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The Revolution in Retailing: from Market Driven to Market Driving

Nirmalya Kumar

The first image aroused by 'retailing' for many of us, especially those of us who are somewhat older, is that of the corner grocery store. Not so long ago retailing was, and it still is in some parts of the world, a fragmented, local, unsophisticated, traditional business run by vulnerable owner-operators. Yet, here we are talking about a revolution in retailing. Why? What has changed? Fundamentally retailers have grown up over the past 25 years into large, global, technology-intensive, powerful, fast-growth corporations managing their own brands. Several retailers have become the darlings of their stock markets. Hennes and Mauritz, the specialty clothing retailer, has been the top performer on the Stockholm Stock Exchange over the past 10 years. Royal Ahold in the Netherlands, Home Depot and Wal-Mart in the United States, Carrefour in France and Marks and Spencer in the United Kingdom have generated spectacular returns for their stockholders. How have they done this? The leading retailers through consolidation, global expansion, technology push and innovative formats, among other approaches outlined in Figure 1, have been *'market driving'* rather than 'market driven.' They have shaped consumer behavior, transformed the market place, and redefined the rules of engagement with their competitors and suppliers. © 1997 Elsevier Science Ltd. All rights reserved

From Fragmentation to Consolidation

Retailing was a very fragmented industry in most countries 25 years ago. Through internal growth as well as mergers and acquisitions, an enormous consolidation has taken place in the industry. Over the past year, Metro of Germany has become the second largest retailer in the world after adding Kaufhof, Asko, Deutsche SB-Kauf to their portfolio. The result is that Metro's sales in 1996 were 57.4 billion dollars worldwide, up three-fold, from 18.8 billion dollars in 1990. Besides there have been several cross-border mergers and acquisitions. Royal Ahold of Netherlands has been one of the most active on this front with their acquisitions of Stop and Shop, Bi-Lo, Giant, Tops, Finast, Edwards among others in the USA and most recently Bom Preco, a 50 store grocery chain, in Brazil.

These mergers and acquisition are driven by several factors.

1. Strong retailers because of their cash management system of cash sales to customers while buying on credit from suppliers are sitting on heaps of cash.
2. Retailers feel that size brings them bargaining power versus suppliers, and therefore, helps reduce what for many retailers is their biggest expense—COGS or cost of goods sold.
3. There are the more traditional economies of scale. If the same products are available through several retailers, then cost control becomes one of the, if not the, paramount driver of profitability.
4. Many developed countries have strict restrictions on opening large new stores (e.g. Spain, Italy, and Japan), over-stored environments (e.g. France, Germany), or lack of availability of prime locations of adequate size (e.g., Switzerland) leaving mergers and acquisition often the only domestic expansion strategy available.

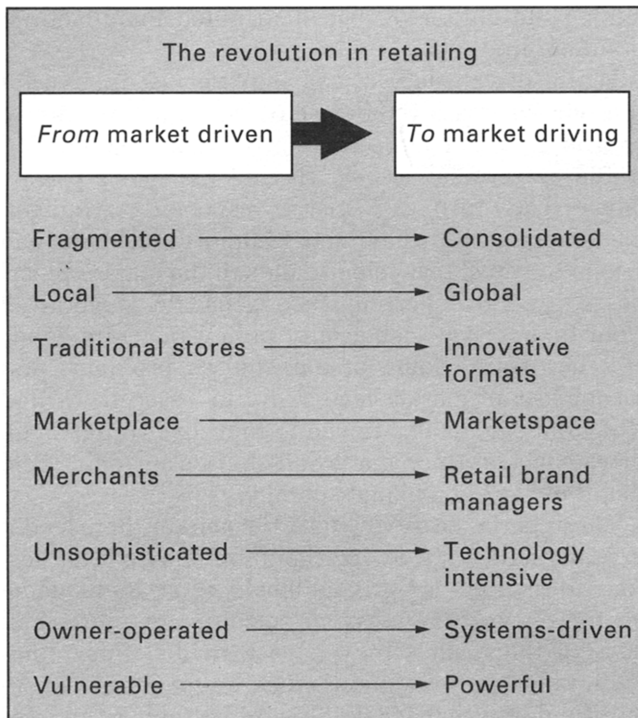

FIGURE 1. The revolution in retailing.

Consolidation has several implications for both manufacturers and retailers. It makes it much harder for the independent retailers to succeed as they just cannot buy as efficiently or invest enough in technology to keep their operations competitive. Thus despite the efforts of many governments to protect the small, independent retailer, we will continue to see M&A activity in the industry moving at a hectic pace. For manufacturers this continuing consolidation in points of sale is worrying. As retailers learn how to integrate their mergers and acquisitions more tightly, especially with respect to sourcing, the pressure on manufacturers will undoubtedly increase. Many of the premier manufacturers who were previously operating as branded bulldozers have now been shocked into talking 'partnerships.' However, partnerships often mean very different things to manufacturers and retailers thereby leaving one party rather unsatisfied with the entire experience, usually the manufacturer.

From Local to Global

Perhaps the most dramatic change in retailing has been the increasing globalization of retailers. Several factors are driving globalization including: low growth in domestic markets, sophisticated formats that have the potential to be unleashed around the world, the availability of technology to help manage far flung operations, global consumption patterns, and the opening up of new markets with relatively under-developed retail sectors. On the last point, consider that in India with a population of almost 1 billion over 95% of retail sales are through independent owner-operated stores or what are referred to in the United States as 'mom and pop' operations. Even in more developed countries or regions, such as Greece, Eastern Europe, Italy, Malaysia, Mexico, and South Korea these independent operations still account for a large percentage of the total retail sales. No wonder, the Wal-Mart's, Carrefour's, and Makro's of the world get misty-eyed when they talk about globalization.

The early leaders in global retailing were specialty formats such as IKEA from Sweden, C&A from The Netherlands, Benetton of Italy, Marks and Spencer, and several McDonalds type franchise operations from the USA. These were mostly private label formats and it was not clear whether their primary activity was retailing or manufacturing. Furthermore, the economic model and business system of these retailers was such that they could break even in a country with as few as one or two stores. Now one observes true retailers such as Carrefour, Dairy Farm of Hong Kong, Seven-Eleven convenience stores (part of Ito-Yokado) of Japan, Makro of Netherlands, Toys'R'Us, Virgin and Wal-Mart going overseas with their formats carrying manufacturer branded products. Since the merchandise they offer is often already available, one of the main distinctive competencies they bring is distribution exellence. However, a certain minimum number of stores (6 to 8) in a country are necessary before their distribution efficiency can be successfully replicated.

Despite the popularity of globalization in retailing, most retailers are still struggling to develop competencies to succeed in global markets. To what extent should the 'original' format be adapted is a major issue. Wal-Mart learnt this the hard way when its initial entry into China had the wrong merchandise. On the other hand, Mexican customers were disappointed when they did not find enough imported US merchandise in the Wal-Mart stores. Another related question is which activities should be centralized and which should be decentralized. Currently, retailers believe that activities where substantial economies of scale exist such as merchandising systems, information technology and vendor management should be centralized whilst others such as merchandising and distribution should be decentralized. To protect against currency fluctuations, comply with local sourcing requirements and serve local tastes, most 'big' retail formats prefer to rely on local suppliers. However, if 90% of merchandise is locally sourced, as is the case for Wal-

Mart and Carrefour, then these retailers start to lose some of their global sourcing leverage against the manufacturers and advantage against local competition. Finally, as local partners are often mandated or necessary, who to select and what should be the role of each partner is a crucial question. Clearly, Carrefour as the late entrant in Mexico ended up with a relatively weaker local partner because Wal-Mart already had Cifra, the best Mexican retailer, tied up in a joint venture.

Most manufacturers are still in the process of developing a coherent strategy on how to interact effectively with global retailers. To what extent can price differences of 40–60% between markets be sustained in the face of transshipments by retailers? How to keep the traditional retailers who still account for a large majority of the manufacturer's sales in a particular country satisfied while serving the global retailer who undercuts established prices to gain local market share? How to organize and compensate a dedicated multinational-multifunctional account management team to serve global retailers? These are all as yet unresolved questions.

From Merchants to Retail Brand Managers

Retailers were once considered true merchants, making their profits from the spread between their buying and selling prices. Today's most successful retailers are not just excellent merchants but they are developing a unique powerful brand image. This is true both for retailers who carry primarily private label merchandise such as Aldi of Germany, Gap and Pier 1 Imports of United States or Zara of Spain as well as for the more traditional retailers who carry manufacturer branded products. While in the United States, the retailers' own private labels tend to be cheaper than the manufacturer's branded products, this is not always the case in Europe. Supermarkets such as Sainsbury of United Kingdom, MIGROS of Switzerland, Albert Heijn of Netherlands and Casino of France have developed premium private labels which are highly respected vis-a-vis the manufacturers' brands. These retailers support their own brands with extensive advertising, product innovation and attractive packaging to develop a distinct brand image and customer franchise. For example, in almost every survey in the United Kingdom, Marks and Spencer tends to top the list of most admired companies and their St. Michael's brand is world renowned. Retailers believe that their own labels deliver greater profits, more control, increased leverage vis-a-vis the manufacturer, and that they help to develop a distinct store image among the clutter of over-distributed manufacturer branded products.

While private labels may look very seductive for the retailer, mass retailers have to be careful not to overdo it. For a mass retailer, customer count and traffic are crucial issues. Having too many private labels can turn off many, especially younger, customers. Despite having in Kenmore and Craftsman two of the most respected brands in the market place, Sears, the US department store, had to move away from their private label only policy in white goods and hardware. Some of Sainsbury's problems and recent loss of market leadership to Tesco in United Kingdom can also be traced to their over-reliance on private labels which made Sainsbury's customers feel that they lacked adequate choice.

The experience of MIGROS, the market share leader in supermarkets in Switzerland, offers two other lessons to retailers for private labels. First, by focusing on their own brands which account for more than 90% of their sales, they have provided their competitors with a strategic window to operate in. There is little doubt that MIGROS is by far the best retailer in Switzerland and that their competition is, to put it bluntly, inept. Yet the competition has almost 60% market share as they offer manufacturer branded products such as Coca Cola which MIGROS still refuses to carry. Second, it is more difficult for mass retailers such as MIGROS who rely on private labels to expand overseas as they have to convince the customers in the new country to switch both stores and brands. And if they do decide to carry manufacturer branded products in overseas markets, they do not have the same leverage with brand manufacturers that other retailers do.

A strong retailer brand supported by advertising has a positive impact on recruitment of managerial talent and employees. By virtue of their strong brand image, many European retailers can successfully compete with the major brand manufacturers for managerial talent, something that I found was relatively rare in the United States. For manufacturers this means that, unlike in the past, their counterparts in the retail sector are better informed and more analytical while having the same educational and social status. One can guess the implications of this for manufacturer-retailer negotiations. The improving quality of private labels implies that manufacturers have to invest more in product innovation while keeping the price differential under control.

From Traditional Stores to Innovative Formats

The past 25 years has seen the emergence and growth of several new retail formats and concepts. Today, we

see the supermarket, department store, hypermarket and supercenter, discount store, cash and carry warehouse club, factory outlets, category killer, convenience store, specialty retailer, as well as the gas station all competing for the same customer. Undoubtedly, of all the formats, the 'big box' (category killers, large discount stores, warehouse clubs and hypermarkets) have had the most revolutionary impact. Their enormous purchasing power which results in lower cost of goods sold and economies of scale puts severe pressure on the traditional formats. Department stores in several countries have either eliminated or severely cut back on their toy department in the face of competition from Toys'R'Us. The independent car dealer in the United States and United Kingdom now faces the emergence of category killers such as Car Max and Car Supermarkets respectively who compete for the profitable used car business.

Clearly, in the future the Internet will revolutionalize retailing in the developed world. The Amazon bookstore which sells books through the Internet only is a prime example of the revolutionary potential of Internet. In contrast to the traditional book industry which is drowning itself in excess inventory because it cannot develop an effective returns policy, Amazon carries no stocks as the books are shipped directly from the book wholesalers. As a result Amazon incurs close to zero inventory and real estate costs while potentially reaching customers across the world. Furthermore, they offer customers a much wider assortment, lower prices, quicker access to newly released books, and no-travel hassle-free home shopping compared to the high street bookstore. A new development, 'intelligent shopping agents' which rapidly search the Internet for the lowest price on a product are also slowing emerging. If they become widespread, retailers may face greater price pressure in categories where the customer does not need to feel, see or touch, and where the customer does not desire instantaneous delivery (unless the product can be downloaded). The retailer's competitive focus will shift from the marketplace to the marketspace.

The traditional formats, especially the supermarket and department store, with their high costs will see more and more customers flee to these new formats in search for better value. To justify their higher costs, supermarkets and department stores have to find ways to increase the value they provide to the customer. Perhaps this may be through higher customization in their services, unique assortments, and/or creating a boutique (e.g. shop within a shop) specialty feeling. If traditional stores carry similar assortments as these new lower-cost formats and delivery innovations negate their locational advantage, they cannot compete on product and price. Their only hope is to deliver a unique experience as Body Shop, F.A.O Schwartz, Starbucks, Nordstrom or Banana Republic do.

The new formats offer both new opportunities and challenges for manufacturers. Which of these new formats to enter and when? How to develop distinctive offers for each type of format? How to manage intra-brand competition? Some manufacturers, such as in the automobile industry, are behaving like ostriches burying their heads in the sand. They are refusing to support and deal with the new category killers. Others like Goodyear Tire and Rubber Company who have decided to distribute their products through mass merchandisers after years of exclusively relying on independent dealers have upset the latter. As the market moves in the direction of the new formats, leading manufacturers have little choice but to enter these outlets forcefully. Smaller manufacturers may, however, develop a distinctive market positioning through an exclusive focus on the traditional formats.

From Unsophisticated to Technology Intensive

Surprisingly to many, retailing has become a technologically intensive industry. Technology is transforming how retailers (1) configure the supply chain; (2) manage their store operations; and (3) interact with customers. By establishing close links with their suppliers, retailers can utilize ECR (efficient consumer response). ECR allows suppliers to receive daily updates of sales, prices and inventories by item and by store. Thus the entire value chain can work on the principle of 'sell one, ship one, build one.' The potential cost savings for the supermarket industry in inventory, order processing, invoicing and payment from such a system are estimated at 30 billion dollars in the USA and 33 billion dollars in Europe. Furthermore out-of-stocks, inventory and returns can all be simultaneously reduced.

Technology also makes it easier to manage thousands of stores spread all over the world and helps the expansion of retailers like Wal-Mart, Home Depot and Toys 'R' Us. Real time information from the stores keeps the headquarters informed of what is happening in each store. Within the store, sophisticated shelf management programs aid merchandising to make the shelves easier to shop for the consumer while maximizing profits for the retailer.

Plummeting data processing and storage costs give retailers today the ability to track their customers on an individual basis. Who is buying what, when, and

for how much? This allows retailers to customize their offers at individual stores and to individual customers. As retailers learn who the most profitable customers are, we will observe more targeted customer attraction strategies. There is a lot of untapped potential with respect to such customer data which retailers are still learning to exploit. Clearly, however, there are privacy concerns in every country and legal restrictions in several countries, such as Denmark, which have to be respected.

Increasing technological sophistication means that today's retailer is much better informed about consumer purchasing patterns. Retailers who do not or are unable to invest in such systems will be at a disadvantage. And manufacturers, in their negotiations with retailers, will need to demonstrate the role that their brand plays in the category for the retailer as well as the profits that it will generate for the retailer. Shelf space according to movement implies that manufacturers must earn the shelf space that is dedicated to them.

From Vulnerable to Powerful Players

Historically, retailers used to be at the mercy of powerful multinational manufacturers such as Unilever, Nestle and Procter and Gamble. Today some retailers find themselves much bigger in size than their suppliers, and size brings power. For example, Unilever, the largest packaged goods company, had sales of just over 50 billion dollars last year but that is still less than half of Wal-Mart's sales of 106 billion dollars.

In response to this shift in power, many manufacturers are allocating a larger proportion of their marketing expenditures to trade promotion instead of advertising. This is a self-defeating strategy. While retailers derive their power from size and market access, a manufacturer must derive its power from advertising and product innovation investments in brand equity. If a retailer does not stock a particular brand and the customer walks out of the store, the manufacturer has the power. On the other hand, if the customer accepts an alternative brand, then the retailer has the power. This is something that even the largest retailer, Wal-Mart, understands. Manufacturers who under-invest in brand equity lose power to retailers, spend more on trade promotion, offer price and service concessions, thereby getting trapped in a vicious circle.

Some manufacturers and retailers are starting to see the benefits of developing trust and focusing on the benefits that partnerships can bring to both parties instead of using their power to pummel the other party into submission. Experienced manufacturers now realize that with some retailers, for example Sainsbury, it will always be a power struggle. However, there are other retailers, for example Tesco, with whom one can develop a partnership that focuses on maximizing joint benefits. Manufacturers increasingly have to develop account management systems that can function differently in different types of relationships, which is difficult.

Conclusion

These changes are dramatic for the retailing industry. Retailers have always been a more market driven than manufacturers because they were smaller, more flexible and closer to the marketplace. A retailer who was not market driven received immediate feedback from customers and had to either adapt or went out of business. Today, however, there are several retailers like Ahold, Amazon, Bed, Bath, and Beyond, Benneton, Body Shop, Carrefour, Car Max, Hennes and Mauritz, Home Depot, IKEA, Makro, Seven-Eleven, Victoria's Secret, Wal-Mart and Zara who are changing the retail landscape and driving customers' shopping behavior and habits. Wal-Mart, for example, has taught consumers not to shop around for sales and instead buy at everyday low prices from them.

The best retailers today are using available technology and new formats to re-invent the competitive retail marketspace. Wal-Mart has a strategy of using technology and systems to lower its gross margins constantly. This drives its competitors bankrupt. Every one of the top 10 US discounters in 1962, the year that Wal-Mart opened its first store, has either gone out of business or reorganized. Similarly, Car Supermarkets, the used car category killer in the United Kingdom, operates with a gross margin of 5% and sells cars below book value. This changes the rules of the game for existing players who are trapped because of their high cost business systems.

These revolutionary retailers are also reconfiguring the value chain. They are using their power to demand changes from powerful manufacturers and driving the manufacturer's pricing, product, promotion and sales strategies. Procter and Gamble, for example, has adopted EDLP (everyday low pricing), eliminated several brands and item variations, reduced trade and consumer promotions, controlled new product introductions, as well as reorganized the salesforce from being dedicated to one of the seven separate divisions to being part of unified teams dedicated to individual retail accounts. All these changes have been in

response to demands from retailers, especially Wal-Mart. Therefore I believe that the term 'market driving' is more descriptive of these retailers than 'market driven.'