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POSTEXPANSION PLANNING CONSIDERATIONS FOR NEW MULTIOUTLET RETAILERS

Abstract

Successful small retailers invariably are tempted to test the adage "more is better." While the expansion allure is more than many can resist, it must be tempered by the realization that many hidden challenges await the unsuspecting entrepreneur.

Success of the new organization will require not only more but a different kind of effort than used in managing the single store. First, successful operation will now depend on delegating operating decisions to professional managers. The autonomy given these managers is a complex decision and may be placed anywhere within a three dimensional continuum depending on the desired image, supervision, and buying patterns for each store. Second, the accounting information required for proper control and performance evaluation of the organization will increase dramatically.

Adequate pre-expansion planning can expose many of the hidden challenges and make the transition one more likely to prove that more is, in fact, better.

POSTEXPANSION PLANNING CONSIDERATIONS FOR NEW MULTIOUTLET RETAILERS

At some point in the life of a successful retailer the question of expansion arises. While retailing is one of the last territories of the small owner-run business, current economic and market trends make it more and more difficult to remain small and successful. The economically healthy firm which has decided to expand faces many strategic decisions crucial to orderly and profitable expansion.

As a single unit firm moves through the stages of creating an existence and survival, and reaches the stage described as success, for many firms the next step is growth.[1] The growth period may be divided into two stages; these are "early growth" and "later growth."[2] Early growth is characterized by testing of initial market strategy and direct contact by the owner with all major activities. Once the firm's sales stabilize, the later growth stage may emerge. For retailers, this stage is typically characterized by multiple site expansion. A successful transition from the early to later growth stage requires considerable strategic planning, not only to successfully implement the expansion but to improve the chances of survival once the expansion is in place.

Strategic factors influencing success have been well documented for large firms especially in the manufacturing sector, but "few such studies have been done in the retailing sector."[3] The dearth of information is particularly noted

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[1]Neil C. Churchill and Virginia L. Lewis, "The Five Stages of Small Business Growth," Harvard Business Review, May-June (1983), pp. 30-50.

[2]R. B. Robinson, J. A. Pearce, G. S. Vozikis and T. S. Mescon, "The Relationship Between Stage of Development and Small Firm Planning and Performance," Journal of Small Business Management, 3 (1984), pp. 45-51.

[3]Richard Miller, "Strategic Pathways to Growth in Retailing," Journal of Business Strategy, Winter (1981), p. 17.

concerning small retailers. Yet, the small firm is a major force in the retail sector. An identity of ownership and management still exists to a large extent in the retail sector. Half of all retail firms in 1982 were sole proprietorships and 95.8 percent of retail firms operated from a single unit.[4]

EXPANSION CONSIDERATIONS

In order to compete in an economy dominated by large chains and franchise organizations, small successful retailers at some point examine the opportunities available through expansion. "If the concept of the business and its execution is reasonably successful, the firm may choose to extend . . . into regional or, ultimately, a national area of operations."[5] Expansion allows one to move beyond areas of "natural dominance" to add outlets under different names to cover diverse market segments.[6] As markets increasingly vary in wants, needs, and buying power, a single way of doing business may not appeal to all market segments.[7]

While the positives may justify the decision to expand, there are negatives which must be given consideration, even at a post decision point. Probably one of the most frustrating changes will be the lessening of clientele contact. Success of owner operated units is often attributed to the owner's informal

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[4]Census of Business, Retail Trade Reports (1982), U. S. Department of Commerce, p. 55, p. 146.

[5]Richard Miller, "Strategic Pathways to Growth in Retailing," pp. 16-29.

[6]Elizabeth C. Hirschman, "A Descriptive Theory of Retail Market Structure," Journal of Retailing, Winter (1978), pp. 29-48.

[7]Jagdish Sheth, "Emerging Trends for the Retailing Industry," Journal of Retailing, Vol. 59, No. 3 (1983), pp. 6-18.

information gathering from customers and the owner's ability to respond quickly to such information.[8]

New management positions will need to be created within the organization. Up until the expansion, the owner has probably served as the major managerial force with only limited auxiliary managers needed. Now the owner is faced with not only the cost of qualified managerial talent, but conducting the search and hiring task with future rather than current conditions in mind.[9]

The owner/manager of a multiple unit operation may, therefore, become much more a manager of paper than a front-line entrepreneur. Span of control becomes a major concern. With growth, the owner/manager's ability to directly supervise personnel and their tasks has been surpassed. New evaluation criteria must be developed. Specialization and delegation of responsibilities become necessary.

Once the decision to expand has been made, however, two distinct sets of strategic decisions must be addressed. These may be viewed as those decisions necessary to physically implement the expansion and those needed to insure a controlled operation during the postexpansion period. Articles and books too numerous to mention are available to assist small firms with their implementation decisions. These decisions focus on such items as staffing, site selection and financing. However, the literature has little to offer with respect to preparing for control of the more complex multiunit retail operation. This paper focuses on two critical postexpansion issues which must be addressed during the pre-expansion planning. These are the level of autonomy given to the new stores

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[8]Albaum, Gerald, R. A. Peterson, and G. Kozmetsky, "Perceptions of Major Problems Facing Small Businesses," Texas Business Review, July-August (1983), pp. 117-179.

[9]Churchill, "The Five Stages of Small Business Growth," pp. 30-50.

and the adequacy of the accounting information system (AIS) for controlling the expanded operation.

LEVEL OF STORE AUTONOMY

Given the decision to expand, the owner must decide upon the level of autonomy to be assigned to each unit. Too often this decision is seen as merely locating a placement on a single dimension continuum somewhere between total centralization and total autonomy. More realistically the decision includes many variables, and thus, the continuum is more like the one shown in Exhibit 1. Control of units, therefore, includes many different components, three of which seem to explain the major levels of autonomy. These three decisions include: 1) the transferability of the store image, 2) the level of day-to-day supervision, and 3) buying independence.

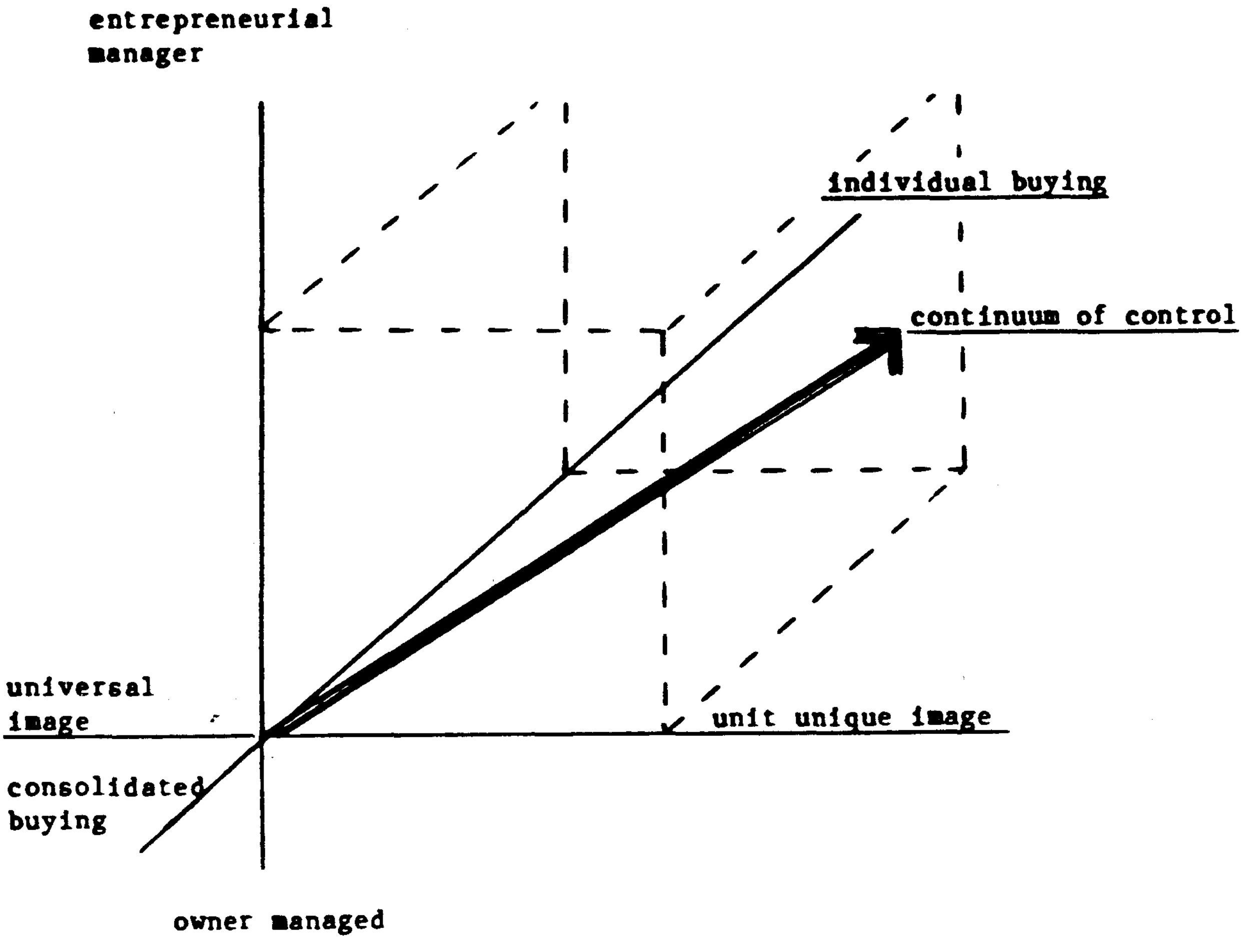
While supporting variables influence the question of control, the three major variables were chosen as reflecting the autonomy each unit is to be given in dealing with its three primary publics: consumers, employees, and vendors. Thus, decisions as to autonomy of image (consumers), level of supervision (employees), and buying (vendors) combine to locate the level of unit control along the continuum pictured in Exhibit 1.

Autonomy of Image

The initial decision on the autonomy of the unit is how much the additional unit will be a clone of the original operation. Is the concept of the operation universal enough that a carbon copy of the original will work, or will adaptations be necessary? Is the basic image of the operation transferable, or will each unit establish a separate image for a distinct market? With the diverging of markets with respect to wants, needs, and buying power a single way of doing business becomes more and more unlikely to appeal to many market segments.[10]

Exhibit 1

CONTINUUM OF CONTROL



Level of Supervision

The owner must then decide on the extent to which he is willing to relinquish day-to-day supervision of the establishments. Traditionally, variations on the basic Mazur organizational chart have been used to describe three

[10]Jagdish Sheth, "Emerging Trends for the Retailing Industry," pp. 6-18.

alternative structures.[11] In the main store organization, total control of branch stores is maintained by the "main" store. "Separate" stores function independently, tailoring operations to meet local needs. The "equal" store centralizes authority, with finance, buying, promotion, and operations controlled from headquarters. Selling is a decentralized function managed by separate sales units (stores).

Supervision is not limited to these three alternatives. As shown in Exhibit 2, at the most limited level of autonomy expanded units serve as satellite units of the "mother" or "flagship" store. Slightly more autonomy may be shown when the owner/manager directs the operation of two or more geographically separated units. Some minor decisions may be made by the unit purely because the owner/manager cannot physically be at all units at the same time. When the owner establishes a separate "headquarters" to manage several units, autonomy of the units grows. Nearly total autonomy is achieved when the manager removes himself from the operation of the units, with financial evaluation his major criterion of performance.

The extent of supervision will be based on owner preferences and talent, established management style, actual physical dispersion of the units, the availability of managerial talent, the ability to transfer the concept of the operation to new management, and the ability to establish workable information channels. Information gathering will of necessity have to be formalized. Stock management information, consumer reactions, and activities of the competition will need formal monitoring and planned responses.

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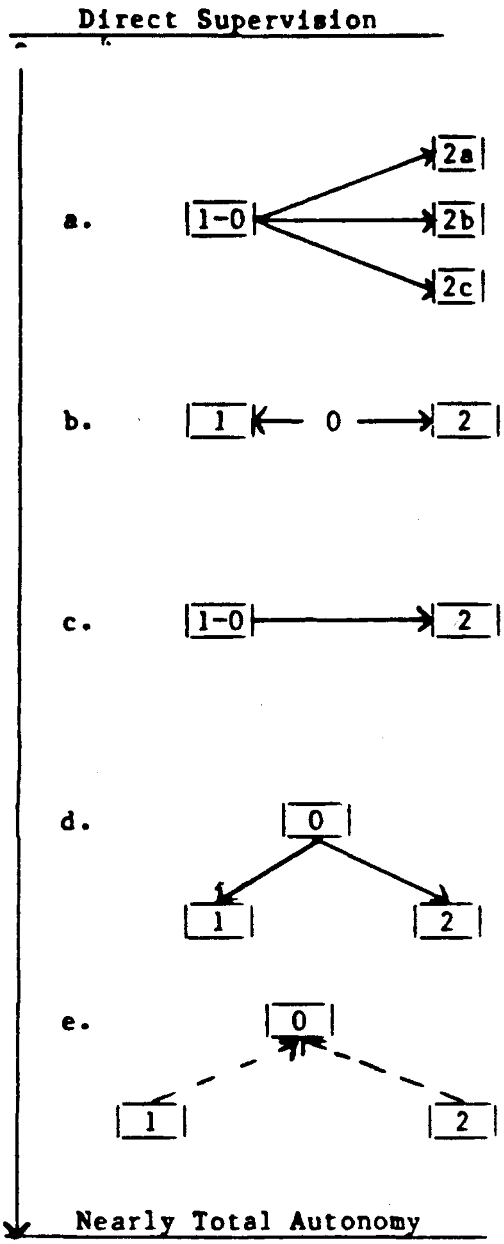
[11]Dale M. Lewison and M. Wayne DeLozier, Retailing (Columbus, Ohio: Charles E. Merrill, 1982).

Exhibit 2

LEVEL OF SUPERVISION



a. expansion as satellite units

b. owner manages 2 geographically separated "departments"

c. separate unit closely supervised by owner from original unit

d. owner supervision of units from "headquarters"

e. separate entrepreneurially managed units with "bottom line" returned to owner

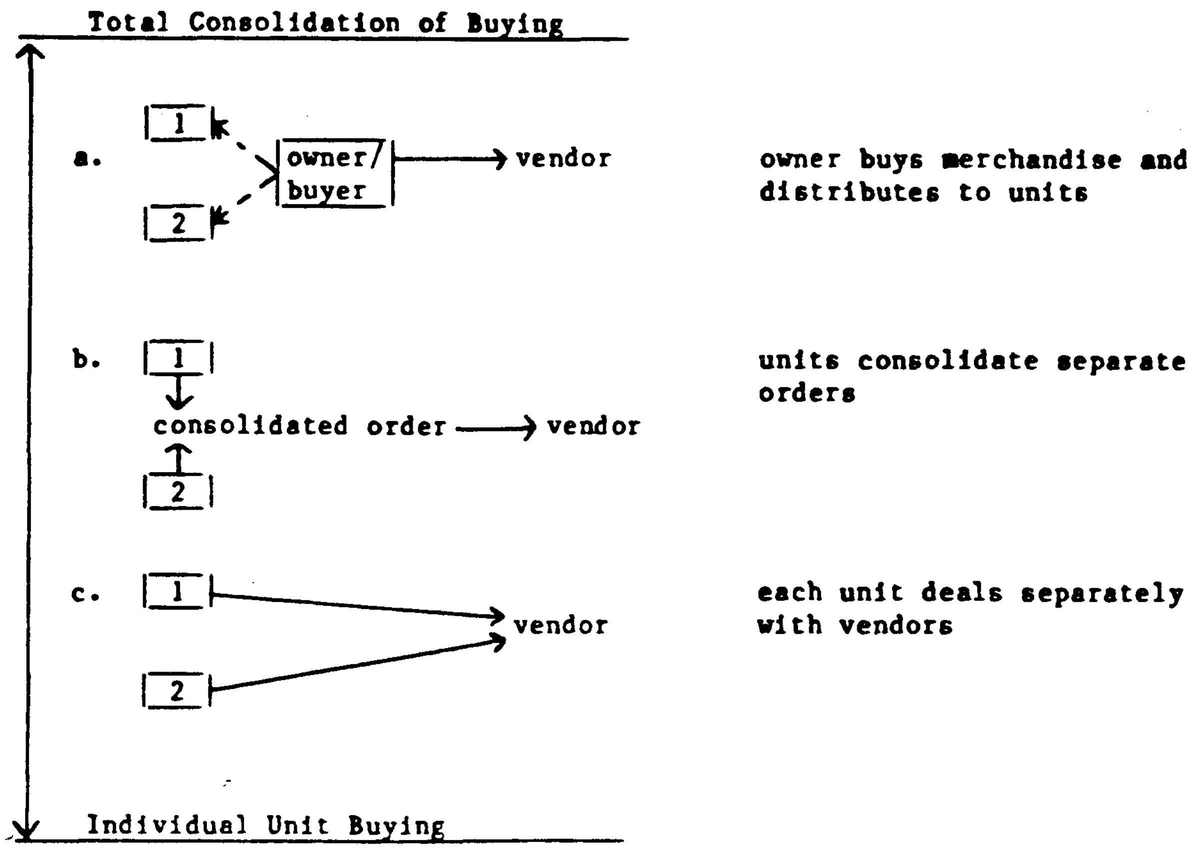
0 = owner
1 = initial unit
2 = additional unit

Buying Patterns

The third major component of the autonomy continuum is buying patterns. If in organizational structure, buying and selling functions have been separated, then the autonomy of unit buying becomes a separate decision. As shown in Exhibit 3, buying structures can take several forms. If the scale advantages of expansion are to be gained, then some consolidation of buying is necessary. On the other hand, with the maturity of many consumer markets and the subsequent need to adapt to each market, many firms are breaking up monolithic corporate buying groups. Consolidated separate orders may thus provide the optimum efficiencies.

Exhibit 3

BUYING PATTERNS



ADEQUACY OF THE ACCOUNTING INFORMATION SYSTEM

Regardless of the position on the autonomy continuum that the owner expects to operate the newly expanded business, control of the total operation will suddenly become a much more complex issue. Although the timing may be right for expanding the business, the owner must be aware that controlling the new organization will be a new and difficult task. Each year thousands of small businesses in their "success stage" fail as they attempt to grow. According to Dun & Bradstreet, in 1985 over 57,000 businesses failed more than half of which were over five years old.[12] A contributing factor may well be the failure to adapt the AIS to meet the changing information needs of the growing business.

Once the newly expanded business begins operation, the owner may find that the once adequate AIS simply will not produce the output necessary for proper control. In order to control any business, indices appropriate for measuring performance must be formulated. Standards must then be developed against which the indices may be compared. With a one unit operation, a single measure, net income, may well have been the only index needed. Net income or any of its transformations (e.g., profit margin, return on assets, or return on equity) may give the owner all the information desired for performance assessment.[13]

However, even with only two units in operation the number of performance measures required increases to four. For each unit the performance of the manager as well as the owner's investment must be measured. It is important to recognize that the same index will not serve to measure the performance of

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[12]F. C. Brown, "Too Far, Too Fast," The Wall Street Journal, 19 May 1986, Sec. D, p. 28.

[13]See Reed Moyer, "Strategic Planning for the Small Firm," Journal of Small Business Management (1982, 6) for a more detailed discussion on setting goals and selection of standards as part of strategic planning.

both manager and owner's investment. As Horngren[14] states, "Many proponents of responsibility accounting distinguish sharply between the segment (department, division, store, motel) as an economic investment and the manager as a professional decision maker. Managers frequently have little influence over many factors that affect economic performance." The degree to which any one index does not serve both purposes depends largely on the degree of decentralization installed.

As the degree of decentralization increases, that is, as movement progresses away from the origin on the autonomy continuum, more and more costs become controllable by the segment manager. Costs are controllable when a given manager has influence in decisions involving those costs. For example, if the store manager makes all of the advertising and promotion decisions for his store, that manager may be held responsible for those costs. However, the manager may not be held responsible if, for example, all advertising and promotional decisions are made by the owner. As a manager is given more and more of a free hand in decision making, monitoring his/her performance becomes proportionately more critical.

Given the increased evaluation requirements, a need for a significantly expanded set of accounting records is created. Specifically, detailed records for each unit must be maintained in addition to those for the entire operation. The implementation of a sound system for keeping adequate records requires careful planning, more planning than the owner would likely anticipate. Four areas requiring special attention as the accounting system is being prepared to handle financial data for the newly expanded business are (1) subsidiary record

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[14]C. T. Horngren, Introduction to Management Accounting, 6th edition, (Englewood Cliffs, N.J.: Prentice Hall, Inc., 1984).

keeping, (2) interstore transactions, (3) adequacy of automated accounting system, and (4) the treatment of indirect costs.

Subsidiary Record Keeping

If the performance of each unit as well as its manager are to be evaluated, subsidiary records must be maintained for each unit. Specifically, the assets, revenue and expenses directly traceable to each unit must be identifiable. For example, the assessment of each store manager's performance may be made by comparing actual direct revenues and expenses with predetermined or budgeted figures. Thus, the budget becomes the standard for controlling store manager performance. Variances from budget figures become better indices of managerial performance than, for example, a comparison of profit between stores. Such interstore comparisons are invalidated by such unit differences as location and length of operation. Further, budgets provide more realistic goals for the manager and thus are more likely to elicit desired behavior.

As suggested earlier, the owner will not only want to monitor manager performance but the efficiency with which his capital is being utilized as well. For this type of measurement, each unit may be treated as an investment center and as such subsidiary records of the investment in (or assets employed by) each segment must be kept. For investment decisions, the owner will continuously want to determine whether the investment in each unit is currently yielding (or potentially will yield) a return greater than that of any alternative uses of his capital. Each unit's contribution to overall profits (or segment margin) becomes an essential ingredient to this part of the performance evaluation process. Segment contribution is measured as the difference between a unit's direct revenue and direct expenses. Segment yield finally then relates segment contribution to segment investment as a measure of profitability. Segment margins are also useful for making interperiod comparisons within each store. For example, the owner may be interested in comparing first quarter results of the current year with those of previous years as a means of establishing trends.

Interstore Transactions

Once in operation, a certain amount of interstore transactions will surely take place. If this activity is substantial, accurate records must be maintained to insure no distortion of segment data. The most significant of these transactions will normally relate to merchandise or inventory transfers. The cost of inventory transferred from store-to-store to relieve overstocking or to meet special orders must be accounted for and incorporated into performance reports. Items of lesser significance relating to merchandise transfers would be those customer transactions initiated at one location and completed at another. These would include gift certificates purchased at one store and redeemed at another or merchandise purchased at one store and returned for credit at another. Additionally, other types of interstore transactions are possible. For example, employees may routinely split their work schedule between two stores. It may be possible for the owners to assume that all (or some) interstore activity will cancel out or at least have no material affect on performance measures. Further. the cost of obtaining this information may outweigh its benefits (e.g., better decisions). The important point to be made here, though, is that this issue should at least be addressed while planning the expansion.

Adequacy of Automated Accounting System

Even if the current accounting system is not already automated, the amount of postexpansion paperwork will probably increase to the degree that an automated system will soon be installed. Assuming, however, an in-house automated system is already in place, the owner must determine whether both the existing hardware and software is adequate to handle the increased processing requirements.

First, the owner will want to establish whether existing software is capable of handling the subsidiary records or segment data which will be generated as input to the system. Likewise, the software must be capable of generating segmented reports as system output. If the current system cannot handle such requirements, software is available which can perform these tasks.[15]

Second, at this point in the growth of the business, a perpetual inventory system may now be warranted as a means of maintaining a competitive edge. According to Stuart Gollin, Director of Retail Consulting for Laventhol and Horwath, a national accounting firm, "As soon as you have more than one store, you should think of putting in point-of-sale terminals."[16] Such systems are invaluable for ordering on a timely basis, producing periodic inventory reports and handling interstore transactions as well. However, installing a perpetual inventory system will not only require additional software but substantially increase the memory required for storing information. The cost of upgrading the computer system hardware may be substantial. However, as Herbert J. Kleinberger, Director of Retail Systems Consulting for Price Waterhouse, states, "The development of less expensive computers and more versatile software has now made automation, particularly inventory management, available for businesses doing as little as $200,000 a year in sales."[17] Given these points,

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[15] "Buyers Guide," PC Week (May 28, 1985), pp. 62-67, and "Changing with the Times - CFO Buyer's Guide to Integrated Accounting Software," CFO (August 1986), pp. 27-41.

[16] H. Bacas, "High Tech Power for Small Firms," Nation's Business (November 1985), pp. 72-75.

[17] Ibid.

the assessment of the adequacy of the existing system should not be a minor part of the pre-expansion planning.

Treatment of Indirect Costs

With a one unit operation, the owner would be accustomed to charging all costs of operation against revenue in computing profit. This makes sense since all operating costs are directly traceable to a single unit. With a multi-unit operation, however, common costs become a complicating issue. Common costs are those costs incurred in behalf of all segments of the firm. These costs are only indirectly related to each unit and thus cannot be assigned to them except on some arbitrary basis. Any such allocation may well distort performance measures. Instead, the performance of each unit is more logically based on its segment margin. As previously noted, a unit's segment margin is measured as the difference between the direct revenue and direct expenses of that segment. Common costs are appropriately charged only against the firm's total revenue in an overall performance analysis. It is the combined segment margins (more generally called contribution margins) for all units which contribute to covering the common costs of the business. Any segment with a positive margin is then helping to cover costs which otherwise would have to be absorbed by other units thereby reducing overall profits. Thus, allocating common costs to individual stores as suggested by Sheth[18] can lead to dysfunctional decisions as full cost allocations can make contributing segments appear unprofitable.

CONCLUSION

The retailer planning a move to a multistore operation must be careful not to focus solely on those decisions necessary to initiate the expansion (e.g.,

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[18]Sheth, "Emerging Trends for the Retailing Industry," pp. 6-18.

site selection, financing and staffing). It is vital that the strategic planning also consider the postexpansion period if a successful transition is to occur.

Two critical postexpansion issues to be addressed are the autonomy of each store and the adequacy of the current accounting information system. Autonomy of necessity includes decisions as to the image of the separate units, the level of day-to-day supervision, and the extent of integrated buying. These variables and such possible supporting variables as: diversity of target market, vendor contact, location characteristics, shared receiving and personnel policies; complicate the expansion process.

The expansion decision will further place much heavier demands on the firm's accounting information system. In order to properly evaluate performance and to control the organization, accounting information needs will increase dramatically. A major part of the pre-expansion planning process, then, should involve an evaluation of the current system's ability to handle the increased processing requirements. A well conceived expansion plan will address the new problems of the postexpansion period and significantly improve the chances for a smooth and successful transition to a multiple unit operation.