

1966

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## Recommended Citation

Quarterly, Vol. 12, no. 1 (1966, March), p. 24-29

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# The Discount Industry Today

by Thomas J. Niemann



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During the 1950's, a phenomenon appeared upon the retailing scene—the discounter. A discount store is a departmentalized retail establishment utilizing mostly self-service techniques and operating at a lower margin than conventional stores selling the same type of merchandise. From its inception, when its activity was limited to the sale of appliances at lower than normal prices, to the present, when virtually every product saleable at the retail level is available through a discount outlet, the discount industry has undergone many dramatic and often painful changes. Indeed, the old adage “nothing is constant except change itself” seems particularly applicable to this industry.

Originally termed a revolution, it now seems clear that the appearance of the discounter and his influence upon the retail scene could better be described as an evolution. The discounter has not completely changed the concept of retailing. He has merely placed before the consumer, at a lower price, merchandise previously available only through traditional retail establishments. This is possible because the discounter customarily sells at a lower gross margin and because he does not offer all the services offered by the traditional retailer.

In addition to these apparent operating differences, the discounter, especially in his earliest years, has often accentuated his price comparison advantages by carrying lower quality merchandise. However, in recent years, a definite upgrading of merchandise has occurred in the industry and the difference in quality has been narrowed considerably.

#### *Characteristics of a Discounter:*

From its humble beginning—when the discounter could best be identified by the physical unattractiveness of his plain, sparsely adorned outlet filled with simple shelving and pipe racks overflowing with medium to low-

quality merchandise—to the present time, the change in the discount industry can best be illustrated by examining some of its basic philosophical characteristics.

1. One-stop shopping. The capability to satisfy all essential needs of the consumer at one location has always been a basic characteristic of the discounter. Perhaps the most noteworthy advance in this respect has been the increasing importance of the role of the grocery supermarket in the discount operation. In 1964, food sales represented an estimated 25% of discount volume; this is approximately 5% of total national grocery volume. Originally received with some skepticism, the supermarket methods have proved to be important merchandising tools of the discounter. While not a significant profit contributor, the supermarket's ability to draw customer traffic from one part of the store to all the others has proved so valuable that the entire food operation is often used as a “loss leader” for this purpose.
2. Self-service. This is still a salient characteristic of the discounter. Some have increased sales service by changing from central check-out to departmental cashier centers, thereby locating store personnel nearer the merchandise, but in most discount stores a sales clerk is indeed a very elusive, if not illusive, person.
3. Location and physical facilities. Significant changes have taken place in the discounter's viewpoint on physical facilities. While the location still tends to be in a suburban area with adequate parking space, a newly constructed discount outlet often bears little resemblance to its earlier counterpart. The new store is larger, better fixtured and much more impressive. Gone are the pipe racks, lighting is much superior, the exterior and interior decor more pretentious, aisle space increased and mer-

chandise more attractively displayed. Many of these newer outlets are not greatly dissimilar in appearance to the new suburban branch of a traditional department store. Many of the older stores have undergone extensive remodeling.

4. Cash vs. credit selling. Originally a cash and carry operation, credit selling has now become commonplace in the discount industry. The modes of credit are varied. Some discounters own and service their accounts although most sell them to financing institutions which assume the responsibility for servicing and collecting, often with recourse to the discounter when the collection attempt fails. The emergence of credit as a recognized and required merchandising stimulant must be considered as a major development from the embryonic stage of discounting.
5. Quality of merchandise. This is the real "grey" area of discounting. The traditional retailers have always contended that price comparisons are misleading since the merchandise carried by discounters is inferior. This statement has some merit, not solely because of the inferior merchandise inference, but mainly because the discounter is offering merchandise similar to that sold in the "popular-priced" and basement departments of the department stores and in variety stores, and is not competing against the "better" department stores or the high fashion apparel outlets. Also, nationally advertised brands have not always been generally available to the discounter. To be sure, there were and still are discounters, just as there were and still are traditional retailers, who specialize in low-end merchandise. However, in the 1960's, the larger discount chains, which always offered medium-to-better quality merchandise, have definitely further improved the overall quality of their merchandise lines. More brand names are continually appearing on their shelves and private label items are increasingly more in evidence. The soft goods lines, traditionally not an important brand-name area, have been materially strengthened. Although better quality merchandise is now being offered by the major discounters, this upgrading trend has not been adopted by all discount operators. A natural corollary of higher quality merchandise is greater profit margins. In the July, 1965, issue of THE DISCOUNT MERCHANTISER, Nathaniel Schwartz, in an editorial entitled "Up and Out with Upgrading", admonished the discounters to be cautious in this area. His contention, shared by many discounters, is that

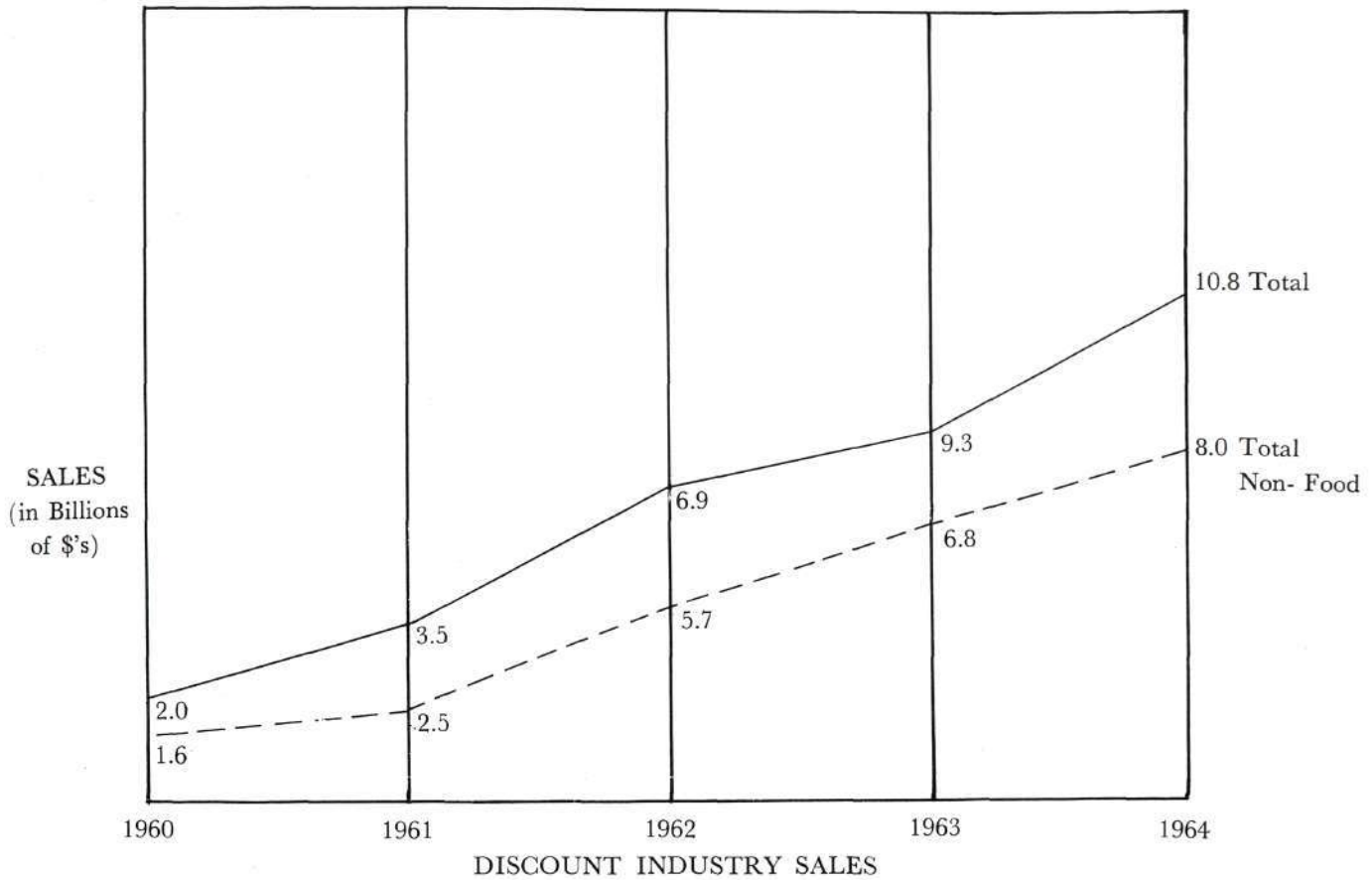
the success of the industry has been based upon low profit margin merchandising and that abandonment of this concept would remove an advantage of paramount importance.

6. Merchandising policy. The typical discounter is still highly promotional. The public address system in the store continuously calls our attention to the bargain now being offered in the shoe department, next in the jewelry department, etc. The discounter also continues to stock heavily the lines which sell and to ignore the remainder. For example, only the popular sweater sizes and colors are stocked. Sol Cantor of Interstate Department Stores, says, "Thick on the best, to hell with the rest". This philosophy has obvious advantages in lower inventory investment and better stock turnover and also presents fewer inventory control problems.
7. Store hours. Most discount stores are open longer hours than the conventional retailer — generally every night and Sundays where permitted by law. Although more rigid enforcement of existing blue laws or enactment of new legislation has tended to restrict Sunday selling, this day has always been popular with the consumer and is considered, where permitted, a normal store day by discounters.
8. Customer service. With the exception of the expansion of credit previously mentioned, available customer services are still limited and, where offered, are generally optional with a charge to the user.

It is clear that changes have taken place in the modus operandi of the discount store from its infancy to the present. In many respects the discounter has moved closer to the conventional retailer in his concept of operations. However, the basic distinguishing features — self-service and lower profit margins, remain and continue to provide impetus for the continuing growth of the industry.

#### *Industry Development:*

The following statistical data have been excerpted from "The True Look of the Discount Industry, 1964," the fifth annual study of the industry conducted by the Research Department of THE DISCOUNT MERCHANTISER. Certain of the data are based upon estimates, discounters being notoriously reluctant to disclose or exchange information. Nevertheless, this survey is generally recognized as reasonably presenting the industry and in any event is certainly the best available. There are no government statistics since the Bureau of Census does not separately classify discount activity.



The study disclosed that sales in discount stores have increased 444% (400% exclusive of food) in the period 1960-1964, compared with a 15% increase in department store sales and a 19% increase in total retail sales during the same period. The number of discount stores increased from 1,329 to 2,951, the average store size from 38,400 to 58,800 square feet and the average volume per store from \$1,480,000 to \$3,643,000. The fabulous growth rate of 1961 and 1962, when the industry virtually doubled in size each year, has decreased noticeably. However, this was to be expected and discounters now look for volume in 1965 to exceed 12 billion dollars — more than total department stores sales of only 5 years ago. The leveling off of the growth trend is also reflected in the rate of new store openings. Two hundred and twenty-one new stores were opened in 1964, an increase of 8.1% from the prior year, compared with increases of 15.5%, 30.3% and 36.5% in the 3 immediately preceding years.

Thirty-nine discount chains had 1964 sales in excess of \$50,000,000 and accounted for approximately \$5 billion of the discount industry volume through 1,292 stores. The leaders are:

	<i>1964 Sales</i>
E. J. Korvette, Inc.	\$529,000,000
S. S. Kresge Co. (K-Mart, Jupiter)	\$325,000,000
Interstate Department Stores, Inc.	
(Topps, White Front, Family Fair)	\$323,000,000
Gem International, Inc.	\$250,000,000

The statistics of growth are indeed impressive!

However, this era of expansion was not without its pitfalls. In 1960, it seemed to interested and ambitious observers that all that was required to succeed as a discounter was to open one's doors to accommodate the great hordes of consumers eager for whatever the discounter had to offer. This apparently simple road to riches led to a great rush to be among the first to reap the golden harvest. Stores were opened as quickly as possible, often with little or no consideration as to marketing or economic reality. Scant attention was paid to suitability of location, adequate capitalization, obtaining satisfactory management personnel and the other ingredients necessary for a successful enterprise. By 1962, the folly of this approach was becoming readily apparent. Too rapid expansion had over-extended the financial capabilities of

many discounters. Gross mismanagement was harassing others. The prophets of doom stood ready to sound the death knell of the fledglings, which by now they were certain were doomed from the start and would never succeed. Indeed, some did not survive, the most noteworthy being Grayson Robinson Stores, Inc., which finally failed only recently. However, the discounters' problems were generally due to inadequate planning and management and were not the result of an inherent defect in the discount concept itself. The basic soundness of the concept was indicated by the fact that virtually all discounters were able to tighten their belts, to take the necessary actions to cure operational defects and to establish the nucleus for a sound operation with favorable long-term prospects. Once over the shocks of this period most of them have found the sailing somewhat smoother. The grand rush of expansion was slowed appreciably and discounters were content to solidify their early gains and to provide for future expansion in a planned, orderly manner.

This is virtually the picture of the industry today. Further growth is expected and desired—but not the pell-mell type of the early 1960's. Discounters presently seem much more interested in maximizing profits by increasing operating efficiency rather than in compiling impressive volume statistics that may not contribute to increased profitability.

#### *Operational Concepts:*

Two significant operational concepts merit renewed attention due to their application in the discount industry: (1) the lessor-lessee relationship and (2) the closed-door, or membership, plan.

While the sales volume of the traditional retailer is accounted for mainly through sales of owned departments, the volume through leased departments generally being less than 10% of total store volume, no such universality of practice exists in the discount industry.

Operations range from 100% owned to 100% leased with no median within the range which can be considered typical. For example, E. J. Korvette, Inc., the largest discounter, sells principally through owned departments while GEM operates heavily through leased operators—the service stations and certain soft goods departments being the only owned segments of activity. Other discounters operate anywhere between these extremes. Some operate as owned departments those which they have found to be the most profitable. Others operate owned departments only when unable to acquire competent

leased operators. The leased department concept has been one of the important contributions to the rapid growth of the industry since it permits the discount store operator to expand quickly with limited capital requirements. Of course, this approach also has presented problems since not all leased department operators proved sound either financially or management-wise. In earlier years dissatisfaction was commonplace and changes of leased operators were a routine occurrence. However, as the industry has developed, many large leased operators have emerged and it is now a relatively simple matter for a sound discount store to obtain satisfactory leased operators.

This emphasis on leased operations by many discounters has created an industry within an industry. Many successful leased operator chains have developed. Some operate departments in over 100 discount outlets. Over the years, the pendulum has swung in the lessor-lessee operator relationship until at present many adequate leased operators are available and are actively competing for departments in the declining number of newly opening stores. This competition is further accentuated by the fact that many discount operators have policies which offer new departments automatically to the operators in their present stores. In their desire and need for expansion, some leased operators have even opened their own discount stores, operating the department in which they have competence and obtaining leased operators for the others.

As the growth rate levels off and capital is generated through profits, many discounters probably will attempt to expand inwardly by taking over previously leased departments. In December, 1965, GEM announced plans to merge with Parkview Drugs, Inc., a leased operator principally of the drug departments in many of the GEM stores and in other discount outlets. This joining of the major lessor operator and one of the larger lessee operators in the industry, could well herald significant activity in this area with expansion occurring either by merger or by absorption of previous operators upon termination of present license agreements. Aside from the obvious profit motive this has appeal to the store operator who, even with the most favorable relationship with his leased operators, is continually frustrated by his inability to implement his programs as quickly and completely as he could with owned departments.

The closed-door, or membership, concept of merchandising, where selling is limited to a select group of consumers, gained importance in retailing through its use in

the discount industry. GEM, the largest closed-door organization, limits its membership to government employees, employees of firms doing a substantial amount of government work, members of the military, including reserves, and employees of religious, scientific, educational and charitable institutions. Memberships are generally for a fee and may be either permanent or renewable. The concept seems to have great appeal to some consumers because it implies that they as members are able to secure something not available to others. The membership fee also has economic appeal to the operator but is not a vital consideration which will lead a discounter to a decision to adopt the closed-door method of operation.

This method of operation has an obvious disadvantage in that while it admittedly does induce some members to buy who would not otherwise have done so, it also limits its customers to its membership. Much has been written, pro and con, on the merits of a closed-door operation but to date no conclusions have been reached. GEM and others still adhere to the concept (although GEM has gone open-door in two of its unprofitable stores in March, 1966). Some previously closed-door operators have gone open-door, others have new open-door outlets while remaining closed-door in their previous outlets. The final relative significance of the closed-door operation in the discount industry is yet to be determined but the trend is definitely away from it.

#### *An Industry Maturing:*

There are many signs that the industry is truly coming of age. There is no longer a question as to whether the discounter will remain upon the scene, but rather one as to his eventual position in the retail trade picture. The industry has respectable leadership, both as to companies and personalities. More discounters are going public all the time. Many are casting covetous glances overseas and some have already moved in this direction.

An area of particular interest to watch in evaluating the industry's maturity will be its efforts to develop a meaningful "figure exchange" program. The Harvard University Graduate School of Business Administration and the Controllers' Congress of the National Retail Merchants Association have for many years developed studies of the merchandising and operating results of department stores. These annual studies are developed

from reports submitted by companies within the industry and are generally acknowledged to be of great value. Early efforts to develop such a survey among discounters were singularly unsuccessful since, as previously noted, discounters were generally unwilling to divulge their statistics. However, efforts persisted and in April, 1965, the Marketing Department of the University of Massachusetts released the first formal survey of the industry, entitled "Operating Results for 19 Self-Service Discount Department Stores: 1963". The analysis was admittedly only a first step and was candidly described by its preparer as a pilot research study. Nevertheless, it is an important start. Step two will be the study of 1964 results due to be released shortly. Much remains before these studies become meaningful. The sample included in the statistics must be increased, more detailed data must be obtained and consistency of reporting must be achieved to permit the assemblage of data in a uniform manner.

#### *Future of the Industry:*

The development of the discount industry clearly indicates that the discounter is here to stay and that he will definitely retain his individual identity in the retail picture although he will never replace the traditional retailer. The preferences of the consumer are too varied to permit any one form of merchandising to reign supreme. The discount concept is not now, nor will it ever be, limited to the low end of the market. In an era of unprecedented prosperity and continually increasing disposable income, the consumer has once again demonstrated that he relishes a "bargain" whether buying high quality furs or automotive oil. The growth rate in the industry will slacken. A 10% annual volume increase in the immediate future appears more realistic than the much higher increments of the past five years.

The discount industry is solid, solvent and strong. Its periods of greatest turbulence and peril are past. Periods of adjustment will no doubt come but should be handled in stride by a maturing industry. Still to be determined is the eventual significance of the leased department operator and the closed-door operator. Their final relative importance may not be ascertained for many years but certainly will be of interest in following the future development of the discount industry.