Joachim Zentes / Dirk Morschett
Hanna Schramm-Klein

Strategic Retail Management

Text and International Cases

2nd Edition

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Preface

Retailing is constantly becoming more important in economic terms. This becomes evident when looking at the development of many individual countries in Europe, America and Asia. In highly developed countries, retailing is assuming more and more of a leadership role in the distribution channel. Expansion strategies, retail branding strategies, innovative solutions for supply chain management etc., all reflect this trend. In transformation countries, such as in Central and Eastern Europe, as well as in emerging countries, such as China or Brazil, fundamental changes in retailing structures are becoming apparent and these may lead to comparable developments. In view of internationalisation, a further profound change can be noticed. Retailing companies that were formerly characterised by a local or national orientation are increasingly developing into global players with worldwide operations.

Book Concept and Overview

The present book is devoted to the dynamic development of retailing. The various strategy concepts adopted by retailing companies and their implementation in practice are at the core of the book. This is not a traditional textbook or collection of case studies; it intends to demonstrate the complex and manifold questions of retail management in the form of 15 lessons that provide a thematic overview of key issues and illustrate them with the help of comprehensive case studies. Internationally known retail companies are used as examples to facilitate an understanding of what is involved in strategic retail management and to present some best practices.

The book is divided into four main parts. Part I introduces "Functions, Formats and Players in Retailing" and comprises Chapters 1 to 6. In Part II, growth, internationalisation and retail branding strategies, as fundamental aspects of "Strategic Marketing in Retailing" are dealt with (Chapter 7 to 9). Part III focuses on the "Marketing Mix in Retailing". Store location, merchandising and category management, pricing, instore marketing and customer relationship management are discussed in Chapters 10 to 14. Finally, Part IV "Buying, Logistics and Performance Measurement" deals with retail purchasing strategies and concepts, the modern concepts of physical distribution and IT-based supply chain management, as well as methods of performance and financial controlling (Chapters 15 to 18).

Teaching and Learning

The book is targeted primarily at students in their third and fourth academic year (undergraduate and graduate level) in the field of Business Administration/Marketing/Management at different institutions, such as universities, academies and business schools. In addition, practitioners in the consumer goods industry and in retailing companies, who wish to obtain compact and practice-oriented information on current retail concepts, will also benefit from reading this book.

Furthermore, the book can be used in education as a basis for working with case studies. For this purpose, the case studies are integrated into the lessons in such a way that they provide additional content and a specific application of the individual lessons. That is, 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, a solution draft is provided via the publisher's webpage (www.gabler.de).

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Saarbrücken, Fribourg and Siegen, July 2011

JOACHIM ZENTES DIRK MORSCHETT HANNA SCHRAMM-KLEIN

Contents

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 the consumer than manufacturing companies. Retailers represent the culmination of the marketing process and the contact point between consumers and manufactured products. While retailing has long set buying decisions as its highest priority and was very focussed on the product assortment, it now follows a more holistic 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 of doing business has been transformed into a highly sophisticated form of management and marketing. Retail marketing consistently features more efficient, more meaningful and more profitable marketing practices (Mulhern 1997, p. 103).

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 in market concentration. **Large-scale retail chains** have appeared and have 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 intensified 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 almost 300 billion EUR, which exceeds the gross domestic product of many smaller countries, and employs about 2 million people. *Carrefour*, the largest European retailer and the no. 2 in the world, 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 different retail formats for their customers. 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*), food supermarkets (*extra*), consumer electronics category killers (*Media Markt and Saturn*), cash & carry wholesale stores (*Metro C&C*) and other formats and earns about two thirds of its turnover in markets outside Germany. *Tesco* is expanding rapidly into Eastern European and Asian markets and, in addition to several store-based formats, very successfully operates an e-commerce channel, *Tesco.com*. While the rise of e-commerce in retailing was initially over-

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estimated in the days of Internet hype, it has nonetheless developed slowly but surely and *Tesco* now achieves sales of almost 2 billion EUR with its online-channel.

In most country markets, retailing is also a very concentrated industry. According to the market research company *Planet Retail*, the top five food retailers account for more than 55 % of the market in the UK; in Germany and France, it is even above 70 %. Consequently, a **shift in power** within the distribution channel is one of the most influential developments 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 for global brand manufacturers such as *Procter & Gamble*, *Sony* or *Nestlé*. Thus, manufacturers now often depend on a few large retailers for a substantial share of their global turnovers. Hand in hand with this increasing size, retail marketing budgets, IT budgets and budgets for top managers have also been increasing. Furthermore, not only the growing size and concentration, but also the increased sophistication of retail management, combined with the better availability of customer data, has contributed to the power shift. Retailing is currently one of the leading industries in the application of new technologies. Retailer **PoS data** has become more valuable as IT systems have facilitated the collection of data at the checkout. Furthermore, as retailers have grown from regional to national chains, they have been able to accumulate knowledge about consumer trends and the development of product sales, etc., which has enhanced their relevance as gatekeepers for products on their routes to the customer. Customer-specific data that is now increasingly being gathered via **loyalty cards** adds to this knowledge. Where manufacturer brands once used to be all important, the past few years have witnessed the power of **retail brands** challenging the positions of suppliers. Retailers have started to embrace the concept of **strategic marketing**; they use strategic planning and position themselves relative to their competitors. Thus, the enormous buying volume of a retailer is only one source of its power base – albeit certainly the most important – with other developments adding to its power.

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, while it was the manufacturers who traditionally fulfilled large parts of the logistics function, retailers today also strive towards **logistics leadership** in the distribution channel.

With this book, our objective is to cover the most important aspects of retail management with a comprehensive, yet brief, and innovative approach. We discuss 18 different topics in retail management by first giving a thematic overview of the topic that covers the key issues and explains the most important concepts and then illustrating them with the help of extended case studies. For the case studies, internationally known companies were chosen that can be considered best practice cases in the respective strategy fields.

In Part I, the functions of retailers are first introduced (Chapter 1). Then, formats and players in retailing are discussed. A **retail format** represents a specific configuration of the retail marketing mix (e.g. store size, typical location, merchandise, price and service offered) and it often forms the core of the retail strategy. Different formats are described and there is a discussion of those that are currently gaining market share and those formats that are on the decline. For example, category killers such as *IKEA, Media Markt* and *Leroy Merlin* have been growing tremendously over the past few decades. Hard discounters, such as *Aldi*, are certainly one 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* and *Ebay*, have reached a considerable scale. At the same time, more and more stationary retailers embrace online-shopping, so Internet shopping is offered more and more often as part of a **multichannel** approach (Chapter 4). At the same time, not only new formats, but also new players are competing with existing retailers. The most important trend explained in this book is the emergence of manufacturers as competitors. To an increasing extent, manufacturers operate in vertical marketing systems, trying to control the distribution of their products to the consumer, either through contractual or even by means of equity-based vertical strategies (Chapter 5). But also, vertically integrated players like *IKEA*, *Zara* or *H&M*, that are simultaneously retailers and manufacturers, have captured major market shares in many retail sectors (Chapter 6).

In Part II, the most important aspects of strategic retail marketing are discussed. Dynamic growth is one of the most important developments in retailing over recent decades and forms the foundation for many other subsequent changes. This growth is being achieved through various different **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 more and more often achieved by entering foreign markets. The process of **internationalisation** poses a complex task, since the local environments in host countries often differ considerably from the home market (Chapter 8). Growth, whether nationally or internationally, can only be achieved with a sustainable competitive advantage, and retailers are now increasingly trying to develop a clear **positioning** for their companies relative to those of their competitors. One important component of this marketing strategy is to create a strong **retail brand**, with clear and distinct associations in the consumer's mind that support the development of customer loyalty to the company (Chapter 9).

Within the framework of strategic retail marketing, retailers have more options available in their **marketing mix** than do manufacturers, because they are in direct contact with the final consumers, who visit their stores and interact directly with them. Part III of the book examines the marketing mix and takes an in-depth look at a number of retail marketing mix instruments. The **location of the store** is considered a dominant determinant of retailing success, because in store-based retailing, good locations are key elements for attracting customers to the outlets. Also, because of its intrinsically fixed nature, location cannot be changed in the short-term (Chapter 10). Within the store, the retailer offers a **merchandise** assortment to its customers, and one of the primary functions of the retailer is to select the appropriate breadth and depth of the assortment and the specific products (e.g. manufacturer brands or **store brands**) and to tailor the offer to the target customers. A new concept is **category management**, which aims at implementing a more strategic and holistic approach to merchandising (Chapter 11). Closely related to the assortment is the **pricing policy**. Since consumers spend a large share of their incomes on retailing, pricing is considered highly relevant for retail patronage decisions and, within pricing processes, retailers have many strategic and tactical options available to influence purchasing behaviour (Chapter 12). As already mentioned, the customer is also influenced by the store environment. Many buying decisions are made at the point-of-sale, so professional **instore marketing** can increase sales substantially. Store layout and store design can support customer orientation in the store and create a positive store atmosphere (Chapter 13). **Customer relationship management** (CRM) is a relatively new element in the retail marketing mix. A key objective of CRM is to establish enduring relationships with customers, and loyalty programmes are manifestations of CRM in retailing. However, behind the loyalty cards that most consumers now carry are very different methods and concepts with which retailers intend to collect data and tailor their marketing to individual customers (Chapter 14).

While Parts I to III focus on the aspects of retailing that are at least partly visible to the customer, Part IV deals with back-end and internal processes that are necessary to create the offer to the consumer. Retailers need to buy the merchandise they offer to their customers, and they use various, heterogeneous supply sources, ranging 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 the **buying concepts** employed must be closely adapted to the specific supply situation (Chapter 15). The products must be transported along the supply chain – from the factory to the store shelf. More and more frequently, **physical logistics** is considered a core competency of retailers who need to establish the necessary infrastructure and coordinate **product flows** (Chapter 16). Those product flows within the **supply chain** are dependent on **information flows**. It is necessary to establish when a product is sold in a certain store, so as to trigger an order to a warehouse, and subsequently to a supplier. The exact process depends on knowing the available products in stock at the various stages of the supply chain and forecasting consumer demand, etc. To enhance the efficiency of the supply chain, different **collaborative concepts** for achieving efficient replenishment have been developed, and these are based on new enabling technologies (Chapter 17). Finally, the intensive competition in retailing, combined with the price pressure to which most retailers are exposed, make it necessary both to perform well and constantly improve the effectiveness and efficiency of all applied strategies and processes. Adequate **monitoring** of financial and operational performance is, thus, necessary, and retailers have developed sophisticated systems for evaluating the profitability of their store networks, supply chain efficiency and financial performance. New concepts, such as value-based management, have also been quickly embraced by retailers (Chapter 18).

This short overview of the different fields of strategic management in retailing shows that the world of retailing has become complex and challenging. In the following 18 Chapters, we cover the most important aspects and give the reader an insight into the main developments and concepts. Based on the case studies, the reader will also gain an understanding of how the concepts are implemented by successful retail companies around the world.

Part I

Functions, Formats and Players in Retailing

1 Retail Functions

In this Chapter, the tasks of retailers within the distribution channel are explained and recent trends concerning these functions are discussed. This serves to explain the reasons for the existence of retailers as intermediaries between suppliers and final customers in general as well as the complexity of their activities.

1.1 Introduction

Retailing refers – as the definition states – to the process of purchasing products from other organisations with the intent to resell those goods to the final customer, generally without transformation, and rendering services incidental to the sale of merchandise. This is a rather static and traditional definition. While traditional retail functions are still predominant, retailers have developed into complex and sophisticated companies that often coordinate or even own value chains from the production stages down to sales to the customer.

The retailing process itself is the final step in the distribution of merchandise. It results in an intangible outcome, as do all services. While the value a production company adds is obvious, it is – at first sight – less evident what value is created by a retailer. Therefore, marketing and retail researchers have long tried to explain to students as well as to the general public what added value is provided by retailers.

An early justification of the existence of retailers was given by Butler (1917, p. 14; cited from Rosenbloom 2007): "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 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 so-called **Baligh-Richartz effect** (Baligh/Richartz 1967). This effect is based on the fact that the integration of an intermediary in the distribution channel (between m suppliers and n consumers) helps **reduce the number of necessary contacts** between the different actors in the system. If m different manufacturers (e.g. one for meat, one for bread, one for detergents, etc.) were to sell to n different households, then the number of necessary contacts would be m*n. Using, in the extreme case, only 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

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firms in general and the level of vertical integration with the differing costs of transactions (Williamson 1985). As an example, for highly complex products, the cost of transferring the necessary 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, but in many other cases using independent intermediaries leads to lower transaction costs.

1.2 Traditional Retail Functions

1.2.1 Purpose of Catalogues of Functions

To answer the fundamental question of why retailers exist, instead of, as an extreme scenario, all manufacturers selling their products and services to all final consumers that want to buy these products directly, different catalogues or lists of retail functions (or "distribution service outputs") have been brought forward (Alderson 1954; Sundhoff 1965; Bucklin 1966; Coughlan et al. 2006; Waterschoot et al. 2010). In the following explanation, we do not follow a specific one of these catalogues but derive a list of functions that retailers usually perform in the value chain between producers and consumers as a synthesis of the above-mentioned sources.

1.2.2 Sorting

One of the benefits that a retailer in the value chain provides is the sorting of goods. 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). Sorting, in this respect, includes **assorting**, i.e. the building up an assortment, and **breaking bulk**, i.e. offering small lot sizes.

Creating an assortment

Retailers provide the customer with an assortment of products and services and thereby offer him **variety** (Bucklin 1966; Waterschoot et al. 2010). They offer the consumer a selection of products (the merchandise mix or product range), which they preselect from a very broad offer of products offered by existing manufacturers, and retailers bring these products into association with each other (see Chapter 11).

For example, in a supermarket, retailers offer a choice of up to 15,000 items that usually originate from over 500 different suppliers. Thus, while manufacturers can specialise in producing a very limited product range, retailers still make a broad product range available for the consumer. Consumers can choose between different products in one category and can combine their purchases and buy several items in the same store, fulfilling the increasing need for "one-stop-shopping".