, provide substantial parking facilities. Because of their low operating costs and the combination of food with higher margin general merchandise, which allow for **aggressive pricing strategies** and increased shopping convenience (e. g., in terms of a broad and deep assortment), over the past few decades large retail formats have gained market share mainly at the expense of conventional supermarkets. However, some countries (e. g., France) seem to have reached a saturation point, and hypermarket operators are searching for ways to modify the format to maintain market share.

2.3.6 Convenience Stores

Convenience stores ("c-stores") are usually in easy-to-access locations, such as heavily frequented areas or urban neighbourhood locations. They open long hours (up to 24 hours, depending on local or national legislation). The stores are small and facilities are limited, with an average atmosphere and average service level. Convenience stores can be operated as standalone units (e. g., *Tesco Express*, *7-Eleven*, *Auchan, Coop Pronto*), but are often coupled with petrol stations (e. g., *Shell Shop*s, *BP* or *Aral Stores, Esso Shops*).

The focus of convenience stores is on **ease of shopping**. They offer fast shopping, allowing customers to pick their merchandise quickly and check out quickly (Levy et al. 2014, p. 46).

The **very limited assortment** of these stores is food-oriented. Convenience stores thus also offer "mental convenience", as the limited assortment enables customers to make their choices quickly (Berry et al. 2002). A high proportion of sales are impulse purchases, mainly in areas such as snack foods, soft drinks, beer and wine, tobacco products or newspapers and magazines. The average transaction in convenience stores is small, and the products are often consumed shortly after purchase. Prices in convenience stores are usually above average.

2.3.7 Hard Discounters

Hard discounters in food retailing usually follow a very aggressive **everyday low-price strategy**, with prices up to 20 to 30 % below those of conventional supermarkets. They offer a small selection of items and, therefore, are also referred to as **"limited-line stores"** or **"limited-assortment stores"** (e. g., Berman and Evans 2013, p. 153). A typical *Aldi* store, the best-known example of this format, carries about 1080 stock-keeping units (SKUs). The basic assortment consists of food items with a high rate of turnover in few size options and brands are offered per product category. Other prominent examples of internationally successful hard discounters are the German *Lidl* and *Carrefour's Dia*.

The stores are characterised by their "no-frills" approach, meaning that, for example, there are almost no services available (no helpdesk, no sales staff in attendance, etc.) and store design and atmosphere are very simple and cost-oriented. Often, products are sold out of boxes (**"box stores"**) or cut cases and are presented on pallets. Food-based hard discounters often carry a limited range of manufacturer brands and rely heavily on **low-price store brands** (see Chap. 12). Thus, prices vary between different retailers.

Discounters often complement their assortments with a weekly or semi-weekly changing selection of **general merchandise**, sold at very low prices and heavily promoted via newspaper advertising or flyers distributed to households. These items come from a variety of product categories (ranging from personal computers and furniture to home accessories) and often have no association with the regular merchandise carried by the retailer. Such items are offered in order to increase store traffic, and non-food items (in some cases produced exclusively for this purpose) usually have a higher margin than food items.

Hard discounters are usually located in easily accessible **traffic-oriented and cost-oriented locations** with a focus on low occupancy costs, e. g., neighbourhood locations or periphery sites with adequate parking facilities. Because of their aggressive pricing strategies, the different types of convenience they offer (e. g., "mental convenience" because of the limited assortment and quick shopping because of the small store size) and location strategies, hard discounters have grown consistently over recent decades. They often play an important role in **proximity retailing**.

2.3.8 Drugstores

Drugstores are specific types of specialty stores that focus on beauty, health and personal grooming merchandise (Levy et al. 2014, p. 54). In addition, these stores often sell categories such as food items, magazines or newspapers, stationery, toys or gifts. Depending on governmental healthcare policies, in some cases **pharmacies** are associated with drugstores and sell prescription pharmaceuticals in addition to over-the-counter (OTC) medicine. The product categories sold in this store format are similar to food items in some respects, mainly in terms of shopping frequency and purchasing patterns **(near-food items)**. In some statistics, drugstores are therefore classified as food store formats.

Compared to traditional specialty stores, drugstores tend to be more aggressive on price and apply pricing strategies such as everyday low-price (EDLP) strategies or promotion pricing. Important players include *Boots*, *Walgreens*, *Rite Aid*, *A.S. Watson* or *dm-Drogeriemarkt*.

Drugstores are often located in city or shopping centres, but are now increasingly found in local neighbourhoods or isolated sites. Thus, they play an important role in **proximity retailing** and usually offer a high degree of **shopping convenience** via their location strategies, small store sizes and speedy checkout facilities.

2.3.9 Warehouse Clubs

Warehouse clubs are a food retail format developed in the USA and later introduced into countries such as Spain and France. However, the format is not prevalent worldwide. Warehouse clubs sell their products to both end-users and small- to medium-sized companies. Business members typically represent less than 30 % of the customer base, but account for approximately 70 % of sales. **Membership** is required and customers are charged an annual fee. The largest warehouse clubs in the USA are *Costco* and *Sam's Club* (*Walmart*).

This type of store is characterised by **low prices** for a limited assortment comprising half food and half general merchandise. The stores are very large (9000 m^2 or larger) and are located in secondary sites (i. e., in low-rent districts). Store architecture and design are very simple and cost-oriented, characterised by a simple interior, concrete floors and wide aisles (Ogden and Ogden 2005, p. 104).

Items are usually presented on pallets. This type of store offers fast-moving, high-turnover merchandise, thus minimising holding costs. Warehouse clubs concentrate on special purchases from popular brands. Often, products are sold that are sourced from manufacturers in special circumstances (e. g., overruns, returns, etc.) (Berman and Evans 2013, p. 160).

The warehouse club format resembles **cash and carry wholesalers** (e. g., *Metro Cash & Carry*), which also require membership. Even though membership is restricted to companies and these outlets focus on **business-to-business trade**, end users also frequently purchase at these stores.

2.3.10 Non-store Formats in Food Retailing

While most food retailing occurs via store formats, there are several **non-store formats** through which consumers can purchase groceries and related products. For example, **remote ordering** channels, such as traditional catalogues or Internet shops, can be used to distribute merchandise. While these formats are generally gaining in importance, the share of groceries offered through mail order channels remains limited (see Chap. 4).

For fresh merchandise (e. g., farm produce, bakery products, meat or fish), **market stands** or **truck and van sales** are traditional modes of distribution mostly used by small producers to reach their customers as a specific form of direct selling or implemented by retailers as specific methods of **proximity retailing** in rural areas. Because of the close and personal contact with their customers, these vendors often have high retention rates among their customer base. However, the costs associated with direct selling are very high and, therefore, so are the prices. **Vending machine retailing** is another alternative. Merchandise such as snacks and soft drinks are stored in a machine and dispensed to customers who pay via cash or card. Vending machines are usually placed at convenient locations with high traffic (Levy et al. 2014, p. 72). Vending machines have undergone several innovative developments recently. For example, new types of **kiosk vending machines** provide customers with product displays and information on the merchandise and electronic systems track inventory and cash, thus reducing stock shortages or malfunctions.

2.4 Conclusion and Outlook

The food retailing landscape has changed dramatically over the past few decades. While the relevance of these diverse store formats in food retailing differs around the world (see Fig. 2.5), **competition** has increased due to various factors, including mergers and acquisitions and the internationalisation of retail companies. In addition, the main retail formats in this sector have also changed as a result of these developments, **technological progress** and responses to changes in customer behaviour.

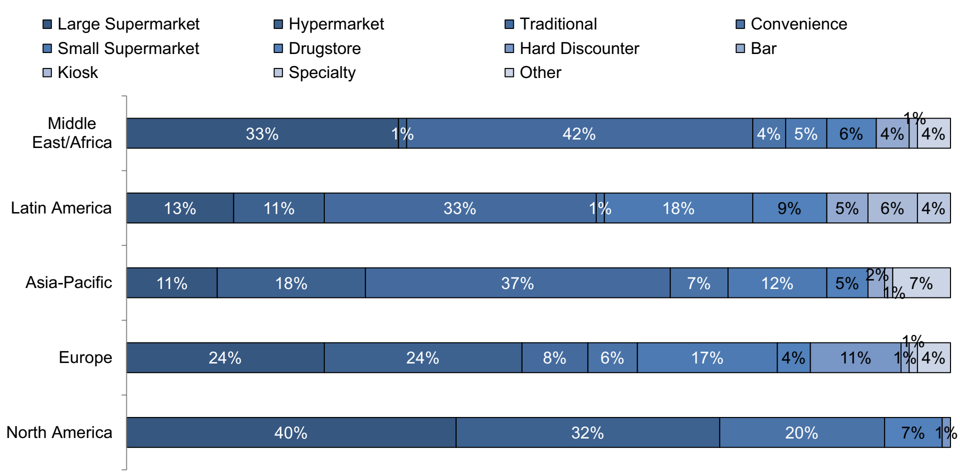


Fig. 2.5 Regional share of trade by retail format. (Nielsen 2014)

Even though new non-store retail channels have been developed due to new developments in information and communication technology, **brick-and-mortar store formats** remain the most important channels for selling groceries. Still, new store formats which gain market share spur important developments. The most important in this context is the increase in discount-oriented retail formats such as large retail formats (e. g., hypermarkets) and small, food-based hard discounters. *Convenience stores* are also becoming more important.

In order to remain competitive in the mature business of food retailing, more and more retailers are carrying merchandise which falls outside their traditional assortment. This phenomenon is referred to as **"category migration"** (Zentes et al. 2005, pp. 52–55) or the "blurring" of retail formats (Fox and Sethuraman 2010, p. 246; see Chap. 12). For example, food discounters offer general merchandise as special offers in weekly or semi-weekly promotions to generate store traffic and improve profit margins. Another important trend is that food retailers are extending their regular assortment to increase sales and margins. For instance, hard discounters have extended their basic assortments in recent years by adding fresh meat and frozen food.

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2.5 Case Study: Lidl and Kaufland

2.5.1 Profile, History and Status Quo

Both *Lidl*[1] and *Kaufland* are part of the *Schwarz Group*, the biggest European retail chain. With over 79.3 billion EUR in revenue in 2014, the group surpassed competitors such as *Carrefour* and the *Metro Group* (Handelsblatt 2015b). Both *Lidl* and *Kaufland* are based in Germany with headquarters in Neckarsulm. However, as a result of their international

[1] Sources used for this case study include the companies' websites www.lidl.com and www.kaufland.com, various annual and interim reports, presentations and the explicitly cited sources.

activities, only 34 billion EUR of their 2014 revenue came from Germany (Lebensmittel Zeitung 2015).

The roots of the Schwarz Group date back to 1930, when Josef Schwarz began to invest in the small company *Südfrüchte Großhandlung Lidl & Co*. Immediately after his initial investment, the former fruit vendor was transformed into the wholesale market *Lidl & Schwarz KG*, offering a wider range of foods and goods. After the end of World War II, Schwarz and his partner started to rebuild at once and were able to reopen a few years later.

When Dieter Schwarz, son of Josef Schwarz, began to take over the family business in 1973, he decided to open the first discount store, with a new name that no longer reflected his own. Thus he took the name of his fathers' former business partner. *Lidl* was introduced in Ludwigshafen, Germany, and was an immediate success; just four years later, the chain had 30 different stores. At first, Schwarz was uncertain about the chain's future, so not all of these were discounters. It wasn't until the late 1970s that he decided to concentrate on discount stores with his *Lidl* brand.

After *Lidl* developed into a pure discount store, Schwarz introduced *Kaufland* as an alternative to this philosophy. In 1984, he opened the first self-service superstore under this new brand, the beginnings of another success story. After the first store opened in Neckarsulm, *Kaufland* grew rapidly. After the fall of the Berlin Wall and German reunification, Schwarz was eager to implement his West German brand in this new market. In the late 1990s, the first East German *Kaufland* store opened its doors to new customers, followed by many others. Today, *Kaufland* operates over 635 stores in Germany and employs over 80,000 people. With over 60,000 products on its shelves, *Kaufland* is one of the leading full-range retailers in Europe.

Early on, Schwarz decided to develop both chains separately from each other in order to avoid cannibalism between the two formats and to gain market share by targeting a larger group of potential customers. Therefore, *Lidl* and *Kaufland* differ in a number of key ways (see Table 2.2) and can be defined by the elements relevant to their specific target group. Even though some of the initial standards have been altered, both formats still occupy distinct positions. While *Lidl* is positioned as a typical food hard discounter, *Kaufland* displays some elements of a hypermarket, albeit with a clear emphasis on cheaper prices, smaller

Table 2.2 Characteristics of *Kaufland* and *Lidl*. (Adapted from DIWG/STIWA 2012, FAZ 2015)

	Kaufland	Lidl
Size (m^2)	3000–5000	800
SKUs	60,000	1600
Prices	Low/average	Low
Merchandise and Services	Fresh meat, fresh cheese, bakery, few non-food items	Bakery, few non-food items, store and manufacturer brands
Location	City or neighbourhood, traffic-oriented, large parking availability	City or neighbourhood, traffic-oriented

store sizes and a smaller share of general merchandise than the typical hypermarket. Thus, *Kaufland* is an example of a large-scale discounter (see Table 2.2).

2.5.2 International Activities and Distribution Network

Ever since their successful launch in Germany, both divisions of the company have also been very active internationally. In 1998, *Kaufland* began its international expansion by opening a store in the Czech Republic. Recently, the highly saturated German market has made *Kaufland's* successful growth heavily reliant on European expansion (German Retail Blog 2014). Today, *Kaufland* operates in six foreign markets and plans to enter Serbia as a seventh in the near future. The company has supported its international expansion by installing 17 distribution centres all over Europe to ensure on-time delivery to all of their 1200 branches. Unlike competitors like *Auchan* or *Carrefour*, *Kaufland* rarely enters another market by acquiring an existing chain. Although they have indicated interest in acquisitions at several points, the *Schwarz Group* has so far relied on its strong growth potential (German Retail Blog 2014). In recent years, *Kaufland* has been the most active full-range retailer in terms of expansion, which is partly the basis for their latest financial success compared to their major competitors.

Lidl first entered foreign markets in 1989 with a store in France. Since then, *Lidl* has been extremely active in international expansion, and is now active in 26 European countries with 9875 stores (Planet Retail 2014). These expansions have mostly met with great success. *Lidl* is particularly successful in France, where it currently holds the largest market share of any discounter, operating more than 1500 stores in total. In some cases, *Lidl* has made an exception from their strategy of always implementing their own structures when expanding, by acquiring competitors in countries such as Bulgaria and Romania, where they acquired stores from their competitor *Tengelmann*. *Lidl* relies on numerous distribution centres that each deliver to around 60 stores in their area (Tengelmann 2010).

2.5.3 Economy forces Change

Although initially designed to cater to very different demands and therefore different kinds of customers, *Lidl* and *Kaufland* are growing closer. As a full range retailer, *Kaufland* has always sold product categories that *Lidl*, as a pure discounter, did not offer. But due to recent trends and developments, *Lidl* and other discounters have had to change their appearance to ensure their survival.

After a noticeable decline in the early 2000s, discounters such as *Lidl* are now regaining market share. One of the main reasons for this new prosperity is the expansion of their range of goods. By adding a higher share of higher quality fresh products and selling them at a higher profit margin, they have been able to improve performance. In their current strategies, *Kaufland* and *Lidl* both sell freshly baked pastries, meat and other high quality organic products in their stores. Nowadays, only 40 % of revenue comes from lower priced categories and products (FAZ 2014). Adding to those developments, service has also become more important to discounters. An improved focus on service is another reason behind *Kaufland's* and *Lidl's* recent success (Handelsblatt 2014).

Lidl and *Kaufland* have made significant changes to their assortments of wine, meat, bread, vegetables and fruit. Nowadays, *Lidl* carries over 20 different coffee products and offers meat from animals butchered just 48 hours before hitting the stores to ensure freshness.

By adding well-known premium brands to their offerings while other, bigger chains concentrated on cheaper products offered as private labels, *Kaufland* and *Lidl* were both able to garner a lot of attention and market share in the early 2000s. In recent years, however, their competitors have closed this gap and also introduced higher quality products onto their shelves. A famous example of this fierce competition is *Lidl's* partnership with *Coca-Cola*. *Lidl* was the first discounter to offer this brand to their customers. However, after *ALDI* and other competitors also introduced the brand into their assortments, a price war began, and intense competition forced these companies to sell *Coca-Cola* products at extremely low prices (Die Welt 2014).

Following this trend, *Kaufland*, *Lidl* and competitors introduced their own premium brands to better cater to their customers' demands and secure higher profit margins (Genios 2015). These recent developments brought *Lidl* and *Kaufland* even closer. With *Lidl* expanding their products and therefore sales, they are not as clearly separated as when Schwarz first established his retail brands in the 1970s. Since both are still performing well financially, the oft-feared cannibalism of market share has not been a major issue so far. Nevertheless, both companies are keen to use synergies to get ahead of other competitors. Initial attempts such as the *Bonback* bakery that delivers to both *Lidl* and *Kauf-land* have proved very successful, and the CEOs of both brands are eager to widen this cooperation (Planet Retail 2015). With rising interest in their new products, *Lidl* will be forced to create more production facilities to meet higher demand. They currently only have three food production facilities under their own control and are therefore strongly reliant on outside suppliers (Planet Retail 2015).

As *K2020*, *Kaufland* is rebuilding its brand and revaluating its products and store quality. In the coming years, many stores will either be upgraded to meet modern standards or be closed. Only those that provide added customer value will survive the *K2020* initiative. As well as offering newer, fresher and locally produced products, this will also mean implementing a modern style for *Kaufland's* interior design: factors that used to be unimportant. Non-food products such as bicycles, folders or other supplies will no longer be part of their product line, reducing store size and increasing efficiency. Frank Lehmann, CEO of *Kaufland*, predicts that at least 24 of their German stores will close because they will not meet these new standards (FAZ 2015).

In 1997, *Lidl* established a website (www.lidl.com) where they started to offer products not sold in their stores. In addition to the weekly special offers in their stores, *Lidl* customers can find another set of promotional offers online that often complement the in-store offers. In addition to these online purchase options, both *Kaufland* and *Lidl* customers can find

Fig. 2.6 Lidl's "Good Quality" campaign. (Lidl 2015, https://www.lidl-lohnt-sich.de)

additional information on products, special offers and stores on the companies' websites. Customers can further engage through special recipes and competitions. Each country or market has a unique website that follows an overall design template but varies in content and products displayed. These websites are also an example of further cooperation between the two retail brands, as both are operated by the same service department at the Neckarsulm headquarters (Planet Retail 2015).

2.5.4 Rebuilding a Brand – "Lidl lohnt sich"

As mentioned above, *Lidl* and *Kaufland* have both undergone a series of changes to their appearance and product assortment. *Lidl* was especially keen on softening their earlier discount-driven image. Faced with declining sales and a growing trend for convenience and naturally grown products, they were forced to act. Therefore, they started a new communication initiative in the late 2000s that focused on high quality products. Through new slogans and an alternative look and feel to their stores, they began to move away from their earlier price-driven image.

Previous *Lidl* advertisements focused on their cheap prices and had almost nothing in common with the new marketing approach, as shown in Fig. 2.6. In general, this new imagery is keen to convey the newfound quality of *Lidl* products. In addition, the products chosen for these advertisements are not part of the discount markets' usual product lines. With the addition of freshly baked pastry and finer wines in particular, *Lidl* is trying to reach new customers who are less price-sensitive than their former clientele. Given the huge number of stores, it took until early 2014 to implement a bakery section in all of their European subsidiaries. Because of the targeted new look and feel of the *Lidl* retail brand, the general appearance of their stores will also change in the coming years. These changes will be visible both inside and outside the stores.

The store depicted in Fig. 2.7 is a new concept that represents the best-case scenario for a *Lidl* store. Their new design has been specifically built to be as energy-efficient as possible, complementing the more natural and high quality focus of their general communications. *Lidl* is currently working on implementing energy norm ISO 50001 in all of their stores, reducing CO_2 production and costs through lower energy consumption. By the end of 2015, all of *Lidl's* German stores are supposed to be ISO 50001 certified. However, the model store is obviously not suitable for every circumstance, particularly within cities and highly populated areas.

Fig. 2.7 Lidl store. (Lidl 2015, http://www.presseportal.de/pm/58227/2976929)

Furthermore, *Lidl* has made and will continue to make significant changes to their stores' inside appearance. Their employees will be responsible for transforming the stores to better match those shown in the advertisements. The changes will have a major effect on the price tags, signs and shelves used within the stores. In addition to these physical changes, employees have received special training to better understand and communicate *Lidl's* new image and philosophy.

2.5.5 Conclusion and Outlook

To ensure further growth in the near future, *Kaufland* has declared an interest in taking over a few stores from the former competitor *Tengelmann* in Germany (Handelsblatt 2015a). With over 400 potential stores located in the south of Germany, this acquisition would greatly boost *Kaufland*'s market share in that region. The German cartel office has yet to approve this acquisition, as it could lead to a monopolistic situation in the region. In addition, *Kaufland* has recently announced plans to further invest in reshaping their existing branches. Seeing as their initial store design and set-up can no longer cater to current customer demands and standards, they are forced to respond to these pressures. During their rapid growth in the early 1990s, *Kaufland's* focus was mainly on expanding as fast as possible to secure the perfect spots for their stores. Now, *Kaufland* CEO Frank Lehmann plans to invest in these stores' atmospheres as well (German Retail Blog 2014).

Given the highly saturated European markets, opportunities to secure further growth are limited. *Lidl* is therefore planning to set up stores in the US and enter a new market. As with all of their international activities, *Lidl* plans to adjust their format to better suit American customers, while trying to remain loyal to *Lidl's* established standards, visions and philosophies. The quality-oriented communication approach will be part of this next stage, and further steps will be taken to gain additional shares in all markets in which *Lidl* is currently active. Initial plans to enter the US market with 100 stores during 2015 had to be cancelled, since the US situation differs significantly from that of *Lidl's* home market. Establishing the necessary supply chain is the main challenge to overcome before starting operations in the US (Planet Retail 2015). Competition from *ALDI*, their arch rival, which started its US operation in the late 1970s, has given *Lidl* another challenge to overcome. With planned annual investment of over 600 million USD in the US market, *ALDI* will almost certainly be able to obtain further market shares in this highly competitive market (Planet Retail 2015).

Schwarz Group CEO Klaus Gehring also showed interest in increasing synergies between the two growing retail brands, despite formerly operating them as completely separate departments. As discussed above, they have already started using similar production facilities and delivering goods to one another. Gehring wants to build upon this experience and try to merge areas such as administration or equipment procurement. These ideas are vastly different from *Schwarz Group's* early days, when speed was often more important than efficiency. In the near future, both companies will use currently overlooked synergies to ensure a steady growth in revenues (German Retail Blog 2014).

Questions

1. *Lidl* is planning to enter the US market in the next few years. What are likely to be the biggest obstacles to overcome when entering this unknown market?
2. *Lidl* and *Kaufland* are growing closer. What advantages and disadvantages will this have?

- See the companies' websites.
- See Planet Retail (2014).

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Store-based Retailing – General Merchandise

3

Abstract

This chapter discusses the main characteristics and empirical relevance of a variety of store formats applied in non-food retailing. The diverse forms of retail stores represent different strategies for selling goods and services and are a result of the diversity of product groups covered by the term "general merchandise".

3.1 Major Types of Non-food Retail Formats

In general merchandise retailing, a variety of retail formats is used to sell non-food merchandise to consumers. This **diversity** results from the **plurality** of product groups characterised as non-food items. Even though consumer shopping behaviour varies for different product groups within the food sector, there are major differences between general merchandise and food items, based on product characteristics such as perishability, specific demand patterns, product value (e. g., in relation to product size or volume) or turnover rate. For example, while food is usually purchased daily or several times per week, general merchandise is usually purchased infrequently, and specific frequencies vary significantly: some categories such as cosmetics or household articles might be bought every few weeks, while items such as TV sets, bicycles or computers are usually only purchased every few years.

This chapter will discuss the major types of store-based retail formats for general merchandise, namely specialty stores, category specialists, department stores, full-line discount stores and variety stores, off-price retail formats and pop-up stores. These formats differ in terms of store size, typical location strategy (see Chap. 11) and store positioning when it comes to price, assortment and service strategies. Table 3.1 summarises the main characteristics of the most important general merchandise store formats.

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Table 3.1 Selected **characteristics** of store-based formats in non-food retailing. (Adapted from Berman and Evans 2013, p. 150; Levy et al. 2014, p. 48)

	Specialty Stores	Category Specialists	Department Stores	Discount Stores	Variety Store	Extreme Value Retailers	Off-Price Stores
Size (m^2)	300–1100	4500–9000	9000–60,000	5500–7500	3000–6500	650–1500	1800–3000
SKUs	5000	20,000–40,000	100,000	30,000	5000–10,000	3000–4000	50,000
Merchandise	(very) low breadth but very high depth of assortment; average to (very) good quality	Low breadth but high depth of assortment; average to good quality	Good breadth and depth of assortment; average to good quality	Good breadth but average to low depth of assortment; average to below average quality	Good to average breadth and some depth of assortment; below-average to average quality	Average breadth and depth of assortment; average quality; varying assortment	Moderate breadth but poor depth of assortment; average to good quality; low level of continuity
Prices	High	Low	Average to high	Competitive/low	Average	Very competitive/low	Low
Atmosphere and Services	Average to excellent	Low to high	Good to excellent	Low/below average to average	Below average	Low	Low/below average
Location	Business district, regional malls/shopping centres	Stand alone, power strip centres	City centre, business district, shopping centres, isolated store	Business district, stand alone, power strip centres	Business district, shopping centres, isolated store	Urban, strip	Outlet malls, business district, suburban shopping strip, isolated store

Table 3.1 (*continued*)

	Specialty Stores	Category Specialists	Department Stores	Discount Stores	Variety Store	Extreme Value Retailers	Off-Price Stores
Promotion	Heavy use of displays; extensive salesforce	Use of newspapers; moderate salesforce	Heavy ad and catalogue use, direct mail, personal selling	Heavy use of newspapers, price-oriented; self-service	Use of newspapers; self-service	Use of newspapers; heavily price-oriented; self-service	Use of newspapers; limited sales force
Examples	*Douglas, WH-Smith, Gap, Abercrombie & Fitch*	*IKEA, Curry's, Staples, PetSmart*	*John Lewis, Sears, JCPenny, Saks Fifth Avenue, Harrods*	*Walmart, Kmart, Target*	*Woolworth, Ben Franklin*	*Family Dollar, Dollar Tree, EuroShop*	*T.K. Maxx/T.J. Maxx, Marshalls*

As well as these major non-food retail formats, further retail channels and formats are used to offer non-food items. Specifically, general merchandise is often added to retailers' assortment portfolios when retailers decide to increase the breadth of their assortment. For example, many retailers originating in food retailing now include additional items in their assortments, such as toys, gift items, flowers or household supplies, leading to a blurring of food- and non-food retail channels (see Chap. 2). Therefore, customers' spending in the main retail channels is subject to change. Fig. 3.1 illustrates the share of retail sales in Germany by retail channel.

This strategy adding goods and services that are unrelated to the rest of a retailer's assortment is called **scrambled merchandising** and is followed for several reasons (see Chap. 12). Mainly, retailers aim to increase overall revenue by adding fast-selling and highly profitable items. Particularly if the popularity of the retailer's original merchandise decreases, new product lines might be sought to maintain or increase the customer base. Also, scrambling merchandise addresses several purchasing trends such as preferences for one-stop shopping and fosters impulse buying (Berman and Evans 2013, p. 145).

3.2 Specialty Stores

Specialty stores specialise in one or very few product types and consequently carry a limited number of products within one or few product (and service) lines. Usually, the merchandise is of average to good or **high quality**. While the breadth of the assortment is narrow, the depth is usually extensive, and specialty stores thus provide a **better selection** than competitors from other retail formats such as department stores (Ogden and Ogden 2005, p. 99). In addition, specialty stores offer a high level of **service** and knowledgeable sales personnel. Stores are typically located in city locations or shopping centres, are small and the **in-store atmosphere** is tailored to creating a pleasant shopping experience (see Chap. 15).

Limited line specialty stores are a specific type of specialty store that only carry a very narrow assortment, but offer enormous depth within this limited sector. Often, these stores offer (very) high quality merchandise and a high level of customer service and in-store design, while prices are above average.

Traditionally, retailers that sell merchandise such as clothes (e. g., *Gap* or *Abercrombie & Fitch*), footwear (e. g., *Footlocker*), cosmetics (e. g., *Douglas, The Body Shop* or *Sephora*), books (e. g., *Barnes & Noble* or *WHSmith*) or jewellery (e. g., *Christ*) choose specialty stores as their store format. In many cases, however, independent local retailers run specialty stores.

The main element of a specialty store's strategy is a focus on a specific market segment. While this offers many opportunities to tailor their stores to their **target group**, it also makes them vulnerable to changes in consumer tastes and preferences. They also incur the high costs that result from a **quality-oriented strategy** in terms of store environment, merchandise and service offered to customers. This often leads to higher than average prices.

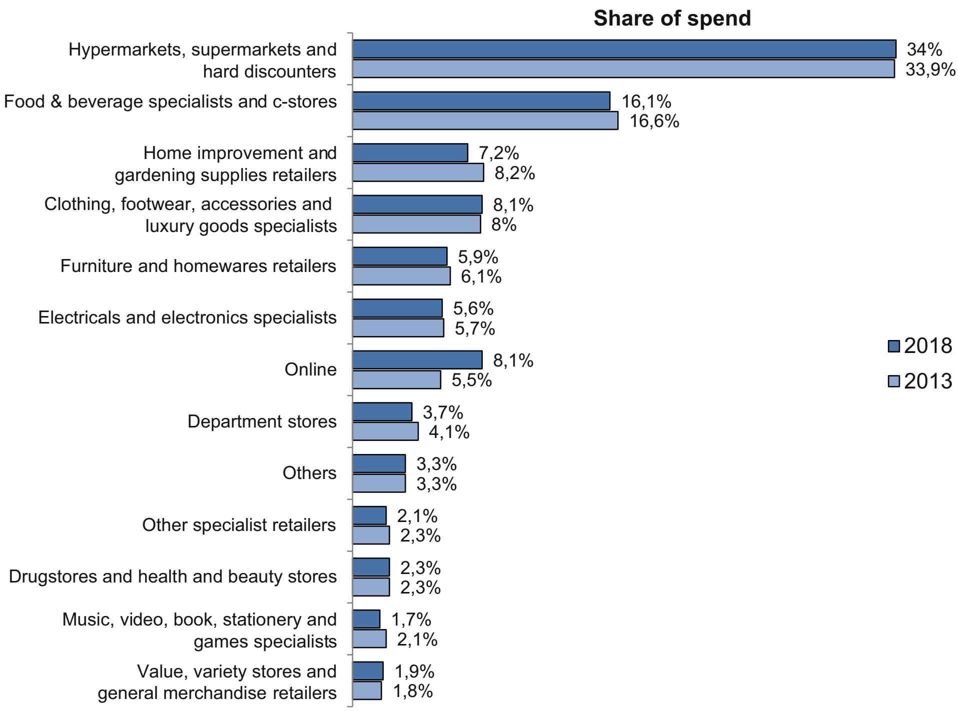

Fig. 3.1 Share of total retail spend in Germany by channel. (Retail Week 2014, cited from Statista 2015.)

While specialty stores have been the traditional format for non-food shopping, in recent years they have been one of the weakest, slowest growing retail areas and have lost market share to other store-based or non-store formats.

However, a specific form of specialty stores has evolved and is growing despite this trend. Mostly seen in fashion retailing, **fast-fashion chain stores** have emerged as a successful store format (see Chap. 6). Companies such as *H&M*, *Zara* or *Mango* are taking a new approach to specialty retailing by rapidly changing their store assortments with new product introductions several times per month. By doing this, they can guarantee very fashionable and up-to-date products in store.

This approach to quality is also different from traditional specialty retailing. Whereas traditional specialty stores suffer from efficiency problems resulting from their high quality strategies, fast-fashion retailers vary their approaches to in-store environments, products and service quality. While they ensure a minimum quality standard, the general quality of store atmosphere, merchandise and services offered is in many cases lower than average, with an explicit focus on being up to date and having short refresh periods. This strategy, combined with efficient back-end processes, especially in terms of logistics (see Chap. 18), helps reduce costs and thus enables fast-fashion retailers to establish low or medium price strategies. It is also a strategy to enhance customers' shopping frequency thanks to the constantly changing assortments.

3.3 Category Specialists

Category specialists, also referred to as **specialist markets**, **category killers** or **power retailers**, are price-oriented stores that provide a high depth of merchandise in a particular category, usually in large stores. They offer an almost complete assortment in a particular category at **low prices** and thus can "kill" a category of merchandise for other retailers (McGoldrick 2002, p. 158), mainly specialty stores. The service level offered by category killers is usually kept low. Self-service approaches are generally applied to sell merchandise, but assistance is offered if requested by customers.

Outlets are usually located in out-of-town locations. Exceptions, such as *Saturn*, a German category killer in the field of consumer electronics, mainly focus on city locations or combine both out-of-town and city locations, as *IKEA* is currently trying.

Category killers are usually targeted at customers travelling by car, and thus they usually offer extensive parking facilities to draw customers from a **large catchment area**. Store architecture and in-store design are kept very simple and offer a shopping experience dominated by size and pricing (Wileman and Jary 1997, p. 78). Category specialists are increasingly joining into specific agglomerations, called **power centres** (see Chap. 11). Such centres provide consumers with several category specialists in one location, thus enabling both multi-purpose and comparison shopping.

The strategy of **low operating costs** in terms of rents, personnel costs and low cost designs, sometimes with a warehouse atmosphere, combined with huge buying power, usually leads to high asset productivity (e. g., space, stock turnover). This made category killers one of the retail formats with the highest growth rates during the 1990s and 2000s. They have gained market share mainly at the expense of specialty stores, because of their advantages in terms of price and product range. Category killers are now established in many non-food categories such as consumer electronics (e. g., *Curry's*, *Darty*, *Media Markt* or *Best Buy*), DIY and home improvement (e. g., *Leroy Merlin*, *B&Q* or *Home Depot*), sports (e. g., *Decathlon,* the case study for this chapter), furniture (e. g., *IKEA* or *Conforama*), office products (e. g., *Staples* or *Office Depot*), pets (e. g., *PetSmart*, *Mille Amis* or *Fressnapf/ Maxi Zoo*) and toys and baby products (e. g., *Toys 'R' Us* or *Babies 'R' Us*). The format is expanding into new categories, but it is also coming under pressure in some countries, as the examples of *Best Buy* in the US, *Media Markt* in Germany and *Curry's* in the UK show.

3.4 Department Stores

Department stores are **large retail units** that carry a broad variety of merchandise and offer a deep assortment "under one roof". Department stores often have several floors. The term "department store" is due to the store being divided into separate departments for displaying merchandise in a manner that resembles a collection of specialty stores, i. e., each department acts as a "mini store" in the larger store. Each department not only has a specific selling space allocated to it, but also usually has its own point-of-sale terminals and dedicated salespeople to assist customers (Levy et al. 2014, p. 48).

The merchandise sold by department stores traditionally covers a wide range of categories such as clothes, accessories, appliances, home furnishings, jewellery, cosmetics, toys, furniture, sporting goods and consumer electronics. Recently, however, most department stores have been reducing product variety to focus on "soft goods" (e. g., clothes and footwear).

Department stores are usually located in **city centres** and often serve as anchor stores in **shopping centres**. Department stores offer a pleasant atmosphere, which creates an enjoyable shopping experience. In-store design and visual merchandising are thus important (see Chap. 15). Department stores also offer diverse services, which may include tailoring services for clothes or home deliveries.

In terms of the merchandise carried and services offered, department stores can be categorised into three tiers (Weitz and Whitfield 2010, p. 91):

- Upscale, **high-fashion** stores with exclusive designer merchandise and excellent customer service; these are often the flagship stores of department store chains (e. g., *Harrods*, *Selfridges*, *Jelmoli*, *Saks Fifth Avenue, KaDeWe, Galeries Lafayette Paris Haussmann*); these are usually located in very large cities such as New York, Berlin, Paris, London or Zurich.
- Modestly priced, **mid-level** merchandise with less customer service (e. g., *Manor, Hoopers, Debenhams*, Galeria *Kaufhof, John Lewis*; also see the case study on *Macy's* in Chap. 15).
- Stores with **lower level** merchandise and prices (e. g., *Sears*, *JCPenny, Kohl's)*.

Most department store chains such as *Galeries Lafayette*, *Karstadt, El Corte Inglés, House of Fraser* or *Saks* operate department stores in several of these tiers.

In recent years, the overall sales and market share of traditional department stores have declined and internationally, they face substantial competition from other retail formats such as category killers and discount stores or non-store formats (e. g., online retailers). These difficulties mainly result from problems in retail positioning due to the **"all under one roof"** approach. First-tier department stores often have a clearly differentiated position and usually produce strong financial results, so these difficulties mainly apply to outlets in the second and third tiers, which lack such a clear positioning and are therefore struggling. Furthermore, the overheads and **operating costs** associated with such large retail outlets oriented towards ambience, attentive service and a broad variety of products are very high compared to more cost-focused and price-aggressive retail formats (see Fig. 3.2), which also often have better assortments in the limited lines they carry. The departments in a department store simply cannot offer the same depth (Berman and Evans 2013, p. 156).

Problems can also occur due to the sheer size of the stores, which in some cases are larger than 50,000 m^2. In terms of shopper convenience, department stores offer one-stop

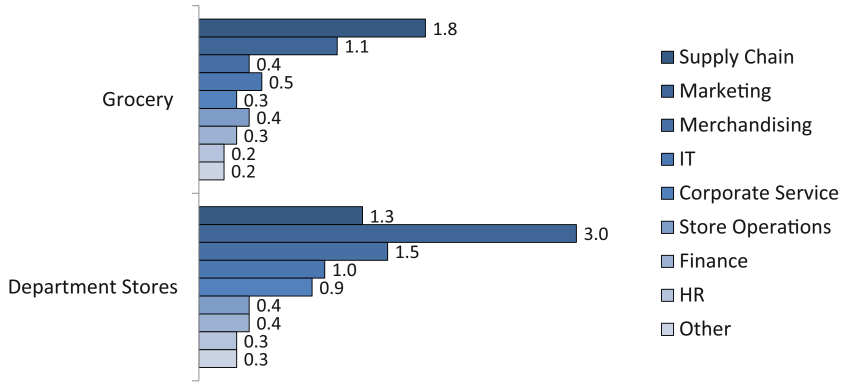

Fig. 3.2 General and administrative costs as a percentage of sales. (PwC 2013)

shopping for diverse products or needs with the approach of offering general merchandise all under one roof. Because this strategy results in big stores with a large number of SKUs, it places high demands on customer orientation within the store, shopping duration and so on. Department stores therefore offer limited "mental convenience", and shopping in department stores may be both difficult (in terms of the mental processes surrounding choices within the store) and time consuming.

Even though department stores are trying to respond to their deteriorating positions by giving stores clear profile, for example, tightening up their assortments, increasing the amount of exclusive merchandise or brands offered, introducing store brand programmes and improving customer relationship management or marketing campaigns to improve their image, this erosion of market share looks set to continue.

3.5 Full-line Discount Stores

Full-line discount stores are a specific type of department store that offers a broad variety of merchandise at low prices, in categories such as electronics, furniture and appliances, household goods or gardening tools (Levy et al. 2014, p. 50). This store format originates in the US, with *Walmart*, *Kmart* and *Target* as the most important players.

Store architecture and in-store design are very simple, mainly to keep costs low. The merchandise is usually less fashion-oriented than in department stores. Full-line discount stores offer both store brands in non-durable goods and manufacturer brands in hard goods (e. g., TVs or household appliances). Customer service is usually limited. Products are sold via self-service. Customers use **shopping carts** to make their purchases and pay at centralised checkout areas (Berman and Evans 2013, p. 157). Thus, operating costs are kept low. However, this store format struggles due to the less pleasant shopping experience and its similarity to hypermarkets (or supercentres) with respect to general merchandise. Full-line discount stores therefore face strong general competition from hypermarkets and category killers in each product category. Over the past few years, they have lost market share. This has led *Walmart*, to name one example, to close some of its full-line discount stores or convert them into supercentres.

3.6 Variety Stores and Value Retailers

Variety stores, such as *Woolworths* or *Ben Franklin*, offer a broad assortment of inexpensive and attractively priced merchandise. They sell products from categories such as clothes, accessories, jewellery, confectionery and toys. Stores offer limited services and do not carry full product lines (Berman and Evans 2013, p. 158). This store format faces strong competition from retail formats such as category specialists, discount stores and (large) food retailing formats that carry a range of general merchandise of similar product lines.

While the conventional form of variety stores is struggling, several new forms have evolved over the past few years. One form is variety stores with a fast-fashion approach to their assortments. These retailers offer more focused assortments than conventional variety stores, mainly concentrating on home accessories, household supplies, textiles, and occasionally furniture and clothes. Products are offered at reasonable prices. However, these retailers do not stock products permanently, instead frequently changing their assortments to offer fashionable and up-to-date products in diverse categories. This strategy aims to increase their customers' shopping frequency, and the constantly fresh atmosphere combined with rapid changes in the assortment help develop "buy it now" shopping behaviour among customers.

Another evolved form of variety stores is **(extreme) value retailers**. These are general merchandise discount stores that mainly target low income customers and are thus located mainly in low rent, lower income urban or rural areas (Levy et al. 2014, p. 54). The merchandise sold is similar to that in conventional variety stores, but prices are much lower.

One specific form of extreme value retailers is **one-price stores** that offer every product at the same price (e. g., dollar stores or euro stores such as *Family Dollar* and *Dollar Tree* in the US or *EuroShop* and *HEMA* in Europe). These "true" one-price stores offer a wide range of products mainly from categories such as homewares, confectionary, cosmetics, gifts and stationery.

3.7 Off-price Stores

Off-price stores sell an inconsistent assortment of merchandise, e. g., soft goods such as clothes, accessories, cosmetics or footwear, at low prices. Some off-price retailers focus on fashion-oriented, brand name or designer labelled items. They target middle to upper-middle customer groups by offering products at markdown prices of 30 to 50 %. Important off-price chains include *T.K. Maxx* (*T.J. Maxx* in the US) and *Marshalls*.

Off-price stores use a very **aggressive buying strategy** without asking manufacturers for additional services such as return privileges, advertising allowances, markdown adjustments or delayed payments. They often negotiate with manufacturers to discount orders, e. g., for merchandise that is out of season or for **irregular items** that have minor flaws (Ogden and Ogden 2005, pp. 99–100; Berman and Evans 2013, p. 158).

Specific types of off-price stores include **closeout retailers** that sell a broad assortment of merchandise purchased at closeout prices or **outlet stores** owned by department stores, specialty stores or manufacturers (**factory outlet stores**, see Chap. 6). These stores sell excess merchandise, overruns or irregulars while avoiding the need to mark down prices in primary stores (Levy et al. 2014, p. 56).

3.8 Non-traditional Non-food Retail Formats

3.8.1 Pop-up Stores

Pop-up stores are a very specific new store format, also called **temporary stores**. The aim is to create a **"limited edition"** type of retail atmosphere, as these stores only open for a specific period (e. g., a few days, weeks or months) and then close. This can be seen as a "promotional gimmick". Pop-up stores offer a limited assortment of usually seasonal products. Because of the limited opening period and assortment, temporary stores benefit from the scarcity principle, which says scarce items are valued higher by customers and provoke urgency to purchase.

The pop-up store retail environment is usually highly experiential, conveying brand emotions in an event atmosphere. While pop-up stores can also serve as retail events to promote special offers (e. g., with marked down prices), they often serve as retail venues to present and introduce product innovations or conduct market research. Therefore, they are usually located in city centres or the trendy neighbourhoods of big cities. Thus, typical locations for these promotion-oriented concepts are very unique and experiential places. For example, *H&M* opened a "beach store" in a wooden stall on Scheveningen beach in the Netherlands and *IKEA* ran several pop-up stores in New York in the form of 20-foot cubed cardboard boxes, symbolizing the typical size of New York apartments, before opening its first store in Brooklyn. Brand manufacturers such as *Adidas*, *Nike* or *Puma* often open pop-up stores.

Vacant business locations or salesrooms in city centres are often used to establish temporary stores. Specific mall concepts have also been developed that use the idea of pop-up stores to create an environment with varied occupants. For example, the *Bikini Center* in Berlin operates a specific space, the so-called *Bikini Boxes* (see Fig. 3.3), offering flexible modular wooden spaces, available for experiential pop-up stores.

By creating a climate of scarcity through **pop-up stores**, retailers try to create a higher willingness to pay among their customers. Because there is no option for price comparison and offers are only available for short periods of time, **desirability** can be increased. In particular, temporary stores that sell special offers are consumption events for customers, whose main objective is to secure discounts. In some cases, pop-up stores are used to give

Fig. 3.3 Bikini Center. (Bayerische Hausbau/Bikini Berlin)

special offers to long-term, high value customers. These events reinforce the scarcity effect, as the products are only available to specific customer groups, in addition to the usual **temporal limitation** on the offers. This kind of customer segmentation can be used to deepen customer relationships (see Chap. 16).

Pop-up stores offer a very high degree of flexibility for retailers. As they are not involved in long-term leases, location changes are possible and profitability is usually high. However, this store format presents difficulties in terms of customer attraction and communicating the store's existence. As they are only open for a limited period of time, the main challenge is to advertise the stores, gain customer awareness and become known among target customers. Huge communication efforts are often necessary to establish successful pop-up stores.

3.8.2 Non-store Stationary Retail Channels

In addition to these store formats for non-food retailing, there are other non-store, but still stationary, retail channels. Even though these are less important in terms of market share, they address customer needs of convenience (e. g., in terms of opening hours) or situational or urgent customer needs.

Fig. 3.4 Vending machines in non-food retailing. (Media-Saturn; Bikefixtation; Seidensticker)

For example, **vending machines** can be used to sell books, newspapers, phone cards and CDs or DVDs, etc. While the operating costs are relatively low, there are logistical drawbacks, such as filling processes, stock outages and reverse logistics issues (e. g., in the case of damaged products). Several retailers, such as *Best Buy*, *Media Markt* and *Saturn*, have started vending machine operations that sell specific consumer electronics items through vending machines positioned in convenient and highly frequented places such as airports or railway stations (see Fig. 3.4).

3.9 Conclusion and Outlook

In general merchandise retailing, traditional retail formats such as department stores, specialty stores and pure catalogue retailers are struggling with competition from new formats such as **price-aggressive store formats** (e. g., category killers, off-price stores), retailers that sell fast-moving non-food items as **special promotions** on a weekly or semi-weekly basis (e. g., *Tchibo*) or **innovative non-store formats** such as Internet shops. This trend towards more price-oriented and flexible formats is predicted to continue in the next few years.

Apart from this trend towards discount-oriented channels, the main developments in general merchandise retail formats have come from new developments in **information and communication technologies** that have not only led to the emergence of new retail formats such as mobile commerce, but also offer potential new business models and new modes of communication to customers within the framework of existing retail formats. While substantial general merchandise retail sales are generated by traditional store-based retail formats, non-store formats such as catalogue retailing or electronic channels (see Chap. 4 and 5) are also crucial.

New developments in technology and customer behaviour in recent decades have led to a change in the relevance of different retail channels and to the evolution of **new retail formats,** mainly in the field of non-store retailing. Another important trend is that many traditional store-based or catalogue retailers have started to sell their merchandise through several retail formats. By adding additional retail channels, they are evolving into **cross-channel retailers** (see Chap. 5).

The new retail channels are not only important as **new competitors**; many retailers are expanding their existing retail formats by adding these new channels and evolving into multichannel retailers. These retail developments are creating more sophisticated customers and changes in consumers' shopping motives and behaviour, such as a desire for better prices, "more-for-less" or convenience orientation. Thus these developments can be seen as a response to customer needs.

Further Reading

- Ganesh et al. (2007). Retail patronage behavior and shopper Typologies: A replication and extension using a multi-format, multi-method approach. *Journal of the Academy of Marketing Science*, 35(3), 369–381.
- Levy et al. (2014). *Retailing Management* (9th edn.). Boston et al.: McGraw-Hill Education.

3.10 Case Study: Decathlon

3.10.1 Profile, History and Status Quo

The success story of *Decathlon*[1], a French manufacturer and retailer for a wide range of sporting goods including sports equipment and sportswear, began on 27th July 1976, when Michel Leclerq opened the first store in Englos, a small city near Lille in France. Leclerq is the cousin of Gerard Mulliez and therefore part of the Mulliez family, which controls retail chains such as *Auchan*, *Boulanger*, *Leroy Merlin* and *Pimkie*. Although these companies are linked by ownership, they operate independently. Although they have a similar name to the French retail chain "*E.Leclerc*", these chains are completely different. The company is still privately owned today. About 43 % of the stocks are controlled by the Mulliez family and 42 % by the Leclerq family. Company employees control the remaining 15 % of stocks. Management has always offered a shareholding option to the workforce since the company was founded.

With the launch of *Decathlon* in 1976, Leclerq introduced an innovative store design to the market, which even today is part of their main service and USP. First, products for every type of sport are offered under one roof at attractive prices. There is no sport specialisation or discrimination against less popular sports (Decathlon 2015). Second, every store has a dedicated indoor and often outdoor area in order to try out the products sold in the store. Hence, *Decathlon* tries to make **"the pleasure and benefits of sport accessible to all"**. Today *Decathlon* focuses on innovations in their main activities, from research to retail, including conception, design, production and logistics, and their own brands, called "passion brands", which have played a huge part in their success. Their twenty passion brands channel their expertise into developing simple, yet fully functional and appealing products, at the lowest possible prices to reach a maximum number of customers (Decathlon 2015). In doing so, *Decathlon* targets a broad range of consumers: from beginners to experts.

As of 2015, *Decathlon* runs 884 stores with more than 63,000 employees in 21 countries (Decathlon Corporate 2015). The top three countries are currently France (288 stores), Spain (129 stores) and China (115 stores). Since 2008, *Decathlon* has been a subsidiary company of *Oxylane*, which is part of the *Mulliez* empire, which operates multiple retail brands and networks, e. g., *ATAOS*, *Cabesto* and *Decat*. Nevertheless, *Decathlon* is the holding's most important retail chain by far. In addition, although this case study is focused on *Decathlon's* store-based retailing, the online shop should be mentioned very briefly. This was introduced in late 1999, although the website originally opened in 1996 as a corporate presentation and information source. Even then, the online shop gave customers the opportunity to select and buy equipment for a broad range of sports (20 categories) and offered more than 5500 articles (Archive.org 2015). Today, almost every product that can be found in stores can also be ordered in the online shop. *Decathlon* tries to closely

[1] In addition to those explicitly cited, sources used for this case study include the company websites http://decathlon.com and http://corporate.decathlon.com, various annual and interim reports.

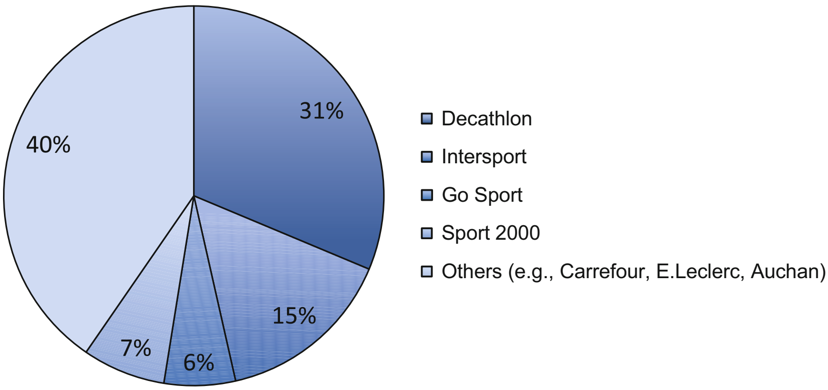

Fig. 3.5 French market share of sports retail chains in 2013. (Adapted from Le Figaro 2014; Isaconso 2014)

link their online shop and retail stores. For example, *Decathlon* offers a "Click&Collect" service, where products bought online can be delivered for free to the retail stores. In addition, if a product does not fit, it can be exchanged in store at no cost (e. g., for a different size or colour). A reverse link was also introduced: in Germany, almost every store has terminals called "Auswahl+" (Choice+). If a product is not in stock in that store, customers can order it via the terminals and the online shop. The receipt is printed immediately and can be paid at the checkouts in store. Then the products can be delivered to that store or any chosen destination. *Decathlon's* online shop can be seen as an add-on to the classical stores as a convenience service and a move towards a cross-channel or, with the increase in links between the channels, omni-channel strategy (see Chap. 5).

In 2014, *Oxylane* posted a turnover of 8.2 billion EUR, before tax. Overall, *Oxylane* achieved an increase of 11 % compared to the previous year and an increase of 64 % taking the last five years into account. This turnover can be divided into the contribution for France and that for the remaining international markets. Stores in France contributed a substantial 60.5 % of overall revenue, where *Decathlon* had a market share of 31 % in 2013, double that of its closest rival, *Intersport* (Le Figaro 2014). In addition, in 2014 *Decathlon* contributed 5 % to *Mulliez Holding's* net revenues, a record for their section (Le Blog Mulliez 2015). Fig. 3.5 shows the overall market share of sport retail chains in France in 2013. *Decathlon* has adopted the strategy of a big company willing to increase its market share by entering high margin segments (Michel and Salha 2005).

3.10.2 Decathlon's Store-based Retailing: The Main Retail Format

As previously described, *Decathlon's* core store formula is a big superstore **category specialist store** with equipment for sports enthusiasts of all levels occupying a sales area of approximately 5500 m^2. The stores are mostly located out of town, and usually in industrial zones to make the huge sale areas possible. This strategy usually reduces the financial investments needed due to lower rental fees. However, as of mid-2015, there are two exceptions to this store location strategy: the *Decat' stores,* which will be described in the next paragraph, and a completely new city-store concept in Mannheim (Germany). In 2014, *Decathlon* opened a pilot 4000 m^2 store on three floors in the so-called “T-1-structure” in central Mannheim, almost in the centre of the pedestrian zone. The store is based on a full assortment strategy and offers the same services as the regular stores. While this midtown store concept seems completely contrary to stores in industrial zones, a closer look shows the Mannheim store is similar in terms of requiring low financial investment. The building had been vacant since 2001, required urgent maintenance work and was denoted as a “property of concern” in the heart of Mannheim (Scholl 2013; Scholl 2014). Therefore, it can be assumed that *Decathlon* received an attractive offer for rental fees, on top of the generally low rents in Mannheim (Pressebox 2015). In addition, *Decathlon* received a say in the exterior renovation, conducted by the investor who bought the building in 2007, and had it altered to fit the corporate identity (Scholl 2014). Overall, having an attractive building in the centre to attract new customer groups, in combination with limited financial investments, seems a sensible strategy that perfectly complements the classical out-of-town store approach.

Decathlon's products are priced from entry level to top of the range. Most stores' assortments comprise more than 35,000 items organised and displayed in 70 different sports categories (Decathlon 2015). The range of the assortment and size of each store's selling area are key factors in *Decathlon's* economic success and major areas of differentiation from the competition. *Decathlon's* assortment contains both private labels and products from major sports brands such as *Nike*, *Puma* and *Reebok*. Private labels play a particularly important part in *Decathlon's* strategy: More than 60 % of *Decathlon's* sales come from private labels, compared to only 15 % of *Intersport's* or 30 % of *Go Sport's* sales (PointsdeVente 2009).

To sell sports equipment at low prices, *Decathlon* could follow a standard *low operating costs* strategy, which would be normal for a category killer, but would run contrary to their promise of offering high quality products. Thus, to make its business model work, *Decathlon* controls almost its entire value chain. *Decathlon* is therefore both a distributor and producer of sports products:

- Product range development: There are around 35,000 products in *Decathlon's* range, almost all part of *Decathlon's* passion brands; this makes it easier to achieve higher margins at low prices than with third party brands.
- Production: In 2001, *Decathlon* created a design department, where more than 120 designers channel their expertise into developing products. As a result, no external support is needed. Production units are mostly based in low-wage countries (e. g., China and India), but local production is also possible.
- Sourcing/Distribution: *Decathlon's* worldwide production departments are in charge of managing production and providing cost-efficient, on-time delivery to warehouses. *Decathlon* has split multiple departments across five continents and by domain of

activity. Each of them is tasked with finding suppliers in a specific geographical area (Pecuchet 2015).
- Outlets: Stores are mostly located outside towns in industrial zones to reduce costs and provide enough space for the sales areas.

However, in the early days of *Decathlon*, store brands were not the focus. This strategy only emerged after running into problems with the major sports brands. During *Decathlon's* launch, the major sports brands felt *Decathlon* was not suited to reselling their products. Products were delayed or not even delivered. For example, *Peugeot Bicycles* refused to supply *Decathlon* at all (Capital 2009). To counteract this problem, *Decathlon* introduced its own low-priced *Decathlon* brand, the start of an aggressive sales strategy against the established brands. The decision was a success: within ten years, a third of *Decathlon's* overall turnover came from its own brand products (Capital 2009). To capitalise on this success, *Decathlon* extended the strategy in 1997 and introduced the new passion brands. *Quechua* (mountain sports) and *Tribord* (water sports) were the first passion brands, which replaced the *Decathlon* umbrella brand. While *Decathlon* had covered the whole spectrum of sports, each passion brand focused on a particular sport (i. e., category-specific) and received a unique name. The goal of this strategy was clear differentiation across the brand spectrum.

These passion brands are increasingly pushing manufacturers' brands from *Decathlon's* shelves, although *Decathlon* still supplies their stores with products from major sports brands like *Nike* or *Adidas*, mainly because of their attractiveness and the ability to use their pull- and image-effects to attract customers. These brands also create higher consumer frequency within *Decathlon* stores. *Decathlon* can leverage this effect using its own brands and compensate for the pull effect from the manufacturer brands (Pederzoli 2011). First, the private labels are not simply "cheap" copies of the major brands; they are strongly positioned brands in their own right. Second, own brand products produce higher net margins. Hence, this pull-effect is a net positive for *Decathlon*. This assortment strategy is the result of various experiments conducted throughout the entire history of the company and also of continually extending the product range to increase specialisation and customer segmentation. In doing so, *Decathlon* is information-driven and fairly centralised. Its headquarters analyse each store's catchment area and decide on the appropriate breadth of all product categories and sub-categories. This maintains a high level of standardisation throughout the chain, while still responding to localised needs (Pederzoli 2011).

In addition, each store also offers a broad range of services to complement the products sold, including refunding, workshops for personalising sports equipment, checking and maintenance for bicycles and skis and cylinder refills for scuba divers. Some services are available in every *Decathlon* store, while other, more complex ones are only provided at regional maintenance workshops and hubs. Another very innovative service is *Trocathlon*, which lets people trade second-hand sports equipment inside a *Decathlon* outlet. These week-long events are organised twice a year and take place in marquees and special trading areas outside *Decathlon* stores in the parking and testing areas. *Decathlon* sales assistants visually evaluate the articles before allowing them to be offered for sale. If an article is sold, *Decathlon* gives the seller the entire amount in the form of vouchers that can be used in every *Decathlon* store, and no commission is charged. The *Trocathlon* service is a way to increase shop visits and encourage contact with potential new customers. The service is beneficial to both customers and the company, because *Decathlon* lets customers sell their used sports equipment while simultaneously encouraging them to buy new products at *Decathlon*, through offers during *Trocathlon* and the voucher system. In addition, *Decathlon* offers additional services such as equipment conditioning to customers who buy the used products. This lets *Decathlon* monetise this second group of customers while reinforcing its brand.

Some French and international locations directly connected to Decathlon stores host a *Decathlon Village* fitness park (previously *Parc de la Forme*). These are very large areas surrounding a typical *Decathlon* store which offer a lot of different sports activities. A good example is *Decathlon's* fitness park near Marseille. It opened in the South of France in 2005 and covers 45 hectares. The park offers a broad range of activities, including beach volleyball, a football/rugby field, an adventure park and a 5980 m^2 *Decathlon* store with an area to try out products. The park employs 13 specialised staff, can host around 6000 sport enthusiasts and is open seven days a week (Decathlon Village 2015). The total investment was 30.5 million EUR (Brugvin 2005). Entry to *Decathlon Village* is not free, but *Decathlon* offers free training sessions and activities organised by store employees in the village area. *Decathlon* hopes to reinforce its brand through the *Decathlon Village* and create stronger relationships with local authorities. This strategy is really just an expansion of their main business concept: to let customers try out new sports at *Decathlon* and buy the necessary equipment. There were nine *Decathlon Villages* in France as of April 2015. This format cannot be introduced everywhere, because some stores are located in very busy areas and so it would be very difficult to find enough space to create these facilities. Nevertheless, *Decathlon* has already announced it will expand the *Decathlon Village* idea further, with new *Villages* in France and in international locations like the UK. Therefore, in 2011 *Decathlon,* became the "anchor tenant" for *Orford Park* in Warrington close to Manchester (Harker 2011). Costing 30 million GBP, *Orford Park* will include various sport and leisure facilities, including walking and cycling paths, skateboarding and *BMX* facilities and swimming pools, sports halls and a new *Decathlon* store.

Decathlon's core concept remains stable, even though it has undergone some internal and external modifications over the years. The current trend is to increase the average sales area, because the stores have to accommodate a growing assortment of goods and a growing number of services and areas to try out products and to entertain customers. But *Decathlon* continues to expand, even as opportunities to construct large out-of-town superstores are decreasing. It also continues to exploit the brand reputation of its passion brands.

3.10.3 Decathlon's Stores: Diversification of the Retail Network

Oxylane is not limited to selling its products via its *Decathlon* offline retail stores; they have also been testing and focusing on other sales methods (Buyse 2014). To diversify the retail network, *Decathlon* has opened specialised outlets, some under the name of their passion brands.

One example of this approach is the launch of an *Inesis* concept store near Villeneuve d'Ascq in 2006. *Inesis* is *Decathlon*'s golf brand, and the store specialises in golf products and services. Here, the idea of the sport parks was extended along with the passion brands. Thus, *Inesis* opened its own 92,000 m^2 golf park near Lille in 2013. The park offers a golf course and putting green, a golf school, an *Inesis* boutique with golf equipment and an indoor area to test new golf equipment. Another example of diversification is the 2007 launch of a discount hunting and fishing store in southeast France under the *Decathlon's Fonisto* brand (later *Terres et Eaux*). Today, *Terres et Eaux* also includes horse riding products, pet food and accessories. The assortment is mostly composed of major international brands in each sector. In 2003, the company opened an *Ataos* brand store near Lyon in southwest France and later a second store in Lille. These stores were dedicated to second-hand sports products, displayed in a sales area of about 1200 m^2. *Decathlon* charged a commission on each sale. Both stores and the website were closed in 2013 and 2014 due to decreased success. However, the ten-year lifespan must be seen as a net positive, because *Ataos* was originally introduced as a concept store (Buyse 2014) and it can be seen as a pilot scheme for the *Trocathlon* service described above.

In 2006, the company started to develop a new market renting skis and other mountain sports equipment. Here *Decathlon* did not enter the market directly, instead deciding to collaborate with independent retailers located in major tourist locations. In France, ski resort patrons often rent skis and other equipment for a week or even more, so *Decathlon* decided to try and exploit this market with its *skimium.com* brand. Their 2006 agreement with independent outlets located in France's ten most popular winter sports resorts lets these stores rent out *Quechua* and other ski products to tourists. The independent stores which participate in this scheme currently use the *skimium.com* brand alongside their own brands to show customers they belong to this national network (Pederzoli 2011).

Decathlon's most successful diversification so far has been the launch of a discount retail format, based on the brand *Koodza*. The first outlet was launched in France in 2004, but the concept was not validated until 2007, when a strong expansion strategy was adopted both in France and internationally (e. g., Spain, China, Morocco). The *Koodza* format only offers *Decathlon's* passion brands and adopts an EDLP pricing strategy (Pederzoli 2011). The stores have an average sales area of 1500 m^2. Today, these shops are branded as "*Decathlon easy"* rather than *Koodza* to promote the brand connection. Like the main brand, the *Decathlon easy* shops emphasise their wide range of sports equipment, while stressing the attractive prices even more. This is a good strategy, because it lets *Oxylane* isolate the sale of their own products from the main *Decathlon* stores and can appeal to other groups of buyers with lower budgets.

Other store-based retail formats have been developed. *Chullanka* stores specialise in mountain sports (e. g., hiking, mountaineering, canyoning, skiing). *Cabesto* stores focus on maritime activities, with five stores currently in operation. A typical *Cabesto* store has an assortment of around 15,000 products in a 2500 m^2 sale area. They sell products from the *Cabesto* passion brand, but also national and international brands such as *Roxy*, *Quicksilver* or *O'Neill*. Finally, *Decat'* stores have a sales area of 600 m^2, with goods from urban sports and leisure sports sectors. Unlike standard *Decathlon* stores, they are mostly located in town centres. *Decat'* stores sell hardly any of the equipment available in standard *Decathlon* stores, focusing instead on clothing and other sportswear articles. In addition, the current *Decat'* format only sells products from the passion brands. This diversification has not been entirely successful, and after years of tuning the concept, only five *Decat'* stores remain in France as of 2015. Nevertheless, the new *Decathlon* store concept opening in Mannheim can be seen as an evolution of *Oxylane's* experience with *Decat'*.

Decathlon offers a broad range of store-based retail formats. It is interesting to observe how *Decathlon* remains loyal to their vision of offering all kinds of sports to all kinds of people. While *Decathlon* positions itself unambiguously as "all sports under a single roof", the outlets are consciously assigned to passion brands or a particular sport or activity area, e. g., marine sports. The advantage for *Decathlon* is obvious: By offering stores specialising in certain sports, they can better meet customers' needs, e. g., by offering more precise advice by specialists in stores for a particular sport or an ambience which better fits different clienteles like in *Decat'*. In addition, *Oxylane* can position themselves more strongly against their competition by operating specialised stores to attack competitors in each field.

Some of *Decathlon's* strategies, like the sport parks near the stores, are expanding. Thus, a whole service system was introduced around the *Inesis* brand. The idea of the sport parks was extended to a golf course with additional services like the golf school. In addition, the outlet offers a direct opportunity to try new products and buy them in a single location.

Introducing the *Decathlon easy* format (formerly *Koodza*) gave *Decathlon* the opportunity to offer even lower prices without damaging the main retail format by projecting a "low-end" image. They can introduce low-price strategies to customers with lower budgets without decreasing regular customers' willingness to pay. Except for some concepts which did not translate to long-term success or which were replaced by other services (e. g., *Ataos* and *Trocathlon*), the diversification of sales formats and stores has been a huge success (Buyse 2014).

3.10.4 Internationalisation Process

As mentioned above, another element of *Decathlon's* business strategy is their internationalisation process. In 1986, Leclerq opened the first store outside of France in Dortmund (Germany). Shortly after, in 1988, *Decathlon* began producing its own goods in Asia. Internationalisation became a focus and continued over the following years. In 1992, the first store in Spain was opened, followed by stores in Italy (1993), the UK and Portugal

(1999), Shanghai (2003) and the first store in Moscow in 2006 (Decathlon 2015). In 2014, *Decathlon* opened 32 new stores in China, 10 in India and 8 additional stores in Russia. However, despite its expansion in Europe, Asia and Latin America, *Decathlon* announced in 2006 it would withdraw from the US market. This was the only example where *Decathlon* entered the market by taking over an existing retail chain. At the end of 1999, *Decathlon* acquired the local sports chain *M.V.P.*, which operated 20 shops around Boston. But by 2003, *Decathlon* chose to close 14 of the 18 remaining stores. *Decathlon* failed in the US for multiple reasons (Pederzoli 2011):

- Acquiring *M.V.P.* was the first operation of that kind for *Decathlon*. Thus, they lacked experience in integrating into a different company with its own culture and organisation.
- During the acquisition, *Decathlon* faced strong competition in the US market from companies such as *Foot Locker* and *Sports Authority*. Both companies were significantly bigger than *Decathlon* and could leverage economies of scale that *Decathlon* could not. In addition, US customers were more sensitive to these national brands. There was little acknowledgement of *Decathlon's* reputation for quality private brands and the percentage of passion brand products never exceeded 20 % of their stock, even though this was important for penetrating the market due to their high margins.
- Finally, the *M.V.P.* stores were generally too small to hold the standard *Decathlon* sports collection, making it difficult to implement *Decathlon's* main services and differentiate themselves in the US market.

Although this was a failure, there are many examples of successful diversification of *Decathlon's* store-based retailing. As mentioned above, *Decathlon* decided to enter into Latin American markets (e. g., Argentina in 2000 and Brazil in 2001) and Asia (e. g., Shanghai in 2003) (Craven 2003; Pederzoli 2011). The first store in South America opened in 2001 in Campinas, about 100 km north of Sao Paulo. Following the French model, it had a sales area of about 3000 m^2 and a 50,000 m^2 park adjacent to the store. Unlike the US market entry, *Decathlon* already had a three-year experience of the Brazilian market thanks to their domestic production facilities, and it exploited this knowledge when setting up its retail activities. The first store offered an assortment where a third of the goods were based on the passion brands. The Brazilian entry is a good example of *Decathlon's* strategy of applying the French model (superstore as category specialist, additional services like the sports park) while considering local customer needs.

The first store in Asia opened in Shanghai in 2003. The retail store had a sales area of 1800 m^2 and was a carbon copy of the French stores (Pederzoli 2011), including the logo, colours and store layout. Like in Brazil, *Decathlon* already had over six years of experience to draw on, since *Decathlon* managed three factory outlets near the production units. The biggest difference from the French model was the very limited assortment, with only 9000 articles available. However, only 20 % of the assortment was based on national and international third party brands, with the remaining 80 % consisting of passion brands.

China is today the third most important country for *Decathlon* and clarifies the success of *Decathlon's* internationalisation strategy.

Over the past few years, *Oxylane* has not limited itself to implementing *Decathlon* internationally. The discount brand *Decathlon easy* (formerly *Koodza*) has also been developed outside France, with presence in eight countries as of May 2015, a decrease from ten countries in June 2010. However, the internationalisation process of *Decathlon easy* is still in its infancy. This format may still be a strong tool to reinforce the company's strength in countries where *Decathlon* already has a presence (Pederzoli 2011). In addition, the format is easier and cheaper to develop due to smaller sales area requirements.

In 2014, *Decathlon* opened 32 new stores in China, ten in India and eight additional stores in Russia. *Decathlon* is also scheduled to begin operations in Slovakia. The first store will have a sales area of 4000 m^2 at a planned cost of 236 million EUR.

3.10.5 Summary and Outlook

Since its founding, *Decathlon* has had a huge impact on the French market with its model of store-based retailing. *Decathlon* has succeeded as a category specialist in offering consolidated breadth and depth of sports equipment. Unlike its competition, *Decathlon* focused on attractive prices, with products to match every budget. Additional services like *Trocathlon* or the branded sport parks are unique and provide a USP for *Decathlon*.

These services provide an extraordinary example for offline retailers (even though, strictly speaking, *Decathlon* uses an omni-channel approach, see Chap. 5) for how to differentiate themselves from pure online retailers. Services like product trials and salespeople who are sports experts, and even additional services like maintenance for used products, are services which cannot be offered by pure online players.

The key success factors in *Decathlon's* long-term success can be divided into three areas:

- Products: large range of products, adaptation to the local market, quality of products, research and development policy.
- Managerial expertise: implementation, i. e., geographic implementation and high number of stores, relationship with suppliers in the form of strong partnerships with sub-contractors but worse relationship with big brands.
- Marketing expertise: communication and advertising policy and services and customer relations.

In the future, it will be interesting to see how *Decathlon* implements smaller stores in inner cities to target high wages and urban populations. There are multiple strategies available, such as expanding *Decat'*, creating a new brand or adjusting the standard *Decathlon* store format. In addition, targeting new countries with low purchasing power may prove a successful strategy due to *Decathlon's* competitive advantage throughout the whole value chain.

Questions

1. What was the difference between *Decathlon* and its competitors during the launch? How exactly could *Decathlon* position itself relative to its competitors?
2. What are the main success factors of *Decathlon's* core store-based retailing concept? How could it be improved in the future, e. g., additional services?
3. *Decathlon* expanded its store-based retailing by adding new brands to its portfolio and introducing new stores under its passion brands. Considering the internationalisation process, how could this concept be a competitive advantage?

- Take a look at the different sections of *Decathlon's* corporate website at corporate.decathlon.com/en/ to get an impression of *Decathlon's* brands, services, past direction and future orientation.
- This chapter contains multiple examples of store-based retail concepts. Consider how the sporting equipment category fits perfectly with these store concepts and the possible additional services in this context.
- Analyse the article by Hillairet et al. (2009) to get a better insight into the *Decathlon Group's* dual innovation management and adapt this information to the internationalisation process.

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Online Retailing 4

Abstract

This chapter discusses the main characteristics and empirical relevance of retailing over the Internet, known as "online retailing". As well as traditional forms of online retailing via computers, the proliferation of technologies offering Internet access has broadened the range of online retailing formats, with customers now able to access online shops via numerous devices, including smartphones, tablets and Internet-enabled TVs.

4.1 E-commerce and Online Shopping

4.1.1 Overview

In **online retailing** or **electronic retailing** (or e-retailing, electronic commerce, e-commerce, Internet retailing, etc.), retailers offer their products and services over the **Internet**. Merchandise is thus presented in Internet shops. Customers usually place their orders via **electronic checkouts**, or they can use e-mail or traditional modes of communication (e. g., mail, phone and fax).

While in most cases customers pay through traditional systems (e. g., credit card, purchasing on account), some Internet shops also offer **electronic payment systems** (e. g., bank transfers, direct debits, *PayPal* or *Google Wallet*). In electronic retailing, retailers can be divided into general merchandise and specialty retailers based on their merchandise strategies.

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	Global average	United States	United Kingdom	Germany	Japan	India	Brazil	Russia	China	South Africa	Nigeria
Electronics	77	83	84	90	53	79	88	71	96	60	65
Home appliances	59	46	65	58	41	67	70	62	83	41	52
Home furnishings	53	56	65	66	53	59	48	43	65	34	30
Fashion and apparel	76	87	85	88	66	84	75	64	97	47	65
Sports and outdoor	52	56	53	66	36	52	49	51	78	35	35
Beauty products	57	50	56	62	48	68	59	53	85	41	45
Household items	45	36	48	40	41	60	35	36	84	31	35
Groceries	45	26	60	36	68	52	29	31	90	31	30
Toys, kids and baby products	49	48	53	49	32	61	47	44	75	38	34
Tickets	64	74	69	63	43	79	65	51	71	69	47
Music and games	62	74	75	66	46	65	62	43	69	64	57
Books	73	82	82	80	65	70	75	52	89	64	71
Services	76	80	76	77	63	82	70	63	87	79	80

Fig. 4.1 Types of products purchased online in May to July 2014 (share of customers that purchased category online in %). (Adapted from A.T. Kearney 2014)

4.1.2 Scope of Online Retailing

Generally, all kinds of products can be sold over the Internet, but major sales are generated in categories such as books, CDs, DVDs, clothes, computer software, toys and home electronics (see Fig. 4.1).

The Internet is also very important for **digital products** such as software, music and e-books that – unlike physical goods – can be transferred through electronic channels. In such cases, the Internet offers additional shopping convenience due to the direct and immediate availability of the products purchased (**transaction convenience**).

The most prominent example of a successful Internet retailer is *Amazon,* which started off as a specialty retailer focusing on books. Over time, *Amazon* has added more and more product categories to its portfolio, such as toys, consumer electronics, pet supplies and even groceries, and added a range of digital products such as e-books, films and music. As a result, *Amazon* has experienced high sales growth with annual growth rates of more than 20 % in recent years.

The hype initially associated with Internet shopping as a revolutionary retail format has receded, and a **market consolidation process** has driven many Internet retailer innovators out of the market. Nonetheless, for several years, electronic retailing has internationally been the retail format with the fastest growth (see Fig. 4.2).

The Internet is a highly relevant shopping channel throughout the world. In 2014, there were 466 million Internet users in Europe, about 620 million in the Americas, 1366 million Internet users in Asia-Pacific, about 172 million Internet users in Africa and approximately 130 million in the Arab States (ITU 2015). While this amounts to global penetration of about 40.6 % of the total population, there are strong differences between different regions, mainly between the developed and developing world (see Fig. 4.3). These numbers show the high potential of online shopping.

The percentage of people who use the Internet as a shopping channel varies, from highs of 70 % in Sweden to 32 % in Spain and only 20 % in Italy. The average penetration rate for Europe is 47 % (see Fig. 4.4).

In 2013, US online retail sales were 264.3 billion USD, with a predicted growth of about 42 billion USD per year until 2015 (eMarketer 2015). This growing importance of Internet shopping seems to be a worldwide trend. For example, online sales in China are predicted to grow by almost 80 % from 2013 to 2015 to over 560 billion USD. The overall relevance of the Internet as a retail channel is also growing, with a market share of 11.6 % of all retail sales in North America and 7.2 % in Europe in 2014 (Centre for Retail Research 2015).

When the Internet was introduced as a retail channel, there were pessimistic prediction that e-commerce would damage traditional brick-and-mortar stores. To a certain extent, online shopping has indeed cannibalised physical stores' sales; however, the emerging reality suggests that e-commerce has become a supplementary shopping channel for customers.

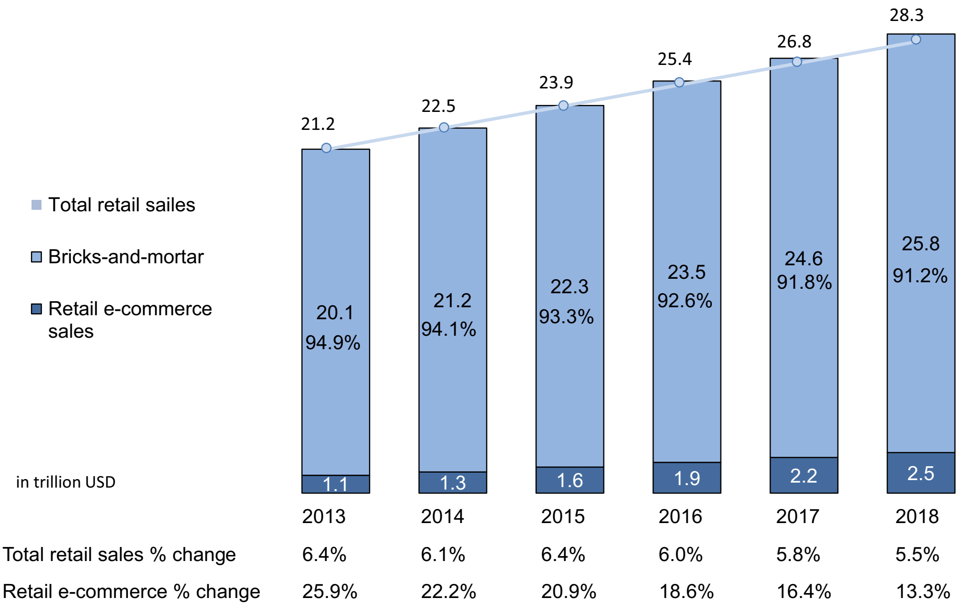

Fig. 4.2 Global retail and e-commerce sales growth. (Adapted from eMarketer 2015)

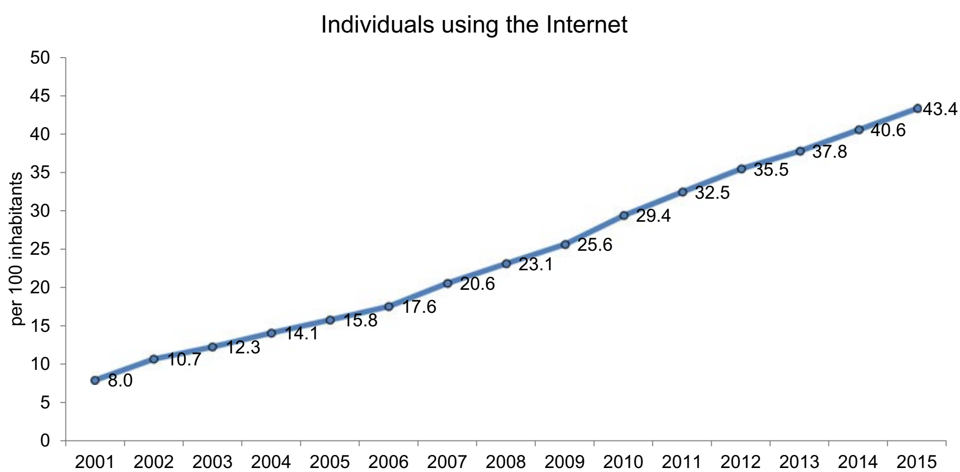

Fig. 4.3 Global Internet users. (Adapted from ITU 2015)

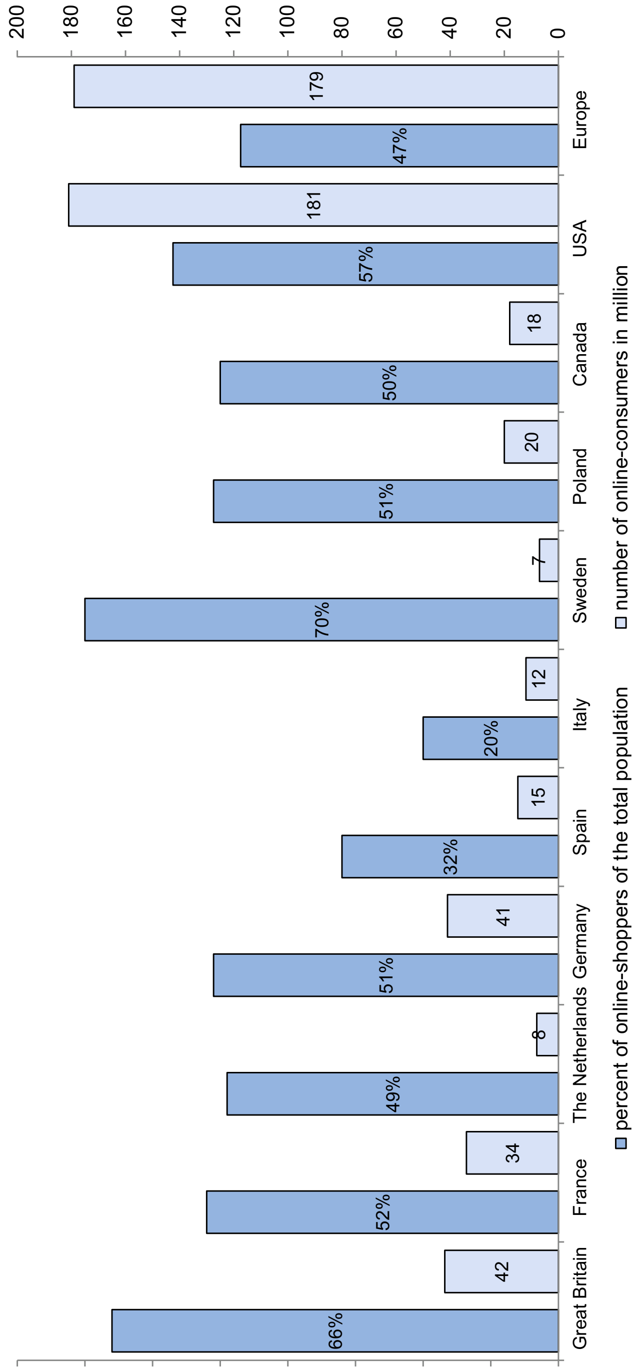

Fig. 4.4 Percentage of online and offline consumers in millions in 2014. (Adapted from Centre for Retail Research 2015)

4.1.3 Shopping Formats in Online Retailing

4.1.3.1 Overview

Because technological developments are so dynamic, online shopping provides a highly innovative retail environment. Online shops follow different business models, so – similar to the categorisation of store formats – it is possible to distinguish between a wide range of **shopping formats in online retailing.** Fig. 4.5 provides an overview of the most important retail formats for online retailing, as well as selected examples of each format, categorised by their unique selling propositions (USPs).

4.1.3.2 Price Formats in Online Retailing

Various **pricing strategies** can also be differentiated for online retailing. For example, there are online discounters who sell products at below average prices, and quality-oriented retailers who charge higher prices for more exclusive offerings. In online retailing, low price formats such as value retailers, off-price stores and factory outlets also exist, offering products at below average prices along with stock-outs and end of line stock. For example, *Overstock.com*, *Sears Outlet* or *Tesco direct Clearance* sell overstocks, remnants or products from the previous season.

Private shopping clubs such as *Gilt Groupe, vente-privée* or *brands4friends* are a specific form of online closeout retailers where members can buy popular brands at high discounts. Through this shopping channel, retailers organise time-limited online shopping events where remnants or liquidation stock in apparel, accessories, homewares or toys are sold only to club members. To become a member, consumers need to be invited by other members or join the waiting list. One advantage of the closed membership base is that offers from these online shopping clubs do not appear in price comparison sites, which would hurt the brand image of the designer brands on offer.

The emergence of Internet retailing has also led to **new business models** and new forms of computer-mediated retail transactions. In the context of price formats, dynamic pricing models are important. One example is **Internet auctions**. While in **online Dutch auctions** prices start high and are reduced until the first bidder accepts the price, the most common form of online auction is the **English auction,** where the initial price starts low and the price is built up by successive bidders. This traditional type of auction is employed by *eBay*, the most successful online auction platform.

Bids are not always free. For example, **bidding fee auctions** (also called **penny auctions**) (e. g., *Beezid.com*) are auctions where bidders must purchase credits to make bids. However, these types of auctions are controversial and have been criticised as being a specific type of gambling.

Another new price format is **live shopping**. This price format is characterised by a very limited assortment, usually only a couple of products, that is available on the live shopping platform for a very low price, often the best online price of the day, but only for a very limited time, usually 24 hours. This time limit and the limited availability of the products forces customers to make quick purchasing decisions and often stimulates impulse pur-

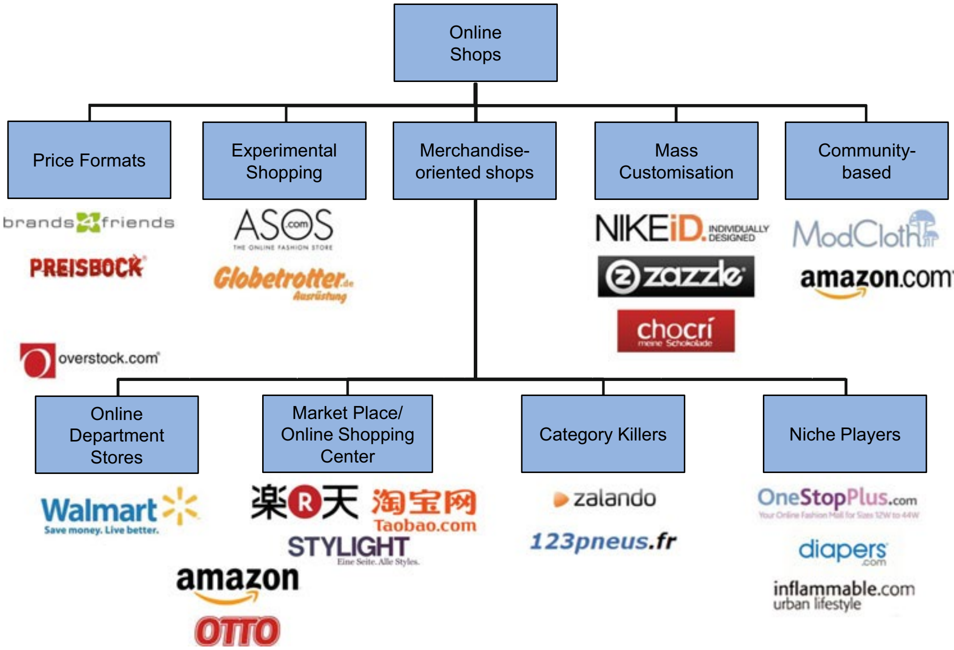

Fig. 4.5 Online retailing formats

chases. Live shopping is applied by specialist retailers that operate live shopping websites such as *Woot*, *Groupon* or *Daily Deal*, but traditional retailers such as *Sears* or *Buy.com* also integrate live shopping elements into their online shops.

Other price formats include **Internet price comparison** (e. g., *pricegrabber.com*) or **name your own price** systems (e. g., *Priceline.com*), although not all of them are successful.

4.1.3.3 Experiential and Community-based Online Retailing

Technological developments in online communication offer new dimensions for **experience shopping**. Using videos, avatars, user communities, live chats or other interactive measures, many retailing websites have implemented a trading-up process. Retailers that follow this approach usually use sophisticated methods to address their customers. Companies such as *ASOS* or *Globetrotter,* for example, provide emotional shopping environments with detailed product specifications and use product rating systems where customers rate and discuss products, combined with further options to interact with customers and topic-related **discussion forums**. Some even offer video shopping, where featured products can be put into a shopping cart right out of the video.

While social communities are important but peripheral elements of these types of online shops, **community-based retailing** sites are established around a social community or use a social community as an integral element of the retailing concept. For example, on the *Amazon* website, product ratings and discussions between members of the community are integral parts of the retailing concept. *ModCloth* provides a community as the basis for a product search platform that links products from several retailer websites. Many retailers now use such features, but some online shops now focus on these social interactions in their marketing efforts.

4.1.3.4 Mass Customisation

Online retailing also allows for new business models in terms of the products offered. One type of assortment strategy that has emerged mainly in the online environment is product **individualisation**. In Internet shops that focus on this type of strategy, customers can alter product specifications to assemble bespoke products. Typically, customers can combine different product elements (e. g., shape, colour, ingredients, etc.) to create their own, individualised configurations. Retailers usually provide a standardised set of product elements for the end user to customise. On retailing sites such as *spreadshirt*, *zazzle* or *chocri*, customers can create or alter the product themselves; the product is then configured "on demand" and shipped to the consumers.

Manufacturers who use an online channel to directly sell to their consumers often apply this strategy, including many manufacturers of soft goods such as apparel or shoes (e. g., *Nike* with *NIKEID* or *Adidas*). It is also popular in the consumer electronics industry, with companies such as *Apple* or *Dell* providing product individualisation or personalisation options (see Chap. 6). However, mass customisation is also applied in the food industry. For example, sites such as *elementbars.com* or *mymuesli.com* let customers create their own energy bars or breakfast cereals.

4.1.3.5 Merchandise-oriented Shops in Online Retailing

Assortment-oriented online retailers provide online shops in which customers primarily search for products. A common type of assortment strategy in online retailing is **online department stores** which – like their brick-and-mortar equivalents – carry a broad and deep assortment. *Amazon* proudly announces that it has the widest assortment in most categories offered. Companies such as *Otto* or *Walmart* are also influential in online retailing, thanks to their wide selections of products from a broad number of categories. This strategy corresponds to general merchandise catalogue retailers.

A more common strategy online is **specialty online retailing**, where retailers concentrate on one or a few specific categories of merchandise. Similar to specialty stores, they offer deep but narrow assortments in specific market segments. Retailers that operate such specialty online shops include *Lands' End* or *Next* in apparel retailing or *Barnes & Noble* online bookstores. As a specific form of these specialty retailers, niche players have also emerged that focus on subcategories such as specific styles in apparel (e. g., *Inflammable.com* with its focus on urban lifestyle clothing, *Diapers.com* selling baby supplies, or *igigi.com* that offers plus-sized clothing).

Because of the high transparency of prices on the Internet, these online specialty retailers are under high pressure because price-aggressive formats are common online. **Online category killers** such as *Microspot*, a price-aggressive online retailer in consumer electronics;

Zalando, a price-aggressive online shoe, clothes and accessories retailer or *123pneus*, an online tyre retailer, offer complete assortments in their categories at low prices.

However, online retailers face challenges in attracting customers and raising awareness. Therefore, strong **communication efforts** are often necessary to establish their online shops. In addition, the operating costs of online shops may be very high, especially if the retailers focus on emotional or experiential shopping environments and want to use individualisation options on their websites. One method to solve these problems is cooperation between retailers. In this context, platform strategies are common. **Marketplaces** or **online shopping centres** have emerged. On these platforms, customers can access a wide and deep selection of products. Unlike traditional online stores operated by a single retailer, the products on these sites are offered by many retailers. Examples include *Stylight* or *Taobao*, but *Amazon* and *eBay* also serve as electronic marketplaces as they operate platforms for third-party retailers.

4.1.4 Media for Online Retailing

While online shopping is often understood and analysed as purchasing on a retailer's website via a personal computer or laptop (stationary Internet), new digital devices (e. g., smartphones, tablets or Internet-enabled TVs) provide further possibilities for customers to shop online (see Fig. 4.6).

In particular, **mobile commerce** (m-commerce) is rapidly emerging as an alternative form of online shopping. While for a long time m-commerce was mainly associated with mobile phones, today portable two-sided digital devices such as smartphones or tablets are the most significant devices in mobile shopping (see Fig. 4.7).

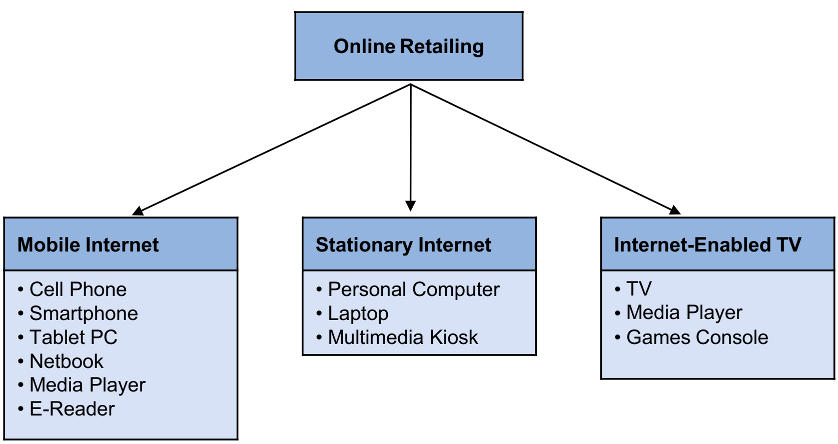

Fig. 4.6 Forms of online retailing. (Adapted from Schramm-Klein/Wagner 2013)

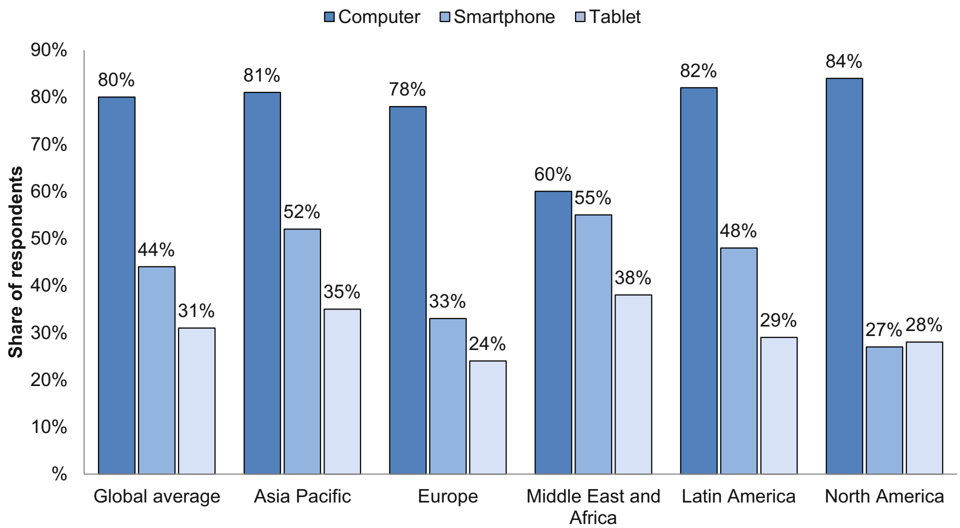

Fig. 4.7 Devices used most frequently for online shopping. (Nielsen 2015)

Growth rates for mobile commerce are expected to be higher than for traditional online shopping via desktop access, as more customers tend to choose mobile shopping in addition to traditional online shopping (see Fig. 4.8).

Access to online shopping is spreading from desktops to the living room, thanks to a growing number of Internet-enabled TV sets (IETV). Mobile Internet and Internet access

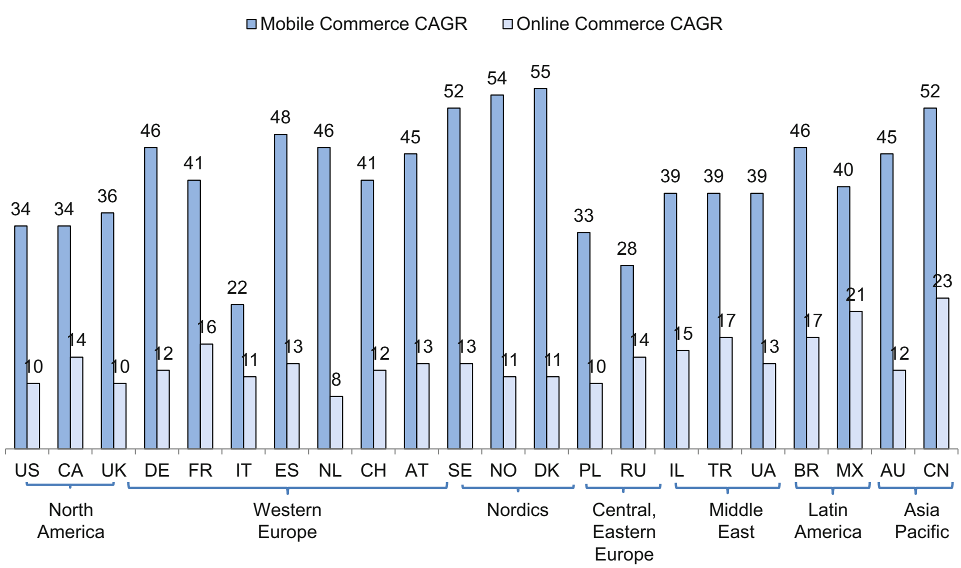

Fig. 4.8 Estimated compound annual growth rate 2013–2016 for mobile commerce and online shopping via desktop computer/laptop in %. (PayPal 2015)

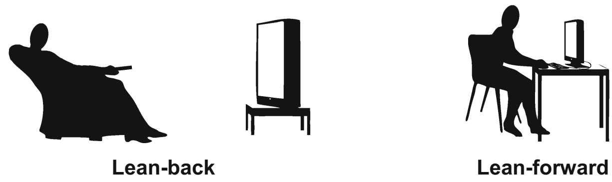

Fig. 4.9 Lean-back and lean-forward shopping situations

via TV obviously differ from stationary Internet, and it is expected that these differences will present online retailers with new challenges and opportunities.

One of the main differences is that consumers shopping online via computers or laptops usually adopt a **lean-forward** attitude. Lean-forward browsing is characterised by high engagement, with customers sustaining attention to perform their shopping task. Shopping of this type is task-focused and usually more functionally oriented. **Lean-back** browsing, on the other hand, implies a more relaxed shopping context. It is often associated with the use of IETV or mobile devices in leisure situations, for example, when customers are shopping via smartphones or tablets while sitting on the sofa or shopping via IETV shopping apps. Lean-back situations usually involve less task-focused activity and less engagement or concentration on the shopping task, with shoppers seeking a higher degree of entertainment. The different **shopping postures** are described in Fig. 4.9.

Shopping situations also differ with regard to the distance from the device. Online shopping via desktop or mobile devices involves a small distance between the consumer and their shopping device, while IETV usually involves significantly larger distances between the shopper and the TV set. This implies larger distances between the shop and the customer and requires fostering different shopping styles.

4.2 Conclusion and Outlook

The range of devices that online shoppers can use to access online shops to search for product information or purchase online has expanded. The devices vary in design, handling and functionality. These differences, such as in screen size, resolution or interactivity, affect how consumers respond to shopping content, implying that interfaces shape consumer reactions to otherwise identical content.

Even in these times of growing e-commerce, catalogues remain an important means of retailing. Retailers therefore need to evaluate online shopping not merely on the quality of technological facilities but also situational context. **Online shopping touchpoints** should be designed to fulfil shoppers' needs and requirements in specific situations, e. g., "on the go" or in a lean back-situation at home. For example, IETV devices present new opportunities to combine TV advertising with the option to purchase the advertised goods directly via the TV. This lets consumers access additional product information more easily or purchase products spontaneously.

The **multiplicity** of online shopping devices and related online shopping channels implies that retailers could combine different e-channels to introduce multichannel e-commerce. Online shopping through different devices has influenced the state-of-the-art of modern remote ordering strategies, and almost all large online retailers such as *Amazon*, *Zalando* or *Pixmania* now provide multichannel e-commerce systems for their customers.

Further Reading

- Laroche et al. (2005). Internet versus bricks-and-mortar retailers: An investigation into intangibility and its consequences. *Journal of Retailing*, 81(4), 251–267.
- Wagner et al. (2013). Effects of cross-channel synergies and complementarity in a multichannel e-commerce system – an investigation of the interrelation of e-commerce, m-commerce and IETV-commerce. *International Review of Retail, Distribution & Consumer Research*, 23(5), 571–581.
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4.3 Case Study: Zalando

4.3.1 Profile, History and Status Quo

Zalando[1] is a German online retailer that delivers fashion to customers in 15 European countries. The company offers products from a variety of brands and a shopping experience through multiple e-channels (desktop computer, tablet or smartphone). *Zalando's* assortment comprises a broad range of manufacturer brands, local designer fashion and private labels. All orders are distributed through custom-built logistics centres.

Zalando is a relatively young company founded to provide customers a convenient and simple way to buy shoes online. The company started in 2008 in a shared apartment in Berlin that served as both an office and warehouse, but went on to become Europe's biggest online fashion retailer (see Table 4.1).

As an online shop, *Zalando* offers consumers access to a wide and up-to-date assortment of relevant brands and a large selection of shoes in many sizes, colours and styles. The founders realised that shopping for fashion and shoes is above all an emotional event, with first impressions of products being just as important as detailed information. Thus the company makes it easier for its customers to discover new favourites on the online store through innovative search and screening functions, assistance tools and inspirational features.

[1] As well as explicitly cited sources, this case study uses the company's website www.zalando.de, various annual and interim reports and investor relations presentations.

Table 4.1 Historical overview of *Zalando's* development and internationalisation

	Company Development	International Expansion
2008	*Zalando* founded as an online shoe shop	
2009	First television advertisement	Austria
2010	Assortment expands to include apparel, accessories and sports Launch of the shopping club *Zalando Lounge* and creation of a private label Launch of *Zalando's* shop platform	Netherlands France
2011	Launch of *Zalando Magazine* Opening of first self-operated fulfilment centre *Zalando* partner programme is launched	Italy United Kingdom Switzerland
2012	Designer cooperation with *Kaviar Gauche* Opening of first custom-designed logistics centre Launch of first smartphone app in Germany	Spain Poland Finland Norway Sweden Denmark Belgium
2013	*Zalando* becomes a private German stock corporation (AG)	Luxembourg
2014	Launch of first tablet app in Germany International apps rolled out Designer collaboration with *Eleonora* *Zalando* transforms into a *societas Europaea* and goes public	

When the *Zalando* online shop went live in 2008, the store used a standard operating system that was functional, but placed constraints on displaying fashion products. The company's founders decided that a proprietary platform was needed to offer customers and fashion brands the product presentations they expected while keeping up with fast-changing assortments and the company's growth. Hence, a key focus in the set-up process was to develop a high-performance technology platform, tailored to the specific needs of the fashion industry and individual customer preferences.

Over the past few years, the company has insourced key logistics expertise and built three fulfilment centres in central Germany, the first of which opened in Brieselang in 2011. In late December 2012, *Zalando* added a custom-designed fulfilment centre in Erfurt with a logistics area of 125,000 m². In October 2012, construction began on a third fulfilment centre in Mönchengladbach, which started operations at the beginning of 2014.

The technological platform provides the backbone of the company and covers everything from store operations to fulfilment and purchasing software. *Zalando* uses its digital environment to offer its customers a convenient, inspirational shopping experience and dedicated service. Using innovative features and relevant content, the company strives to

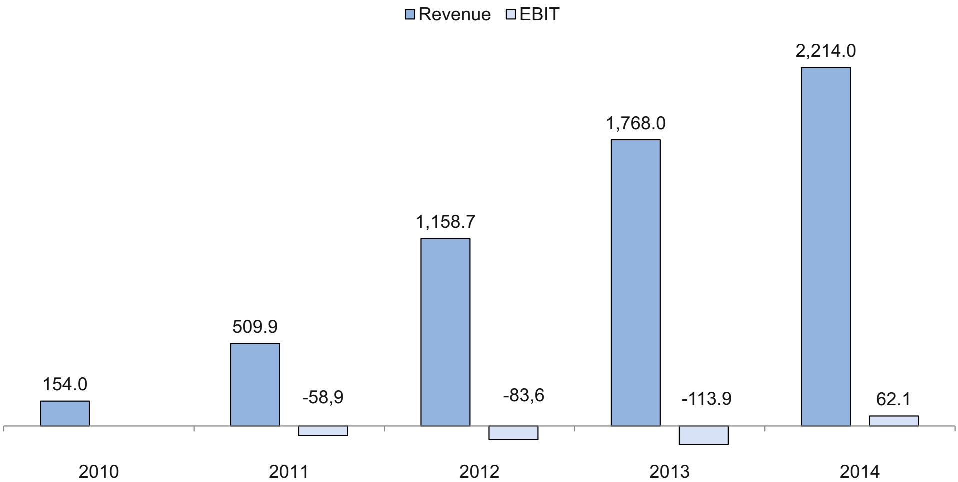

Fig. 4.10 *Zalando's* revenue and EBIT

translate the latest trends for their customers and engage them in new ways through detailed product presentations, personal recommendations and smart search functions.

In 2015, *Zalando*'s websites offered about 150,000 products and attracted more than 100 million visits per month, resulting in nearly 15 million active customers. 53 % of these online store visits came from mobile devices (e. g., smartphones, tablets). After seven years of operation, the business has grown enormously, generating 2.2 billion EUR in revenue in 2014 (see Fig. 4.10). In the first quarter of 2015, *Zalando* employed more than 7000 people from more than 50 countries. However, *Zalando's* business model has not always been profitable and is still subject to criticism, because *Zalando* suffers from very high return rates of about 50 % on average.

4.3.2 Zalando's Fashion Value Chain

Zalando's retailing strategy is defined by technology and based on *Zalando's* proprietary technology platform *ZEOS* (*Zalando E-commerce Operating System*). Technological solutions are not simply a prerequisite of *Zalando's* online stores; they are also the foundation for every step in the company's fashion value chain (see Fig. 4.11). *ZEOS* comprises enterprise resource planning and merchandise and warehouse management systems, all developed in-house. The platform's flexibility is enhanced by a team of 700 experts, who continuously provide software and data management innovations. *Zalando's* focus on technology and big data is illustrated through the fashion value chain. The company uses the combination of technology and big data for demand forecasts, marketing and discount decisions, cross-selling recommendations, controlling payment options and return and order forecasts.

Supported by the latest technical and analytical tools, *Zalando* has detailed knowledge of its customers' needs and preferences when it comes to offering and choosing fashions. Collected and analysed by in-house software, this data also helps *Zalando* continuously

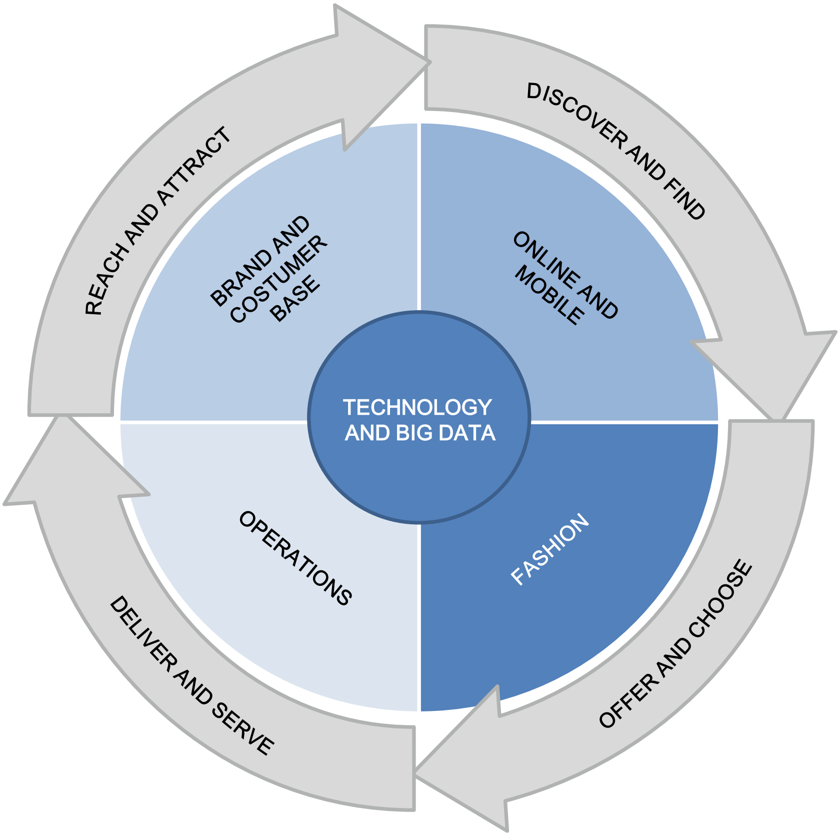

Fig. 4.11 *Zalando's* fashion value chain

optimise operations for delivering and serving customers. Analytical tools improve the interpretation and forecasting of customer requirements and brand preferences: *Zalando* uses data to reach and attract its customers and also to offer them tailored recommendations and a personalised shopping experience through mobile and online channels, striving to reach a higher degree of customer loyalty.

4.3.3 Zalando's Brand Platform

Zalando's fashion concept has persuaded many brands to start selling their products online with *Zalando*. The company works closely with these brands to determine their position on the *Zalando* shopping platform. *Zalando* offers its brand partners access to a large target group, *Zalando's* strong brand awareness and profound commercial expertise. The *Zalando* buying team continuously works with brand partners to select attractive fashion products, introducing an average of 1000 new items every day to its online offering. This keeps the store's online appearance and assortment "up-to-date" and allows *Zalando* to keep pace with ever-shorter fashion cycles.

Brand Assortment

Zalando's assortment of over 1500 international brands includes popular global brands, fast fashion and local brands, and is complemented by a set of private label products. *Zalando's* assortment includes global brands (e. g., *Tommy Hilfiger*, *Adidas*, *Nike*) that are familiar and relevant to a large group of shoppers. These "global brands" are complemented by strong local brands (e. g., *Modström*, *Morgan*, *Minimum*), which vary between country markets. To stay up to date with the latest fashion, diverse fast fashion brands (e. g., *New Look*, *Vero Moda*, *Jack & Jones*) are included. For more prosperous customers and luxury shoppers, *Zalando* offers a choice of premium brands (e. g., *Fendi*, *Aigner*, *Liebeskind*). Specific outdoor and sport brands (e. g., *Asics*, *Under Armour*, *Patagonia*) are provided for customers who want to engage in sport and leisure activities or prefer the sporty look.

Private Label Brands

Zalando's own brands, which include *mint&berry*, *Zign* and *even&odd*, cover a wide range of fashion styles and trends. Originating in Berlin, these brands have been well-received. Some of the so-called *zLabel* brands are top-selling brands within the assortment and have established a loyal customer base. With shoe, apparel and accessory collections for men, women and children, these private labels are a key success factor and contribute several hundred million EUR to *Zalando's* revenues every year. *zLabel* designers work on new ideas for future fashion trends, making *Zalando* one of the largest employers in Berlin's fashion industry.

Brand Partnerships

Zalando has established exclusive brand partnerships, for example with the Spanish label *Mango* and the British brand *Topshop*. In this way, the *Zalando* platform offers fashion labels that represent their own brand story. A specific form of these partnerships is brand shops, i. e., exclusive areas within the *Zalando* online store which are reserved for brand partners and can be tailored to suit their individual needs. A brand partner shop is seen as a stage to tell a label's own story, to create an online flagship store, to engage with customers, to visualise campaigns and to present the newest products. Brand partners are also supported through improved knowledge of online retailing and customer preferences (e. g., through customer data analysis), and boosted appeal for their products though in-depth consultations. Through the brand partner shops, customers receive current and authentic brand content and an authentic brand experience.

4.3.4 Zalando's Internationalisation and Mobile Retailing Strategy

Zalando's activities in foreign markets require adapting their retailing strategy to meet domestic customers' demands. Therefore, the company analyses its assortment, payment options and services for the different countries to decide whether they need to adapt to local needs. The growing share of mobile visits and purchases spurred *Zalando* to launch a mobile-first strategy.

Internationalisation by Localisation

Zalando operates in 15 country markets with different online shopping expectations and e-commerce developments. Therefore, *Zalando* tries to identify solutions best suited to each country market. Country teams develop ideas to serve customers individually and meet their specific expectations in terms of assortment, onsite experience, marketing, payment methods and delivery options.

Local websites are tailored to domestic needs, including a country-specific assortment (e. g., specific local private brands), local online catalogue sorting, visual merchandising and marketing campaigns. Customer service is another focus. *Zalando* offers customer service in the local language across all of its markets and supports over 20 localised payment options for selected countries. At the checkout, customers can choose between standard global payment methods (e. g., credit cards), and those standard for their country. For example, cash on delivery is very common in Italy, Spain and Poland.

For partner brands, *Zalando* offers a platform to enter 15 markets in local languages and currencies, with full handling of shipments and returns. For example, *Gap* has struck a deal with *Zalando* to sell its core brand to reach more consumers in markets where the brand has no physical stores. *Gap* already delivers to 24 European countries from its own website and has more than 200 stores on the European continent, but it is not present in all European key markets.

Mobile-first Strategy

Zalando sees great potential in mobile Internet usage. The focus here is on developing new designs and content for mobile devices. Mobile commerce is a significant and rapidly growing part of *Zalando's* business: In 2015, more than half of *Zalando's* online store visits came from mobile devices (see Fig. 4.12). The use of mobile devices is expected to increase still further, and *Zalando* is investing in meeting the expectations of their growing mobile customer base. Customers should be able to access *Zalando*'s store anywhere, anytime, from a stationary or mobile device.

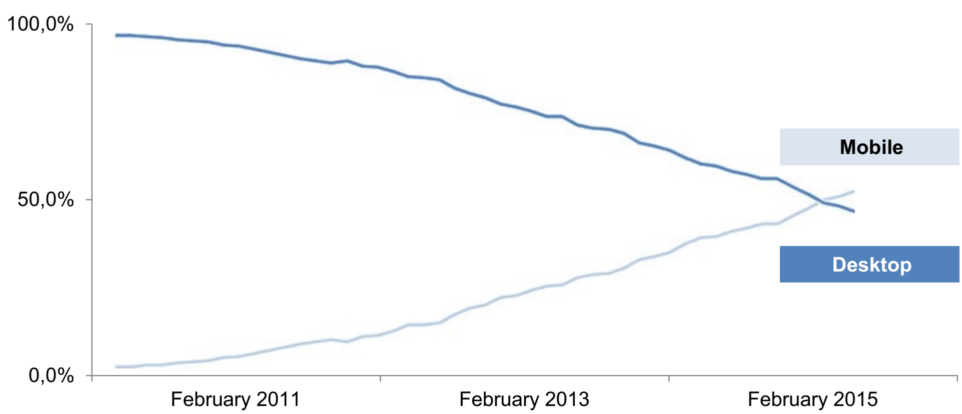

Fig. 4.12 Share of total online traffic on Zalando's stores by device (in %)

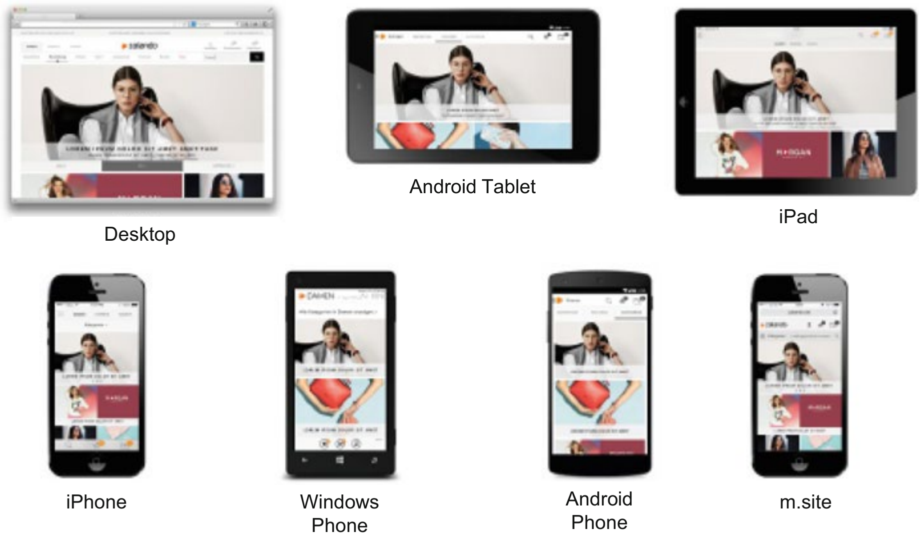

Fig. 4.13 Zalando's e-channel touchpoints

Zalando continues to expand its e-channel touchpoints, as mobile devices offer more touchpoints and opportunities for e-commerce than conventional shopping via stationary devices (see Fig. 4.13). The *Zalando* mobile app, which is locally adapted to all 15 country markets, has been downloaded more than 7 million times since its launch. To improve mobile customers' experience and engagement, innovative features have been developed, such as the photo search function, where customers can take a picture of a fashion item and the app searches for the same or similar items (by colour, pattern and other characteristics) in the *Zalando* assortment. In addition, the *Zalando* app provides features such as an inspiration feed, mobile campaigns, and a barcode scanner.

4.3.5 Zalando's Focus on the Online Fashion Experience

Zalando's self-imposed mission is to "create the world's best online fashion experience". Therefore, the coverage and the features of the *Zalando* online store are continuously enhanced and improved. *Zalando's* approach to satisfying increased customer expectations and convenience demands while only providing relevant content is *Zalon*, a curated shopping service. In addition, the *Zalando Lounge* members shopping club gives customers exclusive access to brand promotions. Customers can use their *Zalando* login credentials to shop in the *Zalando Lounge* or receive *Zalon* services. However, it is not necessary to become a *Zalando* customer to shop at the *Zalando Lounge* or *Zalon*.

Online Store Features

With tailor-made landing pages for target segments, advice microsites, high-quality product presentation (in some cases supplemented by 360° product views), specific fashion editorials and interactive features, *Zalando* strives to create a unique customer experience for fashion shoppers. This includes continuous technical and inspirational improvements. For example, the *Your Zalando* feed offers customers personalised brand and product recommendations derived from past purchases. Based on their individual preferences, this curated content hopefully inspires customers to discover new brands and trends.

Curated Shopping: Zalon

Zalon is *Zalando's* personal shopper service, providing customers with free personalised outfit suggestions from a team of more than 100 professional stylists. The stylists work as freelance collaborators for *Zalon* and come from a wide range of backgrounds, including bloggers, models, design students and entrepreneurs. *Zalon* targets customers looking for inspiration, people who lack the time to shop and those who do not like shopping at all.

To receive outfit suggestions, shoppers must first fill out an online fashion questionnaire. Different stylists are then suggested, and customers are asked to choose their personal stylist, who then contacts the shoppers by phone to discuss style preferences and ideas. Based on a shopper's individual style profile, the stylist will put together up to three outfits from *Zalando's* broad assortment and send these to the customer's home. The customer can then decide whether to buy or return the outfits or individual pieces of clothing.

Shopping Club: Zalando Lounge

The *Zalando Lounge*, *Zalando's* exclusive shopping club, began in Germany, but soon expanded into other countries. Registered members of the *Zalando Lounge* have access to time-limited sales events. *Lounge* customers can benefit from reductions of up to 75 % off the original price. The assortment is drawn from *Zalando's* entire product range. Sales events are usually tied to a specific brand. For brand owners, the *Zalando Lounge* offers an opportunity to sell overstocks and maturing collections and reach price-conscious shoppers.

4.3.6 Zalando's Logistics and Return Management

With warehouses centrally located in Germany, *Zalando's* logistics resources help the company serve approximately 85 % of its active customers throughout Europe within a nine-hour period. The company dispatches all of its shipments using its own logistics network that includes three fulfilment centres with a total floor space of 225,000 m^2 storing around 150,000 products. In addition, the company draws on its extensive knowledge base to foster cross-sector developments, for example for their brand partners' logistics operations.

Logistics Processes

When a customer places an order on a *Zalando* website, the in-house inventory control system checks which logistics centres have the product available. The customer's order request is then sent to the appropriate logistics centre, and the search for the product(s) begins. *Zalando* uses a random warehousing system, which means products are placed wherever there is currently space. The logistics software, built in-house by *Zalando* developers, helps track where each product is stored.

Employees then "pick" the product from the shelves and put it in a cart. The logistics software helps employees optimise their routes when picking products. In the packing area, individual orders are packed and prepared for dispatch. For orders with more than one item, the various parts of the order are consolidated here before being packed. The package is passed to the outbound area, where the packages are sorted by destination country before leaving the logistics centre. Packages are then loaded into lorries and shipped to customers across Europe.

Zalando is also working on packaging design and creating an unpacking experience. In 2014, a new parcel design was introduced with the aim of communicating quality and style in accordance with *Zalando's* brand orientation.

Return Management

When *Zalando* entered the market in 2008, the company heavily relied on mass media to communicate the new retail brand, employing the slogan "Schrei vor Glück – oder schick's zurück" ("Cry tears of joy – or send it back"). This slogan highlighted *Zalando's* policy of offering free returns on any item to all its customers. This policy has led to around 50 % of items being returned. This is the main problem in *Zalando's* business model, because the costs associated with these returns affect profits. *Zalando* is therefore trying to reduce the return rate.

Because free returns are a core service, the return policy has not been significantly altered, even though *Zalando* changed its marketing slogan to "*Zalando* – be happy" to reduce the emphasis on free returns. To reduce returns, the company mainly focuses on reducing returns of products that customers do not like or feel arrive different than described in the online shop. Offering more suitable and detailed information helps reduce these kinds of returns. Therefore, the company has put a lot of effort into improving product descriptions and related information in their online shop by providing better images and more helpful information. *Zalando* is committed to continuously optimising its workflows to increase customer satisfaction and retention rates. A lot of information is gathered and synthesised in order to offer customers helpful recommendations on outfits, trends or sizes and speed up transaction processes.

Despite the focus on reducing return rates, *Zalando* is also working to provide customer-friendly returns systems, enabled by eight local returns centres. The return process has been simplified by adding a pre-printed return label to the delivery and by equipping packaging with adhesive strips for returns. Customers no longer need to print return labels or source packaging, which has led to increased satisfaction with the returns process. *Zalando's* market research found that the label in parcel campaign resulted in 12 % more orders annually and 9 % higher customer lifetime value.

A new returns process has been introduced to provide faster refunds through prompt refunds after returns (see Fig. 4.14). In the new returns process, the refund is issued immediately after the parcel is dropped off, whereas before, this was delayed until the parcel arrived and was checked in the returns centre. This has reduced refund times by

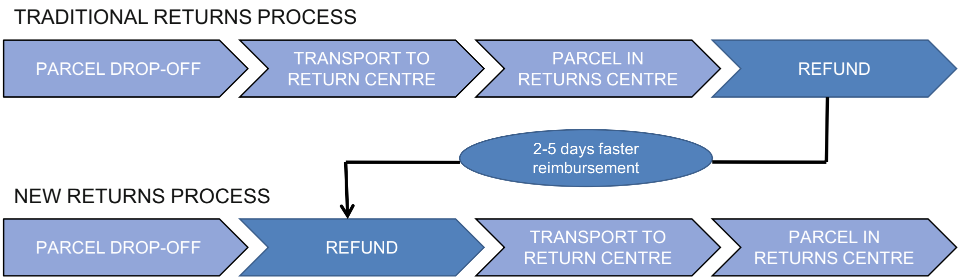

Fig. 4.14 Faster refund process

between two and five days, quickly freeing up customers' funds to buy something else on the *Zalando* store.

4.3.7 Conclusion and Outlook

This case study illustrated and discussed the online retailing activities of *Zalando*, a major player in the European online fashion market with presence in 15 European countries. The company's development is characterised by a consistent focus on an e-commerce business model combined with a brand and product range tailored to market needs and on online fashion experience exemplified by *Zalando's* fashion value chain.

With more than 150,000 products from more than 1500 brands, *Zalando* offers its customers a wide choice of fashion brands and items. Procurement teams work continuously on steadily expanding the assortment to keep the selection up-to-date. The company can respond quickly and flexibly to new trends thanks to the fast fashion brands in its product range. In addition, *Zalando* has developed its own private label brands that expand and enhance its product range across all price categories.

Strong partnerships with fashion brands allow *Zalando* to offer a choice of relevant international brands along with brands tailored to local preferences. Adapting the assortment to meet the demands of customers in different country markets is a key to *Zalando* offering an inspiring and convenient shopping experience. This is critical for the company to succeed in the heterogeneous European market with its diverse local tastes. *Zalando* has developed various online offerings tailored to regional customer needs. The country-specific alignment and a stronger adaptation to local customer needs sets *Zalando* apart from other online fashion retailers. At the same time, the group uses a central platform and infrastructure for logistics, technology and procuring products for all European markets. This approach promotes economies of scale and distinguishes *Zalando* from its competitors.

Zalando's success is at least partly based on improving the online shopping experience through innovative features on their online store, curated content and shopping solutions and relevant shopping formats. New e-channel touchpoints, e. g., shopping apps on mobile devices, give *Zalando* additional ways to connect with its customers. Because of the increasing shift to mobile Internet use, the company developed a mobile first strategy. This will let *Zalando* extend its revenue potential via mobile e-channels and improve customer journeys. In addition to the online shopping experience, *Zalando* is working to improve ordering logistics and returns operations and reduce return rates, in order to maintain customer satisfaction throughout the shopping, purchasing and delivery processes.

Zalando aims to further enhance its brand awareness levels, acquire new customers and create lasting customer relationships. To achieve these goals, the company has defined four key strategies: First, to prioritise customer benefits; second, to push the development of mobile shopping; third, to enhance *Zalando*'s attractiveness as an employer; and fourth, to accelerate the transformation of its business model to a platform.

Questions

1. How do the various features of the online store improve the online shopping experience for *Zalando* customers?
2. What are the advantages of *Zalando's* online retailing strategy compared to traditional retail store outlets?
3. Discuss the opportunities and risks of *Zalando's* transformation to a brand platform.
4. Discuss the strengths and weaknesses of *Zalando's* business model.

- Consult the website www.zalando.com for an overview of online features and brand presentations.
- See *Zalando's* 2014 annual report.
- Consider the insights from the chapters on online retailing and multichannel retailing.

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Cross-channel Retailing

5

Abstract

Cross-channel retailing is when retailers use a multiplicity of retail channels in parallel to sell their merchandise. This has long been a common strategy, but it has recently become more relevant because of new distribution channels, particularly the Internet.

5.1 Combining Retail Channels

Purchase decisions are heavily influenced by a multiplicity of information sources that customers consult prior to buying a product, for example to gather information on specific product attributes or price. Online information sources such as manufacturer or retailer websites, search engines or price comparison websites are becoming increasingly important.

A study by *Forrester Research* (2015) stated that while e-commerce sales only represent 9 % of all global retail sales, online and **web-influenced offline sales** (e. g., purchasing in a retail store after online price comparison) account for 45 % of total retail sales combined, and this figure will continue to grow steadily with a compound annual growth rate of 9.1 %. Consequently, many retailers have combined several retail formats to form retail channel portfolios, such as brick-and-mortar stores and/or traditional catalogues with Internet retailing.

Many retailers thus sell their merchandise through multiple retail channels that are combined in retail channel portfolios. There are many terms for this phenomenon, including multiple channel retailing, multichannel retailing, cross-channel retailing and omni-channel retailing (Schramm-Klein et al. 2014, pp. 20–21):

J. Zentes et al., *Strategic Retail Management*, DOI 10.1007/978-3-658-10183-1_5

- In **multiple channel retailing**, a retailer runs multiple separate retail channels, each under a different retail brand (see Chap. 9). They intentionally avoid channel integration, especially for customer-oriented functions. This could have to do with the retailer's pricing policy. For example, they might offer lower prices in their online shops than their brick-and-mortar stores to compete with price aggressive online competitors. This price differentiation would irritate customers if the channels were not separated.
- In **multichannel retailing**, a retailer uses several retail channels in parallel to sell merchandise which is similar across all retail channels. Thus, the channels have overlapping assortments. Customers can choose between the various retail channels to purchase the products they need (Schramm-Klein 2003).
- **Cross-channel retailing** implies a further degree of channel integration, offering seamless shopping opportunities for customers across all of a retailer's retail channels. Customers can switch retail channels at any stage of the shopping process. For example, they can order a product online but pick it up at a brick-and-mortar store.
- The highest level of channel integration, **omni-channel retailing**, involves total channel integration. Customers can shop via all retail channels in parallel, because the omni-channel system is designed as a holistic entity, ideally with every touchpoint of every retail channel available. Customers can therefore combine channels as they see fit, depending on their specific needs. For example, they can use the retailer's shopping app on their smartphones while shopping at the retailer's brick-and-mortar outlet to scan product barcodes and collect additional information via mobile Internet.

The differences between these types of channel integration in retail channel portfolios are illustrated in Fig. 5.1.

The following lists the main reasons for retailers to introduce retail channel portfolios as a strategic measure (Schramm-Klein 2003, pp. 2–3; Levy et al. 2014, pp. 72–79; Alba et al. 1997):

- To **expand market presence** into new markets (e. g., new target groups, new geographical markets, etc.).
- To establish a **strategic advantage** over single-channel competitors who are restricted to the boundaries of a specific retail channel.
- To **leverage skills and assets** to increase revenue and profits (e. g., well-known retail brands, supplier relationships, buying power, customer information, supply chain systems, etc.).
- To **overcome the limitations** of existing formats (e. g., store size, flexibility in pricing and merchandise provision, information provision modes, etc.).
- To increase **customer satisfaction and loyalty**, especially share of wallet (customers' percentage of total purchases with the retailer), by offering diverse touch points that can be used or combined according to customers' specific needs.

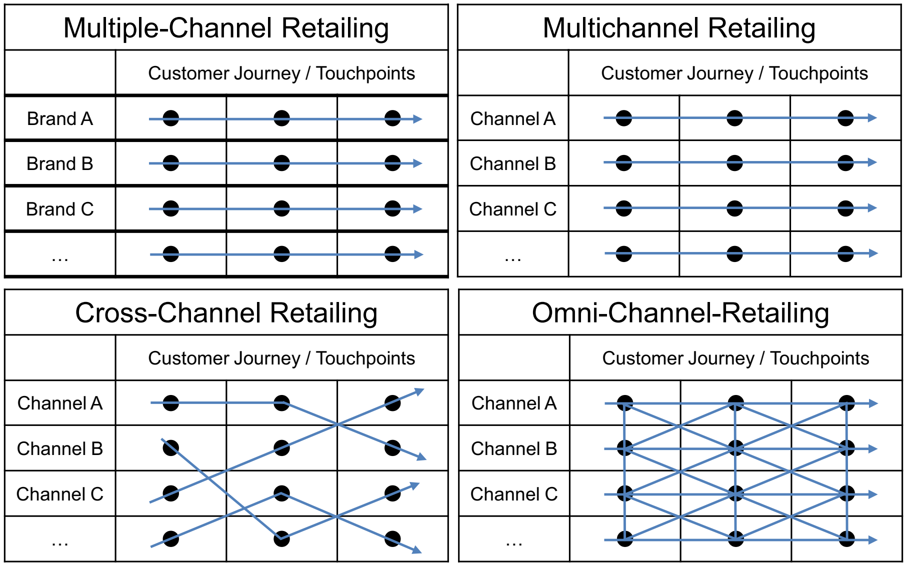

Fig. 5.1 Different degrees of channel integration in retail channel portfolios. (Adapted from Schramm-Klein et al. 2014, p. 20)

5.2 Channel Formats in Cross-Channel Retailing

By combining alternative channels to form cross-channel retailing systems, retailers can exploit the unique benefits of different retail formats and thus increase customer benefits. However, they also have to deal with the specific drawbacks associated with each retail format (see Table 5.1).

Diverse combinations of cross-channel systems are possible based on the major retail formats (i. e., stores, catalogues, online and mobile shops). Successful cross-channel retailers include *Otto* (catalogues, stores, Internet shop, mobile commerce and TV shopping), *Lands' End* (catalogues, stores and Internet shop), *Tesco* or *Walmart* (multiple store formats, Internet shop and mobile commerce) and *Douglas* (stores, Internet shop and mobile commerce). Like developments in the wake of the first Internet boom, it is expected that these new developments in online retailing with new forms and situations of online access will bring new challenges and opportunities for cross-channel retailers and profoundly reshape the retailing landscape.

Store formats for food (see Chap. 2) and general merchandise (see Chap. 3) are often the lead channels in cross-channel retail strategies (offline-first strategies). However, the growing relevance of online retailing has led to online-first strategies based mainly on the diverse online shopping formats, expanded by offline channels, for example stores or catalogues (see Fig. 5.2).

Table 5.1 Relative attractiveness of alternative retail formats to consumers

Channel / Dimension	Retail Outlet	Catalogue	Mobile Channels (Smart-phone, Tablet, etc.)	Computer Channels (PC, Laptop, etc.)	Internet-enabled TV Channels (Smart TV, etc.)
Shop Format	Store as point of purchase	Print, online (telephone, fax, Internet) ordering	App, mobile optimised site, computer optimised website	Website	IETV app, IETV optimised site, computer optimised website
Reach	Regional	Home	Nearly everywhere	Home, work	Home
Access	Opening hours	service hours (telephone only)	24 h	24 h	24 h
Product Range/ Assortment	Low/medium	Low/medium	High	High	High
Timeliness of Products/ Data	Medium	Low	High	High	High
Handling	Easy	Easy	Limited	Easy	Limited
Entertainment Potential	High	Low	Low	Medium	High
Social Interaction	High	Low	Low	Low	Low
Privacy	Low	High	Medium	High	High
Comparing Alternatives	Low	Medium	High	High	High
Delivery Time	Immediate	Ranges from same-day delivery to several days	Ranges from same-day delivery to several days	Ranges from same-day delivery to several days	Ranges from same-day delivery to several days
Payment Options	Cash, debit card, credit card, mobile payment	Invoice, debit card, credit card, wire/bank transfer	Invoice, debit card, credit card, PayPal, wire/bank transfer	Invoice, debit card, credit card, PayPal, wire/bank transfer	Invoice, debit card, credit card, PayPal, wire/bank transfer

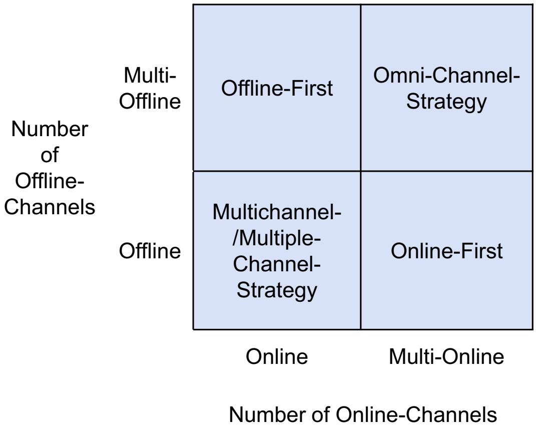

Fig. 5.2 Types of multi-format retail strategies

The emergence of new online formats combined with customers' growing preference for shopping online has reduced the importance of catalogue retailing, the traditional non-store retailing format where the available assortment is communicated to consumers through a catalogue and customers order by mail, phone or fax. The two main catalogue formats are general merchandise catalogues and specialty catalogues, which are respectively used by retailers who offer a broad variety of product categories (e. g., *Otto*, *JCPenny*, *La Redoute*, or *Freemans*) and those who focus on specific categories of merchandise such as clothes (e. g., *Madeleine*, *Lands' End*) or sporting goods (e. g., *SportScheck*) with an extensive assortment depth. The assortment policy for general merchandise catalogue retailers is comparable to that of department stores, with specialty catalogue retailers corresponding to specialty stores. In recent years, many general merchandise catalogue retailers have switched from annual catalogues to providing two or three general catalogues per year. In addition, general merchandise catalogue retailers have also begun to print separate catalogues focusing on specific product or target groups.

Because catalogues let consumers browse merchandise and place orders at any time from almost anywhere and make information easily accessible, they provide specific benefits for multichannel retailing. Even Internet retailers acknowledge that their customers like to browse catalogues and that this often generates the initial (or final) buying impulse. Thus **magalogues** have emerged as a specific element of multichannel retailing, a new form of catalogues used by online retailers. Magalogues are like magazines (see Fig. 5.3), and as well as showcasing merchandise, they are enriched with editorial content, thus enhancing customers' desire to read them.

The evolution of new devices that allow Internet access in innovative ways has precipitated the development of a new form of multichannel retailing systems by combining different types of online shopping devices (see Fig. 4.6) into multichannel e-commerce systems (see Chap. 4). In such a multichannel e-commerce environment, consumers conduct their customer journeys across multiple e-channels (e. g., mobile devices) and e-channel touchpoints (e. g., mobile shopping apps). Thus no physical or traditional channels (i. e., no stores or traditional remote ordering channels) are involved.

Fig. 5.3 mytheresa.com magalogues. (Mytheresa)

5.3 Retail Channel Integration

5.3.1 Customer Journey in Cross-Channel Retailing

Cross-channel retailing lets customers actively combine diverse retail channels for a multi-path purchase. During their purchasing process, consumers access and use a multitude of information sources and expect seamless transition between channels. Multichannel, cross-channel and omni-channel retailers (i. e., retailers applying an **umbrella brand strategy**, where all retail formats belong to the same retail brand), must provide a consistent image to consumers across all their channels. Thus, the integration of retail channels is one of the major issues of cross-channel retailing, one which retailers still struggle with.

In many cases, customers use several retail channels during their **buying processes**. For example, consumers might get initial information on brands and product types from a catalogue, inspect them physically (e. g., for colours, materials, content) in-store, check prices and availability online, complete the transaction in the Internet shop and finally pick up or return products in-store (see Fig. 5.4).

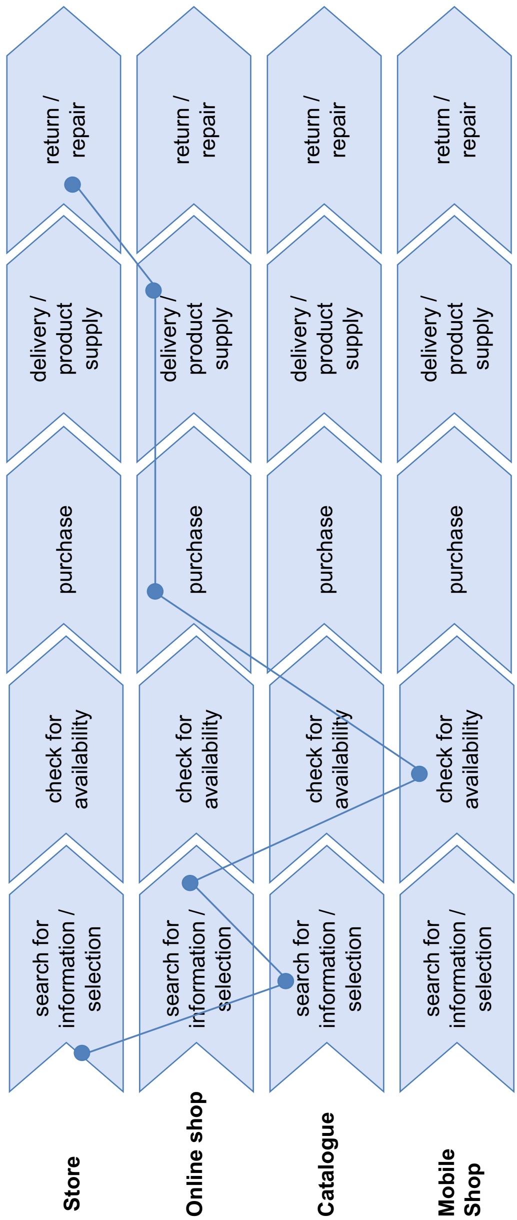

Fig. 5.4 Customer journey in cross-channel and omni-channel retailing

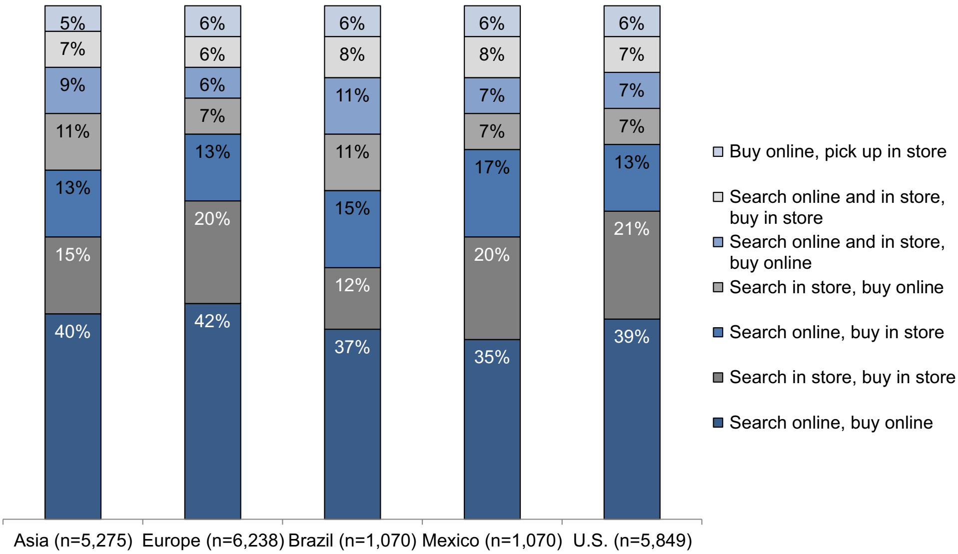

Fig. 5.5 Most common purchase paths when using cross-channel retailers. (Adapted from UPS/comScore 2015)

5.3.2 Front-end Integration

During the purchasing process, channel integration can facilitate front-end processes involving the interface between retailer and customer (i. e., those processes that involve the retailers' **customer touchpoints**). Front-end integration might relate to information research, the purchasing phase, product handover and delivery or the post-purchasing phase. Channel integration therefore has to be guaranteed for every part of the retail marketing mix.

For example, customers often use the online channel to gather information on products, prices and delivery options (see Fig. 5.5). They frequently prepare their purchase online, but ultimately make their purchase in-store. This behaviour is also referred to as **ROPO** (research online, purchase offline) behaviour or **webrooming**. However, the opposite phenomenon can also be observed, with customers visiting brick-and-mortar stores to gather information before using online or mobile stores to complete their purchase. This behaviour is called **showrooming**, because shoppers us the stores as physical showrooms without buying the products in-store (Rapp et al. 2015).

These behaviours mean that retailers applying integrated channel strategies must offer their customers consistent retail brand images, regardless of which channel these customers use. In this context it is important to consistently design the appearance, atmospheres and marketing and promotion strategies for each channel in order to maintain distinct retail brand images.

To guarantee the parallel or complementary use of alternative channels along the customer journey, it is crucial for retailers to consistently integrate their service, as-

Table 5.2 Strategy options in cross-channel marketing mix strategies. (Adapted from Bearing Point 2012)

Strategy options	Customer experience	Price	Assortment	Fulfilment	Customer segments
Enter new customer segments	Different, orientated towards target segment	Equal and different	Different, target orientated	Isolated, partially integrated	Different
Predominance of a customer segment	Consistent, not necessarily equal	Equal	Generally equal	Core tasks integrated	Equal
Predominance of a category	Consistent, not necessarily equal	Equal, online widened	Deeper online	Integrated	Equal and different
Cross-channel leader	Identical customer experience over all channels	Equal	Equal	Integrated	Equal

sortment and pricing strategies. Consistency in this context does not mean that the service levels, assortment mix and prices must be identical for all channels. On the contrary, to leverage the additional benefits that result from mixed channels, it is often important to implement distinct, channel-specific strategies that allow retailers to offer well-integrated but complementary services (see Table 5.2). Efficiency concerns may also play a role. For example, offering identical assortments across all channels could incur high inventory costs.

Cross-channel retailers can actively promote **channel-switching** behaviour among their customers by applying different channel integration strategies, for example introducing **cross-channel promotions**. Applying these strategies, retailers offer promotions through one channel that are converted via other channels in their cross-channel retailing system. For example, they could offer coupons via their online or mobile stores that can be redeemed in their brick-and-mortar stores, or vice versa.

Other strategies focus on information and assortment integration (Morschett 2012). For example, retailers can offer additional product information via **QR-codes** attached to their shelves, products or catalogues which direct shoppers to the retailers' mobile stores or information platforms to access further product information, customer reviews or multimedia content such as product videos or **augmented reality** features (see Chap. 15). Augmented reality can also be used to complement in-store information in an experimental, multimedia-based form by transferring elements of online shops into the physical store.

Actively fostering and promoting **channel integration** can help overcome the disadvantages of alternative channels (see Table 5.1). For example, brick-and-mortar stores often

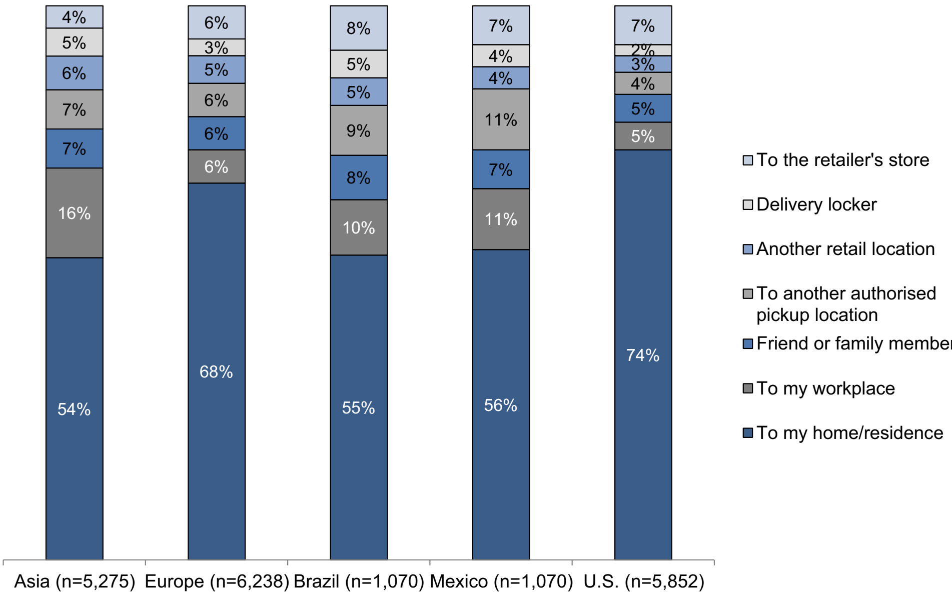

Fig. 5.6 Delivery preferences for items ordered online. (Adapted from UPS/comScore 2015)

suffer from limited store space, both in terms of the sales floor and branch inventories. It is easier and more efficient to offer large assortments, especially slow-moving items, in online channels, because there is no floor space limitation and logistics can be centralised in central warehouses or specialised distribution centres. In stationary retail branches, on the other hand, inventories are more vulnerable to obsolescence and it is difficult to keep large stocks available. Channel integration in the form of integrating online shop elements such as virtual shelves into the stores can be used to expand the store assortments, thus allowing stationary retail outlets to offer a (theoretically) unlimited product range.

One of the main advantages of retail stores is direct product availability. This cannot be achieved online (for physical products). Regardless of where the transaction takes place, there are diverse forms of merchandise **delivery** available. In cross-channel retailing, the most important forms are delivery to the consumers' home, workplace or specific pick-up points. However, retailers also offer additional delivery forms that are not currently as established (see Fig. 5.6).

There is a new trend of retailers allowing items ordered online to be delivered to stores ("click-and-collect"). Return processes can also be relayed via stores, i. e., customers return products bought online to a physical store and can directly choose a more suitable product alternative. Reserve-and-collect approaches are similar strategies that combine online availability checks with store pick-up. Many retailers in home improvement or consumer electronics, such as *Currys, MediaMarkt*, *Saturn* and *B&Q*, apply this strategy. Several food retailers, such as *Asda*, offer this service as well.

The goal of such strategies is not simply to offer customers faster access to their items; they also try to foster channel integration to achieve cross-selling goals when customers visit stores to pick up their items or to return unsuitable products.

Delivery to stores or pick-up approaches thus offer several advantages to cross-channel retailers, such as (Morschett 2012):

- Store pick-up or delivery is usually free for customers.
- Store pick-up and delivery are usually more efficient for the retailer, because the customer is responsible for last-mile logistics.
- Online stores generate footfall at retailers' local stores, thus providing cross-selling opportunities.
- Return rates can be reduced, because customers can inspect and try the items ordered online at the store.

5.3.3 Back-end Integration

Channel integration, especially in cross-channel and omni-channel approaches, requires more than simply a strongly coordinated interface between the retailer and the customer, as described in the previous section; it also requires integration of the so-called back-end (i. e., the processes that support customer-related selling and marketing activities, such as procurement, supply-chain management or organisational processes).

Even though there are diverse strategies for integrating back-end processes to various degrees (see Table 5.3), it is advantageous to fully coordinate these processes in cross-channel retailing. Integrated back-end systems provide retailers the best opportunity to offer a similar and inter-coordinated shopping experience to their customers across every channel and to achieve cost efficiency throughout the channel system.

5.3.4 Complexity in Cross-channel Retailing

Dealing with a multitude of retail channels, formats and customer touchpoints in addition to implementing cross-channel integration significantly increases the complexity of retailers' structures and processes. As well as dealing with the individual constraints and specifics (see Table 5.1) of each channel, channel integration demands strong coordination across all processes and activities such as sales, logistics, promotion, pricing, assortment or services strategies for every channel to guarantee a consistent channel system.

Together, the integrated retail channels form the image of the retail brand. While positive spill-over effects are likely to occur when consumers are satisfied with their shopping process, if problems occur in one channel, negative image spill-overs are likely to affect the other channels and harm the entire retail brand.

Channel integration therefore also reduces retailers' **strategic flexibility**. To guarantee a consistent image, coordinated channel strategies reduce freedom of activity for each channel, because the retailer is optimising every channel as a holistic construct, rather than each individual channel. This might lead to drawbacks that affect the operation of individual channel processes and reduce the efficiency of specific channels.

Table 5.3 Back-end process integration strategies. (Adapted from Bearing Point 2012, p. 41)

<table>
<tr><td rowspan="4">Procurement/ Supply Chain Management</td><td>order management</td><td colspan="4">centralised services</td><td colspan="4">centralised controlling</td><td colspan="4">isolated, channel-specific procurement</td></tr>
<tr><td>limit management</td><td colspan="4">integrated for all channels</td><td colspan="4">decentralised, IT based</td><td colspan="4">isolated channel-specific</td></tr>
<tr><td>supply information management</td><td colspan="4">integrated information system</td><td colspan="4">partly channel-specific information management</td><td colspan="4">isolated, channel-specific information management</td></tr>
<tr><td>integrated planning</td><td colspan="4">fully integrated planning</td><td colspan="4">partly integrated, channel-specific planning</td><td colspan="4">isolated, channel-specific planning</td></tr>
<tr><td rowspan="3">Sales</td><td>inventory management</td><td colspan="4">inventory available and accessible to all channels, integrated inventory management</td><td colspan="4">inventory information available to all channels, no access across channels</td><td colspan="4">isolated/ channel-specific inventory management per channel</td></tr>
<tr><td>return management</td><td colspan="3">centralised planning, centralised inventory</td><td colspan="3">decentralised planning, centralised inventory</td><td colspan="3">centralised planning, channel-specific inventory</td><td colspan="3">decentralised planning, channel-specific inventory</td></tr>
<tr><td>sales management</td><td colspan="4">centralised sales management</td><td colspan="4">centralised planning, decentralised sales</td><td colspan="4">channel-specific sales management</td></tr>
</table>

5.4 Conclusion and Outlook

In the current retailing landscape, a large number of companies are engaged in cross-channel retailing. Almost all large retailers with physical stores have opened online shops, and most category specialists such as *H&M*, *Deichmann*, *Best Buy* or *Decathlon* operate omni-channel retailing systems. Even though catalogues remain an important means of retailing, online channels are proving vital for remote ordering retailers.

Even though there are many successful examples of multichannel, cross-channel and omni-channel retailers, these strategies are not appropriate for every retailer. For example, small and medium-sized retailers rarely have the financial and managerial resources needed to create seamless omni-channel environments by consolidating disparate retail management systems into a single, customer-focused system. Additionally, the potential

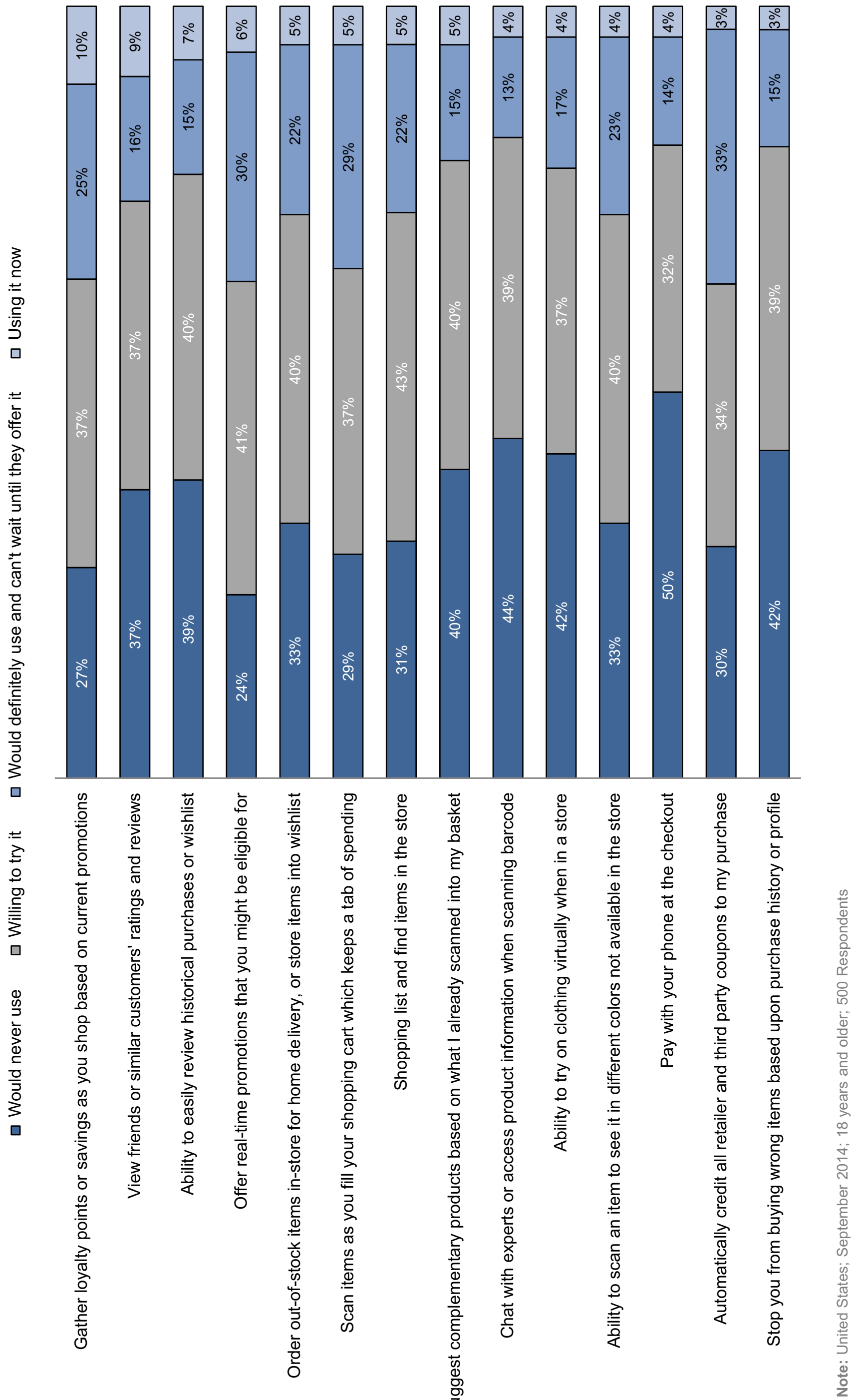

Fig. 5.7 Willingness to use services offered through mobile devices while shopping in-store. (Adapted from Accenture 2014)

synergies of a multichannel, cross-channel or omni-channel system are not the same for all retailers.

It is likely that **omni-channel retailing**, offering on-line services to the shopper, will become even more important in the coming years. One of the main challenges of cross-channel retailing is that customers are increasingly using different retail channels in parallel. For example, it is common for consumers to engage in **second screen** usage (i. e., using a tablet or smartphone while also watching TV or using their desktop computer). Similarly, consumers often use their smartphones while shopping or strolling at brick-and-mortar stores and show a high propensity for using integrated retail services in-store (see Fig. 5.7).

However, pure online retailers such as *Amazon*, *Zalando* and many others are among the most successful retailers in their industries, offering successful multichannel e-commerce systems. Their strategies imply that cross-channel retailing does not necessarily need to include traditional store-based or offline remote ordering channels. Based on the success of click-and-collect services, some primarily online companies such as the German consumer electronics retailers *Notebooksbilliger.de* and *Cyberport* have begun to rethink their e-commerce position and invest in physical stores, in an attempt to develop an omni-channel approach. For example, in February 2015, *Amazon* opened its first physical store at Purdue University in Indiana, offering students cheaper books and supplies and employing a click-and-collect service system. Of course, this particular shop is not a large bookstore in a shopping arcade, but it is an interesting sign when a large online retailer expands its delivery options through physical stores. Another example is *Google's* physical store in London. Beyond the fact that *Google* is not really a retail-based e-commerce player like *Amazon*, the shop itself is designed for customers to try out *Google* technologies such as phones, tablets and laptops running *Android* and *Chrome*. These kinds of company expansion indicate the ways a brand can engage with customers through different channels.

Further Reading

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- Wagner et al. (2013). Effects of cross-channel synergies and complementarity in a multichannel e-commerce system – an investigation of the interrelation of e-commerce, m-commerce and IETV-commerce. *The International Review of Retail, Distribution and Consumer Research*, 23(5), 571–581.

5.5 Case Study: B&Q

5.5.1 Profile, History and Status Quo

B&Q[1] is one of the *Kingfisher Group's* main retail brands, along with *Castorama*, *Brico Dépôt* and *Screwfix*. For more than 40 years, *B&Q* has been successful in the DIY business and has become one of the largest home improvement retailers in Europe. *B&Q* generally operates via large-scale warehouses with extended opening hours, a wide range of products and highly trained staff, although there are also some smaller mini-warehouses with standard products for basic needs. Every week, over three million customers visit one of these stores.

Richard Block and David Quayle founded the company in 1969. They opened their first store in Southampton (UK) as *Block & Quayle*, which was later abbreviated to *B&Q*. From the very beginning, Block and Quayle's unique selling proposition was for their company to provide high-value service, long opening times and a wide range of products to serve every unique customer need, including tools, screws, hardware, outdoor furniture, building supplies, lights, and bathroom and kitchen accessories. Ten years later, the company massively expanded with more than 20 stores evenly distributed throughout the United Kingdom. By 1982, *B&Q* had upgraded their retail stores and become a wholly owned subsidiary of the *Kingfisher Group*. During that time, both founders left the business. Under the direction of the *Kingfisher Group*, *B&Q* grew rapidly through acquisitions and expansions.

In the mid-1990s, *B&Q* became an international business, opening the first overseas home improvement centre in Taiwan and a subsidiary in Shanghai, as well as launching

Table 5.4 Historical overview of *B&Q*'s development and internationalisation. (*B&Q* 2015a)

	Company Development
1996	Company founded by Richard Block and David Quayle
1979	Expansion with 26 *B&Q* stores in the United Kingdom
1982	*B&Q* becomes part of the *Kingfisher Group* Expansion to 280 stores
1995	Opening of the first larger *B&Q* Warehouse store
1996	The first store outside the United Kingdom opens in Taiwan
1998	*B&Q* merges with French retailer *Castorama* *B&Q* becomes the largest home improvement retailer in Europe
1999	Shanghai store opens
2001	Launch of the website www.diy.com

[1] As well as the explicitly cited sources, this case study uses the websites www.diy.com and www.kingfisher.com, as well as various annual and interim reports and investor relations presentations.

the website www.diy.com (see Table 5.4). *B&Q* celebrated the opening of their first store in Hong Kong in 2007. Today, the company manages over 320 stores, mostly located in the UK and China, employing over 36,000 people and offering approximately 40,000 different products. As a result of this expansion, in 2013/14 the company reported retail sales of 3.7 billion GBP with profits of 187 million GBP. Together with other ventures like *Castorama*, *Brico Dépôt* and *Screwfix*, the *Kingfisher Group* is currently the largest home improvement retailer in Europe and the third largest in the world.

This success is primarily based on *B&Q's* customer retention strategies. In recent years, *B&Q* invested over 60 million GBP in omni-channel activities to offer a homogeneous shopping experience to its customers through their different retail, online and mobile channels. This investment should provide the technology and software needed to respond to changing shopping behaviours.

5.5.2 Omni-channel Strategy and Digital Applications

Mike Durbridge, *B&Q's* omni-channel director, has explained that digital infrastructure must always support the customer at every stage of the purchase process via a consistent user interface and design, making it easier and faster to browse through the different product categories, become inspired and ultimately reserve and order the desired products. For Durbridge, it is important to offer customers a wide range of purchase methods. Based on this idea, *B&Q* has developed different digital applications for their omni-channel strategy, in addition to local stores.

Digital Touchpads

Every store is equipped with large digital touchpads that allow the customer to search and browse for specific products. Additionally, the display directs the customer to precisely where the product is located. The touchpads also provide product installation instructions, how-to guides, project-specific shopping lists and product recommendations. All this information can be printed for free in-store or sent via email.

Club System

B&Q has also established an online club system which lets customer earn personalised rebates and coupons for future purchases. In addition, if a customer provides their membership number during the purchase process, the company saves all necessary information in case they want to change or return the product. So the customer no longer needs to retain the physical receipt.

Website

The company website www.diy.com was launched in 2001, providing 24/7 access to every product (including 20,000 extra products for home delivery only). In addition, the website provides expert advice, inspirational room ideas and tutorials, customer reviews and ratings, general information, community activities and recommended links. The website has a responsive design for mobile devices. This was an essential move for Durbridge, as by 2013 half of *B&Q* website traffic already came from mobile devices, split evenly between tablets and phones.

Mobile App

B&Q has developed a mobile app and has offered free Wi-Fi in its stores since 2012. Aside from the service benefits of the Wi-Fi connection, customers can use the *B&Q* app on their mobile devices as a verification process for club membership offers. The app also provides localised promotions and product and company information. Another important feature of the mobile app is that costumers can scan the barcode of every product, giving them access to product pages, instructional videos and reviews. Customers receive a unique identifier, which lets *B&Q* track data from individual customers across the different offline and online channels throughout the search and purchase process, including desktop, mobile or in-store touchpoints.

Click & Collect

One crucial success factor for *B&Q's* omni-channel strategy is the *Click & Collect* service, which lets customers search for specific products and pay online via the website. Later, the customers can collect the item from their local store. Depending on when they place the order, many items will be available for collection in-store the next day. Products which are available for *Click & Collect* will be marked with a blue button on the product page. Customers using this service can choose a store to collect their item from (see Fig. 5.8).

After the purchase process is complete, the customer receives a confirmation e-mail and a telephone call from the store, explaining when the item will be available. The customer can

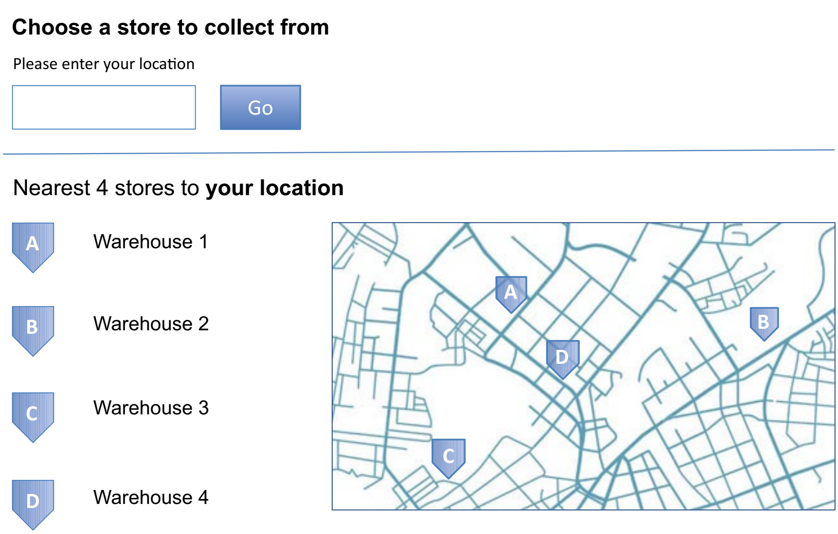

Fig. 5.8 *B&Q's* Click & Collect service. (Adapted from B&Q 2015b)

collect the item, with no need for further payment. In 2015, Mike Durbridge explained that the *Click & Collect* service is the central driver for all omni-channel activities. The ability to not only search for a product but also purchase it to collect in-store without long delivery times is essential for a convenient customer journey. This kind of service has proven very successful, particularly in the UK. In a company survey in 2014, 95 % of all shoppers reported that they planned to use the *Click & Collect* service during the Christmas season. Furthermore, 40 % stated that they also buy extra products when collecting their order from stores, generating additional sales. According to Durbridge, the biggest challenges faced by a *Click & Collect* service in the near future is to reduce customer waiting times to a maximum of a few hours and to make the collection process even more convenient, for example via drive-through options.

Home Delivery

Customers can also order almost any product from the website for home delivery, including heavy and bulky products such as timbers, bricks and blocks. All these items are marked with a "delivery booking service available" indicator. Customers purchasing these items online can enter their delivery details and automatically be offered the earliest available delivery date (usually 24 hours after purchase). Customers can also change this date whenever they want. *B&Q* also provides free delivery on orders over 250 GBP.

Art Technology Group Platform

Since 2015, *B&Q* has implemented an *ATG platform* on their website. This content management system allows the company to deliver a personalised buying experience for each customer. After the customer logs in, this technology creates bespoke websites on every digital touchpoint with individual product information, personalised search options and recommendations. The *ATG* features also help the customer find the products they want faster and let them pre-order products and receive coupons. The system also provides staff with the same level of individual customer purchase information, which supports in-store consulting services.

B&Q was the first business-to-consumer company in the *Kingfisher Group* to launch this kind of platform, providing personalised content on their website, mobile sites, in-store and contact centre systems. The main differences for customers were changes to the navigation systems on these digital channels. Instead of searching for a specific product or product category, the customer now browses through digitally designed rooms on the website. Thus, instead of searching for, say, a table, they can now look at different furnished rooms and get inspiration for what kind of furniture would be appropriate for their own living rooms. In this way, the system always generates individual customer journeys to a product.

5.5.3 Improving Customer Communication

With this kind of omni-channel strategy, *B&Q* has evolved a different approach to customer communication. Based on the premise that today's customers want to receive information through their preferred channel, it is important for *B&Q* to contact potential consumers at the appropriate time and via the most appropriate channel. A personalised approach with homogenous branding and relevant product content is much more effective at boosting customer loyalty than simple promotions or coupon drives.

Vicky Garfitt, *B&Q's* digital marketing manager, explains that: "Loyalty is a two-way street: to foster loyalty in our customers, we have to provide the right sort of experience for them online and in store. However, in order to get the most out of a loyalty scheme, it's important to have a dedicated team, which is able to put effort into both launching and sustaining it. A considerable amount of work and resources goes into maintaining a loyalty scheme and it's only through cross-department collaboration, focus on the customer and the integration of requests that retailers can hope to make a real change inside the business" (Garfitt 2013). Therefore, it is also important to invest in new technology and take the risk that individual ideas may not work out. The chance to build quality, long-term relationships with customers through these channels is far more important.

5.5.4 Summary and Outlook

Having presence across different channels and providing a high-quality user experience is not simply a way to gain new customers and foster brand loyalty, it is also a way to quickly adapt to changing shopping behaviours. The *Kingfisher Group* has recognised these opportunities and invested in omni-channel technology, trying to roll out platforms and business models across their different retail brands.

They have also optimised their distribution and logistics treatments to ensure all their products can be delivered on demand to the appropriate store via the most efficient routes. *B&Q* and *Screwfix* are currently the most prominent and important brands here.

"Where there are opportunities to expand and innovate we will do so using a combination of existing and new formats. We will pursue low risk market entry and new flexible store format strategies based on the utilisation of current skills and capabilities available within the Group" (Kingfisher Group 2015).

Questions

1. Describe or illustrate three different customer journeys to the same product via *B&Q's* offline and online channels.
2. Besides the fact that the customers have different ways to buy products, what are the major advantages of this kind of omni-channel strategy?
3. Evaluate the opportunities and risks involved when a formerly pure e-commerce company like *Zalando* opens a local store.

- Look at the service section of the company website www.diy.com to analyse different customer journeys.
- Read the interview on https://econsultancy.com/ (2013) with *B&Q* director Mike Durbridge about the advantages of an omni-channel strategy.

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Vertical Players – Manufacturers and Verticals

6

Abstract

This chapter will describe the role of controlled and secured distribution systems in manufacturers' channel strategies and explore the business model of a vertically integrated manufacturer/retailer. Traditional retailers are increasingly adopting vertical integration to innovate, conduct quality management and even produce products. The impact on retail competition will also be discussed.

6.1 Channel Innovations and New Business Models as Driving Forces of Competition in Retailing

Some of the most important changes in the retailing industry involve new vertical marketing systems or new distribution arrangements for many manufacturers and verticals (**vertical retailers**).

Manufacturers operating in **secured distribution systems** (fully integrated systems) or **controlled distribution systems** (contractually-based systems) are increasingly common retail players. In both types of vertical marketing systems, the manufacturer can exercise power over the distribution channel (Zentes et al. 2006). Fig. 6.1 illustrates the motives or goals for manufacturers implementing vertical marketing systems.

In addition to this **downstream verticalisation** tendency from manufacturers who have traditionally operated with wholesalers and/or retailers in **independent systems**, other approaches can be identified. **Born verticals** perform all production and distribution functions from the moment they are founded. **Vertical retailers** are traditional retailers who modify their **value chain architecture** via upstream verticalisation to exploit the competitive advantages of verticals.

J. Zentes et al., *Strategic Retail Management*, DOI 10.1007/978-3-658-10183-1_6

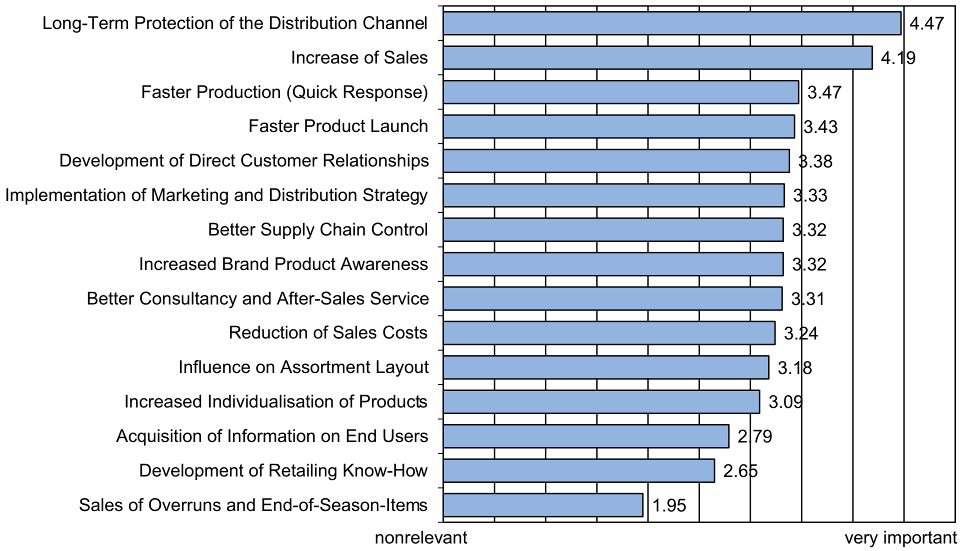

Fig. 6.1 Reasons for verticalisation. (Zentes et al. 2006, p. 12)

6.2 Downstream Verticalisation

6.2.1 Secured Distribution Systems

Overview

In secured distribution systems (fully integrated systems), the manufacturer performs every distribution function. In addition to traditional direct selling, new kinds of secured distribution systems are emerging, including electronic selling (online retailing) and equity stores.

Direct Selling

Direct selling is a traditional vertical marketing system where salespeople interact with customers face-to-face either at the customer's home or work. They demonstrate the merchandise and/or explain a service, take orders and sometimes deliver the merchandise (Levy et al. 2014, pp. 70–71). This kind of fully integrated system "emphasizes convenient shopping and a personal touch, and detailed demonstrations can be made" (Berman and Evans 2013, p. 175). Because no stores are needed, direct selling has lower overhead costs. Direct selling is employed by manufacturers such as *Avon*, *Tupperware* and *Amway*.

Fig. 6.2 illustrates the development of the economic importance of direct selling in terms of turnover and sales force. Overall, the worldwide total turnover generated by direct selling has grown by more than 40 % in recent years (1998–2009; the database from 2010 onwards is not comparable with previous years). Table 6.1 shows the importance of the sales force in the direct selling systems of leading manufacturers in this field.

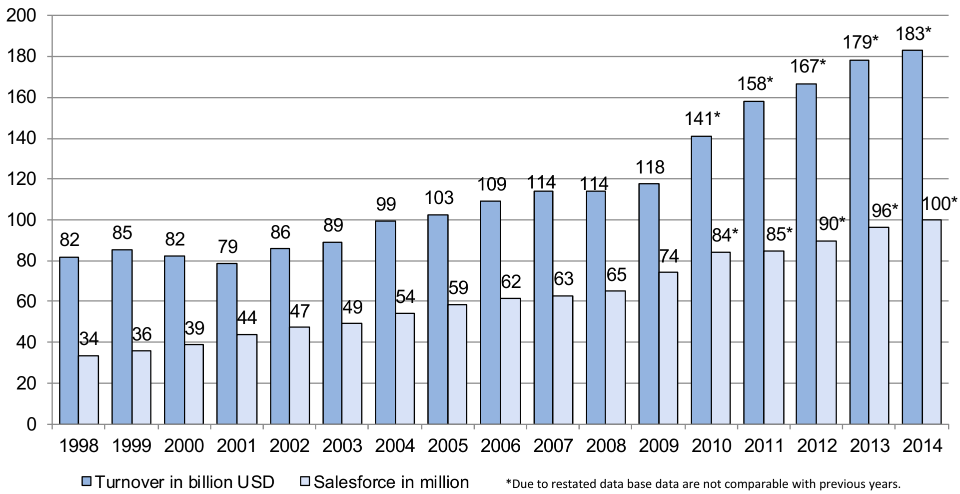

Fig. 6.2 Development of direct selling (worldwide). (World Federation of Direct Selling Associations 2015)

Table 6.1 Sales force size of leading direct selling firms in 2013. (Direct Selling News 2014)

Company	Country (HQ)	Salespeople/Partners
Amway	USA	3.0 million
Avon Products	USA	6.0 million
Herbalife	USA	3.0 million
Vorwerk	GER	0.6 million
Mary Kay	USA	3.0 million

Electronic Selling

Electronic selling (via Internet, e-commerce, m-commerce or television) is a technological variant of direct selling. Manufacturers communicate with customers and offer products and services for sale via digital channels such as the Internet or television (see Chap. 4). Some manufacturers, such as *Apple*, have also begun using this distribution channel within the framework of a **multi-channel** or **cross-channel approach** (see Fig. 6.3).

Manufacturers from all industries are increasingly “discovering” this form of secured distribution via online selling. A recent example is *Procter & Gamble*, which has begun selling its cosmetics, hair care, shaving and home care products via its Internet store.

Equity Stores

Equity stores are a brick-and-mortar approach to secured distribution. The manufacturers operate store retail formats. The major types are concept stores, flagship stores and factory outlets.

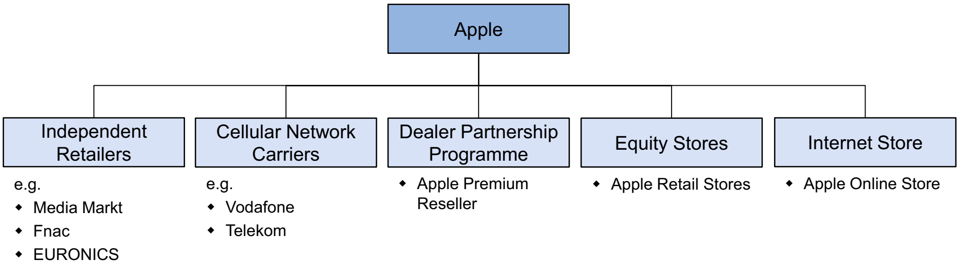

Fig. 6.3 Multi-channel/cross-channel distribution example – *Apple*

Manufacturers, especially in the apparel, footwear, jewellery, sports equipment and homeware industries, often operate **monobrand concept stores**. These stores, usually located in traditional shopping streets, shopping centres or malls, can be classified as **monobrand specialty stores** (see Chap. 3), offering a manufacturer's complete assortment via in-store marketing which communicates the "fascination" of the brand. Under the ownership of the manufacturer, multiple store units are managed as a **retail chain**. The manufacturers exert strong control and decision-making, including **price fixing**, is centralised.

Manufacturers from all industries use equity stores. For example, the Swiss company *Nestlé* runs around 320 *Nespresso* shops in key cities around the world. These combined retail outlets and coffee shops are exclusively managed as equity stores.

In **flagship stores**, top manufacturers (e. g., *Gucci*, *Nike*, *Apple*) offer their entire assortment via high quality presentation (lifestyle presentation) in premium locations in large metropolitan markets. Kozinets et al. (2002, p. 17) identified three characteristics of flagship stores:

- They carry only a single brand of product.
- They are company-owned.
- They aim to build brand image rather than simply generate profit.

Factory outlets, operated as isolated stores (freestanding retail outlets) or integrated in factory outlet centres (FOCs), are viewed by manufacturers "as an opportunity to improve their revenues from irregulars, production overruns, and merchandise returned by retailers" (Levy et al. 2014, p. 56).

In an example of a comprehensive multi-channel distribution system, *Nike* sells its products through different types of channels: independent retailers or retail chains such as *SportScheck* in Germany, *Foot Locker* in the United States, Canada and the United Kingdom or *Finish Line* in the United States; flagship stores, as in New York, Miami, San Francisco, London and Berlin; factory outlets, for example in factory outlet centres in Zweibrücken, Herzogenaurach and Metzingen (Germany), New Orleans (USA), Brisbane (Australia) and Alicante (Spain); and an online shop.

6.2.2 Controlled Distribution Systems

Overview
Controlled distribution systems have extremely diverse structures which vary from industry to industry. In general, these so-called **contractual concepts** can be broken down into contractual dealer systems*,* franchise systems and commercial agent or commission agent systems.

Contractual Dealer Systems
Contractual dealer systems or **dealer partnership programmes** are (long-term) partnership contracts in which the manufacturer offers a limited support package to participating dealers. This support package could include marketing, advertising, training or IT support, among others. In most programmes the dealer also benefits from a shared corporate or retail branding. As a reward, the dealer focuses on marketing the manufacturer's brands. "The concepts are often viewed as customer loyalty programmes for independent dealers through which the company can rapidly increase its retail presence" (Uellendahl 2002, p. 208).

There are also dealer partnership programmes, for example in the apparel industry as **shop-in-shop concepts** and **corner concepts** (Zentes et al. 2006), or in the tyre business (replacement business) as dealer partner concepts. For example, the *Goodyear Dunlop Company* runs contractual outlets in Germany through the retail concepts *HMI* and *HMI plus*, in the United Kingdom as *HiQ* and in France as *Vulco*. Contractual dealer systems in the fashion or apparel industry include support for in-store marketing, assortment or merchandising management and supply chain management, as discussed in Chap. 12, 15 and 19.

Franchising
Franchising (see also Chap. 7) involves a contractual arrangement between a franchisor (e. g., a manufacturer) and a (retail) franchisee, "which allows the franchisee to conduct business under an established name and according to a given pattern of business" (Berman and Evans 2013, p. 128). Linked by a shared business interest, each partner contributes to the cooperation. Thus, the franchisor and franchisee benefit from each other's strengths. Uellendahl (2002, p. 208) describes the structure of franchise systems, using the example of *Goodyear Dunlop's Premio* and *Quick* franchises, which operate in the German tyre replacement market:

- The franchisor contributes their extensive business expertise and organisation (e. g., a full support package including marketing, sales promotion, training, IT, auto service, CRM, national advertising, business counselling, business planning, common branding, financial support, etc.).
- The franchisee contributes their individual effort as an independent businessman in the local market.

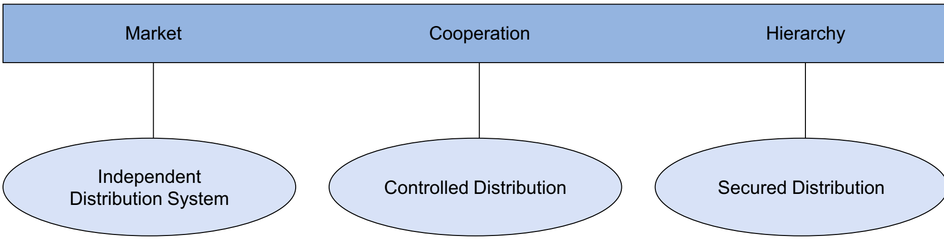

Fig. 6.4 Vertical marketing systems and transaction cost economics

As controlled distribution systems, franchise systems are operated in many industries, for example by car manufacturers (auto/truck dealers), auto accessory manufacturers (auto accessories stores), consumer electronics manufacturers (consumer electronic stores), hardware manufacturers (hardware stores) and apparel manufacturers (specialty stores). Examples in the apparel industry include *Palmers*, *Rodier*, *Benetton*, *Boss*, *Marc O'Polo*.

Commercial Agent/Commission Agent Systems

A third category of contractual arrangements is commercial agent systems and commission agent systems. A retailer operating as a **commercial agent** or **commercial representative** "is constantly entrusted with the task of arranging transactions on behalf of another business person (i. e. the manufacturer) or concluding such transactions in their name. The arrangement of transactions in the name of a third party distinguishes the commercial representatives from a **merchant** who concludes transactions in his own name for his own account" (Committee for Definition of Terms in Trade and Distribution 2009, p. 23).

Commercial agent systems let manufacturers control the retail prices of their goods and services. In other forms of controlled distribution, e. g., contractual dealer systems or franchise systems, **vertical price fixing** is not allowed (in the European Union). Besides equity stores, an agent system is the best way to fix consumer prices. Another possibility is **consignment selling**, whereby the manufacturer owns items until they are sold by the retailer. This contractual arrangement can be combined with controlled distribution systems. However, this combination is rare in practice because of legal restrictions (in the EU).

A **commission agent** is a commercial operator who undertakes the sale of goods in his own name for the account of his principal. The commission agent bears the risks resulting from the commission contract towards the customer (Committee for Definitions of Terms in Trade and Distribution 2009, p. 23).

Commercial agent and commission agent systems are common in the oil distribution business, but also in food and non-food retailing. Oil companies like *BP*, *Esso* or *Shell* run worldwide networks of equity stations and petrol stations operated by self-employed commercial agents. Another example is the German company *Tchibo*, which runs equity stores and cooperates with retailers and bakeries by using commercial agent contracts.

Table 6.2 Advantages and disadvantages of secured and controlled distribution concepts

	Strengths	Weaknesses
Equity stores	High degree of control organisational control brand/promotional control guaranteed distribution	High capital costs huge operational costs
Franchising	Limited/no capital costs less ownership risk guaranteed distribution low fluctuation	Limited control
Commercial/Commission agent systems	High degree of control organisational control Brand/promotional control guaranteed distribution	Capital costs (of goods)
Contractual dealer systems	Relatively low-cost solution rapid expansion	Little control high risk of losing partners less stability

Concession Shops

Concession shops are positioned between secured and controlled distribution systems. “A concession shop refers to a cooperative space concept in the trade in which a concessionaire rents a selling area from a trading company and manages it. As in the case of shop-in-shop concepts, the concession area is separate from the rest of the shop by its own design and corresponding shopfitting elements. The concessionaire sells its goods for its own account, i. e., bears the merchandise risk. A concessionaire normally operates the shops with its own personnel. Marketing activities and merchandise-management processes like shop design, assortment planning, price policy or merchandise procurement and control are normally within the area of responsibility of the concessionaire” (Committee for Definition of Terms in Trade and Distribution 2009, pp. 60–61). The retail company acts as a **lessor**, receiving both a flat rate for its services and remuneration based on turnover (**concession fee**). In this way, the retailer bears part of the sales risk, rather than solely letting space.

6.2.3 Advantages and Disadvantages of Secured and Controlled Distribution

Secured, controlled and independent distribution systems are presented in Fig. 6.4, which characterises these systems in the context of the market-hierarchy paradigm of **transaction cost economics**.

Table 6.2 provides an overview of the main advantages and disadvantages of the different concepts of controlled and secured distribution. The “high degree of control” in secured distribution systems (equity stores) and commercial agent systems includes retail pricing.

Table 6.3 H&M's global outlet network. (H&M 2015)

Country	Number of Outlets	Country	Number of Outlets
Australia	3	Lithuania	7
Austria	73	Luxemburg	10
Belgium	77	Malaysia	19
Bulgaria	16	Mexico	9
Canada	73	Netherlands	136
Chile	1	Norway	118
Croatia	14	Philippines	5
China	278	Poland	140
Czech Republic	43	Portugal	30
Denmark	98	Romania	38
Estonia	6	Russia	75
Finland	59	Serbia	5
France	205	Singapore	10
Germany	439	Slovakia	16
Great Britain	253	Slovenia	12
Greece	31	South Korea	22
Hungary	35	Spain	163
Ireland	21	Sweden	177
Italy	133	Switzerland	94
Japan	53	Turkey	30
Latvia	6	USA	364

6.3 Verticals

6.3.1 Value Chain Architecture of Verticals

Born verticals perform or at least coordinate all production and distribution functions themselves from the time of their founding. Examples are often found in e-business, but also in store formats. *Chocri* (www.chocri.de), for example, sells customised chocolate bars exclusively over the Internet. *Hennes & Mauritz* (*H&M*), *Mango* and *Zara* are all successful examples from the apparel industry, where verticals are gaining market share, and *IKEA* is a well-known example from the furniture industry. Table 6.3 provides an overview of the global outlet network of *H&M*.

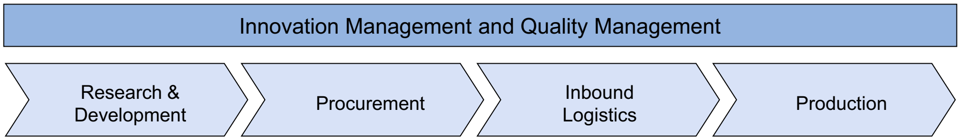

Fig. 6.5 A producer's (supply-side) value chain architecture. (Hertel et al. 2011, p. 94)

The value chain architecture of a vertically integrated manufacturer or retailer corresponds to the model of a **producer** or a **coordinator** on the supply side. Verticals usually produce a significant share of their products, and sometimes produce all of their products themselves, in which case they act as producer (see Fig. 6.5). *Zara,* for example, a company from the Spanish *Inditex* group, produces around 50 % of its merchandise in its own manufacturing facilities.

As a coordinator, verticals control or coordinate upstream value chain activities like procurement, production and logistics for their contract manufacturers through their own internal innovation and quality management. They concentrate on *intellectual value creation* (see Fig. 6.6).

Looking downstream (i. e., at the demand side of the value chain architecture), verticals sell their merchandise according to a **secured distribution** model, meaning through equity stores and other channels such as online shops (see Fig. 6.7). But they also use controlled distribution, e. g. franchising.

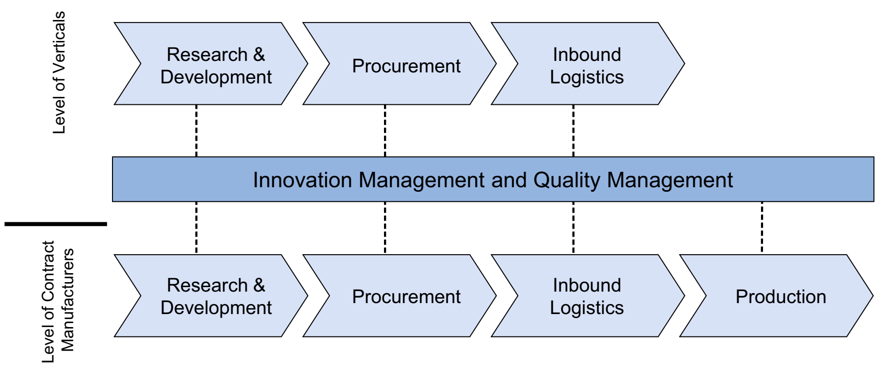

Fig. 6.6 A coordinator's (supply-side) value chain architecture. (Hertel et al. 2011, p. 94)

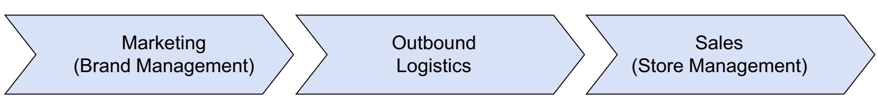

Fig. 6.7 Secured distribution (demand-side) value chain architecture. (Hertel et al. 2011, p. 98)

6.3.2 Competitive Advantages of Verticals

Verticals create essential competitive advantages through their uniform market image. They have direct market access, meaning direct access to the consumer, and thus can fully implement their **branding strategy** (see Chap. 9). They control assortment, store layout, merchandise presentation, market communication, customer relationship management and retail pricing (in the case of secured distribution). This uniform market image guarantees them control over conveying the "fascination" of the brand.

Therefore, they can create a **unique selling proposition** (USP) in the form of exclusivity. Products marked by official, unique designs and/or specific qualities that are different from competitors' products are only available in their outlets, where they are offered in a brand-compliant manner.

Vertical integration via in-house sourcing or procurement through contract manufacturers not only leads to cost advantages compared with outside suppliers (see Jennings 2001), for example in production and inbound logistics, but also leads to other market-based competitive advantages. Verticals can create an innovative competitive advantage through a highly efficient supply chain. In this context, **speed** is a key factor in the competitive strategies of so-called **fast-fashion retailers**. *Zara,* for example, has significantly influenced this strategic group by optimising its supply chain. As a result of this optimisation, *Zara* can produce and sell a piece of clothing – from design to production to delivery and availability in its stores worldwide stores – in under 15 days (Ferdows et al. 2005, p. 84).

6.4 Verticalisation of Traditional Retailers

Today's retailers and most sectors' most important **buying groups** have an increasing number of store brands in their assortments (see Chap. 12). "This development will continue, whereby a clearly modified working method in the conception, management and character of these brands will be added. It will further enhance the triumphal procession of exclusive store brand concepts and it will further increase the importance of these concepts on a retailer's profitability" (Janz and Swoboda 2007, p. 301).

These brand concepts have led to increasingly independent store brands and have blurred the distinction between store and manufacturer brands. These brand concepts have also led to increasing vertical integration. Thus, traditional retailers are not only trying to catch up with verticals' competitive advantages in **product differentiation**, but also in areas such as **supply chain management**.

Outside supply for these companies means control over the upstream value chain of their contract manufacturers via their own innovation and quality management (coordinator's value chain architecture). In addition to this form of **controlled production, secured production** (in-house sourcing) sources products through company-owned production facilities.

In food retailing, many companies have been verticalised upstream for a long time. The American company *Kroger* is one example. Approximately 40 % of *Kroger's* store brand units are produced in *Kroger's* 37 manufacturing plants. The remainder are produced by outside manufacturers according to *Kroger's* strict specifications.

With the exception of verticals, external production dominates the fashion industry. However, the influence of retailers on the supply chain is increasing, for example via store brands (see Merkel et al. 2008, p. 32). Retailers are creating assortments and procuring products directly. Although manufacture of the finished product remains with suppliers, retailers are verticalising the process by taking over the procurement and logistics of fabrics and ancillary items (yarn, labels, accessories, and packaging) which are then delivered to production plants (Merkel et al. 2008, p. 41). This kind of external production is called **cut-make-trim (CMT)**.

KATAG is a European buying group that directly influences its independent retail partners' marketing through an innovative **floor management model** and also influences its contract manufacturers' production (controlled production) in the Far East, by

- designing products internally,
- setting ecological, social and ethical standards, and
- procuring accessories.

6.5 Effects on Retail Competition

6.5.1 Channel Conflicts

The development of controlled and secured distribution channels as possible sales channels is a core element in many manufacturers' marketing strategies (**downstream verticalisation**). While secured distribution used to involve the development of equity chains (owned by the manufacturer), the situation has changed significantly. Thanks to the Internet, manufacturers can sell directly to consumers without brick-and-mortar stores, and dealer partnership programmes and franchising let manufacturers engage in contractual distribution systems (cooperation with independent dealers). Technological developments and contractual arrangements have increased the potential for controlling distribution channels.

The main challenge for manufacturers is to manage the conflict in multi-channel and cross-channel distribution systems between independent retailers selling products from a particular manufacturer, retailers cooperating in a contractual system with this manufacturer and competition from the manufacturer's equity stores or other direct distribution channels.

Conflicts in distribution channels or **channel conflicts** are not a new phenomenon. They are well known in the consumer goods industry. **Conflict theories** in retailing explain retail change in terms of rivalry between new and established retail institutions (see Chap. 1). This approach refers primarily to **horizontal conflicts** (i. e., conflicts between different retail formats), but can be transferred to "vertical retail institutions" as new players (see, e. g., McGoldrick 2002, pp. 24–25).

Vertical channel conflicts are the result of **shifts in power**. Traditionally, consumer goods distribution was characterised by a manufacturer-centric view of channels. Retailing was a relatively passive link in the distribution channel from manufacturers to consumers. However, the abolition of **resale price maintenance** (e. g., in 1964 in the UK and 1974 in Germany), the concentration of retail trade, the development of store brands and retail branding have shifted power from manufacturers to retailers. This development of **retailer power** can be seen in the relative weakness of manufacturers in customer negotiations. The dependence of suppliers on major retailers has spurred the development of new vertical systems to control or even secure the distribution, including the intention of building brand image. Through verticalisation, manufacturers are **re-balancing** the power within the distribution channel. This re-balancing has led to a new type of channel conflict, where manufacturers are suppliers to both retailers and their competitors.

6.5.2 Corporate Social Responsibility and Supply Security

Another competitive advantage of an integrated value chain and shift in the competitive arena is how consistent control of all processes affects compliance with ecological and social standards. **Corporate social responsibility** (CSR) and **sustainability** are increasingly important in public debates, and are also necessary elements of future-oriented corporate strategies (see Chap. 10). At the same time, social and ecological positioning offers the potential for corporate profiling. This in turn requires holistic **compliance management**.

Hennes & Mauritz (*H&M*) provides a good example of **managing sustainability**. "Our Head of Sustainability reports directly to our CEO and the responsibility for the implementation of our sustainability strategy is held by our executive management team. We have a total of around 170 colleagues who work with sustainability as a core task. At our head office, our sustainability team consists of more than 20 people responsible for developing global targets, reviewing progress, and encouraging and advising all relevant departments on the development and implementation of prioritised Conscious Actions. With this support, in turn each department is responsible for developing and carrying out their Conscious Actions to fulfil our seven commitments. […] Major sustainability issues influencing more than one department and conflicting interests are discussed in a decision-making form called the Green Room with the involvement of our CEO" (H&M 2013, p. 10).

Sustainability, in the sense of a company's social, ecological and economic responsibility ("**people**, **planet**, **profit**") is increasingly paired with **supply security**. Besides the responsible handling of natural resources (e. g., agricultural and metal resources), the question of access to these resources is increasingly found on strategic corporate agendas. The growing global population and changing consumption patterns in developing and emerging countries has led to shortages due to limited expandability of supply, for example of agricultural cultivation areas (see PwC/H.I.MA. 2010). Thus, **backward vertical integration** includes not only production but also preliminary stages, all the way down to agricultural production (e. g., cultivation of bio-cotton). Verticals have a competitive advantage over traditional retailers here, and (downstream) verticalised manufacturers will exercise this competitive advantage in the same way.

For example, the Dutch fashion company *C&A* emphasises long-term business relationships with suppliers to secure **win-win situations***:* "At *C&A* we recognise that the best way to achieve sustainable success is to act in the long-term interests of our internal and external stakeholders, the wider society – and our planet" (C&A 2014, p. 6). These long-term partnerships also include cooperation with **non-profit organisations** (NGOs): "It was through dialogue with non-profit organisations on organic cotton that we initiated a partnership to develop new methods and innovations in the supply chain and to launch our Bio Cotton initiative" (C&A 2014, p. 10).

6.6 Conclusion and Outlook

Manufacturers' main demand-side challenges involve managing multi-channel or cross-channel distribution systems and conflicts between distribution channels. They are also restructuring their value chains upstream, for example by outsourcing production activities and concentrating on "intellectual" activities such as innovation and quality management. In addition, the challenges of sustainability and supply security require new approaches to backward vertical integration. Ultimately, this leads to new **value chain architectures.**

New value-creation systems, such as verticals, compete not only in downstream markets but along the entire supply chain. In this context, the **agile fashion industry** provides a clear example of the competitive advantages that strong performing supply chain management can create via a **quick response** (QR) approach. While QR originated in the fashion industry, this approach can be adapted for other sectors, e. g., the grocery sector.

In response, traditional retailers are increasingly integrating upstream activities into their value chains: developing store brands produced by contract manufacturers ("controlled production") or at their own production sites ("secured production"). This strategy leads to a higher degree of **upstream verticalisation** ("vertical retailers") and ultimately means a convergence of manufacturers and retailers' value chain architectures (see also Chap. 1).

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6.7 Case Study: HUGO BOSS

6.7.1 Profile, History and Status Quo

HUGO BOSS[1] is a globally active fashion and lifestyle group and one of the global leaders in the premium and luxury segment of the apparel market. Today, the company focuses on developing and marketing men's and women's premium fashion and accessories. The company's early success is based on a long history of practical experience in exclusive fashion industries and producing and distributing clothes.

The German group dates back to 1924, when Hugo Ferdinand Boss opened his clothing factory with financial support from two other manufacturers in Metzingen, Germany. Until the end of the 1960s, production and manufacturing steadily expanded under the control of Boss' son-in-law, Eugen Holy. After receiving its first orders for men's suits during the 1950s, the company started its first series production. This was the start of a new era and laid the foundation for the company's future success. Nine years later, Jochen and Uwe Holy, Eugen Holy's sons, absorbed the fashion group and transformed it into the international company it is today. In 1985, *HUGO BOSS* changed its company structure into a public holding company and was listed on the German Stock Exchange in Frankfurt. In 2007, *HUGO BOSS* presented its collection for the first time in New York. Today, the company is a regular part of the New York Fashion Week (*The New York Times* 2014).

Nowadays, the former manufacturing plant in Germany has developed into a global player in the premium and luxury segment in classic and elegant clothing, along with accessories that appeal to modern, successful and self-confident customers. Fig. 6.8 shows

[1] In addition to the explicitly cited sources, the sources for this case study include the website http://group.hugoboss.com and various annual and company reports.

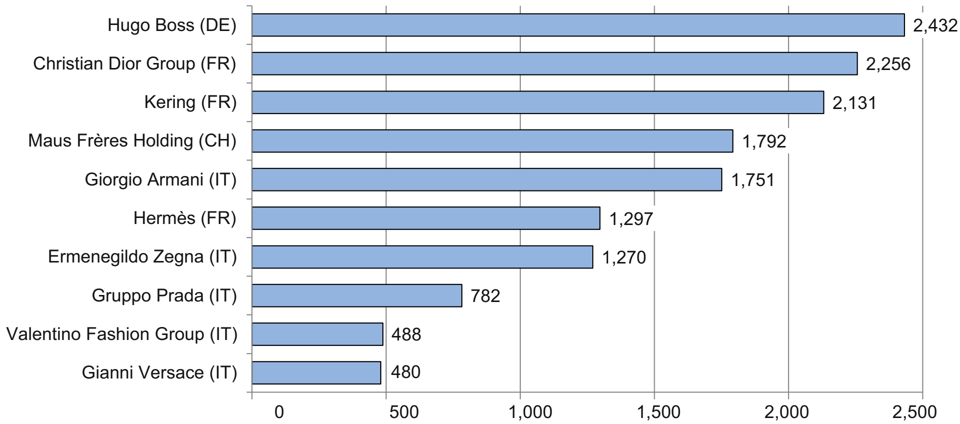

Fig. 6.8 Leading European clothing manufacturers in the luxury segment as of 2013 (sales in million EUR). (Adapted from TextilWirtschaft 2013)

HUGO BOSS' turnover compared to other European clothing manufacturers in the luxury segment.

In recent years, *HUGO BOSS* has been pursuing a multi-branding strategy that seems to be successful. This includes the *BOSS* core brand for authentic and understated luxury with business, evening and casual attire for men and women. The *BOSS* core brand is complemented by *BOSS Orange* and *BOSS Green*. *BOSS Orange* offers urban casualwear outfits with an uncomplicated and modern look, while *BOSS Green*, the group's premium sportswear line, contains functional golf apparel and modern leisure collections in impressive colours. In addition, the *HUGO* brand provides progressive looks in both business and leisurewear. The brand portfolio comprises a huge product assortment from classic to modern collections, shoes, leather accessories, licensed watches, eyewear, children's fashion, home textiles, mobile accessories and fragrances. With its wide selection, the company addresses clearly differentiated target groups and simultaneously satisfies their needs.

For years, *HUGO BOSS* has been one of the most profitable listed clothing manufacturers worldwide. In the 2014 fiscal year, *HUGO BOSS* generated annual sales of 2.57 billion EUR, a 6 % increase compared to 2013. *HUGO BOSS'* annual turnover is based on four operating segments: sales in Europe, Americas, Asia/Pacific and licenses, which include business with external companies. As Table 6.4 shows, Europe (including Middle East and Africa) experienced the highest sales at 1.5 billion EUR, a 7 % increase over 2013. America also played an important role with sales of 586.6 million EUR, followed by Asia/Pacific with annual sales of 360.8 million EUR. Licenses provide the smallest turnover at 57.7 million EUR. In 2014, the company's EBIT was 448.7 million EUR.

HUGO BOSS is also a new entrant in *Interbrand's* (2014)'s "Best Global Brand" ranking. *HUGO BOSS'* brand value is 4.1 billion USD, making it the world's 97th most valuable brand (Interbrand 2014).

Table 6.4 Sales by region (in million EUR). (Adapted from HUGO BOSS 2015, p. 80)

Region	2014		2013	
	Sales	Share of Sales [%]	Sales	Share of Sales [%]
Europe	1566.5	61	1457.3	60
Americas	586.6	23	570.1	24
Asia/Pacific	360.8	14	346.8	14
Licenses	57.7	2	57.9	2
TOTAL	2571.6	100	2432.1	100

Today, *HUGO BOSS* operates in 130 countries and runs about 7600 points of sale worldwide. In addition, the company owns 1041 retail stores and runs 19 showrooms, where the collection is demonstrated and sold to the wholesale customers. The company also owns five production facilities in Germany, Turkey, Poland, Italy and the USA, which allows the company to protect crucial expertise and provide consistent development for subsequent industrial manufacturing. The company currently has around 13,000 employees who form the basis of the company's success by adhering to the group's mission statement "*HUGO BOSS* inspires people towards success" (HUGO BOSS 2015, p. 51).

6.7.2 HUGO BOSS' Verticalisation Approach

With its diverse retail activities, *HUGO BOSS* employs a verticalisation strategy, distributing its products to globally selected partners among upmarket retailers and through *BOSS* stores, which are run as franchise systems or through the group's directly operated stores (DOSs). The company benefits from both secured and controlled distribution as it conducts a range of sales activities from *BOSS* flagship stores to freestanding stores, factory outlets, shop-in-shops, multi-brand points of sale, franchising and license agreements and Internet sales.

Secured distribution is the most significant part of *HUGO BOSS'* distribution system, with a sales share of 57 % of the company's total revenue. This includes a huge range of totally integrated secured distribution channels from the group's DOSs to outlets and online sales. Table 6.5 shows the retail stores' total sales structured by distribution channel for the past five years.

The group combines its extensive expertise as a long-established manufacturer with various distribution activities to provide its customers a first-class retail experience. This has led to strong control over the vertically integrated channels and allows for flexible decisions about store designs and concepts, such as the product range and in- and out-of-store marketing.

Table 6.5 Sales by distribution channel (in million EUR). (Adapted from HUGO BOSS 2015, p. 80)

Distribution Channel	2010	2011	2012	2013	2014	Share of Sales 2014 [%]
Directly Operated Stores	447.7	617.7	757.6	874.0	976.4	38
Factory Outlets	223.7	273.6	343.2	378.6	427.1	17
Online	19.7	32.9	48.9	61.5	67.8	2
Group-run Retail Business	691.1	924.2	1149.7	1314.1	1471.3	57
Wholesale	993.2	1085.3	1139.7	1060.1	1042.6	41
Licenses	45.1	49.3	56.5	57.9	57.7	2
TOTAL	1729.4	2058.8	2345.9	2432.1	2571.6	100

In the 2014 fiscal year, sales at *HUGO BOSS'* DOSs increased by 12 % to 976.4 million EUR and contributed 38 % to the group's positive sales development. This includes revenue from the company's own freestanding stores and sales generated by *HUGO BOSS* shop-in-shops in retail partners' sales areas.

During the past five years, the number of *HUGO BOSS'* retail businesses has almost doubled, from 537 in 2010 to 1041 in 2014. The group has focused on establishing retail businesses in growth markets, where the company's presence is still relatively low.

Flagship stores are a special type of DOS which boost *HUGO BOSS's* brand impact and customer retention due to their size and exclusivity. Flagship stores also play a major role in *HUGO BOSS's* global image, so the group continues to open and renovate flagship stores in major cities all around the world, including Rome, Shanghai, Hong Kong, Zurich, Amsterdam, Vienna, Stuttgart, Moscow, Tokyo and New York.

HUGO BOSS factory outlets are specialist stores that sell preseason products in highly frequented outer city locations. The outlet stores offer casual and business apparel along with accessories such as eyewear, ties and wallets at discounted prices (Metzingen-Best 2014). In 2014, *HUGO BOSS* owned 122 outlet stores worldwide, most of them in Europe (49 stores), immediately followed by the Americas (46 stores). The outlet business contributed 427.1 million EUR to the group's retail business revenue.

HUGO BOSS stores are operated as mono-brand concept stores. In the future, the core brand *BOSS* will cover an even greater area of the group's retail stores to provide a globally persistent brand image and an exclusive setting with a wide variety of goods. By using standardised store designs and well-trained personnel, the company can create an extensive brand perception and reinforce its brand equity. This strategy is applied to wholesale partners as well, who can only sell the *BOSS* brand in a mono-brand context, such as shop-in-shops, to further boost brand image. Nowadays, *HUGO BOSS* runs more than

2000 *BOSS* stores, 531 of them in shop-in-shop systems and 388 part of the group's own freestanding stores.

Like the *HUGO BOSS* flagship stores, regular *HUGO BOSS* stores also concentrate on top locations in metropolitan regions. In 2014, a new store portfolio was opened across Washington, D.C., Canada and Mexico. In addition, *HUGO BOSS* expanded its European and Asia/Pacific network in 2014 by adding 56 new stores and taking over 15 stores and five shop-in-shops previously managed by wholesale partners.

Women's fashion is also increasingly important for the group's retail business. Standout presentation and the use of large areas in new stores ensures a coherent worldwide approach and provides an opportunity to attract new female customers. The group also aims to produce unique products via its "Made to Measure" approach, offering customised and tailored apparel.

The group also runs *HUGO BOSS* online stores. In 2008, the company started selling products over the Internet in the UK. Today, the group owns eleven online shops in Austria, Belgium, China, France, Germany, the UK, Italy, Spain, Switzerland, the Netherlands and the USA. In addition, *HUGO BOSS* distributes online with the aid of specialist online retailers within its controlled distribution strategy, with special emphasis placed on a high-class brand presentation to attract new customer groups.

In recent years, *HUGO BOSS* has increased its sales significantly in both stationary retail and online business. In the 2014 fiscal year, sales from the group's own online stores rose by 10 % to 67.8 million EUR. In 2015, *HUGO BOSS* plans to improve its online experience and user-friendliness by adding new features. Soon they hope to offer customers a digital flagship store.

In addition to the group's own retail business, *HUGO BOSS* also operates with wholesale partners. These include department stores, specialist retailers, franchise partners and a few specialist online retailers. While the first two offer *HUGO BOSS* products either in shop-in-shops or multi-brand points of sale, franchise partners run freestanding *HUGO BOSS* stores according to the group's guidelines. In total, wholesale partners manage 6550 points of sale worldwide. In the 2014 fiscal year, the wholesale business contributed 1.6 billion EUR (41 %) to *HUGO BOSS'* sales.

As well as the group's own retail business, which is predominantly located in superior areas, the franchise partners run stores mainly in smaller foreign markets which have not been entered by *HUGO BOSS'* own retail industry. *HUGO BOSS* grants franchisees rights to the *HUGO BOSS* brand name, which helps the company generate global awareness, humanise the brand and increase its brand perception. In total, the company operates more than 1200 franchise stores.

Nevertheless, the wholesale business declined in recent years thanks to the group's takeover activities. In March 2015, *HUGO BOSS* took over all 17 existing franchise stores from its partner *TDCo Limited* in Korea. The company will also operate seven duty-free shops in collaboration with its partners in the future. These activities demonstrate the growing significance of the Korean market as a tourist destination and fashion trend-setter. The takeover opens up new opportunities for *HUGO BOSS* to attract the Korean female market and simultaneously strengthen its market position in men's apparel. In June 2014, its brand presence was also strengthened by the complete takeover of joint venture activities with the *Rainbow Group*, a former franchise partner.

HUGO BOSS also pursued its strategy of expanding its own retail business and acquired ten stores from former franchise partners in Australia, the US and Singapore in 2013. Additionally, the group took over shares of a shop in France and absorbed mono-brand shops in Great Britain from their long-standing franchise partner *MOSS Bros* in 2011.

In 1984, additional revenue opportunities were opened up by a license business for fragrances, which includes some of today's leading products in high-class perfume market. In addition, *HUGO BOSS* offers licenses for eyewear, watches, mobile accessories, children's fashion and home textiles. License partners include *Procter & Gamble* and *Safilo*, who both hold license agreements until 2020 (Safilo 2012). *HUGO BOSS* also collaborates with *Children Worldwide Fashion SAS* and *MGI Luxury Group S.A.*, a Swiss subsidiary of *Movado Group* (Textilwirtschaft 2009, Movado Group 2012). Thus, *HUGO BOSS* profits from its licensees' expertise and distribution system.

By integrating previously licensed clothes, socks and knitwear into the group's own retail business as well as the takeover of *MH shoes & accessories*, a former licensee of *HUGO BOSS'* shoes and leather goods, the group continues to expand and gain control over its vertically integrated distribution activities.

In the 2014 fiscal year, licensing showed stable development by contributing 2 % to the group's total sales. The license income from fragrances fell only marginally in comparison to 2013, with women's fragrances compensating for declining sales of men's fragrances. License income for watches rose by over 10 %.

6.7.3 HUGO BOSS' Group Strategy and Future Activities

Over the past few decades, *HUGO BOSS* has established a strong economic performance that underlines the power of the group's business model. Based on this, the company aims at sales growth and profitability in the high single digits by 2020. By characterising new core themes, the proven strategy has been enhanced in 2014 and now focuses on five pillars:

- The elevation of the *BOSS* core brand supports the increasing verticalisation of the brand portfolio and is expected to be used in markets where the brand has been perceived principally in a multi-brand context or among entry-price products. By 2020, *BOSS* brand sales are predicted to double to around 20 % market share in the luxury segment.
- The group also plans to expand its market position in womenswear with the help of a new artistic director, Jason Wu, and to increase its share of sales to 15 % by 2020 (2014: 11 %).
- *HUGO BOSS* will also bolster its own retail operations, both online and offline, to present and sell its collections in the best possible way and provide its customers

with a seamless experience. In addition, the group will acquire components of the e-commerce value chain to provide several digital services, such as "Click & Collect" in 2016. Although the group's wholesale business will shrink, it will still remain an important channel and provide an opportunity to gain new market shares. Thanks to new openings, increased productivity and takeovers, the company expects the sales share of its retail businesses to increase to at least 75 % by 2020 (2014: 57 %).

- *HUGO BOSS's* global growth strategy also includes opening new stores or shop-in-shops, predominantly in cosmopolitan areas, as well as renovating or taking over existing stores. The group sees strong opportunities in the Asian market, so *HUGO BOSS* is working on its retail network and brand perception in the region. Thus, the group will now run partner-operated stores in Korea and the Middle East under its own initiative. The group will also absorb the last franchise stores in China. Their agreement from January 26, 2015 with the franchise partner *Wenzhou Noble* gives the group control over all 21 BOSS stores, which are currently run as franchises, from April 1, 2015. After completing this transferral, the company will run around 130 stores on the Chinese mainland. Additionally, the group plans to establish its own distribution company in the United Arab Emirates in 2015. The company will be headquartered in Dubai and will take over distribution activities in the region from January 2016. As a result, *HUGO BOSS's* collaboration with the commercial agent *Fashion Trading Company SARL* from Lebanon has been cancelled effective December 31, 2015. Despite these developments, Europe will continue to be the group's largest sales market.
- The *HUGO BOSS* group's strategy aims to maximise operational strengths to retain control of all business-critical proceedings and ensure high-performance processes to deliver excellent quality products.

6.7.4 Summary and Outlook

In recent years, the *HUGO BOSS* group has become one of the global leaders in manufacturing luxury and premium goods within the apparel industry. By operating different distribution strategies, the company is internationally active in the world's largest markets. In particular, the group's own retail business, such as directly operated stores, will become increasingly important as part of the group's verticalisation approach for penetrating new markets. *HUGO BOSS's* global growth strategy allows for extensive brand control and autonomous increase of retail operations. By assuming full control over its brand impact in the Asian market, *HUGO BOSS* reinforces its presence in the region, particularly in essential growth markets.

Finally, *HUGO BOSS'* distribution strategy lets the group attract customers in a targeted and individual manner and react to market trends. In addition, the integration of regional companies fosters speedy knowledge exchange and puts the company in the optimal position to secure further international growth.

Questions

1. List possible reasons to implement secured distribution activities from a manufacturer's perspective and apply these insights to *HUGO BOSS'* situation in detail.
2. Describe potential channel conflicts for a manufacturer adding a new company-owned retail channel and use *HUGO BOSS* to illustrate some examples. Focus on methods that are suited to managing channel conflicts.
3. Assess the contribution of *HUGO BOSS'* company-owned retail activities to the long-term success of the company.

- For a general overview of motivations for secured distribution from a manufacturer's perspective, see Tsay and Agrawal (2004).
- Consider channel conflicts between a manufacturer and independent retailer's channels and between manufacturers' channels. See the discussion in Bucklin et al. (1997) for potential channel conflicts and a framework for managing them.
- Transfer Hauptkorn et al. (2005) on success factors for verticalisation strategies to *HUGO BOSS'* current situation.

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Part II

Strategic Marketing in Retailing

Growth Strategies

7

Abstract

This chapter will introduce alternative routes to company growth for retailers. Ansoff's matrix is introduced as a strategy tool. Outlet multiplication, cooperation and mergers and acquisitions are described as the basic alternatives for expanding retail store networks.

7.1 Growth Options

Store-based retailing almost always starts with independent, single outlet operations. Compared with 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 value is often a fundamental objective from the beginning. For retailers, among other benefits, sales growth provides economies of scale in operations (e. g., IT, logistics and administration) and from purchasing from suppliers in large quantities (Ogden and Ogden 2005, p. 92).

For decades, strategic management has analysed alternative routes to company growth. The Ansoff Matrix (also called the product-market matrix) is a well-known categorisation of growth strategies (see Fig. 7.1). It consists of four separate strategies, depending on **what** products and services are offered and **to whom** they are offered (Ansoff 1988):

- With existing products in existing markets, growth can be achieved by **market penetration**. Higher sales from existing markets can be obtained by attracting current non-customers, who either do not buy products in the offered categories or who

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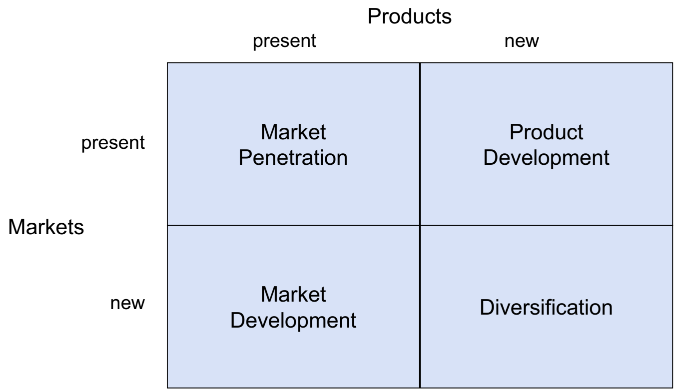

Fig. 7.1 Alternative routes to company growth – Ansoff Matrix. (Ansoff 1988, p. 109)

buy them from competitors. Alternatively, the loyalty of existing customers can be improved and the value of their shopping baskets increased.

- **Product development** involves offering new products to existing markets. This can be done by providing the existing customer base with new product categories in existing stores (see Chap. 12). One example would be apparel retailers expanding into selling shoes. Another would be *Amazon* expanding its product assortment from media products to electronics, fashion and many other categories.
- Considering that a retailer's "products" are its stores (see Chap. 9), product development in retailing often means introducing **new retail formats** in existing markets (see Chap. 2, 3 and 4). Superstore retailers like *Tesco* that open convenience stores or electronics stores that establish an online shop are examples of such "product development".
- An existing product can be targeted at a new customer segment, often in a new geographic area (**market development**). Examples include regional retailers expanding their traditional store formats into other regions or national retailers expanding into new countries. International expansion will be discussed in more detail in Chap. 8. However, it is also possible to simply target a new customer segment in an existing geographic market. A recent example of a market development strategy is the so-called **R2B** (**"retail-to-business"**) strategy (Zentes et al. 2015; Channel EMEA 2013). While retailers by definition mainly sell their products to the final consumer, some retail companies also target business customers. The main focus is usually micro and small businesses who use retail channels for their purchases. A survey by Zentes et al. (2015) showed that the main retail segments in which R2B is relevant are office supplies, electronics (including ICT), food, furniture and home improvement.Companies like *Staples* and *Office Depot* have long followed this approach, but electronics and IT retailers (e. g., *Best Buy for Business*, *Conrad Business*), furniture retailers (*Ikea Office*) and food online shops (e. g., *Asda business*) are newer examples. In 2012, *Amazon* launched *AmazonSupply*, before integrating it into the newly established

AmazonBusiness in spring 2015 to tap the business customer segment with a specific assortment, pricing and even business-specific procurement processes (including multi-user accounts, order approval workflows, etc.).

- **Diversification** involves offering new products to new markets and includes several sub-strategies: horizontal diversification, vertical diversification and conglomerate diversification.
- **Horizontal diversification** involves diversifying into a related business field at the same value chain level. In the case of a retailer, this would involve opening (or acquiring) stores dedicated to new product categories. A typical example is the German food retailer *REWE*, which now operates home improvement stores (*toom*). Here the distinction between diversification and product development is somewhat blurred, since offering new products (or new retail formats) often attracts new customer segments as well.
- **Vertical diversification** involves moving into business at the level of customers (forward diversification) or suppliers (backward diversification). Since retailers are usually the last commercial stage in the value chain, forward diversification is rare. However, backward diversification is common. As shown in Chap. 1, retailers now often operate manufacturing facilities in which they produce their own products.
- Finally, **conglomerate diversification** involves offering new products or services to new markets unrelated to the company's core business. For example, a number of retail companies (e. g., *Tesco*, *Migros*, *Auchan*) are active in banking. This is not entirely unrelated, because customer credit cards, financing, etc. for the retail process can be handled via these banks as well. Some retailers have entered into the travel and tourism market, (e. g., the *REWE Group* or *Casino*). The archetype for conglomerate diversification is the *Virgin Group*. Originally started as a record store which owned *Virgin Megastores*, the company now operates *Virgin Airlines*, *Virgin Finance* and many other unrelated businesses.

Diversification often takes retailers outside of traditional retail markets, and the management literature warns of the dangers that arise when a company's core competence lies in other fields. Diversification into unrelated domains can often lead to low performance and even failure.

Growth strategies for retailers can basically take two different forms:

- Increasing sales in existing retail outlets. This is mainly achieved via improved application of the retail marketing instruments presented in Part III of this book.
- Increasing sales by enlarging the outlet network. This is the focus of this chapter.

Establishing new stores is the most important growth route for retailers. For example, *IKEA* entered Poland in 1991 and now operates seven large stores in the country; in 2005 alone, *Macy's* (then still called *Federated Department Stores)* added 400 department stores to its store network in the USA; while *Fressnapf*, a German-based pet supply retailer, was founded in 1989 and now controls a store network of more than 1300 stores in twelve European countries, of which around 850 are in Germany. *Inditex* entered Germany in 1998 and now operates 122 outlets there, 79 of which are under the *Zara* banner. *Tesco* entered Eastern Europe in 1994 and as of 2014 operated about 1025 stores in four countries. These examples also highlight the most important options for outlet growth:

- **Organic growth**: *IKEA's* stores in Poland – and in fact most other countries – were established through organic growth.
- **Joint ventures**: *Inditex's* market entry into Germany was achieved in a joint venture with the German retail group *Otto*, before later being transferred into full ownership.
- **Franchising**: Most of *Fressnapf's* growth in Germany comes from attracting new franchise partners who open outlets under the *Fressnapf* brand.
- **Acquisition**: *Macy's* growth in 2005 was the result of acquiring the *May* company and converting these stores into *Macy's* department stores.
- **Mixed strategies**: *Tesco* entered most Eastern European markets with small initial acquisitions, buying a few stores from regional retailers or, as in the case of the Czech Republic and Slovakia, from US retailer *Kmart*. Many new stores were then opened via organic growth. However, if the opportunity to purchase additional stores emerged, the company took it. For example, in Poland, *Tesco* acquired stores from a German retailer that was exiting the country. And in the Czech Republic, *Tesco* acquired two convenience store chains, *Koruna* and *Zabka*, in 2011. While the *Koruna* stores were transformed into *Tesco Express*, *Zabka* stores are still operated by independent franchise partners. Thus, *Tesco* uses a wide range of different growth options in parallel in Eastern Europe.

7.2 Organic Growth through Outlet Multiplication

Retailers primarily expand their businesses by establishing their own new outlets. This is also called organic or internal growth. The resulting chain stores operate multiple retail stores under shared ownership and usually engage in some level of centralised decision-making. Large retail chain stores can comprise up to several thousand stores.

Advantages of Outlet Multiplication

Opening new branches has the advantage that the retailer's concept can be applied to the new store from the start. Location decisions, store layout and all the attributes of the new store can be tailored to fit an existing strategy. Store managers are company employees, which allows activities to be monitored closely and decisions to be made centrally. Risk is limited as expansion is gradual. By opening new outlets, necessary changes can be identified early, allowing the process for subsequent outlets to be modified. In addition, financing is sequential (i. e., the existing outlets can contribute to financing new outlets).

Constraints of Outlet Multiplication

At the same time, outlet multiplication can tie up considerable financial resources in the store network. Opening branches requires substantial capital investment, which is a major constraint on growth. In many markets, organic growth is slow because of zoning restrictions, planning permission, the search for sites, including the acquisition and development of premises, and so on. This runs the risk of not reaching critical mass fast enough, letting other retailers with similar concepts – but not constraints – expand faster. This problem particularly affects retailers that require large sites for their outlets (e. g., category killers and hypermarkets) (see Chap. 8), because approval for these sites is restricted in many countries.

Another drawback is the loss of flexibility over time. Many chain stores are slower to respond to changes in consumer demand and other situational factors because of the bureaucracy and decreased employee motivation typical of larger businesses. Tailoring the assortment to specific local needs is often easier for independent retailers than large chain stores (Ogden and Ogden 2005, p. 93). However, modern retail information systems increasingly allow centralised decision-making to be combined with locally adapted marketing, including a locally adapted merchandise mix or prices.

7.3 Cooperative Arrangements

7.3.1 Joint Ventures

Joint ventures are one of the most popular of the wide range of possible cooperative arrangements. Since joint ventures are not retail-specific, they will only be outlined briefly here. A joint venture is formed when two or more parties decide to undertake economic activity together and create a new enterprise as a legal entity in order to pursue a set of agreed goals. The parties agree to contribute equity and share the revenue, expenses and control of the enterprise (Morschett et al. 2015, p. 397; Sternquist 2007, pp. 148–150). For example, when the Spanish *Inditex* group entered Germany in 1998, it did so in a 50:50 joint venture with the German *Otto* group. This joint venture operated *Zara* stores in Germany.

Combining Resources

A major advantage of forming a joint venture is combining two companies' resources. Both companies bring financial and management resources, expertise, store outlets or other assets to the deal. When a retailer enters a new retail or service sector or a culturally distant foreign market, the market knowledge of a joint venture partner is particularly valuable and can facilitate expansion. In the example of *Inditex* and *Otto*, *Inditex* owned the retail brand and had the operating model for fast fashion, while *Otto* had the knowledge of the local market and better insights into location selection in Germany.

Risk Reduction

Another benefit of joint ventures is reduced risk, with risk split between the participating companies. The larger the retail company, the more likely it is to expand on its own, because larger companies can more easily manage the associate expenses and risk, while smaller companies may appreciate the support of a partner.

Coordination Costs and Conflicts of Interest

The major drawbacks of joint ventures are the high coordination costs involved when two independent partners with potentially conflicting objectives have to work together. Opportunism can emerge if one of the companies can profit at the expense of the other. Thus, managing a joint venture is more complex than managing a wholly owned company. Full control over the strategy of the joint venture is impossible, because all decisions must consider the interests of all participating companies. As a consequence, the stability of joint ventures is often rather low.

7.3.2 Franchising

The best-known examples of franchises are fast food chains like *McDonald's* or *Subway*, but franchising is also a common retail growth strategy. *7-Eleven* is probably the best-known example, but *The Body Shop* across Europe, *Fressnapf* in Germany, *ACE Hardware* in the USA, a significant number of *Carrefour's* convenience stores in France and the garden centre chain *Gamm vert* in France are other well-known retail brands operated as franchises.

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 ongoing fees (royalties), which average about 5 % of gross sales, plus some advertising fees (Inma 2005, p. 29; Sternquist 2007, pp. 138–148).

According to different national franchise associations, the franchising sectors in different country markets have reached considerable size. As of 2014, there are about 1800 franchise systems in France, about 1075 in Germany and around 930 in the United Kingdom (although the latest available figures for the UK are from 2012). On average, each franchise system has between 40 and 50 franchise outlets, but the largest often exceed 1000. All statistics show that franchising is growing steadily (see, for example, Fig. 7.2).

Division of Tasks

A fundamental characteristic of franchising is that it always involves two separate and independent companies that assume distinct roles and a strict division of tasks in order to

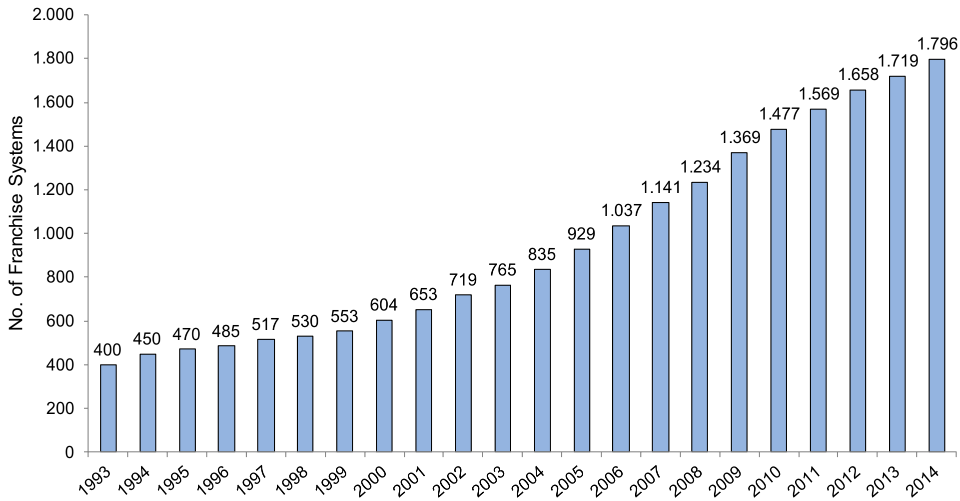

Fig. 7.2 Franchising in France. (Fédération Française de Franchise 2015)

achieve a joint objective. Since the franchisee owns their business, they are entitled to all profits that are generated. Franchising thus combines the benefits of a large, efficient retail system, including economies of scale in procurement, logistics, national advertising, IT systems and administrative activities, with the strength of an independent entrepreneur managing the outlet, including customer contact and supervising store employees (Zentes et al. 2003). The shared brand lets all participants in the franchising system benefit from the advertising and goodwill generated by each outlet. From the consumer's perspective, it is often impossible to detect the difference between franchises and company-run branches.

Forms of Franchising

There are two main forms of franchising (Sternquist 2007, p. 138):

- **Direct unit franchising** is the basic form. In a unit franchise, the franchisor grants the franchisee the right to engage in a single franchised business operated at a specified location.
- In a **master franchising** agreement, the franchisor grants the master franchisee a territory, and within this territory the master franchisee is allowed to establish unit franchises.

Sources of prospective franchisees can vary:

- Often, start-up entrepreneurs are targeted. Their inexperience makes the franchisor's business package relatively more attractive.
- In **multi-unit** franchising, successful franchisees are allowed to open new branches. This strategy is a type of organic growth within a franchise system. The number of

outlets per franchisee, however, is often strictly limited, because multiple franchise outlets diminish some of the advantages of franchising.
- **Conversion franchising** occurs when a franchisor adds new franchisees to the system by recruiting existing independent retail businesses (Hoffman and Preble 2003). Store owners may affiliate with the franchise system to take advantage of the brand and other components of the operating system.

Advantages for the Franchisee

There are a number of benefits to being a franchisee compared with running a non-franchised independent business. Upon opening the franchise store, the franchisee enjoys instant goodwill in the market because they can use an established brand name, exploit a tried-and-tested business concept and carry out standard operating procedures. The franchise headquarters will also take on certain tasks, e. g., organising a central logistics system, developing IT systems, negotiating with suppliers, developing national advertising, etc.

The franchisee also receives comprehensive information on the business concept before starting, including information on necessary investment and likely profits. They obtain training and support, and belonging to the franchise system usually provides the franchisee with easier access to financing, because from a bank's perspective it is less risky to extend credit to a franchisee, since it can provide a business plan based on the example of existing franchisees.

Advantages for the Franchisor

Franchising also conveys considerable benefits to the franchisor (Berman and Evans 2013, pp. 128–131; Cliquet and Pénard 2012; Zentes et al. 2003):

- Franchising facilitates rapid growth, particularly when the success of a concept depends upon rapid market coverage. Franchising is a way of multiplying a concept without the usual financial constraints, as franchisees finance the investment for establishing stores.
- Franchisees are highly motivated, because they manage their own stores.
- Franchisees have knowledge of local markets and customer and employee contact is direct and personal. Franchisees usually develop close relationships with their customers and local communities.
- Written franchise agreements require franchisees to adhere to stringent operating rules set by the franchisor.

Disadvantages for the Franchisor

One major disadvantage for the franchisor is that it has no direct hierarchical control over its franchisees. Franchisees are independent contract partners, not employees. Franchisees can harm the overall reputation of the franchise if they do not maintain company standards. From a transaction cost perspective, this means that a franchisor must conduct tight monitoring to avoid such freeriding. Representatives of the franchisor will often have to regularly visit the franchisees, both to advise and monitor them. Changes in the franchisor's strategy may be slow to implement because franchise contracts usually run for three to five years and substantial changes are only possible by changing the contracts. Competition between different outlets leads to stronger conflicts than in chain store outlets, because profits are shifted from one franchisee to another. Also, franchisees can ally to restrict the influence of the franchisor and attempt to change the rules. Another drawback is that, under European law, the franchisor is not allowed to fix final consumer prices for products. Accordingly, the marketing and management of a franchise system is more complex than for a truly uniform and hierarchically managed system of company-owned stores.

Often, the balance between the benefits and drawbacks of franchising leads to an evolving growth strategy during the retailers' lifecycle. The resource scarcity that motivates retailers to embrace franchising as a growth strategy in the expansion stages lessens as the system becomes more established and growth rates decline. The costs associated with managing a complex franchise system gradually outweigh the benefits associated with the resources provided by franchisees. Consequently, over time franchisors tend to buy back franchises and increase the number of company-owned stores (Oxenfeldt and Kelly 1969). However, over the past few years the opposite has been seen, since many chain stores have found operating small, company-owned stores with low turnover in certain market areas is not profitable, and the higher motivation associated with manager-owned stores has often been enough to make such stores profitable. Thus, some large chains have started to spin-off certain retail outlets and transform them into franchised stores. Smaller supermarkets and convenience stores are typical objects of such transformations (Zentes et al. 2003, p. 227).

Plural-form Networks

Franchising is rarely used exclusively; franchisors usually own a substantial number of retail outlets themselves. The complexity of managing such plural-form networks is higher than that of managing monolithic systems of company-owned stores or franchises. While synergies can be leveraged by applying two different growth strategies simultaneously, such as higher franchisor flexibility when deciding on new store openings, the risk of conflict throughout the network is substantially higher, and the management culture required to manage a franchise system of independent store owners is often different from the culture needed to manage a chain store (Cliquet 2000; Cliquet and Pénard 2012).

7.4 Mergers and Acquisitions

Companies also have the option of external growth, namely expanding by acquiring resources from other companies. Expansion through mergers and acquisitions (M&A) involves consolidating or purchasing existing retail companies or retail outlets. Like diversification, it can also involve purchasing companies in other sectors than retailing. 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) from another company. The term "acquisition" is often restricted to a full takeover. The legal independence of the acquired company can remain intact (Zentes et al. 2013, pp. 264–265).

M&A are a well-established growth mechanism which have played a major role in structural changes in the retailing sector over recent decades (Burt and Limmack 2001), both in international (see Chap. 8) and domestic contexts. Some domestic examples will now be provided.

In 2005, the merger of *Sears* and *Kmart* into *Sears Holding* created the US' fourth largest retailer. In 2014, *Dollar Tree* announced its intention to acquire *Family Dollars*, still subject to approval by the competition authorities. In 2007, the Swiss retailer *Migros* bought a 70 % stake in the Swiss discount chain *Denner*, adding 470 outlets to its store network. In the same year, the *Coop Group*, which already owned *Interdiscount*, the no. 1 consumer electronics retailer in Switzerland, acquired *Fust*, the no. 3 consumer electronics retailer in Switzerland. In 2013, the *Casino Group* acquired the remaining 50 % stake in the retail company *Monoprix*, which it had previously co-owned with the retail company *Galeries Lafayettes*. At the beginning of 2015, the US supermarket chains *Albertsons* and *Safeway* completed their merger to form a 9 billion USD company. And in mid-2015, the merger of *Ahold* and *Delhaize* was announced. When this comes into force in 2016*, Ahold Delhaize* will be one of the biggest grocery retailers in the USA and Europe. An exhaustive list of such examples would be very long.

Advantages of M&A

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 site selection to finally opening a store (Burt and Limmack 2001, p. 4). Within a short period of time, an acquisition makes an entire bundle of resources available to a company. This can be a critical success factor, especially when first-mover advantages are pursued in a new market (Meyer 2001, p. 359). Since the customer base of the acquired company can be preserved, market share is gained quickly in a new market. Thus M&A provides a company with substantial turnover in a new market from the outset, which can help pay for the investment.

After an acquisition, the original retail brand of the acquired retail outlets can be changed or retained. The brand is often kept 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, because the acquired company's existing resources – management expertise, personnel, sites and so forth – will be focused on its established field of business. Thus, one objective of an acquisition is to exploit the expertise and dedicated assets of the acquired company.

Disadvantages of M&A

However, integration costs following an acquisition can be high. Incompatibility of company strategies, capabilities, resources and cultures often results in insufficient exploitation of existing potential for synergies. The takeover and associated cultural change in the acquired company may also lead to brain drain and the loss of significant management skills. Also, in many markets it is difficult to find suitable takeover candidates. Successful retailers are usually not available for acquisition and the retail locations, stores and premises of less successful retailers are often insufficiently attractive for acquisition. However, properly evaluating the value of a retail company is difficult, and the real value and quality of the acquired company can often only be correctly assessed after the acquisition (Burt and Limmack 2001, p. 4). For example, in Germany *Walmart* found the store network it had acquired for market entry was unfavourable and no other targets for takeover became available later. The option of further expansion through acquisition may also be limited by antitrust laws, as the example of *Safeway* in the United Kingdom illustrates. In highly concentrated markets, authorities often prevent the largest players from acquiring other outlet networks.

In summary, acquisition is a strong fast growth strategy when adequate takeover objects are available, but the associated risk is substantially higher than with organic growth.

7.5 Minority Investment in Retail Companies

Owing to the difficulties associated with full-scale acquisitions, acquiring a minority stake in another retail company is another frequently pursued strategy. For example, *Kingfisher* bought a 21 % stake in the German DIY retailer *Hornbach* and supported *Hornbach's* national and international expansion, for example by providing funds. However, this stake was sold back in 2014 when Kingfisher entered the German market with its own retail chain. In 2004, Hong Kong-based *A.S. Watson* purchased a 40 % stake in the German drugstore chain *Rossmann* (see the case study for this chapter). In 2015, Australian retail market leader *Woolworths* acquired a 25 % stake in the purely online cosmetics company *Adore Beauty*.

Acquiring partial ownership of another retail company involves similar advantages and disadvantages to an acquisition strategy, but it also shares similarities with **equity joint ventures**. However, successful retail companies generally prefer for another company to buy an equity stake in their company rather than be fully acquired. Equity participation by a larger company can add resources to support further expansion. The strategy can also be useful in situations where full-scale acquisitions are difficult because of the particular market conditions or government control. At the same time, the remaining equity stake in the initial company reduces the risk of a brain drain (Zentes and Morschett 2002, p. 174), since the established management team of the acquired company often retains control, frequently only supplemented by additional management capacity from the acquiring company. This is evident when large store-based retailers acquire smaller online players, where the human capital of the online retailer is one of the most important assets to be acquired. The risk of overestimating the value of the partially acquired company is reduced compared to a full acquisition, because the acquiring company achieves full transparency over business processes and results, facilitating a potential full acquisition after a certain period.

7.6 Divestment – Reduction of Store Networks

While most companies focus on growth, some authors point out that strategic planning and analysis should also include the strategic withdrawal options from certain product or geographical markets. Sometimes closing down or divesting (selling-off) the unprofitable parts of a business or those that do not match the current strategy can help the retail company as a whole. Again, divestment can occur internationally (see Chap. 8) or domestically. Some domestic examples will be provided here.

In 2002 *Fressnapf*, the European market leader in pet food and pet supplies, closed down its online shop (which it reopened in 2010). In 2008, German retail group *Tengelmann* sold an 85 % stake in its discount chain *Plus* to German competitor *Edeka*. In 2011, *Carrefour* divested its global discount operation *Dia*. However, in 2014, *Carrefour* bought back *Dia's* 800 discount outlets in France. In 2014, German retail group *Douglas* sold the jewellery chain *Christ* to focus on its perfumery business. In early 2015, *Tesco* announced the closure of 43 unprofitable stores in the UK to optimise its store network. Also in 2015, US retail company *Dollar Tree* announced it would sell 300 of its stores to secure approval for its takeover of competitor *Family Dollar*.

These examples demonstrate that retail growth strategies are closely connected to withdrawal or reduction strategies. Withdrawal or reduction are not always the result of failure (although they often are). Other reasons can include a change in corporate strategy, a change in external conditions, the need to generate cash to strengthen operations in another retail sector or low future expectations for the specific retail format.

Generally, divestment means a retailer expects a better opportunity for investment and growth elsewhere. Retailer portfolios are often reassessed in terms of their stores, store formats and country markets, and strategic withdrawal from one retail format, region or national market often provides the starting point for expanding into other markets or for opening additional stores in the remaining markets.

7.7 Conclusion and Outlook

Growth is highly relevant for the success of a retail company, but is has become harder to achieve, for several reasons. Large retailers hold a lot of power, crowding out independent retailers and small chains, and there is already a high and increasing level of concentration in many retail markets, combined with market saturation in many product categories.

Flexible growth strategies are more important than ever. Retail companies do not normally use these strategies in isolation, as the example of *Tesco's* internationalisation or the description of plural form networks illustrates. If a retail company wants to enter a completely new country or establish a new store format (e. g., a food company entering into electronics retailing), an initial acquisition can help quickly achieve critical mass. From there, the company can grow by establishing new sites and opening stores. In addition, as was shown in the context of increasing concentration in retailing, companies often gain a major boost by acquiring smaller chains who are leaving the market.

Larger, divisionalised retail store groups with different retail formats often implement different growth strategies for different formats and/or markets. For example, *Carrefour* operates its hypermarkets in most parts of the world as its own outlets, but it franchises its system in the Middle East (United Arab Emirates, Egypt, Saudi Arabia) to the *Majid Al Futtaim Group*, which operates a number of large hypermarkets. This is probably due to difficult market conditions in this region, which are offset by its franchise partner's local knowledge. Most of *Carrefour's* convenience stores throughout the world are franchised, and the expansion of supermarkets stems at least partly from franchised outlets, although they also have a substantial number of their own outlets. In the Balkans, *Carrefour* established a joint venture in 2010 with the Greek company *Marinopoulos* to open stores in Bosnia, Slovenia, Serbia and Croatia, among others. This is typical for retail companies who use different growth strategies over time and who tailor these strategies to the retail format and specific situation.

Further Reading

- Hoffman and Preble (2003): Convert to compete: Competitive advantage through conversion franchising. Journal of Small Business Management, 41(2), 187–204.

7.8 Case Study: A.S. Watson

7.8.1 Profile, History and Status Quo

The forerunner of *A.S. Watson*[1], a small dispensary named *The Canton Dispensary*, opened in 1829 in Guangzhou, China. In 1871, the company changed its name to *A.S. Watson & Company, Limited*. Today, *A.S. Watson* is the largest international health and beauty retailer in Asia and Europe. It operates 13 retail brands with more than 11,600 retail stores in 24 countries worldwide and employs 110,000 people. Since 1963, *A.S. Watson* has been part of the Hong Kong-based conglomerate *Hutchison Whampoa Ltd.,* which comprises different core businesses: telecommunications, energy, infrastructure, investments, retail, property and hotels, ports and related services. *A.S. Watson* is *Hutchinson Whampoa's* retail division; almost all of *Hutchison Whampoa's* retail formats are run by *A.S. Watson*. In 2014, Singaporean *Temasek Holdings* bought a 25 % stake in *A.S. Watson*, partly because *A.S. Watson* is well-suited to serving the growing middle class in emerging countries.

[1] As well as the explicitly cited sources, sources used for this case study include the website http://www.aswatson.com and several editions of the newsletter WatsOn.

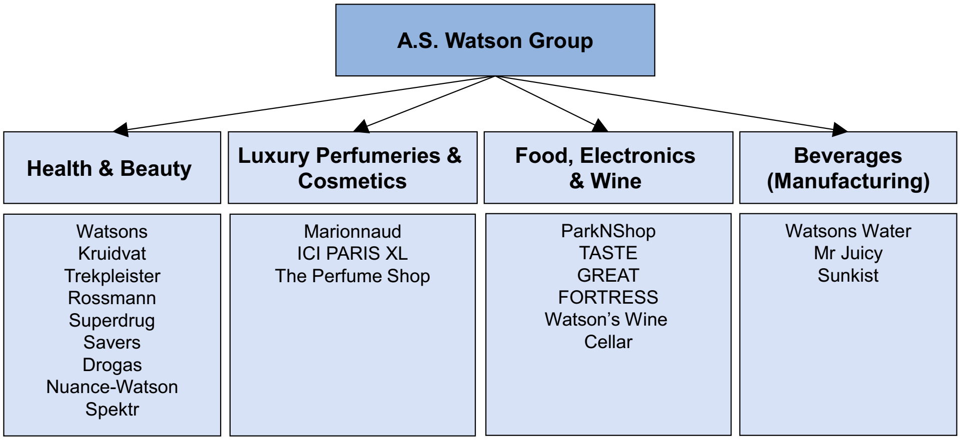

Fig. 7.3 Divisions and retail brands of *A.S. Watson*

A.S. Watson operates retail stores selling health and beauty products, perfumes and cosmetics, food and electronics and airport retail stores in Asia and Europe. The company also produces and distributes a range of own-label beverages including distilled water, fruit juices, soft drinks and tea products for retail, office and domestic supply. In the course of expanding the group's operation in Europe, business units were realigned into divisions. As shown in Fig. 7.3, there is a health and beauty division, a luxury perfume and cosmetics division, a food, electronics and wine division and a beverages manufacturing division.

A.S. Watson consists of several business units and offers a diverse brand portfolio. The health and beauty category, for example, is represented by *Watsons Your Personal Store* in Asia (Hong Kong, mainland China, Taiwan, Macau, Singapore, Malaysia, Thailand, Philippines, Indonesia, Korea and Turkey), *Kruidvat* (the Netherlands, Belgium), *Superdrug* (UK), *Rossmann* (Germany, Poland, Hungary, Czech Republic, Turkey and Albania), *Savers* (UK), *Trekpleister* (the Netherlands), *Drogas* (Latvia, Lithuania), *Spektr* (Russia) and *Watsons Your Personal Store* (Estonia, Slovenia, Ukraine) in Europe. *A.S. Watson* also sells luxury perfumes and cosmetics. It operates the retail chains *Marionnaud* (France, Austria, Switzerland), *ICI Paris XL* (Netherlands, Belgium, Luxembourg) and *The Perfume Shop* (UK, Ireland). In Asia, *A.S. Watson* operates groceries retail chains such as the *PARKnSHOP* supermarket chain (Hong Kong, Macau, mainland China). The company also owns *Watson's Wine Cellar* (Hong Kong, mainland China).

In 2014, *A.S. Watson* reported a 6 % growth in total revenue to 157.4 billion HKD (18 billion EUR) while EBIT increased 11 % to 13.0 billion HKD compared with 2013. The company reported like-for-like sales growth (i. e., sales growth in previously existing stores) of 2.3 %, with 1.4 % in Asia and 3.0 % in Europe in 2014. Thus more than half of overall growth resulted from opening new outlets. Fig. 7.4 shows the changes to the number of stores worldwide since 1999.

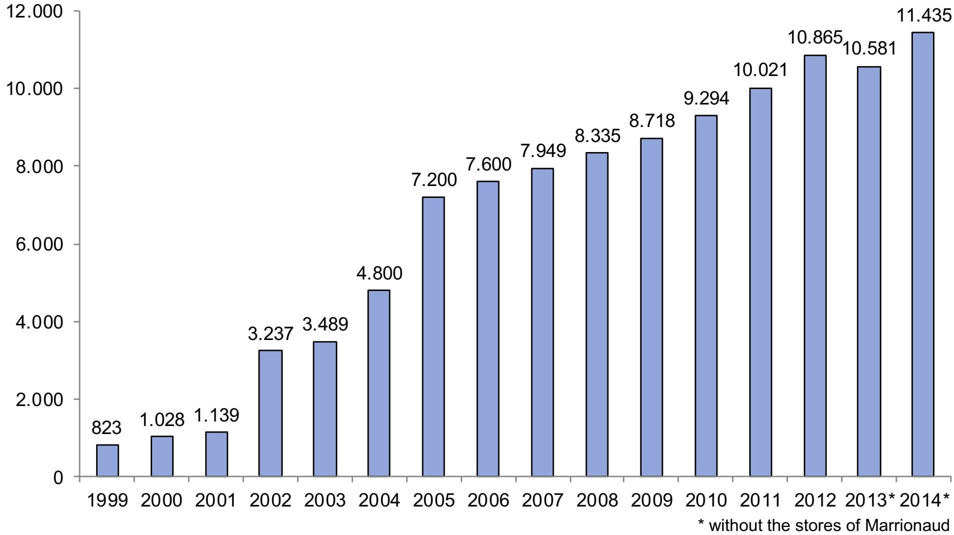

Fig. 7.4 Changes to the number of *A.S. Watson* stores worldwide. (Hutchinson Whampoa 2014, p. 27; Hutchinson Whampoa 2011, p. 9)

7.8.2 Organic Development in Selected Fields in Recent Years

A.S. Watson intends to continue to expand into high growth markets. Its strategy can be explained as a mix of market penetration (e. g., further extending the chain store network in existing markets) and market development (mainly through internationalisation into new country markets). *A.S. Watson's* international operations outside China (incl. Hong Kong) contribute about 70 % of the company's total revenue, showing the significance of internationalisation to the group's success. The internationalisation of *A.S. Watson* began as early as 1883 with market entry into the Philippines. Since 1987, *A.S. Watson* has gradually expanded into other Asian countries before entering Europe in 2000 (Zentes et al. 2011, p. 171).

As discussed in this chapter, a primary method for a retailer to expand its business is organic growth – usually through outlet multiplication. *A.S. Watson's* strategy includes a diversified product offering and an expanding customer base owing to new store growth. In 2011, Ian F. Wade, former Group Managing Director of *A.S. Watson,* stated: "Organic growth plays a major part in our expansion" (Zentes et al. 2011, p. 173).

The retail brand *Watsons* has seen particularly strong growth rates in recent years. Growing rapidly across Asia and Eastern Europe, *Watsons* has been organically expanding its store portfolio to bring quality health and beauty products and professional services to its customers. In 2013, its store expansion accelerated. The highest growth was achieved in mainland China, where it increased its total number of stores by 255 in 2013 and by 395 in 2014. The company currently operates 2000 stores in 353 cities in mainland China (Hutchison Whampoa 2014). "Our global expansion plan for *A.S. Watson* is to exceed 13,000 stores in 2015. *Watsons* is one of the Group's flagship retail brands. This year alone we plan to open 1200 new stores, amongst which 700 will be under the *Watsons* brand. This represents an average of over 3 new stores a day throughout the year", says Dominic Lai, Group Managing Director of *A.S. Watson*. For its 2015 expansion in China, the company announced plans to further penetrate existing regions (mostly China's first and second tier cities) with additional outlets while simultaneously beginning to expand its outlet network into lower tier cities.

However, as Fig. 7.4 illustrates, retail companies do not only grow; **divestment** from specific markets and **downsizing** of store networks may also be necessary and useful. Since 2013, the *Marionnaud* store network is no longer included in the group's store figures, because this retail brand is being restructured and was separated from the rest of the *A.S. Watson* group by *Hutchinson*. *Marionnaud* is also not part of the deal with *Temasek Holdings*. In fact, the luxury perfume chain has shown weak performance in Europe, particularly in the aftermath of the financial crisis. Therefore, the retail chain divested from Poland and drastically reduced its store network in Spain and Portugal.

7.8.3 Cooperative Growth and Buying Stakes in Retail Companies

Cooperation is another growth strategy. The most popular forms of alliances for growth are joint ventures, which combine the resources of at least two companies to reduce the business risk for both parties. *A.S. Watson* also uses this strategy to grow.

In 1998, the company formed a partnership with the *Nuance Group* to form the *Nuance-Watson* retail airport concessions joint venture. The business operated 46 stores in Hong Kong, Macau, mainland China, Singapore and Malaysia, offering travel retail services and duty-free stores, primarily in airports. However, in 2014, *A.S. Watson* reached an agreement to sell its share in the travel retail business back to the *Nuance Group* (CK Hutchison Holdings 2014): "The *Nuance-Watson* joint venture has been strong and fruitful, and the co-operation with the *Nuance Group* has been a win-win partnership for many years. We see this deal as an opportunity for us to focus on our core retail operations, as we continue to expand rapidly in Asia and Europe."

In 2002, *A.S. Watson* launched a joint venture with the *SM Group* in the Philippines. This partnership brought *Watson's* health and beauty and pharmacy stores to the Philippines. It has acquired the existing 61 health and beauty and drug stores under the *SM Group* to launch the popular *Watsons* concept nationwide (Hutchison Whampoa 2002). Today, *Watsons* operates 402 stores in the Philippines and plans to increase its share in the local retail sector with an aggressive expansion programme, adding 50 new stores each year (The Philippine Star 2014).

In 2005, *A.S. Watson* established a 50:50 joint venture with the leading Korean retail company *GS Retail* (formerly *LG Mart*), which signified the expansion of its flagship *Watsons* health and beauty retail chain into the Korean market. The joint venture company was given the name *GS-Watsons* and the retail chain was launched under the *Watsons* banner (Hutchison Whampoa 2004). "The success of any joint venture depends much on

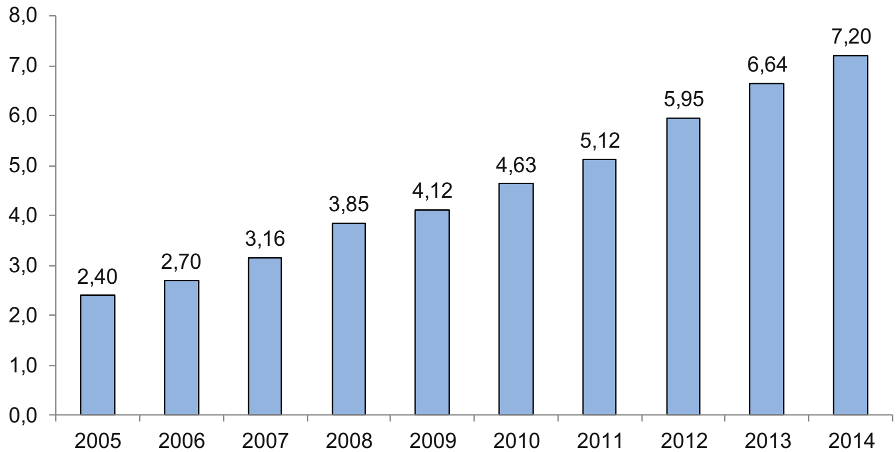

Fig. 7.5 Growth of *Rossmann's* revenues (in billion EUR). (Rossmann 2015b, p. 9)

the complementary strategic values each party can bring to the business. *LG Mart* is an established retailer in Korea with all the market know-how and network, while *Watsons* health & beauty chain is a proven successful concept that travels. Combining *Watson's* advanced operating skills and global sourcing capabilities with *LG's* distribution, logistics infrastructure, information system, and site development expertise, the growth potential of Watsons chain becomes very promising in Korea," said Ian F. Wade.

In 2004, *A.S. Watson* acquired a 40 % stake in the German retail chain *Rossmann*, adding 786 new stores to the group's portfolio. *Rossmann* was founded in 1972 by Dirk Rossmann, who has developed the company into a network of over 3200 stores in six European countries. In Germany, where it has 1930 stores, *Rossmann* is one of the leading players in the health and beauty retail market and a very established name in the community. Today, *Rossmann* operates 1353 stores outside Germany: more than 1000 in Poland, nearly 200 in Hungary, about 120 in the Czech Republic, 32 in Turkey and six in Albania (Rossmann 2015a). As Fig. 7.5 indicates, participating in *Rossmann* contributes to the *Watson* group's steady growth in Europe; *Rossmann's* revenues have seen constant growth. This rapid expansion will continue with the opening of 340 new stores within and outside Germany in 2015 (Rossmann 2015c). This joint venture also shows the benefits of such a growth strategy: *Rossmann* knows the German retail market and the Eastern European retail markets very well, and the financial strength of *A.S. Watson* lets the company fully leverage this market expertise into growth.

7.8.4 Acquisitions by A.S. Watson

Expanding by acquiring other companies is another way for companies to grow. *A.S. Watson* recently used this strategy.

In 2000, *A.S. Watson* acquired *Savers*, a health and beauty chain that sells fast-moving toiletry products. *Savers* operated 176 stores at the time, and the discount format complemented *A.S. Watson's* fast expansion strategy. Today, *Savers* operates over 230 stores in England, Scotland and Wales. *Savers*' retail strategy is a pared down product range, with customers only able to choose from 3000 products, compared with 10,000 at other key specialists. Its strategy involves opening 50 new stores a year. Since 2002, England's *Superdrug* has been part of *A.S. Watson* as well. *Superdrug* is the second largest health and beauty chain in the UK, with over 900 stores nationwide. *Superdrug* offers thousands of own-label products, specially tailored to the needs of British customers.

In 2001, the Swiss company *Badaracco* was added to *A.S. Watson's* portfolio, and its wine business was expanded into Europe via this international distributor. Exports represented a share of 75 % of total sales, underlining the international orientation of *A.S. Watson's* partners. However, in 2013, this business was sold off again.

In 2002, *A.S. Watson* acquired the *Kruidvat Group*, making *A.S. Watson* the world's third largest beauty retailer. Together with *Kruidvat, A.S. Watson* took over *Trekpleister*, *Ici Paris XL* and *Superdrug* and integrated *Rossmann* into the group. *Kruidvat* currently has a store portfolio of 1900 stores and operates in the Netherlands, Belgium and Luxembourg. This merger was an important step in their progressive expansion plan into the European market. Consequently, the group's European portfolio instantly increased to 12 countries. This merger was also an important factor in *A.S. Watson's* expansion strategy, as it brought geographical balance to the group's retail business and increased and diversified the group's earnings in Europe. *Kruidvat* was seen as an important entry point for expansion into the Eastern European market, which has high growth potential in terms of GDP and store expansion. In addition to growth potential, there is also room to increase efficiency thanks to companies' synergies in IT, logistics, accounting, best practices and sales trends.

Drogas was taken over by *A.S. Watson* in 2004. *Drogas* is a well-established health and beauty chain in Latvia and Lithuania. The acquisition was the first step into Eastern Europe, where *A.S. Watson* wants to exploit the great potential for economic growth and customer spending. In 2004, *Drogas* operated 85 stores and had a market share of 30 % in the Latvian market. The acquisition was an important strategic factor in the group's expansion: "Latvia and Lithuania is our springboard to the Baltics, the Confederation of Independent States and Nordic markets," says Ian F. Wade.

The acquisition of *Marionnaud* in 2005 made *A.S. Watson* the largest health and beauty retailer and luxury and cosmetics retailer in the world. *Marionnaud* has presence in France, Austria and Switzerland and adds to *A.S. Watson's* strong family of brands. In the same year, *A.S. Watson* acquired the Russian retail chain *Spektr,* expanding the group's global reach to 34 markets. *Spektr* owns 24 stores in Russia. The first entry into Korea also took place in 2005. Today, the portfolio has expanded to 27 stores.

In 2006, *A.S. Watson* acquired a 65 % stake in *DC*, Ukraine's largest and only nationwide health and beauty retail chain with 113 stores. It is operated using the format of a convenience drugstore, offering a comprehensive mix of personal care and toiletry products.

Since the acquisition in 2006, *A.S. Watson* has successfully expanded the *DC* network in Ukraine increasing the number of stores from 112 to 212. In 2010, *A.S. Watson* bought the remaining shares in *DC* Ukraine and rebranded the retail network from *DC* to *Watsons* (CK Hutchison Holdings 2011).

In 2015, *A.S. Watson* bought all 50 stores of the Dutch drugstore chain *Dirx* and announced they would be transformed into *Kruidvat* or *Trekpleister* stores.

As well as direct acquisitions, *A.S. Watson* also participates in the growth its joint venture partners or other venture partners achieve through acquisitions. For example, in 2008, *Rossmann* acquired more than 150 German outlets from its smaller competitor *Kloppenburg*. The resulting sales growth also contributes to *A.S. Watson's* growth thanks to their 40 % stake in *Rossmann*.

As this section has demonstrated, retail chains are rarely rebranded after acquisition because of the low brand awareness for *Watson* in Europe. Instead, local brands provide consumers with a familiar shopping experience and appeal to local customers. Hence, they can operate in heterogeneous markets with diverse formats and concepts while still achieving economies of scale thanks to an efficient procurement system. Even within China, *A.S. Watson* tailors its offers to specific customer demands. Dominic Lai, managing director, puts it this way: "Our offer is different in Shanghai from in the south. This isn't cookie-cutter expansion" (Danaher 2009).

7.8.5 Conclusion and Outlook

Over the past 20 years, *A.S. Watson's* expansion has accelerated tremendously. The group now operates retail chains all over Asia and Europe and still plans to continue its strategy of aggressive growth. *A.S. Watson* wants to benefit from Asia's growth potential by expanding its presence into markets such as China and Singapore. *A.S. Watson* also plans to further penetrate European markets to tap into the economic growth in newly developing countries in Eastern Europe.

A.S. Watson does not focus on a single growth strategy, instead using different strategies in combination. One such strategy is organic growth. In recent years, the company has been steadily opening new outlets in Europe and Asia. Another growth strategy is cooperation, for example the joint venture with *GS Retail.* Similarly, *A.S. Watson* has bought stakes in companies like the German retail chains *Rossmann* and *DC* to develop new market segments. These ventures continued to grow themselves after establishing the partnerships, often via organic growth but also partially through their own acquisitions.

Because of *A.S. Watson's* international expertise and knowledge of regional conditions in the target countries, it can offer precisely the right products and services to satisfy customer demand. It can achieve growth advantages in procurement despite having a very diverse portfolio of retail brands. Furthermore, the company has a very strong financial basis, which helps achieve organic growth and also helps alliance partners fund their own growth.

Questions

1. Retail companies have different options for growth. What strategies does *A.S. Watson* pursue?
2. What are the advantages and disadvantages of mergers and acquisitions for the growth of *A.S. Watson*?
3. Discuss the main benefits and challenges of forming a joint venture, using the example of *A.S. Watson*.

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The Internationalisation of Retailing 8

Abstract

This chapter will discuss the key themes surrounding the internationalisation of retailing. The chapter describes the various facets of international retailing and the scope of retailer internationalisation, considers the basic strategic options and methods for market selection and entry (going international) and reviews international retail marketing opportunities (being international).

8.1 International Activities

The internationalisation of retailing has two main elements: sourcing and selling. International retail sourcing has a long tradition and is by no means a new phenomenon. "Even if their stores are entirely domestic, many retailers have been buying goods from foreign countries for a long period" (Howard 2004, p. 96). This chapter concentrates on the internationalisation of store operations (cross-border retailing): "Cross-border retailing has accelerated dramatically through the last two decades, though of course it began much earlier" (Howard 2004, p. 97). However, this is still a limited activity for most retailers.

Table 8.1 compares the relative importance of international activities conducted by the largest retailers worldwide in terms of total turnover.

J. Zentes et al., *Strategic Retail Management*, DOI 10.1007/978-3-658-10183-1_8

Table 8.1 International Sales of the Largest Retail Companies in 2013. (Deloitte 2015, p. 20)

Rank	Company	Country	Retail Revenue (in million $)	% Retail Revenue from Foreign Operations
1	Walmart Stores Inc.	US	476,294	28.9
2	Costco Wholesale Corporation	US	105,156	28.2
3	Carrefour S.A.	France	98,688	52.7
4	Schwarz Beteiligungs GmbH	Germany	98,662[e]	58.2
5	Tesco PLC	UK	98,631	32.3
6	The Kroger Co.	US	98,375	0.0
7	Metro AG[1]	Germany	86,393[e]	62.3
8	Aldi Einkauf GmbH & Co. oHG	Germany	81,090[e]	59.2
9	The Home Depot, Inc.	US	78,812	10.8
10	Target Corporation	US	72,596	1.8

[e] Estimate
[1] Metro changed its fiscal year to the end of September. Fiscal 2013 results reported here include the 9 months ending 30 September 2013 plus the quarter ending 31 December 2013 to create a 12-month period equivalent to prior years.

8.2 Basic Strategic Options

The major issue in international retailing – and international marketing – is **standardisation** vs. **adaptation**: "Some products are global products, meaning they can be sold in foreign markets with virtually no adaptation. This is what is meant by standardisation. Most products, however, need some changes in the product or promotion strategy to fit new markets. This is what is meant by adaptation. In retailing, the product is the retail business" (Sternquist 2007, p. 7).

There are four basic options for approaching standardisation vs. adaptation (Helfferich et al. 1997, p. 303; Zentes et al. 2013, pp. 49–65):

- Domestic market orientation,
- global orientation,
- multinational orientation,
- glocal orientation.

This market-oriented classification corresponds with the **integration/responsiveness-framework** (I/R framework) by Bartlett and Ghoshal (1989) in the context of international management (see Morschett et al. 2015, pp. 32–35). Fig. 8.1 shows these basic options in the "benefits from local responsiveness/benefits from integration" matrix. **Global integra-**

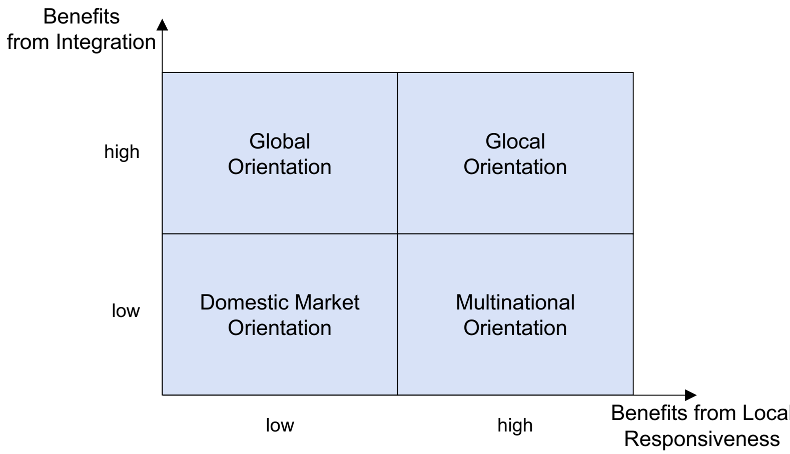

Fig. 8.1 Basic types of international retailing

tion involves connecting international activities across all countries to achieve synergy and scale effects, while **local responsiveness** requires adapting to differences in customer demand to exploit market potentials.

Domestic market orientation involves transferring the retail concept from the home market to other countries. This approach leads to a unified, ethnocentric programme ("**transference**"). Similarly, a **global orientation** in international retailing does not adapt to differences in local markets, instead focussing on exploiting markets with comparable consumer preferences, etc., across the world and benefiting from economies of scale. Unlike the domestic market approach, the company seeks homogeneous markets worldwide, which are the basis for developing a standardised retail strategy or concept.

This global approach is the diametrically opposite from a **multinational orientation**, which is characterised by substantial adaptations or diverse formats/concepts operating in heterogeneous markets. A **glocal orientation** ("think global, act local") seeks the advantages of both: moderate adaptations to heterogeneous markets. The retail company tries to combine economies of scale ("**efficiency**") and an adaptation to country markets ("**effectiveness**").

These four basic kinds of international retailing largely determine decisions over market selection and timing, mode of entry or mode of operations in foreign countries and, of course, the marketing strategy itself (store location, assortment, pricing, communication mix, etc.).

8.3 Market Selection and Timing

8.3.1 Assessment of Potential Markets

The issues surrounding assessing potential markets, selecting a market and timing are closely connected. Timing is especially crucial in the internationalisation process. Companies must look for an opportune moment to enter a market (Zentes et al. 2013, p. 99).

Table 8.2 International market appraisal checklist. (Adapted from McGoldrick and Blair 1995, pp. 169–170; McGoldrick 2002, pp. 558–559)

Spending Power	Barriers and Risks
Total GDP disposable incomes: spending patterns, spending improvements, seasonal fluctuations, taxes on income, taxes on spending, saving ratios, employment structure population: size/growth projections, age profile, cultural/ethnic groupings, expatriates and tourists, lifestyles, religion residential structure: urban vs. rural, housing density, ownership levels, household structures adjacent markets: cornerstone status, market proximities, market similarities, market accessibility	Entry barriers: tariffs, quotas, development restrictions, competition laws, barriers to foreign entry, religious/cultural barriers political risks: government upheaval, nationalisation or controls, war or rioting, international embargoes civil risks: police effectiveness, theft rate, murder/violence rate, level of organised crime economic risks: inflation, exchange rate fluctuations, employment structure and stability, business taxes other risks: geological, climatic
Costs and Communications	**Competition**
Factor costs: land availability and costs, costs of acquiring targets, business taxes, energy costs, labour availability and costs, training costs, development costs logistics and costs: road networks, rail transport, air freight, sea freight, available carriers, distances between markets, transport safety, transport reliability communications and costs: telephone/fax/Internet connections, automatic international dialling, available international lines, costs of calls marketing communications: TV/radio advertising, direct mail agencies, outdoor advertising, print/magazine advertising, cable TV penetration	Existing retailers: competition same or similar formats, indirect competition, specialist retailers, other marketing channels, price competitiveness, extent of differentiation existing retailers: co-operation synergies from partnerships, international alliances, franchising activities, cumulative attraction, acceptance of format saturation levels: structure of outlets by sector, concentration levels, primary/secondary markets gap analysis: positioning of competitors, viability/size of gaps, reasons for gaps, age of existing stores competitive potential: site availability, financial strength of home retailers, attractions to international retailers, opportunities to reposition

International market appraisal and timing are closely linked to the four basic options outlined in the previous section.

Retail companies following a global approach must evaluate the extent of shared consumer preferences or **cross-cultural groups** and similar infrastructures (logistics, media, norms, regulations) in different countries in order to implement a standardised strategy. Similarly, a retailer pursuing a domestic market strategy must look for foreign retail markets

Table 8.3 Market assessment matrix. (Alexander and Doherty 2009, p. 236)

Country	Regulation	Economy	Society	Culture	Retail Structure	Total	Average
French Hypermarket Retailer							
Bulgaria	4	3	4	2	4	17	3.4
India	1	2	2	1	4	10	2.0
Kenya	2	1	1	1	4	9	1.8
UK	3	4	3	3	1	14	2.8
US	3	4	3	3	2	15	3.0
French Premium Fashion Retailer							
Bulgaria	4	1	3	2	1	11	2.2
India	3	2	2	1	1	9	1.8
Kenya	2	1	1	1	1	6	1.2
UK	4	4	4	3	4	19	3.8
US	4	4	4	3	4	19	3.8
Note: 4 = very suitable, 3 = suitable, 2 = unsuitable, 1 = very unsuitable							

similar to its home market. The multinational approach largely concentrates on country markets, developing a specific strategy for each. For this strategy, market size, spending power and the competitive environment are the primary considerations. A glocal retailer must combine the appraisal and selection criteria from the global and multinational approaches: identifying target groups which are similar, but not homogeneous, in terms of consumer purchasing preferences or consumer behaviour.

Table 8.2 contains a general checklist for evaluating international markets. This matrix provides a very rough way to evaluate national market opportunities. Specific locations are then appraised in a second step.

Based on a few assessment criteria, Table 8.3 illustrates a hypothetical market evaluation process of two retailers using a simple **scoring model** (with equal weighting factors). This **market scanning** "is relatively inexpensive, and provides an overview of the relative merit of different markets; however, it does not clearly identify the nuances that will prove important if a retailer decides to enter the market" (Alexander and Doherty 2009, p. 238). An *in-depth approach* using secondary and primary data means comprehensive market research, which is more expensive and therefore used at a later stage, e. g., after market scanning, to analyse only a limited number of markets.

Foreign markets can also be scanned by using the results of market research studies, conducted by research institutes or consulting firms. Table 8.4 shows the actual values of the **Global Retail Development Index** (GRDI), calculated for emerging countries by *A.T. Kearney*. The

Table 8.4 Global Retail Development Index (GRDI) 2014. (A.T. Kearney 2014)

Rank 2014	Country	Country-Risk (25 %)	Market-Attractiveness (25 %)	Market-Saturation (25 %)	Time-Pressure (25 %)	GRDI-Score	Change in Rank (Compared to 2013)
1	Chile	100.0	100.0	13.2	47.3	65.1	+1
2	China	52.5	60.9	44.5	100.0	64.4	+2
3	Uruguay	57.5	93.4	70.3	32.4	63.4	–
4	United Arab Emirates	82.3	98.5	17.5	43.8	60.5	+1
5	Brazil	59.8	99.4	48.7	33.2	60.3	−4
6	Armenia	35.3	26.4	81.5	86.7	57.5	+4
7	Georgia	32.8	32.4	79.6	78.8	55.9	+1
8	Kuwait	72.6	78.8	32.9	31.7	54.0	+1
9	Malaysia	68.7	66.7	32.2	43.5	52.8	+4
10	Kazakhstan	38.5	45.4	72.7	54.3	52.7	+1

index values are calculated using a scoring model with country risk, market attractiveness, market saturation and time pressure as assessment criteria (equal weighting factors: 25 %).

A multi-stage process of market selection based on market scanning and detailed **feasibility studies** using secondary and primary data is illustrated in Fig. 8.2. This figure shows the market selection process of the *Metro Group*.

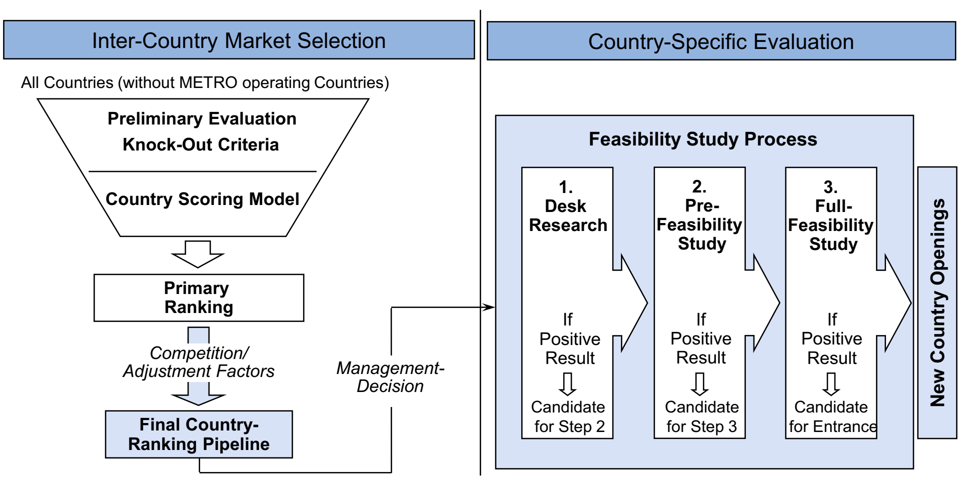

Fig. 8.2 *Metro Group's* market selection process. (Adapted from Swoboda et al. 2007, p. 262)

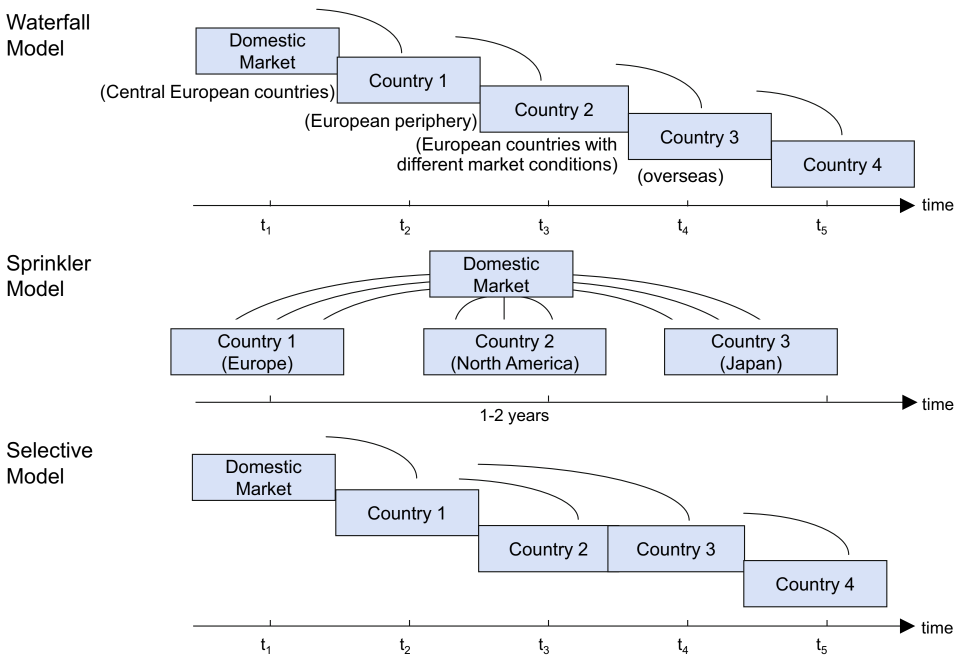

Fig. 8.3 Strategic sequencing of market entry. (Adapted from Swoboda and Meyer 1999; Swoboda 2002, p. 95)

8.3.2 Expansion Patterns

The literature provides three main approaches to the sequence for entering a foreign market (Zentes et al. 2013, pp. 118–126) (see Fig. 8.3). Ayal and Zif (1979) proposed a hierarchical approach "that produces a slow sequence of entries to different markets depending on the receptivity. This approach has been dubbed the **waterfall model** to depict the situation where innovations trickle down in a slow-moving cascade from the most to the least technologically advanced country" (Bradley 2005, p. 294). This helps the company exploit the experience gained in various markets. However, with every additional step, a commensurate increase in the degree of heterogeneity of foreign markets must be accepted.

Ohmae (1985) recommended an alternative approach. The **sprinkler model** involves simultaneously entering all relevant markets in the triad regions (Europe, North America and Japan), to leverage competitive strategies such as quickly reaching critical mass for products with a short lifecycle. This model has very limited relevance for store formats in retailing, but it is increasingly important in **electronic retailing**. While traditional retailers must invest in a global network of **brick-and-mortar stores**, electronic retailers ("e-tailers") can operate worldwide simply by creating multilingual websites and delivering via global logistics service providers (see Chap. 4). This lets them be global retailers from the outset ("born global").

The third approach is the **selective model**, and can often be observed in reality. The selective model involves a combined approach, where company resources are concentrated on developing and adapting to specific foreign markets. Conversely, other markets are developed simultaneously or successively, depending on the situation, and given less attention (Zentes et al. 2013, p. 120).

The waterfall and selective models are expansion patterns where companies change their international activities gradually rather than suddenly (see, e. g., the **Uppsala concept** of internationalising a firm over time in Zentes et al. 2013, p. 12). These patterns are typical for retail companies. A second dimension of expansion is where retail companies will be active, i. e., which countries should they enter? According to the concept of **psychic distance**, retail companies often venture first into familiar countries, i. e., those that are psychologically near. Next, they cautiously approach countries which are less familiar or considered psychologically remote. The strategic shape of the market entry sequence is a series of **concentric circles** radiating from the home country (Kutschker and Schmid 2011, pp. 466–472). This means that in the initial phase of internationalisation, retailers enter those countries with less (subjectively felt) psychic distance from the domestic market.

As an example of an **evolutionary pattern** of internationalisation, Fig. 8.4 illustrates the international expansion process of the *Metro Group*.

8.4 Entry and Operation Strategies

8.4.1 Overview

Chap. 7 described and illustrated retailers' growth options, namely organic growth through multiplication, cooperative arrangements such as franchising and mergers and acquisitions. This section refers to Chap. 7 and analyses the peculiarities of these growth strategies in the context of internationalisation.

The choice of market entry mode or operating mode depends on the basic strategic approach, the firm's market position, market conditions in foreign countries, the amount of resources available for expansion into foreign markets, the acceptable risk level and the desired level of control: "In particular, the selected entry method indicates the level of control that the retailer seeks to exert over their foreign operations, the degree of flexibility required in order to effectively respond to market conditions that their foreign enterprise may face" (Moore and Fernie 2005, p. 16).

Table 8.5 describes the basic characteristics of retailers' most important entry or operation modes in foreign countries.

8.4.2 Exporting

Export involves the lowest levels of commitment and risk. It requires fewer resources, because the retailer has no foreign direct investments (FDI) and therefore risks are low.

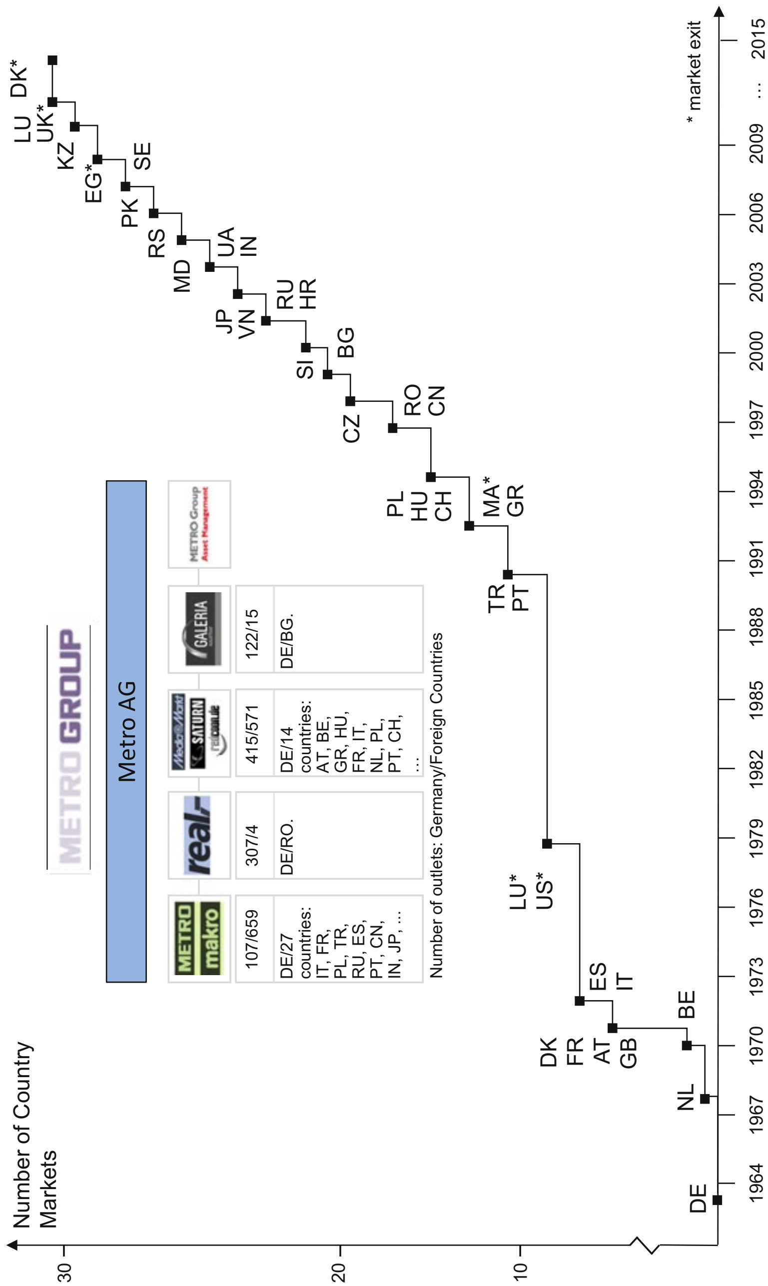

Fig. 8.4 *Metro Group's international expansion pattern.* (Metro Group 2014; Metro Group 2015)

Table 8.5 Factors determining entry/operation modes

	Resources Required	Risk	Control
Exporting	Low	Low	High
Franchising	Low	Low	High
Equity Joint Ventures	Medium	Medium	Medium
Wholly-owned Subsidiaries/ Acquisitions	High	High	High

If the retailer is selling **directly** to consumers (business-to-consumer) in foreign countries (**direct exports**), the level of control is generally high. **Indirect exports** are rare in the retail industry, but are generally important for business-to-business transactions, e. g., in the manufacturing sector. In these cases, the level of control is low, because the manufacturer sells to intermediaries in its home country who then control all cross-border and foreign market operations.

Exporting in general has been fairly rare in retailing. However, **mail-order companies** are an exception. For example, a German consumer can buy goods from an US mail order company like *Sears* and have the merchandise delivered by a logistics service provider to his home. The growing importance of online retailing (see Chap. 4) and cross-channel retailing (see Chap. 5) has changed the relevance of (direct) exports dramatically. Cross-border Internet shopping or cross-border e-commerce (m-commerce) is now widespread.

Another peculiarity is **cross-border shopping**, which involves store-based retailing in border areas. For example, US consumers living in the state of Washington buy in Vancouver (British Columbia) in order to exploit price differences (**arbitrage**) between the US and Canada, while Swiss consumers shop in Germany to exploit differences in price and value-added taxes. In 2013, Swiss families bought consumer goods worth 8.8 billion Swiss francs outside of Switzerland (in Austria, France, Germany and Italy) (GfK 2014, p. 120). From the perspective of retailers and statistics, these transactions are usually counted as domestic rather than foreign sales.

8.4.3 Cooperative Arrangements

The next level of involvement for retailers is a **cooperative arrangement**. These contracts allow a foreign company to use the name or concept of the licensing company (Sternquist 2007, p. 8). For example, *Migros*, a Swiss food retailer, licensed its name in Turkey. Another example is the *Garant Group*, a German cooperation of furniture retailers, which licenses its marketing concept (formats) and name to roughly 3300 partners in 22 international markets throughout Europe and Asia. Like (traditional) exporting, licensing arrangements are a relatively rare form of international expansion in retailing.

Franchising is a cooperative market entry or operation mode that has seen the rapid expansion of a large number of well-known global retailers (see Chap. 7). Through the franchising arrangement, the **franchisor** gives other companies (franchisees) the right to use the franchisor's brand and concept (format, retail marketing). In turn, the franchisor supports the franchisees in running their business by providing marketing, training, controlling, logistics, IT, etc. The main forms of international franchising are **direct franchising**, where foreign franchisees are linked directly to the franchisor, **master franchising**, where the franchisor allows the foreign master franchisee to establish unit franchises in a country or a defined territory, and **franchisor-owned foreign subsidiaries** (or **equity joint ventures** with foreign partners), which operate as the franchisor's national headquarters of the franchisor.

A **joint venture** (equity joint venture) is the next level of cooperative international involvement for a retailer. This entry and operation strategy has become an important part of international activity. In most cases, joint ventures involve a local and a foreign (incoming) company. However, there is no reason why two or more retailers should not establish a joint company in order to enter a new market. "Joint ventures provide the incoming retailer with an opportunity to learn about operations in a new market, while at the same time giving indigenous retailers the opportunity to learn from an international player" (Alexander and Doherty 2009, p. 258). The French company *Carrefour*, which is currently no. 3 worldwide (see Table 8.1), often enters foreign markets this way. A good example is the relationship between *Carrefour* and the Arabian *Majid al Futtaim Group*, which operates more than 100 *Carrefour* stores (hypermarkets, supermarkets and an online store) in the Middle East (Saudi Arabia, United Arab Emirates, Egypt, Oman, Bahrain, Kuwait, Jordan, Syria, Lebanon, Pakistan, Georgia and Qatar).

8.4.4 Organic Growth and Acquisitions

The replication of domestic operations abroad (**outlet multiplication**) through new store development is a growth strategy based on experience (and success) in the domestic market. This strategy involves **internal expansion** (Dawson 1994, p. 273) or **organic growth** by establishing wholly-owned subsidiaries (see Chap. 7). Retailers following a global orientation can also establish wholly-owned subsidiaries ("greenfield investment").

Acquiring a foreign retail operation can also be the starting point for transforming existing stores to match a domestic or global market concept. This can happen when legal constraints in foreign countries are barriers to developing new stores, e. g., in large-scale retailing (such as superstores or hypermarkets). One example is *Walmart's* unsuccessful German market entry by acquiring the former retail companies *Wertkauf* and *Interspar*. Alternatively, **acquisitions** ("brownfield investments") can be the appropriate method of entry and operation for implementing a specific country market approach (multinational orientation), e. g., the acquisition of the French catalogue retailer *3Suisses* (*Groupe 3Si*) by the German *Otto Group*.

8.4.5 Choosing a Mode of Entry and Operation

International marketing and management research and international retail research both include extensive and in-depth analyses of the strategic determinants for choosing a method of entry or operation and the consequences of this choice (see, e. g., Zentes et al. 2013, pp. 285–290; Swoboda et al. 2009b, pp. 112–113).

8.4.6 International Retail Marketing

Retailers planning to internationalise their operations must define their marketing mixes in domestic and foreign markets based on the four basic types of international retailing (as illustrated in Fig. 8.1). These retail marketing strategies can be roughly characterised using the primary elements **format** and **assortment**. For the assortment, a distinction can be draw between the strategic or structural dimension and the operational dimension. The structural dimension refers to the basic categories and the quantity of SKUs sold, the level of product quality, the price level and the share of store brands, etc. The specific products a retailer offers form part of the operational dimension.

8.4.7 International Retail Divestment

Retail internationalisation also involves **divestment**, "considering not only 'what works' but also 'what hasn't worked'" (Burt et al. 2008, p. 31). Alexander et al. (2005, p. 19) define international retail divestment as "company actions resulting in a reduced presence in a foreign market. This may take the form of closure of stores, sales of store chains, termination of a business contract/agreement (joint venture/franchising and so on) or organisational restructuring in the form of changing from corporate ownership to a franchising or licensing or distribution agreement. Divestment may or may not involve market exit." The international marketing literature contains a vast range of terms used in this context, such as divestiture, marketing exit, business exit, deinternationalisation, decommitment, failure and business restructuring (see Alexander and Doherty 2009, p. 327; Zentes et al. 2013, pp. 104–112).

According to Burt et al. (2008, p. 33), **failure** can take various forms:

- "**Market failure**, where the market does not 'behave' as expected and sales do not meet expectations,
- **competitive failure**, where operational performance does not 'match' that of competitors or regulation impacts upon competitive capabilities,
- **operational failure**, when a domestic retailer is simply not a good international retailer and domestic competencies do not transfer,
- **business failure**, when decisions impacting upon the international business are made because of changing domestic circumstances (performance, stakeholder expectations, etc.)."

Table 8.6 illustrates the most important reasons for exiting a market from the perspective of international retail companies, especially in the field of food retailing.

Table 8.6 selected market exits. (Swoboda et al. 2009a, p. 132, completed by new data)

Retail Firms	Country and Year	Key Factors Leading to Exit
Marks & Spencer (DE)	US 2006; FR/ES/BE/NL/DE/P/LU 2001	Resource concentration on domestic market corporate restructuring
Ahold (NL)	AR/BR/BE//ES/CR/ESV/GTM/HN 2005; TH 2004; CL/ID/MY/PY/EC/PE 2003; CNSG 1999	Bad forecast and resource reallocation losses, financial irregularities (domestic market)
EDEKA (DL)	CZ 2006; PL 2003	Strong competition/no perspective
Auchan (FR)	AR 2005; US 2003; MY 2002; TH 2001	No perspective no critical mass
Intermarché (FR)	DE 2005; IT 2002	No partner
Dohle (DL)	PL 2002	Attractive sales option
Dairy Farm (HK)	AU/NZ 2002; ES/GB/JP 1998	Concentration on core competencies, reorganisation strong competition/bad perspective
Reitan (NO)	PL 2003; HU 2002; CZ 1998	Competition/bad perspective
Jerónimo Martins (PL)	BR/GB 2002	Financial difficulties
Seiyu (JP)	TH 2001	Losses and loss of JV partners
Julius Meinl (AT)	CZ/HU 2005	Reorientation
Carrefour (FR)	SK 2008; CH 2007; KR 2006; MX 2005; CL 2004; HK 2000	Competition, difficulties in domestic market hypermarkets with weak performance
Casino (FR)	PL 2006	Losses and no perspective
Walmart Stores (US)	GR/KR 2006; ID 1998; HK 1996; DE 2006	Losses, difficulties with JV partner
Metro C+C (DE)	MA 2010	Losses, difficulties with JV partner
Real Metro Group (DE)	PL/RU/TR 2013	Improved financial situation
Delhaize (BE)	US 2014 (Discount), BA 2014	Concentration on core format no perspective
Target Corp. (US)	CA 2015	Revitalising the core (US) business

8.5 Conclusion and Outlook

The success of retail operations in non-domestic markets is based on one main criterion: Only companies who achieve domestic success will have the necessary **firm-specific assets** (FSAs) for internationalisation. Any attempt to "escape" into foreign markets because of weaknesses in the domestic market will fail.

One of the greatest challenges facing international or global retailers is appraising new emerging markets in the BRICS countries (Brazil, Russia, India, China, South Africa), Eastern European countries that are not members of the European Union and countries in Southeast Asia. The right strategic choices for timing and mode of entry are crucial.

Further Reading

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8.6 Case Study: Carrefour

8.6.1 History, Profile and Status Quo

Headquartered in France, the *Carrefour Group*[1] is one of Europe's leading retailers and the third largest retailer worldwide (see Table 8.1). With about 10,100 stores in 34 countries, *Carrefour* generated net sales of 74.7 billion EUR in 2014 and is one of the most important retailers in the food sector.

Established in 1960, the retailer soon after invented the concept of the hypermarket, pursuing the idea of one stop shopping – a store where customers can find almost everything they need for their daily lives (Frynas and Mellahi 2011, pp. 148–149).

Today, *Carrefour* satisfies different consumer preferences (private and professional clients) via different formats and channels worldwide. For city dwellers, *Carrefour* offers supermarkets, convenience stores, drive-in stores and food and non-food e-commerce

[1] As well as the explicitly cited sources, sources used for this case study include the website http://www.carrefour.com, various annual reports and investor relations presentations.

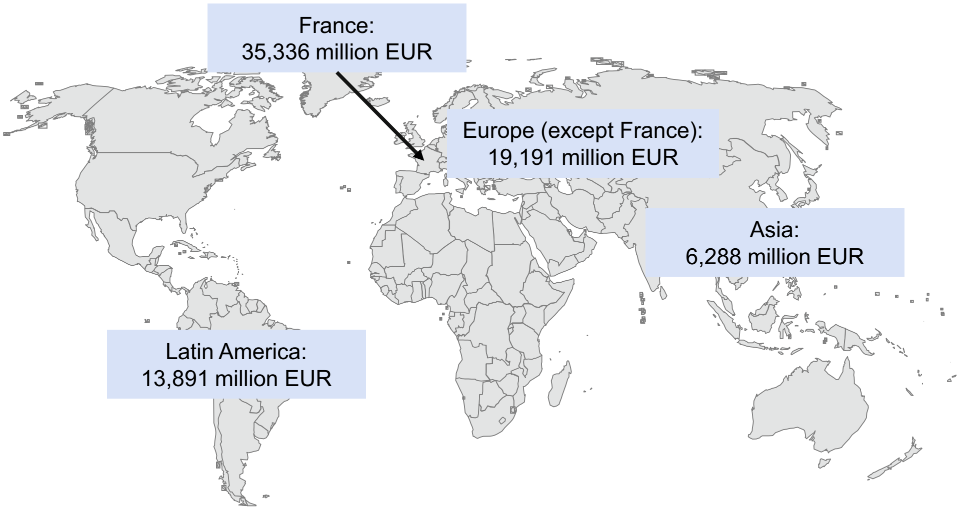

Fig. 8.5 International net sales in 2014 (in million EUR). (Carrefour 2015)

formats. Rural clients can shop at the group's hypermarkets and business owners can visit their cash and carry stores. In some markets, the group also operates hypercash formats, connecting both businesses and individual customers. Examples include *Atacadão* (Brazil), *Carrefour Maxi* (Argentina) and *GrossIper* (Italy). A new organic store format was introduced in March 2013 in France. With a sales floor of 170 square meters and 2000 products, the mini supermarket only offers organic food.

Divided into five geographical operating regions (France, Europe, Latin America and Asia), *Carrefour* bundles different countries with similar characteristics. In 2014, *Carrefour* generated 25.7 % of its total net sales in Europe (excluding France), 8.4 % in Asia and 18.6 % in Latin America (see Fig. 8.5).

8.6.2 Carrefour's Basic Strategic Internationalisation Decision

The group's main operations are in France/Europe (see Fig. 8.5), but oversea territories, including Latin America, Asia, North Africa and the Middle East, are increasingly important. In these markets, the group mostly cooperates with local partners but also runs equity stores. *Carrefour* describes its internationalisation strategy as multi-local "… tailored to fit the needs and profile of its customers. The teams form partnerships with local producers, hold sales events, recruit staff and contribute to economic, environmental and social projects at the local level" (Carrefour 2015). *Carrefour* occupies the glocal field of the market orientation matrix. Like most international food retailers, *Carrefour* pursues a multi- or transnational strategy according (see Fig. 8.6) to the I/R-framework (Morschett et al. 2015, pp. 44–45).

This strategy gives *Carrefour* proximity to its customers but simultaneously provides the support, logistics and power of an international retail group.

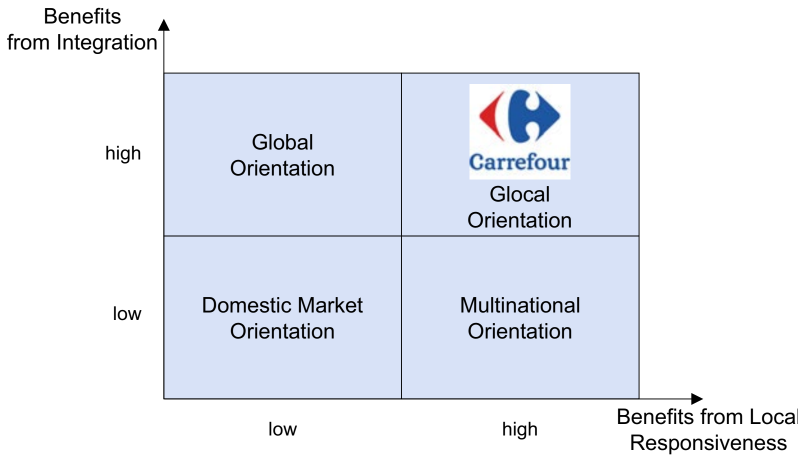

Fig. 8.6 *Carrefour's* classification among the basic types of international retailers

In 2009, *Carrefour* implemented a new strategy with different pillars to strengthen its profile and implement different exogenous drivers in the future. One important decision was to decentralise assortment decisions, giving store management more autonomy. This strategy guarantees efficiency while limiting unnecessary spending. Although store management now have more independence, *Carrefour* keeps buying centralised for major brand products that benefit from large volume purchases and help comparability with other retailers (Wall Street Journal 2013). *Carrefour* follows a tripartite brand strategy, with a low price brand (*Carrefour Discount*), standard price brand (*Carrefour*) and premium price brand (*Carrefour Sélection*) (Lebensmittel Zeitung 2014). Thus *Carrefour* has a high degree of adaptability for its assortments, but also centralised product management for its retail brands.

Another strategic decision was stronger focus on local supply chains, starting in 2009. About 75 % of *Carrefour's* food products come from local suppliers.

Carrefour has different store formats in different countries. The in-store layout does not differ much, but local demands are considered. For example, the retailer has introduced opticians and tyre fitting in Taiwan and petrol stations in Argentina (Frynas and Mellahi 2011, pp. 148–149). In China, *Carrefour* has created large "wet markets" in their stores to meet the Chinese preference for fresh products and picking fish straight from the tank (Chan 2012).

The *Carrefour* brand differs slightly between countries and formats. For example, the retailer operates in the hypermarket sector using the *Carrefour* (Europe) and *Atacadão* (Brazil) brands. Its different retail brands are *Carrefour market*, *Carrefour bairro* and *Carrefour express* (supermarkets) as well as *8 à Huit*, *Carrefour City* and *Proxi* (convenience stores). In 2010, *Carrefour* revised and redefined its portfolio to convert its stores to the group name and strengthen the *Carrefour* brand.

Carrefour's price policy is to offer a simple and consistent low-price guarantee on different everyday products. One of the most important strategies in its reinvention was to give the brand a strong and clear price image.

The group's communication strategy is closely linked to its assortment strategy, differentiating between standardised and localised features. Looking at the homepage show the basic structure (colours and presentation of offers) are identical worldwide, but language and sales vary significantly.

In summary, *Carrefour* pursues a glocal orientation including the advantages of integration and local responsiveness, combining efficiency and effectiveness. As explained above, this strategy influences different aspects of the internationalisation process, e. g., the mode of entry or operation in foreign markets.

8.6.3 Carrefour's International Expansion Patterns

France is *Carrefour's* most important market, where the retailer generates 47.3 % of its net sales. *Carrefour* has previously had to deal with sales slowdown, decreased surface area productivity, increased market concentration and price aggressive discounters (Lebensmittel Zeitung 2014). Pushing internationalisation is just one logical response to these negative trends. With a presence in more than 34 countries, *Carrefour* generates more than 52 % of its sales outside France. *Carrefour* began its international expansion in 1973 by opening a hypermarket in Spain. Soon after, it entered the Brazilian market (1975), Argentina (1982), USA and Taiwan (1989). Its most recent entry was in 2010, opening cash and carry stores in India and Indonesia. As well as entering profitable markets, *Carrefour* has also quit ineffective and difficult ones (e. g., Columbia, Indonesia, India, Malaysia and the USA). *Carrefour's* main criteria for selecting a market are good prospects for economic growth and a general absence of hypermarkets (Dibb and Simkin 2001, p. 182), *Carrefour's* preferred international format within emerging markets. This concept has been successful due to *Carrefour's* choice of countries and ability to adapt this format to local forces (e. g., different local customer demands) (Frynas and Mellahi 2011, pp. 148–149).

Carrefour's internationalisation strategy is dominated by organic growth thanks to high knowledge inflow and complemented by mergers and acquisitions and franchising (McKinsey 2006, p. 80). One advantage of this organic growth strategy is the replication of domestic operations abroad by transforming selected components, e. g., the assortment, to meet domestic standards. In addition, several countries, e. g., Dominican Republic, Madagascar, Romania, Tunisia and United Arab Emirates, are served through a franchise partnership (Frynas and Mellahi 2011, pp. 148–149). Local partners of *Carrefour,* e. g., *Marinopolus* and *Majid al Futtaim Group*, operate stores under the *Carrefour* banner. The franchise arrangement helps *Carrefour* focus on strategically important core markets. It also reduces the risk of expansion (Retail Week 2012). To strengthen its presence in these areas, the group reorganised its exclusive franchise partnerships over the past year. To be better prepared to deal with local influences and drivers, *Carrefour* also entered various countries via local joint owned partnerships (Chuang et al. 2011, p. 451). For example, these local joint venture partnerships are a critical element in *Carrefour's* successful operations in China, which will be analysed in the next section. This strategy is more flexible in dealing with local protectionism issues and leads to effective market expansion.

8.6.3.1 Expansion into Asia

As of 2014, *Carrefour* operated about 375 hypermarkets and 19 supermarkets in Asia, generating net sales of 6.3 billion EUR.

Beginning its Asian expansion with Taiwan in 1989, *Carrefour* entered China 6 years later, in 1995. The idea was to implement the same French concept of hypermarkets, but this failed, and *Carrefour* soon realised that adaptation is one of the most important features of entering the Asian market (McKinsey 2006). Today, China is one of *Carrefour's* most important emerging markets after Brazil, because it is one of the most lucrative and rapidly growing retail markets in the world. Booming retail sales are influenced by a steady rise in household incomes. Today, China is the world's second largest retail market and is expected to surpass the USA in 2016. Better living standards have shifted people's focus on higher quality. But there is also a wide disparity between different regions and rural and urban incomes. *Carrefour's* competitors in the Chinese market are very fragmented and mostly comprise very small to medium-sized retailers (China Briefing Magazine 2014).

Carrefour started its expansion in a few Chinese cities, working together with local partners. In addition to legal considerations, partnering was also attractive due to the huge and complex market. *Carrefour* wanted to understand and enter the market very quickly, so partnering was the best way to acquire knowledge about excellent suppliers and build a network with them. Because China is so decentralised, *Carrefour* had to choose different partners for different regions. "The rule is to have a Shanghainese partner in Shanghai, a Cantonese partner in Guangzhou, and a Beijing partner in Beijing" (McKinsey 2006, p. 78). Following this kind of strategy also brings risks. For example, *Carrefour* chose the wrong partner in Beijing, and bankruptcy and a very bad network limited *Carrefour's* operations there (McKinsey 2006, p. 79).

The highly fragmented Chinese consumer market also supports decentralisation to respond more efficiently to the heterogeneous needs of the customers. This requires unique logistics and market operations strategies (Chuang et al. 2011, p. 456; Tacconelli and Wrigley 2009, p. 63). Because of this underdeveloped logistics and infrastructure network, *Carrefour* had no Chinese distribution centres until 2014 (DCs) (McKinsey 2006, p. 81). Instead, the retailer required suppliers to deliver products directly to outlets. In June 2014, the retailer decided to build its first distribution centre in East China. In 2016, more regional DCs will be set up in Chengdu, Wuhan, Beijing, northeast and south China. The DCs will cover 20,000 square meters and support the expansion of hypermarkets, convenience stores and the online business. The Head of *Carrefour China* stated: "I don't think a national network is the best way to do business. But we are thinking that maybe tomorrow we will want to organize a platform and a network for large cities like Shanghai, with 10 or 15 stores, but only for those stores. Stores that are 100 or 200 kilometres away would not be connected to a central network" (McKinsey 2006, p. 81). For future operations, *Carrefour* aims to open more stores, expand its formats and gradually integrate its supply chain (Retail Analysis 2015).

As the world's second most populous emerging country, India is important for international retailers. Strong retail potential, rising income levels and infrastructure developments make India enormously attractive for foreign retailers. In 2010, *Carrefour* opened its first store in India using the cash and carry format. However, four years later the retailer announced its intention to close its five cash and carry stores and exit the market (Lebensmittel Zeitung 2014).

Thus, India joins a raft of countries that *Carrefour* has left since 2012. By focusing on its strengths, the retailer has exited several unprofitable markets, including Greece, Malaysia, Colombia, Singapore and Indonesia. Divestment of this nature is an essential part of *Carrefour's* international strategy.

8.6.3.2 Expansion into Latin America

As of 2014, *Carrefour* operates 291 hypermarkets, 169 supermarkets and 370 convenience stores in Latin America, in Brazil and Argentina, where *Carrefour* generates annual net sales of 13.9 billion EUR.

Carrefour entered the Brazilian market in 1975, ahead of international rivals, and followed with Argentina in 1982. The retailer started its operations by acquiring *Ultracenter*. Similar to its market entry into China, *Carrefour* started its development with the hypermarket format. In doing so, *Carrefour* played a dominant role in the modernisation of the local Brazilian retail industry (Da Rocha and Dib 2002, p. 65). More acquisitions between 1996 and 1999 changed the Brazilian retailing industry substantially. The four largest chains, including *Carrefour*, acquired a lot of small and medium-sized chains (e. g., *Lojas Americanas, Eldorado, Rainha, Panaltão*) during this period to gain more market power and expand faster (Da Rocha and Dib 2002, p. 70).

In 2007, *Carrefour* acquired *Atacadão* and finalised its partnership with *Itaú Unibanco*. *Artacadão* was one of Brazil's leading operators of discount hypermarkets, running 34 stores. The acquisition underlines "*Carrefour's* strategy to reinforce its presence in key markets through a locally adapted multiformat approach" (Reuters 2007). The acquisition was strategically attractive, because at that point *Carrefour* had lost market leadership. *Carrefour* also supplemented its portfolio with a new format targeting low-income customers and wholesalers (Bloomberg 2007).

Carrefour's logistics and decentralised assortment strategy involves sourcing nearly 100 % of food products from local suppliers. In 2014, *Carrefour* supported this strategy by inviting outside investment from *Penìnsula* to strengthen its local ties and support its growth in Brazil.

Today, *Carrefour* is one of the major players in both markets. The next step will be to consolidate its position as a food retail leader through continuing expansion within these markets.

8.7 Summary and Outlook

Over the last 50 years, *Carrefour* has expanded into a variety of foreign markets. As well as many successful market selections, the group has also had to exit different markets and learn from its mistakes. The Indian market is just one example of *Carrefour's* exit strategy.

Since 2009, the retailer has revised its strategies by strengthening the group via a lean structure, helping the group be more manageable and flexible.

In addition, *Carrefour* is working on a more efficient and effective structure, combining standardisation and differentiation in a profitable manner. In the future, *Carrefour* will continue to pursue its strategic objectives of restructuring, enhancing its image, evolving its outcomes and remaining competitive.

Questions

1. Describe the different entry and operation strategies, taking into account the different advantages and disadvantages.
2. Compare *Carrefour's* expansion strategy to that of *Walmart*.
3. What future markets might be attractive to *Carrefour* and which mode of operation would be preferable? How important is the theoretical concept of psychological distance?

- See Morschett et al. 2015.
- Visit the company website and annual reports for further information.
- See Chuang et al. 2011, pp. 443–463 as well as Da Rocha and Dib 2002, pp. 61–73.

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Retail Branding and Positioning

9

Abstract

This chapter will explain the concept of retail branding and the advantages of establishing and strengthening a retail brand. The chapter also discusses different retail brand architectures, approaches to measuring brand equity, the concept of brand positioning and principles of successful retail brand management.

9.1 Emergence of Strategic Retail Marketing

Even though retailing has long had the opportunity to be marketing-oriented because retailers are in closer contact with customers than are manufacturers, mass retailing has been slow to take advantage. Buying decisions, operational concerns and short-term objectives have been given higher priority than strategic marketing concepts (Mulhern 1997, p. 104). The result has been a frequent lack of clear differentiation between competitors.

However, this has changed in recent decades. Thanks mostly to changing industry conditions and increased management capabilities in retail companies, there has been a change in attitudes towards strategic marketing. Retailers have begun to recognise the relevance of establishing a clear-cut and differentiated profile, and retail brands are being systematically established and managed (Morschett 2012).

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9.2 Retailers as Brands

While in the past the term "**brand**" mainly applied to manufacturer brands (such as *Pampers, Nike* or *Gillette*), the brand concept can be applied to all kinds of "products", including retailers.

Some authors define a brand as a name or formal sign. According to the *American Marketing Association*, a brand can be defined as a "name, term, design, symbol, or any other feature that identifies one seller's good or service as distinct from those of other sellers" (www.ama.org). However, separating the brand name from the product or service alters the nature of the brand. Taking the *IKEA* logo and linking it to a grocery supermarket might retain part of the brand strength, but the character of the brand would change with the underlying product. Other definitions therefore use the combination of brand name (or brand logo, brand sign) and branded product to define a brand: "A brand is therefore a product, but one that adds other dimensions that differentiate it in some way from other products designed to satisfy the same need" (Keller et al. 2012, p. 5).

Stores as Branded "Products"

Retail branding is a strategy based on the brand concept that transfers it to a retail company. A retailer's "products" are its stores, which can be marketed in a similar way to a branded good. A **retail brand** is then a group of the retailer's outlets, which carry a unique name, symbol, logo or combination thereof. While all retailers are brands to a certain extent, some retail brands are strong, while many are not. Customer recognition and appreciation are the essential elements of a strong retail brand (Morschett 2002, p. 108). Retail branding is a comprehensive and integrated marketing management concept, focussing on building long-term customer loyalty and customer preference.

The term retail brand has to be distinguished from the term store brand (see Chap. 12). While retail brand refers to the brand on the level of stores (e. g. *Currys, Lidl, FNAC*) (Interbrand 2014; Das 2014; Morschett 2002), the term **store brand** refers to the product level, and is used synonymously with private label. While often, the retail brand is also used to label store brands, this is not a universal characteristic (Wileman and Jary 1997, p. 17, 134).

Retail brands are enormously complex, due to retailers' service attributes and the multiplicity of brand attributes and consumer-retailer interactions. While manufacturers usually only offer a few products under one brand and the industrial production process is completed through quality control, customer experience with a retail brand is often shaped by several hundred outlets, each with different locations and store designs, thousands of products and dozens of employees, who are also influenced by their moods and emotions. It is therefore difficult to convey a uniform performance and brand message (Wileman and Jary 1997, pp. 40–42).

Employer branding is a more recent branding trend which must be distinguished from retail branding. It refers to a corporate strategy that uses the branding concept to build an image of the company as an attractive place to work. Thus, the objective is to position the company as an attractive employer and differentiate it from the competition in the labour market (Sehgal and Malati 2013, p. 51). Given that retailing generally has reputational problems with highly qualified labour, more and more retail companies have started investing in this type of branding. The term "retail branding", however, refers to branding targeted at consumers, not employees.

9.3 Advantages of a Retail Brand

Establishing a strong brand can provide considerable advantages (Keller et al. 2012, pp. 8–11; Morschett 2012, pp. 442–443; Morschett 2002, pp. 31–41) and be key to long-term performance (Aaker 1996, p. vii):

- An existing retail brand strengthens **brand awareness** and **differentiation** from the competition because it can serve as an anchor for associations with the brand.
- An established brand enhances the **efficiency of marketing measures**. In an age of increasing consumer information overload, established and well-known brands receive more attention than unknown brands. For example, advertising for strong retail brands is more likely to be noticed and recognised by consumers, resulting in a higher efficiency of marketing budgets.
- From a consumer perspective, strong retail brands **simplify the purchasing process** because there is already some knowledge about the retailer, and buyers do not have to search for additional information about assortments, prices, service and so on.
- Strong retail brands also reduce **perceived purchasing risk**. Buying products from well-known and trusted retail brands is a risk-averse purchasing strategy.
- Consequently, strong retail brands may lower consumers' **price sensitivity**. A well-defined brand profile can establish a preference position that allows a retailer to minimise price competition.
- Strong brands exert **halo effects**. An overall positive general attitude towards a brand affects the perception of all brand-specific attributes. The positive impact of these perceptions on the general attitude can produce a virtuous cycle.
- As well as providing functional benefits, strong brands can also serve as **symbolic devices**. They represent different values, traits and characteristics. Shopping at a certain retailer might, therefore, allow consumers to project a certain self-image onto themselves and others. Research into so-called **self-congruity** has frequently demonstrated this mechanism (Sirgy et al. 2000; Zentes et al. 2008).
- If a retail company operates in different market segments, **differentiated marketing** with different retail brands facilitates approaching each market segment with a targeted approach. Cannibalisation is easier to avoid and each retail brand can develop its own image without contradictory image transfers.
- Conversely, a strong brand can be used as a **platform for expansion**. This occurs when retailers open new outlets, which are loaded with a certain image from the outset. Franchising concepts, in which the retail brand is transferred to independent shop owners, clearly illustrate this advantage.

- A strong retail brand can also facilitate extension into new product ranges. This type of **brand extension** occurs when retailers use their image in one merchandise category to expand into others.

Measuring Brand Equity

These advantages are particularly enjoyed by strong retail brands. However, measuring brand equity is not easy, and there is no generally agreed concept. Nonetheless, there are broadly two types of measurement approach, which also differ in their definition of brand equity (Lassar et al. 1995, p. 12):

- Financially-oriented, monetary approaches,
- consumer-oriented approaches.

The following definition is typical of the **monetary approach**: “Brand equity can be thought of as the additional cash flow achieved by associating a brand with the underlying product or service” (Biel 1992, p. RC7). For example, using a complex formula to forecast future revenues for the brand and converting them into a current value, the consulting company *Interbrand* estimated that the most valuable European retail brand in 2014 was *H&M*, with a brand equity of about 18.2 billion USD. This was followed by *IKEA* (13.8 billion USD), *Zara* (10.8 billion USD), *Carrefour* (10.3 billion USD) and *Tesco* (9.0 billion USD). In North America, *Walmart* leads the ranking (with an enormous brand value of 131.9 billion USD), followed by *Target* (27.1 billion USD), *The Home Depot* (25.7 billion USD) and *Amazon.com* (23.6 billion USD) (Interbrand 2014).

Although deriving a monetary brand value is important in certain situations (e. g., when selling or licensing the brand), the result of long-term investment in a brand is equity. For brand management, **consumer-oriented brand equity** concepts might be more appropriate and sensitive to changes. Keller (1993, p. 1) provides a typical definition: A brand is said to have positive customer-based brand equity when consumers react more favourably to an element of the brand’s marketing mix than to the same element attributed to a fictitious or unnamed version of the product or service. This type of brand equity or brand strength is developed in the mind of the consumer, and the consumer’s attitude towards the brand, his associations and experiences with the brand and his evaluation of the brand’s quality are the most important factors in measuring brand equity.

Different researchers propose different indicators for measuring consumer-oriented brand strength, which can, individually or in aggregate, be considered when managing a brand and evaluating the success of certain marketing measures (e. g., Aaker 1996, pp. 7–25, 318–333; Lassar et al. 1995; Morschett 2012, pp. 443–446). Indicators of consumer-oriented retail brand equity include:

- Awareness,
- perceived trustworthiness,
- customer satisfaction or loyalty,

- appeal,
- differentiation.

Other indicators suggested in the literature for brand equity are generally inappropriate for retail brands. **Price premiums**, for instance, are sometimes used to evaluate brand value; however, many successful retailers emphasise their low prices (e. g., *Walmart*, *IKEA*, *Aldi, H&M*), and trade potential price premiums for higher sales volumes or productivity.

9.4 Brand Architecture

As explained above, the term "retail brand" applies at the level of the store group. However, a retailer's brand system is more complex. **Brand architecture** refers to the internal structuring of a retailer's brands and revolves around how many and what kinds of offers are provided under a certain brand (Ailawadi and Keller 2004, p. 338). Within the **brand hierarchy**, a retailer's brands can be divided into different levels (Keller et al. 2012, pp. 580–596). Retailers have brand names at the level of the retail company as a whole ("corporate brand"), the retail stores, the merchandise (e. g., store brands) and specific retail services (e. g., banking services or loyalty programmes). In addition to individual branding decisions at each level, the interconnections between each level must be considered. Merchandise level branding is discussed in Chap. 12.

As in industrial multi-product companies, retailers with more than one store have to decide whether the stores should carry the same or different brands. Three general branding strategies can be distinguished at the retail brand level (see Table 9.1 for examples):

- An **umbrella brand strategy**, where all of a company's stores have the same brand, and in most cases the corporate brand is differentiated by a sub-brand (sometimes called an "endorsed brand").
- A **family brand strategy**, where groups of stores (usually with different retail formats) have different brands, i. e., the brands are strictly separated.
- A **mixed strategy**, which applies an umbrella brand for some store formats and separates others via different brand names.

The main decision here concerns **brand image transfer vs. brand image separation**. Under an **umbrella brand strategy**, the shared brand name leads to substantial image transfer. For example, consumers at least partly transfer their associations with *Tesco* superstores to *Tesco Express* stores. Every store is part of a large brand and must convey the same message to the consumer to keep the image strong and uniform. This is usually the most cost-efficient way to establish a brand image, since all brand advertising and touchpoints are loaded onto the same brand. A **family brand strategy**, in contrast, is usually the result of market segmentation and an unambiguous brand focus with different brand attributes for each store format. *Carrefour* hypermarkets, for example, target a similar

Table 9.1 Branding Strategies of Different Retail Companies

Brand Strategy	Retail Company	(Selected) Retail Brands of the Company
Umbrella Brand	Tesco	Tesco Extra, Tesco (Superstores), Tesco Metro, Tesco Express
	Système U	Super U, Hyper U, U-Express, coursesU.com
	Toys 'R' Us	Toys 'R' Us, Babies 'R' Us
Family Brands	Kingfisher	B&Q, Castorama, Brico Dépôt, Screwfix, Koçtas
	SuperValu	Save-a-lot, Cub Foods, Hornbacher's, Shop 'n Save, Shoopers, Farm Fresh
	Metro	Metro Cash & Carry, Real, Kaufhof, Media-Markt, Saturn, Redcoon
	Sears Holding	Sears, Kmart, Land's End
	Inditex	Zara, Pull & Bear, Massimo Dutti, Bershka
Mixed Strategy	Coop (CH)	Coop, Coop pronto, coop@home, Coop bau+hobby, Coop City, Interdiscount, Fust, Microspot, TopTip, Christ
	Migros	M, MM, MMM, m-electronics, Migros LeShop, Denner, Globus, OBI (as franchise partner in Switzerland), Office World
	Carrefour Group	Carrefour, Carrefour Market, Carrefour Express, Carrefour City, Carrefour Contact, Atacadao, Dia
	Groupe Casino	Casino Supermarché, Géant Casino, Casino Shop, Casino Drive, Leader Price, Monoprix, Franprix
	GAP, Inc.	Gap, GapKids, babyGap, GapMaternity, Gap-Body, Banana Republic, Old Navy, Athleta

customer segment to *Carrefour* supermarkets, but probably appeal to a different group of customers than *Carrefour*'s discount chain *Dia*. An image transfer is therefore unlikely to benefit either set of stores.

Thus, if a company wants to address different customer segments via different stores with **different positioning**, using a family brand strategy is more appropriate. In addition, separate brands facilitate divestments and changes in portfolio.

There has been a strong trend among retail companies over the last decade of focusing on fewer retail brands and using an umbrella brand. For example, *REWE* in Germany used to run supermarkets under the labels *minimal*, *REWE*, *HL* and *Stüssgen*. In a strategic move in 2006, it united all these 3000 supermarkets overnight under the shared retail brand *REWE*. However, given that many retail companies are highly diversified and used to use family brands, more mixed strategies are often more appropriate. For example, *Carrefour* has renamed its supermarkets worldwide from *Champion* to *Carrefour Market*, and many of its convenience stores around the world are now named *Carrefour Express* or *Carrefour City*. Similarly, French retailer *Casino* has given an umbrella brand to some of its store formats and now calls its hypermarkets *Géant Casino* (formerly only *Géant*), its supermarkets *Casino Supermarché* and its small neighbourhood stores *Casino Shop*. *Macy's Department Stores* in the US comprise many stores that were formerly part of small regional chains and for a long time maintained their names. But in the past decade, *Macy's* has renamed most of these stores as *Macy's*.

Branding Strategies after Acquisitions

In large retail companies that operate different store formats and different chain store groups, the brand architecture is frequently reviewed. In particular, acquiring additional stores or an entire business usually requires making a strategic decision on whether to maintain the established retail brand of the acquired chain or to convert it to the acquiring company's retail brand. Given the frequency of acquisitions in recent decades, there are many examples of both decisions. For example, *Walmart* kept the name *ASDA* in the UK, but quickly changed the names *Wertkauf* and *Interspar* to *Walmart* after their acquisition in Germany. *Macy's* converted all the *May* department stores into *Macy's* stores and *ASDA* changed the *Netto* stores it acquired in the UK into *ASDA Supermarket*. However, *Migros*, after acquiring the Swiss discounter *Denner*, continues to run the group under the name *Denner*. The French *Boulanger Group,* who bought *Saturn's* 35 stores in France, converted the stores into *Boulanger* markets, but when the Swiss retail group *Coop,* which already operated an electronics retail chain under the retail brand *Interdiscount*, acquired the competitor *Fust*, it continued to operate both formats under a dual brand strategy.

Generally, the branding decision after an acquisition is similar to the decision in other multi-format retail companies: Should there be a strong **image link** between the acquiring company and the acquired retail stores or not? But other factors must also be considered. For example, the acquiring company has to decide on the **intended future positioning** of the acquired chain. If that is not fully congruent with its own retail brand, it might be wise to maintain the acquired retail brand to be able to keep both separate. In addition, the acquired store chain may have accumulated substantial **brand equity** over time. For instance, consumers in the UK liked shopping at *ASDA* and trusted the brand, so customer loyalty to the brand gave it high brand equity. By eliminating the old brand name, *Walmart* would have risked destroying this brand equity and decreasing the value of the acquired stores. Converting stores to the acquiring company's retail brand can lead to negative customer reactions, protests and even boycotts (e. g., if the acquiring company is seen as a foreign intruder). Finally, a company may not have a free decision, since the buying contract with the former owner may not allow it to continue under the old brand name. For example, when *Carrefour* left Thailand, it obviously did not want the new owner *Groupe Casino* using the name *Carrefour*. Therefore, it did not sell the right to use the retail brand name, only the stores themselves.

A similarly delicate question surrounds the branding of online shops within a multi-channel strategy. While a cross-channel or omni-channel strategy usually requires the same retail brand for the online and store channels, a multi-channel strategy can be designed to separate channels to target different segments and avoid issues like price comparisons between the channels. *MediaMarkt's* online shop *Redcoon* is an example of this strategy.

Retail Branding in Retailer Cooperatives

Retail cooperatives are a type of retail institution with strong market relevance in many countries and sectors. These are cooperations between independent retail companies, often between many single-store operations. Well-known examples of networks of retailers that jointly carry out certain central functions are *Intersport*, the world's leading sporting goods retailer and certain large food retailing groups such as *Leclerc* in France, *REWE* and *EDEKA* in Germany and *Shoprite* in the US. In European electronics retailing, three of the top 10 are retailer cooperatives: *Euronics*, *Expert* and *Electronic Partner*.

Initially, most of these cooperatives were founded to provide a centralised purchasing organisation to provide smaller retailers with shared economies of scale, i. e., better purchasing prices by bundling the volume of many retailers. However, their functions often grew over time and, nowadays, many of these cooperatives provide central marketing and have often established a shared retail brand. The examples given above all link their stores via a shared retail brand, similar to a franchise system. The logo, corporate identity, brand colours and so on are harmonised, allowing the group to conduct marketing, for example in the form of cooperative-wide TV advertising campaigns.

However, the independent status of the individual retailers is sometimes signalled in the retail brand via co-branding. For example, retailers that belong to the *Intersport* group often use their own names along with the group retail brand (e. g., *Intersport Meier*). Electronics stores that belong to the *Electronic Partner* group are usually named in a similar way, e. g., *EP: Müller*. Other groups, such as *REWE*, do not use co-branding; despite having different owners, their stores are all labelled *REWE*.

The advantages of each approach are evident: while using a completely uniform brand for all stores, regardless of ownership, creates an image of a uniform, very large system that is perceived as one large retail company, the co-branding strategy strengthens the dual nature of a retailer cooperative. It emphasises the local ownership of a specific shop and signals to the customer that the store has a strong regional component. This may make it easier to establish local customer loyalty. At the same time, it indicates that the retail store belongs to a large chain, and can thus utilise the synergy effect of national advertising. It may also signal to the customer that the store has the necessary buying power to offer attractive prices.

9.5 Retail Brand Positioning

Strategic brand management starts with a clear understanding of what the brand should represent and how it should be positioned relative to competitors (Keller et al. 2012, p. 44; Wortzel 1987, p. 47). **Positioning** is the deliberate and proactive process of defining and in-

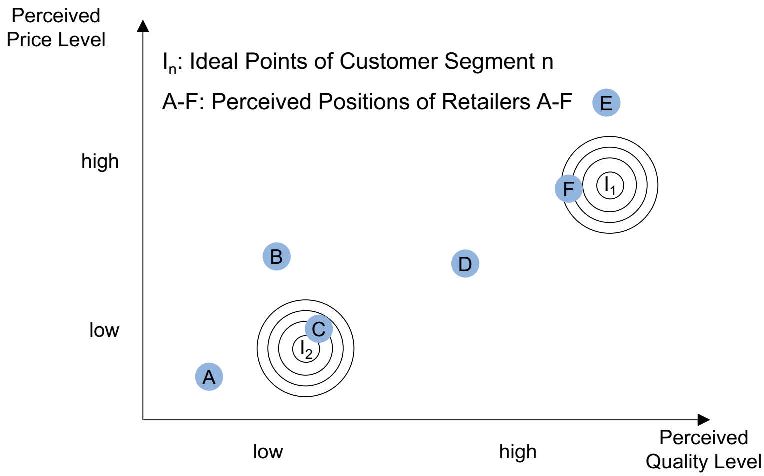

Fig. 9.1 Differently positioned retailers in the price-quality space

fluencing consumer perceptions of a marketable object, with a strong focus on the competitive position. A product is thus positioned in the minds of consumers (Arnott 1993, p. 24).

Positioning usually applies certain fixed dimensions along which the retail brand defines its position relative to its competitors. Positioning diagrams represent the location of different brands and the different target groups' ideal points in a two-dimensional space (see Fig. 9.1).

Market Segmentation

Market segmentation is often necessary for successful brand positioning. Market segmentation refers to the process of using certain attributes to divide a (heterogeneous) market into (more homogeneous) partial markets. **Segmentation criteria** can be demographic, socioeconomic, lifestyle, geographic or many others. Segmentation involves selecting one or several market segments and targeting marketing towards their purchasing behaviour, motives and expectations. However, segmentation is often considered difficult for retailers with particular catchment areas and those who need high customer traffic in their stores, as these require appealing to broad customer groups (Wileman and Jary 1997).

Positioning is often based on the two generic competitive strategies by Porter (1980): cost/price leadership vs. differentiation (similar to Fig. 9.1). While this broad classification can also be applied to retailing, researchers have proposed other frameworks, because retailing reality shows that there are many viable approaches to differentiation. The following are the most frequently proposed positioning dimensions (see, e. g., Wortzel 1987, p. 50; Morschett/Swoboda/Schramm-Klein 2006; Varley 2014, p. 10):

- Quality of merchandise,
- variety of merchandise,
- convenience,

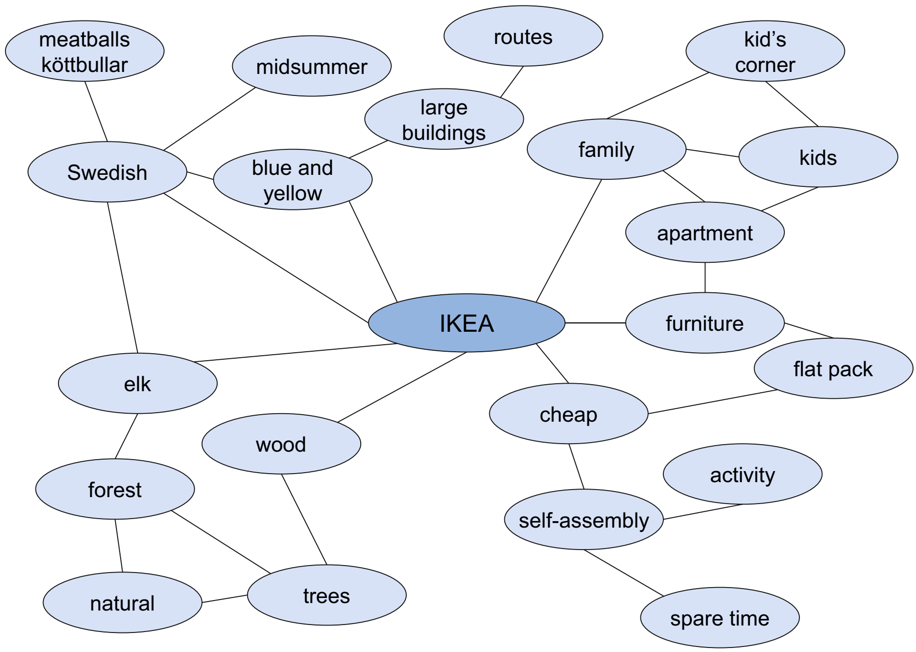

Fig. 9.2 Consumers' associative network for IKEA (hypothetical example). (Morschett 2012, p. 447)

- price,
- customer service,
- location,
- store atmosphere.

Successful positioning can be achieved for any retail activity, and a unique profile along the various dimensions yields a clear position that is the prerequisite of a strong brand. At the same time, retailers' advertising spending has increased strongly over the past few decades and – as an indicator of the increasing relevance of retail branding – in many countries, retail stores are among the most heavily advertised "products" in terms of media spending.

Retail Brand Image

Retail brand positioning is based on a set of fixed dimensions along which a retailer is perceived to be located. However, the retail brand is broader than the actual positioning. The total **brand knowledge** that a consumer associates with a brand determines the brand strength.

The **associative network model** views memory as a network of nodes that represent stored information and connecting links. Any type of information connected to the brand is stored in the memory network, including verbal, visual, abstract and acoustic information. A **retail brand image can be defined as perceptions about a retailer as reflected by the brand associations stored in consumers' memories.** The strength of the brand

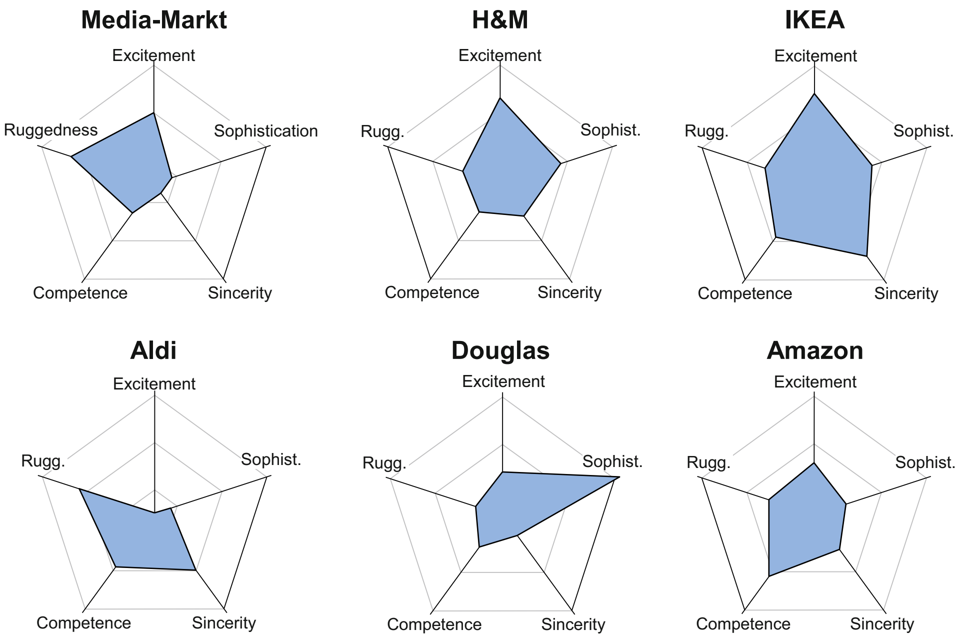

Fig. 9.3 Perceived brand personality of different retail brands in Germany. (Zentes et al. 2008, p. 178)

can be evaluated by analysing the various relevant associations. The relevant dimensions are: uniqueness, favourability, strength and the certainty with which consumers link the information with the brand (Keller 1993). Retail brand image is complex and connected to an array of other images, both at a higher level and in the form of sub-images. The retail store format image (i. e., category killer image), shopping centre image, location image, price image, merchandise image and other components of the store or its context are all connected to the retail brand image and are part of the consumer's memory network. Fig. 9.2 provides an example of a possible associative network that customers typically have for *IKEA*.

Another way to capture the retail brand image is via the **brand personality** concept introduced by Aaker (1997). She established five dimensions of brand personality:

- Sincerity,
- excitement,
- competence,
- sophistication,
- ruggedness.

Surveys have shown that consumers perceive retail brands along those dimensions, and that these dimensions are useful for highlighting differences in the perceptions between different retail brands (Zentes et al. 2008; Das 2014) (see Fig. 9.3).

9.6 Principles of Successful Retail Branding

Every retail marketing instrument affects the overall retail brand, as illustrated by the notion of a comprehensive retail brand image, which is made up of a universe of interconnected associations. To develop a strong and successful brand, the literature emphasises three basic principles (Morschett 2002, pp. 43–47):

- Differentiation from competitors,
- long-term marketing continuity,
- coherence of different marketing components.

As mentioned in the section on positioning, achieving **differentiation** (in consumers' minds) is a central characteristic of a brand (Aaker 1996, p. 329). Clear differentiation from competitors should lead to higher profitability. Only brands that are well distinguished from their competitors can build long-term customer loyalty and avoid store switching.

Establishing a clear brand image is a long-term process. Brands are established through consumer learning processes. Consumers store associations in their memories. Brand associations become weaker over time and they must be reinforced by repeated exposure to the same brand messages. Past investment in brand building is at least partly lost if the brand marketing changes. Thus, **continuity** is important. Also, risk reduction is one of a brand's main functions. Consumers trust a brand because it implies a standardised level of product quality. Some of the world's most successful brands have demonstrated that retaining the same brand message and communication (with slight variations) for years and even decades is one of the key prerequisites of successful branding.

The **retail marketing mix** includes every marketing instrument that a retailer can deploy. The term "mix" indicates that the instruments are not used in isolation, but that they jointly influence the consumer. In order to be successful, all marketing measures must be coordinated to ensure a close **fit** and that they all convey the same brand message.

Because inconsistency makes a brand image fragile, and consumers strive for internal congruity in their knowledge and information ("theory of cognitive dissonance"), creating **coherence** between all the different facets of the retail brand is crucial for success. Given the complexity of the retail environment, ensuring a fit among marketing instruments and brand contact points is challenging. *IKEA*, *Sephora*, *dm-drogerie markt*, *The Body Shop*, *Zara* and others are examples of successful brands that manage to project a uniform image with their store atmospheres, merchandise, pricing, communication and service.

9.7 Conclusion and Outlook

Some of the world's most successful retailers have developed into strong brands without conscious brand management (Wileman and Jary 1997, p. 20). However, while this is true, it is important to note that many successful retailers have developed strong brands by adopting the principles of branding described above, even if they did so unconsciously. From their founding, *Aldi*, *IKEA*, *The Body Shop, Walmart*, *Migros* and others have had clear and distinct profiles. They have pursued their own marketing approaches over several decades and, supported by strong corporate cultures, have been coherent in all their activities. Differentiation, continuity and coherence were often ensured by their founders, who, over the years, developed a clear understanding of what their companies should stand for and followed through on that rigorously.

Brand management is becoming more relevant as retailers expand internationally (e. g., should retailers use the same name in all countries?), as a result of the ongoing wave of mergers and acquisitions in retailing (e. g., should an acquired retail chain be operated under its old retail brand or be adapted to the acquirer's brand?) and with the increase in multi-channel retailing. Store retailers expanding their businesses onto the Internet must especially consider the strategic decision surrounding using the same retail brand across channels or separating the Internet shop from the store outlets. The consequences are crucial and far-reaching.

In recent years, competition and changing consumer behaviour have increased the relevance of retail branding tremendously. Retail branding aims to enhance differentiation and customer loyalty. Retail brand management involves every component of the retail marketing mix and leads to a strategic understanding of the retailer's intended positioning. Developing a retail branding strategy helps ensure the coherence of a retailer's marketing messages and market appearance. Successful companies change over time, but the core brand should remain stable.

Further Reading

- Aaker (1996): *Building strong brands*. New York: Free Press.
- Wileman and Jary (1997): *Retail power plays: From trading to brand leadership*. New York: Palgrave Macmillan.
- Zentes et al. (2008): Brand personality of retailers – an analysis of its applicability and its effect on store loyalty. *The International Review of Retail, Distribution and Consumer Research*, 18(2), 167–184.

9.8 Case Study: Trader Joe's

9.8.1 Profile, History and Status Quo

The *Pronto Markets* chain of convenience stores, the forerunner of *Trader Joe's*[1], was established in the USA in 1958. The stores were owned by *Rexall* and managed by Joe Coulombe. By 1966, *Pronto Markets* were not performing well due to increasingly strong

[1] As well as the explicitly cited sources, this case study uses the *Trader Joe's* website.

competition from *7-Eleven* convenience stores, and *Rexall* decided to sell them. In 1967, Joe Coulombe bought the chain, changed the name to *Trader Joe's*, reinvented the business strategy and transformed it into a speciality grocery store.

The store targeted educated consumers who travelled. The assortment included items from all around the world, healthy foods and beverages at low prices (Dobrow 2014). In the 1970s, *Trader Joe's* introduced its customer newsletter (now called *Fearless Flyer*), which remains the company's primary form of advertising. The store increased its selection of wines, private label grocery products, nuts in barrels, etc. In the 1980s, the company grew its store brands, and it expanded from southern California into northern California. In 1979, Coulombe sold the chain to the family trust of the German Theo Albrecht family (who also owns *Aldi Nord*), but he remained the CEO until 1988, when Stanford University graduate (and friend of Coulombe) John Shields took over the management. The chain grew steadily. In the 1990s, the company formalised its mission statement, and in 1996, the company launched its website.

In the 2000s, *Trader Joe's* continued to grow and eliminated GMO (genetically modified organisms) from all its merchandise. *Trader Joe's* introduced the famous Charles Shaw wines at very low prices ("Two Buck Chuck"), which proved a customer favourite and won numerous wine competitions. In 2003, Dan Bane became the new CEO.

Trader Joe's has steadily opened stores throughout America, but it is not yet a nationwide chain. The company is still mainly based in California, the Chicago region and some east coast states, with plenty of room for growth throughout the USA. As of 2014, *Trader Joe's* has more than 400 stores and the company is worth an estimated $11.3 billion (Reuters 2014). *Trader Joe's* outlets are mostly located away from prime locations, allowing the company to keep real estate costs low (Schermerhorn 2012). Many shops are found in suburban neighbourhoods.

9.8.2 Retail Brand Positioning

The company sees itself as "a national chain of neighbourhood specialty grocery stores" (Kowitt 2010). Shopping at *Trader Joe's* "represents **adventure**, a foreign food experience, and a place where a time-pressed homemaker can assemble an interesting meal rather quickly" (Berman 2011, p. 185) and for a low cost (Bloomberg 2004). It is also positioned as a healthy food retailer committed to green brands. A study showed 21- to 29-year-olds ranked *Trader Joe's* the number two brand in terms of commitment to green brands (Berman 2011). The company also applies a **feel-good strategy** among consumers; for example, it does not sell fish from overfished and endangered regions (Berman 2011). In a recent product description for organic chia seeds, the retailer states that "[w]e're also pleased to note that the way our supplier handles their seed production – with well-managed crop rotation, and holistic support to the local farmers – guarantees living wages for farmers and their families, and protects the environment. That's a win for the farmers, a win for our supplier, and a win for you (…)". *Trader Joe's* target customers are similar to *Whole Foods* customers in terms of searching for healthy and organic products, but they have different lifestyles and budgets (see the case study on *Whole Foods* in Chap. 12).

When it comes to retail branding, "*Trader Joe's* is no ordinary grocery chain […] *Trader Joe's* is one of the hottest retailers in the U.S." (Kowitt 2010). In brief, the positioning of *Trader Joe's* is based on **healthy**, **innovative** and **unique** grocery products for very **low prices**, an **in-store experience** that fully deserves the name "retail theatre" and dedicated, **enthusiastic employees**. One article describes this positioning as follows: "Imagine a grocery store where everything is incredibly cheap, tastes delicious, and is provided to you by staff that vacillate in kindness somewhere between Santa Claus and Jesus Christ. Then imagine that everyone who shops there is so completely thrilled to have avoided a regular supermarket that they're chipper and polite, regardless of the long lines and packed aisles" (Donovan 2010).

Trader Joe's retail brand creates excitement and builds an enormous amount of loyalty, which is the ultimate goal of any retail brand strategy. Where other retailers have loyal customers, *Trader Joe's* has "fans". Statements like this, from a blog, are not rare: "I love Trader Joe's. I mean it. I LOVE Trader Joe's. I love their selection, their quality, and I love the quirky people that work there. I just spent ten minutes with their sommelier who had nothing better to do than show me his favorite wines under $ 10 (will share findings in a future post, I promise!)" (Gabrielson 2011). Another one reads: "If you aren't a fan of Trader Joe's, chances are you've never been to one […] If you're like the rest of the world, Trader Joe's likely has a soft spot in your heart and your grocery shopping experience often ends up being the highlight of your day […] What's not to love? Specialty foods you can't get anywhere else, cool jams and chill vibes, unbeatable bargains […] and a constant stream of something new and intriguing to try" (Baker 2015).

Kevin Kelley, a consultant who investigated *Trader Joe's* competitors, jokes that the typical shopper is a "Volvo-driving professor who could be CEO of a Fortune 100 company if he could get over his capitalist angst" (Kowitt 2010). *Trader Joe's* customers are very diverse. They range from "[f]oodies, hipsters, and recessionistas alike" (Schermerhorn 2012, p. C-2); from gourmands to starving artists (Bloomberg 2008); they also attract young Hollywood actresses (e. g., Jessica Alba is regularly seen there), which obviously adds to the brand image. Senior citizens do their shopping early in the day, and on weekends and evenings a "well-heeled crowd takes over" (Kowitt 2010).

Today, the company uses a very limited amount of advertising, with the primary method being the *Fearless Flyer* newsletter, published three times a year and distributed directly in stores or via the retailer's website. The flyer is about 12–20 pages long, includes descriptions of products and uses Victorian cartoons (Berman 2011). The flyer aims to be both informative and fun to read to maintain consumer interest in the store.

9.8.3 Selected Retail Marketing Mix Instruments at Trader Joe's

9.8.3.1 Quality and Price of Merchandise

Retail brand positioning is mostly dictated by the merchandise a retailer offers. Around 80 % of merchandise in *Trader Joe's* stores is **store brand** products (Business Insider 2014) that cannot be found in other stores. The quality is equivalent to that of major national brands, but the price is much lower (Berman 2011). *Trader Joe's* states that their products contain no artificial flavours, preservatives, synthetic colours, MSG (glutamates), GMO ingredients or artificial trans-fats. All store brands undergo extensive product testing. For example, in the Boston and Monrovia offices, up to 20 people try the products in the development stage. The marketing senior vice-president claims that only 10 % of sampled products are approved (Berman 2011). Customers also recognise the high quality of the merchandise. In a survey conducted by *Market Force Information*, *Trader Joe's* was ranked number 1 among North American grocery retailers for satisfaction and 82 % of consumers gave *Trader Joe's* high scores for private label products and natural and organic selections (Store Brands 2014).

Customers have noticed *Trader Joe's* unique merchandise mix. *Trader Joe's* "stocks its shelves with a winning combination of low-cost, yuppie-friendly staples (cage-free eggs and organic blue agave sweetener) and exotic, affordable luxuries – Belgian butter waffle cookies or Thai lime-and-chilli cashews – that you simply can't find anyplace else" (Kowitt 2010). In addition, the company creates a **mystique** for its products, making them seem unique, with a **particular story**. This appeals to loyal customers (Merrefield 2013). This exclusivity is a very strong part of *Trader Joe's* brand positioning.

In addition, the company allows customers to **taste products** before they buy them (except for alcoholic beverages) by asking a salesperson. The company is very responsive to its consumer's concerns. For example, they withdrew single ingredient products from China such as garlic, frozen organic spinach and ginger after customers voiced concerns about their quality (USA Today 2008).

Like a **discount chain**, **prices** at *Trader Joe's* are substantially lower than in competitor stores. This is mostly achieved via a limited assortment and high stock turnover, a focus on store brands, almost no advertising and the other cost advantages of such a format. The company's sales per square metre are estimated to be double that of their average competitor, with much smaller stores (Merrefield 2013).

Surveys regularly show that a shopping basket at *Trader Joe's* costs substantially less than at a regular supermarket. In addition, *Trader Joe's* has an EDLP policy which facilitates shopping. There are no loyalty cards, coupons, special promotion days, etc. This enhances consumers' trust in the retailer and complements the brand positioning very well.

9.8.3.2 Limited Variety of Merchandise but Frequent Launches of New Products

Trader Joe's is a role model for stores with limited assortments (The Washington Post 2014) which are still perceived as having a wide selection. The company offers a limited selection of products; for example, it offers only two kinds of pudding or one kind of polenta. In total, the company only carries between **3000–4000 SKUs** (Schermerhorn 2012; Berman 2011), substantially less than competitors. The obvious reason is stock turnover and efficiency, so it is possible to sell high quality products at very low prices (Kowitt 2010). The unique merchandise comes from all around the world. The company has about 15–20 buyers who have relationships with hundreds of vendors and who continuously search for the new and distinctive items (Berman 2011). Every week, around 10 to 15 new products are introduced into stores, following a strict "one in, one out" policy. Items which do not sell well are taken off the shelves (Schermerhorn 2012); hence shelves are only stocked with best-selling product lines (Berman 2011). Despite the limited assortment, the Market Force study mentioned above found that the consumers' scored the selection of merchandise highly (Forbes 2013).

Trader Joe's customers get access to a combination of low cost, healthy, exotic affordable luxuries that cannot be found elsewhere (Kowitt 2010). The retailer does not sell well-known brands like Cheerios or Coca-Cola (Berman 2011) or try to compete with supermarkets over items such as meats or fresh produce. In fact, these items are mainly offered in pre-packaged form (Berman 2011). *Trader Joe's* does not carry necessities or baby food, so families cannot complete their full shopping here (Kowitt 2010).

9.8.3.3 Store Atmosphere

The store atmosphere is another distinctive feature of *Trader Joe's*. The stores have kept their identity over the years by staying true to the "**spirit of aloha**" (Stern and Ander 2008, p. 98) (see Fig. 9.4). The main idea is that customers will see shopping as less of a chore and more like a treasure hunt (Schermerhorn 2012).

The idea was instigated by the founder Joe Coulombe, who wanted the **shopping experience to resemble a vacation**. Hence, since the early years the employees have dressed in **Hawaiian shirts**, handed out samples of food and drink and used nautical language. Every *Trader Joe's* has a hidden plastic lobster and stuffed turtle toy for children to find. Children who point it out to the cashier are rewarded with a "treasure" (treat) (Culture Map 2012). The stores play upbeat background music and have rustic **hand-painted signs** (Bloomberg 2008). Each store is unique, as the signs are painted by a local chalkboard artist (Stern and Ander 2008, p. 98). The signs vary depending on the location; for example, units close to lakes or rivers might have nautical themes, while downtown stores have urban themes. In New York, *Trader Joe's* has a sampling station called Grand Central Sampling Station (Berman 2011). There are chalkboards around the store with slogans like "You don't have to join a club, carry a card, or clip coupons to get a good deal" (Schermerhorn 2012, p. C-2). This is yet another measure to differentiate the retailer from its competition.

The stores have no loudspeaker or pager system to call employees (e. g., to open an additional cash register); instead, the company uses a simple code with the sound of bells. These bells are another link to the nautical "aloha" theme. One bell means "open another cash register", two bells means a question needs answering at a cash register and three bells calls a manager. The stores do not have flat-screen TVs or other media at the check-out counters, as the CEO claims customers should be entertained by talking to employees rather than watching TV (Bloomberg 2008).

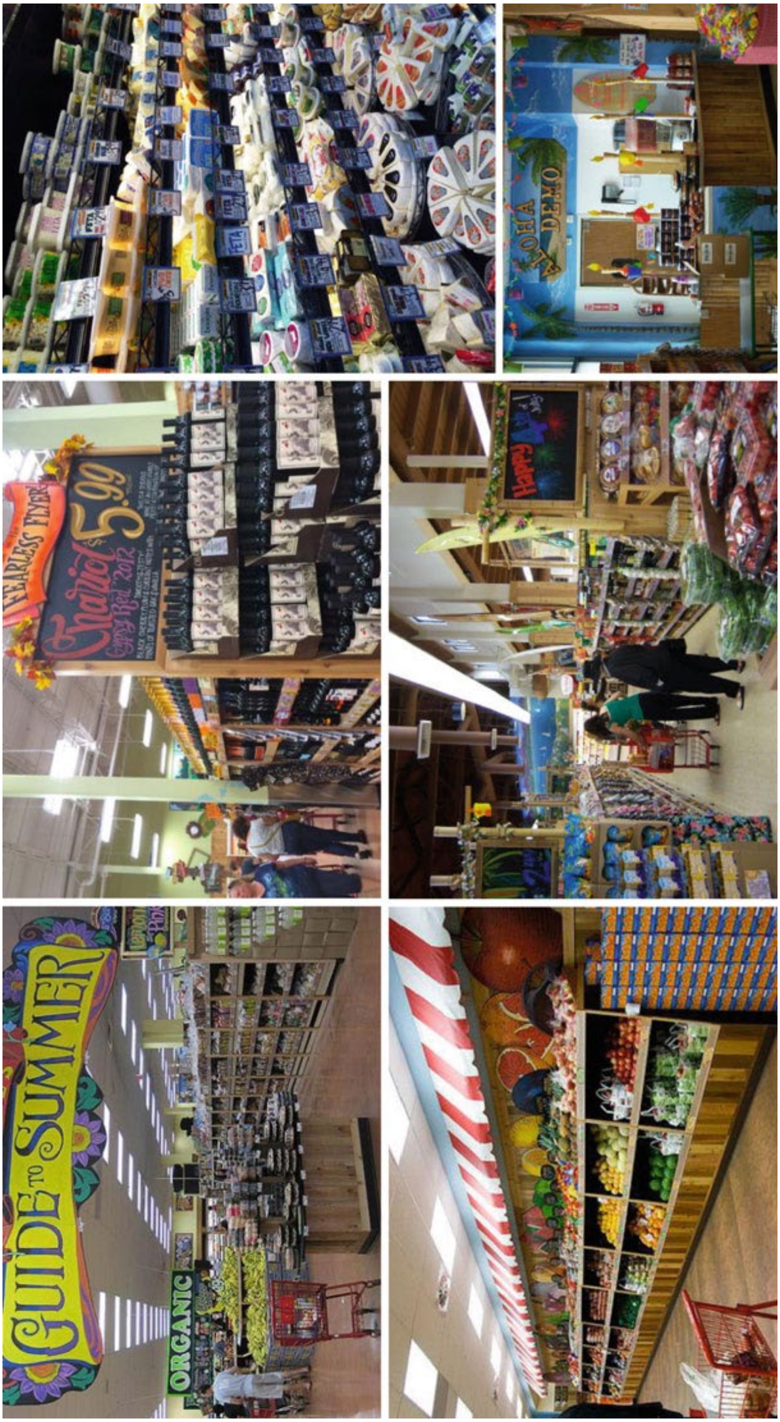

Fig. 9.4 Interior design of *Trader Joe's* stores

9.8.3.4 Customer Service

Service is another element of *Trader Joe's* brand positioning. Customer surveys show *Trader Joe's* customer service and satisfaction levels consistently exceed expectations (Store Brands 2014). To achieve this, the company relies on conversations between staff and customers (Berman 2011). Friendly and happy employees contribute to customer well-being and a very positive atmosphere.

Store employees refund money for returned products without asking questions. The motto is: "We tried it! We liked it! If you don't, bring it back for a full refund, no questions asked".

9.8.4 Employer branding and employee branding

Trader Joe's has extremely low turnover rates. The company offers high, competitive salaries with many benefits for both their full- and part-time employees. For example, part-time employees who work over 900 hours per year get health benefits. Moreover, the retailer voluntarily contributes about 15 % of the salary into the retirement plan. In addition, *Trader Joe's* provides paid time off, family and medical leave, short- and long-term disability, life insurance and training programmes, amongst other things. This is regularly discussed in the US media, and *Trader Joe's* is seen as a role model here, in strong contrast to other low-cost retailers like *Walmart*.

Employees are reviewed periodically and measurable benchmarks and goals are set based on these reviews. The evaluation criteria include traits like "is always friendly," "creates a genuine fun shopping experience," "greets and asks customers if they need assistance while on the floor," "educates self about product features and shares with customers," and "promotes high morale in the store" (Berman 2011), i. e., they are strongly linked to the **store experience** and customer contacts.

Outlet managers are promoted from within the company and receive excellent compensation. The company offers training programmes to its future leaders at *Trader Joe's University*, which creates the sense of loyalty necessary to run the stores (Schermerhorn 2012). The company is perceived as looking after its employees, as evidenced by independent websites where employees review companies as employers. On platforms like *indeed.com*, *Trader Joe's* ranks highly for all relevant criteria: work-life balance; compensation, job security, management and job culture (Indeed 2015).

Employees at *Trader Joe's* are highly engaged (Kowitt 2010). In its job descriptions, the retailer focuses on soft skills, e. g., "ambitious and adventurous, enjoys smiling and has a strong sense of values" (Schermerhorn 2012). Job advertisement also highlight the company's fun culture and the Hawaiian shirts instead of suits. Employees are encouraged to be perky and happy. For example, during the opening of the Chelsea store, customers were greeted with high-fives from the employees and free cookies (Kowitt 2010).

Management promotes a culture of product knowledge amongst employees and encourages them to be honest with customers, e. g., when recommending products. At check-out, staff ask whether the customer found what they needed, and if not, the employee quickly gets the item for the customer (Berman 2011). Shoppers at *Trader Joe's* can often recall helpful staff members finding or recommending products to them (Schermerhorn 2012).

9.8.5 Conclusion

Trader Joe's is clearly different from its competitors and has an extremely successful business strategy. By differentiating itself in many aspects of retail marketing and overall strategy, *Trader Joe's* has created a strong retail brand with a very clear and unique positioning. *Trader Joe's* has stayed consistent in its visual merchandising (Berman 2011) since its founding in 1967. The company has outstanding quality merchandise, an interesting assortment of products which is consistently improved and an exciting store atmosphere with a money-back guarantee central to its customer service strategies (Berman 2011), which reduces consumer risk. In addition, *Trader Joe's* has been able to establish a very successful store brand strategy, with products that cannot be found in other stores and a level of quality equivalent to that of major national brands at great value prices (Berman 2011). Recently, *Trader Joe's* has increasingly been a threat to the growth model of *Whole Foods Market* (see the case study in Chap. 12), because *Trader Joe's* manages to combine a lower price positioning with a yuppie appeal.

Questions

1. What do you think would be a typical consumer's associative network for *Trader Joe's*?
2. *Trader Joe's* wants to be viewed as a local specialty grocery store, but the company is constantly growing and opening new locations. Explain the main challenges faced by *Trader Joe's* in maintaining its neighbourhood store image.
3. Analyse the strengths, weaknesses, opportunities and threats (SWOT) for *Trader Joe's* from a retail branding perspective.

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Corporate Social Responsibility 10

Abstract

Contemporary society expects companies to act responsibly and sustainably. This has led to the development of business ethics concepts, such as corporate social responsibility (CSR), which influence every activity in the retail value chain, both downstream and upstream. This chapter describes the ethical framework of CSR and its consequences for retailers.

10.1 Stakeholder View and Corporate Social Responsibility

10.1.1 Shareholder vs. Stakeholder Approach

In recent years, society has made increasing demands on companies to meet not only the needs of shareholders but also those of a wide range of internal and external stakeholders (see, e. g., Morschett et al. 2015, p. 302). A stakeholder can be defined, according to Freeman (1984, p. 46), as "any group or individual who can affect or is affected by the achievement of the organization's objectives". Stakeholders include customers, suppliers, stockholders, employees, banks, non-governmental organisations (NGOs) and society in general.

The traditional shareholder approach that "the only business of business is to do business" (ascribed to Milton Friedman) is changing. Retail companies bear the brunt of this challenge, because they interact directly with consumers. Consumers generally have personal and contractual relations with these providers which they are unlikely to have with suppliers upstream. In addition, retail companies operate locally and are

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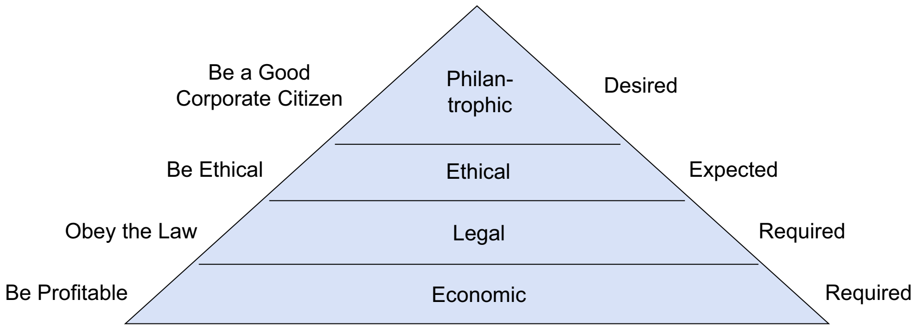

Fig. 10.1 Corporate social responsibility pyramid. (Adapted from Carroll 1991, p. 42)

active in thousands of local communities. In contrast, manufacturers produce in only a few plants worldwide. In addition, retail companies operate on both the supply and demand sides.

10.1.2 Triple Bottom Line and Corporate Social Responsibility Pyramid

Under the stakeholder approach, companies, in addition to generating profits, are held responsible for their social and environmental effects on society. They are required to act sustainably. In this context, the **triple bottom line concept** (TBL) require that companies should not only measure their success through financial performance (e. g., profits or return on investment) but also consider their impact on the wider economy, the environment and general society (Savitz and Weber 2014, p. 4; see Elkington 1997). Company success, from this perspective, has to be measured against multiple criteria, mainly capturing these three areas. In a helpful mnemonic, the triple bottom line concept refers to "people, planet, profit", and hence can be seen as the "**PPP approach**".

Carroll (1979; 1991) developed the widely used "**corporate social responsibility pyramid**" (see Fig. 10.1), which conceptualises corporate responsibility via four expectations that society has of organisations:

- The economic domain ("be profitable") as the necessary financial base.
- The legal domain ("obey the law").
- The ethical domain ("be ethical") characterising a "higher" level of responsibility within the pyramid.
- The philanthropic domain ("be a good corporate citizen") as the top level of social commitment.

While the legal domain seems like it would be a given, there are nevertheless a lot of violations in the "global competitive arena".

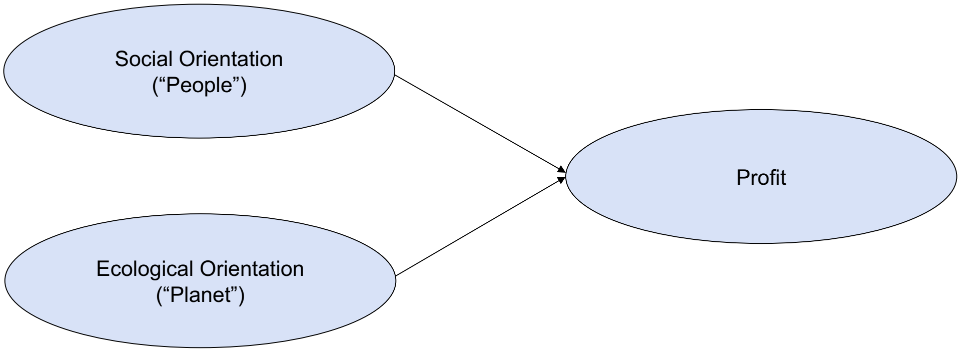

Fig. 10.2 The New PPP model. (Scholz and Zentes 2015, p. 172)

10.2 Corporate Social Responsibility and Corporate Strategy

10.2.1 Strategic Integration of CSR

Following the TBL approach means that companies have to meet three **targets of equal importance**: being profitable and operating both socially and ecologically. There are short-, medium- and long-term approaches to profit, although these perspectives are not necessarily mutually compatible. In addition, there are **interrelations** between the three targets: Acting in a socially responsible way can reduce short-term profits because retail companies that trade responsibly often incur higher costs, e. g., paying fair prices to foreign farmers ("**fair trade**"). But in the long run, this social engagement will be rewarded. Or the retail company might only sell organic products at a higher average price, thus alienating (short-term) profitable market segments. However, in the long run this strategic positioning can be economically lucrative.

Another increasingly important conflict stems from retailers' long-term approaches to securing access to agricultural resources such as crops, coffee or cocoa beans, for example by acquiring farms in foreign countries, and thereby reducing supplies in the regions of origin, which are often the least developed countries. Acting both ethically and profitably requires finding **win-win-situations**, e. g., via long-term partnerships with farmers (**contract farming**), investing capital and transferring knowledge to substantially improve productivity, so that both parties can benefit. A strong example is the partnership between the Swiss companies *Coop* and *Remei* and Indian farmers to cultivate bio-cotton (Morschett et al. 2015, pp. 310–316).

A balanced approach to the three dimensions can be achieved via the **New PPP model** (Scholz and Zentes 2015, pp. 171–173). In this approach, profit is no longer the **target** but the legitimate **result** of economic activities in a market economy: The basic guidelines of entrepreneurial activities are **social orientation** and **ecological** or **environmental orientation**. This approach is illustrated in Fig. 10.2.

A strong example of how companies can successfully follow the structure of the **New PPP model** is the German drugstore *dm-drogerie markt* (see Scholz and Zentes 2015, pp. 175–178). Since its foundation in 1973 by *Götz W. Werner*, *dm-drogerie markt* has focused on entrepreneurial and socially conscious activities. According to *Erich Harsch*, CEO of *dm-drogerie markt*, "the attitude behind everything the company does is what really matters. (…) At *dm*, we believe a company can only be successful in the long term if it can strike a balance between commercial concerns and ecological and social factors. We do not see sustainability as a concrete state but as an intrinsic approach on which all entrepreneurial activities must be based. That is the only way we can ensure we have the necessary foresight to stay fit for the future. Sustainability does not preclude commercial success, it is an essential requirement of it" (Inverto 2010).

The positive economic effects of sustainable business models have been demonstrated in a global study from the *MIT Sloan Management Review* (MIT SMR) and the *Boston Consulting Group* (BCG), based on a survey of 2600 company representatives around the world. According to this study, "more than 60 percent of companies that had changed their business model and had sustainability as a permanent fixture on their management agenda said they have added profit from sustainability." Specifically, companies' reported profits from their sustainability efforts rose 23 % in 2012, to 37 % of the total (BCG 2013).

10.2.2 CSR Management Model

Companies' CSR activities can be classified in different ways (Sen and Bhattacharya 2001; Schramm-Klein et al. 2016). Retailers must embed these in their organisation holistically (i. e., linked to the business proposition and every added value in the value chain) (Jonker and de Witte 2006, p. 4). Based on this approach, an integrated management model can be developed (see Fig. 10.3).

The starting point for the CSR model is a company's business proposition, which comprises their vision, mission and overall competitive strategy. Under the umbrella of the business proposition, four interlinked domains must be defined, in both a business or competition context and a societal context (Jonker and de Witte 2006, p. 6):

- Organising identity: This covers issues such as core values, branding, image and corporate identity. These factors will be discussed in detail in the case study for this chapter.
- Organising systems: This refers to internal and external communication and the design of primary and supporting processes. The following sections focus on the sustainable design of primary processes such as purchasing and production, logistics, marketing and sales and human resource management as a supporting process.
- Organising accountability: This focuses on auditing, reporting and monitoring performance and standards, which will also be discussed in the following sections.
- Organising transactivity: This includes developing partnerships, organising dialogues, etc., which will be described in the case study.

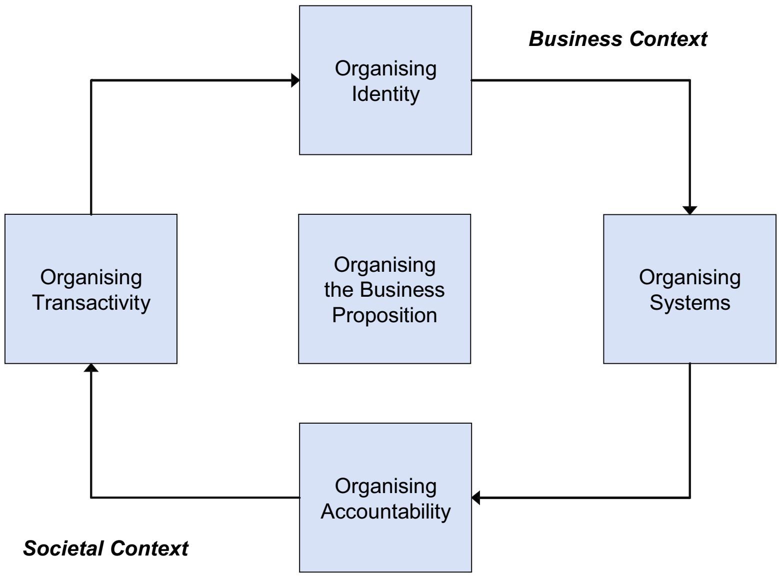

Fig. 10.3 The CSR management model. (Jonker and de Witte 2006, p. 5)

10.2.3 Restructuring the Retail Value Chain

Sustainable purchasing and (in-house) production are important primary processes on the supply side of the retail value chain and require strong labour and ecological standards across all production sites worldwide, buying or producing safe products, sourcing fairly and responsibly and using scarce resources efficiently.

To comply with **sustainability standards** and build partnerships with **trusted suppliers**, many organisations have developed **codes of conduct** which provide consistent guidelines for retailers and manufacturers.

For example, the *Business Social Compliance Initiative* (BSCI) of the European *Foreign Trade Association* (FTA) demonstrates how retail and wholesale companies follow codes of conduct, implement and run audits and react through corrective actions in global purchasing (Morschett et al. 2015, pp. 304–305):

- The BSCI Code of Conduct is built on internationally recognised labour standards to protect workers' rights, in particular the ILO Core Labour Conventions.
- The practical implementation of the code is controlled by independent auditing companies accredited by Social Accountability International (SAI), which issues the SA8000 Standard. This standard ensures workers' basic human rights, based on the UN Declaration of Human Rights and the convention of the International Labour Organization (ILO). To control the BSCI process, the members share the results of their audits in a shared database. This also avoids duplicate audits, thus reducing audit fatigue.

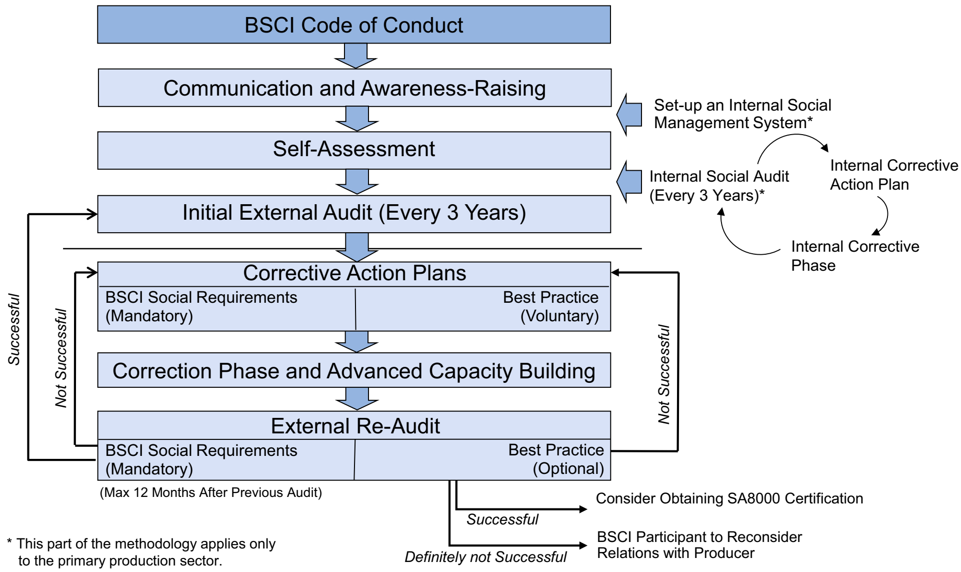

Fig. 10.4 BSCI social audit process. (BSCI 2013)

- The BSCI is based on a development approach and does not rely solely on audits. It aims to continuously improve suppliers' social performance, encouraging them to apply for SA8000 certification. The BSCI has developed follow-up measures such as implementation controls and training measures to support suppliers.
- The entire BSCI process is complemented by local and European stakeholder networks, which bring their expertise to the initiative and help ensure the long-term local ownership of the process. Cooperation with governmental authorities, trade unions, NGOs and associations also facilitates the social acceptance and independence of the system.

Fig. 10.4 shows the *BSCI* process of social audits. These audits mostly improve conditions across the industry via **corrective action plans** to build strong partnerships with suppliers, so they can deliver high quality, safe, responsibly produced products at affordable prices.

As an example, Fig. 10.5 shows the compliance with the code of conduct in factories and workshops associated with suppliers after the 2013 purchase of the Spanish vertical *Inditex*.

Another challenge in this context is reducing **food waste**. As an example, Table 10.1 shows the food waste profile of the most frequently purchased food products at the British retailer *Tesco* across every step of the value chain, i. e., field losses, processing losses, retail waste and consumer waste. Reducing food waste is not just a task for producers and retailers; consumers are also involved. Recently, a new law forbidding food waste was passed in France, banning grocery stores from throwing unsold food away. Supermarket stores larger than 400 m^2 must sign agreements with charities by July 2016 or face fines of up to

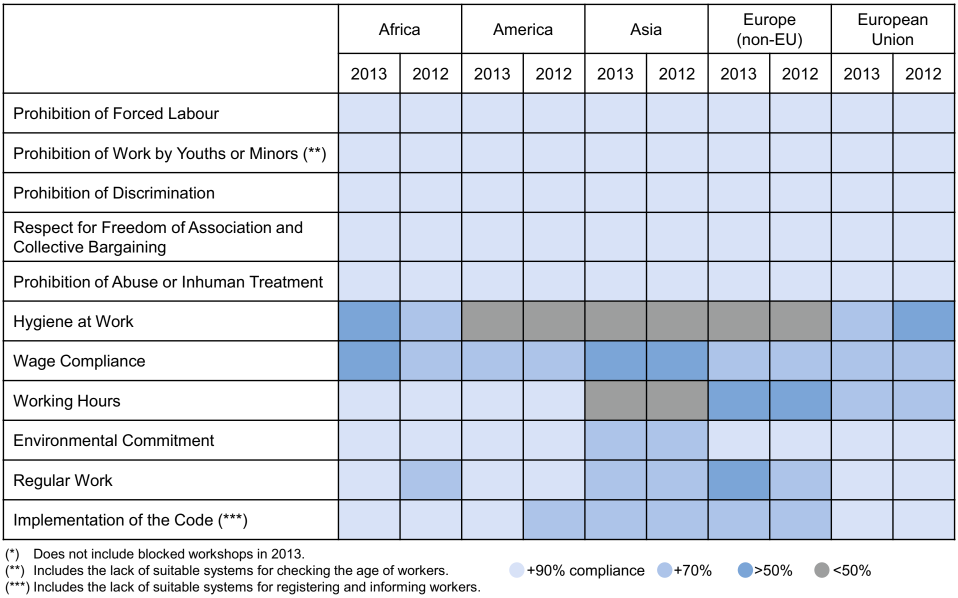

Fig. 10.5 Percentage compliance with the code of conduct in active factories and workshops (*) in 2013. (Inditex 2013, p. 58)

75,000 EUR. Separately, other voluntary initiatives have been introduced: For example, the German *REWE Group* has been voluntarily donating unsold but edible food to the German charity association *Tafel* since 1996.

In addition to sustainable purchasing, ethical trading and responsible production, sustainable logistics (**green logistics**) is another challenge for retail companies wanting to increase their energy efficiency and reduce CO_2 emissions. Energy reduction measures have also been implemented for the construction and operation of all sales outlets, e. g., lighting technology, refrigeration systems, heat consumption, etc.

The Swiss retailer *Coop's* expanded **rail shipments** provide a good example of environmentally friendly goods transport. In May 2015, *Coop* was awarded the *Schweizerische Umweltstiftung* [Swiss Environmental Foundation] annual environment prize for delivering

Table 10.1 Food waste profiles for selected food products. (Tesco 2014, pp. 14–15)

	Field Losses	Processing Losses	Retail Waste	Consumer Waste
Potatoes	9 %	6 %	1 %	39 %
Cheese	1 %	1 %	1 %	4 %
Lamb	7 %	13 %	1 %	5 %
Grapes	6 %	1 %	1 %	13 %

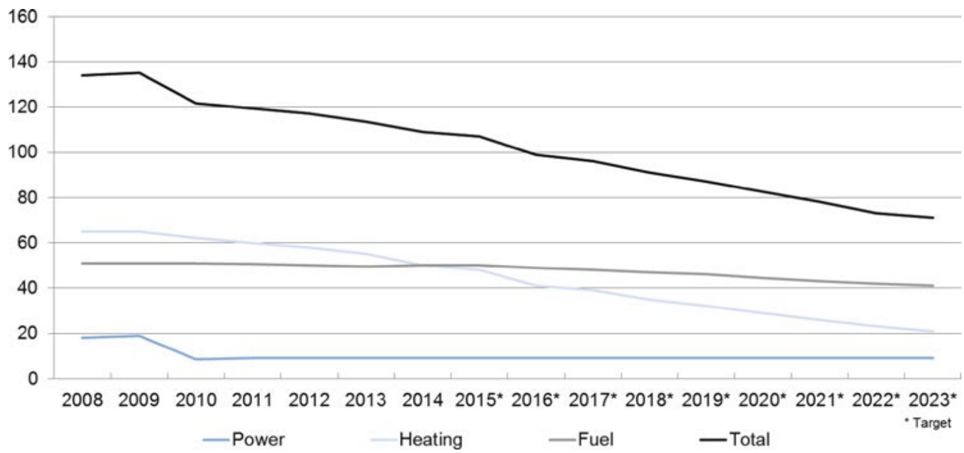

Fig. 10.6 *Coop's* (Switzerland) CO_2 emissions and reduction targets until 2023 (Switzerland) (in '000s of tons). (Coop Group 2014, p. 27)

to *Coop* supermarkets via unaccompanied combined transport (UCT). This combination of rail and road transport from *Coop's* subsidiary *Railcare* AG helped the company save 7.2 million truck kilometres in 2014, avoiding 6400 tons of CO_2 emissions (Coop Group 2015). All these energy efficiency or climate protection measures contribute to *Coop's* goal of being CO_2 neutral by 2023 (see Fig. 10.6).

Retail companies can also contribute to sustainability on the demand side of their value chain. Measures here include switching product ranges to organic and fair trade versions, developing innovative (i. e., environmentally friendly) packaging solutions, focusing on regional organic production, promoting animal welfare and also supporting consumers with information that helps them to make **sustainable buying decisions** (i. e., promoting sustainable consumer behaviour).

Coop, the largest supplier of organic food in Switzerland, is a pioneer here. *Coop* launched its organic *Naturaplan* label in 1993. In 2014, the total sales of *Coop* organic products (including organic cotton) totalled 1.1 billion CHF (Coop Group 2014). Fig. 10.7 shows the development of sales of *Coop's* own-label sustainability brands and quality labels.

Promoting consumers' responsible buying and consumption decisions is also a key to improving **health**. "Improving health" was one of the three big ambitions of the British retailer *Tesco* in 2014: "As a global retailer we can provide customers with the information and choices they need and help them to live healthier lives" (Tesco 2014, p. 11). For example, *Tesco* offers the "Healthy Little Differences Tracker". This tracker measures the nutritional content of customers' shopping baskets. Based on this information, *Tesco* can develop solutions to encourage people to buy and eat more healthily (Tesco 2014).

Social orientation (see Fig. 10.2) does not just mean complying with labour standards in low-cost countries; it also involves focusing on all employees to reach a high level of **employee satisfaction**. This approach covers a wide range of activities: traineeships, apprenticeships, training and professional development, internal recruitment, awarding jobs

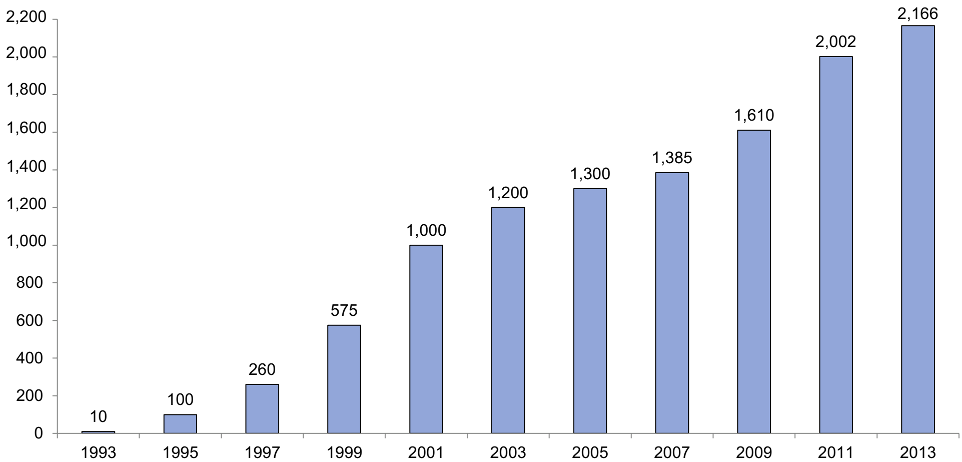

Fig. 10.7 Sales of *Coop* own-label sustainability brands and quality labels (in million CHF). (Coop Group 2014, p. 42)

to people with disabilities, balancing work and family life, granting weeks of maternity or paternity leave and creating opportunities for young people.

10.2.4 Measurement, Reports and Governance

A corporate responsibility strategy has to be embedded in a retail company holistically: from suppliers to stores, from head office to customer service centres, from warehouses to consumers' homes (e. g., for online retailing).

Achieving all this means accurately measuring a company's **social and environmental performance** and its progress as a dimension of **organising accountability** (see Fig. 10.3). Retailers that think and operate responsibly or sustainably do not only measure and communicate their results internally; they also report their measures, achievements and progress externally (i. e., to all stakeholders) via voluntary **sustainability reports**. A comprehensive example is provided by the case study for this chapter.

To compare companies' sustainable behaviour and sustainability reports, internationally recognised guidelines have been developed, such as the principles of the *United Nations Global Compact* (*UNGC*) or the *Global Reporting Initiative* (*GRI*) indicator list.

Retailers are also ranked in terms of their sustainable behaviour by many research institutes and media companies. Table 10.2 presents the ten most sustainable global retailers in 2013, released by *Corporate Knights*.

Implementing a corporate responsibility strategy also requires **governance structures** (i. e., the distribution of rights and responsibilities among the different actors in the corporation, e. g., the board of directors, managers, auditors, regulators, etc.) Fig. 10.8 shows how the Swedish vertical *H&M* has organised its sustainability approach.

Table 10.2 The 10 most sustainable global retailers of 2013

Rank	Company	Country
1	Marks & Spencer Group	United Kingdom
2	Inditex	Spain
3	Wesfarmers	Australia
4	Kesko	Finland
5	Canon Marketing Japan	Japan
6	Companhia Brasileira de Distribuição Grupo Pão de Açúcar	Brazil
7	Aeon	Japan
8	Yamada Denki	Japan
9	Loblaw Companies	Canada
10	Hennes & Mauritz	Sweden

H&M's Head of Sustainability reports directly to the CEO. Around 170 employees have sustainability as a core task. The Central Sustainability Department consists of more than 20 people "responsible for developing, global targets, reviewing progress, and encouraging and advising all relevant departments on the development and implementation of prioritised Conscious Actions based on continued stakeholder engagement, business intelligence and innovation research" (H&M 2014, p. 11).

10.3 Conclusion and Outlook

Thinking and acting responsibly is not simply an important or core element of business or corporate strategy. It is fundamental for retailers' long-term success, and this importance will only increase in the future.

Social or environmental measures can increase costs in the short term, but they will pay off in the medium or long term. In addition, social and environmental failures can induce **reputational risks** which threaten a company's existence. Ultimately, it is profitable for retailers to create greater value for society.

Further Reading

- Chandler and Werther. (2014). *Strategic corporate social responsibility: Stakeholders, globalization and sustainable value creation* (3rd ed.). Thousand Oaks: SAGE Publications.
- Morschett et al. (2015). *Strategic international management: text and cases* (3rd edn.). Wiesbaden: Springer Gabler.

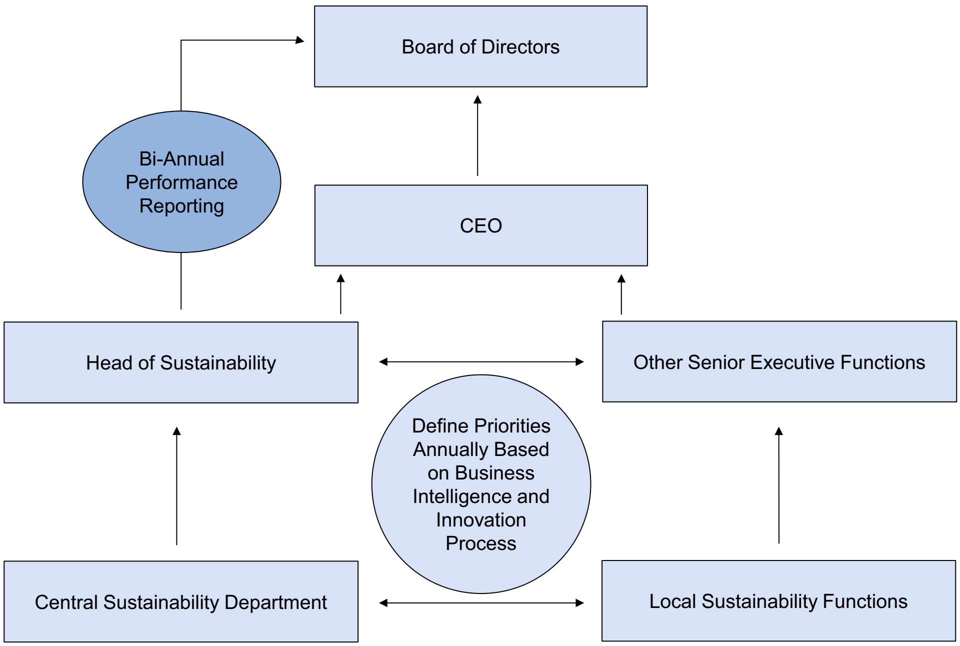

Fig. 10.8 Governance structure of H&M. (H&M 2014, p. 11)

- Porter and Kramer (2006). Strategy & Society: The link between competitive advantage and corporate social responsibility. *Harvard Business Review*, 84(12), 78–92.
- Schramm-Klein et al. (2015). Retailer corporate social responsibility: shedding light on CSR's impact on profit of intermediaries in marketing channels. *International Journal of Retail & Distribution Management*, 43(4/5), 403–431.

10.4 Case Study: Otto Group

10.4.1 Profile, History and Status Quo

The *Otto Group*[1] is a global retail group headquartered in Hamburg, Germany. With 123 associated companies located in more than 20 countries across Europe, Asia and both North and South America, the family enterprise runs more than 100 online shops, 1800

[1] As well as the explicitly cited sources, sources used for this case study include the website http://www.ottogroup.com, press releases and various annual and CSR reports.

catalogues and 400 stores. The *Otto Group's* companies include famous brands, such as its largest single trading company *Otto,* as well as *Baur*, *Bonprix*, *Crate & Barrel*, *Cofidis*, *Manufactum* and *Sportscheck*.

The company's origins date back to 1949, when *Werner Otto* formed the mail-order company *Werner Otto Versandhandel* [Werner Otto Mail-Order Company], based in two small buildings in the Hamburg borough of Schnelsen. In the following year, *Werner Otto* and his three employees published their first hand-produced catalogue with pictures of 28 pairs of shoes featured on 14 pages. Just one year later, the company expanded its product line with a total circulation of 1500 catalogues. Within ten years, the small mail-order house had become a large-scale enterprise, employing over 1000 people. The business then grew rapidly during the 1950s, expanding its range and establishing itself with the help of shoppers from outside major cities who did not have ready access to stores. In the 1960s, *Werner Otto Versandhandel* expanded its position as a pioneer in its industry, surpassing one billion DM (Deutschmark, the former German currency) for the first time in 1970. Within this period, the company, now called *Otto Group*, founded the *Hanseatic Bank*, allowing its customers to finance catalogue goods. In 1972, *Otto Versand* (the abbreviated name of *Werner Otto Versandhandel*) established its own logistics company, *Hermes*. Global expansion into a trade service company began in the 1970s, when the *Otto Group* took a share in *3 Suisse International*, France (initially 25 %, 50 % since 1981). In 1980, *Otto Reisen GmbH* was formed, offering tourist services via catalogue. By 1987, the *Otto Group* had become the world's largest mail-order company. In 1995, the individual company *Otto* started presenting parts of its product line on the Internet at www.otto.de. Just two years later, the complete *Otto* catalogue was published online. Since then, the company has been steadily expanding its online and offline activities, founding start-ups and joint ventures, and making acquisitions all over the world.

As of 2014, the Otto *Group* is Europe's largest online retailer for fashion and lifestyle and the world's second-largest online retailer in the end-consumer (B2C) business (Forbes 2014). With over 54,000, the *Otto Group* increased its revenue by 0.5 % to 12 billion EUR in the 2014/15 financial year.

10.4.2 The Three Pillars of the Otto Group

The *Otto Group's* activities cover three main business areas:

- The multi-channel retail segment encompasses the group's global catalogue, e-commerce and over-the-counter retail business activities, and is the *Otto Group's* highest-turnover business segment. With revenue of almost 10 billion EUR in the 2014/15 fiscal year, it provides more than 80 % of the group's total. Today, almost 60 % of all revenue in the multi-channel retail segment is generated through online platforms.
- With revenue of almost 1.5 billion EUR, the services segment is the second largest business segment. It covers services within the retail logistics value chain, e. g.,

sourcing, quality testing, transportation and warehousing, as well as customer delivery. The *Otto Group's* sourcing companies and logistics service providers are all consolidated under the brand *Hermes* and provide services to both the *Otto Group's* retail companies and other customers.
- The financial services segment comprises the *Otto Group's* range of retail-related financial services, focusing on consumer credit, liquidity management and payment. This segment includes the following global companies: EOS Group, Finnovato GmbH and the Hanseatic Bank and Hanseatic Insurance Service. The financial services segment generated revenue of 644 million EUR in 2014/15.

The *Otto Group* is strongly aware of its responsibility towards its market environment and is working on specific measures within its business segments, notably:

- Developing e-commerce activities within the multi-channel segment,
- developing more innovative concepts within the financial services and services segment,
- further growing through progressive internationalisation, with the BRIC states leading the way, and, most notably,
- increasing focus on its corporate responsibility activities.

10.4.3 Corporate Responsibility (CR) at the Otto Group

Protecting the environment and acting in a socially responsible way has been an integral part of the *Otto Group's* strategy since the 1980s. Today, taking responsibility for people and the environment is the focus of the *Otto Group's* corporate vision, embodied in a corporate mission called "The Power of Responsibility". This mission provides four key targets to strive for throughout the group, namely profitability, innovation, diversity and sustainability. This vision and mission, presented in Fig. 10.9, form the basis for the company culture and are intended to ensure the sustainability of the *Otto Group's* business activities.

Fig. 10.9 Vision and mission. (Otto Group 2015a)

10.4.4 The Otto Group's Fields of Sustainable Action

In line with its vision, the *Otto Group* has developed its "CR strategy 2020", "which group-wide defines the key sustainability issues and goals and embeds the principles of sustainable business practices even more deeply in the group and its business processes" (Otto Group 2013, p. 16). This strategy, adopted in 2012, is valid until the 2020/2021 fiscal year and is an umbrella strategy with five sub-strategies for handling the *Otto Group's* assortment and customers, supporting the climate and environment and managing the supply chain. For each field of action, the *Otto Group* has defined group-wide goals to focus its primary business processes and activities on sustainability (see Fig. 10.10). Every company in the group is committed to these five central objectives, insofar as they are relevant to their business models.

The *Otto Group's* assortment and customer strategies focus on the environmentally friendly extraction and processing of raw materials. To this end, the company established strategies for both textiles and durable goods. The goal of the textile strategy is to switching the *Group's* entire order volume for its own and licensed brands to sustainable cotton by 2020. This is an ambitious objective, as the current share of sustainably cultivated cotton is comparatively low (11 % share of the group's entire cotton take-up) (Otto Group 2015b). The primary goal of the durable goods strategy is to use only FSC (*Forest Stewardship Council*)-certified timber from responsible forestry in order to make a major contribution to preserving biodiversity.

The group's climate and environment strategies again focus on two major goals: climate protection by reducing CO_2 emissions generated by logistics, the company's sites and employee travel, and increasing the share of FSC-certified paper in catalogues and advertising to at least 50 %. The share of FSC-certified wood in furniture is to be increased to 100 %.

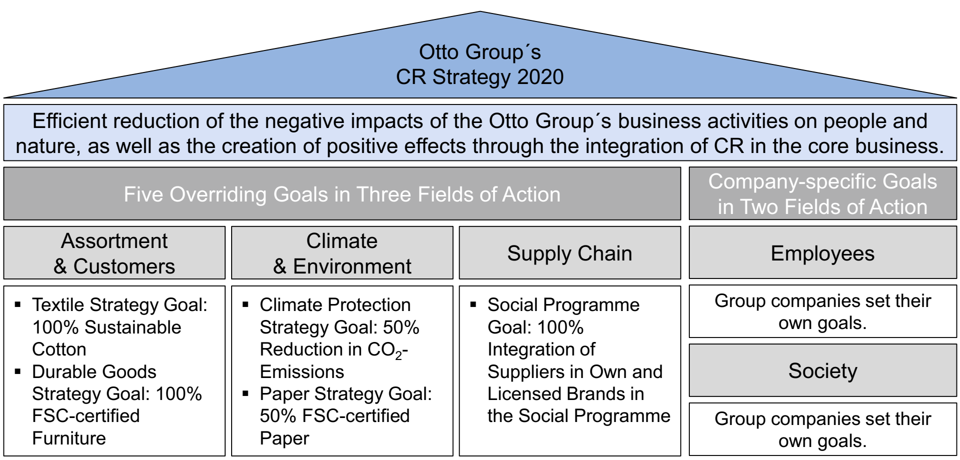

Fig. 10.10 CR Strategy 2020. (Otto Group 2015a)

- As the global demand for raw materials is continually rising, managing a resource-friendly value chain is increasingly important and will make a strong contribution to securing the *Otto Group's* future (Business and Diversity Initiative 2014). Therefore, the *Otto Group* launched its "Social Programme" in 2012 to improve local working and production conditions and ensure suppliers uphold social standards within the supply chain. The primary objective is the full integration of all suppliers with factories in at-risk countries, such as Bangladesh, India and China. In doing so, the *Otto Group* intends to increase transparency within the supply chain and improve social standards. Partners, suppliers and employees have to follow the *Otto Group's* code of conduct that sets out social standards, particularly the "code of conduct for merchandising goods" and the "code of conduct for services and non-merchandising goods".
- Implementing these sub-strategies often calls for strong partnerships. For example, "the Otto Group works with Terre des Hommes to combat child labour in India, and supports the Aid by Trade Foundation initiated by Dr. Michael Otto, which promotes small farmers growing cotton in sustainable ways in Africa. It advocates and promotes educational opportunities for young people at its sites" (Otto Group 2015c).

10.4.5 Management of Corporate Responsibility

Successful implementation of the CR strategy 2020 is highly dependent on the quality of the group's organisational management. This is even more important at the *Otto Group* because of its decentralised structure. Therefore, the group-wide implementation of the strategic CR goals requires clearly defined working processes at a group level. Thus, the company established a "CR board" in 2012, headed by *Hans-Otto Schrader*, CEO and chairman of the executive board. This CR board is the "central decision making body for preparing strategic CR decisions" (Otto Group 2013, p. 19). The CR board is supported by working groups from the strategy-specific action fields and the CR division, which has been promoting sustainable issues at a group level since 1990. The CR division has a group-wide consulting and management function, is responsible for planning and developing strategies and provides the measurement tools used by the CR board. It is also responsible for stakeholder management, CR reporting, networking and knowledge transfer between the *Otto Group* and its constituent companies.

The numerous and diverse companies within the *Otto Group* require CR coordinators for each company, who "coordinate their company's respective CR activities, initiate new measures and manage the administration of key figures" on an operational level (Otto Group 2013, p. 19).

The *Otto Group's* full CR organisation is shown in Fig. 10.11. It is clear that CR is one of the *Otto Group's* top priorities.

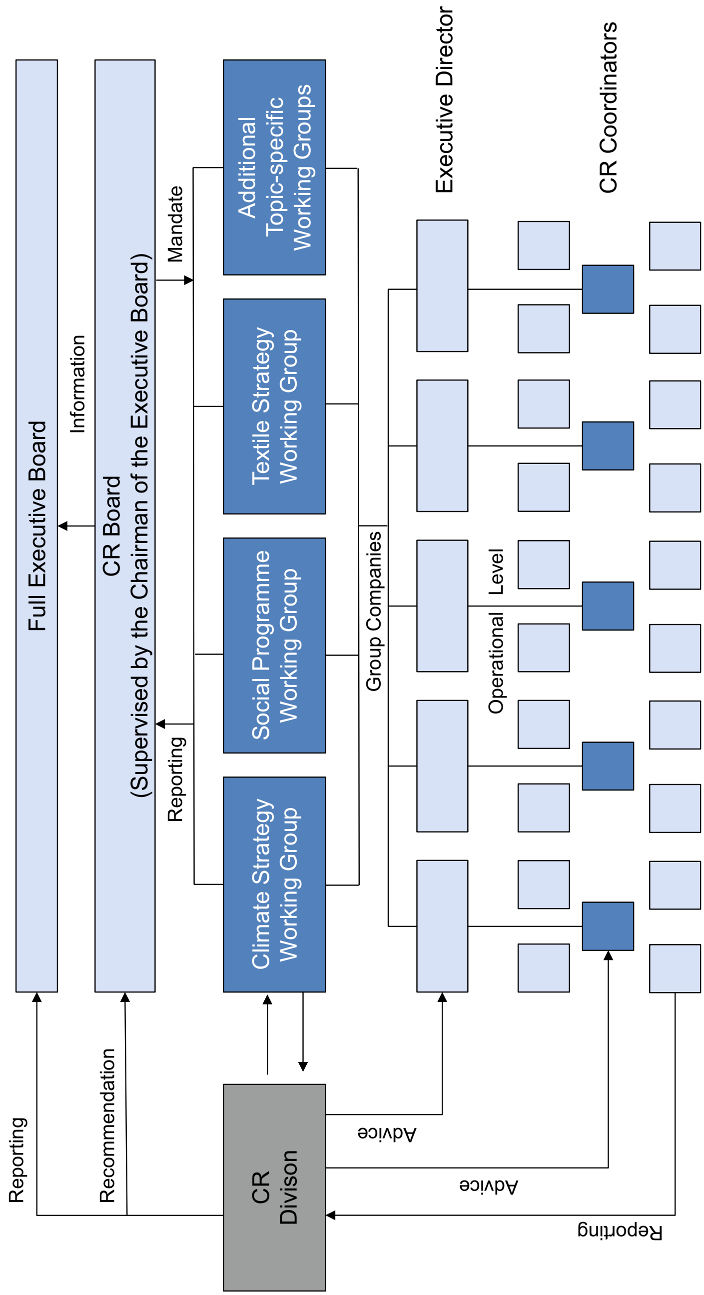

Fig. 10.11 CR organisation. (Otto Group 2013)

10.4.6 Stakeholder Dialogue

Transparent communication and critically constructive dialogue with external and internal stakeholders are crucial for the *Otto Group* in two ways: first, they support the constant development of its sustainable activities and, second, they increase consumer awareness of sustainability issues. The *Otto Group* restructured its stakeholder management system in 2011 to standardise all dialogue procedures within the group's companies. The new system sets out clear guidelines for identifying and involving stakeholders, internal responsibilities and division of duties. The most important stakeholders at the *Otto Group* are customers, suppliers, employees, NGOs and representatives from politics, science and business. Stakeholders are involved in the company's business activities at four different levels:

- Providing information for the sustainability report and the corporate website,
- face-to-face dialogue (e. g., events, workshops),
- consultation (e. g., one-to-one exchange at a specialist level),
- developing goals and solutions with stakeholders, or at least involving them in the process.

Table 10.3 presents a selection of the different information and dialogue formats used at the *Otto Group*, along with the most-discussed topics.

The *Otto Group's* forum initiatives, e. g., in the living wages forum of the Round Table Codes of Conduct of the German Society for International Collaboration (GIZ), "serve to encourage exchange and involve internal and external stakeholders as well as to extend interactions with them" (Otto Group 2013, p. 22), and thus provide a powerful stimulus for its CR strategy.

10.4.7 Summary and Outlook

This case study focused on the *Otto Group's* socially and environmentally sustainable business activities. The *Otto Group* is a strong example of a retail company successfully integrating the principles of the triple bottom line into their business activities. Given the rising number of accusations of greenwashing from general society, the example of the *Otto Group* shows how early integration of sustainable business practices – both upstream within the supply chain and downstream within the context of intensive stakeholder dialogues – help provide an authentic, sustainable reputation and also boost profits. In future, the *Otto Group* will focus on more complex multipliers to attract even more attention to sustainability topics, anchor the topic in the public's mind and stimulate a societal shift on the issue.

Table 10.3 Stakeholder dialogue by target group

Target Group	Information or Dialogue Format	Selected Topics
Cross-target Group Communication	CR report and corporate website press releases forums interviews	CR strategy and media relations, social standards in the supply chain, climate protection
NGOs	Membership in associations and initiatives round table events …	Consumer protection, climate protection, occupational health and safety
Business	Topic-specific working groups sharing best-practice examples with other companies …	Consumer behaviour, social standards in the supply chain
Politics	Membership of associations and initiatives face-to-face discussions …	Consumer protection, climate protection
Science Management	Regular trend study university collaborations …	Sustainability, consumer behaviour, social standards in the supply chain
Customers	Online shop/catalogue customer service online forums/social networks …	Sustainable products, data protection, sourcing raw materials
Employees	Intranet seminars best-practice clubs …	CR strategy, employee engagement, energy efficiency
Suppliers Supply Chain	Codes of conduct audits/trainings …	Climate protection, social standards in the supply chain, raw-material sourcing

Questions

1. Compare the shareholder and stakeholder approaches. Which seems more relevant for the *Otto Group*? In this context, name the *Otto Group's* key stakeholders and outline their typical expectations, power and influence over the *Otto Group*.
2. Corporate responsibility (CR) or corporate social responsibility (CSR) are extraordinarily important for the *Otto Group*. Define the concept of CSR. What arguments in favour to CSR seem most important? Name the driving forces which make CSR more relevant today.

3. Explain the "New PPP model". Does this model apply to the Otto Group? If so, how?

- See the *Otto Group's* CSR report for further information.
- Visit the company website and annual reports for further information.

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Part III

Marketing Mix in Retailing

Store Location – Trading Area Analysis and Site Selection

11

Abstract

Epitomised by the oft-cited saying that the three most important success factors in retailing are “location, loca-tion, location”, store location is 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, therefore, requires distinct planning processes to solve complex location decisions. This chapter focuses on brick-and-mortar retail outlets, discussing the different types of retail locations, the main elements of location decisions and techniques for assessing retail sites.

11.1 The Importance of Location to Retail Companies

Selecting retail store locations is one of the most significant decisions in retail marketing, because in store-based retailing, a good location is key to attracting customers to outlets and can sometimes even compensate for an otherwise mediocre retail strategy mix. A good location, therefore, can lead to strong competitive advantages, because location is a unique element of the retail marketing mix which cannot be imitated by competitors.

Location decisions are highly complex. There are a large number of factors to consider, and the costs associated with, for example, opening 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, either to build a store or sign a long-term tenancy agreement, there is little flexibility, because this decision usually cannot be easily changed without incurring significant losses.

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Unlike other elements of the retail marketing mix such as price, customer service, product assortment or advertising, location cannot be changed in the short term due to its **fixed nature**. Other factors can usually be altered if the environment (e. g., consumer behaviour, competition) changes (Wrigley 1988).

Retail location strategies usually focus 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 (Hernández and Bennison 2000):

1. **opening** new stores.
2. **extending** the floor space of existing stores.
3. **relocating** or **moving** a store from one place to a better site within a particular town or area.
4. **rationalising** decisions, e. g., closing individual stores.
5. **repositioning** locations, e. g., altering a store's image by changing the name or appearance.
6. **refurbishing**, e. g., improving or updating an existing outlet's physical environment and tailoring the product range and assortment to local customers (**remerchandising**).

Opening new stores is the most complex decision, because it is usually the starting point for activities in a specific geographic area. This section thus focuses on retail location decisions of this type.

11.2 Types of Retail Locations

11.2.1 Overview

There are three basic **types of location** available for retail stores: (1) solitary sites, (2) unplanned shopping areas and (3) planned shopping districts. Each of these basic location types has specific advantages and disadvantages (see Table 11.1), depending on, among other things, the size of the catchment area, occupancy costs, pedestrian or vehicle customer traffic, restrictions placed on store operations or the convenience of the location.

In addition, solitary sites and retail agglomerations such as planned or unplanned shopping districts differ in terms of the possibilities for combined shopping. Retail agglomerations have the advantage that customers can find everything they need in a single shopping trip. This is especially important for multi-purpose shopping trips. For example, if a customer wants to buy a new outfit, they might prefer to shop at a shopping centre with a range of fashion and footwear stores, because there will be more choice and less risk of not finding a suitable combination of clothes, shoes and accessories (Oppewal and Holyoake 2004, p. 61). Also, customers might prefer to combine their shopping for different product categories, e. g., for clothes and food. Solitary sites usually cannot provide customers with such advantages.

Table 11.1 Characteristics of different location types. (Adapted from Levy et al. 2014, p. 184)

	Size (1000 m²)	Trading Area (km)	Shopping Convenience	Pedestrian Travel	Vehicular Traffic	Restrictions on Operations	Typical Format
Unplanned Areas							
Free Standing	Varying	5–15	High	Low	High	Limited	Convenience, drug stores, category killers
Urban Locations/ Central Business Districts	Varying	Varying	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 11.2 Top ten global retail rents. (Colliers International 2014)

Retail Strips	Rent in USD per Square Metre per Year
New York, Fifth Avenue	38,212
Hong Kong, Queens Road Central, Central	22,314
Hong Kong, Canton Road, Tsim Sha Tsui	21,646
New York, Madison Avenue	17,685
Paris, Champs Elysées	16,609
London, Old Bond Street	14,424
Hong Kong, Causeway Bay	11,873
Zurich, Bahnhofstrasse	10,742
Milan, Via Monte Napoleone	9580
Moscow, Stoleshnikov Lane	8460

11.2.2 Solitary Sites

Solitary sites are single freestanding outlets isolated from other retailers (Gilbert 2003, p. 288). They are often positioned on roads or near, but not adjacent, to other retailers or shopping centres. Solitary sites are usually characterised by low rental costs or land prices. They usually offer large parking facilities and there is rarely a direct competitor close to the store. However, attracting customers may initially prove difficult and might require high advertising expenditure. Such sites are used, for instance, by convenience shops or by large store formats in food and general merchandise retailing that offer one-stop shopping convenience.

11.2.3 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 store mix is not the result of long-range planning, and there is no centralised management (Levy et al. 2014, p. 184).

Fig. 11.1 shows the diverse types of retail locations. The main kinds of unplanned shopping areas are listed below (Berman and Evans 2013, pp. 283–286).

1. **Central business districts (CBDs)** are the traditional "downtown" areas in cities or towns, i. e., "the hub of retailing in a city" (Berman and Evans 2013, p. 283) that offer the greatest density of stores. The rents in CBDs are comparatively high (see Table 11.2), even though the popularity of CBDs differs internationally. For example, they are very popular in Europe but not very popular in many US cities.

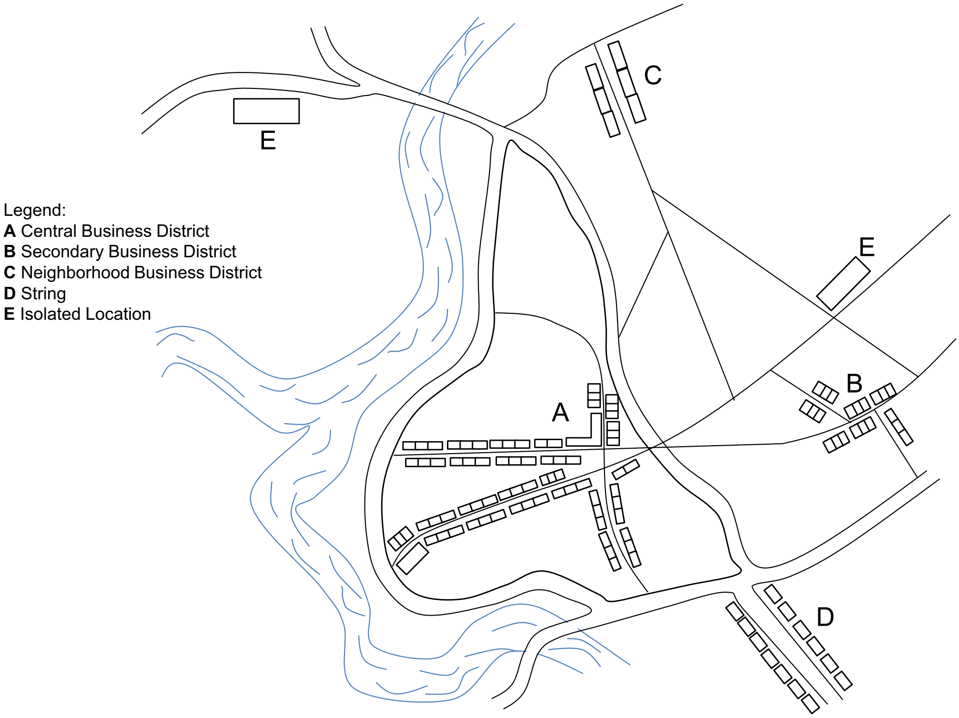

Fig. 11.1 Unplanned business districts. (Adapted from Berman and Evans 2013, p. 286)

2. **Secondary business districts (SBD)** are unplanned shopping districts with less wide and deep assortments than in CBDs, located in larger cities and main streets or high street locations in smaller cities. Larger cities tend to have multiple secondary business districts.
3. **Neighbourhood business districts (NBD)** serve the needs of a single residential area. They are typically situated on major streets. Food retailers are often the leading retailers here.
4. **Strip** or **string locations ("strip mall")** are groups of retail stores situated along a street or motorway. For example, different brands of car dealership are often located next to each other along a major road.

11.2.4 Planned Shopping Districts/Shopping Centres

Planned shopping districts 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 centres are (1) **retail parks** that consist of a purpose-built cluster of freestanding retail outlets and (2) **shopping centres** that consist of one large building marketed as a unified shopping destination, usually with a single name and logo. Both types offer (large) parking facilities but the retail mix in single building shopping centres is different from that in 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 centres have been developed (Levy et al. 2014, pp. 189–195): (1) **neighbourhood** or **strip/community centres** that are typically anchored by a supermarket, (2) **power centres** that consist primarily of large format retailers, (3) **shopping malls** that are enclosed, climate controlled and lit shopping centres (regional or superregional shopping malls), (4) **lifestyle centres** that encompass an open-air configuration of upscale specialty stores, entertainment and restaurants, (5) **fashion/specialty centres** that mainly comprise upmarket clothing shops and boutiques carrying highly priced and high quality fashion merchandise, (6) **outlet centres** that contain manufacturers' and retailers' outlet stores or off-price retailers (see Chap. 2 and 3), (7) **theme or festival parks** that typically employ a unified theme shared by the retail outlets, their architectural design and their merchandise and often anchored by restaurants or entertainment facilities, and (8) **omni-centres** that combine enclosed malls, lifestyle centres and power centres to create a new centre type that combines low-price and premium formats in a single centre that allows customers to cross-shop between discount and premium stores. The main types of planned shopping areas are presented in Table 11.3

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

Table 11.3 Types of planned shopping area. (Adapted from Reynolds 1992, p. 57)

	Types	Examples
Intermediate Centres (10,000–20,000 m²)		
Locational variants	Non-central suburban community greenfield site, transport node	Centro Commerciale 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+)		
Locational variants	Central area in traditional core central area adjacent to traditional core non-central suburban growth zone greenfield site, transport node	Eldon Square, Newcastle, UK La Part-Dieu, Lyon, France CentrO, Oberhausen, Germany Como, Bergamo, Italy

Table 11.3 (*continued*)

	Types	Examples
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 (5000–20,000 m²)		
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 Shopping Park, Leicester, UK
Specialty centres (1000 m²+)		
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

Floor space figures are indicative only; centres providing for local or neighbourhood needs are excluded

11.3 Retail Location Decision Process

11.3.1 Overview

Retail location decisions typically follow a systematic process. Fig. 11.2 shows an example process that can be applied in retail trade area analysis.

The **site selection process** 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 (see Fig. 11.3; Brown 1992, p. 16):

1. **Market selection**: the first step is to identify a region that has the potential for a new retail outlet.

2. **Area analysis**: within the chosen region, a potentially optimal area for the store is selected.
3. **Site evaluation**: in the chosen geographical area, the best available site(s) are examined based on all features relevant to store performance. This step concludes with a final decision on the specific site.

11.3.2 Catchment Area

Analysing the catchment area (**trading area, market area**) of a specific region or site is vital at each phase of the retail location decision process. A **catchment area** is the geographic area that contains the customers for 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.

Catchment areas are usually divided into three parts. The **primary trading area** is where 50 to 80 % of customers are based. The **secondary trading area** contains about 15 to 25 % of customers, and the **fringe** or **tertiary trading area** includes the remaining

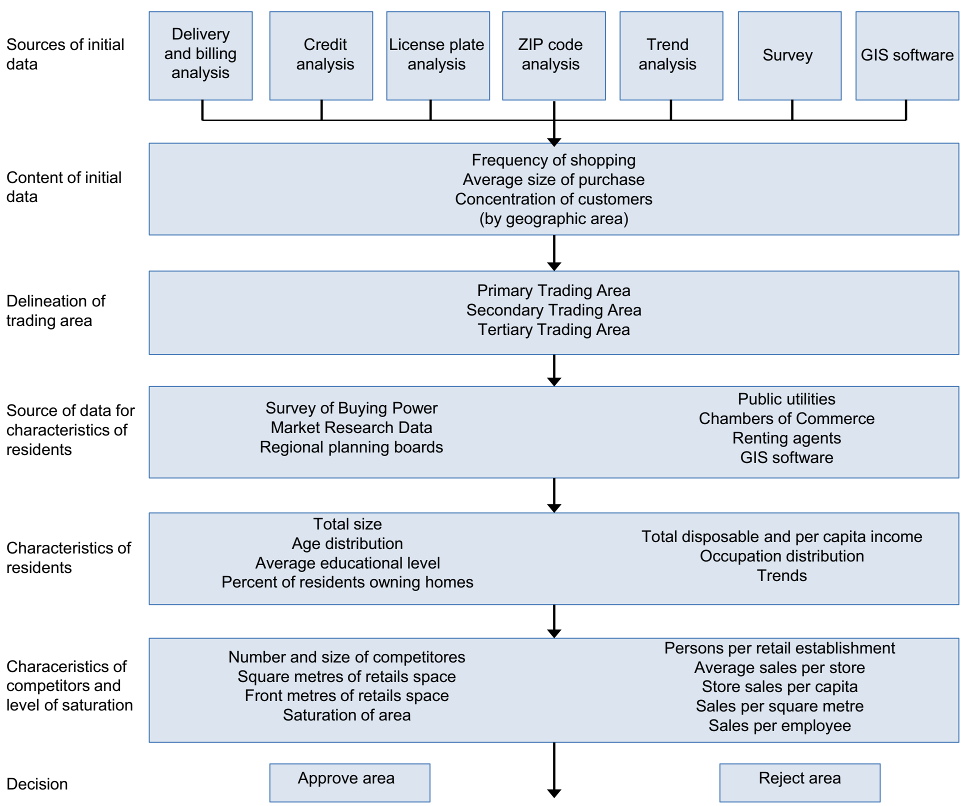

Fig. 11.2 Retail area analysis. (Adapted from Berman and Evans 2013, p. 272)

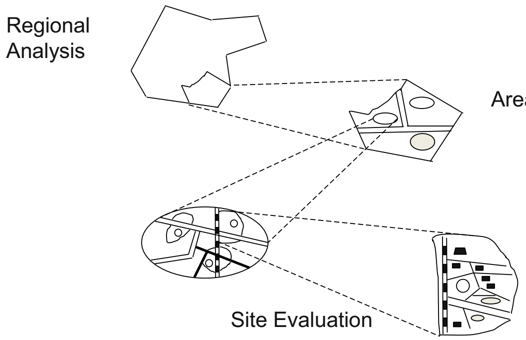

Fig. 11.3 Catchment area assessment. (Adapted from Bienert 1996, p. 115)

customers who shop occasionally at a location as an alternative to local shopping (Berman and Evans 2013, p. 264; Gilbert 2003, p. 280).

These parts of a catchment area are often described in terms of the **distance** between customers' homes or workplaces and the area or site. They are usually delineated by measuring linear distance (e. g., concentric circles drawn around a site), travel distance (by car or public transport) or time distance (by car or public transport). **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 digitised mapping with key location data to depict trading area characteristics such as population demographics, customer purchase data and competitor locations.

11.3.3 Location Assessment Techniques

The **suitability** of a specific site is based on 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 these location factors is presented in Table 11.4.

A number of techniques have been developed to guide retail location decisions and assess or forecast the potential sales or profitability of retail stores in a specific region or area or at a specific site. These techniques range from simple to very sophisticated and computer-based (see Table 11.5). 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, rationalisation, repositioning and so on.

11.3.3.1 Managerial Experience

Location is a retail function that 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 based on company knowledge (Hernández and Bennison 2000).

Table 11.4 Selected location factors. (Adapted from McGoldrick 2002, p. 240; Gilbert 2003, p. 293; Berman and Evans 2013, p. 270)

Customers (potential/ actual)	Accessibility	Competition	Costs	Availability
Numbers by demographics (e. g., population size, age profile, household size) income level disposable income per capita average education level employment by occupation, industry, trends housing density housing age/type neighbourhood classification home-ownership levels building/demolition plans major employers spending patterns shopping patterns population growth, density and trends lifestyle measures cultural/ethnic grouping	Site visibility pedestrian flows pedestrian entry routes barriers (e. g., railway tracks, rivers) type of location zone car ownership levels road network (conditions, driving speeds, congestion, restrictions, plans) parking (capacity, convenience, cost, potential) public transport (types, cost, ease of use, potential) visibility staff access transport and delivery access	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 level 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 minimum wages delivery costs insurance costs promotional media/costs turnover loss/ other branches taxes licensing	Number and type of location zoning restrictions owning versus leasing opportunities

Table 11.5 Location planning techniques. (Adapted from Hernández and Bennison 2000, p. 360)

Techniques	Subjectivity	Cost	Technical Expertise required	Computing and Data Needs	GIS
Managerial Experience	Very high	Low	Low	Low	Limited role
Location Evaluation Checklists	Medium	Low	Low	Low	Limited role
Analogue Method	Medium	Low	Low	Low	Limited role
Multivariate Statistical Techniques	Low	Medium	High	Medium	Information
Spatial Interaction Models (Gravity Modelling)	Low	High	Very high	High	Information, analysis and modelling
Knowledge-based Techniques (e. g., Expert Systems/ Neural Net-works)	Low	Very high	Very high	Very high	Information

11.3.3.2 Location Evaluation Checklists

Checklists consist of a number of chosen variables (i. e., location factors) to consider when evaluating retail locations. Nelson (1958) developed one of the first detailed checklist evaluation formats.

Companies select factors they believe 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. 11.4 illustrates links between retailers' strategic positioning (e. g., focus on price, convenience, variety or proximity), typical locations (e. g., retail parks or high streets) and major influences that are considered important (e. g., population, competitors, demographics, etc.) and which should be analysed in the context of site assessment.

11.3.3.3 Analogue Method

The **analogue method** (Applebaum 1966) compares new store sites 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 based on sales achieved and profits earned by similar stores in existing areas. Such comparisons can be performed by **extrapolating** from internal store data or by comparing the new site with existing competing stores (e. g., stores at the prospective location).

11.3.3.4 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).

The most important techniques are various forms of **multiple regression analysis,** which predict store sales and estimate market potential or profit. **Discriminant analysis** can be used to predict category membership. Such sophisticated procedures can identify relationships between store sales and predictor variables such as population in the surrounding area, population spending power, store accessibility, quality of transport links to sites, average distance to population or nearby competition (Moutinho et al. 1993).

These techniques provide more objective and systematic insight into the impact and importance of location attributes, and thus are useful for screening large numbers of loca-

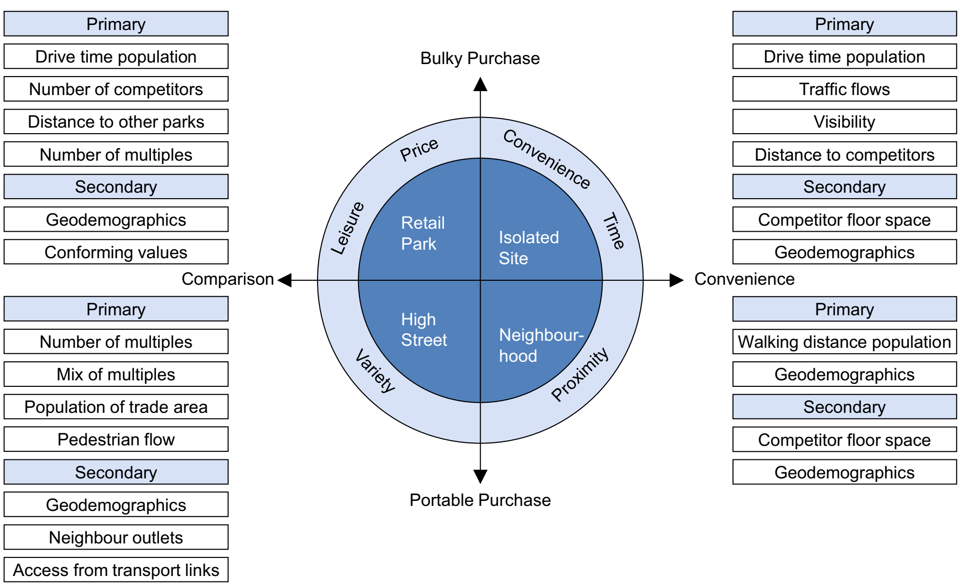

Fig. 11.4 Links between retailer strategies, location factors and location types. (Adapted from Davies and Clarke 1994, p. 7; CCN Marketing 1993.)

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

d_{01} = distance or journey time of the breaking point 0 from town 1
d_{12} = distance or journey time between town 1 and town 2
A_1, A_2 = population of town 1 and town 2

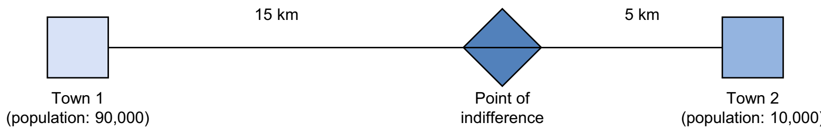

Fig. 11.5 Reilly's law of retail gravitation. (Adapted from McGoldrick 2002, p. 261; Berman and Evans 2013, p. 268)

tions. However, they require more data than simpler methods, as well as a higher degree of technical expertise.

Cluster and factor analysis are techniques which aim to group data or variables to divide a portfolio of stores into similar groups (**cluster analysis**) or a range of variables that can be used to predict site profitability (**factor analysis**). These procedures are particularly suited to developing new store formats or segmenting retail networks. These techniques also require a large amount of good quality data, along with a high degree of statistical expertise and business acumen (Hernandéz and Bennison 2000).

11.3.3.5 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 gravity. 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 (Craig et al. 1984).

Gravity models can be used to forecast store performance by simultaneously considering factors such 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), which 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 Fig. 11.5). Thus, it is the point at which consumers are indifferent as to which location they use (Rogers 1992).

This model helps delimit the trading area from which retailers draw customers. However, the model has many limitations (see, e. g., Rogers 1992; Craig et al. 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 the trade areas of more than two towns and the shape of the function is not constant for all types of shopping trips. Retailers can offer additional competitive advantages and thus – contrary to the model's 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 to 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 shopping at a particular store. It describes catchment areas based on the product assortment carried at various shopping locations, travel times and the sensitivity of the kind of shopping to travel time (trip purpose and type of product sought). Most geographic information systems (GIS) incorporate Huff-type models.

11.3.3.6 Knowledge-based Techniques

Knowledge-based techniques are the most recent models 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 which model 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.

11.4 Conclusion and Outlook

Location decisions have a major impact on a retail outlet's success, as location is an important factor in consumers' store choice. The location decision also has a **long-term impact**, as it is not very flexible. Thus, location decisions are critical to retailers' competitive advantages. Retail site selection is usually conducted following systematic site selection processes.

To guide and support retail site assessment, the various location assessment techniques have become more and more sophisticated. These improvements have been triggered largely by advances in computer and software technologies (e. g., artificial intelligence).

It should be noted that retail location decisions do not just involve opening new stores; monitoring existing stores is equally important. This entails, for example, decisions concerning repositioning, relocating or closing outlets. This is important, as retail environments change rapidly (e. g., changes in customer behaviour or competitive structure) and companies must respond via location decisions.

However, retail location decisions cannot be made without considering the retail environment in terms of the interests of towns and cities or their residents. Establishing a retail store can, for example, influence shopping patterns, traffic and pedestrian flows or the retail structure of a town. The issue of out-of-town vs. inner-city retail centres is often of major concern to local communities. Also important in this context are **business improvement districts** (BID). BIDs are public-private partnerships (PPPs) made up of property and business owners within a defined area, who try to improve that area via collective contributions to maintaining, developing and marketing their commercial districts.

To ensure that specific objectives are met, retail locations are influenced or constrained by local or central government planning policies. Thus, opening a new store or even changing or extending an existing store may require planning permission. For example, most European countries have restrictions on setting up large retail formats and out-of-town shopping centres, because of the potentially adverse impact of large stores on small businesses and of new shopping centres on old ones.

However, local authorities do not only restrict retail store settlement. In many city marketing initiatives, an attractive retail mix is recognised as one of the key factors in attracting customers to a particular town or city. Local authorities, therefore, try to encourage retailers with good images to open stores in their towns or cities.

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11.5 Case Study: The Home Depot

11.5.1 Profile, History and Status Quo

The Home Depot[1] is an American retailer of home improvement and construction products and services. It is the world's largest home improvement chain, with net sales of 83 billion USD (see Table 11.6). The retailer is a broad line specialist in the do-it-yourself home repair market with a high level of consistency of product lines to fulfil complementary end use needs. *The Home Depot* offers up to 40,000 different kinds of building materials, home improvement supplies, appliances, and lawn and garden products. In doing so, the retailer offers the expertise of professional home contractors at markedly lower prices than hardware stores (Kim and Mauborgne 1999). *The Home Depot*'s main competitor in their most important market, the US do-it-yourself home repair market, is *Lowe's* with net sales of 56 million USD in 2014.

Bernie Marcus and Arthur Black founded the corporation in 1978. By the end of 1979, *The Home Depot* had opened three stores and generated 7 million USD in revenue. Just

[1] As well as the explicitly cited sources, sources used for this case study include the company's website www.homedepot.com, various annual and interim reports and investor relations presentations.

Table 11.6 Key indicators for *The Home Depot*. (The Home Depot 2015)

	2014 Fiscal Year (in million USD)	2013 Fiscal Year (in million USD)
Total Net Sales	83,176	78,812
Cost of Sales	54,222	51,422
Gross margin in %	34.8 %	34.8 %
Major Product Categories		
Kitchen	8103 (10.1 %)	7978 (10.1 %)
Indoor Garden	7550 (9.1 %)	7176 (9.1 %)
Paint	7300 (8.8 %)	7026 (8.9 %)
Number of stores	2269	2263

five years later, *The Home Depot* broke the 30 store mark and achieved 4.3 billion USD in sales. In the following years, the company grew very quickly, becoming the fastest retailer in history to reach revenue milestones of 30 billion USD, 40 billion USD, 50 billion USD, 60 billion USD and 70 billion USD (Hess 2012). Today, *The Home Depot* is the world's largest home improvement specialty retailer and the second largest retailer in the United States.

The Home Depot operates more than 2200 retail stores in the United States (1977 stores), Canada (181 stores) and Mexico (111 stores) (US Department of Energy 2013). Between 2006 and 2012, *The Home Depot* also operated stores in China. However, in 2012, the company closed its remaining big box stores in China, citing that the Chinese market, with its massive cheap labour pool, is more of a "do-it-for-me culture", which did not fit *The Home Depot's* do-it-yourself model (Wall Street Journal 2012). China's slowing economic growth spurred the company to close the stores. However, the retailer has kept two specialty stores in China, because they expect potential success in the future. A complete withdrawal from China and subsequent re-entry might be more expensive than keeping the door ajar.

In communicating its values, *The Home Depot* puts customer orientation and social responsibility first. The company visualises this system of values as an "Inverted Triangle" which represents how everything and everyone in the company, from senior management to corporate support systems, is designed to support the success of associates and customers (see Fig. 11.6). As this quote from Arthur Black shows, this strategic approach was one of the central motives for founding the company: "Bernie and I founded *The Home Depot* with a special vision – to create a company that would keep alive the values that were important to us. Values like respect among all people, excellent customer service and giving back to communities and society" (Hess 2012).

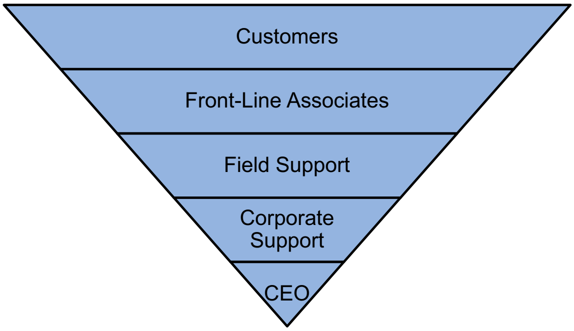

Fig. 11.6 *The Home Depot's* Inverted Triangle. (The Home Depot 2015)

11.5.2 The Home Depot's Store Types and Retail Locations

The average *The Home Depot* store is 106,800 ft^2 (approximately 10,000 m^2) in area with approximately 28,000 additional square feet (approximately 2600 m^2) of outside area for garden and landscaping products. The stores have large entrances for customer flow, providing direct store access and room for loading and unloading materials. They also have large aisles, varied inventory and comprehensive in-store centres, such as garden and home decorating centres, all under one roof. To achieve all this, *The Home Depot* almost exclusively employs a warehouse concept outside of city centres with a wide selection and a high in-stock fill rate. In exchange, the stores forgo the convenience of short drives for their customers and also fulfil their customer's expectations when it comes to store design: Instead of nice displays and friendly service, the retailer focuses on a functional, professional appearance and their staff's advisory skills (see Fig. 11.7). This focus on function rather than design has led to the stores being nicknamed "orange boxes".

Thus *The Home Depot's* stores and location complement the orientation of its target group: The *Home Depot* focuses on customers with home improvement needs who choose to carry out the work themselves rather than hire a contractor. The company's store loca-

Fig. 11.7 Typical *The Home Depot* stores: "orange boxes". (Civil Eats 2014; MSNBC 2013)

tions, atmosphere, range of goods and services are chosen to reduce overheads and maintenance costs and generate economies of scale in purchasing (Kim and Mauborgne 1999). This also clearly communicates the stores' price advantage: A luxurious high-street flagship store would not communicate attributes such as lower prices and suitability for professional home contractors as effectively as a functional warehouse outside of the city.

Following this strategy, *The Home Depot* is already represented in all US states, all ten Canadian provinces and Mexico. Such high market penetration means many markets are becoming saturated (Directions Magazine 2006). Nevertheless, the retailer is still relying on an expansion strategy to keep the pressure on competitors, even though growth rates have shrunk in recent years (see Fig. 11.8).

In addition to opening new stores, *The Home Depot* also focuses on optimising the assortments in its individual warehouses to better suit local target groups. Market analysis is key here, particularly looking at how many stores a market can support, evaluating point of sale data and supporting the merchandising function (Directions Magazine 2006). For example, the retailer monitors its sales per square foot in each store. If this value becomes too high, the company assumes its customers may not be well served and competition may be drawn into the market: When the value reaches approximately 400 USD, *The Home Depot* will often open another store in the area, even though this might decrease the existing store's sales (Dunne et al. 2011). Higher and more suitable customer orientation and increased barriers to market entry for competitors compensate for this cannibalisation.

11.5.3 Site Selection Criteria

The following quotation from Mike LaFerle, Vice President of Real Estate at *The Home Depot*, shows the importance of site selection to the company's expansion strategy: "Location is everything … Convenience is the driving factor for most customers" (Directions Magazine 2006). *The Home Depot* decides on a new store location based on a number of site selection criteria, including:

- low costs,
- out-of-town locations,
- convenient access,
- compatibility with store concept and store type.

The Home Depot aims to offer the expertise of professional home contractors at significantly lower prices than hardware stores. To achieve this, it is important to reduce the main cost drivers of the brick-and-mortar stores, i. e., real estate costs. Because *The Home Depot's* "orange box" stores require a lot of space due to their extensive assortments and high in-stock fill rates, the costs of the retail location can be crucial.

This combination of large spaces at low costs is only rarely found on high streets or in cities. Therefore, *The Home Depot* particularly looks for greenfield locations and those

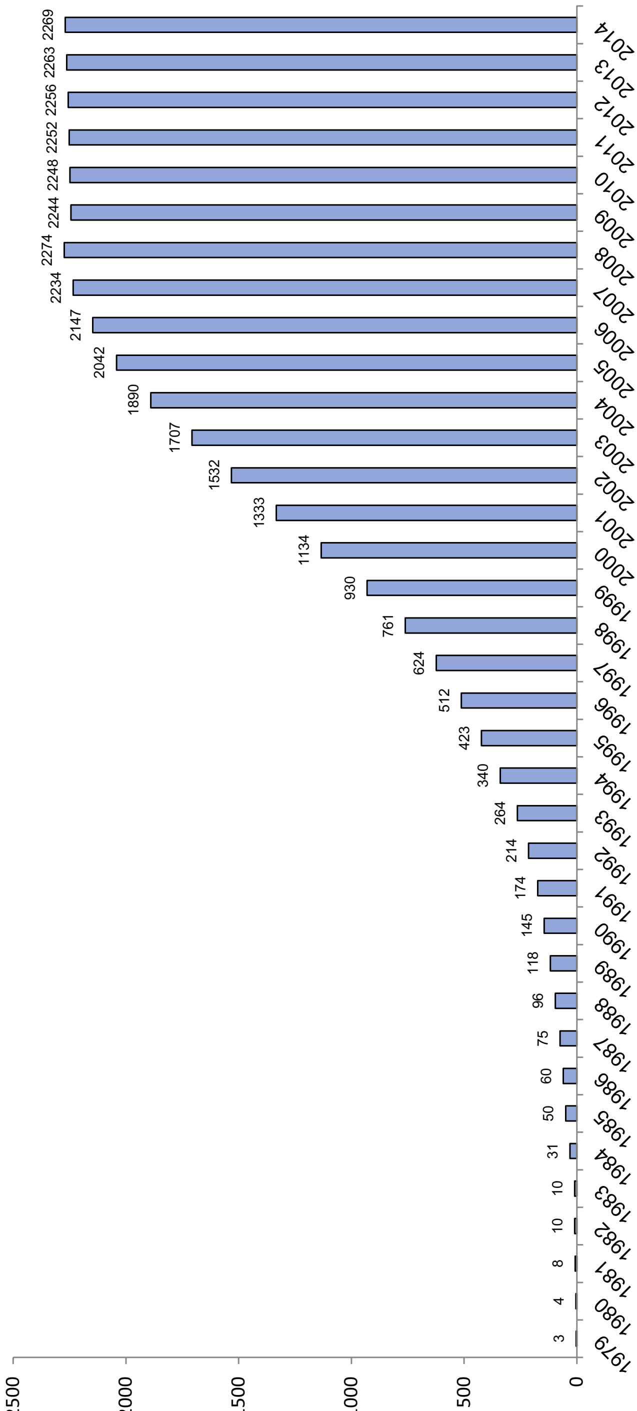

Fig. 11.8 Number of *The Home Depot* stores worldwide. (The Home Depot 2015)

on the outskirts of cities. This strategy is feasible because *The Home Depot* targets DIY enthusiasts who visit their stores with the concrete aim of buying something, rather than walk-in customers or occasional shoppers. Customers generally associate low prices with shops outside of cities rather than those on high streets.

In order to be attractive to customers despite out of town locations, it is important that the stores are convenient to reach. This is especially true for their preferred target group of homeowners. Therefore, *The Home Depot* prefers locations close to highways or within well-connected business districts.

Retailers can profit from an area's store compatibility (Karande and Lombard 2005), which is when stores in the same area offer compatible or very similar assortments. Given this, it is beneficial for *The Home Depot* to establish stores close to direct competitors. Following this approach, one *The Home Depot* store in Lewisville, Texas, experienced a 20 % sales increase after its competitor *Lowe's* opened up a new store nearby (Dunne et al. 2011).

Similar criteria also apply for choosing the location of the retailer's distribution centres. They are usually "selected based on its overall cost, proximity to stores and the opportunity to cost-effectively process ocean containers" (Lee Bandlow, Vice President of Distribution Services for *The Home Depot*, according to Commonwealth of Virginia 2003). Additional criteria include local or regional public incentives or subsidies. For example, *The Home Depot* received 405,000 USD from the Maryland Department of Business and Economic Development and from Washington County to assist with opening a distribution centre in Hagerstown (Blockbuster Deal 2004).

11.5.4 Site Selection and Cross-channel Strategy

Online purchases have become increasingly popular. In this context, customers often use a brick-and-mortar location as a **showroom** (see Chap. 4 and 5), a point of delivery or to pick up goods purchased online (Berry 2012). Consequently, the role of physical stores is changing to integrate more functional features such as order pick-up, merchandise warehousing and product showrooming. This is particularly the case for certain product categories, such as power tools, which are typical products offered by *The Home Depot*. In this case, customers visit the bricks-and-mortar store not only to buy the products immediately, but for a physical or tactile evaluation of a product or for a convenient and prompt pick-up (or, in case, return of online bought products).

Hence, *The Home Depot's* online sales grew by almost 40 % in Q1 of 2014. This result encouraged *The Home Depot* to refocus its attention on building the necessary infrastructure to support increased digital commerce. An essential element of this strategy is its network of approximately 2200 stores. *The Home Depot* can ship goods straight from its inventory to customers on the same day, thus improving its customers' shopping experience (Forbes 2015). Thus site selection must also consider future demand created by electronic or mobile channels. In future, *The Home Depot's* brick-and-mortar stores will increasingly serve as warehouses; thus, sites must be large enough for additional storage room.

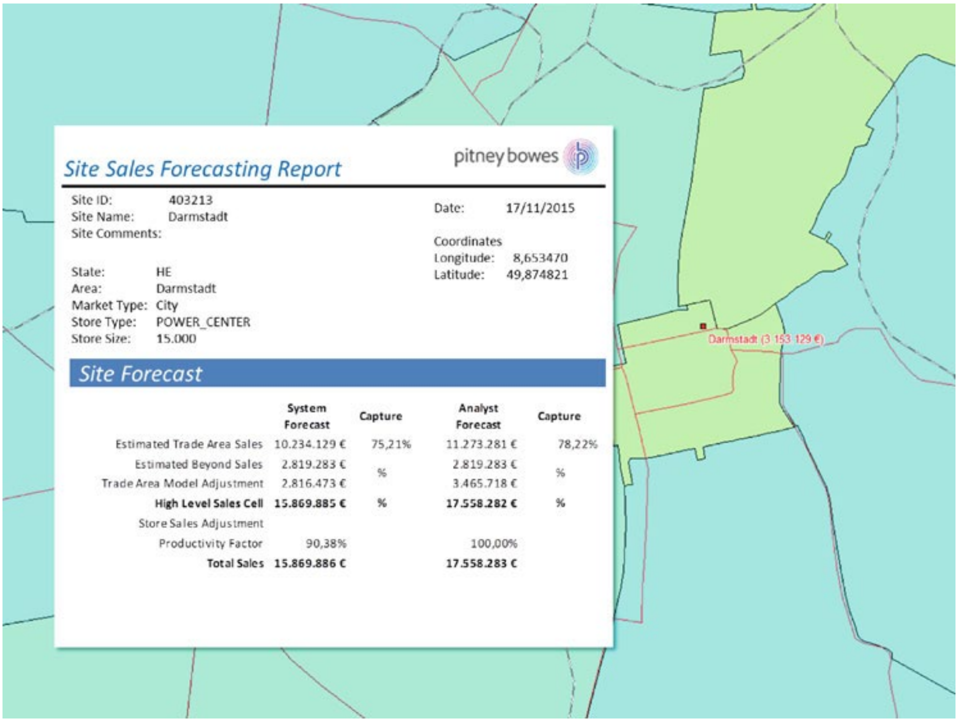

Fig. 11.9 Example of a site sales forecasting report. (Buckner 2004, p. 13)

11.5.5 Predictive Analytics for Reliable Location Intelligence

Early on, *The Home Depot* began to use predictive analytics for reliable location intelligence. The retailer works with the service provider *MapInfo*, who combine retailers' proprietary data (e. g., from loyalty cards) with US census figures and other demographic patterns to calculate statistics like how far customers travel to make their purchases.

Using this data and multivariate analytical methods, software determines spatial models and GIS for *The Home Depot* and offers a strategic outlook on which markets have the best expansion potential, which locations have the highest sales potential and how new stores will impact the retailer's other stores (CNN Money 2004). The results are combined on digital maps, based on which sales projections can be made for specific locations and categories. It is also possible to determine in which locations the retailer can expect the most positive developments (see Fig. 11.9).

The substantial increase in the efficiency of data collection and the development of databases, the use of advanced statistical and modelling techniques and continued rapid evolution of geographic information systems mean predictive analytics have steadily become more important for *The Home Depot's* site selection in recent years (Ladle and Stiller 2009). However, these analytics are based on predictive models, which reflect a standardised reality and cannot address all of the variations inherent to a particular site. Some factors which are not easily measurable (such as operations) can impact unit performance, while other factors (e. g., visibility ratings) can only be measured imperfectly. While such models can accurately assess standard locations, they are less useful in atypical situations (Berry 2012).

11.5.6 Summary and Outlook

This case study has analysed *The Home Depot's* use of site selection criteria in detail. These criteria clearly reflect the retailer's corporate strategy. The retailer has adopted a very customer-centric position, especially when it comes to real estate costs, proximity to competing stores and the convenience of its locations. Thanks to developments such as "big data", but also improvements in IT and statistical models, *The Home Depot* can now not only determine which location best meets its requirements, but also make predictions about future developments and consider them during the site selection process.

These predictions can be vital to retailers such as *The Home Depot*: The process of siting a new store, building it and merchandising the store floor takes 42 months. Thus, sales forecasting, based on up-to-date demographics and sound spatial interaction models, must accurately predict whether the market can support investment in another store. Therefore, *The Home Depot* tries to predict the need for home improvement supply long before residents start moving into their new homes and planning their first trip to the "orange box" (Directions Magazine 2006).

Questions

1. How do *The Home Depot's* site selection criteria reflect the company's strategy?
2. Which customer data and specific information about the geographic region could be relevant for site selection for a new *The Home Depot* store?
3. How do the company's site selection, assortment and pricing interact?

- Consider the likely motives and occasions for purchase of the typical *The Home Depot* customer.
- Remember, the site selection criteria should be relevant to both customer buying behaviour and the retailer's costs.
- Remember that different locations meet different customer needs and expectations.

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Merchandise and Category Management 12

Abstract

This chapter will explain the different attributes of a retailer's merchandise mix and the factors to consider when merchandise planning. The chapter discusses the merchandise mix, the development and importance of store brands and the integration of merchandise planning into the broader process of category management.

12.1 Merchandise Mix

Product assortment is at the core of the retailing offer. A retailer's total product offering is called its **merchandise mix** or **product range** (Varley 2014, p. 82). At a strategic level, merchandise management includes the process of selecting the right items for a store and, at an operational level, ensuring they are available when customers want to purchase them. The latter function is discussed in more detail in Chap. 18 and 19.

Items in the assortment are organised into groups called **categories**. **Merchandise planning** involves selecting the right categories and the items within them**.** Selecting the appropriate items for a store or an online shop requires choosing the breadth and depth of the assortment, quality levels and the brand portfolio.

The lowest level of detail identifying a product in a retailer's assortment is the **stock-keeping unit** (SKU), which identifies a particular item. For example, a pair of trousers of a certain brand in a particular style, colour and size is one SKU, or a bottle of a specific ketchup brand in a specific size and variant. The number of SKUs at various retailers varies tremendously. While hard discounters often carry around 1000 SKUs, a supermarket has 10,000–15,000 SKUs. A typical hypermarket assortment reaches around 80,000 SKUs. A

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DIY store can have around 50,000 SKUs, and a home accessories and furniture store like *IKEA* will have as many as 12,000 SKUs in a store.

Items in the assortment can be grouped using many different criteria. The length of the product lifecycle is one important classification criterion (Berman and Evans 2013, pp. 386–387):

- **Staple merchandise** defines products which the retailer carries permanently and which have relatively stable sales. A hammer or a paintbrush at a DIY retailer or jeans and white T-shirts at a department store are examples of staple goods.
- **Fashion merchandise** refers to products that have cyclical sales because of changing tastes and lifestyles. Colours and cuts of clothing change, and fashion products offered one year are usually out of date the next.
- **Seasonal merchandise** refers to products that only sell well during particular periods. Barbecues, skiing equipment, shorts and similar products have very high sales during one season, but are hardly sold at all during other seasons.
- **Fad merchandise** generates very high sales for a short period. Toys and games, certain clothing accessories or certain music CDs are often fads. *Tamagochis* and *Pokémon* are examples of classic fads. Movie merchandise (e. g., *Jurassic World* toys) is also usually faddish. Price sensitivity is often very low, and ensuring supply while demand is high is crucial for success.

The product lifecycle of merchandise is particularly relevant. All products in the assortment need to be replaced after a particular period of time, but the time span for achieving sales also varies. It also has a substantial influence on the ability to forecast demand.

Another frequently used product taxonomy is **food**, **near-food** and **non-food** items. Non-food products are non-perishable general merchandise items such as clothing, electronics, toys and so on. Near-food products are products such as detergents, toothpaste and shampoo, which are not food, but which are bought in a similar way to fast-moving consumer goods.

Merchandise can also be considered by **quality level**, which is closely related to **price positioning** (see Chap. 13). Should the retailer focus on premium products and target high income customers? Should it offer standard products or focus on lower quality, less expensive items to target mainly (but not only) low income customers? Another strategic option is to cover different quality segments and thereby approach a broader target group. For example, while discount apparel stores (e. g., *KIK* in Germany or the Dutch *Zeeman*) focus on the low-quality segment, clothing boutiques focus on the high-quality segment; department stores often cover different quality levels (see Chap. 3).

The breadth and depth of the assortment are the most commonly used criteria for structuring the merchandise mix:

- The number of product lines (or categories) the retailer offers is referred to as **the breadth (width) of the assortment**. Breadth is generally depicted on a scale from

narrow to wide. A wide assortment usually has the advantage of appealing to **broad target groups** and facilitating **one-stop shopping**, i. e., customers can find most of the merchandise they want "under one roof". One drawback is that very wide assortments often result in a diffuse, non-specific store image.

- The number of SKUs in a particular category (e. g., brands, colours, tastes, sizes) is called the **depth of the assortment**. Depth is mostly measured on a scale ranging from **shallow to deep**. Deep assortments have the advantage of providing consumers a good choice within categories, which appeals to customers with high product involvement. Shallow assortments may lead to a weak merchandise image, but a shallow assortment lets retailers focus on the fast-selling items within a category. Deep assortments often lead to many items with low inventory turnover. When a category assortment is deep, it usually covers different quality and price levels.

Specialty stores are typical examples of retailers that have rather narrow but very deep assortments. Conversely, convenience stores have rather wide but shallow assortments. Traditional full-line department stores have both a very wide and rather deep assortment. Online shops are often characterised by very deep assortments because they do not have the same space restrictions as store-based retailers. This is true for specialist online shops like *Zalando* but also for Amazon, the largest online retailer in the world (see Chap. 2, 3 and 4).

Retailers are not limited to four different strategies, as the combination of these two dimensions (depth/breadth) might imply at first sight. As the examples in Fig. 12.1 show, a women's fashion boutique might carry a deep selection of a few fashion categories (such as evening dresses, blouses and trousers), but also a small selection of shoes, handbags and accessories. Food discounters usually have a rather wide assortment (they cover all relevant

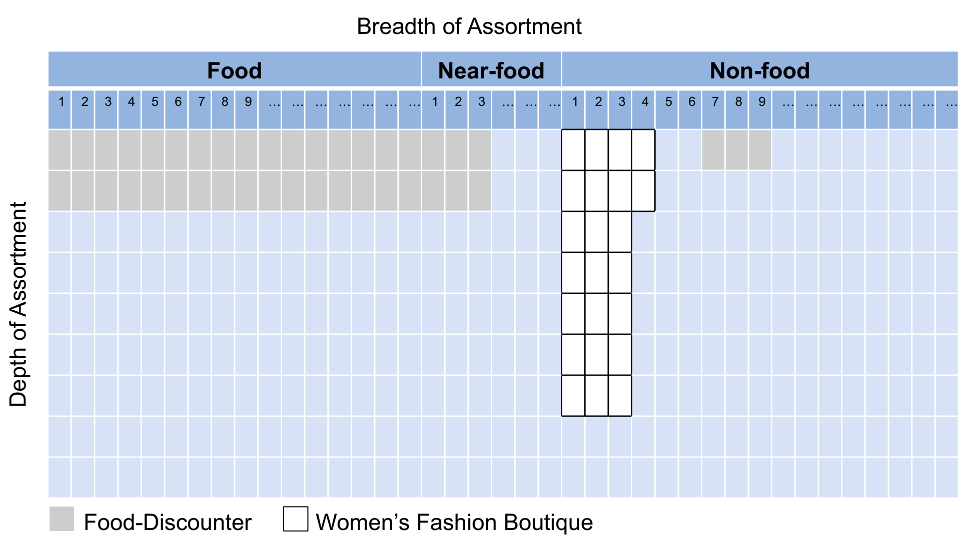

Fig. 12.1 The merchandise mix: breadth and depth of assortment

food categories, some near-food categories and even a few non-food categories), but they have a very shallow assortment in most of these categories. *Amazon* still has a much deeper assortment of books than of most other product categories.

When deciding on an assortment, **demand interrelationships** must be considered. Consumers usually buy a shopping basket. The demand for certain items is interrelated. This is sometimes as simple as it being more convenient to do the whole week's food shopping in a single store. However, complementary effects within the assortment can also arise because products are used together, and thus there are advantages to purchasing them together. Shirts and ties or paintbrushes and paint are typical examples of **complementary goods**.

As a practical consequence, retailers usually try to cross-sell to customers by placing such products next to each other, making it more likely that latent demand complementarities manifest in a joint purchase.

Category Migration as a Trend

An increasing number of retailers use a combination of specialist and general approaches within their product offers. They specialise in one or a few categories, but also add other categories in which they only offer shallow assortments. Retailers temporarily or permanently diversify by adding new products to their assortments that do not belong to their traditional merchandise (Zentes and Morschett 2004b). Supermarkets sell non-food products, DIY stores offer furniture, sports stores offer travel packages and energy drinks, and food discounters like *Aldi* and *Lidl* have promotions on all types of products, e. g., electronics. This blurs retail sector boundaries.

There are a number of reasons for this trend:

- The main reason for limited time promotions with non-food products at *Aldi* and *Lidl* is to attract new customers into the store and to generate short-term profits with high quantities of a few promotion products.
- The permanent addition of new products has other motives. Average store size has increased continuously in recent decades, giving retailers more space to enter new categories. Many product categories have stagnated, making a move into new fields attractive. And some retailers want to exploit their high customer frequency rates by selling new product ranges. Furthermore, from the perspectives of food retailers, non-food items often provide higher profit margins; thus, exploiting the customer frequency created by their food offer to sell more profitable products is a reasonable way to improve margins.

This strategy is sometimes referred to as **product scrambling**, because it risks diluting the retailer's image (Varley 2014, p. 12). The concept of category migration can be compared with **brand extension** by a branded goods manufacturer. New categories that are related to existing ones offer more potential with less image risk. Accordingly, successful category migration usually follows one of two diversification routes (Zentes and Morschett 2004b, p. 163):

- New categories and services are offered that are closely related to the **core assortment**. Examples include furniture stores offering accessories, DIY stores offering garden furniture and sports stores offering skiing trips or sports nutrition. This can even enhance the retailer's competence in the eyes of the consumer and strengthen its image as a specialist.
- Other retailers diversify their assortment into new categories that appeal to their **core target group**. A good example is clothing retailers for young fashion that add cosmetics or music CDs to their assortments.

Reduction in Variety as an Emerging Trend

Adding or eliminating items from a retailer's assortment is a fundamental and ongoing process. Studies into consumer habits have repeatedly found that the variety of an assortment is an important determinant of attitudes towards a store and store choice, ranking only behind location and price. Shoppers are often looking for specific items. A greater variety and larger assortment increases the probability they will find what they want. Consumers may also like variety because of a simple desire to purchase alternatives rather than the same thing each time. This has led many retailers to continuously increase their product assortments.

However, selling space is one of a retailer's most valuable assets, which imposes a severe resource limitation. Thus, retailers must make trade-offs. In addition, too much variety in an assortment has some severe disadvantages (Hoch et al. 1999, p. 528):

- An increasing number of SKUs usually increases retailing costs. Assortment complexity raises various costs, including those of sales, shelf space, planning, advertising, inventory and logistics. Discounters, for example, are very successful despite a strictly limited assortment.
- A large number of alternatives within a category can lead to **choice overload** for consumers and make the shopping process more complicated. Consumers often prefer "mental convenience". However, research has not proven that choice overload actually occurs (Scheibehenne et al. 2010).

There are studies that show that even radical reductions to an assortment do not necessarily reduce customer visits to a store, and sales may remain stable (see the overview by Boatwright and Nunes 2001). It is not the actual number of different products in a category that matters for store choice behaviour, but the consumer's perception of variety.

Eliminating different but similar versions of the same product from an assortment is rarely noticed or evaluated negatively by consumers. Therefore, many retailers are currently analysing their assortments and streamlining each category by eliminating underperforming items and brands (Zentes and Morschett 2004a, p. 2739). For example, in 2015, *Tesco* announced that it would reduce its assortment of 90,000 SKUs (across its different retail formats) by as much as 30 % to increase profitability.

12.2 Manufacturer Brands and Store Brands

12.2.1 Brand Ownership and Brand Management

In defining their merchandise mixes, retailers also have to decide on the mix of manufacturer brands (e. g., *Ariel, Nestlé*, *Philips*, *Ferrero*) and their own brands, so-called **store brands**. While manufacturer brands (in older literature often referred to as **national brands**) are owned, produced, managed and marketed by manufacturers, **store brands** (also called **private labels** or **own brands**) **comprise all product brands owned, managed and marketed by retailers**. The property rights for the brand in this case are held by the retailer.

12.2.2 Functions of Manufacturer Brands in the Assortment

For many retailers, manufacturer brands make up most of their merchandise. Examples include *Danone* in food retailing, *Bosch* and *Black & Decker* in DIY retailing, *Adidas* in shoe retailing and *Sony* in consumer electronics. Retailers include manufacturer brands in their assortments for several reasons, but the two most important are the **pull effect** and **image transfer** (Zentes and Morschett 2004a, pp. 2725–2731):

- **Pull effect**: Strong manufacturer brands often enhance customer frequency in stores, because strong brands have loyal customers and their store choice is influenced by the availability of their favourite brands. Manufacturer brands are often heavily advertised in the media, so consumers have clear images of them. Retailers can benefit from the brand equity built up in this way. Strong manufacturer brands pull customers into stores, allowing retailers to reduce other selling efforts.
- **Image transfer**: Having manufacturer brands in their assortment can influence a retailer's image. A retailer's store image can improve when it is associated with manufacturer brands that are evaluated positively. The number of manufacturer brands and strong anchor brands in an assortment can affect a retail brand positively (Mulhern 1997, p. 110). Positive effects can raise the perceived quality level and enhance certain intangible brand features such as brand character. A store carrying a good range of *Camel Active* clothing, *Mammut* and *Timberland* will be associated with different characteristics than a store carrying mainly *Prada* and *Gucci*.

In addition, manufacturer brands are often **innovation** leaders. Manufacturers invest heavily in R&D and introduce new products onto the market. The examples of *Apple*, *Nike* or even low-tech products such as nappies from *Pampers* show that new product introductions with innovative technologies or features regularly stem from manufacturer brands. However, suppliers of strong brands are well aware of these benefits and their heavy advertising investment has to pay off. They have a strong negotiation position with retailers, which often results in unfavourable procurement prices for the latter. Therefore, manufacturer brands usually yield rather **low profit margins** for the retailer (Ogden and Ogden 2005, p. 265).

12.2.3 Functions of Store Brands in the Assortment

One of the major developments in retail merchandising strategy is the increased share of store brands in many product categories (Bruhn 2012; González-Benito et al. 2015, p. 74). Once seen as low quality by consumers, in most countries store brands are now widely accepted substitutes for manufacturer brands (Varley 2014, p. 104; Kumar and Steenkamp 2007). The store brand market share (by value) has reached 45 % in Switzerland, more than 40 % in the United Kingdom and Spain and more than 30 % in Germany, with an increasing trend in every country (see Fig. 12.2).

The major argument for retailers introducing store brands is profit margins. For example, in 2009, *Metro* announced that one of the most important instruments for increasing profit margins in its hypermarket chain *Real* would be to increase the sales share of its standard store brand *Real Quality* from 7 to 14 %.

Beyond the lower profit margins of manufacturer brands, one of the most significant disadvantages of manufacturer brands for retailers is **ubiquity**, meaning that many other retailers also offer these brands. Store brands, by contrast, provide an opportunity for **differentiation**. They are only available at one retailer, and can therefore be used to distinguish

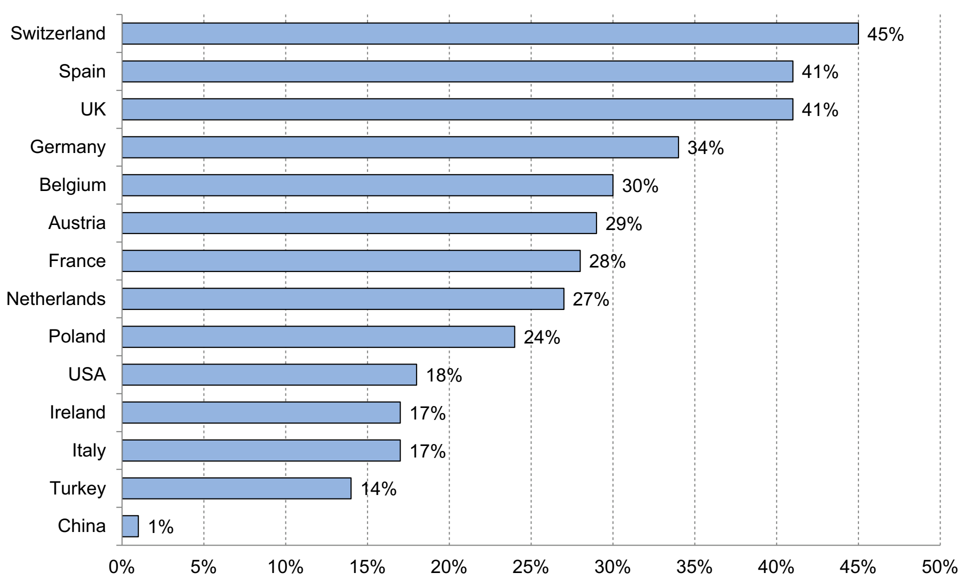

Fig. 12.2 Market share of store brands in selected countries in 2013 (by value; consumer packaged goods). (Nielsen 2014, p. 6)

that retailer from its competitors. A similar effect can be achieved via **exclusive brand** products that are owned by brand manufacturers but only sold at a specific retail chain.

Retailers must establish the brand image of their store brands themselves, but the brand can perfectly match the retailer's brand image. The positive effects of store brands on retail image and retail profits have been proven in many studies (see, for example, Dhar and Hoch 1997, Corstjens and Lal 2000).

Customer loyalty is easier to build via store brands than manufacturer brands. Customers satisfied with a store brand and intending to repurchase it must revisit the retailer. Conversely, customers satisfied with a manufacturer brand can still switch stores and buy the product elsewhere. At the same time, store brands are not easily comparable across retailers. Therefore, price competition can be less severe. This factor, combined with lower procurement or production and marketing costs, often results in higher profit margins for store brands (Corstjens and Lal 2000, p. 281).

Retailers carrying both manufacturer brands and store brands are generally reducing brand selection to avoid consumer confusion and increase efficiency. Only the best manufacturer brands are kept in the assortment, while others are systematically eliminated or replaced by store brands.

12.2.4 Positioning and Labelling of Store Brands

The first store brands were **generics**, i. e., very low-cost commodity products, with no brand-like labelling, simply plain white packages bearing only the name of the product ("sugar" or "milk"). Value store brands such as *Tesco Value* or *M-Budget* still have this appeal today and clearly signal their no-frills positioning.

However, modern store brands exist across all price and quality segments (see Table 12.1 for examples). Store brands also cover different segments with different attributes, for example, organic food or healthy eating. For value and standard store brands, price still plays a dominant role. Standard store brands are usually positioned as being of equivalent quality to the manufacturer brand but at a lesser price, and targeted at the price-conscious customer segment (González-Benito et al. 2015; Dhar and Hoch 1997, p. 211).

Premium store brands, by contrast, are often positioned above manufacturer brands. In the last five years, many retailers have established a premium store brand segment. While all store brands have an impact on the retail brand, premium store brands are specifically introduced to improve a retailer's profile and shape retail brand image.

Creating Store Brand Portfolios

A recent trend in this field is the increasing segmentation of store brands to address even small target groups by offering several sub-brands that appeal to a wide spectrum of consumer needs. These store brand portfolios then help fulfil the heterogeneous objectives of store brands via a portfolio of different brands. For example, many food retailers now offer store brands for vegetarians (e. g., *Coop Delicorn*), for people with

Table 12.1 Examples of differently positioned store brands in four retailers' portfolios

Positioning	Tesco (Food)	Coop (Food)	Castorama (Home Improvement)	Group Casino (Food)
Premium	Tesco Finest	Coop Fine Food		Casino Délices
Value Added	Tesco Free From, Tesco Organic	Coop Naturaplan, Coop Naturafarm, Coop FreeFrom		Casino Bio, Terre et Saveur, Casino Avenir, Casino Fairtrade Max Havelaar
Standard Segmented	Tesco Healthy Living, Tesco Goodness	Coop Delicorn, Coop Weight Watchers, Coop Jamadu, Coop Betty Bossi	Colours, Form, MacAllister	Les Doodingues de Casino (Kids range)
Standard	Tesco	Coop Qualité & Prix	Casto	Casino
Value/Budget	Tesco Everyday Value	Coop Prix Garantie	1er Prix	Tous les Jours

allergies (e. g., *Tesco Free From*) or for children (e. g., *Les Doodinges de Casino* or *Coop Jamadu*). Some retailers have introduced store brands that emphasise sustainability (*Casino Avenir*).

Thus, the portfolio contains store brands designed to improve the retailer's margins (often the standard store brand), others designed to improve the retailer's image (often the premium brands, organic products and fair trade products) and others mainly designed to signal the retailer's price competitiveness (often the value store brands). Still others are designed to attract specific target groups and build their loyalty (e. g., gluten-free products). Table 12.1 shows the store brand portfolios of four selected retailers.

A few years ago, *Castorama* strategically restructured its store brand portfolio, announcing its intention to develop a clear three-layered portfolio: *1er Prix* as its budget brand, *Casto* as its standard store brand (*Casto* across many categories) and other store brands at a standard and sometimes upscale (but not premium) level, segmented by product-category such as *MacAllister* (power tools), *Colours* (paint and decorative products) or *Form* (storage solutions).

As with every portfolio, it is important for such a portfolio to be balanced and interrelationships to be considered. If a portfolio is over-fragmented, then cannibalisation may be strong and the critical mass within each different product brand segment may be too low. If the portfolio is too small, there may be substantial niches which are not addressed.

Choosing a Brand Name for Store Brands

As part of the branding strategy, a retailer must also decide how closely the store brand should be associated with the retail brand. Sometimes, the retail brand is used as an umbrella brand for the store brand products (for example, *Tesco* uses *Tesco Finest*, *Tesco Organic*, *Tesco Everyday Value,* among others, as store brands), while in other cases the store brand is not directly connected to the retail brand. Examples include *Anna's Best*, the store brand for pasta at the Swiss retailer *Migros*, *McAllister*, the power tool store brand of *Castorama* and *B&Q*, or *Kenmore*, a store brand *Sears* uses for its home appliances. *Aldi's* store brands are all of this type.

For labelling, there is a clear trend in grocery retailing towards using the retail brand as an umbrella brand for the store brands as well. For example, in 2008 *REWE* converted its former store brands *Erlenhof*, *Salto* and *Today* into *REWE* products and its ecological line was renamed from *Füllhorn* to *REWE Bio*. *Carrefour* renamed its value brand line from *Numéro 1* to *Carrefour Discount*. *Migros*, in 2010, followed this trend and announced a new *Migros* store brand *M-Classic* that would comprise many established products previously offered under different store brand names.

The reasons for this trend are clear: No retailer has the advertising budget to compete with manufacturer brands in terms of strength. Fragmentation renders this almost impossible. But by uniting the store brand products under an umbrella brand, the store brand can be strengthened and managed like a strong manufacturer brand. Furthermore, linking the store brand to the retail brand leads to a cross-fertilisation of both brands. Launching new products under the established brand name is easier and, simultaneously, a successful store brand is much better for the image transfer to the retail brand.

The downside of this strategy is that the image transfer is strong and – as with umbrella brand strategies in general – there is a risk that a single low-quality product will harm the image of the entire store brand portfolio. Furthermore, using the retail brand as an umbrella brand for differently positioned store brands may lead to stronger cannibalisation.

Particularly for value brands, the optimal strategy is not yet clear. Some retailers link these store brands to their retail brand (such as *Tesco Everyday Value*, *Carrefour Discount*, *Coop Prix Garantie*), but others avoid this (such as *REWE*, who just label these products *Ja!*).

Category-specific vs. Cross-category Store Brands

Retailers generally have the choice between establishing store brands specifically for each product category or across their total product range. The category brand strategy has the advantage that the brand message can be focused on specific product features and that a clear positioning compared with other product brands in this category is easier, while the second strategy has the advantage – as described above – that advertising spending can be bundled across many different categories.

In food retailing, the trend towards shared store brands for different categories has already been described. In non-food retailing, store brands are often focused on specific categories, as the *Castorama* example above showed. *Walmart* and its subsidiary *ASDA*, as a further example, use the store brand *George* for their clothing assortment (here it is logical to separate this brand from, for example, a store brand for yoghurt). *Sears* has a number of different store brands, among them *Kenmore*, which is used for home appliances and is the clear market leader in the USA, and *Craftsman*, which is used for tools and power tools and which is also one of the strongest brands in these categories.

The above mentioned trend towards linking the store brands clearly to the retail brand name is not as pronounced in non-food retailing. Here, some retailers have introduced some store brands with a link to their retail brand (e. g., *Casto* for *Castorama*, *OBI classic* for *OBI*), but the competition's brand names often focus on specific product categories, and the retail brands do not currently evoke the same image. Therefore, category-specific store brands that are not clearly associated with the retail brand are used instead. The brands listed in Table 12.1 for *Castorama* are examples. Similarly, the sporting goods retailer *Decathlon* has structured its store brands into categories; every store brand ("passion brand") represents a particular sport and the brands do not overlap within the assortment. Each store brand clearly focuses on customer needs in their specific category, as the descriptions of some of the brands illustrate (Decathlon 2015; see the case study in Chap. 3):

- *Quechua* is the store brand for outdoor sports. This brand, launched in 1997, contains products for hiking, mountaineering, camping, Nordic skiing, etc.
- *Btwin* covers bicycles and cycling equipment and accessories. The brand is the world leader in the cycling market, with more than 2.7 million bikes sold annually.
- *Kipsta* is *Decathlon's* store brand for team sports, e. g., football, volleyball, sports clothing and shoes for team sports, training equipment, etc.
- *Tribord* is the store brand for nautical and water sports, e. g., diving equipment, swimsuits, inflatable boats, etc.

12.3 Category Management

In the last two decades, the merchandising process has increasingly been integrated into a more holistic management approach to retailing, so-called *category management* (see, e. g., A.C. Nielsen 2006; ECR Europe 1997). ECR Europe (1997) defined category management as a retailer's or supplier's process of managing categories as strategic business units, producing enhanced business results by focusing on delivering consumer value. Each category follows a specific strategy, which is embedded in the retailer's overall strategy.

Category management has developed as a stepwise planning process for categories, and was first proposed by the consulting company *The Partnering Group*. Over the past two decades, it has developed into a standard industry process, promoted by national and international ECR initiatives. Nowadays, most grocery retailers, but also retailers from other sectors (e. g., drug stores, home improvement stores, perfumeries), use this standard process. Standard processes support easy knowledge transfer across different retailers and/ or suppliers. The basic process is shown in Fig. 12.3. This is still the most commonly applied process, although simpler processes have also been developed.

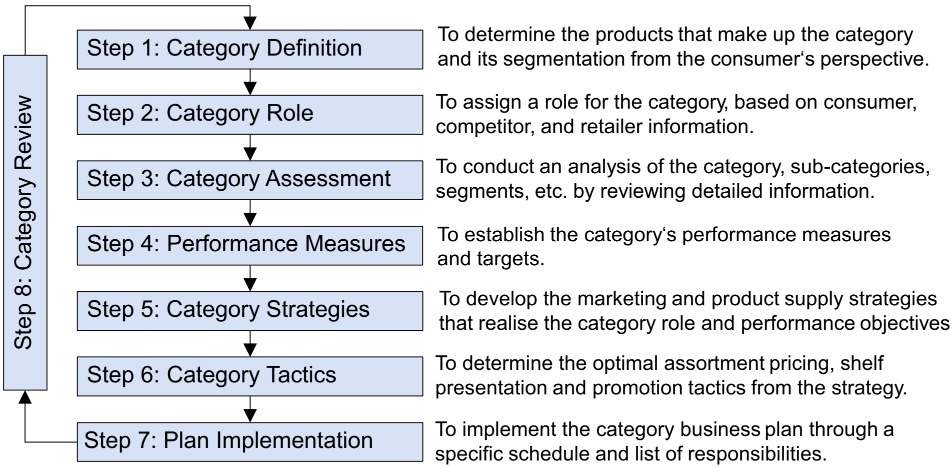

Fig. 12.3 The category management process. (ECR Europe 1997)

The first steps in the **category management process** are the most innovative because they include formulating a clear strategic objective for each category. These first steps distinguish the new process of category management from the traditional, more operational method of merchandising, because they position the retailer by providing a clear profile in its merchandise mix.

Category definition involves determining the specific SKUs that make up the category, based on which products consumers perceive to be interrelated and/or substitutable. The primary aim is to develop a category definition based more on a consumer perspective than the retailer's procurement perspective. For example, customers with babies usually want to buy different baby products (e. g., diapers, lotions, baby food, baby toys), and placing them close together and managing these products together can be very beneficial. For example, a price promotion on specific baby products may draw people into the store who are then very likely to buy other products. This kind of cross-selling can be strongly promoted via category management.

Product categories are also segmented into sub-categories. This segmentation should be based on the consumers' **decision tree** when purchasing in the category, i. e., the sequential consumer choice process. For example, the category "wine" could be segmented at the first level by price (premium, standard or budget wines), countries (French, Italian or German wines), colours (red, white or rosé) or brands. The category "beer" may be segmented into "impulse" (e. g., a single can or a six-pack), "stocking up" (e. g., crates) or by different beer types (e. g., Pilsner, wheat beer or stout) or brands.

In the next step, each category is assigned a **category role**, whereby the retailer determines the purpose of this category. Thus the retailer decides how the category fits into wider company strategy. This facilitates managing categories according to their importance and allocating resources (such as marketing budgets, shelf space and management capacity) optimally. The four roles in the category management approach are shown in Table 12.2. Before assigning a role to a category, the category's importance to the consumer, retailer and competition should be analysed (A.C. Nielsen 2006, pp. 79–93).

Table 12.2 Category roles. (ECR Europe 1997)

Role	Share of Categories [%]	Role Description
Destination	About 5	To be the primary category provider and help define the retailer as the store of choice by delivering consistent, superior consumer value
Routine	55–60	To be one of the preferred category providers and help develop the retailer as the store of choice by delivering consistent, competitive consumer value
Convenience	15–20	To be one of the category providers and help reinforce the retailer as the full-service store of choice by delivering good consumer value (i. e., to support the customer's wish for one-stop-shopping)
Occasional/ Seasonal	15–20	To be a major category provider, help reinforce the retailer as the store of choice by delivering frequent, competitive value

After a more thorough analysis of the category and sub-categories (**category assessment**), the retailer sets category targets and selects relevant performance indicators (**category performance measures**), because different roles lead to different target indicators. The so-called **fair share** is an important indicator. This is a retailer's market share in a category compared with its overall market share and is an indicator of retailer performance in this category relative to overall performance (see Table 12.2).

The next step is to decide on a marketing **strategy** for the category. Many different strategies are possible, including:

- **Traffic building**: attracting many consumers into the store; e. g., by offering price promotions for frequently purchased products.
- **Transaction building**: increasing the average size of the shopping basket; e. g., by exploiting demand interrelationships in space allocation in stores or encouraging impulse purchases.
- **Profit generating**: enhancing the profitability of customers' shopping baskets by offering products with high margins and/or higher inventory turns.
- **Image creating**: improving the retailer's image; e. g., by offering products sold uniquely at the retailer or offering an outstanding choice in the category.

At the level of **category tactics**, operational decisions on the assortment, pricing (see Chap. 13), space allocation (see Chap. 15) and other retail marketing instruments are derived from the overall strategy and the other steps in the process. The final steps of the process are **implementing** the plan and a regular **review** of the category's performance, including adapting the plan if needed.

The high relevance of category management is also due to the fact that the category strategies and category tactics are embedded in a strategic process and thereby follow strategic considerations instead of purely operational optimisations.

Category Management of Online Shops

While the eight-step category management process was developed from the perspective of store-based retailers, it can be applied to online shops as well. However, for certain steps, differences to the traditional approach may emerge. For example, in an online shop, the same product can be placed in several categories (e. g., a *Barbie* doll can be put in the "dolls" category and also in the "*Barbie*" category). Associations between products are not limited to placing them "next" to each other; they can also be created by recommendations, for example "consumers who bought these diapers also bought this baby lotion". In addition, the shop can be customised to match individual customer behaviour. Still, the basic principles of category management (i. e., defining categories, assigning roles to categories, deciding on performance measures, etc.) can also be used in online shopping as well.

Cooperation between Retailers and Suppliers in Category Management

In a category management approach, it has always been vital to work together with the suppliers of a category. One reason is that manufacturers usually have a deeper knowledge of the specifics of their categories, because they often offer only products in one or a few categories and can invest time, effort and money into gaining extensive consumer insight. Conversely, the retailer has knowledge of its customers' behaviour across all categories. Thus, the two can merge their knowledge in the pursuit of mutual goals.

When category management was initially conceived, one far-reaching idea was that retailers could literally "outsource" category management to specific suppliers, so-called **category captains**. These would be leading suppliers in a category who would then manage the category (including their own and competitors' products) on behalf of the retailer to the benefit of both partners. This concept is rarely used in practice, though, because of the obvious risk that the supplier will strongly prefer to optimise their own product sales, even at the expense of their retail partner. However, retailers still have preferred suppliers for a category who provide information and make recommendations. These **category consultants** have a significant influence, but the final decisions are still taken by the retailer. It is still essential for retailers to maintain (and enhance) their competence in assortment management. Retailers and manufacturers may have shared objectives in certain situations, but they are still two independent companies with potentially diverging objectives.

12.4 Conclusion and Outlook

As with many other facets of retail management, merchandising is becoming more strategic and more fact-based, because retail information systems can provide the data needed to analyse the effects of merchandise changes. Some trends have emerged in the past few years:

- Retailers are increasingly adding new categories to their merchandise (**category migration**).
- Retailers are reducing the depth of their assortments in each category, focusing on leading brands and eliminating underperforming manufacturer brands.
- Retailers are increasingly adding store brands to their assortments.
- These store brand portfolios cover all segments, including the premium segment.
- In many cases, merchandise planning is integrated into a category management process, which supports strategic retail positioning by assigning defined roles to a category and systematically deriving subsequent marketing decisions from the role.

The merchandising process is determined by the retailer's most valuable and limited resource: shelf space. Online shops, however, do not have this constraint. Therefore, merchandise planning for e-commerce is different. Assortments can be larger and structured differently. Products can be placed in more than one category, because this does not use shelf space and provides consumers an alternative way to find the right product. More than one consumer decision tree can be modelled.

Online shops increasingly customise their product offers to specific customers (e. g., *Amazon*). Even though online shopping has still not achieved a very high market share in most retailing sectors, these merchandising processes could also have an impact on store retailing. Multichannel retailers can use their Internet merchandising to gather knowledge about consumer behaviour (e. g., demand interrelationships) and subsequently use that knowledge to improve merchandise management in their stores.

Further Reading

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12.5 Case Study: Whole Foods Market

12.5.1 Profile, History and Status Quo

The origins of the American retailer *Whole Foods Market*[1] date back to 1978, when the two founders John Mackey and Renee Lawson borrowed 45,000 USD from family and friends to open a small natural foods store called *SaferWay* in Austin, Texas, where the company

[1] As well as the explicitly cited sources, this case study uses the websites http://www.wholefoodsmarket.com, http://media.wholefoodsmarket.com/ and various reports and presentations.

is still headquartered. Two years later, they merged with another small retail company, *Clarksville Natural Grocery*, which led to the opening of the first *Whole Foods Market* in 1980. In 1984, *Whole Foods* started its expansion into Houston and Dallas. Four years later, expansion continued with the acquisition of the New Orleans-based *Whole Food Company*, followed by the opening of a new store in Palo Alto, California, in 1989. While continuing this organic growth by opening new stores, *Whole Foods* decided to accelerate its expansion by acquiring other natural food chains in the 1990s, e. g., *Wellspring Grocery* in North Carolina, *Bread & Circus* in Massachusetts and Rhode Island, *Mrs. Gooch's Natural Foods Markets* in Los Angeles and *Nature's Heartland* in Boston. In 2002, *Whole Foods* began its international expansion with market entry into Canada, followed by entering the UK in 2004 with the acquisition of seven *Fresh & Wild* stores.

Whole Foods' growth strategy (see Chap. 7) is clearly based on three pillars: Strong growth of sales in existing stores (comparable store sales, see Fig. 12.4), expansion by opening new stores and – to a small degree – acquiring smaller chains to gain access to new geographic areas (Whole Foods Market 2014, pp. 4–5). In particular, comparable store sales indicate that *Whole Foods'* marketing mix appeals to a growing number of customers in their catchment area.

Nowadays, *Whole Foods*, which operates as a publicly listed company in the natural and organic food segment, is the **largest organic food retailer in the United States**. For 17 years, the retailer has been listed in *FORTUNE* magazine's *"100 best companies to work for in America"*. In 2014, the American private label industry journal *Private Label Buyer* elected *Whole Foods* retailer of the year (Peckenpaugh 2014). In addition, it is also the first national *"Certified Organic"* grocer, positioning itself as *"America's Healthiest Grocery Store"*. As of 2014, *Whole Foods* operates 399 stores, generating 7.7 million customer visits per week on average. *Whole Foods* stores are supported by a network consisting of the Austin headquarters, regional offices, distribution centres, bakehouse facilities, commissary kitchens (which produce, e. g., deli food, take-out food, etc.), seafood-processing

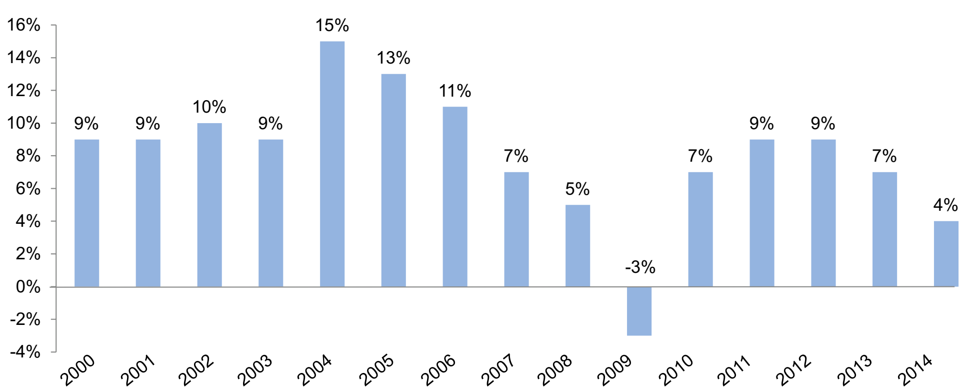

Fig. 12.4 Comparable store sales growth for Whole Foods Market. (Whole Foods Market 2014, p. 5)

facilities, meat and produce procurement centres and a specialty coffee and tea procurement and roasting operation.

The planning process is an interesting feature of opening new stores which is not directly linked to the company's merchandise policy, but to operational and financial performance monitoring (see Chap. 20). When a new target site has been selected, *Whole Foods'* development group conducts an in-depth site study, projects sales and estimates construction and operating costs. **Economic Value Added** (EVA) is used to estimate a store's profitability. Based on expected net operating profits and cost of invested capital necessary to generate those profits (currently calculated with an internal weighted average cost of capital of 8 %), a store is expected to generate cumulative positive EVA in five years or less (Whole Foods Market 2014, p. 6).

In 2014, *Whole Foods* achieved sales of 14.2 billion USD, an increase of 9.8 % compared to the previous year. The EBITDA margin was 9.2 %. Although *Whole Foods* operates internationally, its primary market is still the United States, which accounts for 96.7 % of sales. This strong growth is also observable in job figures: In 2014, the retailer created more than 8800 new jobs and employed 87,200 staff members, including 58,100 full-time, 26,100 part-time and 3000 seasonal employees.

12.5.2 Uniqueness of the Whole Foods Assortment

Whole Foods has achieved its impressive growth through very sharp positioning, with **clear differentiation** from its competitors via its merchandise mix, which is upscale, organic, healthy, ethical and top quality and displays a huge variety and a focus on perishable goods, including prepared meals. The company's motto signals its socially responsible vision: "Whole Foods, Whole People, Whole Planet".

The product range of a *Whole Foods* market covers produce and flowers, grocery, meat, seafood, baked goods, prepared foods, coffee, tea, beer, wine, cheese, nutritional supplements, vitamins, body care and lifestyle products including books, pet products and household products. It focuses on natural and organic food and customer well-being, along with very high quality. The CEO, John Mackey, often claims: "We're selling **the highest quality foods in the world**." The drawback of this strategy is **high prices**. This has strongly influenced *Whole Foods'* image, which is sometimes derided by customers as "Whole Paycheck".

Another factor is the **huge variety** of the assortment, which is much larger than that of equivalently sized supermarkets. The average *Whole Foods* store carries more than **32,000 SKUs**, while some larger stores carry up to 49,000 SKUs. The impression this creates is evident from this journalist's enthusiastic description when the first UK *Whole Foods* store opened: "Aside from Whole Foods' frequently expressed ethical and environmental concerns, the store is infamous for the sheer variety. In the London store there are more than 100 different olive oils, 40 types of sausage and 50 fresh juices. […] The directory above just one of the dozen aisles in the London store reads: 'Marinades, Tinned fish, Mediterranean, Middle Eastern, Macrobiotic, Thai'" (Freeman 2007). This ambition is also clear in the company's quality standards, strongly communicated to customers on *Whole Foods'* website:

"Our Quality Standards:

- We carefully evaluate each and every product we sell.
- We feature foods that are free of artificial preservatives, colors, flavors, sweeteners, and hydrogenated fats.
- We are passionate about great tasting food and the pleasure of sharing it with others.
- We are committed to foods that are fresh, wholesome and safe to eat.
- We seek out and promote organically grown foods.
- We provide food and nutritional products that support health and well-being.
- The aim of *Whole Foods* is to offer a broad selection of high-quality natural and organic products, with a strong emphasis on perishable foods."

Whole Foods' focus on freshness as a strength and differentiation criterion from other competitors is clear from the proportion of perishables in its assortment: 66.8 % of the assortment is perishables, with 19.2 % prepared foods and baked goods and 47.6 % other perishables.

With this strategy, *Whole Foods* profits greatly from the increased demand for organic products in the United States and rising awareness about the importance of organic food, which is one of the most important food trends in the United States (Nie and Zepeda 2011). From 2000 to 2013, organic food sales in the United States rose from 6.1 billion USD to 35 billion USD, corresponding to a growth of 473 % within this period (Statista 2015). Thanks to its very clear positioning in this segment, *Whole Foods* profited greatly from this development. However, despite this strong growth in recent years, the market for organic food is still niche (Haas et al. 2013).

The idea of exclusivity and freshness is also clear from *Whole Foods'* store design; the retailer strives to transform traditional food shopping from a chore into a dynamic experience (see Fig. 12.5). The store design provides a lively, inspirational atmosphere, emphasising freshness and healthy eating with an **experience-oriented product presentation** and produce areas like open kitchens, scratch bakeries, expansive prepared food stations like juicing and hand-crafted coffee stations, greens, beans and grain cooking bars, brick pizza ovens and burrito and ethnic foods stations. Some stores even offer sit-down wine bars and taprooms featuring local craft beer to create areas for customers to gather. The product presentation is characterised by bulk departments and hand-stacked produce, evoking an atmosphere of a weekly market. In addition, *Whole Foods* tailors store size, store design, product selection and pricing to the particular community. When the first store opened in the UK, British newspaper *The Guardian* called it "The Disney World of Food" (Freeman 2007).

Fig. 12.5 *Whole Foods'* store design and merchandise presentation

12.5.3 Whole Foods Store Brand Portfolio

Whole Foods' assortment has two pillars: freshness and exclusivity. Freshness appeals mainly to natural and organic food-oriented shoppers, while the exclusivity attracts gourmet shoppers, based on the fact that the popularity of organic and local foods reflects more than meeting just basic needs; it is an expression of identity and worldview (Senauer 2001). Unlike conventional food, organic food often generates a price premium of 30 % or more (Haas et al. 2010); thus, *Whole Foods* offers a range of exclusive store brands to capitalise on this fact. With approximately 4400 SKUs in different categories, the company's exclusive store brands generated 1.8 billion USD in sales in 2014. At 13 % of total retail sales and 18 % of non-perishable sales, store brands are a key component of *Whole Foods'* value concept and essential for the company's product innovation and differentiation.

As mentioned before, *Whole Foods* offers a **broad variety of store brands** to its customers. Unlike other companies, *Whole Foods* uses a mixed strategy and offers store brands with and without connection to the company name. Most brands are umbrella brands and cover a range of different categories. *Whole Foods* describes its store brands as exclusive brands. The following four private labels are *Whole Foods'* main store brands (see Fig. 12.6):

- "*365 Everyday Value*" combines a high product quality approach with a value price approach. The store brand focuses mainly on price conscious consumers and combines simple packaging design with basic, but still natural and high quality, ingredients and quality standards. *365 Everyday Value* has both conventional and organic varieties. In addition to food products, *365 Everyday Value* also contains simple, straightforward and affordable supplements and body care products. The *365 Everyday Value* store brand accounts for approximately half of *Whole Foods* store brands.
- The *"Whole Foods Market"* store brand focuses on exceptional flavour, authenticity and a remarkable quality. With natural and organic choices, the brand contains a huge variety of products.
- *"Engine 2 Plant-Strong"* contains health-oriented vegan food products for everyday use, especially for people who are short on time. *Engine 2 Plant-Strong* products are based on a diet developed in the USA by Rip Esselstyn, a former firefighter turned health activist and food author. *Engine 2 Plant-Strong* products focus on defined health guidelines, like no use of animal components, 100 % whole grains, no use of added oils, minimal or no sugar and fewer than 25 % total calories from fat.
- "*Whole Trade"* is the brand for fruits and vegetables in *Whole Foods* assortment which are traded under the so-called *"Whole Trade Guarantee"* label. The idea is to highlight *Whole Foods"* commitment to ethical trade and the environment and selling high-quality products sourced from developing nations. Purchasing *Whole Trade* products helps fund projects like building community centres and schools and providing better wages and working conditions for farmers in developing countries like Ecuador and Haiti. In addition, 1 % of sales are donated to the *Whole Planet Foundation* to support environmental responsibility and offer microfinance for local projects.

Fig. 12.6 Selected *Whole Foods'* store brands. (Whole Foods)

It must be noted that the terms "standard" and "budget" do not refer to market comparison, but are relative to *Whole Foods'* other prices, which are higher than supermarket prices. Even the value range is quite expensive compared to competitors' merchandise mixes.

In addition to these four main store brands, further store brands, like *Whole Catch*, *Whole Fields*, *Whole Pantry*, *Whole Living*, *Allegro Coffee*, *Wellshire Farms* and *Nature's Rancher*, have been established. However, these are not the main focus of advertising.

In addition to expanding existing store brands by launching new products, *Whole Foods* decided to diversify its brands in 2013, expanding into the relatively new segment of premium pet supplies with a new store brand line, "*Whole Paws*". In the year of the launch, spending on pet products in the United States hit over 55.7 billion USD; in 2015, the *American Pet Products Association* (2015) expected spending of 60.5 billion USD. *Whole Paws* replaced products which were already available in the *365 Everyday Value* line and which encompassed multiple types of premium pet foods and treats, like gluten-free and weight management products (Peckenpaugh 2014). Pets are an emotional topic, and *Whole Foods* has targeted new customers and created sales potential in a fast-growing segment. In 2015, the retailer strengthened its engagement in pet food and launched a second store brand called "*Tender & True*". *Tender & True* is the first and only pet food line to offer fully USDA Organic certified dry dog and cat food choices, made with animal proteins from farms that have been certified under the *5-Step Animal Welfare Rating System* and with *Marine Stewardship Council (MSC)* certified sustainable seafood. In addition, all *Tender & True* products are made in the United States.

12.5.4 Establishing a New Retail Format Based on a More Focused Merchandise Mix

In reaction to fast-growing demand in the natural and organic food market in the United States, more and more retailers from the classic grocery sector, like *Walmart*, *Kroger Co.* or *Trader Joe's*, have intruded into *Whole Foods'* market segment, and this increased competition has begun to erode organic food prices. As a result, *Whole Foods* has struggled with customer perception that its groceries are **too expensive** and can be easily found elsewhere (Bloomberg 2015). *Whole Foods'* price perception is particularly poor among younger consumers. *Whole Foods*, which has been operating for 37 years, has traditionally mainly addressed upscale clientele. However, it is younger consumers who have been most enthusiastic about organic and natural food products in recent years. Unfortunately, most of these eager consumers do not fall in the upscale category (Consumer Affairs 2015).

To revitalise its brand and defend its market position in the natural and organic segment, *Whole Foods* announced the launch of a new and smaller **store chain concept** in May 2015, which was branded "*365 by Whole Foods Market*". Around 10 stores will be opened in the USA starting in 2016. The aim of this new concept is to address a broader and younger audience, with a clear focus on fun and convenience and also on penetration into new locations where it was previously not possible to operate the established *Whole Foods* store concept. In addition, the *365 by Whole Foods Market* stores will target price-conscious consumers by providing a clear quality meets value shopping experience (Sustainable Brands 2015). This strategic realignment via a new, smaller store concept, which is a kind of budget *Whole Foods* chain, may be a direct assault on its competitor *Trader Joe's* (see the case study in Chap. 9), which has smaller stores, a very high percentage of store brands (much higher than *Whole Foods*) and substantially lower price positioning (Consumer Affairs 2015). Where *Whole Foods* developed as an upscale grocery chain, *Trader Joe's* has received a lot of attention in recent years thanks to a focus on organic and innovative products at the lower end of the market that appeals to younger customers. *365 by Whole Foods Market* is thus a defensive strategy.

Another reaction by *Whole Foods* to increased competition in the natural and organic segment is the shift from a purely natural and organic brand positioning to a stronger combination based on value, responsibility and especially sustainability. In autumn 2015, the retailer launched its first national TV and print advertising campaign, *"values matter"*, along with a new ratings system for its produce, called *"responsibly grown"*, which measures sustainable farming practices such as farmworker welfare, soil quality, water-conservation practices and pesticide use on a "good", "better" and "best" scale. This is a response to an increased consumer interest in going beyond *Whole Foods'* umbrella promise of selling sustainable produce, becoming more granular about the products they buy (Sustainable Brands 2015). However, sustainability and ethical sourcing are still criteria for differentiating *Whole Foods* from many of its competitors, who mainly focus on price.

12.5.5 Summary and Outlook

As the pioneer for the organic and natural food sector in the United States, *Whole Foods* has managed to grow from a small store in Austin, Texas, to become the biggest organic supermarket chain in the country over the past 37 years. Thanks to this clear positioning, the company profited hugely from the emerging trend for buying healthy and organic food. Because there were no big manufacturers or well-known brands for natural and organic food, *Whole Foods* decided to establish its own store brands. *Whole Foods* uses a mixed strategy and offers a variety of store brands with and without connections to the company name. Most brands are umbrella brands and cover a range of different categories. The different brands target different customer needs and price levels.

Besides natural and organic products, *Whole Foods'* most important differentiation criterion from competitors and classic supermarkets is freshness. This is also reflected in the high share of perishable goods in *Whole Foods'* assortment, accounting for approximately 67 % of sales and more than half of the assortment. This is simultaneously a strength and a great challenge, because it is more complicated to deal with changes in demand and speed of rotation within the assortment.

Nevertheless, *Whole Foods* has managed to transform the challenges of a natural and organic assortment with a high proportion of perishables into a competitive advantage. Thanks to continuous adjustment to meet changing customer needs, it is likely that *Whole Foods* will continue its success story.

Questions

1. Do you think that store brands in the natural and organic sector are a profitable and future-safe strategy?
2. *Whole Foods* differentiates itself from its competitors via a high share of perishable goods. What are the risks of this strategy?
3. *Whole Foods* has had tremendous success with a clear focus on organic food and a very upscale market segment. However, this has come under pressure recently from new competitors. Discuss the strengths, weaknesses, opportunities and threats (SWOT) for *Whole Foods*.

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Pricing

13

Abstract

This chapter will discuss the main features of pricing in retailing. The chapter describes the basic methods of calculating a retail price, the structure of a retailer's prices and the dynamics and psychology of pricing. It concludes with some Internet-related aspects of pricing.

13.1 The Importance of Retail Pricing

Pricing in general and price promotions in particular have always been an important marketing instrument in retailing, and price plays a very important role in modern retail marketing. Prices are highly relevant for customers and can draw consumers into stores.

However, it is precisely this focus on price reductions, often based more on belief and intuition on the part of the retailer than on facts and knowledge about its effects, that makes pricing so strategically relevant today. In many countries, retailer **profit margins** are very low. In food retailing in Germany, for example, they make up around 1 % of sales, so a product sold for one euro provides the retailer with an average profit (after tax) of one cent. Such low margins (on average) mean many retailers risk losses if they do not optimally manage their costs. It also means that increasing prices by just 1 % could potentially double profits, assuming consumers continue to purchase roughly the same amount. Consequently, the profitability potential of pricing is substantial.

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13.2 Methods of Price Setting

13.2.1 Cost-oriented Pricing

There are three main approaches to setting product prices in retailing: cost-oriented, competition-oriented and demand-oriented.

The most commonly used method for determining retail prices is the cost-oriented method, also called **cost-plus pricing**. Here, a **mark-up** is added to the cost of products to determine the final retail price. The mark-up percentage can be calculated as a percentage of the retail price or merchandise cost.

$$\text{mark-up in \% (at cost)} = \frac{\text{retail price-merchandise cost}}{\text{merchandise cost}}$$

The formula generally uses the retailer's purchasing price, with estimated operating costs used to calculate the mark-up required to cover them. The mark-up percentage also includes the planned profit per unit. Since different product categories are associated with different operating costs, the mark-up is usually different between categories.

Direct product profitability (DPP) is a sophisticated method for planning variable mark-ups. This technique lets a retailer find the profitability of each product by computing adjusted per unit gross margins and assigning direct product costs for expense categories such as warehousing, transportation, handling and selling. Based on exact costs per product, appropriate mark-ups can be set (Berman and Evans 2013, p. 467). The major problem, however, is the complexity of assigning costs to specific products, since it is difficult for retailers to allocate overhead expenses with a high degree of accuracy.

While cost-oriented pricing rarely provides the optimal price, it is the simplest method of calculating a price. Retailers must set prices for merchandise assortments of 10,000 products in a supermarket or more than 100,000 products in a department store. For some items in a supermarket, prices are changed weekly. The volumes involved make it almost impossible to calculate optimal prices, based on estimated price sensitivity, for all products. Therefore, the cost-oriented method for setting prices is a cost- and time-efficient approach.

13.2.2 Competition-oriented Pricing

In competition-oriented pricing, a retailer identifies its main competitors and sets prices accordingly. Many retailers systematically monitor prices in their competitors' outlets. Depending on the retailer's pricing strategy, prices for certain products are then set at or below competitors' prices.

Retailers in many different retail sectors now regularly give price guarantees, i. e., they guarantee that the customer will not be able to find the product cheaper in a competitor's store within a certain distance. While this instrument is often used in non-food retailing for higher priced products (e. g., by the electronics retailer *Media Markt*), food retailers are increasingly using price comparisons for shopping baskets or product ranges in their advertising, with promotions claiming particular shopping baskets cannot be bought cheaper elsewhere or explaining that the prices of particular product ranges (e. g., value store brands) are constantly benchmarked against competitors' prices.

Competition-oriented pricing has become even more relevant thanks to the rise of online shopping. Customers can now easily compare prices, making it much more relevant for retailers to adjust their prices to their competitors' prices. This is even more pertinent for competing online retailers. Therefore, online retailers often use automated systems (**price-bots**) to compare competitors' prices and automatically adjust their own prices accordingly.

Competition must be considered in many retailing industries, because retailing is often characterised by oligopolistic competition. In many countries, a few large retailers account for a very high market share. In this situation, a company must anticipate competitors' reactions before setting or changing prices. **Game theory** has developed a framework for this kind of analysis, which retailers have applied implicitly for a long time. In Germany, for example, food retailers have long known that they should not set prices below *Aldi's* for a particular product or *Aldi* will react strongly to defend its image as the absolute price leader in the market. Such price wars can generally lower price levels throughout a country, reducing profits for all retailers.

13.2.3 Demand-oriented Pricing

With demand-oriented pricing, retailers base their prices on consumer demand. Consumers' sensitivity to price changes is an important coefficient for setting demand-oriented prices. The **price elasticity** (more precisely: individual price elasticity) of demand is a measure of consumer sensitivity to price. It measures the responsiveness of quantity demanded to a change in price:

$$\text{price elasticity } \varepsilon_A = \frac{\%\text{ change in quantity demanded of product A}}{\%\text{ change in price of product A}} = \frac{\Delta q_A / q_A}{\Delta p_A / p_A}$$

With a price elasticity of $|\varepsilon| > 1$, if the retailer raises prices, total revenue decreases. This is likely when there are many substitute products available. If price elasticity $|\varepsilon| < 1$, that is, demand is relatively price inelastic, a price increase results in a smaller relative reduction in purchasing volume and total revenue increases. For example, late at night, convenience stores usually experience relatively price-inelastic consumer demand.

Studies have shown that there are generally very few products about which consumers are truly price sensitive (these are often products consumers purchase very frequently and about which they, therefore, have good price knowledge). In fact, most categories display generally low price sensitivity, i. e., retailers could improve their profit margins without losing customers (SAP and GfK 2010).

Information on price elasticity can be obtained in different ways. Customers can be surveyed to determine whether they would buy a certain product at a certain price. Experts

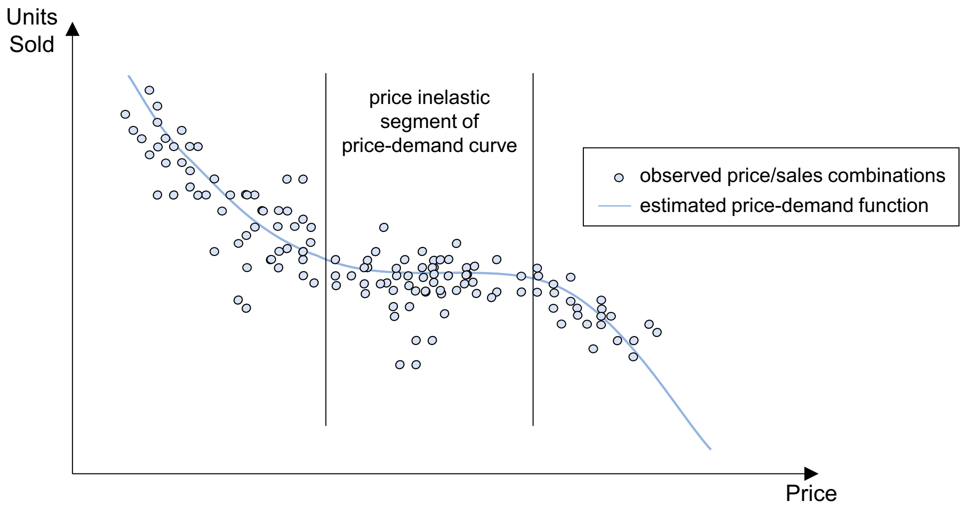

Fig. 13.1 Estimating a price-demand function from scanner data

can estimate sales levels at a certain price based on their knowledge of similar products. For products that have been in the assortment for long periods, historical data from the retailer's information system (price-volume combinations) can be used to estimate both price elasticity and price-demand functions (see Fig. 13.1 for a hypothetical example). Another method is to conduct experiments by using a sample of stores, varying the price systematically in some stores while leaving it unchanged in others (the **control group**), and observing the changes in demand resulting from the price changes.

Competition-oriented pricing is directly associated with demand-oriented pricing, because consumers are likely to use competitors' prices as a reference to inform their demand behaviour. If a retailer offers a product much cheaper than its competitors, demand will strongly increase, and vice versa.

The method described above analyses price sensitivity and can help predict sales at a certain retail price. However, the goal of pricing is usually not to maximise sales but profits. Therefore, cost information must also be used to determine the optimal price. Obviously, the sales price should not be fixed below the merchandise cost plus the required mark-up or operating expenses will not be met. The absolute gross margin is equal to the total of product units sold and margin per unit. Higher prices reduce the number of units sold but increase the margin per unit, and vice versa. From this, the optimal level of demand and, subsequently, the price must be determined.

Interdependence of Price-Demand Functions within an Assortment

Retailers simultaneously offer a large variety of products to consumers, making retail pricing a multiple product pricing activity. The demand functions of different products are interrelated, and not only the individual price elasticity of demand is relevant, but also the various **cross-price elasticities of demand**. Cross-price elasticity measures how the demand for a second product changes with the price of the first. More precisely, it is calculated as follows:

$$\text{cross-price elasticity } \varepsilon_{A,B} = \frac{\%\text{ change in quantity demanded of product B}}{\%\text{ change in price of product A}} = \frac{\Delta q_B / q_B}{\Delta p_A / p_A}$$

Cross-product relations may be substitutive or complementary. **Substitution effects** often occur between similar products. If the price for coffee brand A increases, fewer people will buy coffee brand A and more will buy coffee brand B. Thus, substitution effects are linked to **positive cross-price elasticity**. In this case, cannibalisation occurs and price increases for one product lead to purchases of another. This is often a risk with price promotions. In contrast, demand interrelationships can have **complementary effects**. For example, customers might visit a sports store because the price of ski boots is reduced but then buy other skiing equipment as well. In this case, there is **negative cross-price elasticity**.

As a basic effect, price reductions create footfall within a store, which may benefit many products. Retail pricing must incorporate such demand interdependencies in order to maximise store profitability. In reality, however, there is not just a pair-wise link between products; potentially, every product in the store has a (stronger or weaker) interrelationship with every other product.

Mixed calculations, where certain products are used to draw customers into a store and establish a positive price image, while other products are used to make the customers' total purchases profitable for the retailer, are therefore common strategies. Within such a strategy, **leader pricing** is frequently employed. Here, a retailer sells selected items in its assortment at less than the usual profit margins or even below marginal costs. These products are sometimes known as **loss leaders** and are usually heavily advertised. The goal is to increase customer traffic to sell regularly priced goods, e. g., complementary products, in addition to the specially priced items. Loss leaders are often frequently purchased products from known brand manufacturers, so customers are aware of the low prices and can compare them with other stores (Levy et al. 2014, p. 407). Selling below merchandise cost is prohibited in many countries by **minimum price laws**.

13.2.4 Manufacturer's Suggested Retail Price

Whatever price setting method is being used (and also when analysing consumer goods marketing), it is important to remember that it is ultimately the retailer who sets the price, not the manufacturer.

While manufacturers are often interested in **resale price maintenance**, i. e., ensuring that retailers do not sell items for less than a specific price (Levy et al. 2014, p. 411), this is prohibited in many countries. In the European Union, such **vertical price fixing** is prohibited in most cases since it might reduce competition between retailers. Exceptions include book prices in Germany or prices for pharmaceuticals; however, these latter are often fixed by governments. In the USA, vertical price fixing used to be prohibited, but a recent court ruling argued that resale price maintenance is only a violation if it exerts anti-competitive effects (Berman and Evans 2013, pp. 457–458).

Manufacturers may try to publicly advertise so-called “recommended retail prices”, which may act as an upper price threshold (because in practice consumers would not accept a price higher than a signalled suggested price). Recommended retail prices, however, do not usually lead to the intended minimum retail price. In any case, it is important that these price suggestions are non-binding and that the manufacturer must not place any pressure on retailers to maintain these price levels, as this falls under the prohibition of resale price maintenance as well.

Thus, the only legal influence that manufacturers can exert on retail prices is via their own selling price to retailers. Since selling below costs is prohibited in many countries by minimum price laws, the retailer’s purchasing price usually acts as the lower price threshold.

13.3 Price Positioning and Price Structure

A retailer’s price image is the result of a generalisation process, in which separate price-value impressions created by a retailers’ different products, departments, and stores are aggregated into a total impression of the price level for that retailer in the mind of the consumer. Price images result from the fact that consumers are unable and often unwilling to carry out a full and current price comparison for all products offered by a particular retailer (Diller and Anselstetter 2006, pp. 599–600). Certain products are more important for overall price image than others (SAP and GfK 2010), and the image effect of a price reduction may be different from the direct price-elasticity of demand.

Price Structure

When it comes to retailers’ price structures, distinctions are often drawn between (Fassnacht et al. 2012, pp. 568–569):

- the value (or budget) price segment,
- the medium (or standard) price segment,
- the premium price segment.

In the premium price segment, retailers attract customers who are less concerned with price than they are with service, merchandise quality, prestige and other store attributes. Such products rarely maximise sales, but they usually achieve high profits per unit. Conversely, an aggressive pricing strategy in the budget price segment aims to earn high revenues by setting low prices and selling many units. Profit per unit is low, but total profit may still be high.

Many successful retailers focus on the budget price segment. Hard discounters, such as *Aldi*, full-range discount stores such as *Walmart*, many of the category killers, dollar stores in the USA, *H&M, IKEA* and many more have gained tremendous market shares with low or aggressive pricing strategies. However, offering different price levels (within a merchandise category) allows a retailer to target consumers with differing willingness to pay for a product. In economic terms, different price levels let retailers obtain a larger share of total consumer rent.

Rather than offering merchandise in a category evenly distributed over a continuous price range, many retailers employ **price lining** (Fassnacht et al. 2012, pp. 570–573; Levy et al. 2014, p. 408). This means they sell merchandise at a limited number of price points. Price lining helps consumers avoid confusion about product differences. Distinct price levels within a category simplify the buying process for customers. For example, the French home improvement retailer *Leroy Merlin* indicates on its shelves which price line certain products belong to: "Nos premiers prix" on a yellow sticker indicates products for limited budgets, "Nos meilleurs rapports qualité/prix" on a green sticker indicates products with a standard quality and a good price/quality relationship and "Nos prix haute qualité" on a dark blue sticker indicates the best quality products in a category (with a higher price level). Other retailers have adopted this approach as well.

13.4 Price Differentiation

Price differentiation means charging different customers different prices for the same product. The extreme case is negotiating prices with each customer individually. In some retail industries, such as automobiles, flexible pricing based on negotiations is standard and the prices paid can vary greatly.

While in the service industry (for example, cinemas), prices for students or senior citizens are often lower, this is rarely implemented by retailers. One example is student prices for notebooks sold by IT retailers. **Geographic price differentiation** is the most common approach. The price sensitivity of a store's customers is – among other factors – a function of their spending power and the density and aggressiveness of the competition in the store's catchment area. A store in a poorer region next door to a hard discounter might use lower prices than another store from the same chain located in a wealthy city with no nearby competitors.

Retailers often use **price zones** such as areas (or groups of stores) in which consumers pay uniform prices, while the prices between the zones differ. Such price zones help retailers adapt pricing more effectively to the distinctiveness and competitive environment of a local market area. Retailers sometimes even have multiple pricing zones within large cities (Levy et al. 2014, p. 407).

While geographic price differentiation usually increases profits, some retailers follow a **one-price policy**, charging all customers the same price for a certain item, irrespective of store location (Berman and Evans 2013, p. 471). This policy aims to generate consumer trust in the retailer and is often based on a company mission with a strong corporate social responsibility element. *Coop* in Switzerland is an example of a retailer that employs a one-price policy.

Loyalty programmes, another method of price differentiation, are discussed in Chap. 16.

13.5 Dynamics of Pricing: HiLo vs. EDLP

In retailing, product prices are not fixed permanently; they can change over time. As part of an overall pricing strategy, two different dynamic pricing tactics can be observed for retailers: EDLP and HiLo (e. g., Fassnacht and El Husseini 2013; Hoch et al. 1994; Levy et al. 2014, pp. 388–390).

HiLo (High-Low) Policy
With a HiLo pricing strategy, retailers have relatively high regular prices, but use substantial temporary price reductions to advertise their products and draw customers into stores (Wagner et al. 2012). The effect of such price promotions is **dynamic** (see Fig. 13.2), which ultimately makes it difficult to evaluate the overall profit effect. Usually, the sales volume of a product increases substantially during the promotion period. This immediate effect can be decomposed into the following main sources:

- **Brand switching**: customers in the store who would have bought another brand buy the promoted brand instead.
- **Purchase acceleration**: consumers who would have bought the product or brand later may advance their purchase into the promotion period. In the case of frequently purchased products, this often leads to stockpiling, i. e., the consumer builds an inventory during the reduced price period.
- **Increased consumption**: owing to the reduced prices, consumers may consume more of the promoted product. This may be linked to stockpiling, because the increased availability of a product in a household may lead to enhanced consumption.
- **Store switching**: consumers who usually buy a brand in another store may switch stores to buy the promoted product.

These sources of boosted sales can occur in combination, e. g., a customer who usually buys a certain brand in a competitor's store may be attracted to a store via a price promotion and buy the promoted brand instead of his usual choice. Obviously, not all of these effects are equally desirable from the perspective of the retailer and/or brand manufacturer.

After a promotion, there is usually an **adjustment period** during which the sales volume of the brand frequently decreases. This is the result of purchase acceleration, since at least some of the sales that would normally have occurred during the adjustment period were made during the promotion. The intended **permanent effect** of the promotion is increased sales of the promoted brand. Sometimes this occurs due to brand switching or store switching during the promotion period, which may lead to satisfied customers and a permanent brand or store switch. A store switch is obviously much more desirable for a retailer than a brand switch.

The strength of the sales increase, the subsequent sales decline and the long-term effect depend on many variables, among them the relative strength of the aforementioned components. These, in turn, are influenced by factors such as the usual purchase frequency for

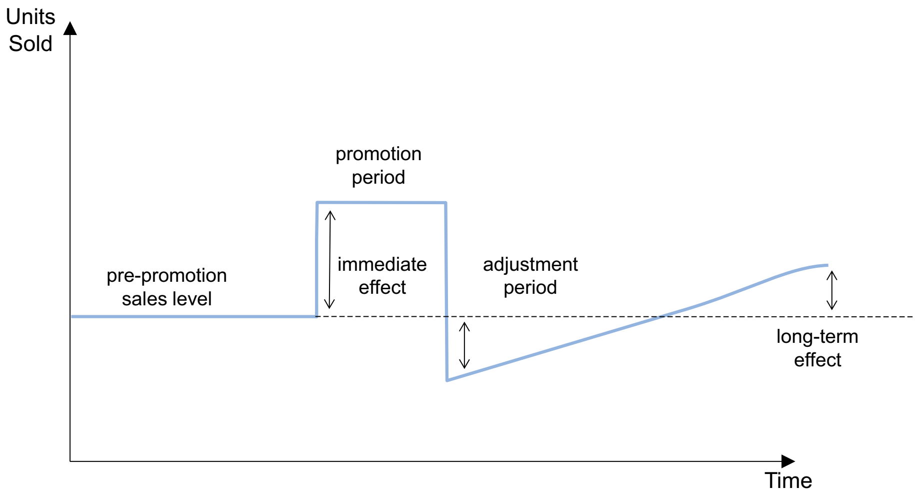

Fig. 13.2 Typical effects of a price promotion

a brand, the consumers' price knowledge, the storability vs. perishability of a product, the availability of similar brands in the category and the strength of promotions for other brands. It must be remembered that a retailer's profits are based on every brand within a category and from interdependencies between categories. Thus, to fully evaluate the effect of price promotions, their influence on sales of other products in the store must also be considered.

Many supermarkets use price promotion strategies. Price promotions are a method of price differentiation through customer self-selection (Gedenk et al. 2010). The promotion is offered to every customer, who then decide whether or not to take advantage of it. Less price-sensitive customers buy at regular prices, while more price-sensitive customers wait for a sale and buy then. Price promotions can influence the retailer's price image. Proponents of a HiLo strategy also argue that price promotions create excitement in the store.

However, price reductions risk changing customers' **reference price**. While a one-off reduction is considered a bargain, frequent or longer reductions to a product's price reduce the reference price, making it difficult to sell the product at its normal price in the future (Diller and Anselstetter 2006, p. 618). Heavy price promotion activity can also erode consumer confidence in regular prices (Hoch et al. 1994, p. 16).

HiLo pricing is often criticised for encouraging customer disloyalty and appealing to smart shoppers who only buy items at special prices. It may also increase customers' long-term price sensitivity. Intensive HiLo strategies in particular can lead to reduced profits for retailers.

EDLP (Everyday Low Price) Policy

The alternative to a HiLo strategy is an EDLP strategy, where prices remain stable over long periods. This involves offering consistently low prices. *Walmart, ASDA* and *Aldi* are examples of retailers who have adopted an EDLP strategy.

EDLP makes the shopping process easier for customers, and the price continuity fosters trust in the retailer. The disappointment that consumers of a HiLo store can potentially experience if they see products being sold at a much lower price than they paid previously can be avoided. Simple and consistent pricing should lead to **price credibility**, because consumers develop trust in the retailer instead of the distrust that strong price deviations create.

However, the real advantages of EDLP for the retailer often lie in improving the efficiency of internal processes and therefore reducing operating costs. While price promotions result in short-term volume volatility (as illustrated in Fig. 13.2), which leads to increased logistics costs and often increased stock holding, EDLP produces stable sales. Therefore, sales forecasts become more reliable. Stock shortages can be avoided, and warehousing and transport costs are reduced (see also the explanation of continuous replenishment CRP in Chap. 19).

However, EDLP has high price transparency, and thus can only be successfully implemented if a retailer has a very low cost structure, as EDLP makes price comparisons much easier for consumers (and competitors) than a HiLo policy. Only the most efficient retailers will be able to sustain such low prices in the long run (Morschett 2002, p. 249).

EDLP and HiLo both have advantages. Surveys often show that most customers claim to prefer EDLP. However, surveys and empirical evidence also show that many customers wait for a price promotion or shop around to get the best deals. The two strategies are not a binary choice for a retailer; they are the ends of a spectrum with many hybrid tactics between them (Fassnacht and El Husseini 2013, p. 265).

13.6 Types of Price Reductions

Adjustments in product prices are common in retailing, usually in the form of price reductions. **Mark-downs** are a permanent reduction of the initial retail price. They are a common pricing tool for clothing and textiles to sell off merchandise. The main reason is the seasonal nature of certain merchandise, which often leads to overstocking at the end of the season, often with products that cannot be sold successfully in future seasons. Mark-downs are planned from the outset and calculated into the initial mark-up in order to later reduce prices as part of a **temporal price differentiation strategy**. Customers with a higher willingness to pay for new fashion early in the season pay higher prices than those who buy later in the season. However, mark-downs are expensive; the first, planned mark-down must often be followed by others to clear out the merchandise. Substantial mark-downs are often a signal of poor demand planning or inadequate pricing during normal selling phases.

Temporary Price Reductions

As well as the simple price reductions described above, there is a wide range of options for temporary price promotions. The following types are common (see Diller and Anselstetter 2006, p. 615; Wagner et al. 2012, pp. 588–509; Levy et al. 2014, pp. 405–406):

- **Promotion packs** have extra content and a lower price per volume (e. g., "10 % extra for the same price").
- With **BOGOFs** ("buy one, get one free"), a customer receives one unit of a product if he buys another for full price.
- In **multipacks**, several units of the same product are tied together (into a simple price bundle), usually at a lower price than the sum of the individual units.
- With **coupons**, consumers have to show the coupons at the store checkout to receive a discount. Coupons can be distributed together with the retailer's advertising or through direct mailings. They can also be distributed by manufacturers' advertising (and be accepted by the retailer, but refunded by the manufacturer) or distributed on the shelves.
- **Store-wide reductions** are another option that applies to the whole assortment. The former German DIY chain *Praktiker* regularly offered "20 % off everything in-store" for a few days. Customer traffic increases dramatically during the price promotion period for such events.

However, consumers can get used to drastic price reductions. At *Praktiker*, consumers developed the habit of only shopping during price promotions and deferring purchases in between. The company eventually went bankrupt because it could not break this disastrous cycle.

There are also less drastic cases which show that anticipated price reductions are far less effective than unanticipated price reductions and that there is a danger of overusing these instruments. The advantage of the multitude of price promotion options is that retailers can vary the instruments they use and thereby avoid wear-off effects.

13.7 Psychological Pricing

Setting prices is not simply a matter of purely rational economics; the psychological aspects of prices also require special attention.

Especially when it is difficult for consumers to evaluate a product's quality, price may be used as an **indicator of quality** (so **called price-quality relationship**). Studies regularly show this influence of price on quality perception, and for many retail products, such as clothing, certain food items or technology, consumers often lack the necessary information and ability to accurately judge the quality of the merchandise. Particularly for store brands where the customer does not have an immediate comparison, higher prices may imply better perceived quality.

Even though price seems to be an objective marketing instrument, price perception is often largely subjective (Hurth 2006, pp. 63–94). Consumers evaluate price-value differently depending on how a price is communicated. Red or yellow price stickers, large price signs, crossed out "old" prices, comparisons with recommended retail prices and many other communicative measures can increase perceptions of lower prices. Presenting the price as a major feature in retail communication, combined with a heavy advertising budget, often influences price image. **Price communication**, therefore, is an important facet of a retailer's pricing strategy.

Another frequently used approach is **odd prices**, i. e., prices on products that end on an odd number, mostly nine. Consumers are believed to perceive prices slightly below certain thresholds as substantially lower than prices at the threshold. So a product priced at 1.99 EUR is often perceived to be much less expensive than one priced at 2.00 EUR. However, research into the effect of odd prices shows ambiguous results, and a positive effect has not been proven. Nevertheless, it is common practice in most retail sectors.

Price Bundles

A frequently used pricing tactic in retailing is price bundling. This tactic is also common in many other business fields, e. g., with McDonald's Happy Meals or the Microsoft Office software package. With this approach, several products are bundled together and offered for a single price. Examples include computers and monitors, combos of different coloured printer cartridges or game consoles with games at electronics retailers, washing machines and tumble dryers at appliance retailers, cosmetics sets at a drugs store or tool sets at home improvement retailers. Bundling products with services is another facet of this tactic, e. g., a home cinema system with installation at the customer's home or a mobile phone with a subscription to a telecommunications service provider. These price bundles are often preconfigured by manufacturers, but they are also often created by retailers.

There are two options for price bundling:

- Products can also be bought separately (**mixed bundling**).
- Products can only be bought in the bundle (**pure bundling**).

In the first option, the bundle can only be offered for a price lower than the sum of the separate products and is a form of price reduction. In the second option, price bundling creates a level of opacity concerning the individual product prices. It is a way to sell more products, to simplify the selling process for the retailer and the selection process for the customer but also to capture more of a customer's willingness to pay compared to unbundled pricing. On the other hand, only being able to buy a bundle may irritate customers, causing them to delay their purchase or search for the individual products elsewhere.

13.8 Technology and Retail Pricing

While retail pricing has often been based on intuition and simple rules (such as fixed mark-ups), the complexity of the decision and the tight interdependency of influence factors, as well as the fact that the prices of many products in an assortment influence the sale of other specific products, have made new technology necessary (Bolton et al. 2010).

Gross profit in most categories can be increased by simply optimising permanent prices. Unused potential for price increases can often be found in frequently neglected product lines belonging to the peripheral assortment where the customer generally has low price knowledge (SAP and GfK 2010).

Price optimisation software (**price engines**) attempt to predict demand for individual products at a certain price level, based on historical price and sales data, competitors' prices, local demographics, inventory, shelf location and other data. It can be used by retail managers to test and forecast consumers' reactions to changing prices and different promotion tactics in hypothetical scenarios. Pricing has been a main focus of retail software development over the last decade and such software can help set basic prices, price promotions and mark-downs. The software does not usually fix prices itself; instead, it provides decision support that helps managers evaluate the consequences of certain prices. However, pricing is highly complex, cross-price elasticities over a larger number of products are difficult to estimate and competitors' price reactions are difficult to predict; therefore, price setting is still a major challenge even with the most recent software developments.

13.9 Retail Pricing and the Internet

The Internet has had a tremendous influence on retailers' pricing, no matter whether these companies sell only in physical stores, only online or via multiple connected channels (multichannel, cross-channel or omni-channel).

For **store-based retailers**, the main effect of the Internet is increased competition and increased **price transparency**. Even if a retailer only sells via stores, consumers can easily compare prices on the Internet. Comparing prices on the Internet is far simpler and faster than visiting different store outlets, and can therefore be carried out more extensively. Certain websites specialise in price comparisons and can nowadays be accessed via smartphones, i. e., while shopping in stores. Since online shops often price their products aggressively, these prices are used by consumers as reference prices, even when shopping at brick-and-mortar stores. Since store retailers have to invest in facilities, employees and stock, they have different cost structures from Internet players, and matching their prices is not always easy. This price pressure is a huge challenge for traditional store retailers.

For **online shops**, the basic pricing instruments and principles described in this chapter still apply. For example, they must be demand-oriented and must cover their costs. Competition-based pricing is even more relevant, just in a different form, because online shops have tactical opportunities for pricing that extend far beyond the options for store-based retailers. The two major methods are (A.T. Kearney 2010; Rueter 2014):

- **Dynamic pricing**, where product prices are regularly changed. This is data-driven and often happens in real-time. In Switzerland, a newspaper recently showed that the price for a certain vacuum cleaner in the online shop *Galaxus* was 159 CHF one day, 175 CHF a few days later and 168 CHF a few days after that (Vogel and Rothenberger

2014). *Amazon* is one the most progressive companies when it comes to this approach, changing prices for some of its products many times a day to react to demand changes, competitor prices, etc. (see the case study for this chapter). But small online shops can also easily incorporate **pricebots**, agent software that continuously searches the Internet and tracks prices for defined products from pre-specified competitors. Even small online shops regularly adjust their prices automatically based on tracking results to optimise sales and profits. Dynamic pricing also includes increasing prices when demand peaks, supply is low (i. e., competitors' delivery times are long) or competitors' prices are higher. This is also applied by *Amazon's* marketplace partners, for whom it is important to be mentioned in the buy box, i. e., the box on *Amazon's* product detail page which lists different sellers.

- Individualised pricing based on fine-grained **customer segmentation**. For example, online shops may demand different prices for the same product from different customers, based on their browsing history. If a customer's browsing history identifies them as price-sensitive, e. g., because they mainly looked at price offers during their last visit or cashed in a coupon or came from a price comparison site, then this customer may see a lower price than another would. The *Wall Street Journal* has shown that a number of large US online shops differentiate prices by geolocation. This means online shops can demand a higher price from customers who enter their website from areas with higher average income or fewer stores in the vicinity. Other customer characteristics beyond geography that can be discovered can also be used to display different prices (Valentino-DeVries et al. 2012).

Very different forms of **price-oriented retail formats** have developed in online shopping (see Chap. 4). *Ebay* has grown via online auctions, a format that was never more than a niche in other retail channels. Even though most listings on *Ebay* are now fixed price, auctions are still possible and other auction channels have developed. Deal-of-the-day websites (e. g., *Groupon*) have emerged. Online shopping clubs (like *Vente-Privée*), group rebates, flash sales or online shops that sell overstock are other forms of pricing which are increasingly relevant with the advent of online shopping.

Multichannel retailers who have stores and an online shop face an additional challenge. These retailers must decide how to align their prices across their different channels. In principle, there are three options for this **cross-channel pricing**:

- Charging a higher price in the store than in the online shop: While this may be justified by the cost structure and the additional service (e. g., direct availability of the product or product advice from salespeople), customers will only accept this for a small price range. Thanks to price transparency and mobile devices, customers quickly recognise price differences. Still, customers may accept slightly higher prices in stores.
- Charging higher prices online than in the store: While this option is unlikely to be observed simply by looking at display prices, online customers may still pay more if the online shop charges a delivery fee in addition to the product price.

- Charging identical prices: While retailers often claim they cannot charge the same (low) Internet prices in their stores due to cost structures, several studies have shown that this is, in fact, today the standard strategy (Morschett 2013). In a study in Germany, the vast majority of surveyed retailers stated that their **online prices and store prices are identical**. Similar results have been found for Switzerland. When different sales channels are linked, it is increasingly difficult to differentiate prices. Customers are unlikely to accept price differences from a retailer with multiple channels who offers a click & collect service where products are bought on the Internet and picked up in store. Given that more and more retail operations are cross-channel or even omni-channel and have linked their channels with cross-channel processes, it can be expected that more and more identical prices will be seen.

Ultimately, this tendency may lead to a differentiated retail branding strategy. If an online shop has the same retail brand as a store, it is usually helpful to link these channels. This, in turn, renders price differentiation difficult. Retailers wanting to follow an aggressive pricing strategy on the Internet should consider launching an online shop with a different retail brand. Examples include *Redcoon*, one of the German *Media-Saturn Group's* online shops, and *Microspot*, one of *Interdiscount's* online shops in Switzerland.

13.10 Conclusion and Outlook

Pricing is a major marketing instrument for retailers. Price is an important element of consumers' buying decisions and can be a decisive determinant in whether a retailer makes a profit or a loss. Certain trends can be observed in retail pricing:

- Retailers are increasingly setting their prices based on consumer demand and what the market is willing to pay.
- Many companies have now introduced everyday low prices (EDLP). The main reason for this is to improve efficiency in the supply chain, forecast demand more reliably and achieve more consistent sales patterns. However, many retailers still prefer to reduce their prices as part of a price promotion, with promotional strategies becoming more varied and increasingly complex.
- Regional price differentiation is likely to become even more widespread. However, it will remain a challenge, because the Internet has increased price transparency.
- Prices not only differ from region to region, but also on the basis of different customer profiles. With loyalty programmes, coupons, price promotions, temporal and regional price differentiation, customers are increasingly unlikely to pay the same price for identical shopping baskets.
- Online shops use dynamic and segmented pricing. Prices are adapted in real-time based on temporal factors (e. g., changes in competitors' prices) and based on customer characteristics (e. g., browsing history).

Overall, pricing is becoming more analytical and data-driven. In the past, pricing decisions were often based on intuition and rough rules of thumb. Today, retailers have far more sophisticated tools at their disposal and can increasingly analyse how price changes affect the buying behaviour of individual customers, with cross-product price sensitivity and competitors' prices included in their calculations. Pricing software also increasingly lets retailers consider the factors that determine optimal price and track competitor prices. Revenue and profit benefits from more flexible pricing can be expected, but price pressure is likely to remain strong.

Further Reading

- Fassnacht and El Husseini (2013): EDLP versus Hi-Lo Pricing Strategies in Retailing – A State of the Art Article. *Journal of Business Economics*, 83(3), 259–289.
- Simon et al. (2010): Retail Pricing – Higher Profits through Improved Pricing Processes, In: Krafft, M.; Mantrala, M. (Eds.): *Retailing in the 21st century*, 2nd ed. (pp. 301–318), Berlin et al.: Springer.

13.11 Case Study: Amazon

13.11.1 Profile, History and Status Quo

Amazon[1] was founded by Jeff Bezos in 1994 and the online shop *Amazon.com* was launched in 1995 as an online bookstore. In just over two decades, the company has grown to be one of the largest retailers in the world and by far the largest online retailer. In 2014, the company achieved net sales of 89 billion USD and had about 150,000 employees.

From its origins as an online bookseller in the USA, *Amazon* quickly started exporting, and in 1998 it acquired a German online bookshop and established its first international presence. Other foreign market entries followed, including some acquisitions, and today *Amazon* serves customers worldwide, partially through country-specific websites – in Germany, the UK, Japan, France, Spain and five other countries. The company has developed from a retailer to a platform on which more than two million third-party sellers offer their products. It also expanded from the category of books into selling media products (books, movies, music), electronics and computers, toys, tools, clothing, home and garden products, health and beauty products and many other categories. In 2010, turnover from general merchandise products surpassed turnover from media products for the first time. In addition, *Amazon* has acquired other online retailers with different retail formats, e. g.,

[1] As well as the explicitly cited sources, sources used for this case study include the websites http://www.amazon.com and diverse country websites and various annual and interim reports.

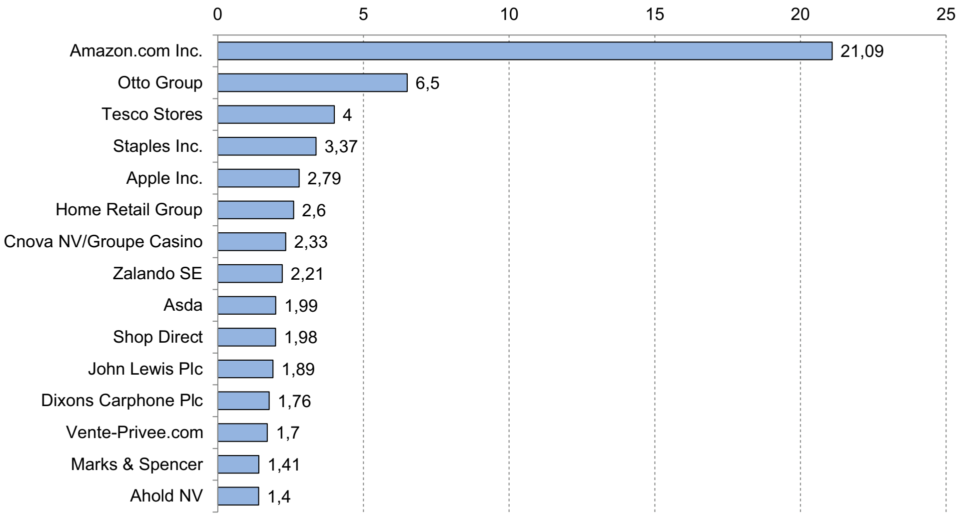

Fig. 13.3 Leading online retailers in Europe, 2014 (online revenues in billion EUR). (Internet Retailer 2015, p. 15)

Zappos, an online shoe retailer, in 2009, and *BuyVIP*, an online shopping club, in 2010. *Amazon* also began selling web services in 2006 and became an important provider of cloud computing. This list of *Amazon's* activities is far from exhaustive. Thus, *Amazon* is a very good example of the use of different growth strategies (see Chap. 7), including product development, market development, diversification and also market penetration, where it continuously gains market share in its initial market for books.

Today, *Amazon* is by far the largest online retailer worldwide and is the market leader in most markets it is part of, as Fig. 13.3 shows for Europe. It has about 270 million active customer accounts worldwide and enormous traffic on its websites. For example, in Germany alone, about 25 million people visit *Amazon.de* per month. Many product searches start on *Amazon*, and *Amazon* prices frequently appear when products are searched on *Google*. Thus, *Amazon* prices have become reference prices for customers.

13.11.2 General Price Positioning of Amazon

Amazon follows a price leadership strategy and positions itself as offering the lowest prices on its products. In general, price studies confirm this claim. For example, a broad study in the USA in 2011 highlighted the price gap between *Amazon* and other retailers. The study compared the prices of 100 randomly selected goods at 24 retailers in the US. Compared to the established brick-and-mortar price leader in the USA, *Walmart*, *Amazon's* prices were on average 5.4 % lower than *Walmart*'s store prices and even 13.2 % lower than *Walmart*'s online shop. Only *Costco* was approximately even with *Amazon*. Other large US retailers, such as *Target*, *Best Buy*, *PetSmart* and *Kohls* were substantially more expensive than *Amazon* (The

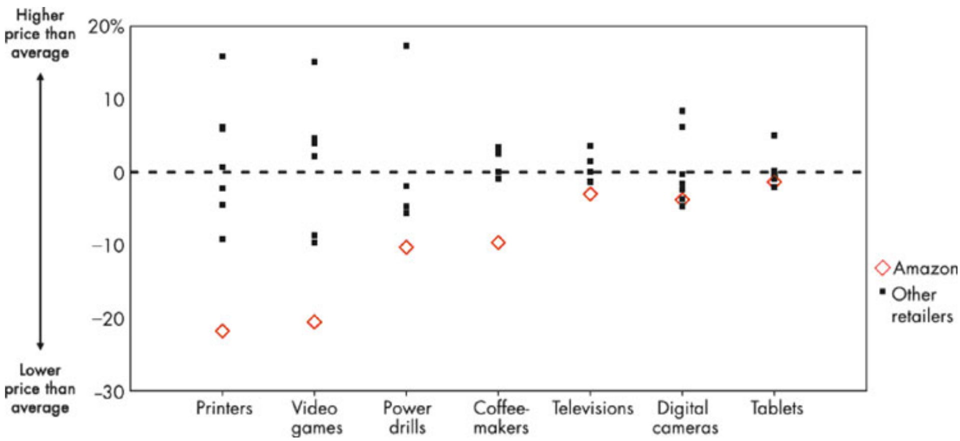

Fig. 13.4 Retailer basket prices in the USA for seven product categories in November 2013. (360pi, cited from Rigby et al. 2013, p. 9)

Economist 2011). A more recent study reached a similar conclusion. *Bain and Co.*, together with the pricing analytics company *360pi*, investigated the prices for popular products in seven different product categories. In each category, a number of different products were combined into a shopping basket (from seven products in the power drills category to 36 different video games) and compared between *Amazon* (excluding market place partners) and at least seven other retailers. The results (see Fig. 13.4) showed that *Amazon* was either the cheapest or at least (for two categories) among the cheapest retailers for these product baskets.

Thus, *Amazon* has earned a reputation among customers of beating most other retailers, in particular brick-and-mortar retailers, on prices. There are several explanations *for Amazon's* generally low prices:

1. The company has a lower cost structure than a store-based retailer and lower overhead costs. Working conditions and employee pressure in distribution centres have been much criticised, for example in Germany.
2. For a long time in the USA, *Amazon*.com was not required to pay sales taxes in federal states where it did not have a physical presence. Thus, shipping from California, *Amazon* saved the sales tax, which is between 4 and 7 %, for most US states. This gave it a considerable cost advantage. However, thanks to increased pressure from US states and *Amazon's* expanding network of distribution centres (thus, a physical presence in many states), this has changed, and as of 2015, *Amazon* has to pay sales tax in about half of all US states. In Europe, *Amazon* similarly managed to heavily reduce its tax burden compared to local store-based retailers by locating its headquarters in the low-tax country of Luxembourg, through which most payments are handled.
3. *Amazon's* enormous size and market power lets it negotiate lower procurement prices, a fact that has caused a number of public conflicts, e. g., with publishing houses and authors, in recent years.

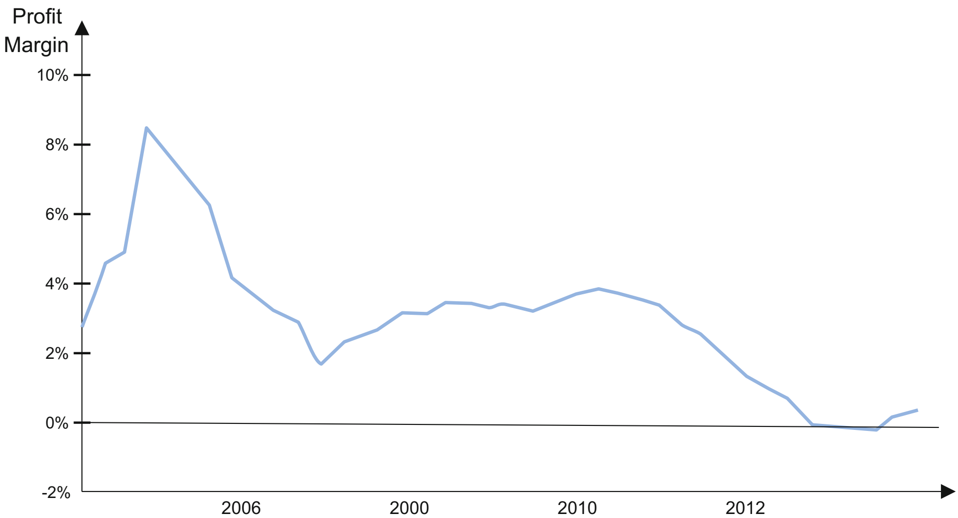

Fig. 13.5 *Amazon's* profit margins (trailing 12 months). (Fortune Online 2014)

4. In recent years, *Amazon* has achieved very small, and in some quarters even negative, profit margins (see Fig. 13.5) This is an indication of a growth-oriented, low-margin strategy, i. e., a long-term **penetration pricing strategy** with the aim of gaining a very strong market position instead of generating profits. Critics argue that this can lead to monopoly situations in certain product categories and therefore to higher consumer prices in the long run.

More detailed studies on *Amazon's* objective price position show more differentiated results. For example, studies by *Kantar* in 2014 found *Walmart's* supercentres to be slightly cheaper than *Amazon* and concluded "*Walmart* beats *Amazon* as low-price leader" (Souza 2014). A recent, very large study based on 40,000 SKUs revealed that *Walmart* and *Amazon* had exactly the same prices on about 60 %, *Walmart* was lower priced on about 15 % and *Amazon* had the lower price on about 23 % (Boomerang Commerce 2015, p. 11).

This shows that *Amazon* does not have the lowest prices across the board. Instead, the company identifies the **most popular products** and prices those under competitors' prices. These are the prices of which consumers have price knowledge and which therefore strongly impact their **price perception**. For example, *Amazon* priced one of the most popular routers in its online shops about 20 % lower than *Walmart*, but for another, less popular router, it asked a 30 % higher price. And while a popular *Samsung* TV was frequently reduced to beat competitors' prices, HD cables – products which garner much less attention – are priced rather high (Boomerang Commerce 2015, pp. 5–9).

In summary, *Amazon's* customers perceive it to be a low-price retailer. Prices are lower or mostly not substantially higher than competitors' prices. However, this perception has been cultivated through **smart price optimisation**. Prices are particularly aggressive on the most popular and most frequently viewed products, but less popular products (with less

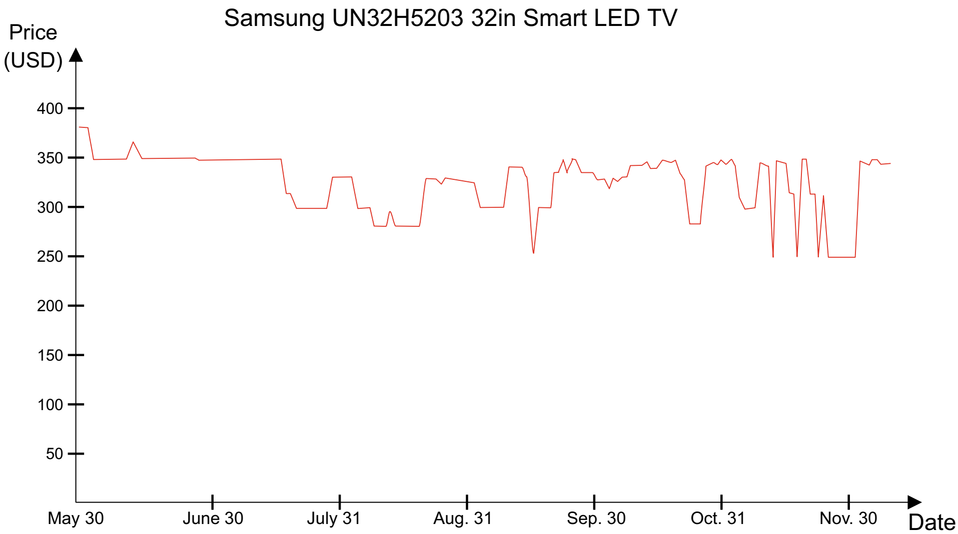

Fig. 13.6 Product price changes on *Amazon* during a 7-month period. (Boomerang Commerce 2015, p. 4)

price elasticity and less price knowledge of consumers) are priced higher (Del Rey 2015). This type of **mixed calculation** has been used in store-retailing for many decades and is also used by *Amazon* to create a low-price image.

13.11.3 Dynamic Pricing

According to a study by the price analytics company *360pi*, *Amazon* changes its prices more than 2.5 million times a day. By contrast, retailers such as *Best Buy* and *Walmart* perform about 50,000 price changes per month. The report mentioned one case where the company changed the price of a wireless Internet router eight times in a single day. The price of the router fluctuated between 185 USD and 200 USD. Fig. 13.6 shows a case from another study. Here, for a very popular product (the bestselling *Samsung* LED TV), *Amazon* changed the price more than 90 times in seven days. Overall, it has been shown that *Amazon* changes the prices of 15 to 20 % of its inventory at least daily (Peterson 2014).

The main reason for price changes is changes to competitors' prices, which are automatically and constantly monitored. Thus, *Amazon* avoids being undercut on relevant prices. *Amazon* strives to be the fastest follower of the price leader, if not the price leader itself. Thus, prices are adjusted more frequently on price-sensitive products such as power tools and less often for apparel, with some of the most prominent items changing price every few minutes. Furthermore, price changes occur according to the time of day when consumers are most likely to be shopping for a particular category. For example, prices for video games change more often in the evening than during daytime. Another influence is market position. If *Amazon* needs to improve its price perception, it will be more active with price

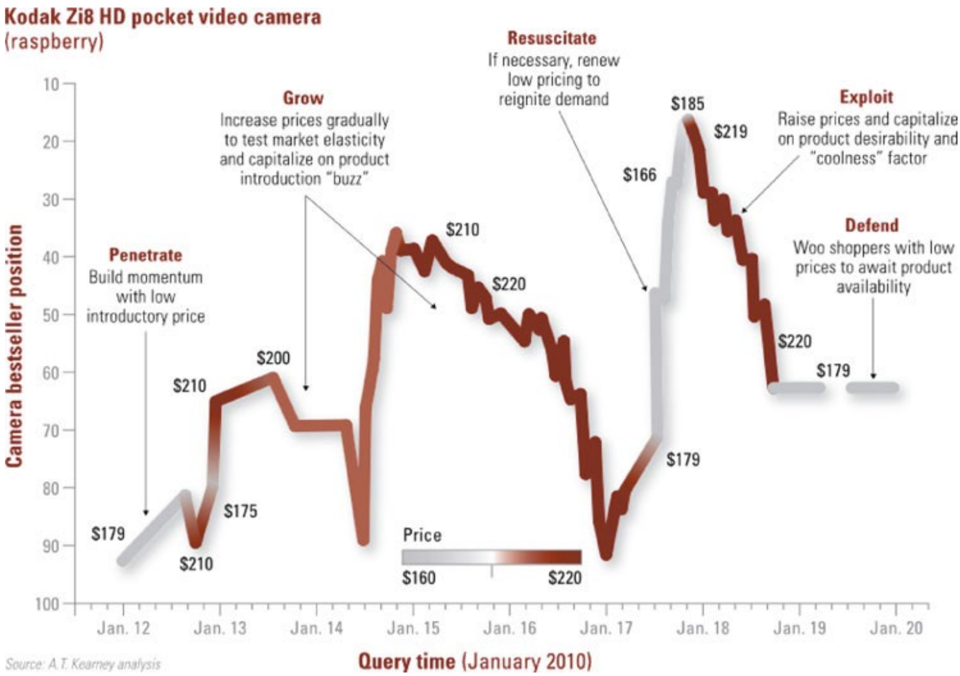

Fig. 13.7 *Amazon* stimulating and exploiting demand by dynamically changing prices. (A.T. Kearney 2010, p. 12)

changes. For example, *Amazon* already has a high market share in electronics and has already cultivated the perception of being the price leader, thus fewer price changes are needed for products in this category. Conversely, more changes are made to home improvement products, a category where *Amazon's* price image is not yet fixed, and which *Amazon* seems to be targeting for growth (Peterson 2014; Rueter 2014).

A.T. Kearney (2010, pp. 11–12) has another perspective on *Amazon*'s dynamic pricing. His analysis showed that *Amazon* also uses price changes to create a so-called **bandwagon effect**, where customers are more likely to buy a product if many other customers buy it as well. Thus, *Amazon* reduces prices on products to stimulate demand. Once the products attract customers and climb *Amazon's* bestseller list, *Amazon* increases the price to exploit this additional willingness to pay (see Fig. 13.7). Thus, the company quickly changes from **penetration pricing** to **skimming pricing** and back, if necessary.

Obviously, there are also risks attached to these pricing tactics, particularly when it comes to retail brand image and consumer trust. The risk of these procedures is highlight by mass media reactions to recent studies. For example, the British newspaper *The Daily Mail* cited them in their title "Study reveals how e-commerce giant fools consumers by constantly changing costs" (Zolfaghariafard 2015). Furthermore, this approach may encourage customers to compare prices even more, delay purchases and observe price changes over time because trust in steady prices is eroded.

13.11.4 Pricing on Shipping Fees: Amazon Prime, Subscriptions and Other Measures

Another highly successful pricing measure – not on product prices but on delivery fees – is *Amazon Prime*. This is a membership programme that gives members a number of advantages. Primarily, members of *Amazon Prime* receive standard deliveries without delivery fees (in the US, that means free two-day shipping on any item). In Germany, premium delivery has no fees or order minimum for *Prime* members. Furthermore, members can borrow one *Kindle* book each month and have unlimited access *to Amazon's* streaming video service. This streaming video service is an important feature; e. g., in Germany, *Amazon Prime instant video* is the market leader, while in the USA, it still trails *Netflix* by a long way. In Germany, *Prime* members get premium access to sales from *Amazon*'s shopping club *BuyVIP* (similar features are available in the USA). *Prime* members also have free unlimited photo storage on *Amazon Cloud Drive*.

The cost for annual membership is 99 USD in the USA, 79 GBP in the UK and 49 EUR in Germany. *Amazon* has heavily promoted its *Prime* programme in recent years, and it is estimated that there are about 20 million *Prime* members in the US (Fortune 2014).

Amazon Prime works similarly to a loyalty programme: Once customers are in the programme, they get special treatment. The fee for the programme is quickly offset for customers who buy very frequently from *Amazon*, because delivery is free. This encourages customers to buy more from *Amazon*, as Fig. 13.8 clearly shows. Different studies have shown that *Amazon Prime* members make about twice as many purchases on *Amazon* than non-members and spend more per transaction. A US study has shown that *Prime* members spend about 1500 USD annually on *Amazon*, while non-member customers spend 625 USD (Tuttle 2015). Customers are likely to shift at least some of their online purchasing to *Amazon*, away from other online shops where they would still have to pay a delivery fee.

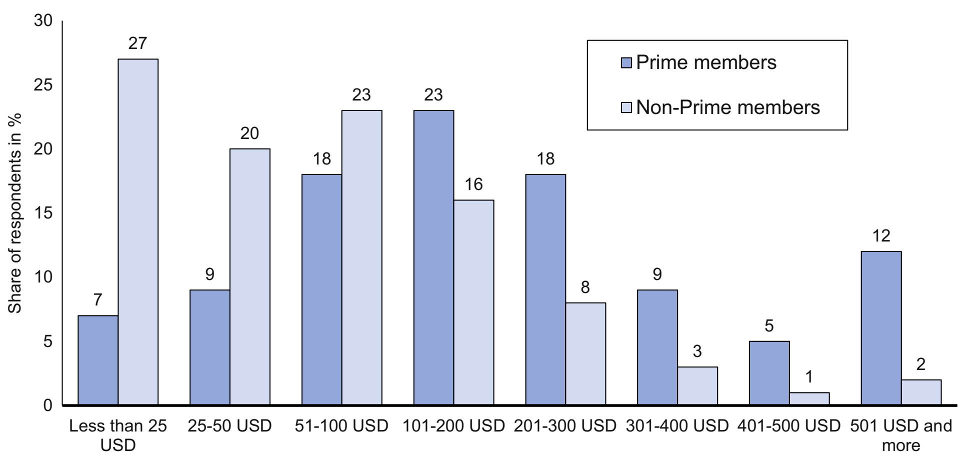

Fig. 13.8 Average amount spent on *Amazon* by *Amazon Prime* and non-*Prime* members in the USA in September 2014. (Royal Bank of Scotland and eMarketer, cited from Statista 2015, p. 37)

As with other loyalty programmes, the effects are not easy to calculate due to a specific phenomenon: customers who buy a lot from *Amazon* are the ones who benefit from a *Prime* membership. Thus, there is a **selection bias**, and a simple comparison between the spending behaviour of *Prime* members and non-*Prime* members is not sufficient to detect the real effects of the programme.

Subscriptions for Price Discounts
Another interesting pricing measure from *Amazon* is the "subscribe & save" programme launched in several countries. Using the example of the German "Spar-Abo" programme, this mechanism works as follows: Customers who order a product from a particular product range (this includes, e. g., beauty products, baby products, etc.) for a regular subscription delivery (i. e., a fixed order delivered regularly, in a fixed cycle, e. g., every month), receive a discount on the product price, currently 5 %, and the delivery fee is waived. Unlike subscription models for magazines, however, the price is charged only after product delivery. If five or more products are ordered via this subscription model, delivered on the same day to the same address, the **discount increases to 15 %**. In addition, customers can become members of *AmazonFamily*. In this case, subscription orders on nappies are discounted by 20 %.

Obviously, such a price measure provides several advantages for the parties involved. From a customer perspective, it provides a price discount and also convenience. From *Amazon's* perspective, it is a regular order, which facilitates forecasting and increases efficiency. It also increases repeat purchases. This is also an advantage from the supplier's perspective, and they are likely to give a discount to *Amazon* for this.

Delivery fees
In June 2015, *Amazon* announced another price move in the USA. While free shipping used to require a minimum purchase of 35 USD, the company intends to use the increased efficiency of its distribution network to start a price war on delivery fees. It announced that it would eliminate shipping fees on all "light and small" products. With this "Fulfilment by *Amazon* Small and Light" service, small packages (below 230 grams) with standard delivery are delivered for no fee. Charges for third-party sellers for this fulfilment service are also reduced. With this move, *Amazon* intends to win market share for smaller and cheaper products like makeup, etc., which mainly come from third-party sellers. Here, it is ultimately the sellers who bear the logistics costs for the customer.

13.11.5 Penetration Pricing for the Kindle E-Reader

Amazon Kindle, the e-reader product line introduced in 2007, is an example of another interesting pricing policy. The price was initially about 400 USD, but it quickly fell to about 100 USD and below for the cheapest models. Compared to other tablet devices with similar features, it was immediately apparent that *Amazon's* profit margins for the product are very low (particularly compared to *Apple's iPad* sales).

In fact, Jeff Bezos admitted in 2012 that the hardware is **sold at cost**. Thus, while the *Kindle* hardware probably makes billions in revenues, there are literally no direct profits from sales of these devices (Clay 2012). This pricing strategy is similar to *Apple's* approach of creating a system of products by combining hardware (like *iPod* and *iPhone*) to locked-in software and media sales (via *iTunes*). At *Amazon*, the software linked to the *Kindle* was initially only e-books, but this quickly expanded to further online content, e. g., videos, music, etc. New pricing models, including flat rates on e-books (*Kindle Unlimited*), were also added to this pricing model.

In 2012, *Amazon* revealed that people who buy *Kindles* read four times as much as they did before and do not stop buying printed books (Clay 2012). More recent surveys showed that *Kindle* owners spend 1450 USD on average per year at *Amazon*, compared to 725 USD per year for other customers (Tuttle 2015). This link between **proprietary hardware** and online content leads to enormous benefits for *Amazon*. It creates a lock-in effect, because only e-books from *Amazon* can be read on the *Kindle*. It strongly increases switching costs for customers, because purchased e-books cannot be transferred to other readers. From publishers' perspective, this creates a "walled garden" for *Amazon* (Cookson 2012).

Kindle has seen enormous success in the fast-growing e-books market. *Amazon* has about 25 % market share of the physical book market in the USA but a dominant 60 % share of the e-book market. In the UK, *Amazon* sells 90 % of all e-books (Cookson 2012).

13.11.6 Price-check in Brick-and-Mortar Stores

To exploit its price leadership over most store-based retailers and further stimulate the trend towards "showrooming" (see Chap. 5), *Amazon* launched a price-check app in 2011. Basically, customers can **scan a product barcode** in a store (or perform an image, text or voice search) and the price-check app will display price comparisons at *Amazon*, product descriptions and product reviews.

To promote its price-check app, *Amazon* even initially offered a 5 % discount if the purchase was performed via the price-check app. In addition to the obvious benefit that this promotes showrooming and **price-comparison** with *Amazon* (which it is likely to win in most cases), it also provides *Amazon* with valuable pricing information. As *Amazon* itself states, the in-store prices that customers submit in price-check are used to ensure the best prices by *Amazon*. Thus, in addition to permanent price-monitoring of its online competitors (as described earlier in this chapter), *Amazon* also gathers pricing information about store-based retailers to align its own prices.

13.11.7 AmazonBusiness: Specific Prices for Business Customers

In 2012, *Amazon* launched *AmazonSupply*, a platform targeted at business customers with additional specific product lines (e. g., protective gear or laboratory equipment). In spring 2015, *AmazonBusiness* was launched and *AmazonSupply* was merged into it. *AmazonBusi-*

ness offers substantially more products than *AmazonSupply* did. This move to target business customers fits well with the trend of **"retail to business" (R2B)** discussed in Chap. 7.

Only business customers can purchase products via *AmazonBusiness*. Registering customers must prove they really are a business (usually via a tax identification number). The business account is then verified by *Amazon*, after which the customer receives a targeted retail marketing mix. This involves a number of products available exclusively to business customers, many business-specific services (e. g., the ability to create multi-user accounts and specific order approval workflows for companies) and also "business pricing".

Business pricing is when certain price discounts are only available to registered business customers and can only be seen by registered business accounts (making it easier for a supplier to charge lower prices because other customer segments cannot see these prices). This is a new form of **price differentiation** on *Amazon*.

AmazonBusiness also lets its customers easily compare prices from multiple suppliers on a single page.

13.11.8 Summary and Outlook

Amazon uses a wide array of pricing strategies and concepts in its online shop, from general low-price positioning to highly dynamic, competition-oriented pricing and lock-in effects with concepts similar to loyalty programmes such as *Amazon Prime* and the penetration pricing strategy for the *Kindle* e-reader, which is sold at cost to drive sales of online content.

Even more facets of *Amazon's* pricing could be described. For example, *Amazon* has a huge influence on the book market and on publishing houses, with intense public conflicts on book prices with publishing houses and authors who fear that *Amazon's* prices will undermine literature and the relationship between authors and publishers. *Amazon* has used its enormous market power in these conflicts, e. g., disadvantaging books from publishing houses that did not agree to its practices. The question of whether books should be sold via an agency agreement where publishers have more control over prices or whether *Amazon* should be allowed to start price wars and sell books at huge discounts has still not been fully solved.

Amazon constantly tests new pricing initiatives. For example, as a further part of its competition-based pricing, *Amazon* **price matches** purchases of TVs and mobile phones with selected other retailers, something it does not do for other product categories. One of the more recent features, introduced in the Q4 of 2014, is a "**make your offer**" option on selected items, which allows customers to negotiate a lower price from third-party sellers. This is particularly targeted at one-off items (that are unique and might not have a clear market price) like fine arts, where *Amazon* wants to counter the pricing options at *Ebay* or *Priceline*. This feature also provides third-party sellers with more flexible pricing and customer interaction while still dealing on the *Amazon* platform, thus ensuring sales commissions for *Amazon*.

In conclusion, *Amazon* provides an example of many different pricing tactics. Given the dynamics of the company, this is likely to remain the case in the future.

Questions

1. *Amazon's* dynamic pricing can be seen as an extreme case of high-low pricing policy. From this perspective, discuss the advantages and disadvantages of this pricing strategy.
2. *Amazon* intends to be a price leader in certain product groups. At the same time, it provides a marketplace for third-party sellers. Investigate how *Amazon's* price compares to those of its third-party sellers for some well-selling items. No matter whether *Amazon* is cheaper or not, conflicts may arise. Discuss these potential conflicts on the basis that Amazon is a retailer and a marketplace provider simultaneously.
3. Discuss the role of delivery fees in *Amazon's* pricing.

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Marketing Communication 14

Abstract

Marketing communication is an important element of the retail marketing mix and involves all instruments and activities used to communicate with the customer. While retailers' marketing communication focuses on customers, notably on consumers, market communication or corporate communication targets all stakeholders, i. e., shareholders, suppliers, trade unions, non-profit organisations, employees, etc., and includes public relations or corporate affairs, among others. This chapter focuses on marketing communication and describes the wide and growing range of media and communication elements and the importance of building an integrated retail marketing communication strategy.

14.1 Universe of Communication Elements and Role of Retail Communication

Even as late as the end of the twentieth century, retail communication has traditionally been fairly simple. "Local newspaper advertising was the primary medium, and the message was typically oriented toward providing incentives – usually a special price – to motivate customers to visit the store" (Levy et al. 2014, p. 418). Retail communication was dominated by traditional advertising, especially **mass media advertising**, such as newspapers, magazines, direct mail, radio and television (see Table 14.1).

Nowadays, retail companies – as well as companies from other industries – can choose from a wide range of media, e. g., traditional media and new electronic and social media. A comparison between 2003 and 2013 shows the shift from traditional to new media among US retailers.

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Table 14.1 Share of advertising media spending of US retailers in 2003 and 2013. (Advertising Age and Kantar Media 2013, p. 10; Kantar Media 2014, p. 1)

Media	2003 (Use in %)	2013 (Use in %)
Newspaper	39.1	25.4
Television	33.5	42.1
Radio	12.4	10.7
Magazine	8.6	7.8
Internet	4.8	9.9
Outdoor	1.6	3.5

The world of retail communication has changed dramatically. As well as a wide range of communication and media activities, retail marketing communication plays many different roles. Different dimensions can be distinguished:

- A retailer's communication programme informs customers about its merchandise, services and prices to motivate customers to visit the store and buy (**transactional selling**) and/or to stimulate repeat visits and develop customer loyalty (**relational selling**) through customer relationship marketing (CRM) (see Chap. 16).
- A retailer's communication programme supports its **positioning** and helps create and maintain a retail image or a **retail brand** (see Chap. 9). This goal is closely linked to market or corporate communication but addresses different stakeholders, e. g., to communicate the retailer's responsible behaviour (see Chap. 10).

There have been numerous overlapping developments within the world of communication:

- from traditional media to new media, e. g., online media, such as websites, e-mail, mobile communications, and social media, such as blogs and platforms like Facebook, YouTube, Twitter,
- from above-the-line, e. g., traditional advertising in mass media, to below-the-line, e. g., special events or event sponsorship, usually in the cultural, sports or entertainment sectors,
- from one-way communication, e. g., via traditional media, to interactive communication or two-way dialogues, e. g., via social media,
- from unpersonalised messages, e. g., in television spots, to personalised messages, e. g., mobile messages delivered to smartphones.

The world of retail communication is even more complex. Communication here involves not only traditional and new media, but also characteristics unique to retailers: in-store marketing or design elements, such as overall atmosphere (**retail atmospherics**)

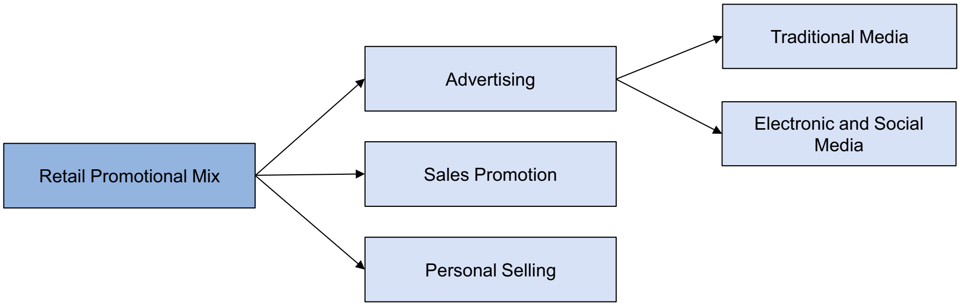

Fig. 14.1 Retail promotional mix

or environmental elements, such as eye-catching point-of-sale displays (see Chap. 15) and personal selling, i. e., face-to-face communication with customers or prospective customers.

The following discussion focuses on **retail promotions**, especially advertising, sales promotions and personal selling. These elements make up a retailer's marketing communication programme. **Public relations** (or corporate affairs) is excluded, because it is targeted at all stakeholders rather than just the "target market". The focus will be on transactional factors; relational factors will be discussed in Chap. 16 (Customer Relationship Management), although there is a fuzzy boundary between the two.

Fig. 14.1 systematises the huge portfolio of marketing communication elements, i. e., the **retail promotional mix**. This figure highlights the challenge of combining the variety of communication elements into an **integrated communication programme**.

14.2 Retail Promotional Mix

14.2.1 Advertising

Advertising traditionally falls into one of the following categories (Dahlén et al. 2010, pp. 277–280; Berman and Evans 2013, p. 510):

- Non-personal communication, i. e., a standard message, which cannot be adapted to individual customers, is transmitted to the entire audience,
- one-way or asymmetrical communication,
- communication delivered indirectly through a medium like TV or Internet,
- communication paid by the initiating company as part of public relations, rather than publicity, although the two are usually complimentary.

Advertising is primarily used to increase customer traffic and short-term sales and to inform customers about products and services. The major advantages of advertising are the ability to attract a relatively large audience with relatively low costs per viewer, reader

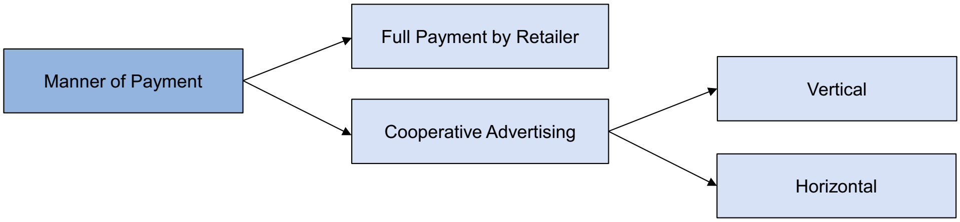

Fig. 14.2 Method of payment for retail advertising. (Berman and Evans 2013, p. 516)

or listener. The major disadvantages for retailers are the standardised nature of most messages, which lack flexibility, and losses due to a **scatter-shot approach** because of large geographic areas (Berman and Evans 2013, pp. 512–513).

Following Berman and Evans (2013, pp. 515–516), retail advertisements can be classified by content (e. g., competitive message, reminder message) and payment method (see Fig. 14.2).

Payment methods are retailing specific. **Vertical cooperative advertising** lets a manufacturer and a retailer jointly transmit a message and split the costs based on an advertising agreement. In **horizontal cooperative advertising**, used by marketing and buying groups of independent retailers or retailers in a shopping centre (in a mall or business district), several retailers share advertisements.

The overall importance of advertising in retailing is presented in Table 14.2.

Table 14.2 Selected US advertising-to-sales ratios by type of retailer in 2013. (Schonfeld & Associates 2013)

Type of Retailer	Advertising Spending as Percentage of Sales (Turnover)
Jewellery Stores	6.0 %
Department Stores	4.5 %
Hobby, Toy and Game Shops	3.6 %
Apparel and Accessories Stores	3.5 %
Shoe Stores	3.0 %
Radio, TV and Consumer Electronics Stores	2.5 %
Family Clothing Stores	1.9 %
Lumber and other Building Materials	1.5 %
Auto and Home Supply Stores	1.4 %
Grocery Stores	0.8 %
Drug and Proprietary Stores	0.5 %

14.2.2 Traditional Media

Traditional media are used in **mass media advertising**. Such advertising "entails the placement of announcements and persuasive messages [...] that seek to inform and/or persuade members of a particular target market or audience about [...] products, services, organizations or ideas" (Levy et al. 2014, p. 419). Traditionally, mass advertising has used newspapers and magazines (e. g., freestanding inserts), television (television commercials or spots) and radio (radio commercials or spots).

One way to use mass advertising to target customers directly without personalising the message is **direct mail.** Direct mail involves brochures, catalogues, advertisements or other printed promotional material, e. g., leaflets or flyers, delivered directly to the customers' homes, usually through the mail. "With the advent of loyalty and CRM programs, retailers are now able to personalise their direct mail to all customers, to a subset of the customers according to their previous purchases, or even on a personalized basis to individual customers" (Levy et al. 2014, p. 420).

The most common traditional media are presented in Table 14.3, comparing market coverage and suitability.

Table 14.3 Comparison of traditional advertising media. (Adapted from Berman and Evans 2013, p. 514)

Medium	Market Coverage	Particular Suitability
Daily Papers	Single community or entire metro area, local editions may be available	All larger retailers
Weekly Papers	Single community usually, may be a metro area	Retailers with a strictly local market
Shopper Papers	Most households in one community, chain shoppers can cover a metro area	Neighbourhood retailers and service businesses
Phone Directories	Geographic area or occupational field served by a directory	All types of goods and service-oriented retailers
Direct Mail	Controlled by the retailer	New and expanding firms, those using coupons or special offers, mail order
Radio	Definable market area surrounding the station	Retailer focusing on identifiable segments
TV	Definable market area surrounding the station	Retailers of goods and services with wide appeal
Transit	Urban or metro community served by transit system	Retailers near transit routes, especially those appealing to commuters
Outdoor	Entire metro area or single neighbourhood	Amusement and tourist-oriented retailers, well-known firms

Table 14.3 (*continued*)

Medium	Market Coverage	Particular Suitability
Local Magazines	Entire metro area or region, zoned editions sometimes available	Restaurants, entertainment-oriented firms, specialty shops; mail-order firms
Flyers/ Circulars	Single neighbourhood	Restaurants, dry cleaners, service stations, and other neighbourhood firms

14.2.3 New, Electronic and Social Media

In recent years, new forms of media, such as electronic, online, and mobile media and social media have emerged and fundamentally changed how consumers communicate among themselves, with companies or institutions and how they expect to be informed or addressed by companies. While the marketing communications debate used to centre on traditional advertising vs. online advertising, especially **Internet** advertising, new methods of blending available media forms have begun to explode (**hybridisation of media**). “Hybrid media is the strategic use of traditional and new media and marketing communication tools to communicate the message in a more efficient way” (Eagle et al. 2015, p. 228).

New forms of **experiential marketing** or **augmented reality marketing** have evolved which dissolve the boundaries between advertising, sales promotion, in-store marketing and even personal selling. These emerging trends will be discussed in the next section.

Websites and e-mails can nowadays be regarded as “traditional new media”. Retail companies use their websites to inform customers about their products and services, store locations, shopping hours and events and to sell merchandise. “Many retailers also devote areas of their websites to community building. These sites offer an opportunity for customers with similar interests to learn about products and services that support their hobbies and to share information with others. Visitors can also post questions seeking information and/or comments about issues, products and services” (Levy et al. 2014, p. 425). To improve the visibility or accessibility of their websites, retailers are using **search engine marketing** or tools such as **search engine optimisation** (SEO). Table 14.4 shows the ranking of retail websites in the United Kingdom by visitors.

E-mail, i. e., sending messages to individuals over the Internet, has changed in recent years from an impersonal medium, used to inform customers of merchandise, services, prices and so on, to a personalised form of communication using **customer databases** to address consumers with highly personal messages. E-mail is also an interactive medium, allowing the recipients to respond.

Access to websites and databases and receiving or sending e-mails has been facilitated by the enormous penetration of wireless handheld devices, such as cellular telephones or smartphones, enabling mobile forms of communications, including **mobile shopping** or **M-commerce** (mobile commerce; see Chap. 4). A new mobile advertising tool called **location-based services** is subject to controversy, especially because of data protection concerns.

Table 14.4 Retail websites ranked by visitors in the United Kingdom in May 2014. (Mediatel 2014)

Website	Visitors
Amazon	16.0 million
Ebay	15.2 million
Tesco	6.7 million
Argos	5.3 million
ASDA	3.9 million
Gumtree	3.4 million
Marks & Spencer	3.2 million
Sainsbury's	2.5 million
Groupon	2.4 million
John Lewis	2.3 million

Location-based service technology allows retailers to locate a consumer's position and send them tailored, localised content to entice them into their stores (Levy et al. 2014, p. 426; Percy 2014, p. 139). *Foursquare* is one of the most famous location-based service providers. It recommends users places, e. g., restaurants and shops, based on users' taste, previous ratings for similar places and the opinions of friends and experts (Foursquare 2015). Another form of mobile advertising is the use of **QR codes** (quick response). QR codes are two-dimensional matrix codes which can be translated into marketing messages, e. g. product videos, by scanning them via a smartphone camera using QR code reader software (Ryu 2013, p. 19).

"Perhaps the fastest growing area of new media is what has become known as social media. Not so many years ago there was no *YouTube*, *Twitter* or *Facebook*" (Percy 2014, p. 135). In 2014, *YouTube* had over 1 billion active users, *Twitter* had 288 million monthly active users, and *Facebook* had over 1.39 billion monthly active users (Facebook 2015; Twitter 2015; YouTube 2015). Kaplan and Haenlein (2010, p. 61) define **social media** as "a group of Internet-based applications that build on the ideological and technical foundation of Web 2.0, and that allow the creation and execution of User Generated Content". According to Mayfield (2008, p. 5), **social marketing** has the following features: user participation, conversation and openness with hardly any barriers to access and a high level of connectedness by using links to other resources, sites and people.

Retailers use social media to initiate a proactive dialogue with their customers. "When a retailer provides content on a social media website, people often begin sharing and commenting on it" (Levy et al. 2014, p. 427). At the most basic level, but still highly relevant, are **blogs** or **microblogs** like *Twitter*, where an individual or group post their opinions on a webpage. "A well-received blog can communicate trends, announce special events, and create **word of mouth**, which is communication among people about an entity such as a retailer or a product or service" (Levy et al. 2014, p. 429). Messages from customers can also be spread exponentially throughout social networks. This is known as **viral marketing**.

Fig. 14.3 Example of a retailer's social media use. (IKEA 2015a)

Social media also lets companies monitor trends and react to consumer demand. "For example, sentiment mining is a process whereby retailers can tap into a variety of online chat formats to collect consumer comments and then analyze these data to identify customers' overall attitudes and preferences for products and advertising campaigns" (Levy et al. 2014, p. 427). **Sentiment mining** provides qualitative data which provides new insights into what consumers think.

Fig. 14.3 shows the *Facebook* presence of *IKEA* as an example of how retailers use social media. The Swedish retailer uses *Facebook* as an information platform for new products and special offers but above all to stay in contact with its customers. Thus, customers' comments are answered by *IKEA* staff (IKEA 2015a). Social media is highly relevant in all retail sectors. The US retailer *Walmart* uses its *YouTube* presence to not only inform customers about the company and its products and campaigns but also about other topics of interest, e. g., household DIY tips (Walmart 2015). The *Twitter* presence of the US DIY chain *The Home Depot* encourages and inspires people to renovate and redesign their homes (The Home Depot 2015).

In terms of market coverage and suitability, there are no differences between new and social media: Unlike traditional advertising media, they both have global coverage and are suitable for all types of retailers (see Table 14.3).

14.3 Sales Promotions

"Sales promotion is defined along the lines of any direct purchasing incentive, reward, or promise that is offered to the target audience for the purpose of making a specific purchase or taking a specific action that will benefit those responding to the promotion" (Percy

Fig. 14.4 German food retailer REWE's sponsorship of Bundesliga team 1. FC Köln. (1. FC Köln 2015)

2014, p. 103). These incentives or excitement-building programmes are mostly short-term in nature, i. e., they encourage customers to purchase a product. Besides this transactional approach, sales promotions are integrated into **long-term customer relationship management programmes** to build customer loyalty.

The instruments used in sales promotions can be classified into traditional promotion tools, special events or event sponsorship, and new forms of hybrid media.

Traditional sales promotions use, e. g., **coupons**, which offer a discount and are issued in newspapers, through the mail or over the Internet; **rebates**, a form of discount, refunded by a manufacturer; **premiums**, which offer an item for free, and **samples**, which let customers try a product (see Chap. 13). **E-coupons** are increasingly relevant in new media. Coupons in paper format, especially as newspaper free-standing inserts, have the disadvantage of lacking personalisation. All consumers receive the same large list of coupons regardless of their specific interest, diminishing the effectiveness of the coupon campaign (Cameron et al. 2012, p. 333). In contrast, e-coupons "from the Internet, or coupons activated at the point-of-purchase using smartphones have the potential for tight targeting" (Percy 2014, p. 107).

Special events or event sponsorship, a below-the-line communication tool, include a lot of quite different techniques where retail companies provide support for a seasonal, cultural, sporting or musical activity (see, e. g., Fig. 14.4).

The growing field of **hybrid media**, used as a sales promotion tool, includes a wide range of communication activities such as games containing embedded advertising or games which are created with the sole purpose of promoting the retailer's brand or assort-

Fig. 14.5 IKEA's catalogue app as an example of augmented reality techniques. (IKEA 2015b)

ment ("**advergames**") or the merging of live reality and computer-based information in the form of "**augmented reality**" (see Eagle et al. 2015, pp. 227–237). Augmented reality combines reality and virtuality on screen, e. g., via smartphone cameras.

Product placements in video games ("in-game advertising") "provide virtual interaction with a product or a brand name. Similar to traditional product placement, the aim is to create an emotional connection between the game, the gamer and the brand featured" (Eagle et al. 2015, p. 233). Products and games are linked by placing the product into the game environment or by developing themed video games which, "for example, […] feature a well-known brand character as a main character of the game" (Eagle et al. 2015, p. 233).

"Augmented reality combines live, direct views of the real world with computer generated elements that 'augment' – or enhance – the reality, for example by providing additional information in real time" (Eagle et al. 2015, p. 235). Fig. 14.5 shows Swedish retailer *IKEA's* catalogue app as an example. This technique can also be used in in-store marketing and in personal selling.

14.4 Personal Selling

The main feature of personal selling is simultaneously its most important advantage and disadvantage: Personal selling involves face-to-face or **oral communication** with customers or prospective customers. The personal and interactive nature of this communication lets retailers adapt messages to meet customers' individual needs, i. e., to personalise the way a customer is addressed. Otherwise, the costs of interacting with customers are generally high.

As a result, personal selling is used in specific retail formats, e. g., in specialty stores and department stores with a service-orientated positioning and target image rather than in price-orientated formats, such as hard discounters or hypermarkets (see Chap. 2 and 3).

True **sales employees** – in contrast to staff who set up or stock shelves (merchandise employees) – are order-winning salespersons, "actively involved with informing and persuading

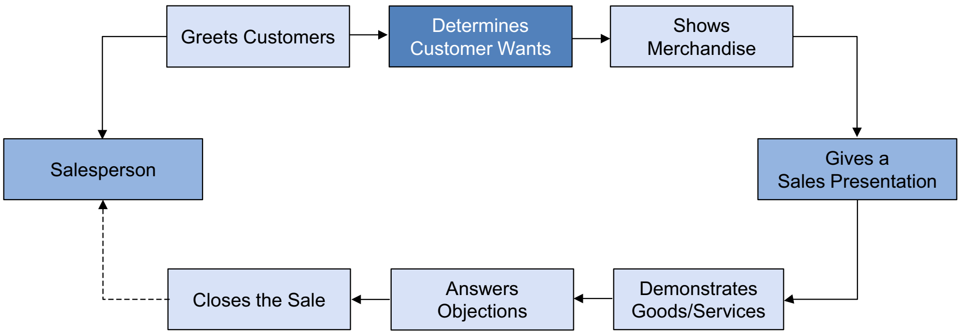

Fig. 14.6 Typical personal selling functions. (Berman and Evans 2013, p. 520)

customers and in closing sales" (Berman and Evans 2013, p. 519) (see Fig. 14.6). They have direct personal contact with customers and are therefore key to increasing **customer satisfaction** or **customer enthusiasm**. Because there is often a standoff between retail companies in terms of assortment, price, etc., personal selling is a significant way to reach a **unique selling proposition** (USP). Sales employees are the most important "brand ambassadors".

In some retail formats, e. g., specialty stores, such as perfumeries or department stores, salespeople from manufacturers provide personal selling activities for their brands or products. Here, a manufacturer's sales promotion activity is integrated into the retailer's personal selling approach.

14.5 Developing an Integrated Marketing Communication Programme

The overall goal behind a retailer developing a marketing communication programme is to combine advertising, sales promotions and personal selling instruments to create a consistent and holistic image that can be coordinated with other marketing activities such as in-store marketing or customer relationship management. The positioning and retail branding strategy must be supported by all marketing communication activities – an **integrated marketing communication** programme is necessary.

Following this strategic approach, four steps can usually be distinguished for developing and implementing a marketing communication programme (see, e. g., Levy et al. 2014, pp. 436–447):

- Establish communication objectives,
- establish budget,
- allocate budget,
- implement and evaluate programmes.

However, these are not retail-specific and therefore will not be discussed in detail.

14.6 Conclusion and Outlook

Emerging electronic and social media, new ways of blending conventional communication tools with online or Internet communication, the merging of social media and real-life experiences and the merging of live reality and computer-based information not only "augment" retailers' communication portfolios; they dissolve boundaries within the field of marketing communication, i. e., between advertising, sales promotion and personal selling, and between conventional marketing fields, such as in-store marketing and customer relationship management. Even the boundaries between formats, such as store-based retailing vs. online retailing, are becoming relative.

Further Reading

- Dahlén et al. (2010). *Marketing communications: A brand narrative approach*. Chichester: Wiley & Sons, pp. 274–288.
- Eagle et al. (2015). *Marketing communications.* London et al.: Routledge, pp. 201–243.
- Percy (2014). *Strategic integrated marketing communications* (2nd edn.). London et al.: Routledge, pp. 3–25.

14.7 Case Study: Coop Switzerland

14.7.1 Profile, History and Status Quo

In the middle of the 19th century, consumption habits in Europe changed radically. Factory workers had no way to care for themselves. As a result, consumer cooperatives were established in many European countries, selling food products to their members at reduced prices. In 1890, five Swiss cooperatives confederated to form the "*Verband schweizerischer Konsumvereine (VSK)*" [Association of Swiss Cooperatives]; by the end of the year, the association had 43 members. In the following years, the number of members increased, and the *VSK* expanded its infrastructure by, for example, building its own warehouse, printing office and shoe factory. In 1969, the *VSK* was renamed *Coop Switzerland*[1]. Since then, *Coop* has been restructured several times by merging the participating cooperatives. Finally, in 2001, project CoopForte united the fourteen regional cooperatives, and *Coop Switzerland* became a single cooperative. Throughout its history, *Coop* has established companies and store formats, e. g., *Coop City* and *Coop Bau + Hobby* [Building and Hobby], and acquired numerous companies across a variety of sectors, e. g., *Christ Watches & Jewellery, Dipl.*

[1] In addition to the explicitly cited sources, sources used for this case study include the website http://www.coop.ch, press releases and various annual and CSR reports.

Ing. Fust AG, The Body Shop Switzerland AG, Transgourmet Holding S.E., Pearlwater Mineralquellen AG and *Nettoshop AG.*

Today, *Coop* is the second largest retail company in Switzerland. The *Coop Group* is active in retail, wholesale and production. Fig. 14.7 illustrates the *Coop Group's* various business areas.

In 2014, *Coop Group* had approximately 2.5 million members and net sales of approximately 27.2 billion CHF. Its network encompasses 2000 retail outlets across Switzerland, including convenience stores, small and large supermarkets, hypermarkets, department stores, over 100 cash and carry markets in Switzerland and Europe and online shops in a variety of sectors. Of *Coop's* 77,087 employees, 46,268 work in retail and 30,819 in wholesale and production. Table 14.5 provides an overview of these key indicators.

For decades, *Coop* has been establishing and raising minimum standards on its standard product range, working on sustainable product innovations and environmental production in its production facilities and stores. So, for example, *Coop* not only sells well-known manufacturer brands, but also a large variety of environmentally friendly, humanely and socially responsibly produced products under own-label sustainability brands or quality labels such as *Coop Naturaplan*, *Pro Montagna*, *Coop Naturaline*, *Fairtrade Max Havelaar* and *Bio Suisse*. As a result, *Coop* has received numerous national and international

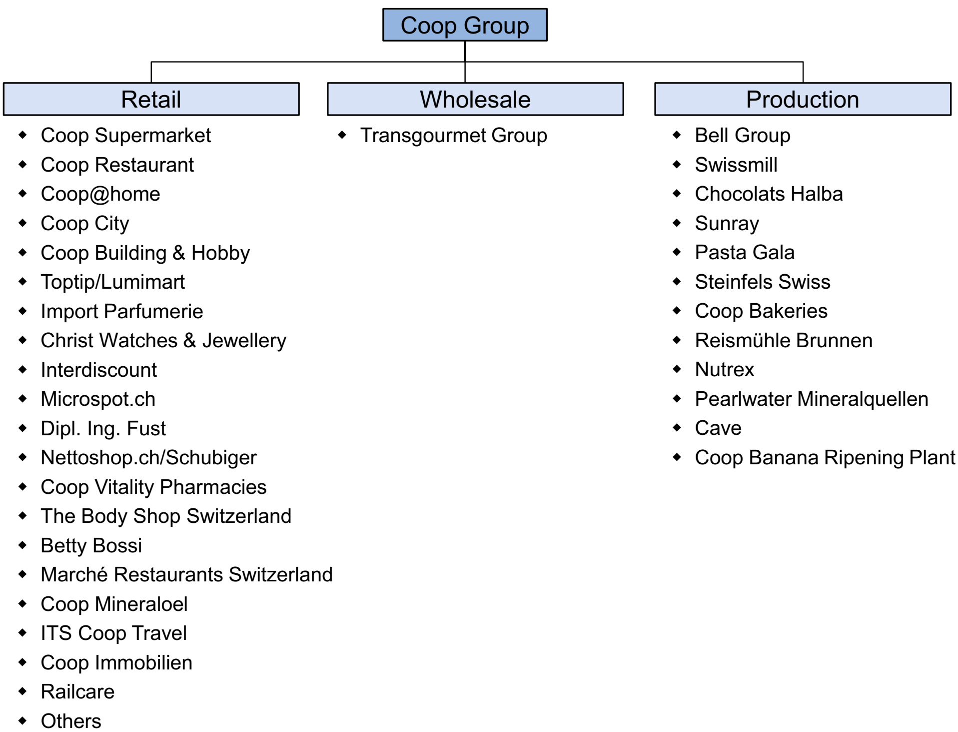

Fig. 14.7 *Coop Group's* business areas. (Coop 2015a)

Table 14.5 Coop Group's key indicators. (Coop 2015a)

	2013 Fiscal Year (in million CHF)	2014 Fiscal Year (in million CHF)
Total Net Sales	26,967	27,163
Retail Net Sales	17,379	17,718
Wholesale and Production Net Sales	11,329	11,193
Employees	74,955	77,087
Number of Retail Outlets	1933	1971
Number of Wholesale and Production Units	229	199

awards, including "World's Most Sustainable Retailer" (2011), the EHI Energy Management Award (2012), the Swiss Solar Award (2012), the Zurich Climate Prize (2013; 2014) and the European Solar Prize (2014).

14.7.2 Coop's Promotional Mix

Coop Switzerland uses a broad range of marketing communication media, including newspapers, TV and the Internet. The following section will discuss *Coop's* promotional mix in detail.

14.7.2.1 Traditional Media

US retailers now spend significantly less on traditional marketing communication media such as newspapers and magazines compared to TV and Internet. However, for *Coop*, traditional media still plays the most important role in the promotional mix.

Coop publishes three weekly newspapers: *Coopzeitung* (formerly *Genossenschaftliches Volksblatt*) and *Coopération* since 1904 and *Cooperazione* since 1906 (see Fig. 14.8). Thus, *Coop* covers the three main languages in Switzerland: German, French and Italian. With more than 3.5 million readers, these three newspapers are the most-read printed products in Switzerland. They not only inform people about *Coop's* product range but also cover a broad range of topics, e. g., leisure, family and culture. Although the three newspapers have the same cover, layout and main topics, their content is not identical. As well as the print versions, *Coopzeitung*, *Coopération* and *Cooperazione* are also available as ePapers.

Coop also advertises via TV. In September 1977, the *Coop Mittwochsstudio* [Coop Wednesday Studio] was broadcast for the first time. Every Wednesday, immediately before *Tagesschau*, Switzerland's main evening television news, two moderators and

Fig. 14.8 *Coop's* weekly newspapers. (Coopzeitung 2015; Coopération 2015; Cooperazione 2015)

studio guests presented different *Coop* products and campaigns and gave household advice and tips. Later the show was expanded to become a cooking show. Due to changes in target groups as part of *Coop's* new advertising presence "für mich und für dich" [for me and for you], the show was cancelled at the end of 2005. In September 2002, *Coop* piloted its own daily TV midday magazine *Telescoop* on *SF1* and *TSR1*. It was a mix of cooking show, infomercial, entertainment, advertisement and game. Channel announcements were made via the *Coopzeitung* and in stores. On average, 20 % of midday TV viewers watched *Telescoop*. In 2005, due to high contact costs and changed goals, *Coop* decided to cancel *Telescoop* and to focus on short TV spots for different target groups.

14.7.2.2 New, Electronic and Social Media

Coop operates several websites: its main website www.coop.ch and one for each subsidiary. Like the weekly newspapers, the websites are available in Switzerland's most important languages: German, French and Italian (see Fig. 14.9). The main website itself has several functions. First, it serves as an information platform to inform people about the company, its products and services, store locations, opening hours and current campaigns. In addition, it serves as a link between *Coop* and its subsidiaries and their websites. Thus, it is possible to reach every *Coop* online shop via *Coop*'s main website. All websites are also accessible via apps for smartphones or tablets.

Coop displays a somewhat ambivalent attitude towards social media, currently only using it in a selective and campaign-related way. On *Coop's* main website, users can share company information with friends via *Facebook*, *Twitter* and other platforms. However, the *Coop Group* does not have its own *Facebook* presence or *YouTube* channel. *Coop* uses *Twitter*, but with only 1024 followers the resonance of this social media presence is quite low. In contrast, some of *Coop*'s subsidiaries use social media extensively and professionally, e. g., *Fust* and *The Body Shop Switzerland* (see Fig. 14.10).

Fig. 14.9 *Coop's* main website. (Coop 2015b)

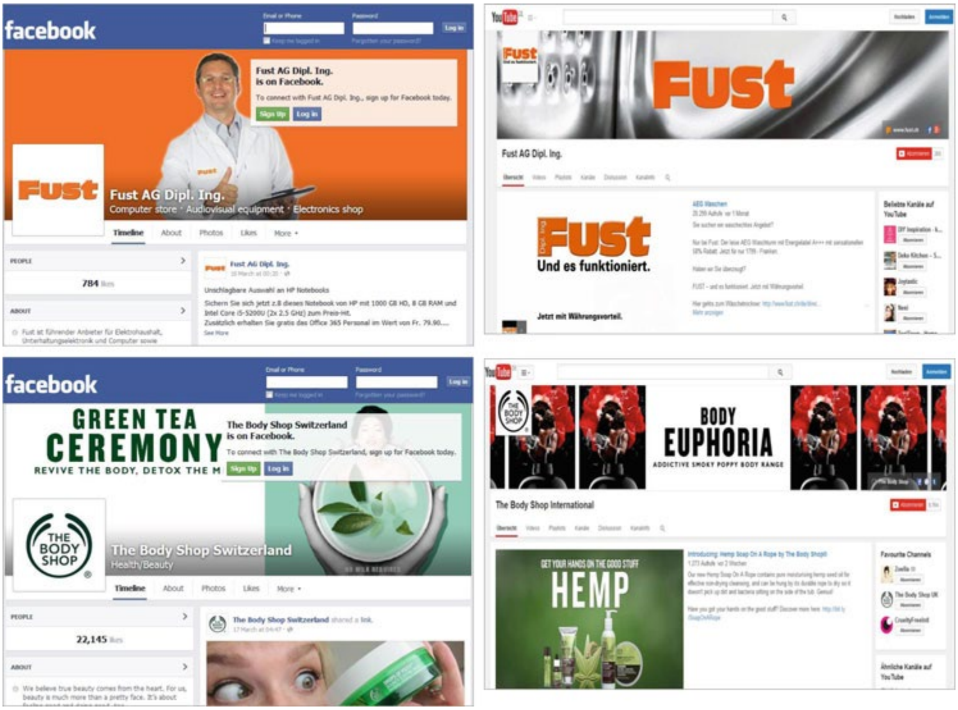

Fig. 14.10 Examples of social media use by *Coop* subsidiaries. (Fust 2015a; 2015b; The Body Shop Switzerland 2015a; 2015b)

14.7.3 Coop's Sales Promotions

As mentioned above, sales promotions can be either short-term initiatives, simply encouraging customers to purchase a product, or long-term customer relationship management programmes for building customer loyalty.

Coupons are a traditional sales promotional tool which *Coop* uses for short-term promotions, e. g., 20 % off the whole *Lumimart* range. However, *Coop* focuses more strongly on long-term customer relationship management programmes like the *Coop Supercard*. Customers collect points with each purchase, then use these points to pay for further purchases. They can also choose premium products from the *Supercard* premium shop and benefit from exclusive sales discounts.

Coop has adopted a uniform sponsorship approach throughout Switzerland. It supports projects in the following sectors: sport, culture, physical activity and nutrition, human welfare and environment, kids and family. For example, *Coop* has supported top-class beach volleyball for several years and open air cinemas in the summer (see Fig. 14.11).

Fig. 14.11 *Coop's* sponsorship of sporting and cultural activities. (Coop 2015c)

14.7.4 Summary and Outlook

This case study presented the promotional mix of Swiss retailer *Coop* in detail. *Coop* mainly uses traditional media, like the *Coopzeitung*, for marketing communication, despite an increasing number of Internet users in Switzerland. However, with 3.5 million readers, this approach still meets with great success. Nonetheless, *Coop* also uses new media like websites and mobile apps to inform people about the company, products, services and other relevant data. *Coop's* management currently view social media with scepticism. *Coop* does not have a social media presence for the company as a whole, and any social media use is sporadic and campaign related.

In light of the increasing number of Internet and social media users, especially among young Swiss people, it is unclear whether *Coop* needs to rethink its social media position or whether a promotional mix with a continuing high share of traditional media supplemented by new media is sufficient.

Questions

1. Identify and explain the strengths and weaknesses of different advertising media from a retail perspective.
2. Should *Coop* rethink its attitude towards social media for the company as a whole? In answering this question, compare *Coop's* social media strategy with that of other retailers.
3. Today, the *Coop Group* is active in a variety of retail sectors, including food, DIY and consumer electronics. Identify and explain the advantages and disadvantages

of a standardised promotional mix across all retail sectors versus a differentiated marketing communication strategy. Apply your results to *Coop's* current marketing communication strategy for its different subsidiaries.

- See, e. g., Berman and Evans (2013).
- Check the activity of different retailers on social media platforms like *Facebook, Twitter* and *YouTube* in terms of frequency, attractiveness and number of users.

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In-store Marketing

15

Abstract

This chapter will highlight the importance of the store environment as part of the retail marketing mix. Options for store layout, the determinants and influence of store atmosphere and the allocation of space to merchandise are described.

15.1 Relevance of In-store Marketing

In all forms of retailing – store retailing as well as non-store retailing such as Internet shops – the store environment is one of the most important determinants of customers' **store choice**. It also exerts a very strong influence on shopping behaviour in the store. Many buying decisions are made at the point of sale, with a frequently cited figure claiming that this in-store decision rate is about 70 % for fast-moving products (Gröppel-Klein 2012, p. 646). Thus, professional marketing within a store can increase sales tremendously (e. g., by pushing impulse purchases), and can guide consumers to specific products and brands. In-store marketing (or "point-of-sale marketing") refers to the use of information and communication-related retail marketing instruments within a retailer's outlets. This includes the structure of a store and its basic layout, the presentation of goods and allocation of merchandise space and measures for influencing store atmosphere, including in-store events (Gröppel-Klein 2012, p. 645). **Visual merchandising** is a frequently used term in the context of in-store marketing. It refers to the way products are presented in a retail outlet. While this expression is often used with a focus on merchandise display (e. g., choice of fixtures and method of product presentation), it also relates to overall store design, store layout and other facets of the store environment

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(Varley 2014, pp. 220–224). Therefore, it is often used synonymously with the design component of in-store marketing.

Two basic objectives of in-store marketing are:

- To facilitate customers' search processes, i. e., to allow **easy internal orientation** and
- To create a positive **store atmosphere**, i. e., to evoke positive emotions in consumers while shopping.

Both goals are important to different degrees in different stores and for different consumer segments. A distinction can be drawn between two different types of shopping processes and motives (Kaltcheva and Weitz 2006):

- **Task completion**, i. e., buying needed items (**utilitarian motives**).
- **Recreational shopping**, i. e., spending leisure time shopping and browsing through stores (**hedonic motives**).

When targeting task completion, retailers should focus on easy orientation and supporting the consumer search process. When targeting recreational shoppers, however, efforts should be shifted towards store atmosphere. In-store marketing must always consider both factors. Even in everyday routine shopping for task completion, store atmosphere is important because it can positively influence customers' moods. And easy orientation also plays a role in recreational shopping, because consumers prefer to feel secure and self-confident when shopping.

15.2 In-store Marketing and Consumer Behaviour

The model most frequently used to explain the influence of store environment on customer behaviour was developed by Donovan and Rossiter (1982), based on earlier contributions to **environmental psychology**. They concluded that the stimuli presented in a store and customers' personality variables combine to influence customers' affective and cognitive responses to the store environment. They found that two main dimensions must be considered as intermediating variables when evaluating the effects of store environment:

- **Pleasure** (level of positive emotions).
- **Arousal** (feelings of excitement and stimulation).

Together, these two dimensions affect customer response behaviour, i. e., the degree of **approach behaviour** or **avoidance behaviour**. Studies have frequently shown that increased **pleasure** also increases the duration of a store visit, amount of unplanned purchasing, willingness to talk to store employees and intent to return. **Arousal** has optimal levels. Very low levels of arousal result in a lack of interest, while very high levels of arousal can lead to "panic" and encourage customers to avoid a store or leave a store as quickly as possible. While this seldom occurs in marketing, crowded situations such as those found in end-of-season sales or on opening days can create this level of arousal. Thus, the interior design of the store environment should evoke an optimum level of customer arousal. It has frequently been shown that moderate levels of arousal (if the store environment is perceived as pleasant) correspond positively with **approaching behaviour**, i. e., a positive customer response to the environment (Gröppel-Klein and Baun 2001, pp. 412–413).

The level of arousal is determined largely by the store's **information rate**, that is, the novelty (unexpected, surprising and unfamiliar elements) and complexity (number of elements, changes in the setting, etc.) of the overall store environment (Mehrabian and Russel 1974). Arousal theory implies that optimal information rates contain some novelty and complexity to activate the consumer, but also include calming elements. In other words, complexity and novelty are attenuated by giving the consumer familiar cues and signs.

15.3 Store Design and Layout

15.3.1 Overview

A store should be planned to (consciously or unconsciously) direct customer flow in specific patterns, ensuring that customers visit certain important merchandise areas. This should achieve optimum sales-space productivity and stimulate impulse purchases. The retail layout must also be easily comprehensible so that customers can quickly understand and assimilate a route through the merchandise (Gilbert 2003, p. 129).

One core component of store environment design is the macrostructure of elements in the store, i. e., the **store layout**. This layout is represented internally in consumers' minds in so-called **mental maps** of a store. Clear and well-arranged mental maps of a store and knowledge of the locations of specific products, categories, checkouts, etc. have been found to positively influence customers' perceived shopping convenience (Gröppel-Klein 2012, pp. 656–658; Foxall and Hackett 1992, pp. 313–314). Stores use orientation points and areas to help consumers create strong mental maps. The design of paths and crossings, appropriate signage, different colours for different sections, escalators, floor material and so forth can act as clues for customers. Some retailers (e. g., *Toys 'R' Us*) support the development of cognitive maps and the search for specific products by providing visitors with real store maps which visually represent departments and routes.

When designing their store layout, retailers have two basic options, which can also be mixed (see Fig. 15.1; Gilbert 2003, pp. 124–125; Varley 2014, pp. 229–231; Levy et al. 2014, pp. 489–493):

- A **grid store layout** is characterised by long parallel aisles, with merchandise on shelves on both sides. This layout channels customer flow and, although it is often not very stimulating, it is well-suited for shopping trips in which customers need to easily locate certain products and move through the entire store. Self-service is generally

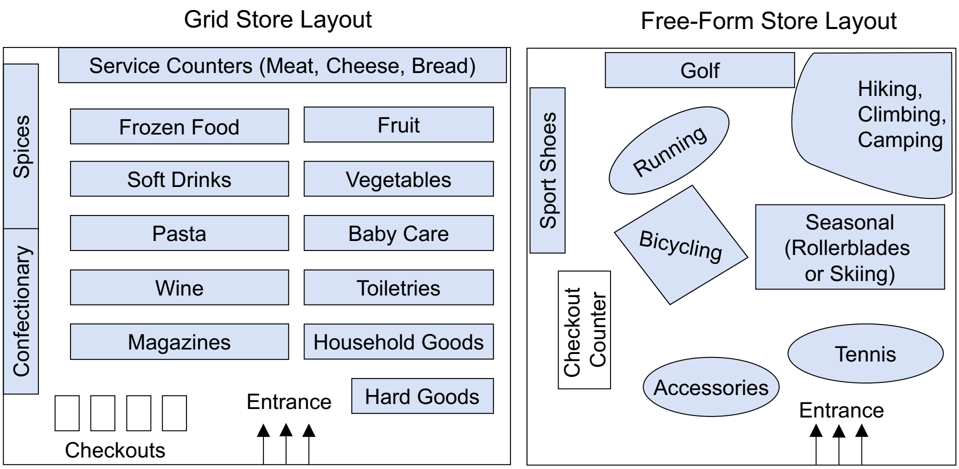

Fig. 15.1 Two basic types of store layouts. (Adapted from Gilbert 2003, pp. 125–127)

easy, and the shopping process is fast and efficient for customers. Space is mostly used. Supermarkets, drugstores and other retailers of fast-moving consumer goods normally adopt this layout.

- A **free-form layout** (also called **free-flow layout**) follows an irregular pattern that allows customers a free choice of movement in certain areas of the store and along certain paths. It allows for more relaxed and unregimented shopping. However, it may require salespeople to help customers find certain products. This style is found in many clothing stores.

There are a number of variations of these basic types. For example, a **loop layout** (also called a **racetrack layout**) provides a major aisle that loops around the store to guide customer traffic around different departments (Levy et al. 2014, p. 492). There is usually a free-form pattern within departments. In an extreme case, a racetrack layout can force a **fully guided customer flow**. This principle is often applied by *IKEA*, where customers have to follow one major path through the entire store, with few possibilities for shortcuts.

Certain store layouts also benefit from use of different fixtures. The most important fixture types are gondolas (shelves), round fixtures (e. g., for hanging clothes), tables (for stacked clothes), dump bins, baskets (for vegetables) and closed counters (e. g., for jewellery). While the grid layout mainly employs shelves, free-form layouts usually have a mix of many different types of fixtures.

15.3.2 Grouping of Store Offerings

Within the store layout, merchandise is grouped together in sections, departments or aisles. Retailers usually use three main types of grouping: item-oriented presentation, theme-oriented presentation and brand-oriented presentation.

- With an **item-oriented presentation**, the most traditional way of displaying merchandise, products are organised by types of items. For example, a fashion retailer might have one area for shoes, one area for trousers and one area for shirts. A DIY retailer might have a shelf for paintbrushes, one for paint, one for wallpapers and so on. While products are easy to find, demand interrelationships are not considered and, therefore, not exploited fully.
- With a **theme-oriented presentation**, merchandise is displayed together according to a specific theme, such as "living in your home" (e. g., furniture, lamps, rugs and accessories), "outdoor" (e. g., backpacks, outdoor clothes, tents, barbecue grills and special food products) or "office" (e. g., suits, shirts and executive briefcases). Sometimes, a theme-orientation can follow a certain **lifestyle** and display in a single area all the fashion associated with a common lifestyle such as hip-hop, sophisticated career woman or casual and denim style. Short-term or seasonal themes such as Halloween, Christmas, the Olympic Games or the FIFA World Cup can influence the decoration in all parts of the store but can also be used to group certain merchandise together temporarily, often in a special feature area. Theme-based presentations promote cross-selling and can support **solution selling**, where products and services are bundled to provide a full solution for customers. Therefore, themes are sometimes implemented as part of category management strategies (see Chap. 12). Examples include tools, materials, delivery services and even trade services in a DIY store. Skis, ski shoes, services such as waxing and edge sharpening, skiing lessons, skiing clothes and travel arrangements in a sports store are another good example.
- With a **brand-oriented** presentation, products from a certain brand are merchandised together in **monobrand** store areas. In a fashion store, different products such as shoes, suits, shirts and neckties from *Hugo Boss* could be grouped together in one area, while the equivalent items from *Armani* are in another. Brand-oriented presentation often takes the form of a **shop-in-shop** (or **store-in-the-store**), a concept where the merchandise for one brand is clearly separated from the rest of the store in a boutique-like manner. This type of **boutique layout** is sometimes considered a variation of the free-form store layout (McGoldrick 2002, p. 468). This often takes the form of **leased space** or a **concession store**, in which an external company (often the brand manufacturer) operates the dedicated selling space, including the coordination of merchandise mix and inventory, with a separate checkout and specialist staff (see also Chap. 6). Brand manufacturers often design their entire product ranges to match. Brand loyal customers buy different products from the same brand to wear or consume together. A brand-oriented grouping facilitates such buying behaviour. Large department stores, such as *Saks Fifth Avenue, Selfridges* or *KaDeWe*, have traditionally employed concession stores for products like cosmetics, fashion and other brand-dominated categories. In this way, they act as a **house of brands**. The concept of a shop-in-shop has recently expanded into other retail sectors, such as *Tchibo* shops in supermarkets, *T-Mobile* concession shelves in electronics stores, *Starbucks* in bookstores or *Bosch* shop-in-shops within DIY stores.

15.3.3 Store Design and Store Atmosphere

Store atmosphere refers to customers' emotional responses to the store interior. This emotional state of mind influences shopping enjoyment and subsequent shopping behaviour (Berman and Evans 2013, pp. 491–497; Varley 2014, pp. 202–204).

While the layout of the store and the arrangement of goods are the core components, store atmosphere is created by many more elements. Consumers perceive the store environment through all five senses. These include (Gilbert 2003, p. 128; McGoldrick 2002, pp. 460–467):

- **Visual** elements (such as colour, brightness, sizes and shapes of fixtures and goods, floors, appearance of salespeople, etc.).
- **Acoustic** elements (such as background music, audio advertising on the in-store radio or noises from other people).
- **Olfactory** elements (i. e., the scent in the store, e. g., perfumes used in clothing stores or the smell from a supermarket bakery department).
- **Tactile** elements (such as the material used for floors or the sensation of touching products).
- **Gustatory** elements (such as food samples in a supermarket, coffee served in a bookstore or champagne served in an elite boutique).

Visual elements are particularly used to influence consumers, especially colours. **Colour psychology** is frequently applied to store design. Examples of the different psychological effects of colour include (Varley 2014, p. 203; Hurth 2006, pp. 140–141):

- White and blue appear calm, cool and clean.
- Red (also orange and yellow) has been shown to be stimulating and arousing, evoking sensations of warmth, action and sometimes even aggression.
- Green is regarded as restful and stimulates associations with life and nature.

Some retailers use a specific colour in their in-store branding that they also use extensively in their stores. For instance, *The Body Shop* uses green (which emphasises its environmental positioning), *Saturn* uses a blue and orange combination (to stress its price aggressive positioning), *Boots* uses blue and white (which strengthens its image as a chemist) and *Douglas* uses turquoise (to communicate a luxury image). Conversely, many retailers prefer to use colours sparingly in-store because they could conflict with the colour of the goods sold, which often change with seasons and fashions. This is particularly true for clothing retailers.

Other sensual modalities are planned to some extent, but their effects are seldom considered systematically. However, **sound** and **scents** have been shown to influence customer behaviour and mood, thereby exerting an influence on purchasing behaviour (Berman and Evans 2013, p. 495). Slow music, for instance, encourages people to move slowly and spend more time in the store, while fast music increases arousal and feelings of excitement, which might lead to more vivid memories of the store and more active shopping behaviour.

15.3.4 Experiential Retailing

Store atmosphere has become even more important with the trend towards experiential retailing. This involves creating a retail environment that offers a unique and memorable sensory experience in order to transform shopping into an interactive, enjoyable and exciting experience for the customer (Schmitt 1999), and provide a coherent emotional profile for the store. The atmosphere aims to appeal to the consumer trends of seeking exciting events, pursuing stimulation in shopping and spending leisure time going shopping.

This kind of "shoppertainment" (Cordt 2008) focuses on consumers who demand pleasurable experiences in their shopping activities. Both in general merchandise retailing with retailers such as *REI*, *Globetrotter* or *Sephora* and food retailing with retailers such as *Trader Joe's* (see the case study for Chap. 9), *Whole Foods* (see the case study for Chap. 12), *EDEKA* or *REWE*, retailers invest in impressive retail environments to create extraordinary experiences for shoppers (see Fig. 15.2).

However, entertaining store atmospheres do not complement all consumer shopping tasks. Shoppers pursuing task-oriented shopping goals often prefer simpler environments that do not distract them. This can be observed in any *Aldi* or *Lidl* store. In contrast, consumers who go shopping for fun might prefer exciting store atmospheres. Retailers must therefore consider their target customers' typical shopping goals when designing their stores. For example, if their customers typically regard food shopping as an unpleasant task, it might make sense to design supermarkets in soothing colours with simpler atmospheres. Conversely, shopping for clothes is often viewed as fun. Thus, fashion retailers can influence shoppers positively by creating exciting atmospheres (Levy et al. 2014, p. 510). Retailers can also vary the level of entertainment and excitement across their stores and can create low arousal environments for categories that are typically purchased in a task-oriented way and high arousal zones for categories that usually are purchased within pleasure-seeking shopping contexts.

While the *Disney Store* or *Warner Brothers' Store*, department stores such as *Galeries Lafayette* and urban entertainment centres are prototypical experiential retailers, elements of this trend are important for every retailer.

These trends show that a retail store's potential to provide pleasure is achieved not only through the static physical facilities of the store, but also through in-store events that can be used as an "experience stage". The store is thus transformed into an interactive "**retail theatre**" (McGoldrick 2002, p. 453). Potential **events** that contribute to pleasant and entertaining in-store marketing include cooking lessons in supermarkets, beauty treatments in department stores, fashion shows at apparel retailers, live appearances of artists in music stores or football tournaments in front of a sports store. However, the effects of such events on consumer behaviour depend on the level of innovation and adequacy of the events, i. e., the fit of the event to the retailer, its store and its merchandise (Leischnig et al. 2010).

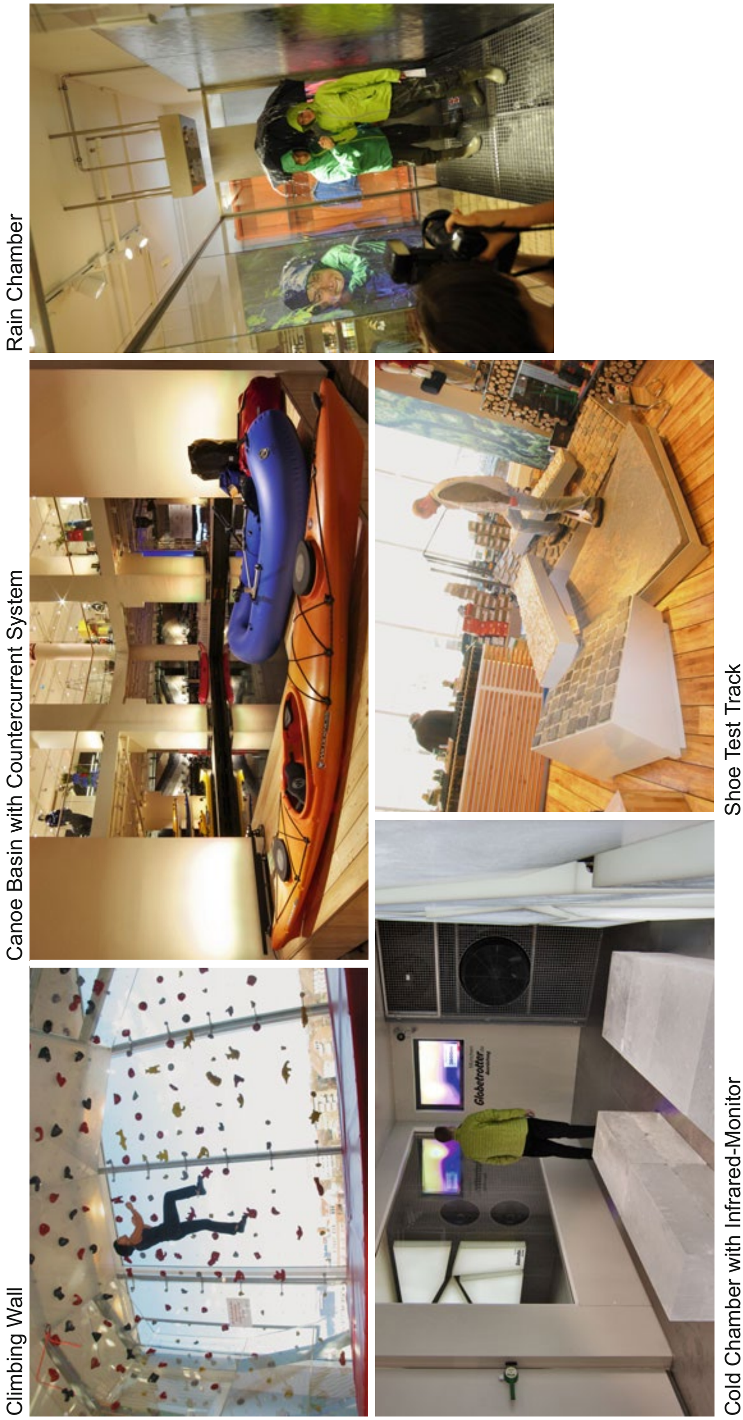

Fig. 15.2 Experiential shopping at Globetrotter. (Globetrotter 2015)

15.3.5 Store Design and the Environment

Running stores, especially when creating pleasant and exciting store environments with elements such as lighting or sound, requires a large amount of energy. Increasing **energy costs** and the importance of the **environment** are leading retailers to rethink their strategies for store design, store maintenance and the exterior and interior facilities of their stores.

Coupled with increasing customer and social awareness of these issues, many retailers are implementing ecologically and environmentally friendly and energy-efficient store buildings and store strategies that are presented using terms such as "**green retailing**" or "greentailing". The basic principles of these greentailing strategies for store design are to reduce energy use and use more renewable resources. Companies such as *Coop*, *Marks & Spencer*, *C&A*, *Tesco*, *B&Q,* the *Metro Group*, *Walmart* and *Zara* have all emphasised protecting the environment in their retail strategies. One element of these strategies is the establishment of "**green stores**" (or at least "greener" stores). With these green stores, retailers are trying to make their stores more energy-efficient and environmentally friendly using, for example, renewable resources (e. g., solar or wind power or total energy units), geothermal heating or cooling and energy-efficient refrigeration and lighting. They are also trying to reduce the carbon footprint of the merchandise they offer by optimising logistics and installing advanced recycling programmes (see Chap. 10 on CSR).

15.3.6 Store Design and Retail Branding

Store design is an important element of any retail branding strategy (see Chap. 9), since it has a strong effect on customers. Consumers' **store image** can be influenced by a direct brand experience (during a store visit) as well as indirect experiences such as advertising (Krishnan 1996, p. 394). Because retailers can offer customers more extensive and direct physical experiences than manufacturers, retailers are better able to relate directly to consumers, trigger intense emotions and build vivid memories.

This effect on a **retail brand** is especially strong when store design is aimed at not only evoking positive emotions and an appealing store atmosphere, leading to a pleasant shopping experience, but also when it represents the **core of the retail brand** and is used to differentiate a retailer from its competitors (Morschett 2006, pp. 537–538). The use of colour has already been discussed, but the concept will be developed further here. The unique store designs of *REI* in the USA, *The Body Shop*, *Sephora*, *Old Navy*, *Boots* and *Lush* are conventional examples, but the flagship stores of manufacturers such as *Nike*, *Apple*, *Timberland* and *The House of Villeroy & Boch*, which are primarily designed to strengthen their respective brands, provide an even more cogent illustration of the effective use of this strategy (see Chap. 6).

However, experiential retailing is not the only way for retailers to use store designs to convey a brand message to their customers. Hard discounters such as *Aldi* and *Lidl* or wholesale clubs such as *Costco* follow the same principle. Simple, basic stores reduced to the essentials, floors and shelves with an inexpensive appeal presenting the goods in cut cardboard boxes and on pallets, with no unnecessary decoration elements and modest and pragmatic exterior design communicate these retailers' main competitive advantages very clearly to the customer.

15.3.7 Store Design and Online Shops

The basic principles of store design (e. g., store layout and grouping offerings), store atmosphere (e. g., colour effects) and experiential shopping also apply to online shops.

Consumers spend a considerable amount of time in online shops. Online shops have to guide their customers through their store and they invest heavily in facilitating this search process. In addition to the "layout" of the online shop in, e. g., a category structure, search functions are usually added. Online shops can provide a product more or less space on a webpage and can position it on a landing page or much less prominently. And they can do this on an individual basis, tailoring the shop layout to specific visitors, e. g. based on browsing history. As *Amazon* has demonstrated for over a decade, products can be displayed based on what the customer has searched for or bought in the past.

Online shops must also create a positive store atmosphere, so customers perceive their visit as pleasant. Obviously, on a tactical level, there are many differences between the design of online and brick-and-mortar stores. Online shops cannot currently address some human senses (e. g., taste, smell) due to technological restrictions; however, visual and acoustic elements play a major role. Online shops can use videos, promote customer interaction through online discussion platforms, and even connect to customers' homes via augmented reality. While store-based retailers have to decide on a specific form of product presentation for each product (e. g., products on a shelf), online shops can use several forms simultaneously and display products in a brand-oriented presentation, a theme-oriented presentation and an item-oriented presentation – depending on how the customer searches for products and which **clickpath** they follow through the shop. In addition, online shops can group products together in the display based on shopping patterns identified for previous customers ("customers who bought product A also bought product B"). Also, online shops can simplify the customer's search process via filtering options, i. e., sets of product characteristics that a customer can select to restrict the products displayed to those possessing all the chosen characteristics (e. g., colour, price range, product features).

The specific design of an online shop depends on the shopping format (e. g., merchandise-oriented shops vs. price-formats; see Chap. 4) and on the device that customers will predominantly use (e. g., notebook vs. smartphone), although **responsive designs** which display optimally regardless of the device used are now the preferred standard. Various kinds of shop design have developed, i. e., designs that customers expect and have learned. For example, *Amazon's* dominance of online retailing has created customer expectations of where the buy button should be located, how products should be displayed and described, that several pictures per product are useful, etc.

Data on the performance of an online shop are more easily available than for physical stores. It is also easier to change the design of an online shop. Both features make it common to measure the performance of an online shop and constantly optimise it. With **A/B tests**, different versions of an online shop (e. g., different product description positioning) can be shown to customers to measure which version performs better. Different **key performance indicators** are commonly used to evaluate online shops, including:

- **Number of unique visitors** and **number of total visits**: These measure how many unique customers visited an online shop during a particular period and how often customers visit a website. Different measures of online marketing, e. g., optimising the website to receive better rankings in search engines like *Google* (search engine optimisation, SEO) or search engine advertising (SEA), can be used to improve this indicator.
- **Conversion rate**: This is the percentage of visitors to an online shop who actually buy a product. Better product descriptions including product videos and customer reviews, better page layout, easier payment processes, simpler purchasing processes, certificates like *Trusted Shops*, low logistics fees, etc., are all ways to improve this indicator.

There are analytic tools which help track individual customers' shopping processes or behaviour during their visit, which can help detect and fix weaknesses in the shop design. For example, a frequent problem is **shopping cart abandonment**, i. e., when a visitor fills his online shopping basket but fails to purchase anything. Identifying when this occurs (e. g., when delivery costs are displayed or when the payment options are presented) can reduce this rate. This is just one example of the many opportunities that online shops provide to monitor and optimise performance.

15.4 Space Allocation

15.4.1 Overview

Space within stores and on shelves and fixtures is a **scarce resource**. The allocation of store space to merchandise categories and the allocation of shelf space to different products are, therefore, crucial processes for retailers. Store space requires heavy investment. Appropriately allocated merchandise is an important determinant in the productivity of the relevant assets. Thus, most retailers measure **space productivity** as part of their operational controls (see Chap. 20). It is typically measured in sales per square metre or sales per linear metre. Retailers who display most of their merchandise on freestanding fixtures usually use square metres, while retailers who display most of their merchandise on shelves prefer to use length, i. e., sales per linear metre (Levy et al. 2014, p. 497–498).

This task has become more critical for **cross-channel retailers**. If customers visit a brick-and-mortar store, look at a product and then buy it in the retailer's online shop (as a form of showrooming), then this does not increase the space productivity for this item, even though the display of the product on the shelf may have caused the purchase. Conversely, if a product is displayed very nicely in a retailer's online shop, leading many people to buy this product in-store ("Research Online, Purchase Offline"; ROPO), then the space productivity of this item might seem very high, even though allocating it less space could result in the same sales levels. Thus, the increasing interdependency between online shops and stores, where purchasing decisions and purchasing acts do not necessarily occur in the same channel, makes the use of certain retail performance indicators for space allocation dubious.

15.4.2 Determinants of Space Allocation

The decision over how much space to allocate to a certain product or category is influenced by a number of variables. A simple rule of thumb is that share of space is allocated according to share of sales. However, other determinants such as product profitability, potential to enhance store traffic, demand interrelationships, retail brand positioning, category role (e. g., destination categories vs. routine categories), display needs (e. g., physical characteristics of the products, such as watches vs. bicycles) and inventory turnover (owing to restocking considerations) are also frequently considered.

An important coefficient for determining space allocation is **space elasticity of demand** (similar to the frequently used price elasticity coefficient; see Chap. 13). Space elasticity of demand measures the responsiveness of customer demand to a change in sales space. It is defined as the ratio of the relative change in unit sales (or change in turnover) to the relative change in shelf space. Average space elasticity has been found to be about 0.2, so that doubling the space allocated to a product would increase sales by 20 %. However, the rate of change is different for different products. Figures have been reported between 0.6 at the high end (e. g., for fruit and vegetables) and close to zero at the low end (for many fashion products, maybe because of a negative impact on exclusivity by increasing sales space). As with many output/input ratios, a declining marginal return on additional space is likely (McGoldrick 2002, pp. 478–479).

However, profit has to be maximised; hence, **space elasticity of profit**, defined as the relative change in profit in relation to the relative change in space allocated, could prove an efficiency-enhancing coefficient. In order to optimize profits, the space allocated to all products or categories must produce the same marginal space elasticity of profits. Otherwise, allocating more space to a product with higher marginal space elasticity of profits at the expense of a product with a lower coefficient would increase total store profits. In contrast, **category management** (see Chap. 12) emphasises the consumer perspective more. Allocating space with only short-term profit maximisation in mind might not enhance customer satisfaction and customer loyalty; thus, beyond pure short-term profit figures, the needs of the customer also have to be considered (Varley 2014, pp. 67–74).

Space allocation also needs to be based on the quality of space. Areas in a store are not frequented equally by customers, the speed with which customers pass through different areas varies and certain areas of the store (or shelf) draw more attention than others. Accordingly, placement has a strong impact on sales success. Some examples of valuable store and shelf areas include (Varley 2014, pp. 180–181; Levy et al. 2014, pp. 495–497; Hurth 2006, pp. 122–129):

- areas at the entrance of the store, especially the first shelf or other fixtures that customers face immediately after entering the store,
- ground-level space compared with other floors, which even results in different levels of rent for different floors,
- **end caps** of gondolas, which are usually highly visible – even for people who do not enter an aisle,
- feature displays/**special displays** (e. g., off-shelf displays in a supermarket), which exert an additional impact and are employed to highlight certain products, especially new product introductions,
- the checkout area, since all customers have to pass through it and may have to queue at the till (which makes this a preferred space for impulse items),
- eye level on shelves, the centre of the shelf and – since customers in Western cultures usually look at items from left to right – shelf space on the right side of the shelf compared with that on the left.

15.4.3 Space Allocation Software

Space allocation is often based on simple rules of thumb and experience. However, the complexity of influencing factors meant optimisation software was developed decades ago. With the rise of retail information systems, scanner data at checkouts and even personalised loyalty card data, these systems can now store an immense amount of data.

Space optimisation software uses information on specific products (e. g., product costs, size of product, variations), general information on space productivity in different areas of the store and on the shelf and data for the specific market (e. g., demographics in the catchment area). It calculates effect metrics (such as space elasticity) and demand interdependencies from past sales data, or provides tools to integrate estimations (e. g., from experiments). Company strategy (such as category role or inventory targets) is also considered and all variables are applied in a multivariate model to generate suggestions for optimal store space and shelf space allocation.

The optimisation results are typically displayed in a **planogram**, which is a visual representation of a store or a shelf that illustrates how many products from a specific SKU should be stocked and where they should be placed. Planograms are also useful for store employees setting up and restocking the shelves, because they help them comply with the planned space allocation

15.5 Conclusion and Outlook

Most of the various aspects of store design, store layout and space allocation discussed in this chapter apply to all types of retailers, including mail order retailers and online shops. Space is also precious in the mail order business, because square metres in stores are analogous to page space in catalogues. While catalogues cannot offer all that "in-store" marketing can achieve, because they only display two-dimensional, static pictures, online shops can now employ methods and approaches that are similar to in-store marketing. Even though products cannot be touched in Internet shops, the medium has other benefits. Online shops can be customised for specific users, space is only limited by the duration of the customer's visit and consumers can be provided with different paths to find the same product and the grouping of store offerings can follow several types of groupings simultaneously. With digital salespeople (i. e., avatars, potentially customised), three-dimensional views on products, videos, virtual trials and sound effects, online shops have many instruments available to create an exciting and pleasant store atmosphere (see Chap. 4).

However, there are many diverse reasons to shop on the Internet. Therefore, online shops should not be designed purely from a technical perspective, but from the consumer perspective. The aim should not be to employ all the available technical resources to excite the customer, but to reduce the effort of buying products (e. g., by providing shopping lists from prior purchases) and support the customer. In other words, technology should be used to facilitate shopping.

If a retailer employs different retail channels, **coherence** between store atmospheres in all channels is important. Coherence of appearance for a multichannel retailer, particularly for cross-channel or omni-channel strategies, has been found to positively influence consumer attitudes towards a retailer (Schramm-Klein 2003, pp. 227–245). Given the influence of store atmosphere on a retail brand, cohesion across a retailer's different retail formats is crucial.

Further Reading

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- Schmitt (1999): *Experiential marketing: How to get customers to sense, feel, think, act*. New York: The Free Press.
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15.6 Case Study: Macy's

15.6.1 Profile, History and Status Quo

Macy's, Inc[1]. is one of the premier omni-channel retailers in the United States. The company operates around 850 department stores in 45 states, the District of Columbia, Guam and Puerto Rico under four different retail brands: *Macy's*, *Bloomingdale's*, *Bloomingdale's Outlet* and *Bluemercury*. It also operates the online shops *macys.com*, *bloomingdales.com* and *bluemercury.com*. It is headquartered in Cincinnati, Ohio, and employs about 167,000 people. Combined, the different retail brands of *Macy's, Inc*. reached sales of 28 billion USD in 2014 (Macy's 2015b). The company was previously known as *Federated Department Stores, Inc.* but changed its name to *Macy's, Inc.* in June 2007 (Bloomberg 2015).

Macy's and *Bloomingdale's* are department store chains with a focus on apparel and related products. They sell a variety of merchandise, including men's, women's and children's apparel and accessories, cosmetics, home furnishing and other consumer goods. While *Macy's* stores target the mid- to upper-market segment, *Bloomingdale's* is clearly upscale. In order to attract more price-sensitive customers, the company plans to open four stores in New York under the name *Macy's Backstage* by autumn 2015. These new stores will offer products at discounts from 20 to 80 %. This strategy is designed to create new market opportunities. The company also operates *Bloomingdale's* outlet stores, which offer a reduced price range. The acquisition of *Bluemercury*, America's largest and fastest-growing luxury products and spa services retailer, was completed in March 2015. This was *Macy's* first acquisition in ten years and provides a completely new channel of growth (Macy's 2015b, p. 10). Additionally, Terry Lundgren, the CEO of *Macy's Inc.*, intends to expand the branch network of *Bluemercury* in the near future. The *Bluemercury* retail brand will also be presented in the department stores with its own sales areas and own brand (Bloomberg 2015; Westermann 2015).

Macy's has established strong brand equity. Both *Macy's* and *Bloomingsdale's* have existed for more than 150 years and are two of the most popular brands in the United States. Both successfully operate in the niche department store branded market, providing a variety of store brands and exclusive brands to their customers. In addition, in 2014 the brand consultancy *Interbrand* ranked *Macy's* as one of the top 50 most valuable US retail brands (Marketline 2015).

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[1] In addition to the explicitly cited sources, sources used for this case study include the websites http://www.macys.com, http://www.macysinc.com and http://www.visitmacysusa.com.

Fig. 15.3 *Macy's* flagship store in New York City

15.6.2 Store Design, Store Layout and Visual Merchandising at Macy's

Macy's has clearly distinguished itself from other major retailers by selling highly desirable brands such as *Calvin Klein*, *Charter Club*, *Estée Lauder*, *Hotel Collection*, *I.N.C*, *Michael Kors*, *Ralph Lauren*, *Sean John*, *Thalia Sodi* and *Tommy Hilfiger* (Macy's 2015b, p. 10).

Like other department store chains, the company focuses on impressive in-store design and visual merchandising. This is particularly obvious in its flagship stores, including Herald Square in New York City, Union Square in San Francisco, State Street in Chicago, Dadeland in Miami and South Coast Plaza in Southern California. The flagship store at Herald Square in New York is advertised as the world's largest store (see Fig. 15.3), although there are actually larger department stores in other countries. Over the past 110 years, *Macy's Herald Square* has become iconic, and the historic building has been added to the National Register of Historic Places. The building comprises almost 200,000 m^2 of retail space. Built in 1902, the store now covers an entire city block with eleven floors of the latest fashion (Macy's 2015c).

In recent years, *Macy's* has invested heavily in this store and a 400 million USD renovation will be completed during 2015. The renovation is designed to attract both millennials and foreign customers looking for luxury brands like *Gucci*. Thus the New York store carries a much wider assortment than regional *Macy's* stores, with brands like *Ralph Lauren*, *Polo*, *Tommy Hilfiger* and *Michael Kors* – the kind of classic American clothes that international customers like to take home. One industry analyst claims: "What *Macy's* is trying to do with the renovation is elevate itself further from the *J.C. Penney* across the street. This is their way of making sure that they are in the luxury game and establishing their foothold early on" (The New York Times 2014).

Table 15.1 Floors at *Macy's* Herald Square

Floor	Categories
Basement Level	Men's accessories and basics, men's furnishing and sleepwear, *Sunglass Hut*
1st Floor	Fragrance, cosmetics, fine and fashion watches, men's furnishing, jewellery, *Louis Vuitton*, *Burberry*, *Longchamp*, *Gucci*, luxury handbags
1½ Floor	Young men's clothing, handbags, cold weather (seasonal)
Mezzanine	Visitor centre, *Starbucks*
2nd Floor	*Shoe Salon*, men's collections, *Herald Square Cafe*
3rd Floor	*Macy's by Appointment*, women's clothing, cosmetics, men's clothing, men's outerwear, men's sleepwear, men's basics, men's hosiery, *Starbucks*
4th Floor	Men's shoes, men's active, *Finish Line*, women's sportswear, women's denim, *LIDS*, *Just Salad*
5th Floor	Women's dresses, suits, *A Pea in the Pod Maternity*, *Fur Salon*, *Starbucks*
6th Floor	Hosiery, lingerie, home/textiles, *Stella 34* (Restaurant), *Cucina Express*, NYC souvenir shop, *Starbucks*
7th Floor	*Macy Woman*, petites, kidswear, *McDonalds*, *Pink Berry*
8th Floor	Juniors, coats/swimwear (seasonal), tabletop, housewares, bridal, *Au Bon Pain*, giftwrap, *Juice Press* (seasonal: Santaland)
9th Floor	Furniture, luggage, fine rug gallery, mattresses, watch repair, *Vision Express*

Like other department stores, *Macy's* Herald Square has a clear structure across its different floors. Table 15.1 shows the store's current structure.

Like in many department stores, the first floor carries fragrances, cosmetics, jewellery, watches and luxury fashion accessories. This floor (but also others) has a particularly **brand-oriented** design, where products from a certain brand are merchandised together in **monobrand store areas**. More specifically, it takes the form of a **shop-in-shop**. As Table 15.1 indicates, in-store designer shops such as *Louis Vuitton*, *Burberry*, *Longchamp* and *Gucci* are located on the first floor and grouped together by brand. Thanks to a partnership agreement, part of the retail space on the basement level is leased to *Sunglass Hut* (Luxottica 2015). The second floor contains a *Starbucks* with an upscale coffee line. This is targeted at attracting high-end customers who come to visit the new in-store designer shops (The New York Times 2014; Jennings 2014). During the Christmas period, a 1000 m^2 mock North Pole village called *Santaland* is located on the eighth floor.

Fig. 15.4 Visual merchandising at *Macy's*. (Macy's 2015b, pp. 3, 11)

The renovation of *Macy's Herald Square* has seen some significant changes to the store's look, product mix and infrastructure. Before the renovation, many windows were blocked up and the store received limited natural light. Now these are open and contain attractive window displays. Similarly, the 750 m^2 retail space on the fourth floor that used to be a stockroom surrounded by opaque windows has become a *Tommy Hilfiger* retail zone. Some of these products are intended for sale in Europe and are exclusive to *Macy's Herald Square*. This is a marketing strategy to increase the number of international customers (The New York Times 2014). In addition, *Macy's* offers a large portfolio of store brands that are merchandised exclusively in its stores. These brands are advertised in-store as "Only at *Macy's*" and are targeted to specific consumers (Macy's 2015b, p. 14). *Macy's* distinguishes between so-called "private brands" and its "labels". According to *Macy's*, private brands have fully developed brand profiles aimed at specific consumers and supported with national advertising and branded in-store environments, whereas labels are just names attached to a category of merchandise that can fill a niche in its assortments. *Macy's* store brands currently include: *Holiday Lane*, *JA by John Ashford*, *Morgan Taylor Intimates*, *The Cellar*, *Home Design*, *Karen Scott*, *Studio Silver* and *Tools of the Trade* (Macy's 2015b, p. 17).

Macy's invests in high-end visual merchandising in all of its stores (see Fig. 15.4). In some cases, products are displayed in shop-in-shops where the brand owner is responsible for the visual merchandising. In other cases, the company uses a mix of product displays, upscale decoration and mannequins that change the atmosphere of the store, enhance its emotional touch and give consumers a better impression of what the clothing will look like when they wear it.

Investing in the *Macy's* store on Herald Square has several benefits. First, the store is very important to the city. As *Macy's* CMO (chief marketing officer) proudly explains: "There's a famous quote from Mayor Michael Bloomberg that, 'If you have not been to *Macy's*, you have not been to New York'" (Palmer 2012). But there is also a huge image transfer from the New York store (and probably the other flagship stores), as the CMO explains: "There is a halo effect on this building that permeates out to all of our other locations" (Palmer 2012).

15.6.3 Macy's In-store Events

Macy's stores hold events almost every day. In addition to many small events, *Macy's* is known for its highly innovative events that attract millions of people every year, with themes such as *American Icons*, which celebrates the people and places "that make America great". The *American Icons* campaign also includes fashion from well-known American designers, in-store events, interactive digital content and a give-back programme in partnership with *Got Your 6*, a non-profit organisation established to empower veterans (Retail Merchandiser 2013, p. 20).

Every year in spring, *Macy's Flower Show* attracts millions of customers to its large stores in New York, Philadelphia, Chicago, Minneapolis and San Francisco. These events are meant to highlight the beginning of spring and each store holds different musical and cultural events, floral seminars, complimentary guided tours, contests and special fashion shows (Macy's 2015d). For a few days, every department in every store is decorated with flowers (see Fig. 15.5).

During the Christmas period, customers from all over the world travel to the *Macy's* stores to look at the holiday window displays and attend the celebrations. Fig. 15.6 shows the *Macy's* Christmas light show in the store in Philadelphia, which has been a tradition since 1870. In fact, *Macy's* was the first store to feature holiday windows. Today, at peak times, more than 10,000 people per hour pass the window displays at Herald Square. Also during the Christmas period, *Santalands* are opened at seven large *Macy's* across the USA. These are theme displays with a Santa theme. For example, the New York *Santaland* includes a mock North Pole village including employees dressed as elves, an enchanted forest and a train display (Macy's 2015c; Macy's 2015d). Stores in other cities include fairy tales, puppet shows and other features are added.

As part of the *American Icons* programme, in summer 2015 *Macy's* on Herald Square and several other locations hosted a special store event called *Camp Macy's*, an afternoon dedicated to celebrating summertime, camping indoors and shopping for summer fashions (Macy's 2015a). Another example of *Macy's* entertainment savvy is the *Macy's Cherry Blossoms Show*. During the National Cherry Blossoms Festival, the store in Washington, D.C., is transformed into a floral wonderland including beautiful visual displays (Macy's 2015e). Over the course of the year, *Macy's* also organises a number of special events. For example, in September 2014, Ryan Seacrest, the host of *American Idol*, broadcast his daily radio show live from a temporary studio in a window of the New York store to promote his new line of men's suits and matching accessories, called *Ryan Seacrest Distinction* (The New York Times 2014).

Fig. 15.5 Macy's Flower Show

Fig. 15.6 Macy's Christmas Light Show in Philadelphia

15.6.4 Omni-channel Retailing

Macy's executives know that today's customers shop via a large number of channels, including stores, websites, smartphones and tablet computers (see Chap. 5). As a result, the company has recently adopted a strong omni-channel retailing strategy (Retail Merchandiser 2013).

Sales associates at the shoe department in the Herald Square store each have an *iPod Touch* to track products using a radio-frequency identification (RFID) system. When a customer wants to try a particular pair of shoes, a sales associate can scan the product tag and the *iPod Touch* immediately displays the available colours and sizes. The order is then routed to the stockroom, where employees are directed to the exact aisle and shelf where the product is located. The aim is to find the shoe box and bring it to the customer in under two minutes (The New York Times 2014).

Macy's has further improved its omni-channel presence recently. Since 2014, orders made online or in other stores can be shipped direct-to-customer in almost all locations. If a store is out of a particular item, *Macy's* associates can select merchandise from other stores where the product is still available or can ship it directly to the customer through *Macy's* online fulfilment centres. Macy's can also use store inventories nationwide to fulfil online orders (Marketline 2014; Retail Merchandiser 2013, p. 21). This fulfilment concept makes it possible to leverage the inventory and customer relationships. Last year, *Macy's* successfully introduced its "Buy online – Pick up in store" concept in many of its locations. This increased popularity of omni-channel retailing means *Macy's* strong presence here gives it a competitive edge (Marketline 2014).

Macy's is currently testing different sales technology innovations at selected stores in Georgia and New Jersey. For example, a new generation of handheld point-of-sale devices and tablets created to improve the in-store shopping experience is meant to empower sales associates to engage customers more effectively and to offer merchandise ideas and product information. In addition, customers can now shop *Macy's* assortment via an electronic kiosk and large interactive "lookbook" displays based on touchscreen kiosks in selected stores (Businesswire 2014, p. 21).

Macy's strongly promotes the use of its own shopping app. For example, during a fashion and rock event sponsored by *Macy's* in autumn 2014 (Rock Fashion), the *Macy's* shopping app let concertgoers shop live. During "Black Friday" – the Friday after Thanksgiving and the busiest shopping day of the year in the USA – *Macy's* encouraged mobile shopping and the use of its shopping app by letting customers scan QR codes in stores to receive prizes. The pool of high-value prizes changed every hour. *Macy's* was also one of *Shopkick's* first partners. *Shopkick* was launched in 2010 and quickly became the largest location-based shopping app in the USA. Since 2012, customer can earn bonus points just for entering a specific store, where they receive store-specific and individualised deals, discounts and recommendations. This app has recently been linked to the *iBeacon* technology, which helps identify a customer's specific location in a store. In late 2014, *Macy's* and *Bloomingdale's* were among the first retailers to accept *ApplePay*, a mobile technology which lets customers with an *iPhone* or *Apple Watch* pay at the checkout by simply presenting their device.

Embracing the most innovative mobile technologies and using them in stores is another measure to attract millennials. Customer interaction occurs through different types of social media such as *Facebook*, *Twitter*, *Instagram*, *Pinterest* and the *Macy's mblog*. For example, *Macy's* 11.5 million Facebook fans were given the opportunity to vote on some of the music played in stores. Special store events such as concerts and fashion shows are also publicised on *Facebook*. According to *Macy's*, 30 % of customers who use these online and digital shopping channels are new customers (Retail Merchandiser 2013, p. 21).

15.6.5 Conclusion and Outlook

In-store marketing is crucial to the success of a department store chain like *Macy's*. Macy's visual merchandising and the store layout of its *Macy's Herald Square* flagship store creates an atmosphere that appeals to a broad target group but also gives an upscale image. Brands are important to *Macy's* mid- to upper-market positioning and these brands demand to be displayed in a prestigious fashion. The most attractive brands are grouped into brand-oriented displays. However, having a nice store with a good atmosphere is not sufficient to draw in traffic; successful department stores also organise events in their stores. In the case of *Macy's*, this includes both small daily events and huge iconic events that take over an entire store or even more. The company's strong omni-channel retailing presence – and the way modern technology has been linked to the in-store experience – also provides a clear competitive advantage.

In recent years, *Macy's* has achieved impressive growth in a generally difficult market. At the beginning of 2015, the company purchased the cosmetics chain *Bluemercury*, *Macy's* first acquisition in a decade. It also started to explore the "off price" business in the hope of attracting a new customer base. *Macy's* has also announced a major restructuring of its marketing and merchandising operations, and *Macy's* executives are considering opening international stores (The Washington Post 2015). The first *Macy's* store outside the USA is scheduled to open in the United Arab Emirates approximately 2018 (Westermann 2015).

Questions

1. *Macy's* department stores structure several of their floors with a brand-oriented shop-in-shop design. Discuss the possible advantages and disadvantages.
2. The case study discussed numerous examples of holistic in-store marketing. What are the precise elements of this approach?
3. Where do you see the main potential for European department store chains in their in-store marketing strategies, compared with American retailers such as *Macy's*?

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Customer Relationship Management 16

Abstract

Building enduring relationships with customers has become a prime strategic objective of retail marketing. The goal of this chapter is to explain the paradigm of relationship marketing and 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.

16.1 Relationship Marketing as Paradigm

Marketing has typically focussed on attracting new customers. Today, however, companies recognise the importance of retaining existing customers by forming relationships with them (Bruhn 2015, p. 11). This focus on relationships assumes that it is less expensive and more profitable to market to existing customers than to acquire new ones (Reichheld and Sasser 1990). Customer relationship management (CRM) encompasses all the management decisions and processes which go into establishing, maintaining and enhancing long-term relationships with selected customers.

From this perspective, a manager's primary task is to identify profitable and unprofitable customers, focus efforts on the former and balance the cost of acquiring and retaining customers with the current and potential revenue from those customers (Bechwati and Eshghi 2005, p. 88). In retailing, advances in IT and the spread of loyalty cards and data collection from online shopping have provided a means for retailers to identify particular customers and collect customer-specific data, thus enabling individualised marketing. Compared with

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other industries, retailers have tremendous advantages in CRM since they are in direct contact with the consumer (Hansiota and Rukstales 2002, p. 260).

Principles of CRM

Even though the methods proposed for CRM are heterogeneous, some common underlying principles have emerged (Homburg and Werner 1998):

- **Customer data**: companies must gather reliable and detailed information on their existing and potential customers, usually stored in an electronic customer database.
- **Individualisation/segmentation**: strong customer orientation leads to a targeted approach to individual customers or customer segments, instead of a standardised mass-market approach to retail marketing.
- **Profit orientation**: not all customers are treated equally. Instead, they are classified and prioritised based on their profit potential. Investment in customers is then based on their profitability.
- **Customer interaction and integration**: instead of one-directional communication (such as traditional advertising), the aim is to achieve bidirectional customer interaction, including stronger integration of customers into the value-added process.

16.2 Customer Value

Loyal customers can be a strong **asset** for retailers (Shugan 2005, p. 191). However, not all customer relationships are profitable. For example, a study into grocery retailing showed that less than 30 % of the long-term customers are actually profitable (Reinartz and Kumar 2002; Eisenbeiss and Bleier 2012, p. 465). Thus, it is essential to focus on the right customers.

In certain product categories, customers do not just spend money once, but regularly (weekly, monthly, yearly) for the rest of their lives. Since this purchasing relationship can extend over many years, the future revenue stream should be considered to arrive at the net present value of future cash flow. For example, if a single customer spends 400 EUR on clothing every six months, the net present value accrues to about 15,000 EUR between the ages of 15 and 75 (at a discount rate of 5 %).

The rise of CRM has given prominence to the concept of **customer lifetime value**see customer lifetime value (CLV), which is the difference between what it costs to acquire, service and retain a customer and the revenue generated by that customer over the entire length of the relationship (Bechwati and Eshghi 2005, p. 88). In its simplest form, the formula for CLV:

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

where R_t = revenue earned from a particular customer in year t, C_t = customer-specific cost in year t, i = discount rate and n = duration of relationship (in years). The same formula can be used to either calculate an average CLV of the existing customer base or the potential CLV if the relationship duration can be extended.

The most challenging aspect of estimating CLV is projecting future revenues and costs. However, this has become more manageable in recent years, thanks to the availability of historical purchasing data for specific customers, based on loyalty card data or buying data and even clickstream data from online shops, which provide a better base for projection.

CLV can be used to develop a profile of **high value customers**, which can then be used to focus customer acquisition efforts on similar consumers. CLV can also be used to categorise the existing customer base into high, medium, and low value customers, allowing product offers and services to be differentiated according to expected customer value and providing an objective basis for directing retention efforts towards higher value customers. For example, if handling a customer complaint costs 500 EUR but the lifetime revenue value of this customer is 5000 EUR, it might be worth investing the money. The same would not be true for a customer with a value of 300 EUR (Bechwati and Eshghi 2005, p. 89).

The **monetary value of customer loyalty** has different components. Higher commitment to a particular company often leads to more frequent purchasing (i. e., more frequent store visits), larger shopping baskets, lower customer price sensitivity and stronger resistance to counter offers from competitors.

Loyal customers spend less time searching for competing products and service offers. Lower marketing costs are also assumed, since targeted marketing is possible, and the company acquires substantial knowledge about its customers, making marketing more efficient. Other advantages of loyalty include **cross-selling**, where customers buy additional products from the company, and **up-selling**, where the company manages to sell higher value products to the customer, partly because their attitudes and preferences are better understood over time. Accordingly, marketing focus has shifted from market share in specific product categories to increased **share-of-wallet** for particular customers (Uncles et al. 2003).

In addition, **non-monetary benefits of loyalty** also accrue. Loyal customers are expected to recommend retailers to friends and relatives, and this **word-of-mouth** is an effective and efficient marketing communication. They also provide **information value** for the company, since they more often complain when performance deteriorates. They communicate with the retailer, thereby contributing to maintaining and enhancing its overall quality (Reichheld and Sasser 1990, p. 108).

16.3 Customer Relationship Lifecycle

Following the notion that customers are potential sources of profit over their entire lifetimes, the relationship between customer and retailer can also be treated as a lifecycle. The relationship thus has a clear beginning, growth stage and maturity stage, after which decline and potential termination are possible (see Fig. 16.1).

The customer relationship lifecycle describes regularly observed patterns in the longitudinal development of customer relationships with a company. However, the model is **non-deterministic**, i. e., not all stages have to occur in a relationship. The durations of the

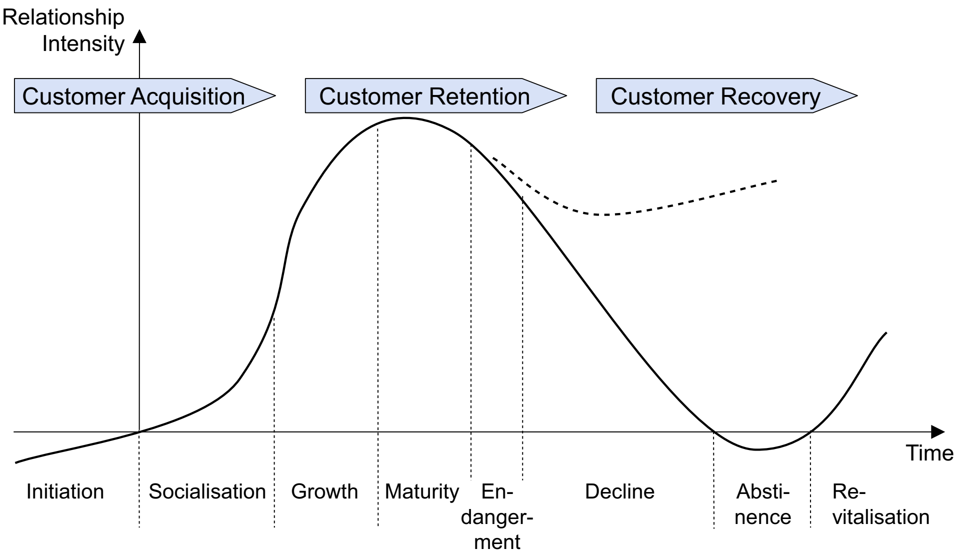

Fig. 16.1 Stages in the customer relationship lifecycle. (Adapted from Bruhn 2015, pp. 66–68)

different stages differ, and a retailer can influence the shape of the curve, for example via effective countermeasures during the endangerment stage.

Different stages in the relationship require different marketing approaches (Bruhn 2015, p. 68). In the early stages, the emphasis is on **customer acquisition**. In the growth stage and through maturity, the company needs to strengthen relationships 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.

Even after customers have been lost, it may be possible to reactivate them. Identifying the cause of such defections can help win customers back and also help avoid the same mistakes with others. Sending lost customers a special offer or calling them to discuss their complaint might bring them back into the relationship. Data analysis can predict defection behaviour, and customers with the highest propensity to discontinue the retail relationship can be targeted proactively (Brown and Gulycz 2002, p. 124).

16.4 Customer Loyalty and Customer Satisfaction

Loyalty has gained increased importance as a marketing objective within CRM. However, there is no universally agreed definition of loyalty. There are two basic approaches to conceptualising loyalty (Dick and Basu 1994, pp. 99–100; Uncles et al. 2003):

- Loyalty is often defined in reference to purchase patterns. **Behavioural loyalty** is measured in terms of repeat patronage, percentage of budget allocation in a category to a store, level of switching or purchase likelihood.

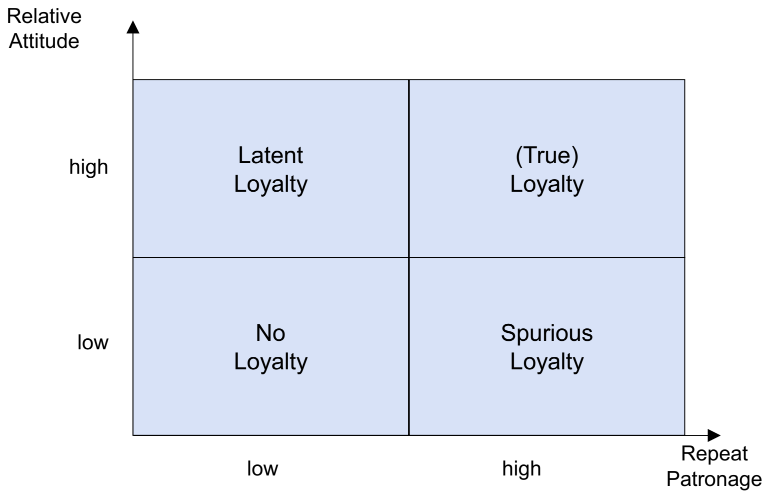

Fig. 16.2 Types of loyalty. (Dick and Basu 1994, p. 101)

- Many researchers argue that true loyalty requires strong commitment to a company. **Commitment** refers to an emotional or psychological attachment to a company. Furthermore, **trust**, which entails confidence in the retailer's reliability and integrity, is closely connected to loyalty (Morgan and Hunt 1994). **Attitudinal loyalty** can be measured by asking consumers if they like and trust a retailer, whether they feel committed to it and whether they would recommend it to others. For example, the case study on *Trader Joe's* (see Chap. 9) showed how many customers develop a close emotional link to the retailer.

Both dimensions are important for evaluating the type of loyalty (see Fig. 16.2):

- **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 region can result in repeated store patronage. Habitual purchasing behaviour might have the same effect. Therefore, behavioural loyalty may merely reflect situational influences, and will be permanently at risk if situational conditions change, such as rivals entering the market (McGoldrick 2002, p. 114).
- While encouraging a positive attitude is an important objective, attitude does not necessarily correspond with behaviour, and **latent loyalty** can occur. Situational influences can form a barrier between attitude and behaviour. For example, people can have a very positive attitude towards *Tiffany's* despite not being able to buy there. They may feel very positively towards *Harrods* in London, but live hundreds of miles away. Ultimately, retailers need to improve sales rather than attitudes.
- **True loyalty**, the most favourable position, is signified by repeat patronage based on a strong relative attitude towards the retailer (Dick and Basu 1994, p. 102). Most definitions of loyalty now include both behavioural and attitudinal loyalty.

Customer Satisfaction

Satisfaction is a primary prerequisite for loyalty, and loyalty is expected to rise with increased levels of satisfaction. Satisfaction (or dissatisfaction) is a consumer's post-purchase response to a product, which results from a comparison between (pre-purchase) expectations and perceived performance (Dick and 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 their overall evaluation of all prior experiences with this retailer, not just their experience of a specific transaction. Therefore, it is important to increase customer satisfaction at all stages of the customer purchasing process, not only in the **pre-sale** and **sale stages**. From the perspective of CRM, the **post-sale stage** is also a pre-sale stage, since the customer is regarded as being in a continuous **buying cycle**. Retailers who provide their customers with friendly and courteous customer service departments, fair complaint handling, etc. are trying to enhance customer satisfaction after a purchase to increase the likelihood of a repeat purchase.

One challenge associated with customer satisfaction is that results are based on comparing performance with **expectations** – and expectations change. Consequently, constantly meeting or exceeding customer expectations leads to increased expectations over time. Service levels that enthused the customer when first experienced can become standard and become a new minimum expectation level. Thus, maintaining stable levels of customer satisfaction is only possible with steadily increasing levels of service quality – a tough challenge.

16.5 Loyalty Marketing of Retailers

16.5.1 Loyalty Schemes and Customer Clubs

In retailing, CRM is closely connected to **loyalty schemes**, which are usually based on **loyalty cards**. The pioneers in Europe were *Tesco* in the United Kingdom with its *Clubcard* and *Albert Heijn* in the Netherlands (Ziliani and Bellini 2004, p. 9). Many retailers now employ some form of loyalty scheme. Typically, loyalty programmes offer delayed, accumulated economic benefits to consumers based on repeat purchases, usually in 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. Providing discounts in different "currencies" (e. g., cash, stamps, miles, reward points) can also offer perceptual advantages, e. g., for the retailer's price image (Cuthbertson and Laine 2004, p. 296; Shugan 2005, p. 190).

Most frequently, the ability to accrue benefits in the form of discounts on purchases, along with the promotional offers connected to the loyalty programme, are the principal motivation for consumers to join a loyalty scheme. However, emotional bonding and psychological relationship awards might also be important. **Self-actualisation** 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 the financial rewards (Shugan 2005, p. 190; Reinartz 2010).

Loyalty programme rewards depend on customers' cumulative spending at the retailer. There are two basic reward accumulation functions. If the **relative rewards remain constant** even though cumulative spending increases (e. g., one point per EUR spent), this function might lead consumers to distribute their spending (without loss) between different retailers. In fact, it is quite usual for customers to distribute their grocery shopping over different food retailers merely to acquire the loyalty cards for each of them, and then continue their shopping as before and simply collect the points for the purchases. Programmes like this only become attractive to customers who spend at more than one retailer if the **relative rewards increase** with cumulative spending (e. g., one point per EUR when spending is below 100 EUR, three points per EUR when spending is above 100 EUR). This gives customers a real reward for concentrating their spending at a single retailer. This supports a strategy of focusing retention efforts on a small group of high value customers (Reinartz 2010). Sometimes, such a measure is implemented with different tiers of loyalty cards (e. g., *Esprit* that has an *Esprit Friends* card, a Gold card and a Platinum card, with increasing levels of services for each customer group). This increases customers' **switching costs**, since customers can perceive accumulated assets as an investment in their relationship with the retailer. This in turn should enhance loyalty.

Single-Company vs. Multi-Partner Loyalty Programmes

In terms of sponsorship, there are two types of loyalty programme:

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

Single-company loyalty programmes are run by an individual retailer. Examples include the programmes run by *Auchan* in France, *Peek & Cloppenburg* in Germany, *Esprit* across Europe or *Boots* in the UK. The loyalty card normally carries the retail brand, and points can only be accumulated at that retailer.

A benefit of **multi-partner programmes** is that customers can use their loyalty cards at different retailers, so they can use it more often, collect points faster and qualify for certain premiums or prizes faster (Zentes et al. 2006, pp. 615–616). These programmes' penetration is often higher than that for single-company programmes. This can be particularly beneficial for retailers with a low purchasing frequency (e. g., DIY stores or consumer electronics retailers), for whom it would be difficult to attract customers via a proprietary programme. 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 retailers can also target profitable consumers who are not yet part of their customer base

(Cuthbertson and Laine 2004, p. 302). Knowing purchasing data across retailers facilitates a much broader analysis of customer behaviour (within the limits of privacy regulations and customer acceptance); however, data protection laws often limit the use of data across retailers, even in multi-partner programmes. At the same time, the high cost of a loyalty programme can be distributed among participating retailers. The disadvantage of a multi-partner programme is that loyalty is often focussed on the coalition programme rather than on any particular retailer (Cuthbertson and Laine 2004, p. 298). In addition, the loyalty scheme (e. g., rewards, accumulation function) is not designed to meet a specific retailer's strategy, but must instead appeal to a group of retailers as a whole. Nevertheless, these multi-partner programmes are popular in many countries:

- One of the most successful multi-partner programmes in Europe is the German *Payback* system, majority owned by *American Express*, which includes about 30 store-based retailers and around 600 online shops, including many large retail companies, such as *Real*, *REWE*, *dm-drogerie markt*, *Aral* and *Zalando*. In recent years, *Payback* has internationalised into Poland, India and other markets. However, it is noteworthy that some partners have also left the programme, including *OBI*, *Görtz* and *Amazon*.
- The British multi-partner loyalty scheme *Nectar* has a similar structure, and includes large retail and service companies such as *Sainsbury's*, *Homebase*, *Argos* and *Hertz*. It also includes a large number of online shops like *Asos* and *Ebay*.
- In France, *S'Miles* offers bonus points for purchases at supermarkets and hypermarkets run by *Group Casino, Galeries Lafayette*, *Intersport*, *Mr. Bricolage*, *BHV* and others.

Customer Clubs

In some cases, customer clubs are simply loyalty programmes. However, the focus of customer clubs is usually more on the emotional bond between customer and retailer. The use of club memberships, preferred services, newsletters, online forums, telephone helplines and other measures establishes **two-way communication** so customers can interact with a company and get to know it better (Rowley 2004, pp. 126–127). For example, some retailers let customers register for a "baby club". They identify (based on loyalty card use) when customers start buying baby products and then directly target them with an invitation. The *Babybonus* programme from *dm-drogerie markt* in Germany focuses less on earning points and more on a welcome pack (including many test products), information for young parents and so on. The *Mondovino* wine club from *Coop* Switzerland promotes interaction with club members. For example, club members get specific information, and some wines are reserved for club members.

16.5.2 Collection and Analysis of Customer Data

In CRM, data mining techniques are used to analyse customer information. Since the results of the analysis and the forecasting of customer responses can be used to develop marketing measures and the subsequent behaviour of specific customers can be tracked and evaluated, a learning system can be created that studies the specific behaviour of each customer and can detect changes in behaviour over time (Zentes et al. 2006, p. 600).

One important potential advantage of CRM is that the success and profitability of marketing measures can be evaluated experimentally by comparing the purchasing behaviour of a target customer group with a control group, based on incremental sales or contribution margin (Hansiota and Rukstales 2002, pp. 262–263). However, IT capacities and data analysis methods have failed to keep pace with the huge amount of data ("Big Data") collected through loyalty cards (often millions of datasets daily).

Retailers' customer databases may include the following data (Kumar and Reinartz 2012; Eisenbeiss and Bleier 2012, p. 474):

- **Personal information**: name, address, birthday, e-mail address, phone number, etc.
- **Socio-demographic information**: age, gender, family status, household size, children, occupation, etc.
- **Psychographic information**: personality criteria, lifestyle criteria, attitudes towards specific product attributes (e. g., organic food), etc.
- **Buying transactions**: purchased products (SKUs), purchased volume, date of purchase, price of product, product bought on promotion, type of promotion (e. g., coupons cashed), etc.
- **Clickstream data** (for online shops only): products looked at, sequence of clicking through shop sites, addition of product to shopping basket, abandoning of shopping basket, etc.
- **Retailer activities towards customer**: type of contact (e. g., coupon sent), date of contact, reaction to contact, etc.

Customer Segmentation

Customer segmentation is a core task of data analysis. In theory, retailers employing loyalty programmes can divide their customer base down to individual customers, but in practice only between 10 and 30 categories are used. Potential **segmentation criteria** include purchasing volumes, demographic characteristics, shopping motives, attitudes and lifestyles.

The options start with simple segmentation criteria. **ABC analysis** is used to categorise customers by their **annual purchases**. Very often, a 20/80 rule is assumed that argues that 20 % of customers (**A customers**) account for about 80 % of retail sales volume. Even though the ratio is rarely so extreme, it has frequently been shown that the relevance of different customers varies considerably. While customer purchase behaviour is a backwards-oriented criterion, **total customer lifetime value** can serve as a sophisticated basis for segmentation. Such customer value-oriented segmentation shows **which** customer groups a retailer should focus on, but it does not show **how** to approach customers.

Segmentations based on consumer behaviour such as **shopping motives** or **attitudes** are better suited to developing tailored marketing campaigns. 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). Furthermore, customers' positions in the **family cycle** (e. g., young singles, young couples, couples with young children, older, retired couples) are usually a good predictor of purchasing behaviour.

Based on their customer data, retailers can use a combination of methods to establish customer segments to suit their specific needs.

16.5.3 Use of Customer Data as Action

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, customer data are used to change the macro-variables of retail marketing, such as the merchandise mix, pricing, promotion or location decisions (**micro-macro approach**; Zilliani and Bellini 2004, pp. 12–13). For example, before delisting a product 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 the most valuable customers in the store, keeping this product in stock is important for retaining these profitable customers (Cuthbertson and Laine 2004, p. 301).

CRM, in contrast, emphasises **micro-marketing** (or **one-to-one-marketing**), which targets specific consumers or consumer segments based on knowledge of their individual behaviour. The retail service (such as the merchandise offered in advertising, promotions, services offered) is then tailored to certain segments and (rarely but increasingly) individual customers. Since the store itself is still standardised for all visitors, CRM often takes place through marketing communication with specific customers. Measures include the following (Zentes et al. 2006, pp. 604–609):

- **Addressed direct mailings**: customised 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 brochure, often with targeted promotions.
- **E-mail marketing**: direct customer mailings have increased tremendously with the advent of e-mail, which is used to distribute customised advertising and newsletters to customers. Distribution costs are much lower and customising more flexible and cheaper.
- **In-store multimedia kiosks**: similar to the Internet, multimedia kiosks in retail stores can be used to communicate with each customer individually. At electronic point-of-sale terminals, loyalty cardholders can (among other functions) check their point balances, order rewards and print value cheques with which they can pay for their future purchases.
- **Mobile marketing**: some retailers already use customers' mobile phones as communication devices, for example of providing coupons by SMS or MMS.

- **Personal shopping assistants**: digital shopping assistants that a customer can carry or attach to their shopping carts are still in the testing stage. After registering their loyalty card, these devices can guide customers 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 locations in the store.

16.6 Loyalty Marketing and the Internet

Online shops do not need loyalty schemes to collect customer data. Customers usually register after making their first purchase and from then on are known to the retailer. Therefore, online shops can use a higher level of CRM and one-to-one marketing. In addition to these purchases, overall purchasing behaviour can be observed via **clickstream data**. By using cookies, electronic retailers can track the date and duration of each visit to their website, the time customers spend looking at specific products, products viewed but not purchased and the sequence in which products were viewed or websites browsed. Unlike in stores, this data can be used to tailor the retail marketing mix to each customer, from the basic merchandise offer, prices and promotions to store design. Online shops can even segment customers who have not yet registered. As shown in the case study on *Amazon* (see Chap. 13), online shops use the location from which a visitor enters the online shop and even the device they use (e. g., *iPhone*) to profile customers and offer them targeted products, prices, etc.

The most successful example of online CRM, *Amazon*, shows how individualised **product recommendations** are derived by connecting the profile of an individual customer (established from their purchase history) to those of other customers. Demand interrelationships are detected systematically. The date of purchases is considered, because purchasing behaviour can change over time. Using cookies or after logging in, the customer is addressed with a **personalised landing page**.

The Internet has created additional options for loyalty marketing. Loyalty can also be developed by stimulating the interaction between customers. For example, some retailers have started online forums and "communities" where users discuss and give each other advice. Often, experts from the retailer join in the discussion. Home improvement retailers around the world (such as *The Home Depot* or *Hornbach*) and pet stores (such as *Fressnapf/Maxi Zoo* or *PetSmart*) have been among the first to adopt this idea. Fashion retailers (such as *Zara*, *GAP* and *H&M*) almost all have a presence on *Facebook* where they provide their "fans" with information and truly interact with their customers. These types of **social media** have brought new opportunities for retailers to get in closer contact with their customers and build loyalty. The negative side is that, unlike traditional mass advertising, the electronic word-of-mouth stimulated by these instruments is not fully under the company's control. However, positive referrals by customers to their friends are usually much more effective than traditional advertising.

Customer Relationship Management in Omni-channel Systems

Today, consumers interact with retailers in many different ways (so called "**touch-points**"): in-store or via the retailer's webpage, e-mail, standard phone calls, smart-phones and/or social media such as Facebook. The term "**omni-channel retailing**" refers to a strategy in which customers have the same customer experience across all of a retailer's different channels and cross-channel processes are seamless (see Chap. 5). This is made possible by the fact that multiple consumer interactions can be structured so that consumers can easily communicate with a retailer via the channels of their choice (Webster 2010).

In omni-channel systems, CRM faces the challenge that information about specific customers' buying behaviour across different channels must be collected and integrated to get a full picture. Thus, in omni-channel retail systems, different sources of customer information can be used to gain consumer insights. For a store-based retailer who also operates an online shop, **loyalty cards** (which can be used across all channels) are the instrument that connect the information from different channels.

Mobile phone and loyalty apps are increasingly providing the link between stores and the online world. **Loyalty apps** like "*Shopkick*" allow customers to browse websites at home and put products on a shopping list which they will be reminded about when entering specific retail stores. Points are awarded when a customer enters specific retail stores or buys specific products that the app recommends. This is a modern, **real-time** and **location-based** form of a loyalty scheme.

Retailers can also leverage their assets across these multiple channels by directing consumers to a specific channel. In-store advertising can be used to attract consumers to the company's online shop. The online shop can recommend that customers visit the brick-and-mortar store. As discussed in Chap. 5, retailers who operate multiple channels increasingly offer cross-channel buying processes. Consumers are invited to search for information on a retailer's website and then buy in-store, or *vice versa*. Retailers such as *REI* in the USA, *Globetrotter* in Germany and *Marks & Spencer* or *House of Fraser* in the UK bring their online stores' offers into their brick-and-mortar stores, and consumers can even order from their online shops in in-store multimedia kiosks, increasing customer convenience. Likewise, many retailers now offer store pick-up for products ordered via the Internet. In addition to reduced logistics costs, the main advantage is that customers who pick up products will experience the physical store and the product assortment there. This often leads to additional purchases and to a stronger exposure to the retailer, which usually enhances loyalty.

There are many new ideas for integrating multiple channels to enhance customer loyalty. While it is not yet clear which concepts will develop and which are sustainable, a closer link between stationary stores and online channels will almost certainly be a strong trend.

16.7 Conclusion and Outlook

Over the past two decades, many retailers have shifted their focus to CRM and introduced loyalty card programmes as a tool. These programmes often incur substantial costs, because of the need to provide rewards, run expansive IT systems and administer the programme (McGoldrick 2002, p. 120). Some researchers are critical of such programmes, claiming that "loyalty programs do not create loyalty" (Reinartz 2010, p. 410). This is because loyalty programmes have to be monitored closely and loyalty cards alone are not enough to establish loyalty, and must be employed as part of the overall retail marketing approach. Some researchers state that it is difficult to judge the ultimate profitability of loyalty programmes, but this is true for marketing in general. Nevertheless, it is usually easier to measure the success of loyalty marketing campaigns than traditional marketing campaigns (Cuthbertson and Laine 2004, p. 299). In addition, online shops and omni-channel systems provide many additional opportunities to track customer behaviour and offer benefits to loyal customers.

CRM must be compatible with the company's broader strategy. If a retailer's primary goal is to achieve market leadership by poaching customers from its main competitors and growing rapidly, the maximum number of new customers should be attracted. In this case, focusing on only the most profitable customers would not meet the company's strategic objectives (Bechwati and Eshghi 2005, p. 96). Thus, while CRM is an increasingly relevant marketing approach in retailing, as with all functional strategies, alignment with overall company strategy is crucial. Some retailers, such as *ASDA*, *Aldi, Lidl or Trader Joe's*, believe that adhering to their core strategies is better for establishing and building loyal customers than creating a loyalty programme. While this is certainly true for them, for many other retailers, CRM offers a wealth of options for interacting with their customers. Ultimately, the potential gains from analysing detailed customer data and targeting consumers, especially with new media that lower the communication costs of tailored marketing communication, are enormous.

Further Reading

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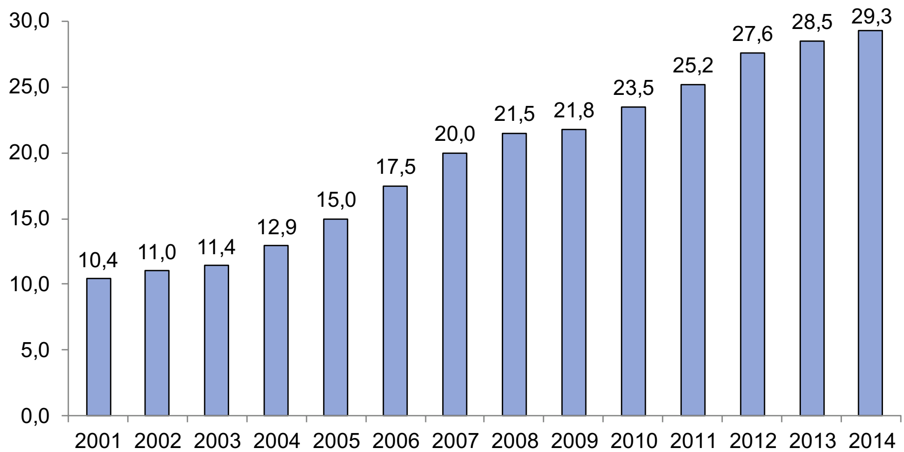

Fig. 16.3 *IKEA* revenues between 2001 and 2014 in billion EUR. (IKEA 2015a, p. 34)

16.8 Case Study: IKEA

16.8.1 Profile, History and Status Quo

Founded by Ingvar Kamprad in 1943, *IKEA*[1] has gone on to become the world's largest furniture retailer, specialising in stylish but inexpensive Scandinavian-designed home furnishings and furniture. Even today, after more than 70 years of business activity, *IKEA* is still strongly associated with Kamprad. The name *IKEA* is an acronym. *I* and *K* are the founder's initials, *E* stands for Elmtaryd, the name of his parents' farm, and *A* stands for Agunnaryd, his hometown in the Southern Swedish province of Småland. Initially selling items such as pens, wallets, jewellery and picture frames, a **mail order catalogue** was established in 1947 to introduce furniture into the product range, which has been the focus since 1951. Due to customer scepticism towards buying furniture unseen, Kamprad opened a **showroom** in the village of Älmhult in 1953, where customers could examine his products before ordering. In 1955, as a result of a supply boycott caused by pressure from competitors, *IKEA* started designing its own furniture. The first flat-pack furniture, now one of *IKEA's* trademarks, was invented in 1956. In 1958, the first *IKEA* store was opened in Älmhult, and since then the company has expanded steadily. Its first international venture was in 1963, when the first store outside Sweden was opened in Oslo, Norway (Zentes et al. 2011, pp. 61–62). Today, the company has 361 stores around the world and a sales volume of almost 30 billion EUR.

Even though the company has grown enormously and is today's only truly global furniture retailer, growth rates remain high (see Fig. 16.3). The company is active globally,

[1] As well as the explicitly cited sources, sources used for this case study include the websites http://www.ikea.com, investor relation presentations and various annual and interim reports.

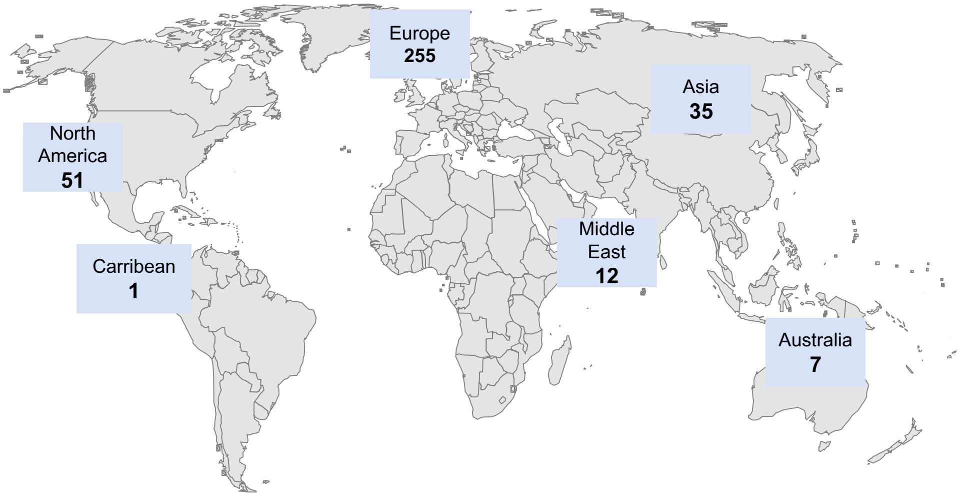

Fig. 16.4 IKEA stores around the world. (IKEA 2014, p. 2)

but most of its stores are still located in Europe, as Fig. 16.4 shows. About 70 % of *IKEA*'s sales are in Europe. The most important country markets are Germany (about 14 % of *IKEA*'s sales), the USA (about 12 %), France (about 8 %), Russia and the UK (each about 6 %). The company's main sourcing markets are China (with about 25 % of procurement volume) and Poland (about 18 %) (Statista 2015, pp. 14, 16).

The company has very loyal customers who will travel considerable distances to IKEA stores. Thus, the company benefits not just from behavioural loyalty but from true commitment from its customers. For example, IKEA is by far the most frequented furniture store chain in Germany (see Fig. 16.5).

IKEA achieves this sales success with a total range of about 12,000 products. Each store carries a selection of these 12,000 products depending on store size. The core range is the same worldwide.

16.8.2 Positioning of IKEA as Modern Category Specialist

IKEA's retail brand is clearly positioned. The company's official **vision** is "to create a better everyday life for the many people", which is achieved by combining aesthetic and pragmatic furniture design and solid quality with a constant drive to cut costs and pass savings on to customers. This vision manifests itself in the business idea: "To offer a wide range of well designed, functional home furnishings at prices so low that as many people as possible will be able to afford them". In many cases, the cornerstones of this *IKEA* strategy are the exact opposite of conventional furniture retailing, and have turned the traditional foundations of the furniture business upside down (Kling and Goteman 2003, pp. 31–32; Zentes et al. 2011, p. 63):

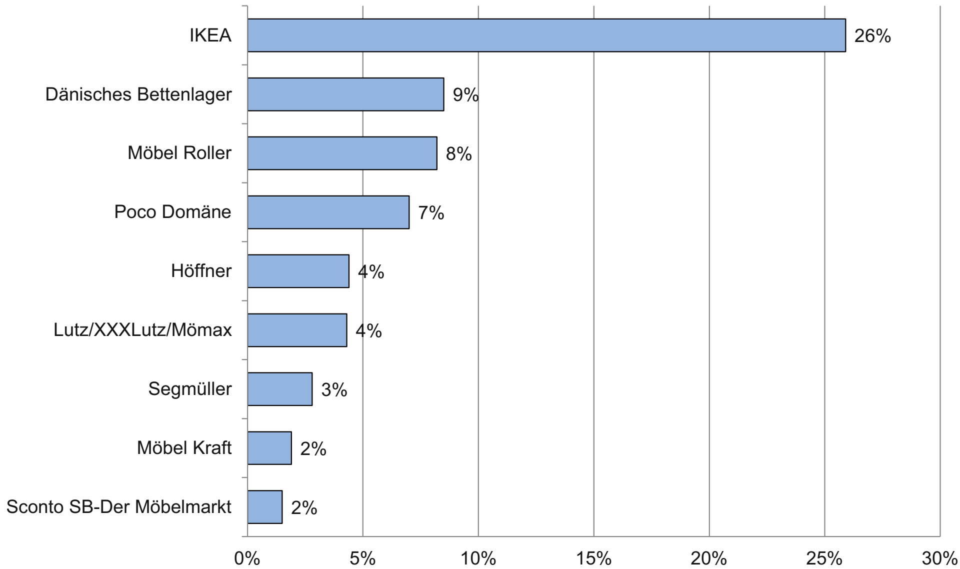

Fig. 16.5 Favourite furniture stores in Germany, 2014 (percentage of customers who bought furniture in a store within the last two years). (Statista 2014, p. 38)

- Traditionally, home furniture stores were located as boutiques in city centres. However, *IKEA* has developed large, even huge stores on the outskirts of cities. Even though the company has recently begun to develop an inner-city format, this does not change the overall footprint of huge *IKEA* stores.
- Instead of shop assistance, customers serve themselves.
- As opposed to traditional local sourcing, *IKEA* has sourced on a global scale from the outset.
- *IKEA* has shifted the traditional furniture store focus from middle- to upper-middle-aged customers to younger people.
- Instead of the assembled furniture being delivered at a relatively high price, customers both transport and assemble the flatpack furniture themselves. This allows *IKEA* to offer significantly lower prices than traditional home furnishings retailers.
- When *IKEA* started in Sweden, dark and heavy furniture was popular, but *IKEA* introduced its trademark light Scandinavian style, characterised by blonde wood, natural material and modern design.
- *IKEA's* advertising adopts a very modern style. For example, in Germany, *IKEA* uses the informal "Du" rather than "Sie" in its advertising, immediately implying a close relationship with the customer.

Thus, *IKEA* has always differentiated itself very clearly from the competition, in the process creating a very strong retail brand which gave customers a reason to be loyal. In

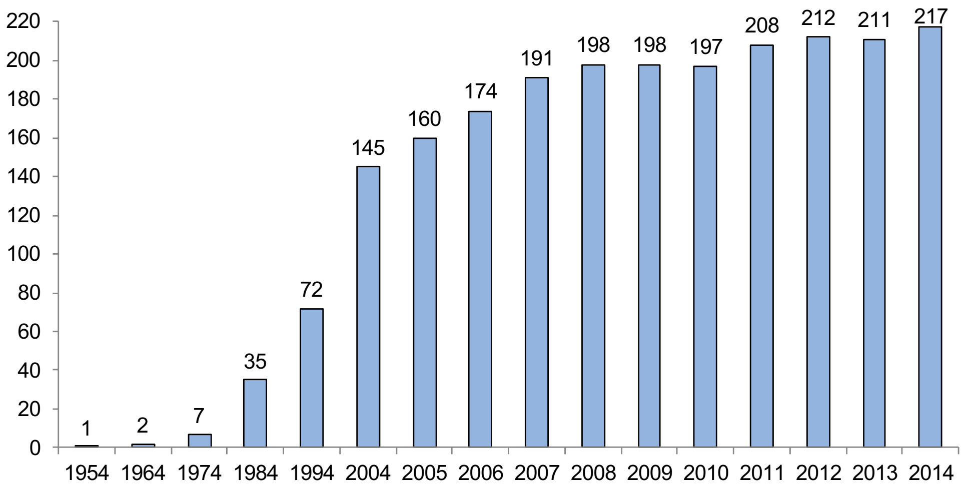

Fig. 16.6 Number of *IKEA* catalogues printed per year in millions. (IKEA 2015b, p. 69; Statista 2015, p. 22)

fact, retail brand rankings currently rank *IKEA* as the second most valuable retail brand in Europe (see Chap. 9).

16.8.3 IKEA's Catalogue as Important Advertising Tool

One of *IKEA's* most important advertising tools is its catalogue. This catalogue is mass distributed annually in the area around each *IKEA* store. The catalogue can also be picked up in-store, ordered online or downloaded as a .pdf. In 2014, almost 200 million *IKEA* catalogues were printed worldwide, and this number is set to rise (see Fig. 16.6).

The catalogue is currently produced in 38 different editions, in 17 languages for 28 countries. However, the editions differ only slightly. National *IKEA* companies can add a few pages to their country's edition, with products they deem especially important. Thus, the catalogue transmits a very uniform image for *IKEA* worldwide (see Fig. 16.7).

Interestingly, in a time of dynamic changes, the *IKEA* catalogue is distributed in late summer of each year and remains valid for a full year. Prices are guaranteed not to increase during this time.

In addition to the print catalogue, *IKEA* launched a catalogue app in 2011. The number of downloads quickly increased, and by 2013 almost 10 million people had already downloaded the *IKEA* catalogue app (Statista 2015, p. 24). In some countries, *IKEA* includes very modern mobile technology in their app. By scanning selected pages in the printed *IKEA* catalogue with the app, users can view videos and get 360° views from furnished rooms. Furthermore, users can see how selected furniture would look in their own living room by using 3D and augmented reality.

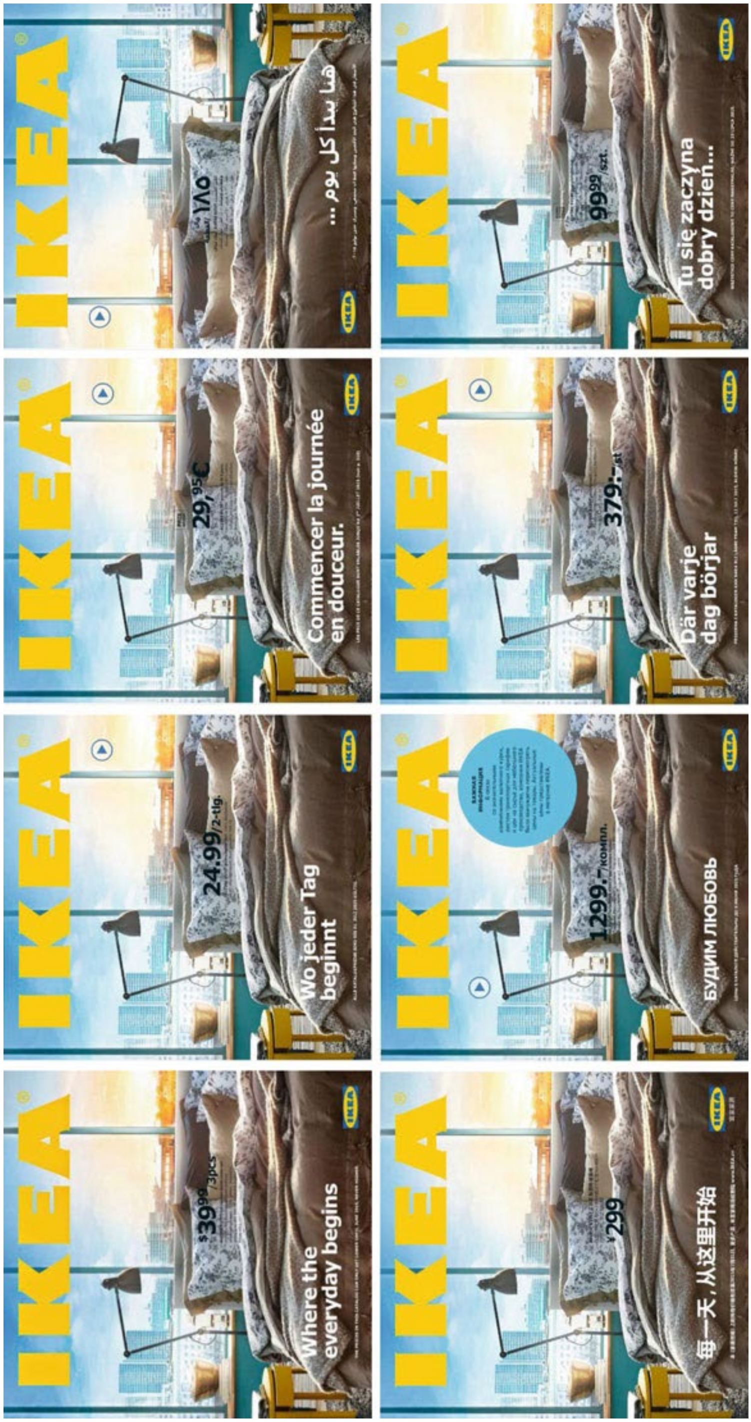

Fig. 16.7 IKEA catalogues in the major country markets. (Ikea)

16.8.4 IKEA Family Club

IKEA's loyalty scheme is a loyalty card called *IKEA Family*. It is designed as a club with (free) membership. Or, as *IKEA* explains on its webpage: "*IKEA Family* is more than just an orange card […] It's an *IKEA* fan club […] It's a pass to special events. But most importantly, it's our way to say 'thank you'."

The *Family Club* was first launched in Sweden and introduced to Germany in 1985. Not every country has a club. The number of *Family Club* members in Germany (a country with approximately 80 million inhabitants) has not been made public, but in 2012, a manager of *IKEA* Switzerland revealed that Switzerland (a country with approximately 8 million inhabitants) has 1.3 million *IKEA Family Club* members (Graf 2012), which may give an indication of the number of members in Germany.

Club members receive the following benefits:

- Special discounts on regular *IKEA* products,
- access to an exclusive range of products that are only available to *IKEA Family Club* members,
- access to promotional in-store events (e. g., workshops and seminars), especially Swedish festivals like Midsommar,
- a free member magazine which appears in four annual editions,
- participation in sweepstakes (e. g., in 2015 in Germany, a Swedish holiday was given away every month),
- free transport insurance against accidental damage of furniture on the way home and during assembly (when swiping the *Family Club* card at the checkout), and
- free coffee and special offers in the *IKEA* restaurant.

The programme, including the minor benefits like free coffee, has sometimes met with unexpected success. For example, in Xu Hui in China, a dating club for the elderly discovered the *IKEA* restaurant was a good location for its twice-weekly meetings. The dating club members registered for *IKEA Family Club* membership and received their free coffees every Tuesday and Thursday, sometimes spending the entire day in the restaurant, bringing their own picnics, radios, etc. When the number of participants reached about 700 in 2011, ordinary *IKEA* customers were so disrupted that *IKEA* had to restrict where people who only had free coffee could sit (Schütte et al. 2013). Even in Germany, the free coffee is restricted to Monday to Friday to avoid disruption.

In the USA, the *IKEA Family Club* was only launched in November 2011. In less than 6 months, it had 1.6 million members. The US club was immediately linked to a multichannel media approach. For example, customers can sign up for the programme at an in-store multimedia kiosk on which they can also view exclusive discounts and offers. People can also register via tablet PCs which sales employees carry, particularly during busy periods. Customers can sign up to receive SMS alerts, for example about in-store campaigns. Customers can also use their phone in lieu of their *Family Club* card by sending a text message to an *IKEA* system which automatically returns the customer's card number to show to a cashier (Tode 2012, RIS 2012b).

16.8.5 Facebook as Loyalty Builder

In addition to the *IKEA Family Club*, *IKEA* also uses social media. For example, its *Facebook* site in Germany has about 950,000 fans. A few years ago in the USA, *IKEA* organised events to increase its number of Facebook fans and drive store traffic. For example, the retailer hosted in-store events to which people could invite their *Facebook* friends. For every friend invited over *Facebook*, *IKEA* donated 1 USD to a charity. The event itself had free meals, special discounts and gift card giveaways. In addition, *IKEA* used registration for the event to acquire customer contact addresses to interact with customers about future events and promotions (RIS 2012a).

16.8.6 IKEA Business

Another *IKEA* club is *IKEA Business*. This follows the retail trend of targeting micro and small businesses in addition to retailers' traditional clientele of private consumers (see Chap. 7). After families with children, *IKEA's* established target group, business customers are the second major target segment. As part of IKEA's retail-to-business strategy (R2B) (Zentes et al. 2015, pp. 14–15), *IKEA* launched the *IKEA Business Club* in a number of countries (e. g., Germany and Japan). Membership is free, and members receive a number of benefits:

- Bonus points with each purchase,
- selected products sold at lower *IKEA Business* prices,
- customers receive an online copy of their invoice with detailed business address and all formal requirements,
- personal and specific sales advice at *IKEA Business Point*,
- specific promotions and information,
- *IKEA* finance solutions so furniture can be bought now and paid for later.

16.8.7 Summary and Outlook

IKEA has a very broad customer base. It is the largest furniture retailer in the world and the market leader in many of the country markets in which it operates. Its success is based on clear brand positioning and clear differentiation from the competition.

In addition to its mass marketing instruments, *IKEA* runs its *IKEA Family Club* in most countries, which gives special treatment to its members and is intended to increase customer ties. This club has recently been linked to mobile media in countries such as the USA. *IKEA* also uses the club concept to directly target interaction with business customers – another key segment – via a loyalty scheme and segment-specific services and solutions.

Questions

1. Discuss whether the *Family Club* scheme really creates further loyalty.
2. *IKEA* is increasingly focussing on business customers. Discuss why this may be the case and whether this is a promising strategy for *IKEA*.
3. *IKEA* is successful across Europe. Discuss whether their clear brand image and positioning with specific target groups are an advantage or obstacle for further growth.

▸ See also Chap. 7 and the literature on R2B.

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Part IV

Buying, Logistics and Performance Measurement

Buying – Strategy and Concepts 17

Abstract

This chapter will examine the importance of retail buying, along with its external environment, characteristics and instruments. It will discuss traditional and non-traditional forms of buying and contrast different buying situations. Buying processes and their impact on performance measurement will also be discussed.

17.1 Strategic Importance and Role of Buying

The costs of goods sold is the most important cost category for retailers. Table 17.1 illustrates this fact via the gross margins of different sectors and formats. Gross margin is defined as net sales minus cost of goods sold (purchase prices and freight charges, less discounts) (see Chap. 20). The costs of goods sold vary between almost 55 % (perfumeries) and 80 % (supermarkets), which shows the high relevance of buying for retailers.

Retailers' buying strategies are influenced by their merchandising philosophy and intended relationship with their suppliers (manufacturers). "A **merchandising philosophy** sets the guiding principles for all the merchandise decisions that a retailer makes. It must reflect target market desires, the retailer's institutional type, the marketplace positioning, the defined value chain, supplier capabilities, costs, competitors, product trends, and other factors" (Berman and Evans 2013, p. 379). The merchandising philosophy determines the breadth of the assortment (narrow or wide) and the depth of the assortment (deep or shallow) within each category. In addition, retailers "must select the quality of the items within the assortment – high or low, national brands or store brands. They need to decide on their pricing policies, across categories and within. Finally, retailers must

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Table 17.1 Average gross margin of different retail sectors in Germany. (Adapted from HDE 2014, pp. 175–179)

Retail Sector/Format	Gross Margin (as a percentage of gross turnover)
Food Retailing	20.7
Pharmacies	22.2
Electronic Retailing	30.5
Specialised Trade: Natural Food	30.9
Specialised Trade: Toys	31.5
Bookstores	31.7
Specialised Trade: Sportswear and Sports Equipment	32.0
Stationery Shops	35.0
Specialised Trade: Furniture (conventional)	36.8
Specialised Trade: Photo	37.1
Specialised Trade: Children’s Clothing and Baby Stores	38.8
Specialised Trade: Shoes	39.2
Specialised Trade: Kitchen and Household	39.5
Specialised Trade: Women’s Outer Garments	40.7
Specialised Trade: Watches/Jewellery	41.0
Specialised Trade: Men’s Ready-made Clothing	41.1
Perfumeries	45.4
Specialised Trade: Home Textiles	47.3

decide if assortments should generally be stable over time or whether there should be surprises, specials, or customisation in assortments” (Kahn 1999, p. 289). These issues are discussed in Chap. 12.

The strategic role of buying in retail companies is reinforced by the growing role of sustainability within the corporate strategy and the vital issue of supply security, factors which will be discussed in this chapter.

17.2 External Environment Affecting Buying

17.2.1 Trade Liberalisation and Regional Integration

Retail buying is strongly influenced by the development of external factors, of which the following play a predominant role:

- Political-legal factors
- Socio-economic factors
- Technological factors

Global trade liberalisation as part of the activities of the *World Trade Organization* (WTO) has opened new sourcing markets throughout the world, with China and other southeast Asian countries being particularly important sourcing markets. As early as 2007, the *HandelsMonitor* predicted an increase in **direct foreign procurement volume** of German-speaking retailers from around 15 to 22 % in 2015 (Zentes et al. 2007, p. 88).

Besides this global trade liberalisation, new sourcing markets are being tapped by increasing **regional integration**, for example through the expansion of the European Union to 28 member states and the intensification of trade within the **common market**. Similarly, bilateral agreements like the one between the EU and Switzerland have opened up new sourcing markets.

17.2.2 Sustainability and Supply Security

Increasing public awareness of companies' and consumers' ecological and social responsibilities (see Chap. 10) have led to higher ecological and social standards (e. g., *Social Accountability 8000* – SA 8000) for production in developing countries, including the prohibition of child labour, the limitation of working hours and others (see Morschett et al. 2015, pp. 299–309). Retail companies embed these standards into their sustainability strategies or their **corporate social responsibility** (CSR) pledges. In this context, **international codes of conduct** such as the *Foreign Trade Association's* (FTA) *Business Social Compliance Initiative* (BSCI) are increasingly important (see Chap. 10).

In addition to sustainability, **supply security** is increasingly important, thanks to the explosive expansion in worldwide demand for resources, energy and agricultural products, driven by rapid population growth and changing consumption patterns in increasingly wealthy emerging countries such as China. The global population will grow from 7.2 billion in 2013 to 9.6 billion in 2050 (United Nations 2013). In East Asia alone, meat consumption per capita is expected to double by 2050. These developments challenge mid- to long-term supply and thus encourage long-term contracts (**contract buying**) (see, e. g., PwC/H.I.MA. 2010).

17.2.3 Internet Technology

Retailers' growing technological sophistication has promoted **retail exchanges**. An exchange is a business-to-business (B2B) platform "where purchasers and suppliers meet to transact business. A distinction may be made between private and public exchanges. **Private exchanges** can be either one-to-one (1T1) or one-to-many connections (1TM). The former are direct connections, while the latter connect all the actors through the central Internet hub

Table 17.2 Sourcing Toolbox. (Adapted from Arnold 1997, p. 93)

Buying Decisions	Options	
Source	Company-owned	Outside supplier
Interacting with Merchandising Source	Active	Passive
Scope of Suppliers	Single	Multiple
Supplier Relationships	Transactional	Collaborative
Stocking Merchandise	Stock – stock reduced – stockless	
Geographical Market	Local/national	International/global
Mode of Buying	Individual	Cooperative
Organisational Form	Internal	External
Technological Form	Traditional	Electronic (web-based)

[…]. **Public exchanges** – often referred to as portals – extend the boundaries of the company and involve many-to-many (MTM) interactions" (Lysons and Farrington 2012, p. 190).

The *REWE Group Supplier Portal* is an example of a private exchange focussing on 1TM connections. The German retailer "offers a platform for optimised communication and cooperation between *REWE Group* and its suppliers. This need arises from the current market situation and the inherent tension between competitive pressure and customer demands. […] As a data hub, the portal serves as a central switch between retail and the consumer goods industry and pursues the approach of optimising communication, interaction and collaboration" (REWE 2015). *mercateo*, a public exchange with MTM connections, delivers an **international sourcing platform** that facilitates the sourcing and development of private labels/store brands for retailers and their network of suppliers, agents and service providers (mercateo 2015).

17.3 Sourcing Toolbox

17.3.1 Overview

Retailers' diverse buying decisions can be systematised using a sourcing toolbox (see Table 17.2). This box describes retailers' options and strategies along several dimensions.

17.3.2 Merchandise Sources

There are two major options for merchandise sources:

- Company-owned suppliers
- Outside suppliers

Table 17.3 Outside sources of supply. (Adapted from Berman and Evans 2013, p. 409)

Source	Characteristics
1. Manufacturer	Physically produces goods, may provide shipping and credit
2. Full-Service Merchant Wholesaler	Buys goods from manufacturers, performs many services for the retailer (shipping, storing, credit, information, etc.)
a. General Merchandise	Carries a very wide assortment
b. Specialty Merchandise	Carries a very deep assortment
c. Rack Jobber	Brings and sets up their own displays, usually deals with non-food items in supermarkets and other stores, may be paid after merchandise is sold, convenient for store
3. Limited-Service Merchant Wholesaler	Same as full service, except that fewer retailer services are provided and costs are lower
a. Drop Shipper	Buys and sells via the telephone (never physically handles merchandise), major task is connecting buyer and seller
b. Mail Order	Catalogue sales to small retailers
c. Cash-and-Carry	Store where small retailers buy and take merchandise
4. Agents and Brokers	Do not take title to goods (ownership remains with manufacturer), provide a variety of functions for a fee or commission. Included are auction companies, salespeople, and selling agents

Company-owned (or internal) sources are sources where a retailer owns a manufacturing and/or wholesaling facility. **Outside suppliers** (also called external suppliers) are not owned by the retailer. Internal manufacturing has a long tradition in food retailing, especially for fresh food like bread, cakes and pastries or meat products. Retailers are increasingly producing products in other fields, too. The development of **store brands** is a key driver of insourcing ("**upstream verticalisation**"), along with the challenge of securing mid- and long-term supply. In this context, company-owned suppliers are not just production sites but also agricultural sites, i. e., farms (see PwC/H.I.MA. 2010).

Two basic kinds of outside suppliers can be identified: regularly-used suppliers and new suppliers. In the case of a **regular supplier**, the retailer knows the quality of merchandise and the reliability of the supplier. In the case of a **new supplier**, the retailer is unfamiliar with the quality and reliability. Therefore, a **supplier evaluation** is required. The different types of outside suppliers are described in Table 17.3.

17.3.3 Interacting with Merchandising Sources, Scope of Suppliers and Supplier Relationships

In **active sourcing**, the retailer influences outside sources in terms of product development and improvement, including packaging, etc. **Passive sourcing** means the retailer buys goods from manufacturers and/or wholesalers that have been developed and produced independently. This situation is typical of the buying process for manufacturer brands (national or global brands).

Store brands are products developed and designed by a retailer and available for sale only from this retailer. The retailer exerts the greatest influence on these products. Developing store brands also means modifying the value chain architecture from a traditional "buyer" (characteristic of passive sourcing) to a "coordinator" or even "producer" (Morschett et al. 2015, pp. 370–372). The store brands are produced by company-owned manufacturing facilities (value chain architecture "producer") or by outside (contract) manufacturers (store brand manufacturers or private label manufacturers) (value chain architecture "coordinator"). Developing and producing store brands is vital for **vertical retailers**, as discussed in Chap. 6.

Single sourcing refers to a buying situation in which a product is delivered by only one manufacturer or wholesaler/distributor. This strategy allows bundling of purchasing volume, reducing purchase prices and transaction costs, but carries risks, including dependence on particular suppliers. **Multiple sourcing** is a counter-strategy where several suppliers provide a single product. According to the *PwC/H.I.MA* study, multiple sourcing will be increasingly important in future to balance supplier risks, particularly in terms of long-term **supply security** (2010).

Transactional relations are typical in short-term buying, e. g., when buying commodities. Electronic marketplaces are modern platforms to run these transactions. Here, the price (given a stipulated quality) is the dominant factor in selecting suppliers. **Collaborative relationships** with store brand manufacturers are possible for both marketing and logistics and to a growing extent with brand manufacturers. Collaborative relationships in the form of mid-term and long-term contracts are increasingly important as a way to secure supply, e. g., via **contract farming**.

17.3.4 Stocking Merchandise

There are three sourcing options for logistics and supply chain management. **Stockless** sourcing means the manufacturer delivers to a retailer's outlets and/or transit terminal/cross-docking terminal according to the **just-in-time** philosophy. This implies collaborative relationships using **electronic data interchange** (EDI) for replenishment (see Chap. 18 and 19). **Stock** is a kind of sourcing where the products are stored in a central warehouse or several regional ones. This situation is typical for commodities bought in foreign countries, particularly ones bought in huge quantities at low prices.

Stock reduced lies in between these two extremes. Using modern supply chain management approaches, such as **vendor-managed inventory** (VMI), can reduce stock volumes while maintaining or even increasing service levels ("never out of stock").

17.3.5 Geographical Market

An important decision is to determine where the merchandise is produced and/or bought: local/national vs. international/global sourcing.

International or **global sourcing** is a current megatrend in retailing. One important reason for sourcing globally rather than domestically is to save money (see Fig. 17.1). This tendency is driven by tariff reductions on manufactured goods pushed by the *World Trade Organization* (WTO) to liberalise trade and the establishment of free trade zones like the *North American Free Trade Agreement* (NAFTA) or common markets like the *European Union* (EU). Retailers who source merchandise globally can benefit from the cessation of tariffs in such zones. However, international sourcing costs must be calculated precisely: "To counterbalance the lower acquisition costs, however, there are other expenses that can increase the costs of sourcing private-label merchandise from other countries" (Levy et al. 2014, p. 366).

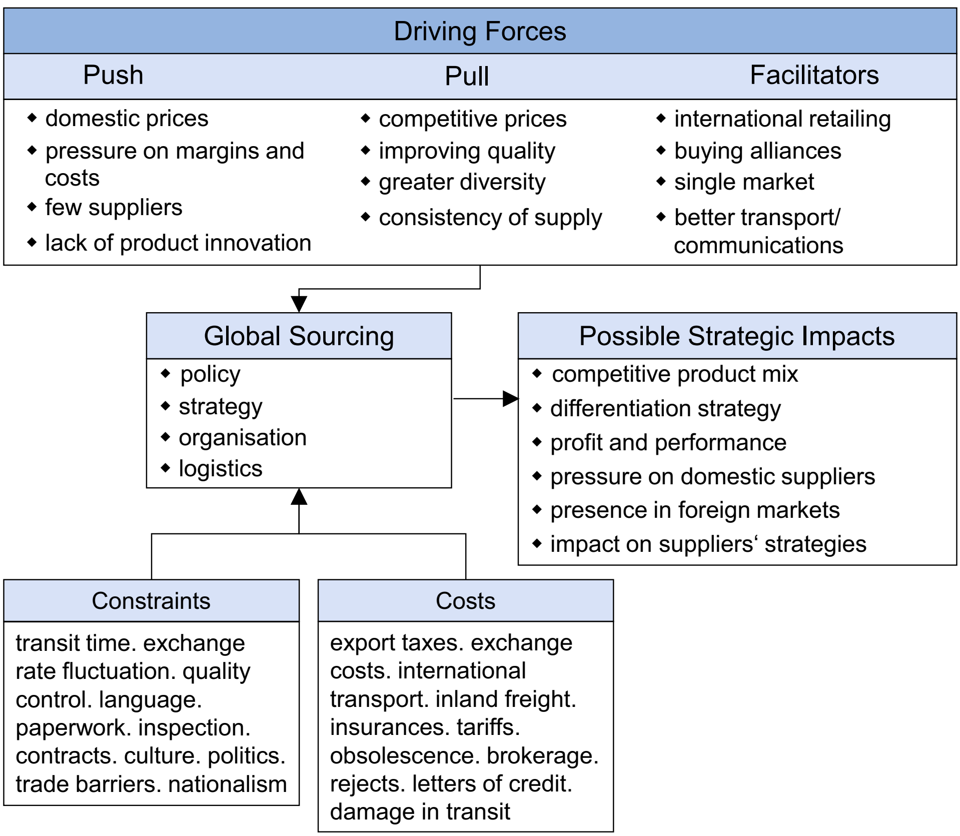

Fig. 17.1 Costs and benefits of global sourcing. (Liu and McGoldrick 1995, p. 102)

17.3.6 Mode of Buying and Organisational Form

A retail company must choose either an individual or cooperative buying mode. In **cooperative buying**, a group of retailers (independent retailers, both small and large chains) bundle their purchasing volumes to obtain volume discounts from suppliers. In addition to bulk buying, **buying alliances**, a new type of buying group with a comprehensive range of responsibilities, are in charge of nationwide or Europe-wide store branding, sales promotion campaigns and launching new products or product ranges (see the case study in this chapter).

Retailers must also choose whether to employ an **inside** or **outside buying organisation.** This decision is closely connected to the chosen buying mode. In cooperative buying, the buying group is involved in identifying trends, product design and development, product sourcing, quality assurance, order tracking and delivery.

However, an outside buying organisation can also be hired for individual buying. For example, within a category, all merchandising functions are transferred to a specialist who operates as a **full-service supplier** (e. g., a rack jobber). Another example is **outside organisations** who specialise in global sourcing. These have buying offices worldwide and thus a better sense of foreign markets and merchandise sources. One strong example is the Hong Kong headquartered company *Li&Fung* (Bang-Yan 2012).

17.3.7 Technological Form

A closely related question is whether to choose an Internet-based or more traditional transaction platform. **Web-based buying** involves using an electronic platform or **electronic marketplace** to negotiate purchases and terms (delivery date, quantity purchased, price and payment agreements, discounts, delivery method), run **(reverse) auctions** and place orders.

Traditional buying also uses regular connections with suppliers through **electronic data interchange** (via the Internet or direct PC connections and other means) to transmit order data or receive invoice data to process and fulfil orders. Here, the Internet (or another technology) is the basis for **operational data interchange**, but not for selecting suppliers and conducting business negotiations, which remain face-to-face processes.

E-auctions or **live auctions** are modern forms of web-based buying. Reverse auctions are a variant of e-auctions. In a **reverse auction,** prices decrease as sellers undercut each other to sell a good or service. Fig. 17.2 shows an example of a **live auction** (reverse auction), starting at 10:40 with opening bids and finishing at 11:20 with a final price considerably below the original asking price.

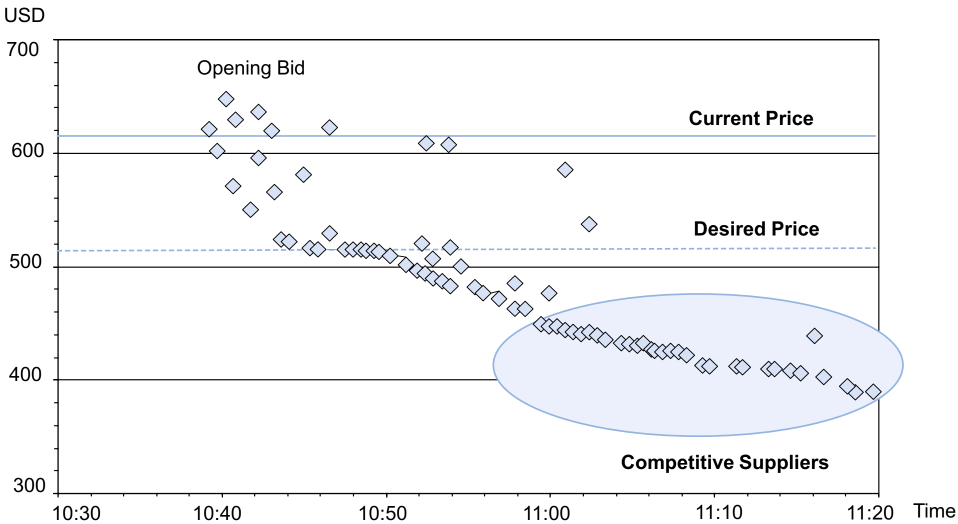

Fig. 17.2 Example of a live reverse auction. (Emiliani 2000, p. 180)

17.4 Sourcing Situations

17.4.1 Overview

Retail sourcing instruments are not applied uniformly across the product assortment, but are chosen based on circumstances and the requirements of the supply and sales markets. It makes sense to use electronic platforms when sourcing certain product ranges, but for others, there is no point in doing so, for example, because there are no product standards. In addition, using electronic marketplaces raises the question of whether a product should be purchased nationally or internationally. Factors such as product quality and supplier reliability are important here.

Decisions about cooperative sourcing cannot be made across a company's entire product range. While it makes sense in many cases, for example to bundle demand or use joint logistics services, cooperative sourcing can also be counterproductive and lead to price increases, for example in markets with extremely low supply or surplus demand, e. g., in high-end fashion assortments.

Retail sourcing involves an enormous number of articles and a highly dynamic assortment. Nevertheless, the various circumstances can be broadly categorised into four sourcing scenarios.

17.4.2 Sourcing Scenario 1 – Branded Products

Sourcing scenario 1 is characterised by the dominance of branded products (national or global brands) and by low complexity in the supply market, both in the food-sector and the near- and non-food sectors (e. g., fashion, electronics). This situation is typical for many branded products that are often indispensable for developing a retailer's **merchandising competence** (see Chap. 12). Here, usually only a few national or international providers (brand product manufacturers) or distributors with strong brands – often global brands – are available as suppliers. These are mostly categories with a high sourcing volume and high turnover speed, e. g., food.

The relationships between retailers and manufacturers in this scenario are changing from **adversarial** to **collaborative relationships**. This has led to a shift from short-term to long-term buying, from a price focus to a total cost focus, including all costs within the buying process. This is a major paradigm shift in buying away from the traditional transactional view of exchange (Fernie 2014). This collaborative approach is discussed in Chap. 19 in the context of **efficient consumer response (ECR) initiatives.**

These changing relationships have also transformed the interface between manufacturers and retailers. Traditionally, there would be a bilateral interaction between the buyer on the retail side and the key account manager (vendor) on the manufacturer side. Today, multi-functional teams from both sides interact with one another. Key account managers and category managers responsible for supplier development also coordinate or orchestrate these activities, which leads to new **supplier relationship management**.

Sourcing scenario 1 has a high potential for **supply chain management partnerships,** because the basic patterns of the ECR approach in the 1990 s were based on this constellation. Accordingly, this sourcing scenario is a starting point for advanced collaborative forms of supply chain management – e. g., vendor-managed inventory (VMI), continuous replenishment (CRP) or collaborative planning, forecasting and replenishment (CPFR) – to obtain win-win situations (see Chap. 19). Traditional forms of electronic data exchange and newer web-based forms of cooperation are indispensable here.

Supply chain management partnerships and category management partnerships are also relevant in the non-food sector, e. g., the fashion industry. In **controlled distribution approaches** (see Chap. 6), manufacturers take over replenishment and, at the same time, design sales areas, product ranges, promotions, etc. In **mono-brand stores**, the most extreme case, the manufacturer takes over sourcing for franchisees in its role as franchisor.

17.4.3 Sourcing Scenario 2 – Store Brands

In sourcing scenario 2, **customer-oriented differentiation** plays a significant role. Companies aim to improve their **gross margins** using store brands. This sourcing scenario is not a passive supply function; it requires proper product development with proper designs.

This does not preclude these tasks from being carried out collaboratively with **private label manufacturers**. When producing store brands, a distinction is drawn between internal production (“make”) and contract manufacturing, usually under the retailer’s quality management (“buy”).

This sourcing scenario carries strong potential for increasing effectiveness and efficiency by extensively combining value-added chains, for example, in the form of **collaborative supply chain management.** The potential here should exceed the potential of ECR partnerships in sourcing scenario 1 due to higher levels of integration.

17.4.4 Sourcing Scenario 3 – Commodities/Indirect Goods

Sourcing scenario 3 is characterised by a large number of articles, usually with low sales importance (“C products”), for which there is a multitude of suppliers, generally distributed worldwide, for example “everyday” watches, jeans, shirts, glassware and housewares. There is normally no transparency in potential procurement sources. Furthermore, brand importance is either non-existent or low (anonymous products, no real brands), so quality sensitivity is also low. This scenario prevails for commodities, but generally also for **indirect goods**, i. e., goods that are not sold, but used in retail operations, for example photocopier paper or laptops for internal use (like manufacturers’ maintenance, repair, operating (MRO) goods).

Because differentiation is basically irrelevant, procurement can potentially be **outsourced** here, e. g., by bringing in **system suppliers**, like **rack jobbers**. These suppliers are generally responsible for the operative sourcing of an entire category.

In sourcing scenario 3, **electronic marketplaces** can also be used to find new suppliers or run reverse auctions.

17.4.5 Sourcing Scenario 4 – Fresh Food

Fresh food is increasingly important for market-oriented profiling in food retailing, and this sourcing scenario is characterised by specific logistical challenges: shelf life/deterioration, ecological challenges such as organic cultivation methods, sustainability requirements such as reducing transport costs and consumer preferences for local/regional products, among others. In the mid- to long-term, shortages present further challenges.

This sourcing scenario is accordingly diverse, ranging from **local** to **global sourcing**, e. g., with exotic fruit and seafood, and local or worldwide production or cultivation, through contract manufacturing or contract farming, to passive sourcing at producers/plantations or wholesalers. **Product safety** is vital in every case, and both buying activities and logistical processes secure it. Fresh products impose special restrictions on the supply chain, e. g., adherence to predefined temperatures in transport and storage areas.

17.5 Buying Processes

Retailers' buying procedures comprise several steps:

- Gathering information to select potential products and suppliers,
- evaluating potential suppliers and selecting suppliers,
- negotiating (purchase prices and terms),
- concluding deals or contracts,
- ordering and re-ordering.

Gathering information is the traditional task of market research on the supply side (supply market analysis). As explained above, electronic marketplaces or Internet platforms are an innovative way to gain access to new suppliers and/or products. Evaluating new suppliers and re-evaluating existing ones is one of the most important steps in both traditional and electronic buying. Before starting a live auction, a retailer must evaluate potential suppliers to finalise the list of participants.

Negotiating a purchase depends on the chosen buying method: either face-to-face interactions or online bidding, e. g. in reverse auctions (see Fig. 17.2). In both cases, concluding a deal or contract closes this stage of the procedure.

The ordering and re-ordering steps are directly related to a retailer's supply chain management and logistics system. There are two extreme positions: **manual ordering** in retail outlets or the purchasing department at headquarters or **automatic ordering** based on continuous replenishment systems (see Chap. 19).

There is a great variety of approaches (e. g., checklists, scoring models) to evaluating suppliers, using quite different criteria (see, e. g., Zentes et al. 2012, pp. 665–668). The most cited criteria for supplier evaluation and selection (based on a literature review of 39 articles on supplier evaluation and selection, published between 2007 and 2013 in business and management journals) are: delivery performance, price, quality performance, production capacity, general demand, financial stability, communication openness, location, transportation, design capability, quality management practices and systems (Moliné and Coves 2014, pp. 220–221). These criteria can be integrated into scoring models (see, e. g., Table 8.3 and 8.4 in Chap. 8, which show scoring models to evaluate country markets).

Retailers are not only interested in the performance of their outlets or departments within their outlets (see Chap. 20); they are also interested in the performance of their suppliers, measured in economic terms (in EUR or USD). In addition to product margin ratios and store operating profits, **supplier operating profits** are increasingly important (see, e. g., Zentes and Knörr 2004).

17.6 Conclusion and Outlook

Based on basic strategic trends in retail sourcing, new responsibilities are increasingly emerging for retail buying. In general, retailers whose strategies involve consistent **customer orientation** are finding marketing and sales (category management) increasingly important at the expense of buying. In contrast, growing process orientation is reflected in the changing nature of **retailer-supplier relations**. While price negotiations were previously vital for traditional buying, other factors are increasingly important, particularly logistics and marketing conditions combined with customer-oriented supply chain management.

To optimise retailers' synergy potential by bundling purchase volumes across countries and sales formats, **international purchasing organisations** are increasingly emerging which coordinate sourcing across a group or company. Specialised quality assurance knowledge is also increasingly important for international sourcing.

The introduction of **e-procurement** is also prompting an extensive change in both organisational and personal aspects of corporate culture. A company's overall aptitude for learning is also important here. Thus, it is generally necessary to organise or reorganise purchasing and sourcing processes in the context of **electronic sourcing** and to ensure compatibility with previous systems with the help of standards.

One of the most important challenges in the mid- to long-term is to guarantee supply security, especially in the food sector. Options such as long-term contracts or the lease/acquisition of acreage in foreign countries raise ethical questions surrounding fair resource distribution. Non-profit organisations increasingly decry this phenomenon as "**land grabbing**". Thus, companies must balance supply security and social responsibility.

Further Reading

- Emiliani (2000). Business-to-business online auctions: Key issues for purchasing process improvement. *Supply Chain Management: An International Journal*, 5(4), 176–186.
- Moore (2005). The anatomy of retail buying. In M. Bruce, C.M. Moore, & G. Birtwistle (Eds.), *International retail marketing: A case study approach* (pp. 64–77). Amsterdam et al.: Elsevier Butterworth-Heinemann.
- van Weele (2014). *Purchasing & supply chain management: Analysis, strategy, planning and practice* (6th ed.). London: Cengage Learning.

17.7 Case Study: Intersport

17.7.1 History, Profile and Status Quo

In 1955, around 15 German owners of sports shops – the exact number is still disputed – founded *IGESPO*[1] (*Interessengemeinschaft Sport*) as an informal cooperation to exchange experience and benefit from joint purchasing advantages. For legal reasons, the cooperation became *EGESPO* (*Eingetragene Genossenschaft Sport*) a year later. By the end of 1956,

[1] In addition to the explicitly cited sources, sources used for this case study include the websites http://www.intersport.de and http://www.intersport.com.

Table 17.4 National buying organisations that have joined the INTERSPORT group since 1971. (INTERSPORT 2015 a)

Year of Joining	National Buying Organisation
1970	Finland
1973	Canada
1974	Spain; UK
1997	Italy
1998	Czech Republic
1999	Slovenia; Greece
2000	Croatia; Bosnia and Herzegovina
2001	Bulgaria; Romania
2002	Serbia and Montenegro
2003	Russia
2005	Poland; Turkey; Hungary
2006	United Arab Emirates

a merger between *EGESPO* and *Sportring Dortmund* led to the establishment of *INTERSPORT*.

In addition to steady growth, *INTERSPORT* increased its links with several national purchasing associations across Europe as it worked towards an important milestone. In 1968, these efforts led to the foundation of the *INTERSPORT International Corporation (IIC)* in Bern, Switzerland. In addition to Germany, the founding members of the *IIC* were Austria, Belgium, Denmark, France, Italy, the Netherlands, Norway, Sweden and Switzerland. *INTERSPORT* was a success from the outset. Consequently, more and more buying organisations from around the world have joined the *INTERSPORT* group over the years (see Table 17.4).

INTERSPORT has always been more than just a powerful purchasing association. Starting in 1971 with the introduction of the first *INTERSPORT* logo into around 1000 stores, *INTERSPORT's* strong momentum has helped it develop into the world's largest purchasing and marketing association for independent sports retailers. Several important steps in this process include:

- modernisation of the logo in 1979 and again in 2009 to combine emotional connection with an enhanced brand image,
- establishment of strong sponsorship partnerships in various sporting categories such as alpine and Nordic skiing, basketball, football, handball and ice hockey,
- support of key events and competitions such as the Olympic Games, the FIFA World Cup and the UEFA European Championships,
- launch of the first wave of *INTERSPORT* exclusive brands in 1983,
- introduction of a consistent store design in 1990 and its relaunch in 2003,

Table 17.5 *INTERSPORT* stores worldwide in 2014. (INTERSPORT 2015b)

Country	Number of Stores	Country	Number of Stores
Germany	1492	Romania	25
France	638	Turkey	20
Canada	439	Hungary	14
Italy	418	Serbia	11
Switzerland	355	Bosnia and Herzegovina	9
Netherlands	317	China	9
Spain	284	Egypt	9
United Kingdom	275	Belgium	7
Austria	268	Bulgaria	4
Norway	257	Iceland	4
Denmark	172	Luxembourg	4
Sweden	151	Cyprus	3
Finland	139	Liechtenstein	2
Ireland	59	Macedonia	2
Greece	42	Montenegro	2
Czech Republic	41	Saudi Arabia	2
Australia	40	United Arab Emirates	2
Russia	36	Albania	1
Slovenia	35	Andorra	1
Poland	33	Belarus	1
Slovakia	30	Kuwait	1
Croatia	29	Morocco	1

- creation of a shop-in-shop formula exclusively for female customers,
- expansion via licensing to South Korea in 2010, China and Lebanon in 2012 and to Belarus and Australia in 2013,
- acquisition of the US franchise *The Athlete's Foot* in 2012, thereby expanding the group's international activities from 41 to 63 countries, including strategic growth markets such as the USA, Brazil, India and Indonesia.

As of 2014, *INTERSPORT* (excluding *The Athlete's Foot*) is present in 44 countries with more than 5600 stores worldwide (see Table 17.5). Fig. 17.3 illustrates the group's solid and sustained positive development over the last few years, as measured by the gross sales revenues of the *INTERSPORT* shops worldwide since 2008.

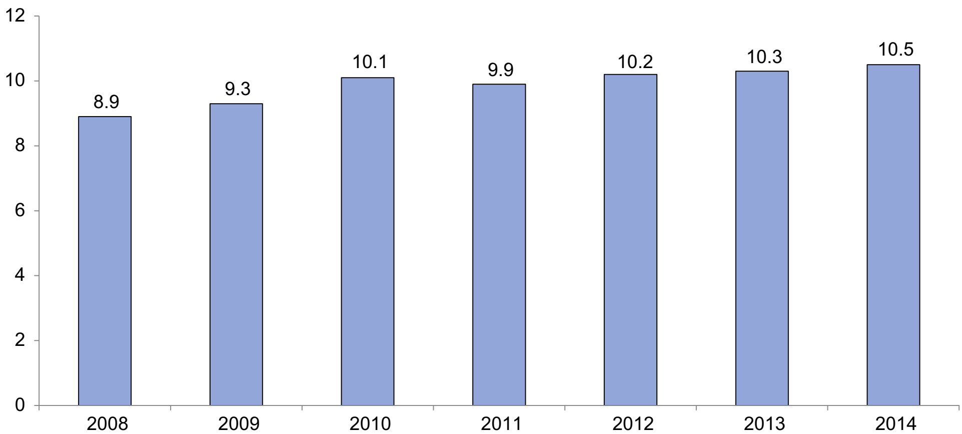

Fig. 17.3 Gross sales revenue of *INTERSPORT* stores worldwide (in billion EUR). (INTERSPORT 2015c)

17.7.2 Operational Structure and Objectives

As a worldwide network of independent sports retailers, the corporation's main objective is to deliver the best customer service, the best range of products and the best prices. The *IIC's* has three main divisions, each contributing to the *INTERSPORT* brand promise, "Sport to the People".

The Marketing, Retail and License division disseminates the corporation's "expertise in strategic, operational retail and marketing topics to all levels of the *INTERSPORT* group" (INTERSPORT 2015d). The division "is responsible for ensuring that all licensees are conforming to the *INTERSPORT* guidelines and regulations" (INTERSPORT 2015d). In summary, the division's main tasks are:

- running sponsorship programmes,
- market research and analyses,
- establishing international marketing campaigns,
- business development,
- store concept and implementation,
- legal actions related to trademark and property rights.

The Services division provides services and advice directly to the national *INTERSPORT* organisations and to *IIC* internally, such as:

- finance, accounting and controlling,
- information technology and order placement for the national INTERSPORT organisations via "classic EDI" (EDIFACT) and web-based EDI,

- human resources,
- international statistics,
- benchmarking,
- legal tax affairs,
- other management services.

The Products and Purchasing division focuses on products, setting the standards for product development and product purchasing. The main tasks of this division include:

- developing exclusive brands and their products,
- managing the exclusive brands,
- securing strategic brand deals (frame deals, central purchase deals),
- providing product and purchasing services to the national organisations.

Since the *IIC* has its roots in the joint procurement of goods, this third division can be considered the heart of the *INTERSPORT* group. In order to function optimally, the division is divided into several specialised business units. There are four business units that focus primarily on managing particular product categories:

- apparel,
- footwear,
- hardware I (winter and summer hardware products),
- hardware II (outdoor, fun wheel sports, ice, water sports and fitness).

These business units conduct negotiations with the leading sports brands and deal directly with designing and producing the group's own exclusive brands in order to create an international range in close cooperation with *INTERSPORT*'s national organisations.

In addition, there are four business units that perform supporting tasks:

- Strategic Brands, which negotiates discounts and develops exclusive products in close cooperation with selected strategic brand partners.
- EB Brand Management, which takes care of brand and product coordination within the different product business units as well as all marketing tasks like packaging, websites, consumer information, photo shoots, manuals and international coordinated marketing campaigns for exclusive brands.
- Supply Chain Operations, which serves as a support department for all product business units and deals with all aspects of supply chain management, order processing, IT support and corporate responsibilities.
- *IOF – INTERSPORT Office Far East*, a daughter company of *IIC* based in Shenzhen, China, which pursues tasks such as sourcing, quality assurance, quality control as well as establishing and improving direct links to suppliers and factories in production countries.

17.7.3 Drivers of Cooperative Sourcing and Current Challenges

When *INTERSPORT* was established, the major motivation behind cooperative purchasing was to reach a critical mass in sourcing, thereby strengthening negotiation power against relevant manufacturers. This still holds true today. Popular sporting goods manufacturers have increasingly intensified their own verticalisation strategies via online distribution or their own retail activities (e. g., *Adidas*, with 2440 concept stores and factory outlets worldwide, or *Nike*, with 858 stores worldwide in 2014). As a result, *INTERSPORT*'s most important task is to provide its members resources, expertise and purchasing power that independent sports retailers cannot achieve on their own.

As a result of increased globalisation, the process of cooperative sourcing is now a lot more complex than it was in the 1950 s, with a multi-layered set of drivers. As the world's biggest cooperative buying and marketing group of independent sports retailers, *INTERSPORT* offers its members a holistic supply chain process that greatly outstrips anything an individual sports shop could achieve, focusing on lower purchasing prices, higher product and service quality, lower transaction and administration costs, reduced supply risk, increased flexibility and mutual learning opportunities (Yu 2014, p. 197). At the same time, potential disadvantages of cooperative purchasing such as a loss of control, increased coordination costs, member commitment issues, disclosure of sensitive information or supplier resistance need to be considered and avoided where possible (Schotanus and Telgen 2007, p. 53).

INTERSPORT laid the foundation for an innovative, expandable and holistic IT system in 2001. The main objective was to implement an integrated solution to meet increasing requirements for merchandise management, customer service and communicating with and retaining members (Montanus 2004, p. 139). Over the years, this holistic IT system has undergone further development, and today it provides a major competitive advantage. The centrepiece of *INTERSPORT's* IT solution is the merchandise planning and control system *Intersys*, which seamlessly combines an ordering system, incoming goods inspection, cash register system and inventory control. Since *INTERSPORT's* members are increasingly different in structure, for example in terms of multi-branch ratio or size of operation, *INTERSPORT* offers two versions of *Intersys*, tailored to large or small organisations.

However, digital change still poses a fundamental challenge for *INTERSPORT*. In 2013, *INTERSPORT* launched its online shop in Germany, aiming towards a full omni-channel customer experience that will unite the online shop with its independent brick-and-mortar sports retailers, for example by connecting the merchandise management systems and choosing capable service providers for content management, fulfilment or payment. As of the beginning of 2015, about two-thirds of all German *INTERSPORT* members were already connected to the group's online shop. *INTERSPORT* considers the strong commitment of all members to an extensive omni-channel strategy crucial to the group's future success in e-commerce.

17.7.4 Summary and Outlook

What started as an informal cooperation to exchange experience and create joint purchasing advantages has become the world's biggest network of independent sports retailers.

Over the decades, *INTERSPORT* has continuously broadened its field of activities, using its enormous procurement power as a stable foundation for its evolution into the world's leading purchasing and marketing association for independent sports retailers and aiming to be the world's most dynamic, famous and profitable sports retail brand.

INTERSPORT is currently in a strong position to meet the major challenges that will fundamentally reshape global sports retailing, such as omni-channel distribution, ongoing verticalisation of strong manufacturers, higher demands for sustainable but effective and efficient procurement and increasing price pressure, mainly from players from outside of sports retailing like *Amazon* or discount supermarkets.

Questions

1. Explain the major differences between horizontal and vertical cooperatives.
2. Describe the critical success factors that affect horizontal cooperative purchasing groups and assess the extent to which *INTERSPORT* meets these factors.
3. List the possible advantages and disadvantages of an omni-channel strategy for a network of independent retailers and evaluate *INTERSPORT*'s situation.

- ► See, e. g., Schotanus 2007.
- ► Use press coverage and company websites for information about INTERSPORT.

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Logistics – Physical Distribution

18

Abstract

This chapter considers the strategic role of logistics in retail management, particularly the issues that provide the context for structuring logistical systems and designing processes. Alternative logistics models for online purchases will also be discussed.

18.1 Logistics as a Core Competency

Traditionally, retailers' warehousing and distribution systems have been viewed as an operational instrument, delivering goods at minimal costs. "Modern retailers, however, realise the advantages that can be derived from investment in such systems and view them as a trade-off between costs to the company and providing optimal service to the customer. As such, distribution and warehousing systems are an integral part of the companies' strategy and a major tool of competitive differentiation" (Bell and Davison 1997, p. 88).

Gaining a competitive **advantage** through warehousing and distribution systems requires managing control of the supply chain, i. e., **logistics leadership** (Zentes et al. 2012, pp. 618–621). For example, as Pablo Isla, Chairman and CEO of the Spanish vertical fashion company *Inditex*, states: "One of the pillars that underpins our global expansion is the high efficiency of our logistics system" (Inditex 2013, p. 11).

Retailers' **logistics management responsibility** is concerned with managing the components of the "logistics mix" (Fernie and Sparks 2014, p. 4). The following basic components can be identified:

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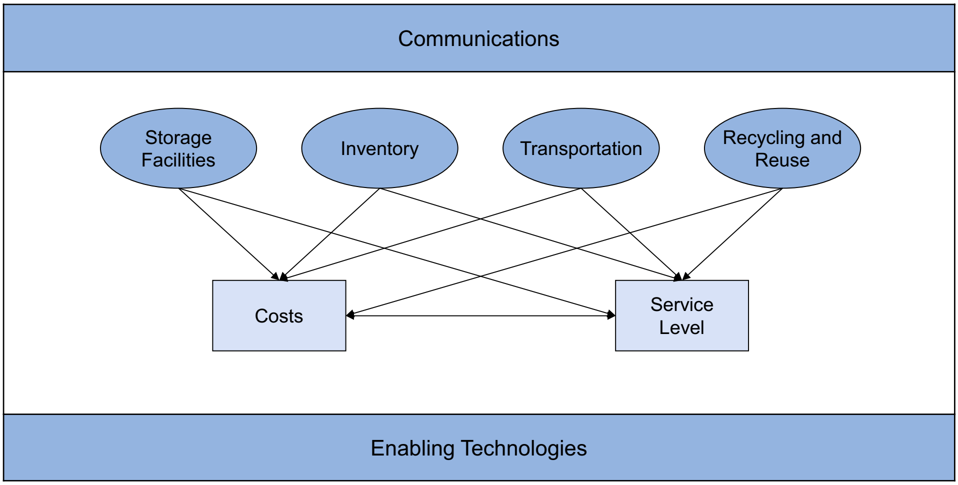

Fig. 18.1 Management tasks in logistics

- **Storage facilities**: Stock rooms in retail stores, warehouses or distribution centres.
- **Inventory**: The amount of stock held for each product or stock-keeping unit (SKU).
- **Transportation**: Transport of products – by ship, truck, rail or plane – from the factory to warehouses or distribution centres (**primary distribution**) and from there to the retail outlets (**secondary distribution**).
- **Recycling/reuse**: In recent years, retailers have become increasingly involved in **reverse logistics operations**. This means increased return of packaging material and handling products for recycling and/or reuse. This trend towards **circulation** has been reinforced by the EU packaging directive (Fernie and Sparks 2014, p. 7).

Information exchange is another basic component. "To get products to where retailers need them, it is necessary to have information, not only about demand and supply, but also about volumes, stock, prices and movements" (Fernie and Sparks 2014, p. 4). The enhanced role of information exchange or communications can be demonstrated by reengineering the supply chain from a **push supply chain** to a **pull supply chain** (Bell and Cuthbertson 2004). **Enabling technologies**, such as identification/coding systems, standards for electronic data interchange (EDI), shared databases, etc., play a major role in both communications and the basic components mentioned above (see Chap. 19).

Managing retail logistics means balancing costs and service requirements (see Fig. 18.1). In order to do this, retailers may outsource certain operational functions to specialist logistics service providers, while strategic functions are mostly performed by the retailer: "Therefore, it is quite natural that we outsource very little of management control of the supply chain" (Cuthbertson 2004, p. 175).

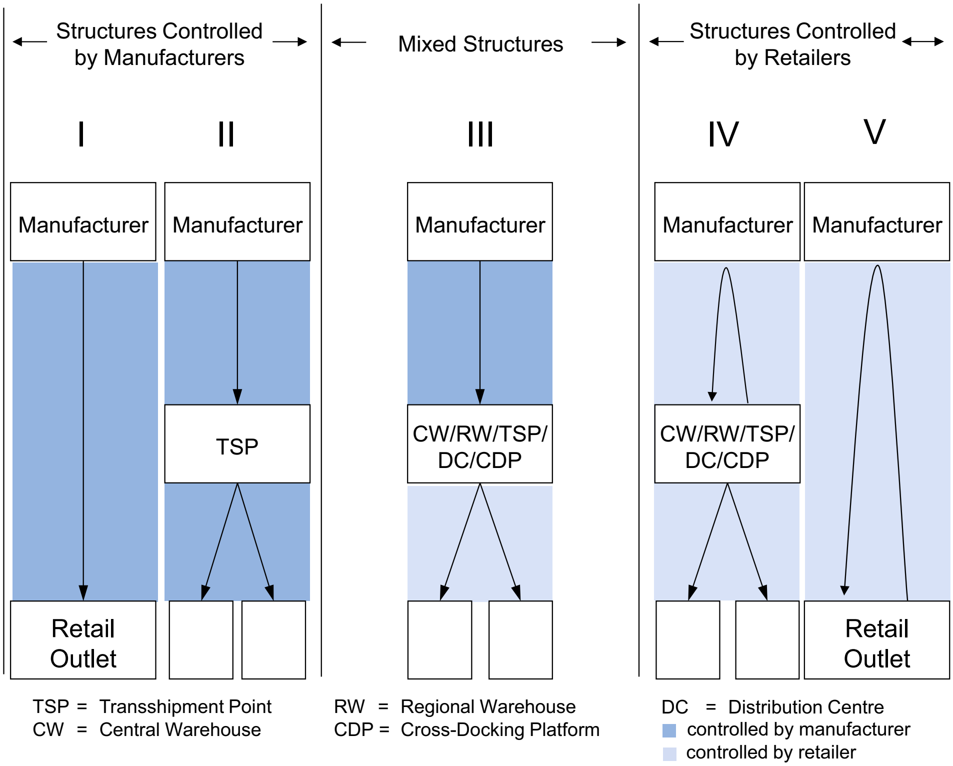

Fig. 18.2 Different supply chain structures. (Adapted from Thorndike and Waltemath 1999, p. 21)

18.2 Structuring Logistical Systems

18.2.1 Basic Options of Supply Chain Structures

Supply chain structures differ according to the actor responsible for delivering the goods (see Fig. 18.2). When this responsibility lies with the manufacturer, the manufacturer controls the retailer's delivery as part of its own distribution. Options I and II represent two kinds of **direct store delivery** (DSL), without and with a transhipment point, respectively. A transhipment point operates as a **break-bulk point**, e. g., a platform belonging to a logistics service provider from which the goods are delivered to the outlets.

Options IV and V characterise structures controlled totally by retailers ("**factory gate collecting**"). In option IV, the retailer controls **primary distribution**, that is from the manufacturer to the central warehouse or regional warehouses, to distribution centres, cross-docking platforms or transhipment points, and the **secondary distribution** from these places to the outlets. Option V illustrates a structure without (central or regional) warehouses or intermediate points.

Mixed or **hybrid structures** are illustrated by option III. In this option, manufacturers manage the primary distribution to retailers' central or regional warehouses, distribution

Table 18.1 Advantages and disadvantages of direct store delivery and central warehousing. (Adapted from Berman and Evans 2013, pp. 420–421; Sparks 2014, pp. 152–157)

	Direct Store Delivery		Central Warehousing	
	Advantages	Disadvantages	Advantages	Disadvantages
Time	Just-in-time delivery quick response to consumers' demands and stock shortages		Centralised/ coordinated time schedule	Quick response difficult, potential ordering delays
Costs		High-cost system, high(er) transport costs, high(er) coordination costs	Efficient transport costs, efficient storage	High cost for small retailers
Coordination		High coordination efforts necessary	Centralised coordination, coordinated merchandise	
Control	Greater control possibilities for store managers		Higher control of retailers	Excessive centralised control possible
Quality of Goods	Advantageous for perishable goods or goods with a limited shelf life, maximises products' residual shelf life			Extra handling of perishables

centres or cross-docking platforms or transhipment points. The secondary distribution is then coordinated by retailers.

Table 18.1 summarises the main advantages and disadvantages of the basic alternatives for direct store delivery and central warehousing, neglecting the other forms of intermediate points.

18.2.2 Increased Control Over Primary and Secondary Distribution

Because of increased competition, retailers, especially in the food and near-food sectors, have extended their control of the supply chain, both upstream and downstream. They have integrated primary and secondary distribution operations (Zentes 2006), and now manage

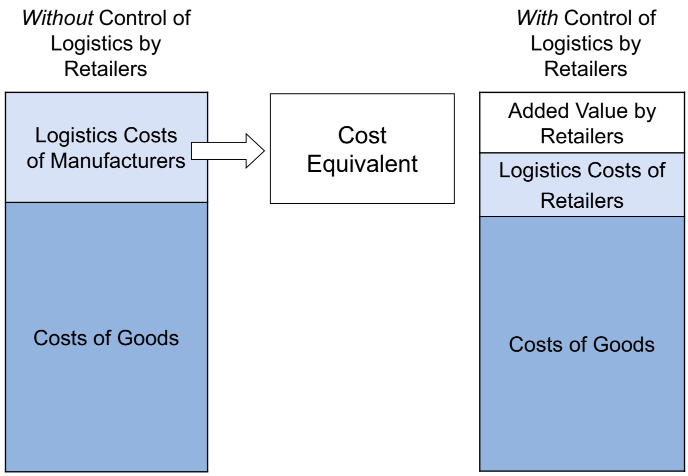

Fig. 18.3 Value added through retail logistics. (Adapted from Prümper et al. 2006, p. 819)

all transport operations and run them as a single network system. This vertically integrated supply chain has led to a new pricing structure for supplier-retailer relations: **factory gate pricing** (Ex Works, EXW).

Logistics not only constitutes a huge portion of total costs; they also make an essential contribution to the commercial value. If retailers can handle the distribution of goods more efficiently, they are creating added value (Prümper et al. 2006) (see Fig. 18.3).

The trend in food and near-food retailing (and also retailing of hard goods, e. g., electrical household appliances) is towards increased retailer control over the supply chain. In sectors characterised by the **downstream verticalisation** of manufacturers (see Chap. 6), in the form of **secured distribution** or **controlled distribution**, manufacturers dominate the supply chain, both in terms of logistical structures and replenishment systems (see Chap. 19).

18.2.3 Rationalisation of Warehousing

In a traditional (central or regional) warehouse, goods are stocked, which is a very costly activity (see Fig. 18.4). Inventory is expensive and can become obsolete. Furthermore, there are many operations associated with the physical flow of products: goods-in, let down, picking and goods-out (Bell and Davison 1997).

To reduce goods inventory and improve the speed of product flow, distribution centres and cross-docking systems have been developed and implemented. Unlike "silos", **distribution centres** or **transit terminals** are designed to run stocklessly. The retailer can transfer from keeping stock to a **just-in-time** approach. The products needed in the retail stores are delivered to the logistics platform (by manufacturers or collected/hauled by or on behalf of the retailer), bundled for the retail stores and transported to them. Ideally, no

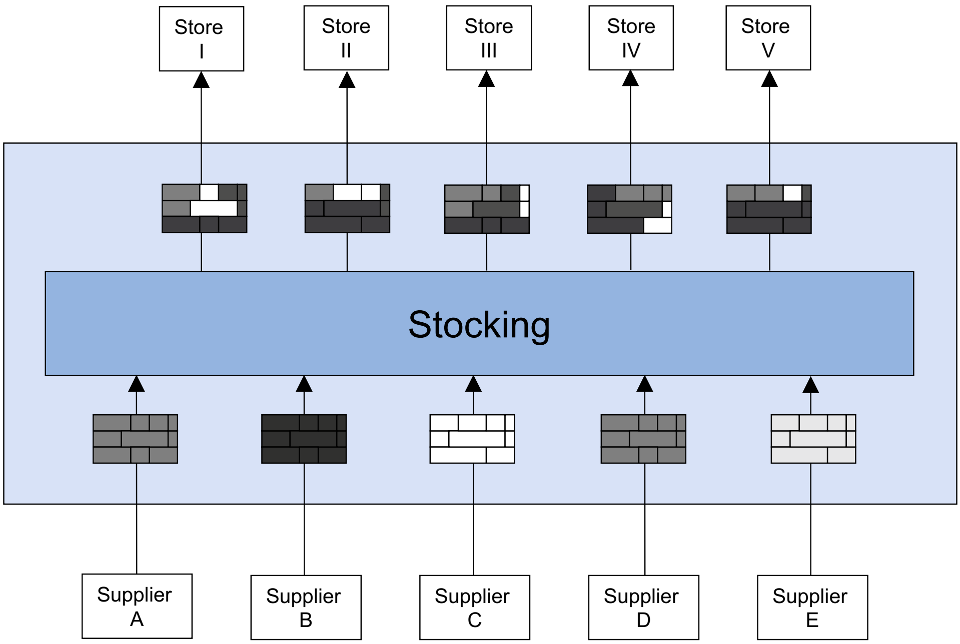

Fig. 18.4 Logistical structure of a warehouse

stock remains and the quantity delivered to the distribution centre is precisely that needed by the outlets. The role of the distribution centre is to partition (**break-bulk point**) the quantity delivered to the platform (usually on pallets) and to bundle (**consolidation point**) the different products for each store (usually on pallets or in roll cages).

In a pure **cross-docking system**, there is no partitioning. The products are delivered to the platform on separate pallets or in parcels for each retail store. The cross-docking process is reduced to the bundling of pallets or parcels for the various retail stores: "Cross-docking is a technique in which goods arriving at an RDC (regional distribution centre) are unloaded from the inbound vehicle and moved from the goods receiving area 'across the dock' for marshalling with the other goods for onward despatch without being put away into stock" (Whiteoak 2004, p. 143).

Both approaches involve greatly reducing order lead time and delivering smaller volumes more frequently. This has greatly increased the rate of stock-turn, i. e., decreased the amount of goods being stored. The logistics facilities of warehouses and distribution centres/cross-docking platforms are quite different: Warehousing is related to silos, whereas distribution centres/cross-docking platforms are related to "**marshalling yards**".

Most retail logistical systems combine all three approaches, e. g., warehousing for non-food products, for example imported from Asia, distribution centres for food and near-food products with high stock turnover and cross-docking for fresh products produced and/or delivered by regional manufacturers.

18.2.4 Integrating Reverse Logistics

The increased return flow of packaging material and the handling of recycling and/or reuse of goods have become a major challenge in retail logistics (Cuthbertson 2004, p. 179). The integration of reverse logistics has extended the traditional linear flow of goods. Recycling and reuse have produced a **circulation system** ("closed loop") in which retailers play an important role (Hertel et al. 2011, pp. 2–5).

18.3 Outsourcing and Joint Physical Distribution

In **new institutional economics**, there are two opposite approaches to carrying out activities: A value chain activity can be carried out internally (i. e., controlled or coordinated by **hierarchy/integration**) or externally (i. e., by other firms). Externalisation always means **buying** goods or services. In this case, the **market mechanism** takes up the task of coordination. In more practitioner-oriented terminology, these two basic alternatives are also called "**make or buy**" (see Morschett et al. 2015, p. 365).

If an activity currently being carried out internally is transferred to an external firm, this process is called **outsourcing.** Conversely, if an activity is integrated into the internal value chain (intra-firm transaction), this process is called **insourcing**. Between these two polar extremes, there are a wide range of **cooperative arrangements** with fuzzy delimitations between externalisation and internalisation.

Managing physical distribution systems does not necessarily mean fulfilling logistical operations internally. Retailers can outsource certain logistical functions such as transportation or warehousing to logistics operators, i. e., they can "**buy**" these services (**market transactions**). For example, transport pooling, a result of outsourcing by manufacturers and/or retailers, lets logistics services providers derive benefit along and across many supply chains (see Fig. 18.5).

These **consolidation opportunities** can also be achieved through joint physical distribution systems belonging to manufacturers and/or retailers (**cooperative arrangements**): "The broad principle here is that the greater the number of participants, the greater the synergy opportunities and the greater the chance of levering action within the logistics and network services provider community" (Whiteoak 2004, p. 159).

The decision criteria for outsourcing logistics activities are based mainly on cost and service level (see Fig. 18.6) (see Hertel et al. 2011, pp. 52–55). The decision to outsource logistics also depends on the importance of these activities for the company's success. This importance particularly depends on, and is measured by, the extent of profiling and the company's differentiation of these services. Despite possible saving potentials through outsourcing, differentiation effects may be stronger if the company properly executes the relevant activities itself.

Naturally, the decision to outsource also depends on the availability of competent partners within the supply chain. These partners need to be capable of taking over the relevant

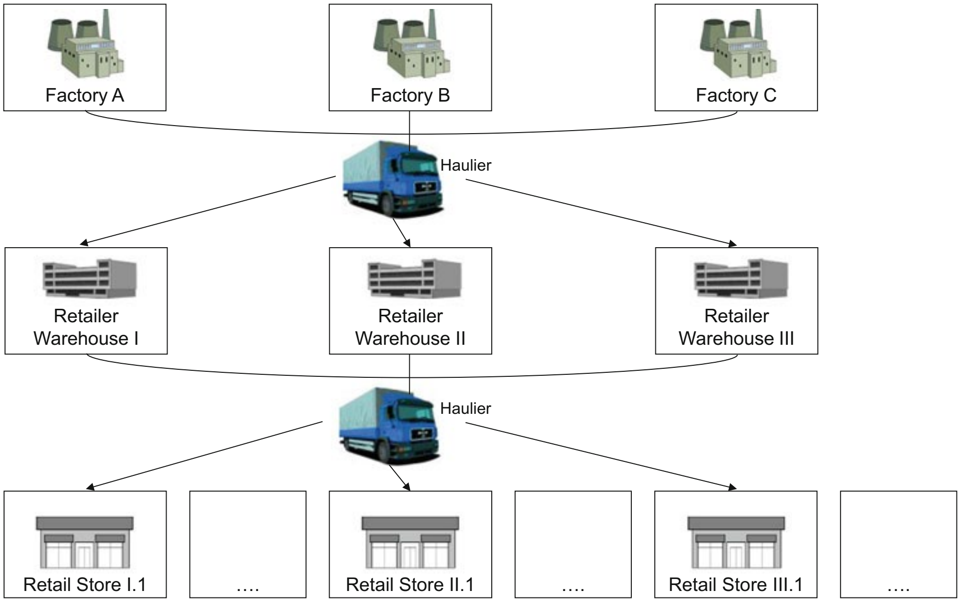

Fig. 18.5 Consolidation opportunities along and across many supply chains. (Adapted from Whiteoak 2004, p. 155)

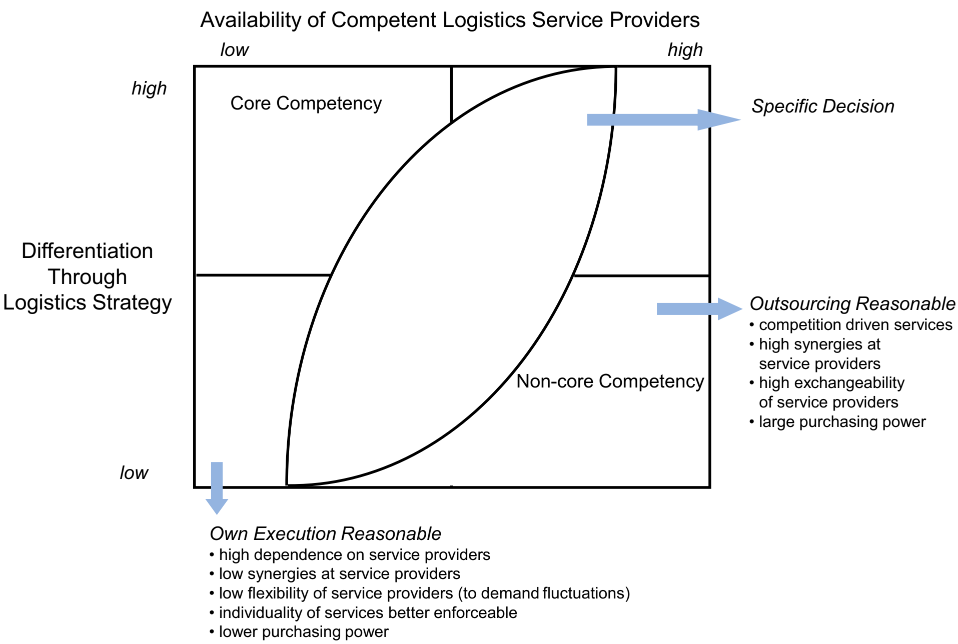

Fig. 18.6 Outsourcing logistical activities. (Adapted from Pirk et al. 1998, p. 259)

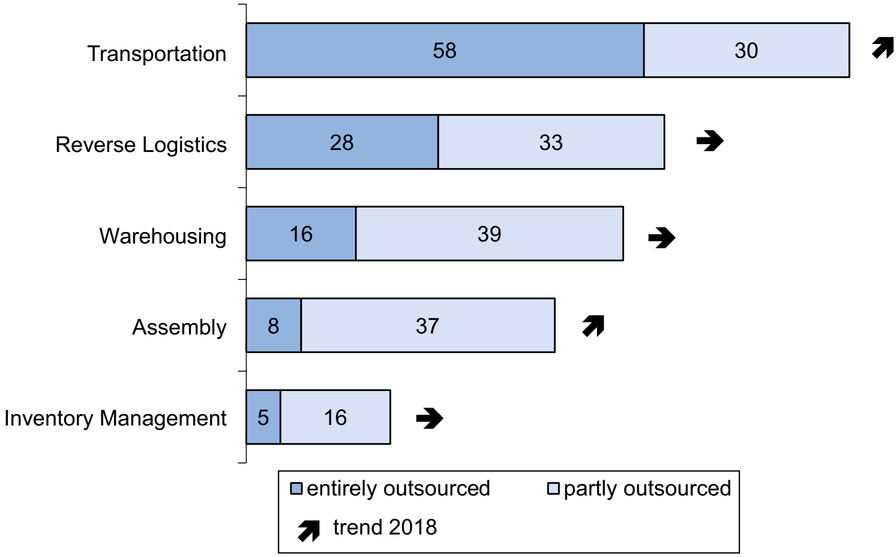

Fig. 18.7 Degree to which manufactures and retailers outsource different processes. (Handfield et al. 2013, p. 57)

activities. The availability of competent partners depends, among other factors, on the degree of specificity of the logistical activity required (e. g., transport and stock resources) and the service levels the partners can provide.

Outsourcing potential can be identified by comparing the differentiation potential of the respective logistical activity and availability of competent logistics service providers (see Fig. 18.6) (Pirk et al. 1998; Zentes et al. 2012, pp. 638–642).

Processes and activities that make up a company's **core competency** and thus contribute greatly to differentiating the company should be executed internally. There are also opportunities for differentiation in logistics, e. g., through high flexibility, short lead times, high customer proximity and high service levels. However, **non-core competencies** that only contribute slightly to the company's differentiation offer higher outsourcing potential.

According to the findings from a current study into "Trends and Strategies in Logistics", most manufacturers and retailers have entirely outsourced their transportation processes. The degree of transport outsourcing will probably continue to increase in the coming years (see Fig. 18.7).

18.4 Distribution of Online Purchases

Online retailers (pure players) or cross-channel retailers (see Chap. 4 and 5) that provide delivery to customers' homes, especially in the grocery sector, face strong logistical challenges: "Over the past decade many e-tail businesses have failed primarily because of an inability to provide cost-effective order fulfilment. Initial market research studies identified

Table 18.2 Return rates in German online retailing in 2013. (Deutsche Post, bvh 2014, p. 9)

German Online Retailers with a Return Rate of …	Share (in %)
0 –5 %	27.3 %
5–10 %	21.2 %
10–20 %	15.2 %
> 20 %	36.4 %

delivery problems as a major constraint on the growth of home shopping" (Fernie et al. 2014, p. 221). In (traditional) store retailing (**brick-and-mortar stores**), these "fulfilment activities" (picking, transport to home) are carried out by consumers.

Traditional catalogue mail order companies have long experience of home delivery, and can extend this experience to online purchases. Therefore, they play an important role in online retailing, e. g., the *Otto Group* in Germany (see case study in Chap. 10). For new players in web-based retailing (e-commerce), online shopping imposes new logistical requirements, such as new distribution centres and vehicle fleets or delivery systems. The greatest challenge of e-commerce is to solve the "last mile problem", i. e., to deliver from a store or an order picking centre (e-fulfilment centre) to the customer's house (Fernie et al. 2014).

Besides this fulfilment problem, online retailing faces another challenge: handling the huge and growing amount of returns. Table 18.2 shows the return rates in German online retailing.

Distributing online purchases often involves very different logistics models. Some retail companies use store-based picking, very often when starting out with online selling. Other possibilities include order picking in existing regional distribution centres, which is difficult and complex because of the different processes and quantities of picking for stores and customers, or establishing e-fulfilment centres as order picking units. Products are then delivered to customers' homes from the stores, regional distribution centres or e-fulfilment centres by van.

Two new solutions in the field of e-commerce are **drive-in concepts** or **click & collect concepts**: Consumers order by phone or via the Internet and pick up the goods themselves, which are commissioned by the retailer in an order picking centre. These solutions have achieved a high degree of consumer acceptance in France.

18.5 In-store Logistics

In-store logistics is a major part of store retailing. Optimising in-store shelf maintenance and reducing handling operations are major objectives in supply chain optimisation. This is because existing floor space is generally the most expensive in the entire chain and the sales staff should primarily handle other tasks.

At the same time, in-store logistical processes are closely related to other upstream logistical processes, such as commissioning processes. Stocking roll containers, which are the basis of retail outlet deliveries, may lead to inefficiencies in retail outlets when stocked by storage layout. This is because the goods are commissioned in the sequence of the storage layout and not in the sequence of the retail outlet layout. Consequently, retail outlet staff are required to move the roll container through the entire store from one item location to another. This problem can be reduced via **roll cage sequencing**.

Roll cage sequencing primarily involves central warehouses. The roll containers are loaded in the reverse order to which they will be unloaded in the store. Ideally, the store layout determines the central warehouse layout. This means that articles from the same assortment segment are placed on the same roll container. Additionally, articles are sorted by store layout within the roll container, meaning articles which will be unloaded in-store first are placed on top.

Radio frequency identification (RFID) uses radio waves to exchange data between a reader and an electronic tag attached to an object for identification and tracking. Some tags can even be read from several metres away, beyond the line of sight of the reader. Most RFID tags contain at least two parts. One is an integrated circuit for storing and processing information, modulating and demodulating a radio frequency signal and other specialised functions. The other is an antenna for receiving and transmitting the signal. Bulk reading enables tags to be read virtually in parallel.

RFID is mostly used in retail during transport and storage (e. g., attaching RFID tags to pallets, outer packaging or individual products). Additionally, RFID can be used in back store areas or in-store sales areas, e. g., in connection with "**intelligent shelves**", which transmit information on shelf inventories based on RFID systems. RFID can also be used in **payment procedures**, with purchases automatically registered based on RFID tags on each article or consumption unit.

RFID "has been over-hyped and raised many concerns, but there seems little doubt that it holds some promise for improving key aspects of logistics and supply chain performance" (Sparks 2009, p. 234). However, there are still a number of problems with RFID implementation, such as technology (e. g., scanning accuracy, size and data storage), costs (infrastructure costs), standardisation and consumer privacy (Sparks 2009, p. 243).

18.6 Conclusion and Outlook

Physical distribution systems in retailing or the consumer goods industry are not only influenced by technological innovations. Environmental and societal issues play an important role, too. **Sustainability** has become a hot topic in business strategy, including logistics. Looking at logistics or physical distribution systems from this perspective leads to questions of **climate protection** and reducing CO_2 emissions. When it comes to supply chains or logistical systems, transport activities and warehousing are the primary concerns. Responsible solutions include alternative consolidation opportunities, e. g., cooperative arrangements or striking a new balance between different modes of transportation (rail, truck, shipping), between stock and delivery frequency or between national/global production and transport (see Chap. 10).

Further Reading

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18.7 Case Study: Walmart

18.7.1 Profile, History and Status Quo

Walmart[1] dates back to 1962 when Sam Walton opened the first *Walmart Discount Store* in Rogers, Arkansas. *Walmart's* fundamental strategy was and still is: "The Lowest Prices Anytime, Anywhere". As a result of this low price strategy, *Walmart* was quickly successful. Just five years after Sam Walton opened his first store, the outlet network had grown to 24 stores and a period of rapid national expansion began.

In the 1980 s, the company extended its distribution format portfolio by opening the first *Sam's Club* in 1983 in Midwest City, Oklahoma, and the first *Walmart Supercenter* in 1988 in Washington, Missouri.

Sam's Club serves small businesses and individuals with bulk groceries and general merchandise. With an average area of 134,000 square feet, most *Sam's Clubs* offers speciality services in addition to groceries and bulk merchandise, e. g., opticians, tyre and battery centres and pharmacies. They are typical warehouse clubs – customers need to be members of *Sam's Club* to shop there and most merchandise is sold directly off pallets. Today, *Walmart* operates more than 600 *Sam's Club* outlets in the USA and 100 clubs internationally.

[1] As well as the explicitly cited sources, sources used for this case study include the websites http://www.corporate.walmart.com, http://help.walmart.com/, http://blog.walmart.com/sustainability/, press releases and various annual and CSR reports.

In contrast, a *Walmart Supercenter* combines a full-scale supermarket with a huge assortment of general merchandise, including apparel, electronics, toys and home furnishings. *Walmart Supercenters* can also contain banks, pharmacies, hair and nail salons, health clinics and restaurants. Each *Walmart Supercenter* employs about 300 associates, is about 182,000 square feet in area and most are open 24 hours.

In 1998, *Walmart* extended its distribution format portfolio again by opening *Walmart Neighborhood Markets*. With an average size of 38,000 square feet, they are approximately one fifth of the size of a *Walmart Supercenter*. *Walmart Neighborhood Markets* sell groceries, household supplies, health and beauty aids and also contain a pharmacy.

Since 2000, *Walmart* has also been active in online retailing with its own online shop *Walmart.com*. This offers a huge assortment of goods – over one million products – and additional services like music downloads and 1-hour photos. *Walmart* aims to provide consumers a seamless shopping experience, whether they are in a store, using a mobile device or online. Therefore, in addition to home delivery, customers can also order products online and pick them up at their local *Walmart* store.

In comparison to other retailers, *Walmart* started its international expansion quite late. Almost 30 years after Sam Walton opened the first *Walmart* store in Rogers, *Walmart* entered into a joint venture with the Mexican retailer *Cifra* and established a *Sam's Club* in Mexico City. In the following years, *Walmart* continued its international expansion strategy, expanding into Canada in 1994, China in 1996, Germany in 1997, South Korea in 1998, UK in 1999, Japan in 2002, Chile in 2009, India in 2010 and South Africa in 2011. *Walmart*'s foreign activities have not all been successful. *Walmart* left the German and South Korean markets in 2006. In the case of the German market, *Walmart*'s exit was partially rooted in cultural differences. For example, German consumers could not get used to employees packing their purchases into bags and greeting them at the entrance. At present, *Walmart* is active in 28 countries. Fig. 18.8 provides an overview of *Walmart*'s international market presence.

Today, according to *Forbes'* "Global 2000: The Biggest Retailers of 2014" list, *Walmart* is the biggest retailer in the world (Forbes 2015). In 2013, *Walmart*'s retail revenue was 4.5 times higher than that of its nearest competitor, *Costco* (Deloitte 2014). In 2014, *Walmart* had total revenues of approximately 485.7 billion USD and employed 2.2 million people worldwide. Its international outlet network encompasses 11,453 retail units, including 5163 units in the USA and 6290 units abroad. An overview of key indicators is shown in Table 18.3.

18.7.2 Walmart's Logistics Mix

As explained in this chapter, retailers' logistics management responsibilities include managing the five basic components of the logistics mix: storage facilities, inventory, transportation, recycling/reuse and information exchange. The following section will discuss two

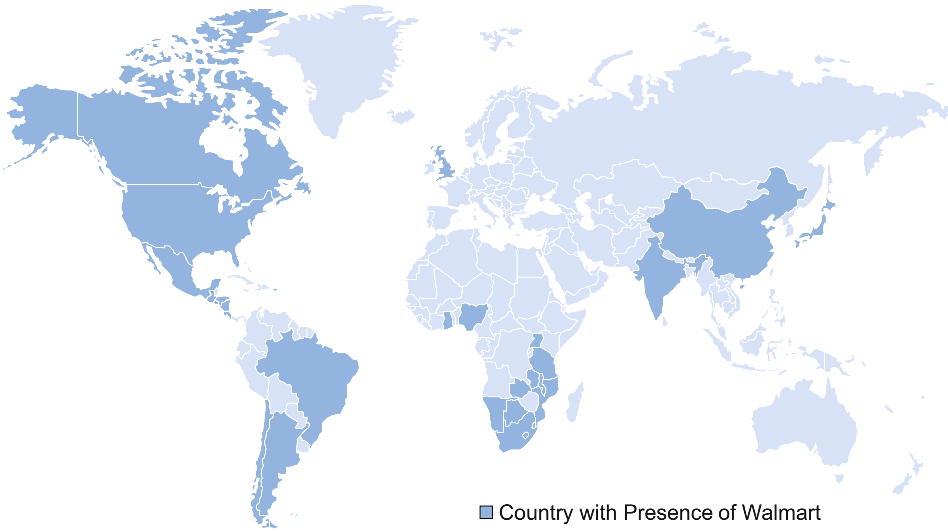

Fig. 18.8 Walmart's international market presence. (Walmart 2015a)

basic components of the logistics mix, storage facilities and transportation, in the context of *Walmart*.

18.7.2.1 Storage Facilities

With a distribution network of 158 distribution centres, *Walmart U.S.* runs one of the largest distribution networks in the world. However, *Walmart's* distribution network is not homogeneous. Instead, seven main types of facility can be identified, depending on the goods they store and the logistical task they fulfil (MWPVL 2015):

- **Regional general merchandise distribution centres**: These are primarily established to distribute non-food products, e. g., electronics, sporting goods, toys and health and beauty aids. They are usually within the range of 1.0–1.6 million square feet and employ over 1000 people each. The average one-way travel distance to *Walmart* stores is about 124 miles. A typical regional merchandise distribution centre serves 90–170 stores.
- **Full-line grocery distribution centres**: These serve as the backbone of *Walmart*'s food distribution network, including frozen food, dry groceries, deli meats, fresh meat, dairy and produce. They are usually in the range between 0.85–1.0 million square feet and employ approximately 750 associates. The average one-way travel distance to a *Walmart* store is around 134 miles.
- **Import/redistribution centres**: These are massive facilities, positioned near major US ports, in Long Beach (California), Norfolk (Virginia), Chicago (Illinois), Savannah (Georgia) and Houston (Texas). Import centres receive containers of merchandise from all around the world and redistribute it to *Walmart*'s full-line grocery distri-

Table 18.3 *Walmart's* key indicators. (Walmart 2014; 2015b)

	2013 Fiscal Year (revenues in million USD)	2014 Fiscal Year (revenues in million USD)
Total Revenues	476,294	485,651
USA Revenues	338,681	348,227
International Revenues	137,613	137,424
Number of Employees Worldwide	2,200,000	2,200,000
Number of Retail Units USA	4835	5163
Number of Retail Units Internationally	6107	6290

bution centres and regional general merchandise distribution centres. Thus, these distribution centres do not ship directly to stores. Most of these facilities are operated by third party logistics providers.

- **Fashion distribution centres**: These are usually large, highly mechanised facilities with conveyance systems. A typical *Walmart* fashion distribution centre is within the range of 0.64–1.6 million square feet and employs over 700 associates. They are designed to service 1000 stores and more.
- ***Sam's Club* distribution centres**: At around 40,000–100,000 square feet, these facilities are fairly small. They are long rectangular cross-dock facilities, with docking doors on both sides of the building. Full pallets are received by associates on one side and then brought via forklift to a staged trailer on the other side. The majority of these facilities are operated by third party logistics providers.
- **Specialty distribution centres**: These handle specific commodities, e. g., there are pharmacy distribution centres and tire distribution centres. *Walmart.com* distribution centres also belong to this category.
- **Centre point distribution centres**: These consolidate inbound merchandise from domestic suppliers before sending it to the distribution centres. They are similar in size and shape to cross-dock facilities. Centre point distribution centres are strategically located around the USA to minimise inbound transportation costs.

While *Walmart* is a titan in the world of brick-and-mortar retailing, with more than one billion USD in sales per day, *Walmart* lags far behind its competitor *Amazon* in terms of e-commerce (The New York Times 2015). Fig. 18.9 shows *Walmart's* position in the USA's mass merchant e-commerce market. Although *Walmart* has the second largest market share of mass merchant e-commerce, with a market share twice as high as its nearest competitor, *Sears*, *Amazon's* market power is six times greater than *Walmart's*.

To expand its e-commerce business, *Walmart* launched a new logistics strategy in 2013 called "Next Generation Fulfilment Network". *Walmart* is opening new distribution centres dedicated to fulfilling online orders (The New York Times 2015). The newest one opened

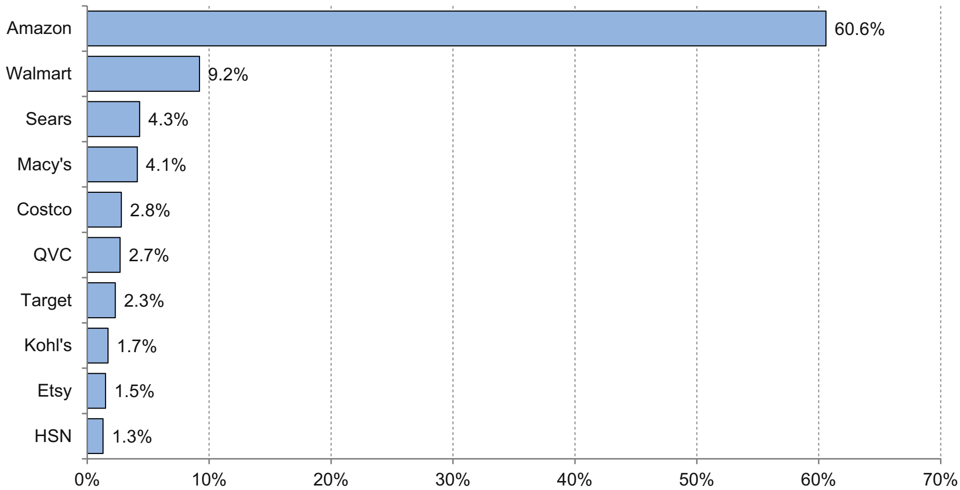

Fig. 18.9 Market share of leading mass merchant e-retailers in the USA in 2014. (Internet Retailer 2015, p. 48)

on July 22, 2015 in Bethlehem, Pennsylvania, in the *Majestic Bethlehem Center*. It spans 1.2 million square feet and is equipped with state-of-the-art automation and warehousing systems.

Walmart's new e-commerce strategy also involves the launch of drive-in and click & collect services. *Walmart* opened its first drive-in service, which is free for customers, in Bentonville, Arkansas. Customers can place their orders online, at any time from two hours to three weeks in advance. They then drive to the *Walmart* pick up warehouse and use a kiosk to notify *Walmart* staff they are ready to pick up their orders. *Walmart* attendants then bring the purchases to the customer's car (Forbes 2014). Consumers can also pick up their purchases at regular stores via *Walmart's* click & collect service, which is already widely applied. When shopping online at *Walmart.com*, consumers can select the store where they want to pick up their orders. After *Walmart* staff commission the order, the customer is informed via e-mail or text message that they can pick up the order. *Walmart's* e-commerce push is not limited to the USA; in fact some of *Walmart's* overseas subsidiaries are one step ahead of American stores. For example, *Walmart's* drive-in service is an adaptation of an idea already applied by its British subsidiary *Asda* (The New York Times 2015). Another major component of *Walmart*'s new Internet strategy is taking full ownership of its Chinese e-commerce arm *Yihaodian*, which occurred in July 2015. *Yihaodian* is currently the fifth biggest Chinese e-commerce retailer (Chain Store Age 2015).

18.7.2.2 Transportation

Transportation is another basic component of a retailer's logistics mix. *Walmart* can move goods to and from distribution centres by itself thanks to its private fleet of 6500 trucks, 55,000 trailers and 7000 truck drivers. Every year, the fleet drives 700 million miles delivering goods to *Walmart* stores, with each driver driving an average of 100,000 miles a year.

In recent years, *Walmart* has launched several projects to reduce the environmental impact of its fleet. *Walmart*'s goal is to double fleet efficiency by the end of 2015 compared to 2005, by making more deliveries while driving fewer miles. According to company information, *Walmart* has already reached an 84.2 % improvement over the 2005 baseline. Since 2007, *Walmart* has delivered 830 million more pallets while driving 300 million fewer miles.

Walmart and its suppliers are improving efficiency in various ways, including:

- **Effective driving techniques**: Including minimising idle times and progressive shifting to ensure optimal performance.
- **Advanced tractor-trailer technologies**: Including electrification, improved aerodynamics, lightweighting and fuel-efficient tires. In collaboration with many supplier partners, including *Peterbilt Motors, Great Dane Trailers* and *Capstone Turbine*, *Walmart* has developed a prototype called the *Advanced Vehicle Experience Concept Truck*. This futuristic looking vehicle, made almost exclusively with carbon fibre, weighs 4000 pounds less than a traditional truck in the *Walmart* fleet, allowing it to carry more freight. The *Walmart Advanced Vehicle Experience Concept Truck* also has a micro-turbine hybrid powertrain, allowing it to run on diesel, biodiesel and natural gas.
- **Improved processes and systems**: for driving efficient loading and routing of merchandise.

18.7.3 Summary and Outlook

This case study discussed two basic components of *Walmart's* logistics mix: storage facilities and transportation. *Walmart* operates one of the largest distribution networks in the world. The distribution centres are not homogenous, but differ according to the goods they store and the logistical role they have to fulfil. *Walmart* is a giant of brick-and-mortar retailing, but lags behind in e-commerce. To compete with *Amazon*, *Walmart* launched a new logistics strategy in 2013, named "Next Generation Fulfilment Network". As part of this strategy, Walmart not only opened new, automatised distribution centres, solely fulfilling online orders, it also developed and launched drive-in and click & collect services. These are not really innovative, having been used by others retailers, e. g., *Tesco* and *Auchan*, for years. So, time will tell whether *Walmart's* new e-commerce strategy will compete against other brick-and-mortar retailers as well as pure online players.

Sustainability factors are becoming increasingly important in retailing, especially in logistics. Walmart's sustainability efforts in logistics focus on improving the efficiency of its truck fleet. This raises the question as to whether the US retailer is doing enough to foster a sustainable image among consumers compared with other retailers.

Questions

1. *Walmart* operates different types of storage facilities. Why is this distinction used?
2. Discuss the advantages and disadvantages associated with outsourcing of physical distribution processes, both in general and for *Walmart* in particular.
3. Imagine you are a business consultant. Would you advise *Walmart's* officials to rethink their logistics sustainability campaign? When answering this question, compare *Walmart*'s sustainability efforts in logistics with those of other retailers.

- 1. See Bell and Cuthbertson 2004 as well as Smith and Sparks 2009 for a description of different supply chains.
- 2. See, e. g., Levy et al. 2014 for a discussion of logistics outsourcing.
- 3. Check annual reports, sustainability reports and the Internet and social media presence of different retailers.

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Logistics – Supply Chain Management and Information Management

19

Abstract

This chapter discusses supply chain management, a major strategic approach for retailers. Efficient consumer response is discussed as a collaborative approach to supply chain management, with a focus on logistics activities. Information technology is a major enabler of supply chain activities. Therefore, the general principles of information management in retail companies, in a logistics context, are outlined.

19.1 The Supply Chain in the Consumer Goods Industry

Traditionally, manufacturers have always been the dominant force in the consumer goods supply chain. However, with the trend towards **retail consolidation** and the emergence of large retailers, power in the supply chain has shifted towards retailers (Fernie et al. 2015, p. 231). Where manufacturers previously designed, produced, promoted and distributed their products or brands and retailers depended on their leadership, retailers have been able to exert pressure back into the supply chain. They have forced manufacturers to change their supply chain strategies, for example by including tailored pallet packs, scheduled deliveries, continuous replenishment systems, etc. (Coyle et al. 2003, p. 6).

The **supply chain** in the consumer goods industry includes all parties directly or indirectly involved in receiving and fulfilling customer requests, namely manufacturers, suppliers, wholesalers, retailers, third-party service providers (transporters, warehouses) and customers (Chopra and Meindl 2013, p. 13). Supply chains are dynamic and involve the constant flow of products, information and finance between the different stages (see Fig. 19.1).

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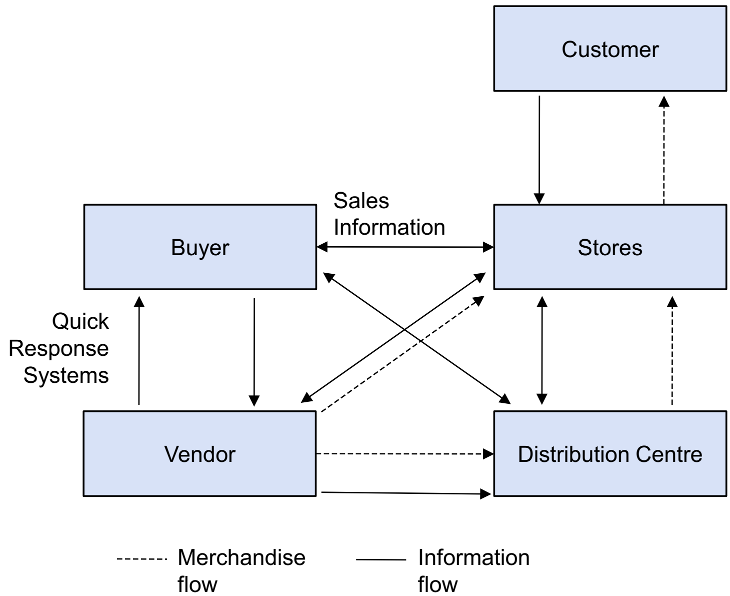

Fig. 19.1 Flows in the consumer goods industry supply chain. (Adapted from Levy et al. 2014, p. 271)

The first flow, the flow of **products and related services** from the manufacturer (and its suppliers) to the retailer and eventually the customer, is the core element in supply chain management. This has traditionally been the major focus in logistics, because customers expect their orders to be delivered on time, reliably and undamaged. **Information flows** comprise, for example, orders, inventory, demand or sales data. These flows are important for replenishment and (demand) forecasting at all stages of the supply chain. **Financial flows** include the transfer of funds or cash between supply chain partners (Coyle et al. 2013, p. 20).

19.2 Supply Chain Management

19.2.1 Overview

Supply chain management is defined as the planning and management of all business activities involved in fulfilling customer requests, such as sourcing, procurement, operations and logistics management. It not only focuses on processes or functions within one particular company, but also includes **coordination and collaboration** with other parties in the supply chain (Stank et al. 2005).

The primary function of supply chain management is to facilitate the **integration** of supply and demand management to improve the performance of individual companies and the supply chain as a whole. The overarching aim is to maximise overall value generated. Supply chain management therefore strongly focuses on **supply chain profitability** (Mentzer et al. 2001).

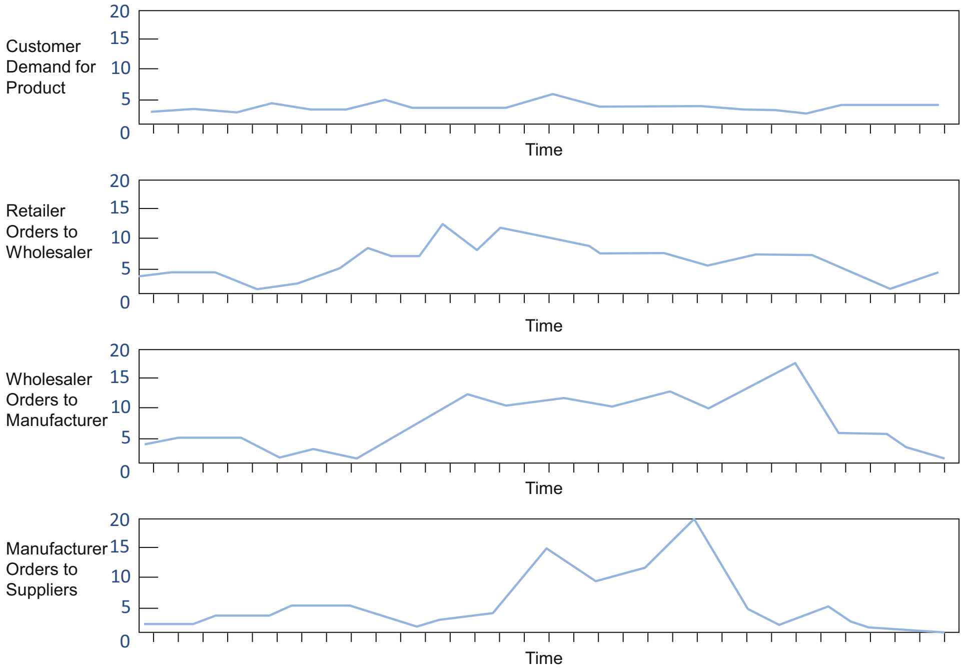

Fig. 19.2 The bullwhip effect. (Adapted from Lee et al. 1997b, p. 94)

19.2.2 The Bullwhip Effect

The fundamental idea behind supply chain management is that all involved parties should coordinate their activities and collaborate, thus improving the profitability of all supply chain partners. If each value-added partner optimises its own part of the supply chain in isolation, **inefficiencies** in the supply chain are likely to result, mainly because of isolated planning and forecasting of materials or order quantities along the value chain, a scenario known as the **bullwhip effect**. This occurs when sales or order quantity fluctuations swing upwards through the various value-added stages, with amplitudes increasing at each stage. The bullwhip effect results from the fact that customer demand is often unstable. Thus, each company in the supply chain must forecast demand. Because of incomplete information and uncertainties, forecasting errors are common and companies therefore usually carry safety stock in their inventories.

Moving up the supply chain from the consumer to suppliers, each participant observes higher fluctuations in demand and, therefore, has a greater need for safety buffers in its inventory. If demand increases, supply chain participants tend to increase stock and orders. However, if demand declines, companies tend to reduce inventory stocks. The bullwhip effect is characterised by variations amplifying the further one moves up the supply chain from the consumer to suppliers (Lee et al. 1997b; see Fig. 19.2).

The effect demonstrates how pervasive **inefficiencies** can arise from delays caused by **uncoordinated planning cycles** (e. g., because of order batching, price fluctuations or manufacturers rationing stock) or inconsistent and possibly out-of-date customer information or sales data (Lee et al. 1997a; 1997b; Disney and Towill 2003). This then affects planning and reduces the transparency of supply and material quantities beyond the specific value-added stage (Lee et al. 1997b).

The main approach to solving these difficulties is implementing comprehensive **interorganisational information and planning systems** to develop an information flow in the supply chain that reduces inefficiency (Schramm-Klein and Morschett 2006).

In addition to information sharing, other sales and marketing practices in the supply chain are important, including the price schedule offered by manufacturers, the frequency and depth of price promotion, demand forecasting methods and allocation rules in case of shortages (Lee et al. 2004).

19.3 Efficient Consumer Response

The scale of the problems associated with isolated planning means that cooperation and collaboration among supply chain participants are at the core of industry efforts to eliminate the bullwhip phenomenon. The concept of **efficient consumer response** (ECR) is significant here. ECR comprises a number of collaborative strategies and operating practices between retailers and suppliers that focus on fulfilling consumer needs better, faster and at less cost (ECR Europe 1998).

The ECR concept implies a shift from the traditional **push-oriented** view of the supply chain that relied on "pushing" merchandise through the supply chain, initiated and performed in anticipation of customer orders, to a **pull-oriented supply chain**. Pull processes are triggered by consumer demand and executed in response to consumer needs. ECR is thus a demand-driven system related to the **just-in-time** concept (Kracklauer et al. 2004, p. 59).

ECR is central to developing concepts to exploit interorganisational potential through the structuring and control of value chains. It offers a range of supply management and demand management-oriented concepts based on **retailer-supplier collaboration** (see Fig. 19.3).

19.4 Supply Management Concepts in ECR

19.4.1 Overview

Whereas demand management-oriented concepts focus on cooperation in marketing, supply side-oriented concepts emphasise **logistical issues**. Following the pull-oriented view, they relate mainly to satisfying demand in terms of delivering the right products in the right conditions to the right destinations and the right customer at the right time and

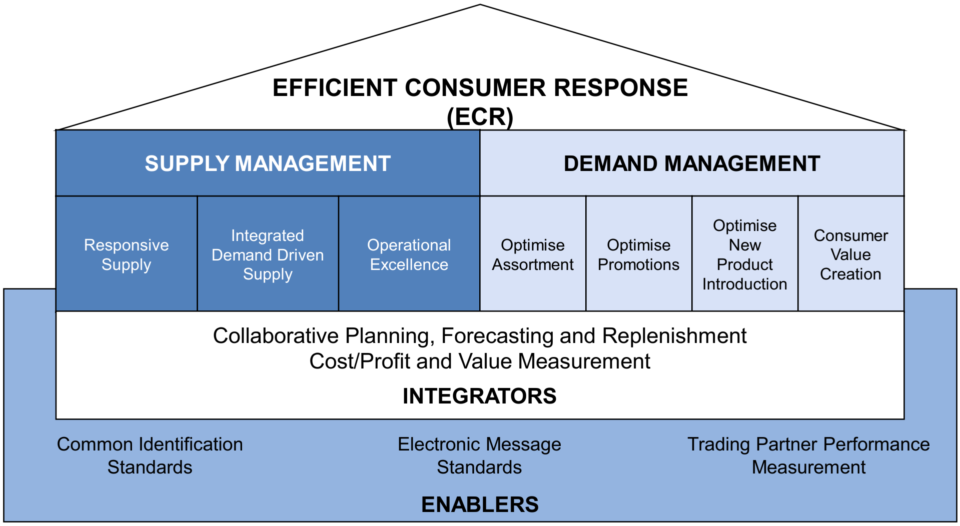

Fig. 19.3 Elements of efficient consumer response. (Adapted from Global Scorecard 2011)

in the right quantities throughout the supply chain at the right price, i. e., at lowest possible costs, thus guaranteeing the "**seven r's**" of logistics. The emphasis is on **minimising logistics costs**, such as transport costs, particularly inventory costs and costs related to asset commitment.

The main areas of collaboration in supply management are (Global Scorecard 2015):

- **Responsive supply**: the main goal of responsive supply concepts is to synchronise manufacturer and supplier operations with retail sales in the context of a just-in-time pull-oriented supply chain driven by retail sales. Responsive supply, therefore, focuses on distribution methods that integrate product flow from the manufacturers' production lines to consumer demand using actual consumer demand to drive replenishment. The aim is to generate very high service levels, which need to be balanced against cost and inventory levels.
- **Integrated demand-driven supply**: integrated demand-driven supply focuses on synchronising both production and purchased goods supply with demand. It thus comprises planning and control methods that align supply frequency and volumes with actual demand. The key objectives are minimum inventory levels and response flexibility and speed, which must be balanced against well-managed costs.
- **Operational excellence**: operational excellence aims to enhance efficiency by establishing industry-wide standards and management methods to increase the reliability of operations when it comes to problems such as stock shortages, late deliveries or administrative errors. Efficient administrative processes between the supply chain parties and **electronic data interchange** (EDI) and other technologies that enable, for example, process automation are crucial here.

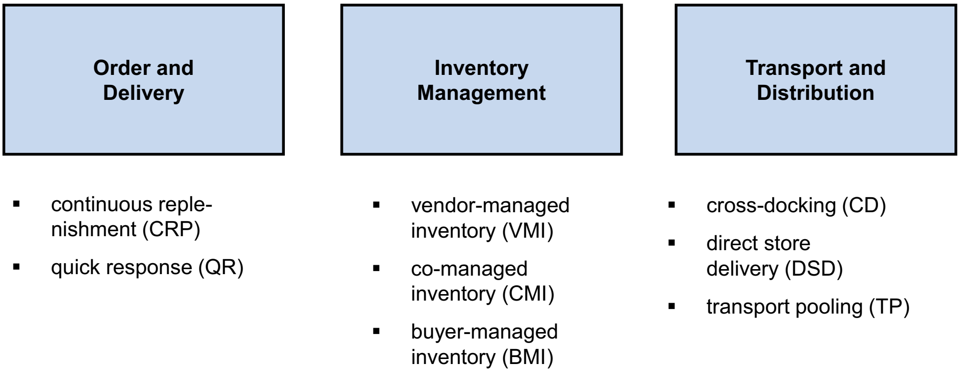

Fig. 19.4 Most important concepts in supply management. (Adapted from Gleißner 2000, p. 169)

In this context, various concepts have been established to increase efficiency and effectiveness in the supply chain. The most important concepts are presented in Fig. 19.4 and will be discussed in the following paragraphs.

19.4.2 Order and Delivery

The overarching concept in inventory management for ECR is **continuous replenishment (CRP)**, which aims to achieve a continuous flow of merchandise based on consumer demand (i. e., retail sales). The fundamental idea is to transfer the just-in-time concept to retail outlets and thus reduce overall inventory at all stages of the supply chain (see Fig. 19.5). Continuous replenishment systems require integrated information systems (e. g., EDIs) that enable close to **real-time transfer** of sales and inventory data between retailer and supplier. This information transfer lets suppliers and retailers **reduce lead times** in production and delivery.

Quick response (QR) is a specific type of CRP which has been developed to accelerate product flows in the supply chain. The concept was developed in the textiles industry to reduce replenishment lead times and it is especially well suited to markets with high demand volatility and rapidly changing assortments. The main objective is to decrease **overstocking** and **stock shortages** in the fashion industry, which is characterised by a high number of product variants and short fashion cycles with low demand predictability and a high share of impulse purchases (Christopher et al. 2004, p. 82). By allowing **multiple orders** to be placed in the selling season, quick response enables a better match between demand and supply.

A manufacturers' **postponement strategy** is closely linked to this concept, and refers to delaying product differentiation until closer (in time) to sale (Chopra and Meindl 2013, pp. 351–353).

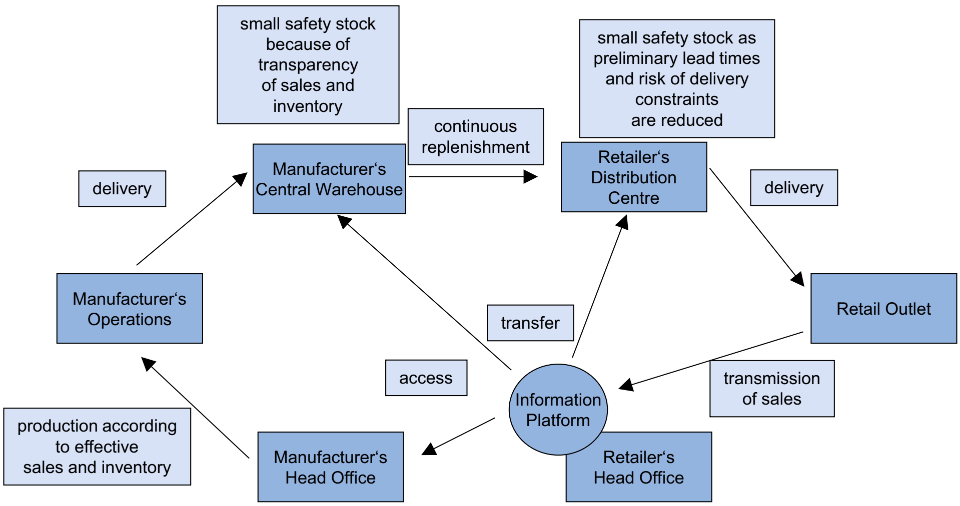

Fig. 19.5 Continuous replenishment. (Adapted from Swoboda and Janz 2002, p. 207)

19.4.3 Inventory Management Concepts

Inventory management strategies in efficient replenishment can be classified according to the party responsible for maintaining inventory levels: vendor-managed inventory (VMI), buyer-managed inventory (BMI) or co-managed or jointly managed inventory (CMI).

Vendor-managed inventory receives the most attention, and is characterised by the vendor being responsible for maintaining the retailer's inventory in the retailer's distribution centre or outlets (Lee et al. 1997b). The main objective is to reduce stock shortages in stores and inventory in the supply chain by centralising forecasting at the supplier and shortening the supply chain. Despite these advantages, VMI is sometimes associated with retailers relinquishing control of the supply chain. VMI requires a **continuous information transfer** of sales and inventory data between both parties, and the vendor generates the orders (i. e., reverse purchase orders). Under ideal conditions, inventories are replenished in quantities that meet the retailer's immediate demand, reducing stock shortages with minimal inventory levels (Levy et al. 2014, pp. 283–284).

Buyer-managed inventories require retailers to maintain suppliers' inventories. They are thus inversely related to VMI. **Jointly managed inventories** entail cooperation between vendor and retailer in inventory management.

19.4.4 Transport and Distribution

ERP applies several transport and distribution strategies, which serve mainly to guarantee continuous product flows in the supply chain (see Chap. 18). For example**, cross-docking** allows for stockless distribution processes and transport optimisation. **Direct store delivery**

(DSD) means that merchandise is shipped directly to the outlets, and **transport pooling** helps use transport capacities fully (Coyle et al. 2013, p. 254).

19.4.5 Collaborative Planning, Forecasting and Replenishment (CPFR)

Collaborative planning, forecasting and replenishment (CPFR) integrates supply-side and demand-side ECR concepts. It mainly focuses on **promotion processes** and thus is primarily related to HiLo pricing strategies that, in contrast to EDLP pricing strategies, are usually characterised by a high risk of stock shortages due to high demand uncertainty (see Chap. 13).

The main goal of CPFR is to increase **sales forecast** accuracy via joint sales planning by manufacturer and retailer, using all available data from both parties. Based on this forecast, production, delivery, warehousing and advertising are coordinated to achieve higher product availability and reduce inventory costs. Additionally, the simultaneous availability of customer behaviour information to all participants makes it possible to react to sudden, unanticipated changes in demand (Wisner et al. 2015, pp. 150–153). The CPFR process is depicted in Fig. 19.6.

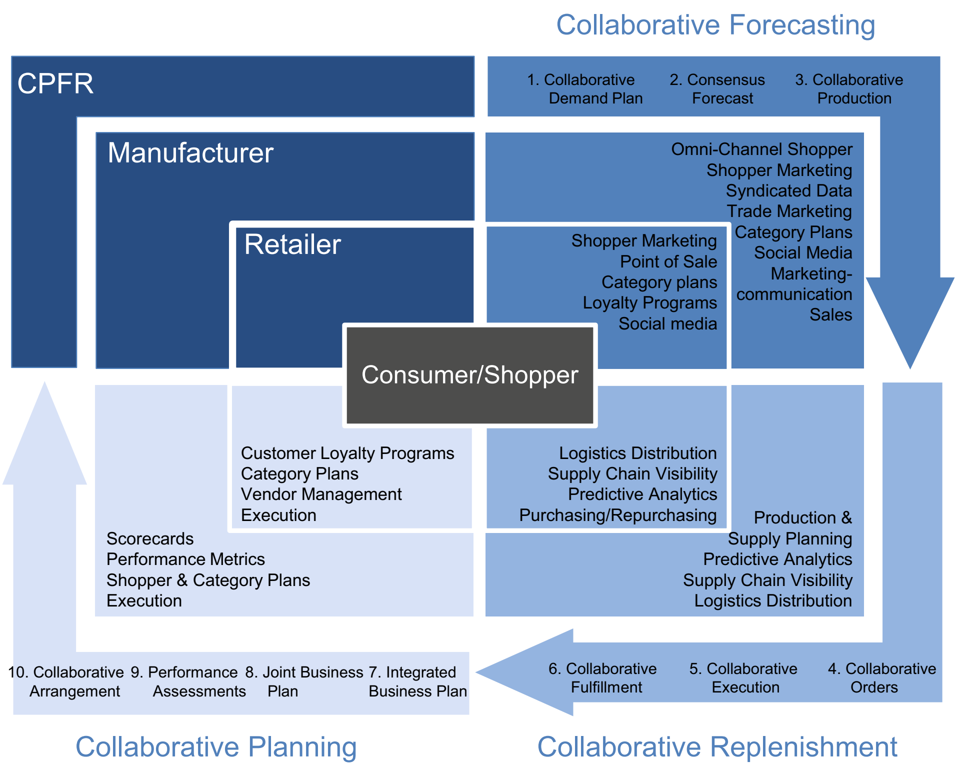

Fig. 19.6 CPFR 2.0. (Adapted from GS1 2015)

19.4.6 Enabling Technologies

Supply chain management requires efficient information-sharing processes between the parties at each stage of the value chain. Many technologies are available to facilitate such information flows.

Inter-organisational data exchange requires **EDIs** and communication networks that enable instantaneous, real-time information transfers such as the Internet, Intranet or Extranet (Chopra and Meindl 2013, p. 65). Standardisation and automation are vital to increasing the efficiency of such information processes. Other particularly important enablers of inter-organisational information exchange include (Hertel et al. 2011, pp. 67–85):

- **Automated identification systems**: The most important auto-id systems are barcodes, optical character recognition and RFID. These are based on coding systems such as the electronic product code (EPC) or the global trade item numbers (GTIN) that identify each SKU (item) in the supply chain, global location numbers (GLN) for identifying each participant in the supply chain or the serial shipping container code (SSCC) for identifying shipping units.
- **Communication standards**: Inter-organisational data transfer requires standardised message formats that can be processed by the IT systems of every party involved. Examples include UN/EDIFACT (United Nations Electronic Data Interchange for Administration, Commerce and Transport), EANCOM (a subset of UN/EDIFACT in the consumer goods industry) or GS1-XML, which is a more flexible message format.
- **Master data**: Master data are the basic data in information processing. They characterise each object in the supply chain, e. g., each customer or supplier. Customer and supplier master data are usually company-specific, whereas article master data are usually exchanged between parties. Thus, standardisation in this field is important.

19.5 Information Management

As the bullwhip effect demonstrates, **information availability** is extremely important in all stages of the supply chain. For example, suppliers need information from the retailer on sales, inventory turnover and feedback on competitors or at the level of customer returns. Information is also needed from consumers on attitudes towards products, brand loyalty and willingness to pay. Retailers need sales forecasts, information on product specifications, advance notice of new models, training materials for complex products and information from consumers on their shopping needs, where else they shop and their satisfaction levels with the retailer and the merchandise, to name just a few (Berman and Evans 2013, p. 228). Retailers play a crucial role in collecting information on consumers, because they have direct contact with customers at the **point-of-sale** and can collect information that goes beyond sales or scanning data. They can thus act as **gatekeepers** in the supply chain and control information flows.

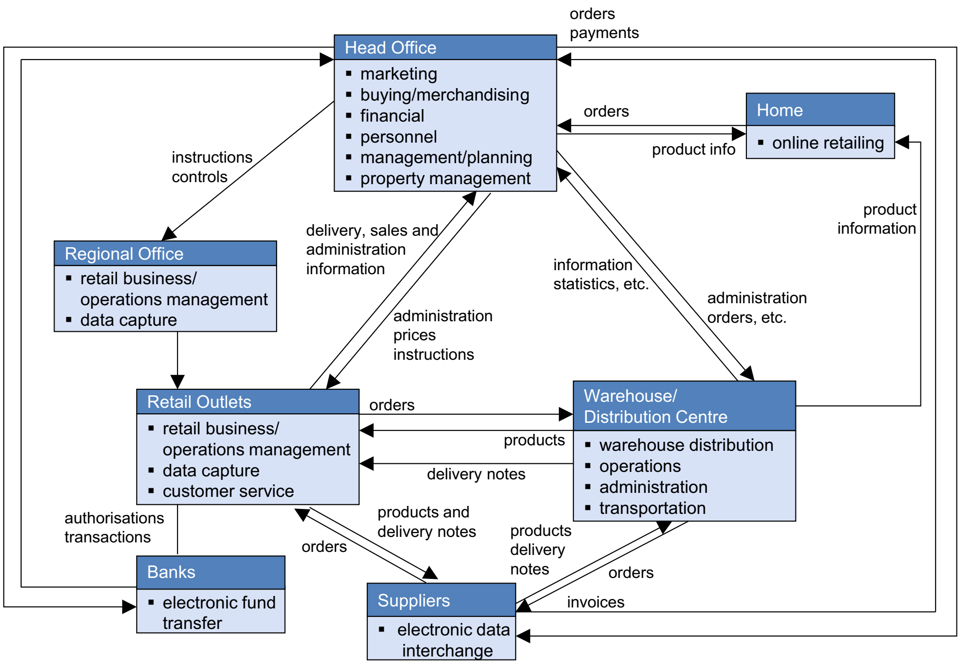

Fig. 19.7 Information flows in the supply chain. (Adapted from Dawson 1995)

The above examples demonstrate the need for **information flows** between a retailer's different departments (e. g., marketing and logistics) as well as at an inter-organisational level (Schramm-Klein and Morschett 2006). Fig. 19.7 shows the most important information flows for logistics. **Information technology (IT)** plays a vital role in guaranteeing efficient and timely information flows and reducing errors in information transmission.

In a pull-oriented supply chain, the starting point for information flows is the retail outlet. Thus, **store-based IT** is particularly important, especially point-of-sale systems that enable barcode scanning. These point-of-sale systems not only increase efficiency and productivity in stores (e. g., faster checkouts), they also provide logistical benefits by facilitating the immediate recording of sales and rapid flow of sales and inventory information. In addition, orders can be automatically recommended or triggered (**sales-based ordering** - SBO) (Varley 2014, pp. 162–173).

Enterprise software systems such as **enterprise resource planning systems** (ERP) or **merchandise information systems** (MIS) are also important. ERP systems integrate all of a retailer's data and processes into a single unified system. They usually consist of various components such as human resources or finance logistics. In retail companies, MIS, as an integral part of ERP systems, play a particularly central role. MIS such as *SAP for Retail* or *Oracle Retail* support all information processes related to product flows in the retail channel, e. g., merchandise planning, ordering and inventory processes.

As previously illustrated, data are important for **decision support** across all stages of the supply chain. The information (e. g., merchandise information, sales, customer data or supplier information) is "stored" in huge databases known as **data warehouses**. This information can be accessed by different departments within a retail company (e. g., marketing, buying or logistics) and serves as an input for the various software systems such as ERP, MIS or **data mining** systems.

19.6 Conclusion and Outlook

In the past, suppliers and retailers were intent on minimising their own logistics costs. This optimisation at a single stage of the supply chain often led to additional costs at other stages, either for retailers or for suppliers. Recently, more integrative views of the supply chain have evolved, which has led to the development of supply chain management and the various concepts of ECR.

In addition to adopting a more strategic view of the supply chain in terms of focusing on total system efficiency, **efficient information processing** is crucial for collaborative supply chain management. In this context, new technological developments such as data warehousing, webEDI, RFID or Internet and mobile apps have added new dimensions to collaboration in the value chain and have facilitated the various new concepts in supply chain management.

Further Reading

- Bell and Cuthbertson (2004). Collaboration in the retail supply Chain. In J. Reynolds, & C. Cuthbertson (Eds.), *Retail Strategy (*pp. 52–77), Amsterdam et al.
- Corsten and Kumar (2005). Do suppliers benefit from collaborative relationships with large retailers? An empirical investigation of efficient consumer response adoption. *Journal of Marketing*, 69(3), 80–94.
- Ralston et al. (2015). A structure-conduct-performance perspective of how strategic supply chain integration affects firm performance. *Journal of Supply Chain Management*, 51(2), 47–64.

19.7 Case Study: Ahold

19.7.1 History, Profile and Status Quo

Ahold[1] is an international retailing group based in the Netherlands and active in the United States (*Ahold USA*) and Europe (*Ahold Europe*). The company operates different retail formats (e. g., supermarkets and hypermarkets) and brands (e. g., *albert heijn, albert, hypernova, Peapod, MARTIN'S*) in Europe and Northern America.

[1] In addition to the explicitly cited source, sources used for this case study include various annual reports, press releases and the website www.ahold.com.

Ahold (*Albert Heijn Holding*) was founded in 1887 by Albert Heijn and had become the largest grocery chain in the Netherlands by the 1970 s. Today, with a market share of about 33 %, *Ahold* is still the market leader in the Netherlands. *Ahold* is also one of the top retailers in the USA, ranked number 8 in the 2014 *"Top 75 North American Food Retailers"*, based on estimated sales of 19.557 billion EUR in 2014, which contributed 59.7 % to the company's net sales. In 2014, the company operated more than 3200 stores, with about 227,000 employees worldwide. *Ahold* is also listed on *Euronext Amsterdam*, the *New York Stock Exchange* and the *Frankfurt Stock Exchange*. Overall, the company is built on a solid foundation with strong local consumer brands.

Ahold's mission is "to make the ordinary affordable and the extraordinary attainable" for customers. This mission is based on the company's vision: "Better choice. Better value. Better life. Every day." This vision describes *Ahold's* ambition to provide the right choices and great value that support a better life not only for its customers but also the company's other stakeholders. Hence, the company wants every member of its supply chain to benefit from this vision.

In this context, *Ahold* has benefited greatly from implementing the concept of efficient consumer response (ECR) throughout the company's supply chain management in addition to its expanding network of subsidiaries. ECR initiatives related to efficient replenishment, including cross-docking and continuous replenishment, are a particularly important part of *Ahold's* supply chain strategy for maintaining the company's relationships with key suppliers.

19.7.2 Main Strategic Areas

To achieve these objectives, the company hopes to revolutionise retail by introducing innovative products, services and store formats. It is also making considerable efforts to improve all parts of the supply chain, to efficiently respond to customer needs and demands, to build customer loyalty and especially to achieve sustainable profitable growth with competitive prices in all channels. Ultimately, *Ahold* is trying to revolutionise retail based on the concept of **efficient consumer response (ECR)** to fulfil consumer needs better, faster and at low cost. This strategy mainly focuses on efforts in five areas:

- **Portfolio**: *Ahold* operates food retail business concentrated in the European and North American markets. The company tries to operate its different retail formats in markets where it can identify clear prospects and achieve a top position in terms of market share as a basis for sustainable profitable growth.
- **Financial targets**: The company's long-term financial targets are to achieve a sustainable net growth of 5 % with an identical level of sales growth and retail operating margin, while at the same time maintaining an investment grade credit rating.
- **Organisation**: Operating two continental platforms – *Ahold Europe* and *Ahold USA* – with different retail brands in different regions lets the company balance its local,

continental and global decision making. This organisational structure ensures a sharp focus on customers' preferences and needs, provides efficient and effective support functions in each country and offers a sound basis for business development. Furthermore, standardised processes and structures ensure easier integration of acquisitions.
- **Brand development**: To achieve its growth objectives, *Ahold* puts enormous effort into optimising all parts of the supply chain to establish powerful local retail brands by continuously improving the products and services it offers and providing a competitive price level and cost savings to efficiently respond to customer demand.
- **Corporate Social Responsibility (CSR)**: CSR activities are an integrated part of *Ahold's* daily business and mainly centred on four issues: healthy living, sustainable trade, climate action and community support. Based on the "Triple-P" model (Dahlsrud 2008; see Chap. 10), the company aims to balance the interests of people, the planet and profit to create a profitable business.

Successfully managing all the operations that fall under this business strategy is a significant challenge for the company. At the same time, competition in food retailing is increasing, with the expansion and consolidation of discount formats in most of the company's market areas. In its different international markets, *Ahold* carries a wide variety and large volume of products and an ever-increasing assortment of perishable goods, resulting in a high degree of complexity and the challenge to efficiently and effectively coordinating the supply chains for the company's different retail brands. In this context, social responsibility and sustainability are vital for the overall business strategy and are incorporated into every part of the company's supply chain management.

19.7.3 Ahold's Supply Chain and Supply Chain Management

Ahold's supply chain management aims to support the health and well-being of customers, employees and communities. For example, product sourcing should always be conducted in a socially responsible and sustainable manner and should respect the environment. In doing so, the company aims to maximise the overall value and profit generated by its supply chain management activities by maximising the performance of individual companies and the supply chain as a whole. These activities include optimising all efforts related to an effective and efficient response to customer demands and requirements and include sourcing, procurement and logistics management. However, successfully responding to customer needs requires coordination and collaboration with third parties along the supply chain.

The company engages its employees and business partners in the supply chain to prioritise responsible retailing and efficiently respond to customer requests. This affects all parts of *Ahold's* supply chain (see Fig. 19.8), from production to the end customer.

For the company and its customers, it is important to understand where *Ahold's* products come from to ensure that their own-brand products are safe and produced with respect for people, animals and the environment. From the company's perspective, this is a very com-

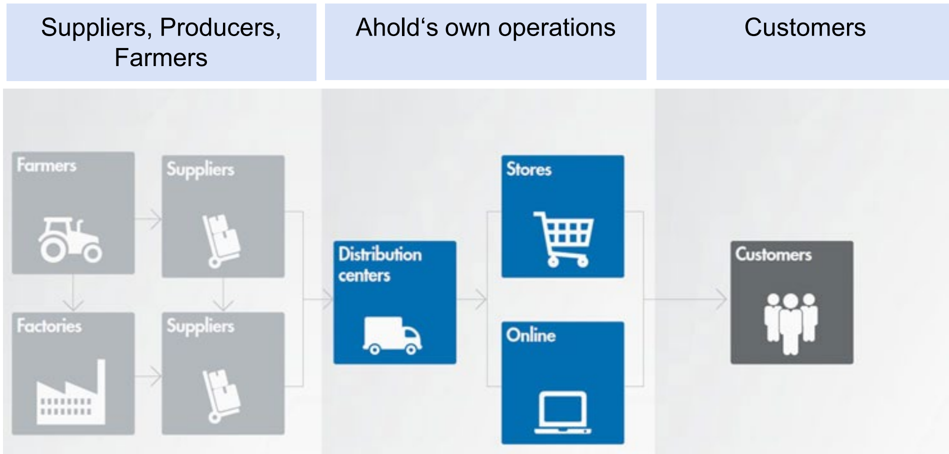

Fig. 19.8 *Ahold's* supply chain. (Ahold 2014)

plex task that requires a high degree of coordination and considerable efforts in monitoring activities along the supply chain. Therefore, *Ahold* requires its suppliers to exchange all business documents in a specific electronic data interchange (EDI) format. The relevant data (e. g., purchase orders, invoices) is exchanged using the *Applicability Statement 2* (AS2) specification, which ensures secure and reliable data exchange over the Internet through the use of digital certificates and encryption.

Both *Ahold* and its suppliers benefit from this form of (automatic) data interchange as electronic transmission of core business documents is one of the most efficient ways to conduct business globally. This enables *Ahold* to improve customer service, lower its expenses and increase productivity through real time data exchange.

Production starts at the farms that provide the raw materials, before moving to the factories and/or other suppliers that take the products through the various stages of production. When the final products are assembled, packaged and ready for sale, they are moved to the company's distribution centres, where the products are received and stored before being transported to the more than 3200 stores. *Ahold* also operates online channels where the products can be purchased for home delivery or collected from a pick up point.

To succeed in its various markets, *Ahold* is increasingly strengthening its collaboration with suppliers and engaging with them in various ways in order to improve and foster **relationships**. The collaboration starts at the beginning of the supply chain and includes sourcing critical commodities, social compliance of suppliers and packaging improvements. The company organises supplier events to discuss a wide range of topics, including company strategy, supplier diversity and food safety. In addition to strong collaboration with suppliers and farmers, food quality is ensured by introducing and following strict food safety requirements in the company's distribution centres and stores. In addition, several of the company's environmental initiatives focus on its own operations, including reducing carbon emissions at distribution centres and stores and separating waste.

19.7.4 Supply Chain Innovation Award

As a result of all these efforts, in 2011 *Ahold USA* was awarded the Supply Chain Innovation Award. In collaboration with *Del Monte Foods* and *ES3*, the company implemented a **direct-to-store programme** that provides a shared, collaborative warehouse for manufacturers and retailers. The direct-to-store programme created a streamlined supply solution for the grocery industry that eliminated a distribution centre and leg of transportation. By leveraging *ES3's* scale, *Del Monte Foods* and *Ahold USA* combined their mixing centres and distribution centres into one large facility. Streamlining the supply chain involved leveraging scale, automation, information technology and collaboration, but has resulted in a synchronised, efficient, end-to-end supply chain solution that is faster, cheaper and greener than the current supply chain models. Combining mixing centres and retail distribution centres into a single facility has reduced supply chain costs by more than 30 % for both *Del Monte Foods* and *Ahold*. In additional, *Ahold's* store labour costs have been considerably decreased by better organising certain pallets to align with store layouts and achieving more accurate picking through automation. In addition to reducing costs, the collaboration reduced carbon usage, improved speed to shelf and increased on-shelf visibility.

In 2012, *Ahold* started a programme in the Dutch market to gradually mechanise handling of non-perishable goods in its regional distribution centres. The ultimate aim is fully automatic processing of almost the entire regional non-perishables assortment from arrival to loading. This automation will lead to more products being processed in the same space, which should enable *Ahold* to better accommodate customer demand and reduce the number of deliveries, as products will be stacked optimally. Another advantage is that products from the same product groups will be delivered together, making it easier for store employees to fill the shelves. The company further aims to simplify its **fresh food chain** by implementing national category centres, meaning that suppliers will deliver their products to a single, central location. As a result, suppliers will no longer have to keep stocks, and *Ahold* stores will take delivery of all products from the same category at once. This should mean fresher products for customers. These innovations are aimed at improving the company's cost structure, meeting customers' requirements and preferences and supporting future growth.

Ultimately, the collaboration within *Ahold's* supply chain management is not only related to supply chain efficiency but also strongly related to responsive supply, integrated demand-driven supply and operational excellence. The company's goal is to synchronise its own and supplier operations with the actual demand at its retail stores to optimise inventory costs and efficiently respond to customer demand.

In 2014, the company was included in the *Dow Jones Sustainability World Indices* (DJSI) for the sixth consecutive year. The DSJI track the performance of the world's leading companies against economic, environmental and social criteria, including an evaluation of the performance of several parts of the supply chain (e. g., ethical sourcing). *Ahold's* DSJI ranking recognises the progress the company has made in recent years in its supply chain management. *Ahold* scored an average of 75 (out of 100) in the "Food and Staples Retailing" sector in 2014 – improving on the previous year's 74, and compared to an industry average of 48, with the sector leader scoring 76. The company scored particularly high in a number of areas, especially in its overall supply chain management practices, carbon emissions and waste reduction programmes, and its active contribution to the health and safety of associates by offering multiple health and well-being programs.

19.7.5 Important Parts of Ahold's Supply Chain Management

Today, the sustainability of its products and the supply chain is an integrated part of *Ahold's* business strategy. The company makes considerable efforts in managing every part of their supply chain to take advantage of opportunities to create a competitive advantage by relying on the concept of **efficient consumer response** to effectively serve its customers. In this context, the company's various activities in several areas of supply chain management should be measurable, realistic, defensible and customer-focused.

Food Safety

Ahold is currently focusing on a strategy to improve consumer health. This strategy is based on the company's strength of being both a full service and health-conscious retailer, which supports future growth in different markets thanks to increased customer loyalty and the fulfilment of social responsibilities. As one of the world's leading food retailers, *Ahold's* main focus is to offer customers safe, high quality food at affordable prices. This is a response to changing customer requirements and preferences, which are reflected in an increased demand for healthy food and products that are produced and sourced in a responsible way.

Consumer health is predicted to be a major issue that will dominate the global food industry over the coming years, as it is a growing concern among customers and governments, most prominently in *Ahold's* US and northwest European markets. *Ahold's* definition of quality includes food safety, consumer health and production with care for the environment, animals and human beings. While *Ahold* aims to be proactive and forward-looking on every product quality issue, this strategy mainly focuses on the company's own-brand products. Many of these own-brand products are offered under the company's brand name and thus customer perceptions of product safety, quality and healthiness are closely related to the brand and its reputation in the market. From the company's perspective, the supply chain of growing, packaging and transporting food from producers to retailers and finally to customers has become increasingly complex. To satisfy customer needs, *Ahold* now provides a wider variety of fresh produce, which requires coordinating sourcing from different suppliers worldwide. Food safety is managed locally at *Ahold*; however, the global consensus on food safety has led to a shared approach, shared objectives and a great deal of cooperation and synergy between the company's different retail brands and operations.

Hazard Analysis and Critical Control Points

Ahold's food safety policy aims to ensure food safety throughout the entire supply chain, from farm and production level to the company's own operations, up to the moment when the customers take the products home. In this context, the HACCP (Hazard Analysis and Critical Control Points) principles form the basis of *Ahold's* food safety policy throughout the supply chain. HACCP lets the company identify where potential food contamination can occur (critical control points) and manages these points to ensure the safest possible products. This process is designed to prevent rather than discover potential hazards.

Food safety starts where the products are made. From *Ahold's* perspective, this is the most complex and hardest part of the supply chain to control and coordinate, as it is generally in the hands of the suppliers. Hence, the company aims to work closely with its private label brand suppliers to ensure the safest possible products. Suppliers are required to follow proper food safety practices. Suppliers of fresh fruits and vegetables must be certified to production or farm level standards. For example, *Ahold* and *ICA* were actively involved in developing the standard for good agricultural practices known as EUREPGAP. This standard is designed to ensure high product safety, reduced agrochemical use, environmental protection and labour safety. EUREPGAP integrates various systems currently used by European retailers. For example, farmers for all produce sold at *Albert Heijn* and all centrally bought produce at *ICA* must be EUREPGAP certified. To ensure that all products intended for the Dutch market produced by its global suppliers comply with the current Dutch MRL legislation (Maximum Residue Level), *Albert Heijn* has issued a manual for suppliers. This precise and strict guidance is important from the company's perspective, because farmers, wherever they are located, have to operate according to Dutch regulations and not only the regulations of their own countries.

Ahold's US retail operations have endorsed the SQF (Safe Quality Food) standard, which is similar to EUREPGAP and has become its US counterpart. For example, since 1991 *Stop & Shop* gives preference to suppliers who adopt integrated farming strategies like *"NutriClean®"*. This is a commercial initiative to minimise pesticide residues through integrated pest management strategies and other methods.

Social and Environmental Issues

The company also has to deal with the social and environmental demands of their customers and stakeholders for supply chains in the US and European retail markets. In this context, *Ahold's* main challenge is to adapt to the specific requirements of each markets to optimise the performance of each part of the various supply chains to meet divergent demands in each market. Although organic products are increasingly popular in all of *Ahold's* retail markets, concerns over environmental issues in the agricultural supply chain are more widespread in northwest Europe. Similarly, animal welfare concerns are more prevalent in the northwest European markets, and the company is actively addressing this issue. It is less of a priority in the US; however, *Ahold's* US retail brands are pioneers in this field by the standards of their markets. The company's US operations focus on supplier diversity, while labour issues in the supply chain are a more predominant concern in the European market.

In general, the company has to deal with the impact of agriculture on the environment and biodiversity in its various markets as well as with sustainable fisheries, and the impact of production on human beings, communities and animal welfare. For example, through the efforts of the *Albert Heijn Foundation* in Africa, the company has been able to improve both the quality of its products and the livelihoods of the company's African fruit and vegetable suppliers, which in turn supports their families and communities and positively affects long-term relationships.

Common Issues, Local Approach

Several local factors impact the management of all aspects of the supply chain, including different legal requirements, market requirements, the local infrastructure available to support distribution and waste management. For example, *Ahold's* US stores are generally bigger than those in northwest Europe and sell larger volumes of fresh and frozen products. Consequently, they need different in-store equipment (coolers, freezers, etc.), which impacts energy requirements.

Preserving and offering safe and fresh high quality food and creating an attractive shopping environment are part of meeting basic customer needs. This translates into energy use, which is one of the company's most important areas of direct environmental impact. Supermarkets consume significant amounts of energy, because of the equipment needed to safely preserve (e. g., refrigeration) and efficiently prepare food (e. g., baking ovens). *Ahold's* retail brands are expected to reduce energy use and related carbon emissions in their operations wherever possible. In this context, the company tries to improve the performance of this part of the supply chain by tracking and benchmarking energy consumption and refrigerants used, investing in energy-efficient equipment, developing innovative solutions with vendors, exchanging best practices among its different retail brands in different markets and training staff in energy saving practices.

Ahold tracks and benchmarks energy consumption and refrigerants used with the aim of improving energy efficiency and lessening the impact on the environment. This also increases the company's overall performance. In the US market, *Ahold* has identified stores with unusually high energy consumption and has performed detailed energy analyses to take corrective measures to optimise energy consumption. For example, in 2004, *ICA* equipped 275 of its stores with the *CoolICA* Intranet system, which makes it possible to monitor and analyse the energy consumption of each store from head office. The system monitors the ventilation systems, heating cables and fans, cooled product displays and cold room temperatures. So far, energy consumption has been reduced by nine to eleven per cent in stores equipped with this system.

19.7.6 Summary and Outlook

This case study investigated *Ahold's* supply chain and the company's efforts to effectively and efficiently manage every part of it to efficiently respond to customer demands. These activities often focus on sustainability and social responsibility and include consumer health and production which respects the environment, animals and humans.

From *Ahold's* perspective, efficiently responding to customer demands is the best and most sustainable strategy. This strategy affects the management of all activities within the supply chain, especially for the company's own-brand products. Hence, *Ahold's* priorities in supply chain management are all generally related to providing customers safe, healthy, high-quality food at affordable prices. This should help the company gain a competitive advantage and form the cornerstone for future growth in the different markets, as it should positively influence customer loyalty and the fulfilment of social responsibilities. The combination of *Ahold's* efforts in sustainable and social responsible corporate behaviour and the introduction of innovations to make shopping easier and meet local customers' specific needs has helped it become one of the top retail companies worldwide.

In 2015, *Ahold* and the Belgium retailer *Delhaize* announced that both companies will merge, thus forming one of the biggest retailers of the world. If this merger also involves coordinating the two companies' supply chains, this will lead to new challenges for enhancing supply chain efficiency.

Questions

1. Explain the concept of efficient consumer response (ECR) and how it is implemented at *Ahold*. Discuss further approaches which should positively influence supply chain performance.
2. Discuss the advantages and disadvantages of *Ahold's* approach to supply chain management from both a customer and company perspective.
3. Do suppliers benefit from collaborative relationships with retailers? Discuss.

- ▸ See, e. g., Kotzab (1999).
- ▸ See, e. g., Corsten and Kumar (2005).

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20 Monitoring Operational and Financial Performance

Abstract

This chapter will consider the relationships between retail strategy and performance, review the balance between and tools for managing productivity and effectiveness, inventory and supply chain evaluation, profit and turnover evaluation and financial performance evaluation and consider new conceptual frameworks.

20.1 Retail Strategy and Performance

Retailers develop strategies to sustain a competitive advantage (see Part II of this book) in a market situation characterised by intense competition. In these circumstances, there is growing pressure on retailers to perform, so they must measure or evaluate their performance. Different kinds of performance measures can be identified:

- productivity/effectiveness evaluation,
- inventory/supply chain evaluation,
- profit/turnover evaluation,
- financial performance evaluation.

The study of productivity in retailing has a long history (McGoldrick 2002, p. 211). Many different measures have been developed as useful and practical indicators of retail performance. When discussing operational performance, not only retail performance, but the terms **productivity**, **efficiency** and **effectiveness** have to be defined and distinguished. According to Goodman (1985), the following distinct definitions can be used (McGoldrick 2002, p. 211):

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Table 20.1 Retail productivity measures of selected companies. (Lebensmittel Zeitung 2014; Annual Reports 2014/15)

Company	Sales per m^2 (EUR)	Sales per employee (EUR)
Auchan	4898	220,434
Best Buy	7371	266,736
Carrefour	4868	205,288
IKEA	2949	199,272
Kohl's	2139	121,363
Macy's	1750	141,463
REWE	4732	153,574
Sainsbury's	13,487	218,458
Tesco	6877	175,394
TJX	3380	121,385
Walmart	2743	187,868

- Productivity relates a single input factor to an output measure, other inputs assumed constant.
- Efficiency measures the effects of all inputs in combination and thus recognises that all inputs and the proportions in which they are employed may vary.
- Effectiveness takes into account goal achievement as well.

These measures are distinct, but there is a hierarchical relationship between them (Goodman 1985, p. 78): "High productivity is a necessary but not sufficient condition for high efficiency, as individual productive factors may not be combined in an optimal manner. Similarly, high efficiency is a necessary but not sufficient condition for high effectiveness, as the efficient combination may be directed to less than optimal goals."

Retailers' inventories have an important influence on profits and financial performance. A wide variety of ratios and performance indicators has been developed to evaluate how efficiently and effectively retailers utilise their investments, for example, stock turnover or inventory turnover. To balance inventory levels and stock shortages with **customer satisfaction** and **customer loyalty**, new tools have been created such as supply chain **performance measurement** (Zentes 2004).

Profit and turnover evaluation are more specific in retailing than other industries because of the huge number of **stock-keeping units** (SKUs) and large number of organisational units, such as outlets in a retail chain. This complexity leads to specific turnover and profit paths in analysing retail performance.

Retailers' financial performance can be examined based on their balance sheets, profit and loss accounts (P&L statements) and cash flow statements. In principle, there is no

Table 20.2 Retail productivity measures of German retail formats. (EHI 2014; HDE 2015, p. 175)

Format	Sales per m^2 (EUR)	Sales per employee (EUR)
Supermarkets	5048	226,800
Superstores (Big Supermarkets)	4737	238,300
Hypermarkets	4492	306,900
Furniture Shops	1400	210,000
Bookshops	3300	152,000
Electronics Stores	5200	148,000
Perfume Shops	6400	136,000

difference between measuring the financial performance of the retail industry compared with other industries using, e. g., liquidity ratios, return ratios, earnings coverage ratios and value metrics.

In addition to these tools, various other instruments have been developed to monitor operational and financial performance, such as activity-based costing and benchmarking (Zentes et al. 2012; Morschett 2004).

20.2 Productivity/Effectiveness Evaluation

Many retailers place great priority on improving productivity. Various ratios can be calculated to measure **retail productivity** or different aspects of retail productivity. The most common ratios are:

- sales per square metre (or square foot),
- sales per employee (i. e., per full-time equivalent, FTE).

Real-world examples of these two ratios are given in Table 20.1. This table shows the considerable differences within and between the sectors. It is important to note that the lower of these measures does not necessarily mean lower effectiveness. "A relatively high number and/or quality of staff **may** be a natural outcome of higher service positioning. Likewise, more space per unit of sales **could** reflect a more comfortable selling environment" (McGoldrick 2002, p. 211).

Nevertheless, these ratios provide **benchmarks** within sectors or **strategic clusters** of retail companies. Retail managers can detect and analyse deviations from the benchmarks or just from the averages. Productivity measures, such as sales per square metre or sales per employee, can help monitor store management performance within retail chains. Table 20.2 illustrates the different ratios used in German retailing in 2013/14.

20.3 Inventory/Supply Chain Evaluation

Retailers apply two main metrics for **financial inventory control**:

- stock turnover,
- gross margin return on investment.

Stock turnover represents the number of times during a specific period, usually one year, that the average inventory on hand is sold (Berman and Evans 2013, p. 446). This ratio can be calculated in units or currency (e. g., EUR, USD or GBP). When calculating stock turnover in currency, two dimensions can be distinguished: retail prices ("at retail") or purchasing prices ("at cost").

Different formulas can be applied (Berman and Evans 2013, p. 446):

$$\text{annual rate of stock turnover (in units)} = \frac{\text{number of units sold during year}}{\text{average inventory on hand (in units)}}$$

$$\text{annual rate of stock turnover (in retail dollars)} = \frac{\text{net yearly sales}}{\text{average inventory on hand (at retail)}}$$

$$\text{annual rate of stock turnover (at cost)} = \frac{\text{cost of goods sold during the year}}{\text{average inventory on hand (at cost)}}$$

In order to increase stock turnover, retailers can reduce stock of slow-selling items ("stock reduced", see Chap. 18), buy in a timely manner ("stockless"), apply collaborative planning tools and supply chain techniques such as CRP or VMI (see Chap. 19) or use reliable suppliers. High stock turnover may forfeit volume discounts and result in higher transportation charges.

One way to monitor inventory investment and profit per unit is to compute **gross margin return on investment** (GMROI). This metric represents the relationship between gross margin and average inventory at cost, by combining profitability and sales-to-stock measures (Berman and Evans 2013, p. 447):

$$\text{GMROI} = \frac{\text{gross margin}}{\text{net sales}} \times \frac{\text{net sales}}{\text{average inventory at cost}} = \frac{\text{gross margin}}{\text{average inventory at cost}}$$

20.4 Profit/Turnover Evaluation

20.4.1 Profitability Ratios

Metrics from this group are designed to measure a retailer's ability to achieve, sustain and increase profits (Dragun 2004a). Profitability can be measured by different indicators. One important relationship is between profits and sales (**margin ratios**); another dimension of profitability relates profits to capital. These so-called return ratios are discussed below within the context of financial performance evaluation.

The "top level" indicators of profitability are (Dragun 2004a):

- gross margin in %,
- net profit margin in %.

Gross **margin**, also called gross profit, is defined as:

$$\text{gross margin} = \text{net sales} - \text{costs of goods sold}$$

"It is an important measure in retailing because it indicates how much profit the retailer is making on merchandise sold, without considering the expenses associated with operating the store and corporate overhead expenses" (Levy et al. 2014, p. 162). Like other performance measures, this indicator can be expressed as a percentage of net sales (**gross margin in %**):

$$\text{gross margin in \%} = \frac{\text{gross margin}}{\text{net sales}} \times 100$$

The term **net sales** represents the total volume of money (e. g., EUR, USD or GBP) after all refunds have been paid and payments have been collected from vendors for promotions (Levy et al. 2014, p. 161) (and after sales tax):

$$\text{net sales} = \text{gross amount of sales} + \text{promotion allowances} - \text{customer returns}$$

The net profit margin in % relates net profits (see Fig. 20.1) to sales:

$$\text{net profit margin in \%} = \frac{\text{net profit}}{\text{net sales}} \times 100$$

This **"bottom-line" profitability** is useful for comparisons across companies.

20.4.2 Profit Path

Different profit margin models or formulas can be illustrated by a firm's profit path (see Fig. 20.1).

Expenses are the costs incurred by a retail company in the normal course of business. There are three types of **retail operating expenses** (Levy et al. 2014, p. 162):

- Selling expenses,
- general expenses,
- administrative expenses.

Selling expenses comprise sales staff salaries, commission and benefits. **General expenses** include rent and utilities. **Administrative expenses** include salaries of all em-

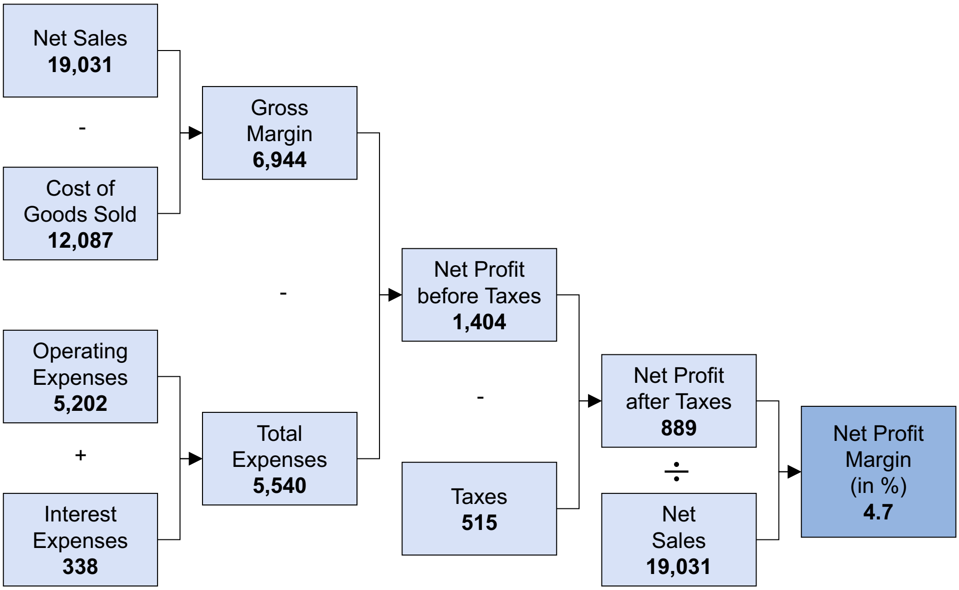

Fig. 20.1 Profit path example – Kohl's (in million USD). (Kohl's 2014, p. 16)

ployees other than sales personnel, operational costs incurred by buying offices and other administrative expenses.

20.4.3 Operating Profit Analysis in Retail Chains

As a simplified example of an **operating profit analysis** in retail chains, Table 20.3 provides a calculation of gross margin and operating profit for a fictitious retail store and the aggregation from store level to company level.

20.5 Financial Performance Evaluation

20.5.1 Financial Ratios

To evaluate the financial performances of retailers, **financial ratios** can be applied. In retail companies, four groups of financial ratios are utilised (Dragun 2004a):

- Internal liquidity ratios,
- return ratios,
- financial leverage ratios,
- earnings coverage ratios.

Table 20.3 Operating profit: department, store and company level (in thousand EUR) (hypothetical example)

Step	Position	Store A			Store B			Company
		Dep. 1	Dep. 2	Total	Dep. 1	Dep. 2	Total	
0	Net sales	278,000	424,000	702,000	723,500	381,500	1,105,000	
	./. costs of goods sold	159,400	242,200	401,600	435,900	234,600	670,500	
1	Gross margin	118,600	181,800	300,400	261,300	174,200	435,500	
	./. salaries	57,500	96,300	153,800	150,500	93,500	244,000	
	./. rent	24,000	16,000	40,000	33,000	22,000	55,000	
2	Operating profit (department level)	37,100	69,500	106,600	77,800	58,700	136,500	
	./. other store level costs			55,000			68,800	
3	Operating profit (store level)			51,600			67,700	119,300
	./. expenses of headquarters							33,200
4	Operating profit (company level)							86,100

In this Chapter, only internal liquidity ratios and return ratios are discussed.

The limitations of ratio analysis have led to the development of a new class of measures called **value metrics**. “The idea behind a value metric is simple and powerful: value is only created if the company generates return on capital exceeding the cost of that capital” (Dragun 2004a, p. 161). This approach will be discussed briefly and illustrated in the following case study.

Table 20.4 Return Ratios of Selected Retailers. (Adapted from Annual Reports 2013/14)

Company	Return on Assets (after-tax basis)
Auchan	2.8
Carrefour	2.9
Kohl's	6.2
Kroger	6.1
Macy's	6.9
REWE	3.2
Sainsbury's	4.9
Tesco	2.7
Walmart	8.1

20.5.2 Liquidity Ratios

Metrics from this group "measure the ability of the firm to sustain current and meet future obligations. Internal liquidity ratios usually compare the short-term assets such as cash and marketable securities with the near-term financial obligations such as accounts payable" (Dragun 2004a, p. 149).

The **current ratio** is one of the best-known liquidity metrics:

$$\text{current ratio} = \frac{\text{current assets}}{\text{current liabilities}}$$

Other metrics from this group are:

$$\text{quick ratio} = \frac{\text{cash and equivalents} + \text{accounts receivables}}{\text{current liabilities}}$$

$$\text{cash ratio} = \frac{\text{cash equivalents}}{\text{current liabilities}}$$

$$\text{cash flow from operations ratio} = \frac{\text{cash flow from operations}}{\text{current liabilities}}$$

The **quick ratio** and **cash ratio** are more conservative ratios, because inventories and other assets included in current assets may not be liquid enough. Formula 12 integrates a cash flow perspective.

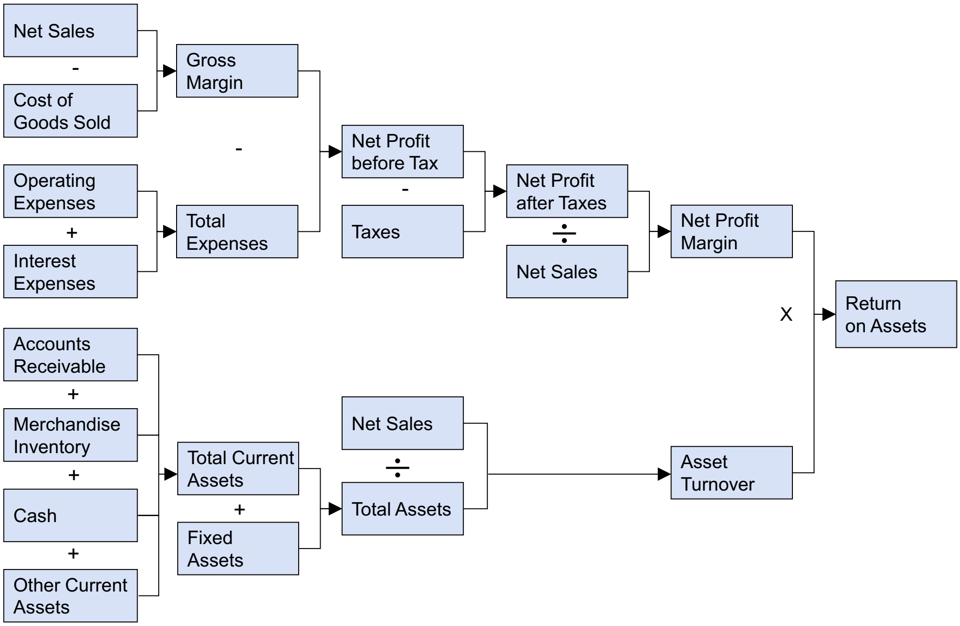

Fig. 20.2 ROA Path

20.5.3 Return Ratios and Return Path

These metrics relate profits to capital in contrast to profitability ratios, which relate profits to sales. A "top-level" indicator measures the efficiency of a company in utilising assets for profit generation: **return on assets** (ROA). This indicator is usually calculated on an *EBIT* basis (earnings before (b) interest and taxes):

$$\mathrm{ROA}^{(b)} = \frac{\mathrm{EBIT}}{\text{average total assets}}$$

On an after-tax and after-interest basis (a), a second metric return on assets can be computed:

$$\mathrm{ROA}^{(a)} = \frac{\text{net profit after tax}}{\text{average total assets}}$$

Other return metrics are **return on invested capital** (ROIC) and **return on equity** (ROE) (see Dragun 2004a; 2004b). Table 20.4 shows returns on assets (ROA) of selected retail companies operating worldwide.

The net profit margin model (Fig. 20.1) can be combined with the **asset turnover model**, which yields asset turnover by dividing net sales by total assets. As a result, the *ROA path* can be derived (see Fig. 20.2).

Table 20.5 Calculation of EVA. (Adapted from Dragun 2004a, p. 163)

	Component	Calculation
1.	Operating profit before taxes	
2.	Income tax expense	
3.	NOPAT (Net operating profit after taxes)	Item 1 – Item 2
4.	Capital	a = interest-bearing debt b = equity capital c = a + b
5.	Debt-to-equity ratio	
6.	Cost of debt (before taxes)	α (%)
7.	Cost of equity	β (%)
8.	WACC	$\frac{a}{c} \times \alpha\,(\%) + \frac{b}{c} \times \beta\,(\%)$
9.	Capital charge	Item 4 x Item 8
10.	EVA	Item 3 – Item 9

20.6 Value Metrics

20.6.1 Economic Value Added

These metrics measure the financial performances of firms by their ability to generate or add **economic value**. Measures of economic value include **market value added** (MVA), which is a purely stock market-based measure, and *economic value added (EVA)*. Economic value added is computed according to formula (15) (see Dragun 2004a, p. 162):

$$\text{EVA} = \text{net operating profit (after taxes)} - \text{WACC} \times \text{capital}$$

The **weighted average cost of capital** (WACC) is calculated as a weighted average of the costs of debt and the costs of equity capital. The costs of debt are the interest expenses required to serve the debt. “For equity, the cost is the rate of return on common stock expected by the shareholders” (Dragun 2004a, p. 161). These costs are more difficult to calculate because they depend “on the uncertain factors such as overall stock market risk, return expectations and the risk-free rate of return available to investors” (Dragun 2004a, p. 161). Table 20.5 shows a calculation scheme for EVA.

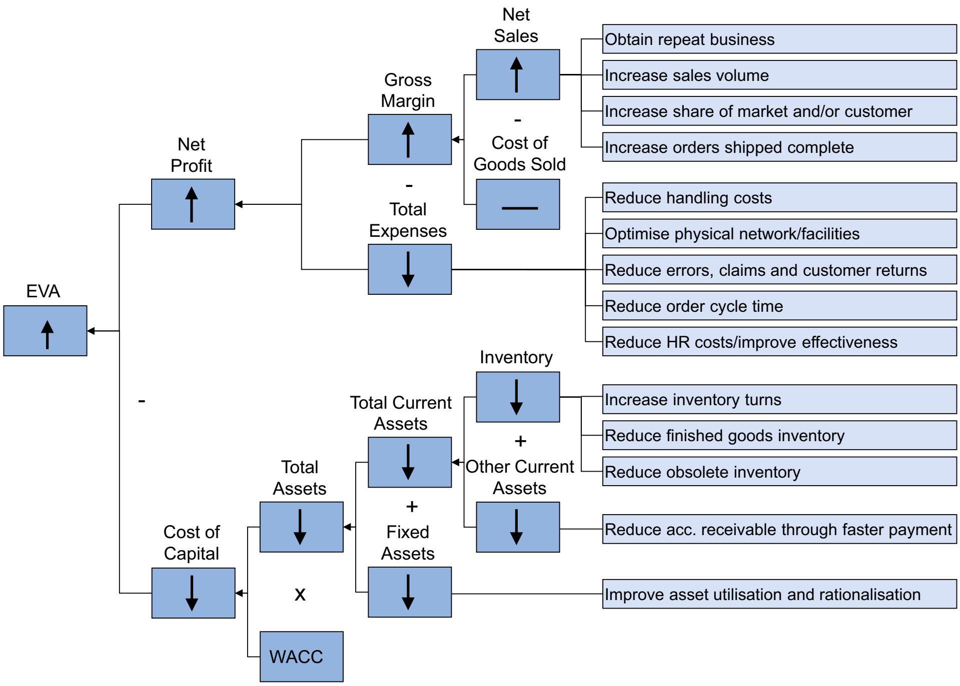

Fig. 20.3 EVA and Order Fulfilment. (Adapted from Lambert and Pohlen 2001, p. 13; Neher 2003, p. 38)

20.6.2 EVA and Supply Chain Performance

Supply chain performance evaluation can be combined with financial performance evaluation. Fig. 20.3 illustrates the means by which supply chain management can improve value metrics such as EVA (Morschett 2004).

20.7 Retail Balanced Scorecard

Apart from the concepts of monitoring operational and financial performance discussed here, new approaches have been developed in which the measurement of **consumer satisfaction** and other aspects comes to the fore. One of the most important concepts in this context is the **balanced scorecard** (BSC), proposed by Kaplan and Norton (1992; see also Morschett et al. 2015, pp. 543–545).

This is a specific, four-dimensional performance measurement system that comprises **financial objectives** as well as **non-financial measures** (see Fig. 20.4). “The balanced scorecard translates an organization’s mission and strategy into a comprehensive set of performance measures that provides the framework for a strategic measurement and man-

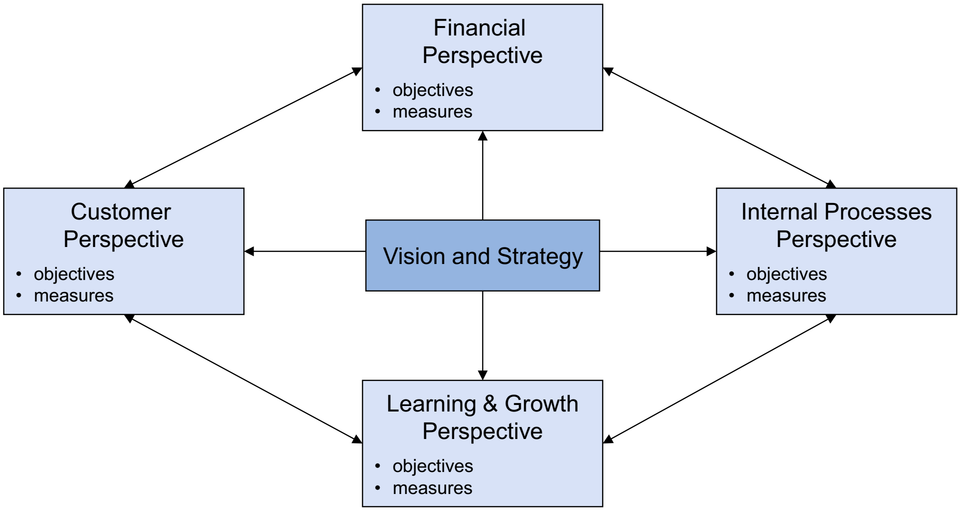

Fig. 20.4 The Balanced Scorecard. (Kaplan and Norton 1996, p. 9; Gowthorpe 2011, p. 425)

agement system. […] The BSC enables companies to track financial results while simultaneously monitoring progress in building the capabilities and acquiring the intangible assets they need for future growth" (Kaplan and Norton 1996, p. 2).

This concept can be adapted to retail companies. Fig. 20.5 illustrates the application of the balanced scorecard by the German department store chain *Breuninger*. They distinguish for performance dimensions: business finance, customer/market, goods/suppliers and internal processes & resources.

20.8 Conclusion and Outlook

A new challenge for performance measurement is emerging from the increasing importance of **corporate social responsibility** (CSR) and **sustainability** (Zentes et al. 2009a, 2009b; Scholz and Zentes 2014). The extension of the corporate goal system into ecological and social dimensions also requires advanced concepts of monitoring social performance (**corporate social performance**).

Following the **triple bottom line concept** (see Chap. 10), retail companies have to report not only economic activities and their results but also environmental and social issues. This finally leads to a three-dimensional balance reflecting the stakeholder view.

Further Reading

- Ayers and Odegaard (2008). *Retail Supply Chain Management.* New York et al.: Auerbach.

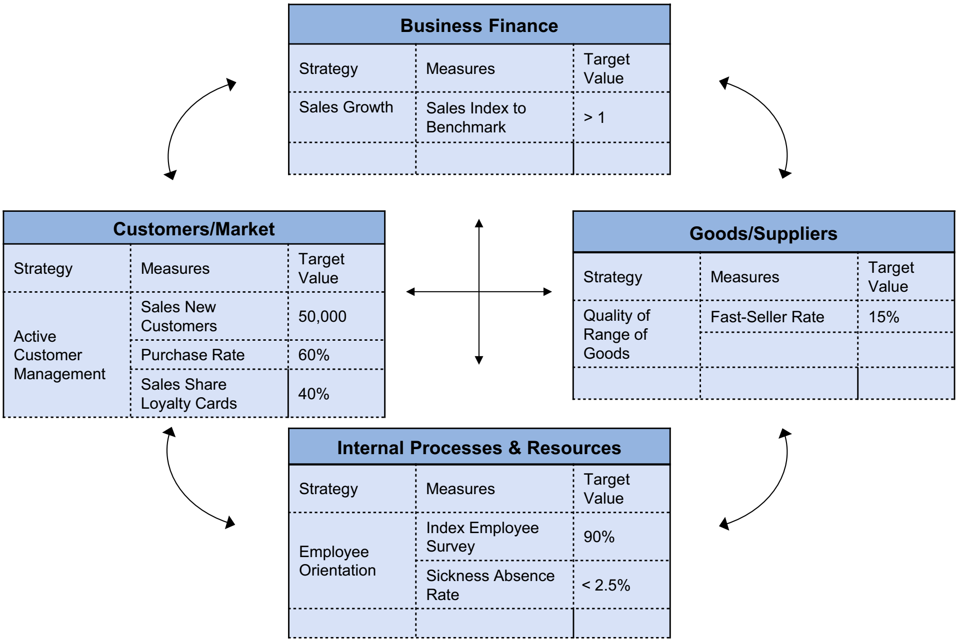

Fig. 20.5 Implementation of the Balanced Scorecard at Breuninger. (Adapted from Guldin 2000, pp. 103–121)

- Brealey et al. (2014). *Principles of Corporate Finance* (11th ed.). New York: McGraw-Hill.
- Meyer (2009). *Rethinking Performance Measurement: Beyond the Balanced Scorecard.* New York: Cambridge University Press.

20.9 Case Study: Metro

20.9.1 History, Profile and Status Quo

With net sales of 63 billion EUR in 2013/14, the *Metro Group*[1] currently ranks seventh among worldwide retail companies (Deloitte 2015, p. 11). The company was created in 1964, when the first German *Metro Cash & Carry* market for commercial customers was opened. The *Metro Group* emerged in its current form in 1996 after mergers with other companies and several portfolio adjustments. Following a broad programme focusing on

[1] As well as the explicitly cited sources, sources used for this case study include the website http://www.metrogroup.de, various annual reports and press releases.

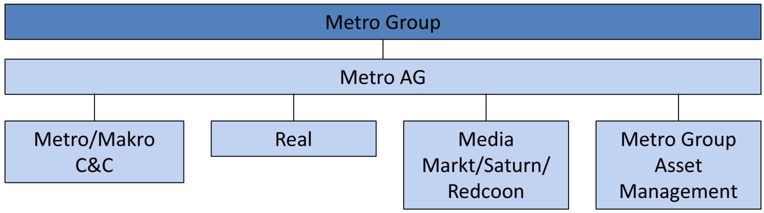

Fig. 20.6 *Metro Group's* structure. (Adapted from Metro 2014, p. 72)

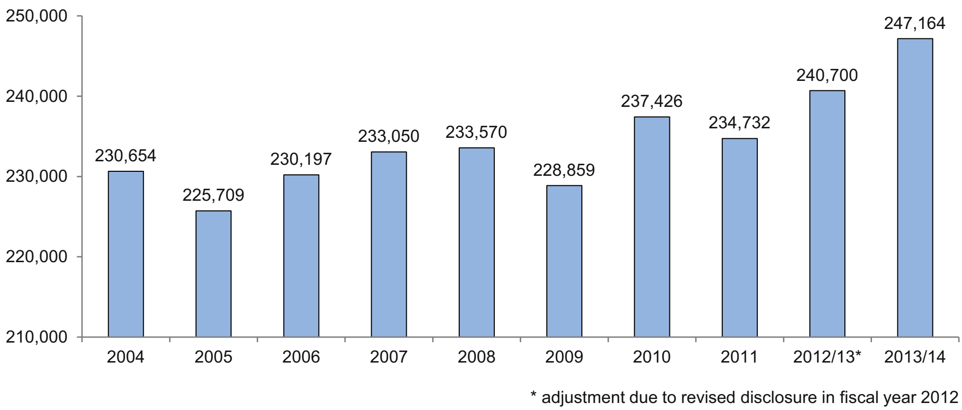

Fig. 20.7 Retail productivity measures: sales per employee at Metro Group (in EUR). (Adapted from Metro 2014, p. 330)

improving value and efficiency called "Shape 2012", the publicly listed DAX company unveiled a new company structure in 2009. The guiding theme of this change was: "as decentrally as possible, as centrally as necessary". The *Metro Group* concentrates on the three key business segments of wholesale, food retail (hypermarkets/superstores) and non-food specialist markets. These are organised into the three sales divisions *Makro Cash & Carry/ Metro Cash & Carry*, *Real*, *Media Markt/Saturn* and the purely online player *redcoon.de* (see Fig. 20.6). In 2015, *Metro Group* sold *Galeria Kaufhof* to the *Hudson's Bay Company.*

Metro AG leads the group as a strategic management holding, responsible, among others, for group-wide finance, controlling and compliance functions. *Metro Group's* real estate portfolio is managed by *Metro Group Asset Management*, acting as an independent profit centre. The sales divisions are independently responsible for their respective operative businesses and in some cases operate in the market with several retail brands. They are supported by cross-divisional service companies, which provide procurement and logistics, among others.

The company currently employs about 255,000 employees in 31 countries in Europe and Asia. In recent years, sales per employee (annual average by headcount) have been volatile but comparatively high (see Fig. 20.7).

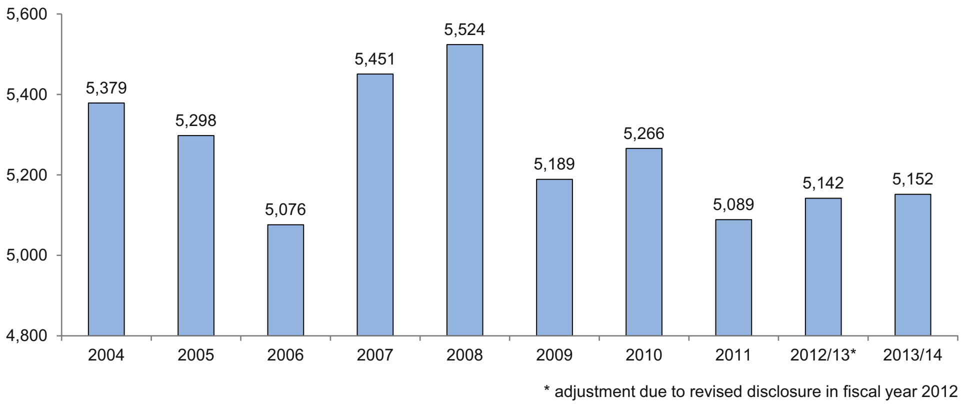

Fig. 20.8 Retail productivity measures: sales per square metre at *Metro Group* (in EUR). (Adapted from Metro 2014, p. 330)

Metro Group's sales per square metre have also been relatively high in recent years (see Fig. 20.8). The strong fluctuation in productivity is strongly influenced by the heterogeneous formats within the group's portfolio.

Roughly 60 % of the turnover of 63 billion EUR in 2013/14 came from abroad. The internationalisation of the cash and carry concept contributed considerably to this success, generating more than 84 % of its turnover outside the domestic market, despite various divestments, e. g., in Eastern Europe. The turnover of electronic specialty stores saw foreign sales of over 50 %.

20.9.2 Shareholder Value Concept

With the internationalisation and liberalisation of capital markets, shareholder value for publicly listed corporations is increasingly important. The basic principle is that the company's strategy is aligned with its owners' interests and decisions are made in the context of their effects on the company's value. This approach is, amongst other factors, designed to counteract opportunistic actions on the part of managers. Rational investors select the investment which they expect will accrue the highest returns on their investment relative to risk (Stern et al. 2001, p. 3). A distinction is generally drawn between investments in a company and capital market investments. As owners of a stock corporation, shareholders expect returns on their invested capital, in the form of dividends or rising stock prices. Especially since the 1990 s, the problem of adequately measuring company value has been complicated by the high number of mergers and acquisitions.

Generally, the shareholder value concept results in implementing value-based management within a company. The value metrics are intended to counteract the deficiencies of still popular conventional performance benchmarks, such as return on investment (Freeman 2004, p. 60), and measure a company's actual value or value creation.

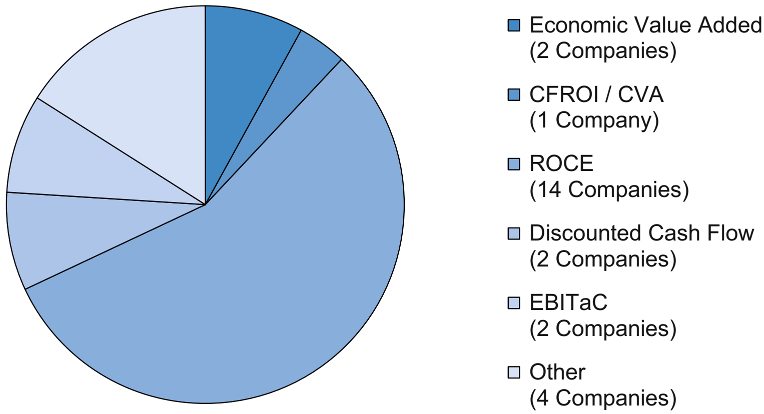

Fig. 20.9 Shareholder value metrics in German DAX-25 corporations 2014 (without banking, finance and insurance). (Own calculation, based on companies' annual Reports 2014)

$$\begin{aligned}\text{EBITaC} &= \text{EBIT} - \text{Cost of Capital}\\ &= \text{EBIT} - \text{Capital Employed x WACC}\end{aligned}$$

Fig. 20.10 EBITaC formula used by *Metro Group*. (Metro 2014, p. 90)

Fig. 20.9 gives an overview of the shareholder value key data most commonly used by the German DAX-25 companies in 2014. Companies most frequently revert to return on capital employed (ROCE).

20.9.3 Value Oriented Performance Metrics at Metro Group: EBIT after Cost of Capital (EBITaC)

To ensure sustained value creation, *Metro Group* has been using value-oriented performance metrics since 2000. At that time, economic value added (EVA) was implemented across the entire group as the standardised steering instrument and was actively and externally communicated, especially to the capital markets and shareholders.

However, in 2009 *Metro Group* changed from using EVA to EBIT after cost of capital (EBITaC), a similar but different value-based management concept. When earnings before interest and taxes (EBIT) rise above the costs of capital needed to finance the average capital employed, positive value contribution is reached. This should ensure a more focused orientation towards *Metro Group's* value drivers. In 2013, the end of the company's financial year was moved from December 31 to September 30 to avoid overlap with the Christmas period.

The following formula is used to calculate the key performance indicator EBITaC to ensure value contribution (see Fig. 20.10).

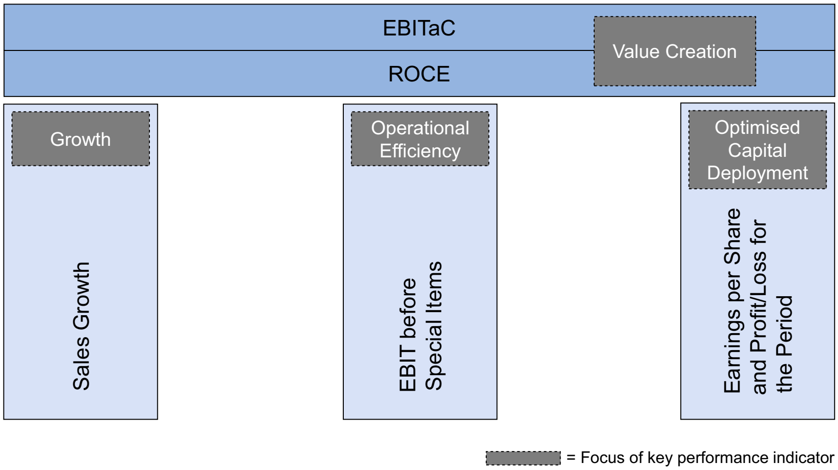

Fig. 20.11 Operational and value-oriented key performance indicators for *Metro Group*. (Adapted from Metro 2014, pp. 75–76)

Determining value creation via EBITaC concentrates on key drivers that can be influenced actively by management: increasing operational efficiency, value-creating growth and optimising employed capital (see Fig. 20.11).

Metro Group's cost of capital before taxes came to 9 % in 2013/14, corresponding to the minimum return on capital demanded by capital providers. This is the result of the aggregation of segment-specific cost of capital and reflects the return investors could generate investing in an alternative portfolio of shares and bonds with a comparable level of risk. The cost of capital should be interpreted as the sum of both equity and debt capital costs and therefore reflects the entire cost of employed capital.

Capital employed represents interest-carrying assets and is calculated as shown in the following formula (see Fig. 20.12). In contrast to EVA, one-time effects are not capitalised within capital employed, for example in the course of restructuring expenses. Using balance sheet items to determine EBITaC enhances traceability compared to system-related adjustments in calculating EVA.

The weighted average cost of capital (WACC) is the average weighted cost a company has to pay for its capital, combining both debt capital costs and equity capital costs. It reflects the risk inherent in an investment and is determined based on the capital asset pricing model (CAPM), which states that investors only invest in a company if they receive at least the return of a risk-free alternative plus a premium for their market risk, weighted with a company-specific risk factor (Bühner and Tuschke 1999, p. 17).

When calculating EBITaC, special items are generally distributed over four years on a linear basis and are considered in earnings before interests and taxes (EBIT). Periodised one-time special items from 2013/14 totalling 454 million EUR include portfolio changes (19 million EUR), restructuring and efficiency improvement measures (264 million EUR), impairment losses at goodwill (88 million EUR) and other special items

Fig. 20.12 Capital employed formula used by Metro Group. (Metro 2014, p. 90)

Capital Employed = Segment Assets
+ Cash
+ Cash Equivalents
- Trade Liabilities
- Other Operational Liabilities
- Deferred Income

Table 20.6 Key financial ratios for Metro Group for the financial years 2012/13 and 2013/14 (in million EUR). (Metro 2014, p. 90)

	2012/13	2013/14*	Delta
EBIT before Special Items	2000	1727	−273
EBIT after Periodisation of Special Items**	1680	1376	−304
Ø Capital Employed	15,076	13,579	−1497
WACC before Taxes	9.0 %	9.0 %	0
Cost of Capital	1357	1222	−135
EBITaC	323	153	−170

* previous year adjusted for comparability reasons
** the effect of special items is spread over 4 years

(83 million EUR). The respective positive effects on EBIT largely occur after a time lag. Distributing the special items over several years therefore provides an accurate representation of operational performance, and consequently, short-term special effects do not fully impact earnings in the period they occur. This ensures that measures which create value in the long term are not abandoned because of negative short-term earnings effects. In the 2013/14 financial year, *Metro Group* achieved a positive EBITaC of 153 million EUR (see Table 20.6).

Another value-based management metric used by *Metro Group* is the return of capital employed (ROCE). This indicates whether the company made profitable use of its available capital, less liquid funds and short-term debt capital. This metric is used to better compare individual segments, since it measures the return from business assets deployed during the review period. ROCE is calculated based on EBIT before special items, because this adequately reflects the units' operational earnings strength, independent of special effects. *Metro Group* uses the following formula to calculate ROCE (see Fig. 20.13).

$$\text{ROCE} = \frac{\text{EBIT (before Special Items)}}{\text{Business Assets (Including Cash Rental Values)}}$$

Fig. 20.13 ROCE formula used by *Metro Group.* (Metro 2014, p. 91)

Besides the net profit for the period (net earnings), ROCE is also a performance-based pillar for calculating the *Metro AG* management board's remuneration.

The results of the EBITaC and ROCE analyses are used, among other things, to manage *Metro Group's* portfolio and allocate investment funds. Consequently, the present value of future value added is the key criterion for all investments within the company.

20.9.4 Conclusion and Outlook

The geopolitical situation in 2013/2014 was very challenging, with unexpected political developments in Russia and Ukraine, which posed major challenges for *Metro Group* and led to poor development of business in this region. Furthermore, measures were implemented to streamline the company's portfolio, including divestments in Eastern Europe, Turkey and Egypt. In addition, *Metro Cash & Carry* Vietnam was sold in the 2014/2015 financial year due to an expected one-time positive effect on EBIT. However, despite the tense economic situation, the company achieved a positive EBITaC of 153 million EUR. Because of the company's strategic transformation via new structures and processes, a slight rise in EBIT before special items adjusted for currency effects is projected for the future, which will also have an impact on value-based metrics.

Questions

1. *Metro Group* changed its steering system from EVA to the similar EBITaC; however, several other companies such as *Henkel* use the more common EVA as a group steering system. Discuss the possible limits and risks of EVA as a group steering system.
2. Compare EVA with the two steering tools EBITaC and discounted cash flow (DCF) and make a comparative analysis.
3. Financial metrics help steer a company as they provide a quantitative outlook on its performance capability. However, a company's true strength lies in its resources, capabilities and competences, which are qualitative factors that underpin financial performance. What value potentials are strategic to *Metro Group* in this context?

- See Holler 2009 and Merchant and Stede 2012.
- See www.metrogroup.de and press coverage for details on strategic value drivers of *Metro Group.*

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