# Retail Management

**ICMR**

Road # 3, Banjara Hills, Hyderabad 500 034

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# Part I
# Introduction to Retailing

## Chapter 1

# Retailing – An Overview

**In this chapter we will discuss:**

- Retailing : Definition and Scope
- Retailers Role in Distribution Channels
- Benefits of Retailing
- Evolution of Retailing
- Retailing Environment

## INTRODUCTION

Retailing is one of the largest industries in the world and one of the biggest sources of employment. Although the retailing industry has existed for centuries, it is only in the recent past that it has witnessed such a tremendous growth.

This chapter introduces the concept of retailing and its role in the distribution channel. It also analyzes the evolution of retailing and the benefits it bestows on consumers, manufacturers and the economy as a whole. The chapter also discusses the factors that have influenced the growth of the retail industry.

## RETAILING: DEFINITION AND SCOPE

Retailing is derived from the French word *retailier*, which means, ‘to cut a piece off’. Thus, retailing can be defined as a set of business activities that adds value to the products and services sold to the final consumers for their personal, family or household use. A retailer is the key player in the marketing process as he regularly interacts with the end consumer. From the point of view of a marketer, retailing can be defined as a set of marketing activities designed to provide satisfaction to the end consumer and profitably maintain the customer base by continuous quality improvements across all areas concerned with selling goods and services.

Retailing involves:

- Understanding the needs of consumers
- Developing good assortment of merchandise
- Displaying the merchandise in an effective manner so that consumers find it easy and attractive to buy.

A retailer is any business establishment that directs its marketing efforts towards the end users for the purpose of selling goods and services. Retailers comprise street vendors, local ‘mom and pop’ stores, supermarkets, food joints, saloons, airlines, automobile showrooms, video kiosks, direct marketers, vending machine operators, etc. An organization qualifies to be a retailer only

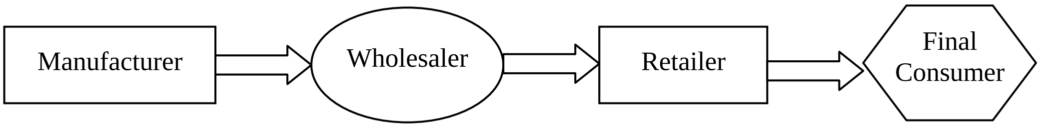
**Table 1.1: List of Retail Institutions**

| | |
|---|---|
| Motor vehicle dealers | Shoe stores |
| Catalog and mail-order houses | Florists |
| Motorcycle dealers | Grocery stores |
| Food stores | Retail nurseries, lawn and garden supply stores |
| Children’s and infants’ wear stores | Hardware stores |
| Radio, television, and consumer electronics stores | Retail bakeries |
| Book stores | Camera and photographic supply stores |
| Fuel dealers | Stationery stores |
| Lumber and other building materials dealers | Drug stores and proprietary stores |
| Home furnishing stores | Meat and fish (seafood) markets |
| Direct selling establishments | Drapery, curtain, and upholstery stores |
| Used merchandise stores | Sewing, needlework, and piece goods stores |

| | |
|---|---|
| Musical instrument stores | Dairy products stores |
| Luggage and leather goods stores | Furniture stores |
| Department stores (excluding leased departments) | Eating places |
| Sporting goods stores and bicycle shops | Fruit and vegetable markets |
| Gift, novelty, and souvenir shops | Gasoline service stations |
| Family clothing stores | DVD and VCD Stores |
| Apparel and accessory stores | Paint, glass, and wallpaper stores |
| Hobby, toy, and game shops | Candy, nut, and confectionery stores |
| Optical goods stores | Household appliance stores |
| Jewelry stores | Floor covering stores |

*Source: ICFAI Center for Management Research.*

**Figure 1.1: A Typical Channel of Distribution**




*Source: ICFAI Center for Management Research.*

when it derives a major chunk of its revenues from its transactions with end users. Thus, a seller is said to have conducted a retail transaction when he sells goods to the end customer while a wholesale transaction is conducted when the seller sells goods to a business concern. Table 1.1 gives a list of the kinds of retail institutions operating in the market.

## RETAILERS' ROLE IN DISTRIBUTION CHANNEL

A retailer is the last entity in the distribution channel. Retailers include all businesses and individuals who actively participate in the transfer of ownership of goods and services to their end users. Figure 1.1 depicts a typical distribution channel.

A retailer usually plays the role of an intermediary, which links the producers, wholesalers and other suppliers with consumers. Companies generally prefer to specialize in manufacturing of products, leaving the task of selling the products to an outside party i.e. few wholesalers or retailers.

## BENEFITS OF RETAILING

Retailers play a major role in the transfer of goods and services from the manufacturer to the end consumer. In this process retailers deliver many benefits to customers, manufacturers, wholesalers, and the economy as a whole.

### Benefits to Customers

Retailers act as buying agents for consumers. They perform various business activities that increase the value of the goods and services they sell to the end consumer. If there were no retailers in the distribution system, consumers would have to personally visit the manufacturers to procure the goods and services required by them. As a buying agent, a retailer performs various activities to satisfy the end consumer. These activities include:

- Breaking bulk
- Providing assortment
- Holding inventory
- Providing after sales services
- Providing information

### Breaking bulk

Retailers buy goods in bulk from manufacturers and divide them into smaller sellable units according to the consumption patterns of the end consumer. By buying in bulk, the retailers gain two benefits - quantity discounts from manufacturers and lower freight rates for large shipment of goods. Availability of products in smaller units enables customers to buy products in quantities, which suit their consumption patterns.

### Providing assortment

Retailers evaluate the products of various manufacturers and offer the best collection of products from which the customer can select the product of his/her choice. Retailers select the product assortment depending on the tastes and needs of their target customers. The variety in assortment offered makes the buying process easier.

### Holding inventory

Retailers carry inventory and make the products available to consumers at a convenient place and time. Retailers make it possible for consumers to make instant purchases. This reduces the cost of storage and enables the consumer to invest his money profitably.

For example, a customer can walk into an electronic goods showroom and buy a music system whenever he wants, or pick up a music album from any music retail outlet. Such spontaneous shopping would not be possible if retailers do not stock the goods.

### Providing services

Apart from selling goods, retailers also provide a variety of value added services, which make it easier for customers to buy and use products. These services include providing free home delivery, accepting credit cards, accepting payments on installment basis, arranging loans, etc.

### Providing information

Retailers play a major role in providing product related information to their consumers. Retailers use advertising and in-store salespersons to provide product information, which helps the consumer to simplify his purchasing process.

## Benefits to Manufacturers and Wholesalers

Manufacturers and wholesalers consider retailing as a channel for delivering their products/services to the end customer. By selling products and services (of a manufacturer on a much larger scale), retailers provide the manufacturer with greater revenues, which could be reinvested in production. Thus, retailers play a major role in smoothing out the variation between the production and sales of the manufacturer’s products.

Retailers can provide valuable insights about the customer. While designing new products or upgrading an existing product, manufacturers depend on retailers to gather information regarding the tastes and preferences of customers. Retailers provide feedback on the goods and services offered by them. This helps them to make modifications to the existing products or launch new products that satisfy the needs of customers.

**Table 1.2: Per capita GDP and Retail sales (in the year 2000)**

| Country | Per capita GDP (US $/ annum) | Per capita retail sales (US $) | Country | Per capita GDP (US $/ annum) | Per capita retail sales (US $) |
|---|---|---|---|---|---|
| Japan | 37,558 | 8,578 | Poland | 4,082 | 2,028 |
| United States | 35,352 | 8,135 | South Korea | 9,656 | 1,908 |
| Switzerland | 33,472 | 6,792 | Saudi Arabia | 8,470 | 1,894 |
| Norway | 36,029 | 6,495 | Czech Republic | 4,943 | 1,727 |
| Denmark | 30,535 | 5,712 | Argentina | 7,699 | 1,561 |
| Germany | 22,845 | 5,448 | Venezuela | 4,983 | 1,527 |
| United Kingdom | 23,792 | 5,268 | Chile | 4,613 | 1,176 |
| France | 21,863 | 4,833 | Hungary | 4,549 | 1,147 |
| Finland | 23,467 | 4,627 | Mexico | 5,800 | 962 |
| Sweden | 25,613 | 4,624 | Portugal | 10,522 | 837 |
| Italy | 18,625 | 4,484 | Turkey | 3,122 | 825 |
| Belgium | 22,203 | 4,382 | South Africa | 2,863 | 580 |
| Canada | 22,747 | 4,278 | Brazil | 3,763 | 533 |
| Australia | 19,841 | 4,219 | Malaysia | 3,841 | 521 |
| Netherlands | 23,226 | 3,894 | Russia | 1,729 | 456 |
| Israel | 17,656 | 3,794 | Thailand | 1,954 | 426 |
| Ireland | 25,343 | 3,532 | Philippines | 959 | 405 |
| Hong Kong | 24,015 | 3,434 | China | 869 | 307 |
| Austria | 23,289 | 3,279 | Egypt | 1,350 | 271 |
| Singapore | 22,672 | 3,061 | India | 468 | 220 |
| Greece | 10,674 | 2,499 | Indonesia | 721 | 119 |
| Spain | 14,200 | 2,409 | | | |

Retailers also share some of the risks of the manufacturer by paying for the goods before they are actually sold to the final customer. A retailer is exposed to three types of obsolescence risks:

- Physical obsolescence
- Technological obsolescence
- Fashion obsolescence

*Physical obsolescence risk* arises from the damage or wear out caused to the products while they are stored in the retail outlet. This type of risk is common for stores dealing in handicrafts, books, greeting cards, gift items, high perishable items such as fruits and vegetables, etc. Retailers dealing in high technology products that are upgraded very frequently face the *risk of technological obsolescence*. Retailers who deal in personal computers and computer components face this risk quite often. In this industry (computer), upgraded versions are introduced very frequently and these are available at a lesser price than that of the previous versions, which may result in severe losses for the retailer. *Fashion obsolescence risk* is very common for apparel retailers who deal in merchandise of varying style, design or color.

## Benefits to the Economy

The retailing business is the largest private industry in the world with a turnover of US $6.6 trillion. Retailing plays a crucial role in the world economy and retailers constitute a tenth of the Fortune 500 companies. Table 1.2 gives the per capita GDP and retail sales of various countries across the world. Retailing also contributes to economic growth through employment generation (both direct and indirect), development of human capital, improving the supply chain and logistics support services, etc.

## EVOLUTION OF RETAILING

Some of the factors, which have been responsible for the growth of the retail industry have been discussed below:

### Economic growth

The gradual increase in Gross Domestic Product (GDP) and the purchasing power of consumers, especially in developing countries have provided an excellent growth opportunity for organized retailing. Table 1.3 provides the data on the private consumption and PPP adjusted per capita GDP of some countries.

**Table 1.3: Private Consumption in terms of GDP: Global Comparison (1998 data)**

| Country | Per - capita GDP | Private Consumption | Consumption/ GDP (%) | PPP adjusted GDP |
|---|---|---|---|---|
| US | 7,468 | 5,106 | 68.4 | 7,468 |
| Japan | 4,301 | 2,633 | 61.2 | 2,848 |
| Germany | 2,489 | 1,292 | 51.9 | 1,871 |
| France | 1,523 | 829 | 54.4 | 1,228 |
| United Kingdom | 1,401 | 905 | 64.6 | 1,387 |
| Italy | 1,180 | 740 | 62.7 | 1,217 |
| Canada | 585 | 346 | 59.2 | 697 |
| China | 920 | 437 | 47.5 | 3,833 |
| Brazil | 744 | 473 | 63.6 | 1,020 |
| Netherlands | 398 | 236 | 59.3 | 352 |
| Mexico | 384 | 262 | 68.2 | 784 |
| India | 368 | 226 | 61.4 | 2,000 |
| Korea | 350 | 212 | 60.6 | 421 |
| Australia | 336 | 198 | 58.9 | 336 |
| Switzerland | 278 | 166 | 59.8 | 175 |
| Sweden | 223 | 118 | 52.9 | 166 |
| Hong Kong | 166 | 104 | 62.4 | 151 |
| Russia | 130 | 78 | 60.2 | 310 |
| South Africa | 126 | 79 | 63.0 | --- |
| Thailand | 125 | 67 | 53.2 | 256 |
| Indonesia | 117 | 83 | 70.4 | 301 |
| Malaysia | 108 | 49 | 45.1 | --- |
| Philippines | 68 | 51 | 74.4 | 207 |

*Source: International Finance Statistics, IMF*

### Urbanization

The twentieth century has witnessed a rapid growth of urban population. For example, while the total population of India grew by 3.5 times from 1901 to 1991, its urban population increased nine fold from 25 million to 217 million in the same period.

This rising concentration of urban population with higher purchasing power has attracted big players to venture into organized retailing in cities. Moreover, time constraints and traffic congestion in the cities has led to the increased popularity of one stop shopping among urban customers.

### Consumerism

The increasing influence of the media has led to a considerable change in the lifestyle and habits of consumers. The growing aspirations for material comforts have also been responsible for consumerism slowly gaining momentum, especially in the developing countries of Asia and Latin America. Consumers in these emerging markets are more inclined towards buying goods like cars, washing machines, audio systems, designer dresses, cosmetics and other personal care products.

### Brand profusion

Consumerism and increased brand consciousness of consumers has led to increased number of brands. Today every product is branded. Even products like salt, oil, flour etc., which were previously sold as commodities are now branded. The launch of more and more brands into the market increased the demand for shelf space and hence the demand for more retail outlets.

# RETAILING ENVIRONMENT

Like any other industry, the retail industry is also affected by the external environment. Some of the constituents of the external environment, which have an impact on a retail organization, are

- Economic environment
- Legal environment
- Technological environment
- Competitive environment

## Economic Environment

The nature of the economic system (capitalism, socialism) in a country has a direct impact on the retailer’s business. Therefore, a retailer should have a thorough understanding of the various economic factors of a country that would influence their operations and profitability. Some of the economic factors that affect the retailer are – Gross Domestic Product, rate of inflation, purchasing power, interest rates, tax levels, employment growth, etc. Higher growth rate of GDP (in real terms) implies that consumers have more income and hence, they spend more, resulting in higher sales and more profits for retailers. On the other hand, increase in inflation leads to a decrease in the purchasing power of consumers.

## Legal Environment

Governments use various laws and regulations to ensure that retailers do not indulge in unfair trade practices. But some of these regulations can also hamper the growth of the retail industry.

## Technological Environment

Technology is one of the most important drivers of change in the retail industry. The computerization of various retail store operations like inventory management, billing, database management and the wide spread use of bar code scanners, computers, point-of-sale terminals, management information systems, etc. have brought about a sea change in the retailing industry.

Retailers are also using technology to improve the shopping environment and to provide a pleasant shopping experience to the customer. Quick-response computer links with suppliers are increasingly being used to reduce lead-time and overcome stock-out problems.

### Competitive Environment

There is severe competition among the existing players in the retail industry. The huge untapped potential has encouraged many players to venture into retailing.

Apart from the existing competition in the organized retail sector, organized retailers are also being affected by the stiff competition posed by traditional stores in the unorganized sector. The competition among retailers varies according to the way the retail operations are carried out and which entity of the distribution channel carries out these retail operations.

## SUMMARY

Retailing involves a set of business activities that adds value to the products and services sold to the final consumers for their personal, family or household use. Retailers play a major role in the distribution system by helping manufacturers to reach out to customers and at the same time, offer an array of value added services like breaking bulk, providing assortment, holding inventory and providing information for their customers. This chapter has discussed various factors that led to the growth of retailing and benefits that it would provide. It also discussed various environmental factors that can impact the retailing industry.

## Chapter 2

# Retail Institutions

**In this chapter we will discuss:**

- Theories of Institutional Change
  - Wheel of Retailing
  - Dialectic Process
  - Retail Accordion
  - Natural Selection
- Classification of Retailers
  - Store-Based Retailer
  - Non-store Retailer

## INTRODUCTION

The store format selected by retail institutions plays a crucial role in attracting and satisfying target customers. The diversity and changing nature of society has compelled retailers to change their store formats to provide a more enriching and complete shopping experience to customers. The retail format influences the entire retail business model and plays a key role in formulating retail strategies.

In this chapter, we will look at various theories that attempt to explain the reasons for the institutional changes taking place in the retail industry. We will also examine the classification of retailers.

## THEORIES OF INSTITUTIONAL CHANGE

Retailing is a dynamic marketing activity, which evolves from time to time to cope with competition, changing consumer demand and other environmental factors. Various studies have been carried out to understand the changes taking place in the retail industry. Some of the most accepted and well known theories of retail institutional change are

- Wheel of retailing
- Dialectic process
- Retail accordion
- Natural selection

### Wheel of Retailing

Malcolm. P. McNair's 'Wheel of Retailing' is one of the well accepted theories regarding institutional changes in retailing. This theory states that in a retail institution changes take place in a cyclical manner. The cycle is: the new retailer often enters the market with a low-status, low-profit-margin, and low-price store format. Later, they move to upmarket locations and stock premium products to differentiate themselves from imitators. Eventually, they mature as high-cost, high-price retailers, are vulnerable to new retailers who come up with some other novel retailing format/concept. This new retailer will, in turn, go through the same cycle of retail development. A typical 'Wheel of Retailing' is shown in Figure 2.1

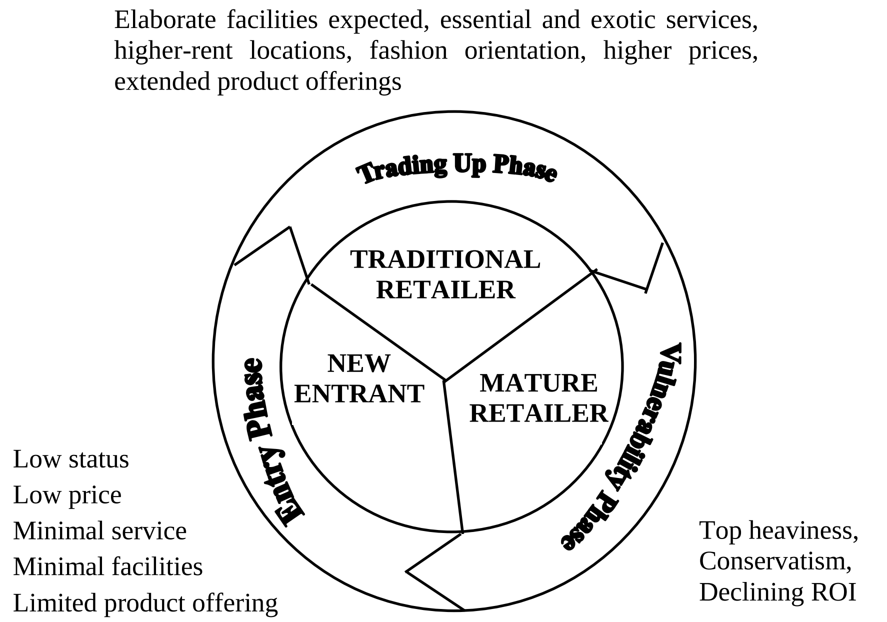
According to this theory, the above cycle can be broadly classified into three phases:

- Entry phase
- Trading-up phase
- Vulnerability phase

In the initial entry phase, the new retailer enters the market with a low status and low-price store format. The new retailer starts with a small store that offer goods at low prices or goods that have high demand. As a result, the retailer is able to attract customers from more established competitors. The retailer tries to keep costs at a minimum by offering only minimal service to customers, maintaining a modest shopping atmosphere, locating the store in a low rent area, and offering a limited product mix.

The success and market acceptance of the new retailer will force the established retailers to imitate the changes in retailing made by the new entrant. This, in turn, would force the new entrant to differentiate its products through the process of trading-up. During this period, the new retailer tries to make elaborate changes in the external structure of the store through upgradation. The retailer will now reposition

**Figure 2.1: Wheel of Retailing**




itself by offering maximum customer service, an upmarket shopping atmosphere, and relocating to a high cost area (as per the convenience of the customers). Thus, in the process of trading up, the new entrant will mature to a higher status and higher price operation. This change will increase the costs of the retailer. In other words, we can say that in the trading up phase, the innovative institution will metamorphose into a traditional retail institution. Finally, this stage will lead to a vulnerability phase. In this phase, the store will have to deal with high costs, conservatism and a fall in the return on investment. Thus, the innovative retailer matures into an established firm and becomes vulnerable to the new innovator who enters the market. The entry of the new innovator marks the end of one cycle and the beginning of a new cycle in the industry.

## Dialectic Process

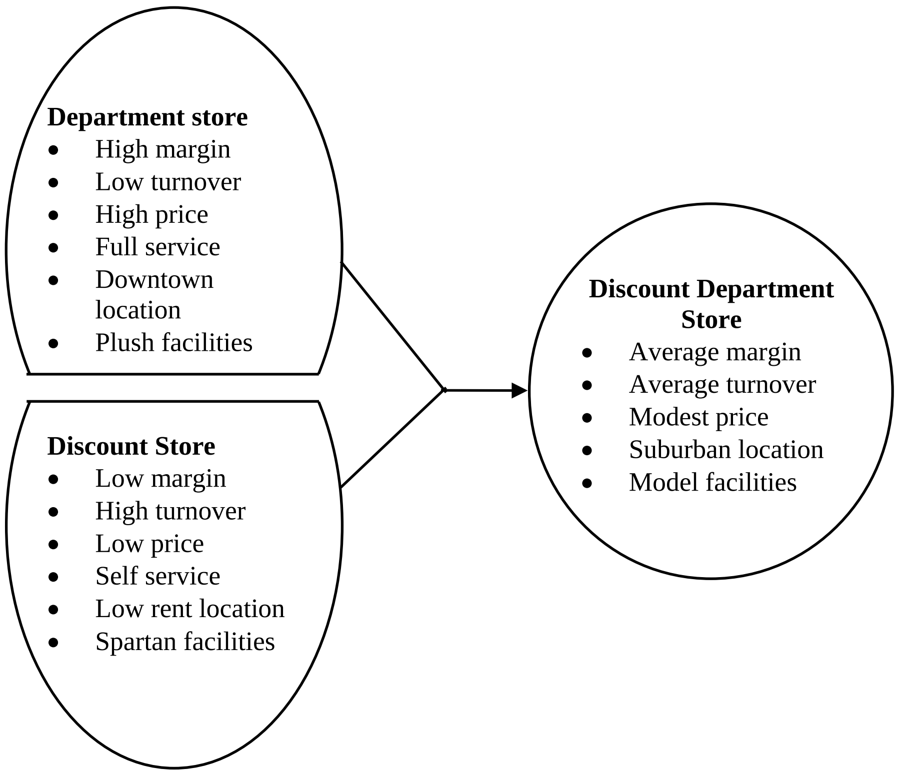
Another theory explaining the changes that take place in retail institutions is the Dialectic process or "melting pot" theory. According to this theory, two institutional forms with different advantages modify their formats till they develop a format that combines the advantages of both formats.

Thomas. J. Maronick and Bruce J. Walker in "The Dialectic Evolution of Retailing," explain the dynamic of the dialectic process as follows;

In terms of retail institutions, the dialectic model implies that retailers mutually adapt in the face of competition from "opposites." Thus, when challenged by a competitor with a differential advantage, an established institution will adopt strategies and tactics that will give it a similar advantage, thereby negating some of the innovator's attraction. The innovator, meanwhile, does not remain unchanged. Rather, as McNair noted, the innovator over time tends to upgrade or otherwise modify products and institutions. In doing so, the innovator moves towards the "negated" institution. As a result of the mutual adaptation, the two retailers gradually move together in terms of offerings, facilities, supplementary services, and prices. They thus become indistinguishable or at least quite similar and constitute a new retail institution, termed the synthesis. This new institution is then vulnerable to "negation" by new competitors as the dialectic process begins anew.

Here, the established firm is the one that earns profits as a result of its economies of scale. The new firm enters the market with a new technology through which it can gain competitive advantage. In this case, both the firms ultimately develop a format that combines the advantages of their different formats. Figure 2.2 depicts the evolution of retail formats according to the dialectical process.

**Figure 2.2: The Dialectic Process**



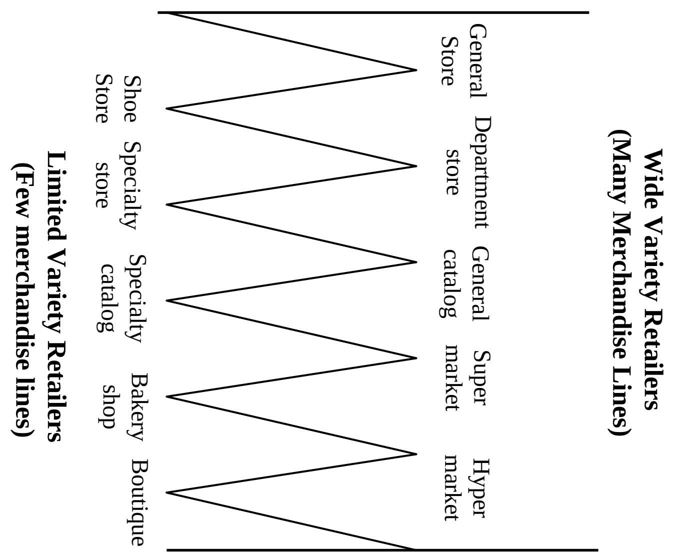

## Retail Accordion

This theory of 'retail institutional change' states that institutions evolve over time from outlets offering a wide variety of merchandise to stores offering specialized products, and then eventually these stores begin to offer a wide variety of merchandise. According to this theory, the merchandise mix strategies of retailers change, while the retail prices and margins remain the same. Retail institutions can choose from a number of different strategies. These strategies range from those that offer multiple merchandise categories with a shallow assortment of goods and service to others that offer limited merchandise with a deep assortment of goods and services. The fluctuations shown in Figure 2.3 resemble an accordion. Firms can choose any strategy between the two extremes. They can offer either a wide variety or limited variety of goods with deep or shallow assortment. For example, a retail institution may start as a small independent store, but as sales increase, it may grow into a department store or even a supermarket.

## Natural Selection

This theory is based on Darwin's theory of evolution. According to this theory, a firm or retail institution should be flexible enough to adapt to the changing environment and should adapt its behavior (to changes in the environment) to survive in the market. The retail institution that is flexible enough to adapt to changes in the economy will be the most successful. If the store or the retail institution is not willing to change, it would stagnate and may even be forced to exit the market. Thus, according to the natural selection theory, a retail institution will survive in a competitive market only if it is willing to change its product line, price, location and promotional strategies according to changes taking place in the retail environment. These changes can be social, economic, political, legal or technological in nature.

**Figure 2.3: The Retail Accordion Theory**




*Source: Essentials of Retailing, Dale M. Lewison, Merrill Publishing Company, 1993*

## CLASSIFICATION OF RETAILERS

Retailers can be classified according to their selling processes as store based retailers or non-store retailers (see figure 2.4). In the following sections we will describe these categories of retailers and discuss the advantages and disadvantages of different retail formats.

### Store Based Retailers

Store based retailers operate at fixed point-of-sale locations. Their stores are located and designed to attract a high volume of walk-in customers. In general, store based retailers offer a wide variety of merchandise and use mass-media advertising to attract customers. They typically sell merchandise for personal or household consumption, but sometimes they also serve business and institutional clients.

Store based retailers can be further classified on the basis of various parameters like:

i. Ownership

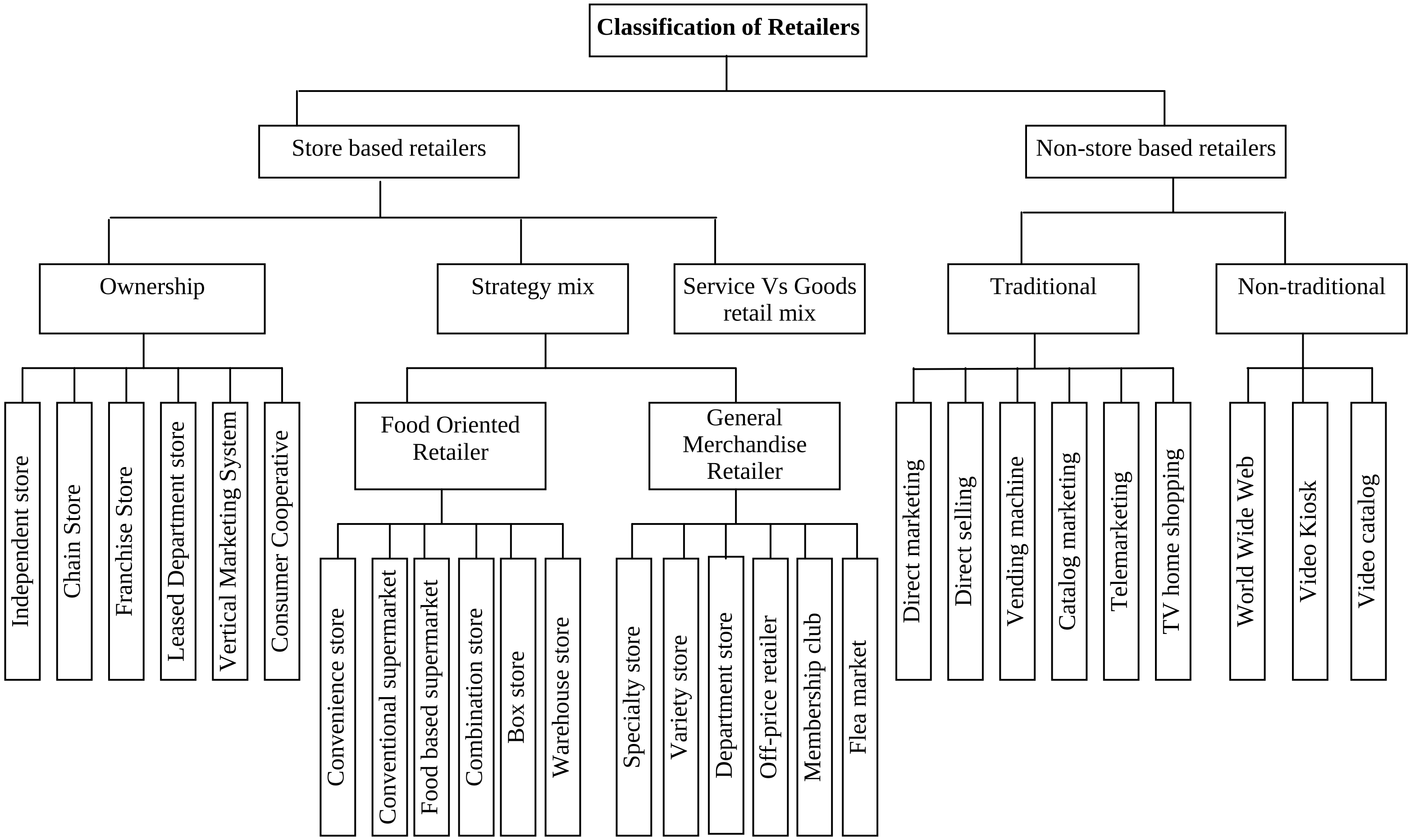
ii. Strategy mix

iii. Service Vs. Goods retail mix

**By Ownership**

Depending on the ownership pattern, stores can be divided into six categories – Independent Stores, Chain Stores, Franchise Stores, Leased Department Stores, Vertical Marketing System and Consumer Cooperatives.

**Figure 2.4: Types of Retailers**




*Source: ICFAI Center for Management Research.*

***Independent store***

An independent store can be defined as a store, which is owned by a single retailer. This retailer does not own any other store. The entry barriers for setting up an independent store are low: licensing procedures are simple and the initial investment is low. As a result, there are many new entrants. This leads to an increase in competition in the retail market. In such an environment, to retain customers, independent retailers should become customer focussed or customer oriented.

***Advantages***

- The independent retailer is free to select a convenient location and suitable store format (unlike the manager of a retail chain store).
- The independent retailer can concentrate on a small target market to achieve its business objectives.
- The retailer can decide on the timing, product assortment and price on the basis of the requirements of the target market.
- The cost of setting up an independent store is low. Such stores employ a few people, have modest fixtures and do not carry much merchandise.
- There is no excess stock or duplication of store functions as responsibilities are clearly defined in an independent store. This increases the efficiency and productivity of the store.
- The owner (the independent retailer) takes all decisions regarding the store. This reduces the time lag between decision-making and the implementation process. Consequently, an independent retailer can respond quickly to changes in the target market and adopt suitable strategies or policies.
- An independent store can act as a specialized store providing limited merchandise with a wide assortment. Such a store can be more consistent in its approach towards customers as it concentrates on a particular consumer segment.

***Disadvantages***

- The bargaining power of independent stores is less than that of other retail formats (like supermarkets and chain stores), as they purchase merchandise in limited quantities. This reduces the ability of retailers to negotiate with suppliers for better price, quantity discounts, better re-order service and access to a wide variety of merchandise.
- The productivity of independent stores is low because they depend on labor-intensive methods for activities like ordering, stocktaking, merchandising and accounting.
- In many cases, independent stores fail because the retailers lack exposure to modern tools and techniques for managing various retail functions like finance, merchandising, promotion and operations.
- Independent stores usually order-limited quantities frequently as they operate with less working capital. This increases their total operational costs on account of increased transportation, ordering and handling costs.
- Independent stores fail to attract customers from distant locations because they cannot promote their product aggressively in the media.

***Chain store***

Chain stores have two or more retail outlets that are commonly owned and controlled. These stores have a centralized buying and merchandising system and sell similar lines of merchandise. Retailers like Wal-Mart Stores Inc. and Best Buy in the US are examples of chain stores.

***Advantages***

- Chain retailers can purchase at a low price and keep shipping costs low because they purchase in bulk.
- As purchases for all retail units are done together, chain stores have a high bargaining power. They can bargain with suppliers over the price, quantity discounts and re-order service. Consequently, chain stores can offer products at less than the Maximum Retail Price (MRP).
- A centralized decision making system and the use of latest technology increases the operational efficiency of the chain store.
- As chain stores are spread over a wide area they can afford aggressive and expensive promotion of their products through electronic and print media.
- Full time experts employed for long term planning allow chain stores to regularly monitor the opportunities and threats in the environment.

***Disadvantages***

- Since chain stores have to maintain consistency across all stores, they cannot customize strategies for every location in terms of price, promotional activities and product assortments.
- The initial cost of establishment is high for chain stores. This type of format requires multiple stores with additional fixtures, product assortments and a large number of store personnel.
- It is difficult for top management to control the activities of every individual store in the chain. This may lead to a communication gap and delay in decision-making.
- Centralized management is difficult for chain stores as the location of each store is geographically dispersed.
- No one takes a personal interest in managing a chain store efficiently. Unlike an independent store, a chain store is managed by several layers of management, employee unions, stockholders and the board of directors.

***Franchise store***

A franchise store can be defined as a store based on a contractual arrangement between a franchiser (manufacturer) and a franchisee, which allows the franchisee to conduct a given form of business under an established name and according to a given pattern of business. In other words, through franchising, small business firms can become a part of a multi unit chain type retail institution. For instance, McDonald’s is an example of a successful global franchise model.

Franchising can be of two types: Product/trademark franchising and business format franchising. In product/trademark franchising, franchised dealers acquire the identities of their suppliers by agreeing to sell the latter’s products and/or operate under the suppliers name. In this format, franchisees are relatively independent from their suppliers. They are free to take decision regarding store timing, store location, facilities to be offered to customers, etc.

**Exhibit 2.1**

**Franchisee Development Program at McDonald's**

McDonald's has spread across the world with more than 23,000 restaurants. Approximately 70 percent of these restaurants are operated by more than 5,000 franchisees and affiliates. The franchisee pays an initial fee, an ongoing monthly fee based on the restaurant's sales, and a specified percentage of gross sales for marketing efforts (which includes national and local advertising, promotion, and public relations).

McDonald's has developed an extensive training and support program for its franchisees. It is known to be one of the most rigorous training programs in the business. The training program starts with part-time hands-on training in a McDonald's restaurant along with classroom training and ends with an Advanced Operations Course at Hamburger University (HU), the company's worldwide management training facility located at Oak Brook, Illinois, USA. The course at HU concentrates on improving the skills of the franchisees in accounting, finance, human resource management, and marketing.

The franchisee development program includes:

**Restaurant Orientation:** In this stage, the franchisee learns various operations like managing food production and directing employees.

**Basic Operations Course:** This is a five-day course covering communications, training, food safety, product quality, customer satisfaction and other areas of restaurant operations.

**Hands-on Restaurant Training:** This enables the franchisee to manage crew shifts.

**Basic Management:** In this stage of the franchisee development program, the franchisee attends a four-day course in handling customer issues, employee hiring, equipment knowledge, time planning and basic management

**Intermediate Operations Course:** This is a four-day course covering areas such as improved restaurant performance, managing costs and crew labor and training.

**Restaurant Training:** Franchisees are trained in advanced supervision, planning, quality, service and cleanliness, people skills and financial management.

**Advanced Operations:** A six-day course at HU focusing on effective people practices, staffing and retention, management skills and building market share.

*Adapted from www.mcdonalds.com*

Under the business format franchising arrangement, the franchiser, apart from giving the right to sell goods and services, also helps franchisees in various aspects of store management, like store location, personnel training, quality control and accounting. Thus, under this type of ownership pattern, the franchiser and its franchisees work together like a chain store. Exhibit 2.1 describes the Franchisee Development Program at McDonald's.

***Advantages***

- By becoming franchisees, retailers can own and operate retail businesses with relatively small capital investment.
- Franchisees get well- known brands and goods / service lines.
- Franchisees gain exposure to standard operating procedures and management skills through their association with the franchiser.
- Franchisees can benefit from the nation-wide promotional activities launched in association with the franchiser.

- Under the franchise agreement, franchisees enjoy exclusive rights to sell the franchiser's products or services at a particular location.
- Franchisees get a better bargain per unit purchase on account of the total purchase volume of all the firms in that particular franchising system.

***Disadvantages***

- Concentration of too many franchisees at a particular location may lead to over saturation and would affect the volume of sales and profit.
- Franchisers may hard sell their franchisee rights by projecting higher returns on investment to prospective franchisees.
- Once retailers enter into a franchisee agreement, they have to purchase raw materials or goods only from their franchiser or its approved vendor till the contract expires.
- Franchisers may terminate the franchisee license when a franchisee fails to meet any of the conditions spelt out in the franchise agreement.
- In many cases, the royalty payable to franchisers is linked to gross sales rather than the profits of the franchisee.
- Retailers have to renew their franchisee rights when the contract expires. The contract time is too short in some industries.

***Leased department***

A department in a retail store that is rented to an outside party is called a leased department. In other words, floor space within a store is leased and run as a separate business. A department store can allot floor space for a shoe department, which is actually run by a different company. The volume of sale of the leased department depends on the existing store's customer base and reliability.

The lessee is accountable for all the activities of the leased department. These activities include furnishing the department, planning the merchandise assortment etc. The lessee pays a part of the sales turnover to the store as rent.

The department store should ensure that the merchandise sold by the leased department does not cannibalize the sales of the existing product lines of the store. In addition, the department store should stipulate various conditions to ensure that the operations of the leased department are in line with its image and overall strategy.

Generally, department stores lease out store space to players whose products will add variety to the merchandise offered by the store. In some cases they may also use leased departments to offer its customers those products/services that require unique skills, which the store lacks. For example, an apparel retailer may lease out its floor space to a coffee retailer to run a coffee shop .

In many departmental stores, leased departments usually offer those products/services that complement the primary product/service offering of the store. For example, a florist operating in a novelty store or a tailoring department in an apparel retailing store. These types of leased departments provide products/services that support the product line of the main store.

***Advantages***

The advantages of the leased department retailing format from the perspective of the lessor and the lessee are described below:

- Department stores can reduce their cost by leasing departments. Leased departments bear a part of the costs of inventory and personnel.
- A department store's shortcomings in handling certain goods and services can be overcome by leasing out floor space to an outside party, which is experienced in handling those products.
- By leasing out space, the store gains a regular monthly income in the form of rent.
- The leased department could increase customer traffic because of the established name of the lessor store. This helps the leased department operator generate sales.
- The initial cost of establishing an outlet is reduced as a result of leasing. For example, the cost of storing equipment, installing security equipment and setting up display windows are borne equally by both the store operator and the leased departments.

***Disadvantages***

The leased department format can be disadvantageous for both the lessor and the lessee.

- Disputes between the leased department and the store may badly affect the image of the established store. Generally, such disputes arise when the operating procedures of the leased department are not in line with the store's overall strategy.
- If there is any conflict between the leased department and the customers, the customer will blame the store.
- The leased department may not be able to attract additional customers to the store and it may survive only on the purchases made by the store's loyal customers.
- The leased department has to function within the working hours and operating pattern of the main store.
- The lessor can impose restriction on the goods and service lines offered by the leased departments.
- The store may increase the rent if the leased department is successful.
- The in-store location of the leased department may negatively affect its sales.

***Vertical marketing system***

A vertical marketing system is a distribution system in which the producers, wholesalers, and retailers act in a unified manner to facilitate the smooth flow of goods and services from producer to end-user. One channel member owns the others or has contracts with them, or has the power to control them. There are three types of vertical marketing systems.

- Independent vertical marketing system
- Partially integrated vertical marketing system
- Fully integrated vertical marketing system

***Independent vertical marketing system:*** An independent vertical marketing system consists of independent businesses like manufacturers, wholesalers and retailers. This type of marketing system is required when customers are scattered, manufacturers and retailers are small, product sales are high, and when the products require extensive distribution. An independent vertical marketing system is generally used by stationery stores, gift shops, hardware stores, food stores, pharmacy stores, etc.

***Partially integrated vertical marketing system:*** In a partially integrated vertical marketing system, only two independent business units in a distribution channel work together. These units take care of all the production and distribution functions, without any interference from a third party. In other words, a manufacturer and a retailer alone manage the shipping, warehousing and distribution functions without the help of a wholesaler. Partially integrated vertical marketing systems are generally used in furniture stores, appliance stores, restaurants, computer retailers, etc.

***Fully integrated vertical marketing system:*** In a fully integrated vertical marketing system, only one player manages all the activities (production and distribution), without any help from other channel members. In this system, several channel members at different levels in the channel are owned by the same company. The company/store using a fully integrated vertical marketing system exercises full control over channel operations like production, wholesaling and retailing. Full control over the channel operations allows the store to lower prices without affecting its profit margins. The initial cost of setting up a fully integrated marketing system is very high. Moreover, the company owning the entire marketing system may have difficulty handling some specialized channel activities.

***Consumer cooperative***

Consumer cooperatives are retail operations owned and managed by its customer members. In a consumer cooperative, a group of customers invest in the retail operations in return for stock certificates, which entitle them to a share in the profits of the retail store. The members vote on the store’s policies and select a group to manage its operations. Consumer cooperatives are common in food retailing.

In many cases, consumer cooperatives are started by the residents of an area. These residents believe that the existing retailers in that area are not serving them well (either charging too much or providing poor-quality goods/services).

**By Strategic mix**

Depending on the strategic mix adopted by retailers, they can be classified into two groups:

- Food Oriented retailers
- General Merchandise retailers

***Food-oriented retailers***

Through out the world, a large proportion of consumer expenditure goes toward food and groceries. Some of the store formats used by the food-oriented retailers around the world are:

***Convenience store***

Convenience stores are relatively small stores that are located near residential areas. They are open long hours, seven days a week and carry a variety of products with limited assortment of merchandise. They generally carry high-turnover convenience products. These stores charge relatively high prices and operate in a 3,000 to 8,000 square foot area.

Convenience stores cater to customers who prefer ‘convenience of buying or shopping’ to the price of the product. Considering the convenience of customers, these stores stay open for longer time than other stores. They also work on all the days of the week. Convenience stores may not carry all the items that are available in supermarkets, but they are very conveniently located for customers. In such stores, the traffic flow is less when compared to other stores and the customers can get their products billed faster than in a supermarket.

***Conventional supermarket***

Conventional supermarkets are similar to department stores, but unlike department stores, these stores focus on food and household maintenance products. These stores earn very limited revenues from the sale of non-food or general merchandise goods. The main characteristic of this store format is the self-service operation. In this type of store, the customer picks up whatever he wants. This self-service arrangement allows the supermarket to reduce costs and provide a large volume of goods and services. Apart from reducing the cost to the supermarket, self-service enhances impulse buying. Supermarkets provide a variety of merchandise with deep assortments.

Some conventional supermarkets follow an every day low price (EDLP) policy. In such stores, goods are priced lower than in other stores.

Recently conventional supermarkets have started facing competition from food-based supermarkets and convenience supermarkets that provide a variety of goods and services at better prices.

***Food-based supermarket***

A food-based supermarket is larger and more diversified than a conventional supermarket, but is usually smaller and less diversified than a combination store. The size of the store ranges from 25,000 to 50,000 square feet and the store earns 20 to 25 percent of its revenue from general merchandise goods like garden supplies, flowers and small household appliances. It provides the full range of grocery items, thus allowing the customer to do all his grocery shopping under one roof.

***Combination store***

A combination store is a blend of a supermarket and a general merchandise store, where the general merchandise contributes more than 40 percent of the sales. It maintains the identity of both a food store and drug store, thus allowing customers to do their food and drug shopping in one trip. The size of a combination store ranges from 30,000 to 100,000 square feet. These stores are designed to allow customers to have a one-stop shopping experience. As economies of scale are higher in a combination store, the prices are less than those in a general merchandise store.

***Box (limited- line) store***

A box store is a food-based discount store that concentrates on a small selection of goods. Such a store has limited shopping hours, limited services, and limited stocks. The retailer offers a limited number of national brands. Refrigerated perishable goods are not available and prices are displayed on the shelf or on overhead signs. The products are kept in cut cases, and customers have to serve themselves. Customers are not allowed to examine products in this type of store. The products sold in these limited-line stores are private label brands, which are priced 20 to 30 percent below market prices.

***Warehouse stores***

Warehouse stores are discount food retailers with an average size of 100,000 square feet. They cater to customers who look for low price deals. Merchandise is often displayed in cut boxes or shipping pallets and services are limited. Customers cannot be sure about the availability of the goods consistently as the warehouse retailer's buy these goods only when a manufacturer or a wholesaler offers a deep price or quantity discount.

Depending on their functioning style, warehouse retailers can be divided into four categories:

- Warehouse showroom
- Catalog showroom
- Hypermarket
- Warehouse club

***Warehouse showrooms:*** They are generally owned by a single-line hard-good retailer. These retailers usually sell well-known brands of furniture and appliances so that customers can see the price benefit they get by buying from them instead of the conventional retailers. As soon as a customer makes the selection and places an order, the goods are shipped from the nearest warehouse. The warehouse showroom retailer offers the customer different services like credit, delivery and installation. The retailer charges extra for these services provided to customers. The warehouse retailer locates himself in freestanding sites that are adjacent to busy roads.

***Catalog showrooms:*** These are discount operations that offer merchandise through a catalog or a showroom. They use showrooms that are near a regular warehouse to display merchandise. Catalog showrooms generally offer hard goods like house ware, jewelry, consumer electronics etc. The customer orders a product (merchandise) by mentioning the corresponding number of product in the showroom or catalog. The product will be delivered a few days after the order is placed. These retailers compete on price. They keep costs low by providing minimal service and locating their showroom (or warehouse) in a low rent area. Moreover, they display only a few goods. These stores concentrate on high margin merchandise and their success depends on how well they plan their merchandise mix.

***Hypermarket:*** It can be defined as a large retail store that offers products at a low price. It is a combination of a discount store and a food based supermarket. Typically, it is spread over 300,000 square feet and offers over 50,000 different items for sale.

*A Warehouse Club:* This refers to a general merchandise retailer who offers a limited merchandise assortment with limited service at low prices to consumers as well as small businesses. Normally the store is located in remote locations in an area of 100,000 sft. The interiors are simple and services are limited. A few warehouse clubs operate on a membership basis and are known as membership clubs.

***General merchandise retailers***

In general merchandise retailing, the strategic merchandise mix ranges from a shallow assortment to a deep assortment of goods and services. On the basis of location, merchandise, price, store atmosphere, service and promotional mix, retailers are classified into:

- Specialty stores
- Variety stores
- Department stores
- Off price retailer
- Membership club
- Flea market

***Specialty store***

A specialty store is a type of general merchandise store that sells limited lines of closely related products or services to a select group of customers. Specialty stores offer a particular product line with a deep assortment to its customers. These stores also assist customers by employing salespeople who have thorough knowledge of that product line.

Specialty stores can be further classified into single line specialty stores and limited line specialty stores. Single line specialty stores concentrate on one or a few related product lines, whereas, limited line specialty stores concentrate on more than one product line at a time. Specialty merchandise line retailers can specialize on the basis of price, unit size, quality, style, fashion, etc.

The major variable in a specialty store's strategy is the merchandise assortment. In such stores a deep assortment is provided to customers i.e. a variety of brands, models, styles, sizes and colors within the product line. These specialty stores provide limited product lines, consisting of quality brands, designer labels and private labels, along with adequate customer support.

Both high margin and low margin operators can be found in the specialty store category. The size of the specialty store varies based on the nature of merchandise and mode of operation. Specialty stores are located in high traffic areas like shopping centers, downtown malls, etc.

The promotional activities of specialty stores emphasize the uniqueness of the store and the deep assortment they provide to customers. Drug stores are specialty stores that concentrate on health and personal grooming merchandise. Toys "R" Us (toys), Circuit City (consumer electronics), Barnes & Noble (book store), and Qwiky's (liquid coffee) are some examples of specialty stores.

A category killer is a new type of specialty store. It offers enormous selection in a product category at relatively low prices. A category killer offers not only low price but also variety within a narrow product line..

***Variety store***

Variety stores offer a deep assortment of inexpensive and popular goods like stationery, gift items, women's accessories, house-wares etc. They are also called 5 and 10-cent stores because the merchandise in such stores used to cost that much. This retailing institution is dying. In fact, Woolworth's, which used to be the largest variety store, has been changing the format of its stores and making them into specialty stores.

***Department store***

Department stores are large retail units that offer wide variety and a deep assortment of goods and services. These goods and services are organized into separate departments for the purpose of gaining control over various store activities like selling, promotion, and customer service. These stores strive to provide a one-stop shopping experience to customers. A typical department store offers clothing, shoes, cosmetics, gifts, luggage, and other household goods. Unlike specialty stores, department stores offer many different product lines. JC Penny is an example of a department store chain.

According to the U.S Bureau of Census, a store should satisfy the following four criteria to be considered a department store:

i. A department store should employ a minimum of fifty people.

ii. The store should generate at least 20 percent of its total revenue from the sale of apparel and soft goods.

iii. The store should have the following product lines: furniture and home furnishings; appliances, radio and TV sets; a general line of apparel for the family; household products and dry goods.

iv. The annual sales of the department store should be under US$ 10 million, where no single product line should contribute more than 80 percent of the total sales.

The US Bureau of Census classified department stores into *traditional department stores* and *full line discount department stores*. A traditional department store offers merchandise of average quality that is priced above average, with minimum customer service.

A *full-line discount department store* offers a broad merchandise assortment at less than prevailing prices. Full-line discount department stores are popular because they offer well-known brands at competitive prices. A full line department store possesses the following features:

- It is a high volume, low cost, fast turnover outlet with a wide merchandise assortment. Prices are less than in conventional stores.
- It has a centralized checkout service.
- It is a self-service store (minimal assistance from the salespeople).
- It follows a low cost model (building is located in low rent area and equipment's and fixtures are modest).
- It offers private brands for non-durables and well-known brands for durables.

Full line discount stores have been very successful because they offer value for money. Moreover, these stores provide latest goods and services from private and well-known national and international brands.

***Off-price retailer***

Off-price retailers offer an inconsistent assortment of branded fashion-oriented soft goods at low prices. These retailers can sell branded and designer-label merchandise at low prices as they purchase goods from manufacturers who have excess inventory (because of cancellation of orders, irregular merchandise and overruns). Off-price retailers have a long-term relationship with their suppliers. As these stores always buy merchandise in bulk at reduced prices and sell at off-prices, they have a high stock turnover. Consequently, they require a regular supply of goods.

In some cases, off-price retailers get special prices from manufacturers by agreeing to order goods in the off-season. At times manufacturers also approach off-price retailers to sell their unsuccessful samples and products. This will give manufacturers quick access to cash and provide a market for goods that are not doing well. Off-price chains do not carry out many promotional activities.

Off-price retailers can be classified into

- Outlet stores
- Close outlet stores
- Single price outlet stores

*Outlet stores* are widely known as factory outlets. These are owned by manufacturers. A factory outlet can be defined as a manufacturer's outlet offering discontinued merchandise, irregular merchandise, canceled orders and, sometimes, in season first-quality merchandise. Manufacturers use these outlets to store and sell production overruns, irregular merchandise and returned merchandise. By liquidating inventory at low prices, manufacturers can earn some money quickly.

*Close outlet stores* are operated by off-price retailers who sell a broad but inconsistent assortment of general merchandise as well as apparels and soft home goods. *Single-price retailers* sell all merchandise at a single price.

***Membership club***

Membership clubs are set up to cater to price conscious customers. Customers have to pay an annual fee to become members of the club. Membership in the club allows them to purchase goods at a low price. Such stores are very large and are located in isolated areas. These stores carry a fraction of the items stocked by full-line discount stores. They are characterized by little or no advertising, plain fixtures, wide aisles, concrete floors, limited or no delivery services, little or no credit, and very low prices. They get merchandise directly from manufacturers. Membership clubs are also known as wholesale clubs, warehouse clubs and wholesale centers.

***Flea market***

The term "flea market" is a translation of the French term *marche aux puces*, an outdoor bazaar in Paris, France. A flea market is an outdoor or indoor facility that rents out space to vendors who offer merchandise, services and other goods that satisfy the legitimate needs of customers. Flea markets provide an opportunity for entrepreneurs to start a business with low investment.

A flea market consists of many retail vendors offering a variety of products at discount prices at places where there is a high concentration of people. On specific market days they assemble for the exchange of goods and services.

**Service vs. goods retail mix**

Service organizations like entertainment firms, hospitals and banks initially had no intention of becoming retail institutions. As competition increased, these organizations started operating like retailers to attract customers. They began providing services at a convenient time and location.

Service retailing consists of the sale or rental of an intangible activity, which usually cannot be stored or transported, but satisfies the need of the user/ customer.

Service retailing can be of two types- services along with goods, and services without any goods (pure service).

Services along with goods can be of three types: rental goods service, owned goods service and non-goods service. Rental goods service involves the rental of all types of consumer durable goods. Owned goods service refers to a service provided by a good owned by a person. Non-goods service refers to services provided by retailers to customers who purchase goods at their store. Providing these services is not the major function of the store.

Services that are provided without any physical product or good are called pure services. These include services provided by hospitals, hair stylists, banks, etc.

## Non-store Retailer

Although non-store retailers serve the general public like store based retailers, they differ in their retailing methods. These retailers reach customers and market merchandise using various methods like broadcasting "infomercials," broadcasting and publishing direct-response advertising, publishing paper and electronic catalogs, going door-to-door soliciting customers, conducting in-home demonstrations, selling from portable stalls (street vendors), and distributing through vending machines.

Non-store retailing takes place in two ways:

- Traditional
- Non traditional

**Traditional non-store retailers**

Traditional non-store retailing involves a variety of retailing methods. These are discussed below:

***Direct marketing***

The Direct Marketing Association (DMA) defines direct marketing as an "interactive marketing system that uses one or more advertising media to yield a measurable response and/or transaction at any location". In direct marketing, a customer is informed about the product through non-personal media like TV, radio, magazine, newspaper, Internet, etc. The customer places an order through the mail or phone.

In direct marketing, responses can be measured. This system allows retailers to keep track of consumers' responses, and maintain a database of customers and prospective customers. In other words, through direct marketing, a company can concentrate its promotional activities on potential customers. And by targeting potential customers, retailers can provide efficient and prompt service.

***Advantages***

- The initial cost or investment for direct marketers is comparatively less than that for retailers using other store formats. This is due to smaller inventories and absence of fixtures or displays. In addition, a prime location is not required in direct marketing.
- A wide geographic area is covered by the direct marketer's promotional activities. This reduces the total cost of the firm. Consequently, the retailer can offer its products at a lower price than any store based retailer. This form of shopping allows the customer to make purchases without having to look for a parking place or waiting in line at the cash register. In addition, the customer need not bother about the safety of shopping at odd hours.

***Disadvantages***

Though direct marketing allows the retailer to market his goods without much investment, it is not without disadvantages. In this type of marketing, customers do not have the opportunity to see and feel the goods before purchasing them. This limits the scope of direct marketing, especially when people want to touch and feel the product before purchasing it.

The direct marketing retailer tries to attract customers, through catalogs, but the cost of developing, printing and mailing these catalogs can be very high. Moreover, there is no guarantee that the person who requested the catalog will buy the products. In general, only 10 percent of those prospected will become customers. Thus, the amount spent on the rest of customers will add to the costs of the company.

***Direct selling***

As defined by the Direct Selling Association, direct selling is a method of "marketing and retailing consumer goods directly to the consumer that relies neither on direct mail, product advertising nor fixed retail outlets". Direct selling encourages convenience shopping as well as personal touch or feel of a product. This type of selling can also be called door- to- door selling because the salesperson approaches customers directly to sell a product or a service.

Direct selling takes place in three ways: person-to-person, multilevel marketing and party plan.

***Person to person***

In this type of selling the company's salesperson directly contacts customers and describes the product to them face-to-face. The salesperson demonstrates the use of the product and also provides a manual of usage. For example, Avon (cosmetics), use the person-to-person approach to market their products.

***Multilevel (network) marketing***

In this type of marketing, a company uses commission/bonus based selling along with person-to-person marketing. Amway (a US based company) uses the multilevel marketing approach.

***Party plan***

This form of direct selling involves product demonstrations/sales to a group of consumers who have assembled in one customer's home or at an outdoor location.

Selling products and services directly to consumers through face-to-face interaction, using a salesperson, can be called direct selling. Direct selling benefits both consumers and sellers. From the consumers' point of view goods are available at their convenience. Moreover, salespersons take the time to explain the use of the product to them. Direct selling is advantageous for retailers as it is an effective, low cost channel.

Direct selling also helps to boost self-employment opportunities. Through direct selling a person can transform himself into a successful entrepreneur.

***Vending machines***

A vending machine involves coin or card-operated dispensing of goods and services. It eliminates the use of sales personnel and facilitates round-the-clock sales. Machines can be placed wherever they are most convenient for consumers. Vending machines generally are installed in busy areas where they can benefit many customers. Though installation costs are high, vending machines help customers avoid the inconvenience of shopping in a store.

Retailing through vending machines is also called automatic merchandising. Customers use cash, prepaid cash cards, coins or credit cards to purchase goods from vending machines. Today vending machines are becoming a part of daily life. Goods sold through vending machine include soft drinks, coffee, photocopies, etc.

Banks use an automatic vending machine called the Automatic Teller Machine (ATM) to make banking more convenient for customers.

***Catalog marketing***

Catalog marketing refers to sales made through catalogs mailed to a select list of customers or made available in a store. In catalogs basic product and pricing information is given along with instructions for placing an order. The kind of delivery (mail, express service, parcel post) that the customer wants can be mentioned in the order

***Telemarketing***

To provide more convenience and service satisfaction to customers, goods and service are sold through telephone contact. This method is useful for customers who want to avoid traffic congestion and parking problems.

Telemarketing allows retailers to provide customers information on new merchandise and upcoming sales events. Retailers who use telemarketing deliver merchandise to the customers' residence or hold it till it is picked up by the customer at a later date.

***TV home shopping***

It is a medium of marketing through which Shop-by-TV retailers demonstrate a product and describe its benefits and uses. If a customer wants to purchase the product, he can order it through e-mail using Internet or telephone.

TV home shopping works in the following manner:

- The merchandise items are displayed, described and demonstrated on television.
- Using the toll-free number provided, customers can place orders.
- Payments are done through credit cards.
- The goods are delivered by courier service along with a guarantee.

### Non traditional non-store retailers

#### *World Wide Web*

The use of the World Wide Web allows people to access information about products (using the web address of the retailer's home page). Retailers' websites allow customers to order with a click of the mouse. To attract potential customers, retailers also send details of new products through email to customers.

Retailers can use the Internet as a medium for promoting their goods and services all over the globe at minimum cost. They can even conduct research on customers with the help of the Internet. Moreover, the Internet reduces the costs of retailers as it allows them to use low cost electronic mail to communicate with customers.

#### *Video kiosks*

The term kiosk is derived from a Turkish word which means open summer house or pavilion. Kiosks are often placed near the entrances of shopping malls.

A video kiosk is a freestanding interactive computer terminal that displays product and related information on a video screen; it often uses a touch screen to allow consumers to select items.

#### *Video catalog*

A video catalog is a retail catalog on a CD-ROM disk. It has to be viewed on a computer monitor. After viewing the catalog, the consumer can call up the retailer to order the goods. The disk allows the customer to quickly gather information about the retailer's products.

## SUMMARY

To survive in the fast evolving retailing industry, retailers should have a fair idea of various retail store formats and their advantages and disadvantages. Retail institutions should continuously adjust their store formats to match the changing market environment. There are many theories, which try to explain the evolution of various retailing formats. Some of these theories are: wheel of retailing, dialectic process, retail accordion theory and natural selection theory. A retailer can use a store based or non-store retail format to serve its target market.

## Chapter 3

# Understanding the Retail Customer

**In this chapter we will discuss:**

- The Market
- Population Analysis
- Demographic Analysis
- Geographic Analysis
- Consumer Buying Behavior

## INTRODUCTION

To understand the purchasing patterns of customers, it is vital to understand the customers' nature and examine the external factors that influence their buying behavior. The increasing value perception among customers is putting more pressure on the retailer to offer merchandise of superior quality that is valuable to the consumer's eye. Retailers explore investment opportunities after analyzing the needs, aspirations, shopping preferences and buying behavior of the customer.

Retailing includes the purchasing and selling of products and services to the consumer, who buys them for individual and household consumption. The consumption of goods and services depends on the preferences and choices of the individual. Thus, consumer behavior plays a crucial role in determining the success and growth of retail stores.

In this chapter, we will analyze the relevance of the retail market, the structure of the buying population and how their buying behavior affects the retail stores. In this chapter, we will also discuss population, demographic and geographic factors that affect or influence the buying behavior of a customer. These factors allow the retailer to calculate the market potential and growth of the retail store in a particular area. Understanding consumer behavior is a prime factor for the successful formulation of a retailing strategy. This chapter gives a detailed explanation of factors that influence the consumers' buying behavior and its impact on the retailer.

## THE MARKET

A market can be defined as a group of consumers or organizations who are interested in a particular product, have the resources to purchase the products, and are permitted by the law to acquire these products. A market definition begins with the total population and progressively narrows down to the target market and then to the penetrated market. Exhibit 3.1 gives various definitions of a market.

A retail market is a place where all the retailers compete with each other for recognition and acceptance through various merchandise promotional activities. Thus, to understand the retail market, one has to understand the structure of the buying population and their behavior.

### Structure of the Buying Population and their Behavior

A retailer should understand the structure of the population and their buying behavior, so that he can cater to the needs of the buyer in a better way. Buying behavior deals with the process a consumer undergoes while deciding whether to purchase a product/service or not. Based on the customer's nature and his intentions behind purchasing the merchandise, the buying population can be divided into two categories - the consumer market and the organizational market. Figure 3.1 gives the classification of buying population.

*Consumer market:* Consumer markets consist of the individuals or the households, which are the ultimate users of goods and services. Consumers purchase goods and services for their personal use or for the use of their families. The consumer market plays a crucial role in the success of a retail store. To understand the consumer market, a retailer should analyze the geographic and demographic distribution of the population.

Consumers' buying behavior or their decisions is influenced by factors like individual preferences, social factors (like the influence of reference group, family life cycle and purchase system).

**Exhibit 3.1**

**Defining a Market**

Defining the market is the first step in understanding it. Since the market consists of consumers whose needs differ, market segmentation is necessary to understand those needs and to select the consumer groups that the retailer will serve. To define a market a retailer should follow the process given below:

**Total population:** Determine the total number of people residing in a particular area in which a retailer operates.

**Potential market:** Identify the individuals in the total population who are interested in buying the product/service.

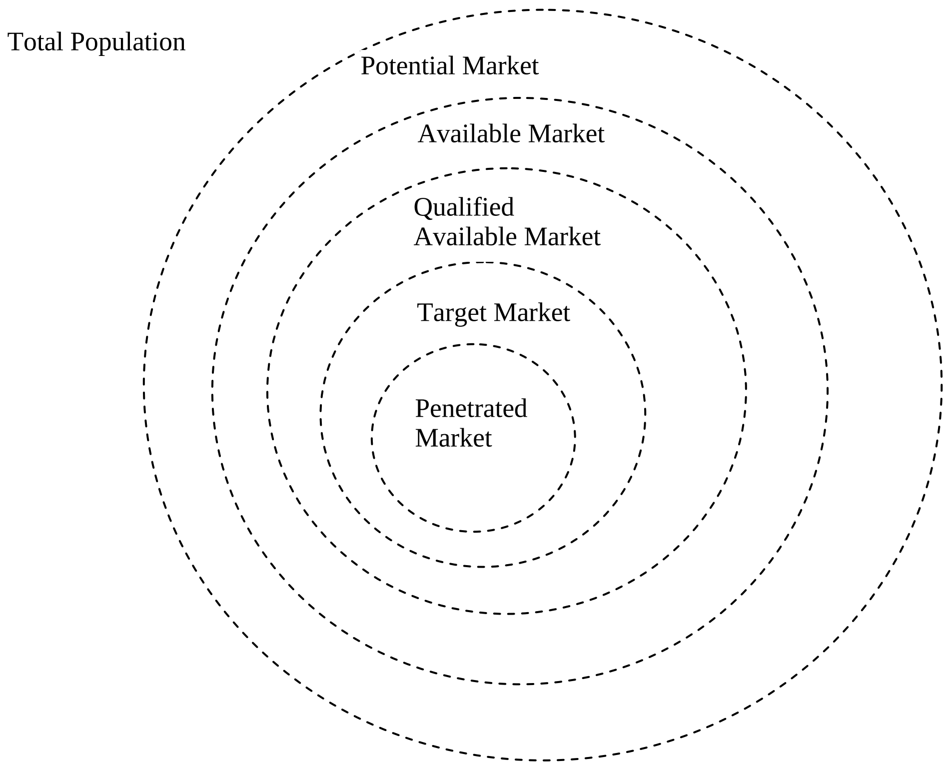
**Available market:** Identify the individuals in the potential market who have enough money to buy the product/service.

**Qualified available market:** The individuals in the available market who are legally permitted to buy the product/service.

**Target market:** Identify the portion of the qualified available market that the firm has decided to serve.

**Penetrated market:** Identify the individuals in the target market who have purchased the product.

Thus, a market can be defined as a group of consumers or organizations that are interested in a particular product, have the resources to purchase the products, and are permitted by the law to acquire these products.




*Adapted from www.netmba.com/marketing/market/definition*

The geographic distribution helps the retailer to analyze the classification of the population - rural, urban and suburban - which helps him to understand the purchasing power of the population. The demographic features explain the classification of the population on the basis of their age, gender, family life cycle, income distribution, and race and ethnicity, which are the major factors that influence the buying behavior of a consumer market. These geographic and demographic features help a retailer understand the purchasing behavior of the target market.

*Organizational market:* An organizational market is comprised of corporates and resellers who represent intermediate consumers of merchandise. The corporate buyers are those companies that either buy the merchandise offered by the retailer for corporate use, or promote sales for the retailer by giving coupons to their employees. Resellers are those who buy merchandise in large quantities at discounted prices from the retailers, and sell them at normal prices in their shops. The organizational market differs significantly from the consumer markets because the consumers look for products that satisfy their own needs while the organizations look for products that satisfy the needs of their consumers. The organizational customers are affected by the organizational and economic factors added to the cultural, social, personal, and psychological factors that affect the ultimate customers. Since retailing has more to do with the ultimate customers, we limit our discussion to the consumer market in this chapter.

Retailing businesses concentrate more on consumer markets and hence, this chapter would be limited to exploring various characteristics of consumer markets with the help of population analysis, demographic analysis, geographic analysis and consumer buying behavior.

## POPULATION ANALYSIS

To determine the actual and potential market for a product, the retailer has to analyze the total population. The analysis of the total population allows the retailer to calculate the total demand in the market. Total population is determined by the total number of persons residing in an area at a given time. The total population of an area is determined by its birth and death rates, and immigration and emigration rates.

### Immigration and Emigration

Immigration and emigration are two ways of population mobility. Immigration is the way of shifting into a new place or country. The population of a place increases when the immigration rates are high. Emigration is the way of leaving one’s own place or country to settle in another place or country. High emigration rates reduce the population of an area or country. Hence, the factors that contribute to the increase of population are birth and immigration, and death and emigration reduce the total population of an area.

The people who leave their original place of birth either for a better life or to escape the hard situations in their place of birth, are called migrants, and the process is called migration.

### Race and Ethnicity

The race and ethnicity of the population also play a role in the consumers’ choice patterns and buying behaviors. The purchase habits of the buying population differ from place to place even within the same country, based on the dominant races in that particular area. Hence the retailer has to be aware of the racial mix of the population in the area of its operation. The ethnicity and races in some of the countries the world over is given in Table 3.1.

**Table 3.1: Ethnicity and Race by Countries**

| Country | Ethnicity And Race |
|---|---|
| Australia | Caucasian 95%, Asian 4%, Aboriginal and Other 1% |
| Bangladesh | Bengali 98%, Others 2% |
| Brazil | White (Includes Portuguese, German, Italian, Spanish, Polish) 55%, Mixed White and African 38%, African 6%, Other (Includes Japanese, Arab, Amerindian ) 1% |
| Canada | British Isles Origin 40% French Origin 27%, Other European 20%, Indigenous Indian And Inuit 1.5%, Other, Mostly African 11.5% |
| China | Han Chinese 91.9%, Zhuang, Uygur, Hui, Yi, Tibetan, Miao, Manchu, Mongol, Buyi, Korean, and Other Nationalities 8.1%. China Has 56 Ethnic Groups |
| Denmark | Scandinavian, Eskimo, Faeroese, German |
| France | Celtic and Latin With Teutonic, Slavic, North African, Southeast Asian and Basque Minorities |
| Germany | German 91.5%, Turkish 2.4%, Italians 0.7%, Greeks 0.4%, Poles 0.4%, Others 4.6% |
| India | Indo-Aryan 72%, Dravidian 25%, Mongoloid and Others 3% |
| Iran | Persian 51%, Azerbaijani 24%, Gilaki And Mazandarani 8%, Kurd 7%, Arab 3%, Lur 2%, Baloch 2%, Turkmen 2%, Other 1% |
| Japan | Japanese 99.4%, Other 0.6% (Mostly Korean) |
| Kuwait | Kuwaiti 45%, Other Arab 35%, South Asian 9%, Iranian 4%, Other 7% |
| Malaysia | Malay and Other Indigenous 59%, Chinese 32%, Indian 9% |
| Mexico | Mestizo (Indian-Spanish) 60%, Amerindian Or Predominantly American 30%, Caucasian or Predominantly Caucasian 9%, Other 1% |
| Nepal | Newars, Indians, Tibetans, Gurungs, Magars, Tamangs, Bhotas, Rais, Limbus, Sherpas |
| New Zealand | European 88%, Maori 8.9%, Pacific Islander 2.9%, Others 0.2% |
| Pakistan | Punjabi, Sindhi, Pashtun (Pathan), Baloch, Mihajir (Immigrants from India and their Descendents) |
| Saudi Arabia | Arab 90%, Afro-Asian 10% |
| Switzerland | German 65%, French 18%, Italian 10%, Romansch 1%, Others 6% |
| United Arab Emirates | Emiri 19%, Other Arab and Iranian 23%, South Asian 50%, Other Expatriates (Includes Westerners And East Asians) 8% (1982) |
| United Kingdom | English 81.5%; Scottish 9.6%; Irish 2.4%; Welsh 1.9%; Ulster 1.8%; West Indian, Indian, Pakistani, and Others 2.8% |
| United States | White: 75.1%; Black: 12.3%; American Indian And Alaska Native: 0.9%; Asian: 3.6%; Native Hawaiian And Other Pacific Islander: 0.1%; Other Race: 5.5%; Hispanic Origin: 12.5% |

*Source: www. factmonster.com*

## DEMOGRAPHIC ANALYSIS

Demography is the study of statistics used to describe a population. Each person can be characterized in terms of age, gender, education, income, occupation, race, nationality, family size and family structure. Individuals of similar character are grouped together to form a consumer market segment. This allows the retailer to serve according to the needs of each segment and cater to varied group preferences.

Though the total population is classified on the basis of their homogeneous nature, customized marketing is difficult, as within one group, people may perceive a product or service differently, based on their age. To overcome this problem and to customize the products and services, the entire population can be classified on basis of the age factor.

## Age Distribution of Population

Age distribution of the population is an important factor that needs to be considered by retailers. Retailers have to change their marketing approach on the basis of the growing population. For example, if the population is more in the age groups of 0-4 and 5-14, the retailer should concentrate more on the kids market, where the strategies should be developed in such a manner that they can attract more kids to the retail store. The retailer can develop various strategies which concentrate on offering more kids' product lines, credit cards for kids (through parents), entertainment areas (videos/reading areas), kids' clubs, kid-oriented visual displays (colorful signs and lighting), kids' fashion shows, placement of items that kids want near the checkout line, placement of kids' items at eye level, focus on designer brands and a large variety of kids' items, "teen" sections, kids' menus, cross-marketing, and training store personnel to value and assist child customers. A retailer should analyze the target market and develop strategies to satisfy their requirements.

Moreover, by analyzing the population distribution, retailers can adopt various strategies, that urge people to buy the products. For example, the young population will prefer to have a shopping experience DIY (Do-It-Yourself) whereas the aged population like to have a DIM (Do-It-for Me) experience, where they expect the retailers to be more cooperative and service-oriented.

## Income

Consumer households, on the basis of their income, can be classified into five categories - rich, consuming, climbers, aspirants and destitute. The consumption behavior of these consumers varies accordingly. These classifications exist both in rural and urban areas and the variation again exists among the similar classes in rural and urban areas. These groupings are chiefly used by market planners for segmenting the target groups for their products.

## Urbanization

Urbanization can be defined as the growth in the number of cities and the number of people living in cities. Increased urbanization refers to the rise in the number of people living in cities. Urbanization is a key demographic trend that has been observed in many developing countries in Asia and Latin America in recent times. The reasons for the growth of the urban population in these developing countries can be attributed to the migration of people from rural areas in expectation of better quality of life, urban expansion and the natural increase in population because of low death rates and high birth rates. The immigrants to urban areas are also drawn by the cultural attraction of cities, the fewer number of social constraints and perception of higher income. The benefits of urbanization are better quality of life, lower mortality rates, better education and literacy rates and lower birth rates.

The United Nations (UN) projects that the world population will expand from 6.1 billion to 7.8 billion between 2000 and 2025, and 90 percent of this growth will occur in urban areas of less developed countries. By 2020, a majority of the population of less developed countries will be living in urban areas. The urban population in some of the biggest cities of the world is shown in Table 3.2.

Urban areas are the focus of organized retailers as there is more concentration of population and wealth in these markets.

**Table 3.2: Population of Biggest Cities in the World**

| Rank | City | Country | Population ('000) |
|---|---|---|---|
| 1. | Tokyo | Japan | 26,444 |
| 2. | Mexico City | Mexico | 18,131 |
| 3. | Mumbai | India | 18,066 |
| 4. | Sao Paulo | Brazil | 17,755 |
| 5. | New York | U.S. | 16,640 |
| 6. | Lagos | Nigeria | 13,427 |
| 7. | Los Angeles | U.S. | 13,140 |
| 8. | Calcutta | India | 12,918 |
| 9. | Shanghal | China | 12,887 |
| 10. | Buenos Aires | Argentina | 12,560 |
| 11. | Dhaka | Bangladesh | 12,317 |
| 12. | Karachi | Pakistan | 11,794 |
| 13. | Delhi | India | 11,695 |
| 14. | Jakarta | Indonesia | 11,018 |
| 15. | Osaka | Japan | 11,013 |
| 16. | Manila | Philippines | 10,870 |
| 17. | Beijing | China | 10,839 |
| 18. | Rio de Janeiro | Brazil | 10,582 |
| 19. | Cairo | Egypt | 10,552 |
| 20. | Seoul | South Korea | 9,888 |
| 21. | Paris | France | 9,624 |
| 22. | Istanbul | Turkey | 9,451 |
| 23. | Moscow | Russia | 9,321 |
| 24. | Tianjin | China | 9,156 |
| 25. | London | United Kingdom | 7,640 |
| 26. | Lima | Peru | 7,443 |
| 27. | Bangkok | Thailand | 7,281 |
| 28. | Teheran | Iran | 7,225 |
| 29. | Chicago | U.S. | 6,951 |
| 30. | Hong Kong | China | 6,927 |

*Source: United Nations, World Urbanization Prospects: The 1999 Revision (2000).*

## The Shrinking Household

The number and composition of households affect the purchases made by consumers. By studying the household structure of the market, the retailers can predict the demand for goods and services. The size of the average household is shrinking. The reasons for this are the increasing longevity, lower birth rates and the prevailing trends of staying independently i.e., away from parents and grandparents. For example, in countries like India, the traditional family structure which has been predominantly a joint family set-up is now being transformed into single-member and nuclear families with or without children.

Hence the size of households has decreased. Members of such households have a greater tendency to spend, as their disposable income per member is higher.

## The Working Women

Be it the purchase of groceries or cars, the majority of purchase decisions in any household have been conventionally made by women. The increased cost of living and the drive to prove themselves has seen more and more women, who traditionally have only been involved in managing the home and children, enter the workforce. Women are now major players in the Asian economies as employees as well as entrepreneurs.

The rise in women's employment in the recent years is particularly dramatic among urban women. With the increasing number of women opting to work, the factors on which they focus to make decisions have changed. Therefore, retailers need to adopt merchandising strategies suitable to cater to these changing needs. This changing pattern means that there are dual earners at home, but the time spent on shopping has decreased since women's free time has decreased. The buzz word is convenience. Women are no longer willing to travel long distances to reach their favorite stores where they can bargain or spend long hours on spotting an apparel of their interest in piles of clothes. Convenience, availability and quality service are the primary factors of importance for women today. It is found that working women spend about 10% more than housewives do, and their spending is much more on lifestyle products. The category-wise spending ratios for lifestyle products are given in Table 3.3.

**Table 3.3 Spending Across Categories of Working Women vs. Housewives**

| Category | Ratio of spending by working women to spending by housewives |
|---|---|
| Eating out | 1.5 |
| Books and Music | 1.7 |
| Gifts | 1.7 |
| Mobile Phones | 2.5 |
| Movies | 2.8 |

*Source: Consumer Outlook, May 2002, KSA Technopak*

To ensure convenience and to increase the footfalls of time-pressed shoppers, the retailers hold sales and special events during evenings and weekends. Playing rooms for children, well equipped with games and entertainment channels, are being provided at many retail stores, so that the parents would have an undisturbed shopping experience. Little gestures like giving gifts and chocolates to children are arranged to make shopping a pleasure both for women and children. Some retailers even provide baby-sitting services.

Working women can be broadly envisioned in the roles of a working partner, the head of the household, and a working person, according to which the patterns of buying behavior vary.

The women's traditional role of being the chief purchasing agent of the household has changed with their new role as a working partner. The purchase decisions today are made collectively by women along with their husbands, and sometimes children are involved in these decisions. The retailer, hence, needs to aim at the satisfaction of all the partners, and also target the products, price and promotions at the team (husband and wife) rather than an individual.

Women are assuming the role of the head of a household either by choice to remain single or due to circumstances (as a widower or divorcee). In this role, along with routine purchase decisions, women are making non-traditional purchase decisions - like decisions regarding investments and purchasing a home, which were traditionally done by men. Thus the line between the purchases decided by women like household products, and those decided by men is fading away.

The buying needs and the decisive attributes for a purchase have undergone a sea change as women have begun to don the role of working professionals. The workplace atmosphere influences many women to dress-up in a better and more polished way. The woman who used cosmetics only occasionally – say make-up for parties - is now using them everyday to go to her workplace. Even the selection of apparel and the frequency of their purchase have undergone a drastic change. Added to these are the office tools like briefcase, appointment books, laptops, etc.

## GEOGRAPHIC ANALYSIS

To know the extent of the spread of a market, a retailer should know the density of population in that area. Using this information, a retailer can calculate the potential consumption of that particular area.

To analyze the population more accurately, geographic analysis is also necessary. The prosperity of the people in a geographic location differs considerably across the different regions of a country. The market potential also varies. Even the way consumers spend money on various categories differs. Geographic analysis can be carried out by a retailer by identifying the characteristic features of various geographic constituents like regional markets, metros and non - metros.

## CONSUMER BUYING BEHAVIOR

A consumer's buying behavior refers to the response and reaction of the ultimate consumer to various situations involved in purchasing and using various goods and services. A retailer has to understand consumers' buying behavior as consumer responses to various marketing strategies would determine the retailer's success. For understanding the retail customers' buying behavior, a retailer should collect information relating to what a customer likes to buy and in what quantity, who buys, from where (location) he wants to buy, who are the ones who influence a customer, etc.

### Buying Considerations - What Consumers Buy?

The first step towards understanding the consumer buying behavior is to find out what consumers buy and their motives behind buying them. Generally, consumers buy products, which are capable of satisfying their needs. Thus a product is anything that is offered to a market and is capable of satisfying the needs of the customer. Successful products include tangible and intangible features that match the consumer's expectations. Realizing the customer's expectations and viewing the product in its broader perspective allows retailers to plan and offer products accordingly. Here, we have to define the products from a buyer's perspective, where he looks at a product based on its tangibility, durability, and availability.

#### Product Tangibility

A product's tangibility is based on its physical and material properties that enable the customer to touch or feel it. Generally, consumers consider a sense or feel of touch as the tangibility of a product. Thus a customer can hold, lift and feel a tangible product, whereas intangible goods cannot be touched and felt.

The degree of product tangibility varies for goods, services and ideas. The tangibility of a good refers to its size, shape and weight along with its chemical and biological nature, for example, a pen, a dress or a car. Services are predominantly intangible in nature and they are the result of the application of human skills for solving a consumer's problem. A service need not necessarily be associated with the sale of a product. Services range from personal services to professional services, entertainment, etc.

Ideas are highly intangible services, which include an opinion or a concept related to a specific event or situation. Here the retailer markets the concept or an idea to the end consumer.

**Product Durability**

The durability of a product is the capability of a product to endure or to last. Based on the useful life span of a product, some products are durable and others are non-durable. Durables are products that are capable of serving the customer for a long period of time. Non-durables are products that last for a very short time. Non - durable goods are perishable by nature.

**Product Availability**

Depending on the level of availability expected by the customers, products can be put in three categories:

- Convenience products
- Shopping products
- Specialty products

***Convenience products***

Convenience products are relatively inexpensive, frequently purchased products, and the consumer spends only minimum time to find the product and purchase it. Customers expect these products to be readily available at the nearest retail outlet. Bread, biscuits, milk are some examples of convenience goods. Even though these products carry lower margins, retailers prefer to stock these convenience products as they have a high turnover.

***Shopping products***

Shopping products are items for which buyers are willing to make more efforts to plan for and purchase. For shopping products, consumers spend considerable time in comparing the brands and sellers with regard to price, product features, quality, service, warranties, etc. Shopping products include furniture, appliances, etc. Compared to convenience products, shopping products are more expensive and consumers are not loyal to any particular brand.

***Specialty products***

Specialty products are those products, while purchasing which, the consumer is least concerned about the time, effort or expense involved. Here, the consumers do not accept any substitute and are willing to spend any amount of money to obtain that particular item. These products are available in a limited number of retail outlets.

## Buying Situations - How much do they buy?

The volume of goods and services that a consumer buys depends on his requirements and his willingness and ability to purchase. Thus, the volume of a retailer's business in a particular market depends on the following:

- Consumer population
- Consumer requirements
- Consumer potential

***Consumer population***

The volume of goods and services that would be sold in a particular area depends on the total number of 'consumption units' in that area. Depending on the product and its intended usage, the 'consumption unit' can be a 'house hold' or a 'person'. For example, when a person buys a home appliance or garden equipment, he is spending for the household, and hence the 'consumption unit' would be a 'household'. On the other hand, when he purchases an ice cream or seeks medical or legal service, the purpose of which is personal, the consumption unit is a 'person'. Thus, the 'consumption units' will depend on the type of product purchased and this is the focus area for determining the market potential.

The total market potential can be calculated by counting the number of consumption units. Thus, a market's total consumption capacity is a function of the total number of consumption units that make up that market.

***Consumer requirements***

After determining the number of consumption units, a retailer should also determine what percentage of these units actually requires a particular product. A person's requirement for a particular good or service depends on his needs and wants. Needs can be defined as an internal desire to satisfy a physiological or psychological urge. Wants are a person's desire for a specific product or service that can satisfy his needs.

***Consumer potential***

Although the number of consumption units are more and each of the consumers require a particular product, everyone in that market might not buy that product as he/she may not have the potential or ability to buy a particular product. An individual can desire to buy a product, but he can do so only when he has the potential or ability to buy the product, and the willingness and authority to pay for a product. Thus, a consumer's buying behavior mainly depends on three factors - ability to buy, willingness to buy and authority to buy a product.

***Ability to buy:*** A consumer's ability to buy refers to his purchasing power. In other words, it is the financial ability of a consumer to purchase a good. Thus, the buying power of a consumer is determined by factors such as the consumer's disposable income, asset position and available credit.

Here, the major factor is the amount of money that the consumer can spend on products that he needs and that he desires to own/purchase. A person's income can be expressed in different ways, like the total income, disposable income and discretionary income. Total income refers to the sum total of the incomes received by an individual in the form of salaries/wages, rents, interest, investment, pension and so on. An individual cannot spend his total income because he needs to pay taxes, has to allocate some amount for his savings and has to take care of his basic needs.

Disposable income refers to the income that remains after tax deduction, and other deductions from the total income. Thus the disposable income in hand is used by the consumer for spending and saving. Though a retailer can use this disposable income, to a certain extent, to forecast the demand or requirement for essential goods, the figures of disposable income are not useful to calculate the capacity of the market for luxury goods and non - essential products. Discretionary income is that portion of an individual's or a family's income that remains after purchasing the basic necessities. Based on their discretionary income, the consumers spend on entertainment, household recreation, etc.

In the nineteenth century, the German statistician Ernest Engel developed a law stating the relationship between the income and consumer expenditure patterns. According to this law, as income increases, consumers' percentage of income spent on food decreases and that spent on clothing remains roughly constant; expenditure on housing and household operations remains roughly constant; and expenditure on luxury and other goods increases.

Credit and assets are other measures that determine the purchasing power of a consumer. From an individual's perspective, income, credit and assets are determinants of buying power. Credit can be defined as the borrowing power of a consumer. Credit is either in the form of money that is placed at a consumer's disposal by a financial or other institution, or in the form of time allowed for payment of goods and service sold on trust. Assets can be defined as anything of value that is owned by an individual. The possession of assets increases the buying power of the consumers in two ways. First, assets can be converted to cash, and second, they are a major factor in determining the amount of credit that borrowers are willing to extend to the consumer.

***Willingness to buy:*** Though a consumer may have enough income to purchase a product, he may not buy the product because he is not interested. Hence the income of the person is not the only criterion for determining the buying process of a product. The buying process is also dependent on various other factors like psychological factors and acceptance by the peer group and family. For example, psychologically a customer may not be willing to buy a product. This is because of his perception about the product that it may not satisfy one of his particular needs.

Sometimes, the customer is a slow decision-maker by nature, which may delay the buying process. The customer requires more information about the product and a lot of time to evaluate the product on the basis of the available information. These factors delay a customer's buying process.

***Authority to buy:*** Apart from the ability and willingness to buy a product, a consumer should possess the authority to buy a product. Such authority may be formal or informal.

Formal authority requires that the consumer must meet various eligibility requirements like age, residency and occupational constraints. For example, non-residents cannot avail many services provided by the state and local governments. Social and professional organizations allow only their members to avail the benefits.

Informal authority for making purchases is an expected courtesy when more than one individual is involved and when the purchase is of great importance.

## Buying Centers - Who buys?

Identifying the person who does the buying plays a crucial role in understanding the nature of retail buying. In the retailing context, a buyer may purchase a product for his personal use or for household use. When an individual purchases a product for himself, his buying behavior depends on his personal choice whereas when the same person makes a purchase for his household, the buying behavior depends on a collective decision based on the collective needs and requirements of the entire household. Thus, identifying the buyer would enable the retailer to study the various factors that may influence his buying behavior.

## Buying Influences - Why do they buy?

Basically, all customers have similar needs. The difference in the buying process depends on the personal preference of the consumers. Thus, here we can define the need as that basic underlying motivation that moves people to action. Therefore, to satisfy these needs, customers engage in shopping. The buying decisions of a consumer are influenced by a variety of factors – psychological, personal and social factors.

**Psychological factors**

Understanding consumer psychology helps a retailer in developing an appropriate retail mix that would appeal to the customer and influence his buying behavior. Motivation, perception, learning, and attitude are the psychological factors that influence buying behavior.

There are many theories that explain the various *motives* of an individual (customer) acting in a particular way (purchase decision). According to Abraham Maslow, a person may have many needs, which he cannot satisfy at one time. Maslow has established a theory of hierarchy of needs. According to this theory, consumers try to satisfy the physiological needs first, followed by the needs of safety, esteem and self-actualization. Exhibit 3.2 gives a list of primary motives as identified by Melvin Hattwick.

**Exhibit 3.2**

**Inventories of Motives**

According to Melvin Hattwick, there are eight basic needs of human beings and they are referred to as primary motives. These needs form the basis of all retailing activities. Described below are some of the basic needs and their impact on retailing.

***Food and drink:*** Food and drink are necessary for the physical sustenance of human being. However, the choice of food varies depending on the individual's taste. Today, more and more people prefer to have food outside, and this has led to the setting up of restaurants and food establishments.

***Personal comfort:*** People want to have a life of comfort. The desire for comfort can be satisfied by providing retail products and services. As the demand for these products is increasing, their production is also increasing.

***Freedom from fear and danger:*** There is an inherent desire in man to avoid danger. To ensure people that they are free from danger, retailers are coming out with various products like smoke detectors, dual air bags, tamper-proof packaging and dead bolt locks etc. These ensure personal protection and enhance the confidence of shoppers.

***To be superior:*** People are competing to be superior to one another in all the aspects of life. To satisfy the competitive spirit among customers, retailers are coming out with various products that claim to be the fastest, the smartest or the strongest, so that the consumer who owns these products feels superior to others

***Personal attractiveness:*** Another major motive of human being is to look attractive. To address this motive, retailers have come out with various personal care products, ready made garments and appointed personal care assistants in these sections to provide personal guidance to each individual (cosmetics, fashion accessories and health products).

***Welfare of loved ones:*** Another basic motive of individuals is the welfare of their family members and loved ones. Various products like insurance policies, college education loans, flame-retardant infant clothing, home safety devices etc. have been introduced to cater to this need of individuals.

***Social approval:*** All individuals seek the approval of the society or social group that they belong to. To help individuals live an active social life, retailers try to follow the latest trends in personal grooming and personnel hygiene (hair shampoos, tooth pastes, deodorants etc).

***To live longer:*** Most individuals have a desire to live longer. This has led to the development of health clubs and fitness centers.

The way a motivated consumer reacts to a retailer’s offer is influenced by his perception. *Perception* can be defined as the process by which an individual selects, organizes and interprets information inputs to create a meaningful impression of the world. But a customer's perceptions about a retailer or its offering may vary due to various reasons like selective attention, selective distortion or selective retention.

Most of the consumers’ behavior is influenced by his learning. *Learning* is a process of acquiring knowledge through experience. A customer's learning is a result of the interplay of drives, cues, responses and reinforcements. A retailer can help the customer in his learning about its offers by exposing him to frequent advertisements and providing free coupons.

The *attitude* of a person is the positive, negative or neutral opinion of a person or his feeling about the people, activities, policies, and other things around him. A person's attitude is also reflected in his perception about a particular retail store, its merchandise, location, arrangement, sales people, prices, quality of products, discounts and offers, ads, and so on. People’s attitude towards the stores is of interest to retailers because it is the way an individual thinks and looks at the stores that determines whether or not he would shop there. Hence, a retailer has to develop a list of store characteristics that can motivate the consumers to shop at a specific store. A consumer has several motives for patronizing a particular store. Patronage motives are the underlying forces that influence the choice of a store. The various patronage motives are:

- price/value
- location
- convenience
- parking
- accessibility
- friendly and helpful salespeople
- merchandise
- assortments
- varieties and brand
- atmosphere
- store image and
- service offered

The primary motives (like personal comfort, social approval, etc.) and secondary motives (like being efficient, seeking convenience) that influence product selection are associated with elements that the retailer can use to influence the consumer’s choice of store.

**Personal Factors**

Some of the personal factors that influence a customer’s buying decisions are his personality, self-concept, lifestyle and stage in the life cycle.

*Personality* is the sum of the characteristics, traits, talents and qualities of a person that make him the unique individual that he is. *Self concept* refers to the set of perceptions an individual holds of himself in a society. Life-style is the way an individual lives. The increasing influence of western culture and the media on Indian households has radically altered lifestyles and spending patterns, giving rise to new business opportunities. The modern consumers are showing an interest in western fashion but only in those that provide them value for money.

A typical family comprises parents (father, mother) and children. The family has a strong influence on our values, morals and attitudes. We generally tend to adopt the values of our parents/grandparents and these influences affect all major decisions of our life. Thus, a retailer needs to understand the role of family in influencing the buying behavior of an individual, i.e. customers should not be just treated as an individual, but a representative of a family.

**Social Factors**

Consumer buying behavior is also influenced by social factors like culture, social class, reference groups and social performance.

A consumer’s *culture* is reflected in his beliefs, customs and norms followed. It is the individual's culture that determines the importance he gives to his family, work, education, and other aspects of life. Indian culture stresses on integrity, tolerance and family values.

*Social class* is a general, informal grouping of persons on the basis of their income group or caste or interests. Members of a social class share the same values and philosophy. A person who is very conscious of his social status tends to buy only those products, which are approved of and regarded with prestige by his reference groups. Such a person may not even think about the value-for-money part of the purchase. The individuals who are not so conscious opt for those products, which serve their purpose and give them satisfaction.

People whose opinions play a role in an individual's decision-making process are called *reference groups*. Such groups may be aspirational, membership or dissociative groups. A group to which a person does not belong, but values its opinion as he personally admires it (like sports persons) or wishes to be a part of that group (like social class) is an aspirational group. A membership group is one to which the individual belongs to by virtue of his birth or interests, like a family. A dissociative group is one to which a person would not like to be associated. Such groups may be groups that oppose the individual’s interests, or lower social groups. The opinions that influence an individual the most are those of the groups with which he has direct interaction.

*Social performance* determines the individual’s tastes and buying decisions. Social performance is the way a person plays his various roles - as an employee, son, friend, husband, etc. Such performance often determines the person's acceptance among his peers and social circles, which is quite an important factor for the individual’s ego. A person yearning for social acceptance may buy expensive products to project an image or try to emulate his peers and seek their approval.

## Consumer Buying Process – How do consumers buy?

The decision- making process of the customer takes place in six steps:

- stimulus
- problem awareness
- information search
- evaluation of alternatives
- purchase
- post purchase behavior

Whenever a customer purchases a product, he goes through a process of decision-making. He may or may not go through all the six steps mentioned above in the decision-making process. The steps in the decision-making process depend on the past experiences of the consumer. For example, a person who shops regularly at a particular store may not undergo all the six steps that a new customer would.

Let us analyze the six factors that affect the decision – making process of an individual.

### Stimulus

A stimulus is a cue or a desire that motivates a person to act. There are three types of cues:

***Social cue:*** A customer receives a social cue when he is interacting with his friends or fellow employees. This type of stimulus originates from a non-commercial source. For example, you may receive a social cue when a friend tells you that Wal-Mart has announced a sale offering discounts up to 50 percent. Such cues may evoke interest in you, depending on your needs.

***Commercial cue:*** These cues are given by the seller. The seller can be the retailer, manufacturer or wholesaler. The main objective is to create interest in a particular retailer, good or service. Commercial cues can be in the form of ads, sales pitches and point-of-purchase displays. Though a retailer wants to create excitement through such cues in a store, it may not have the same effect, as a social cue is a seller-controlled one. Sometimes, customers may react more positively to a cue received from a friend rather than a salesperson.

***Physical drive:*** Physical drive occurs when one or more of a person's senses are affected, like hunger, thirst, feeling of coldness, heat, etc. The action or response to a physical drive depends on the intensity of the drive. If the physical drive is strong, it leads to action and if the drive is weak, it may be ignored.

A potential customer may face all or any one of the above stimuli before purchasing a product. If the stimulus is strong enough to motivate the customer, the customer will go to next step of the decision-making process. If the intensity of the stimuli is low, the customer may not step into the next stage of decision process, that is, he may not consider the idea of purchasing a particular product.

### Problem Awareness

Under problem awareness, the consumer is not only aroused by social, commercial and physical stimuli, but also realizes that the product or service under consideration may solve a problem of shortage or an unfulfilled desire. Sometimes, it becomes difficult to understand why a person moves from the stimulus stage to the problem awareness stage. Every customer who comes to a particular retail store may purchase the same product, but for different reasons, like convenience, price, image, quality, service and durability, without revealing these motives to the retailer.

A consumer recognizes a shortage when he realizes that he needs to repurchase a particular product. In some cases, the goods may have been worn out beyond repair or run out of stock. In these cases, a consumer realizes the need to replenish a product or service. Sometimes, when a customer sees a product in a retail store, he recognizes his unfulfilled desire and becomes aware of the goods and services that he did not purchase before. He buys the goods or service to improve his lifestyle, image, status, looks, etc. Sometimes, a customer wants to buy a product because he does not know the performance of that particular product and wants to test it. Thus, an urge is created in an individual and he tries to fulfill the desire for the product by purchasing it.

### Information Search

When a person feels the necessity to satisfy the unfulfilled desire or solve a shortage problem, he starts collecting information about a particular good or service that can help him do so. Here, a customer undertakes information search to serve two purposes:

i. To determine the alternative goods or service available to solve the problem

ii. To ascertain the characteristics of each of the alternatives.

First, the customer lists down the goods and services that helped him address the problems he faced in the previous stage. The list need not be a written one. Once he identifies the goods and services he requires he thinks about the availability of the product and the sources from where he can purchase the product. The information search can be of two types - internal and external. A customer who has sufficient shopping experience has his past experience to guide him in purchasing a product. In other words, the customer first checks whether he has any information about the needed product in his memory. For example, if a customer who already has a pair of shoes and wants to buy another pair of shoes, he compares all the brands, like Adidas and Nike, before purchasing a product. The customer asks himself various questions before taking a decision: Which shoe will give him more comfort? Will the shoe provide value for money? Which store offers the best price?

On the other hand, a person with less purchasing experience uses external sources for information search. The external sources include commercial sources like the mass media and retail sales people, non-commercial sources like consumer reports and government publications, and social sources like family, friends and colleagues. A customer uses these sources to collect information about a product. With the help of the information about the products and the retail store, the consumers gain knowledge about products along with their characteristics. Here again, a customer with purchasing experience will be able to analyze the negative and positive features of the merchandise while the less experienced customer will have to depend on the external sources for information.

The information search depends on the customers' perception about risk. The degree of risk varies from customer to customer and situation to situation.

The retailer plays a major role in providing correct information to the customers and thereby helping them to do away with the anticipation of risk. The retailer can also help the customer to take a better decision by explaining the functioning and characteristics of the product. To make the information search more convenient for the customer, stores provide point of purchase advertising, product displays and employ knowledgeable salespeople to help customers. All these provisions help the customer gather adequate information, so that they can take decisions easily.

When a customer gathers information about the product, he compares his wants with the features of the product. If the product is able to satisfy the customer's need, he purchases the good; otherwise he drops the idea.

**Evaluation of Alternatives**

Once the customer gains enough information about all the products available, he can make a list of alternatives. He can then arrange them in an order of priority according to his tastes and preferences. The customer can then select the best of the alternatives available.

The customer has to make a careful evaluation of the information. This is because while deciding on the purchase, customers sometimes have two or three good alternatives. Here, the customer has to rank the product according to his personal criteria.

The criteria for taking a decision also vary from customer to customer. Some customers may rank price, quality and color in this order while others may consider the initial cost and mode of payment first. Here the customer has to set standards for each of the characteristics and then evaluate these alternatives on the basis of his requirements. The criterion for judgment also varies depending on the customer's standard of living.

Based on his choice criteria, the customer ranks all the alternatives from the most preferred to the least preferred ones. The customer then chooses the product based on his budget (affordability) and tastes and preferences.

Sometimes, it becomes difficult for the customer to select a product based on the available/collected information. In such cases, the decision criteria change and the customer looks for some other criteria, like the price, brand name, etc. for deciding upon the product's quality, and then reaches a decision.

Once the customer examines the attributes of each product and ranks it, he decides to purchase the product that ranks high in most of his chosen attributes.

**Purchase**

Once the consumer has finished his evaluation of alternatives and finalized the product he wants to buy, he is ready to make the purchase. A purchase act is an exchange of money or promise to pay for the ownership or use of goods or service. While a purchase takes place in a retail store, three factors are deemed important from the store's perspective as well as the customer's perspective -the place of purchase, purchase terms and availability.

***Place of purchase:*** Before purchasing a product, a customer needs to identify the store/place from where he/she would like to buy the product. A customer can buy a product either from a store (kiosk, supermarket, jewelry store) or nonstore (at home, or at office) location. A customer evaluates the alternate stores just like he evaluates the various product alternatives. Customers' select store-based retailer on the basis of location, store layout, customer service, sales help, store image and the level of prices. While for evaluating a nonstore-based retailer the stores image, customer service, level of prices, interactivity and convenience are considered. Convenience is another basis of consumer's selection.

***Purchase terms:*** Purchase terms include the price and method of payment. Price is the amount of money a consumer pays to gain the ownership of the product. The method of payment includes money that the customer is going to pay; it can be in the form of cash, short-term credit or long-term credit.

***Availability and delivery of the product:*** The customer would like to know about the availability of the stock as well as the mode of delivery. Stock-on-hand refers to the amount of an item that a place of purchase has in its inventory. Delivery is the time span between the placing of an order and the receipt of the item. The ease with which an item is transported to its place of use also comes under the delivery criterion.

Once the customer is satisfied with all these three issues of purchase, the actual purchase takes place. There is a chance of the customer dropping the purchase decision if any of the above factors are not agreeable to him.

**Post-purchase behavior**

After buying a product, the consumer may have a tendency to contact the store again for two purposes - for future purchase and for revaluation of the already purchased product. Once the customer likes a retail store and its services, there is a tendency to revisit the store for further shopping. A customer may revisit the store to shop for complementary goods. Here, again, if the customer wants to buy another product, the same process is followed.

The customer will also re-evaluate the further purchases made at the store. If the retail store is able to provide the satisfaction expected by the customer, the customer may turn into a loyal one. But, if the customer is not satisfied with the retail store, it may lead to the customer switching over to other stores and spreading his dissatisfaction to other customers through word of mouth.

In certain situations, this dissatisfaction may lead to cognitive dissonance. Cognitive dissonance is the doubt that arises in the consumer's mind as to whether or not he has made a correct purchase decision. Here, the consumer may regret the purchase he has made or may wish for another alternative from the already chosen list.

To avoid cognitive dissonance, the retailer can provide after-sale care through a telephonic call, a service visit, acknowledgment, etc. The degree of dissatisfaction or cognitive dissonance is more in case of the purchase of an expensive item. The retailer can provide a realistic sales presentation and a realistic advertising campaign to reduce such dissatisfaction. A realistic projection will reduce the customer’s high expectation about the product or service.

**Types of consumer decision-making**

Whenever a consumer engages in a buying process, he undergoes the process of taking a decision. Here, a question arises as to whether he undergoes all the steps in the decision making process before each and every purchase.

The decision-making process varies from individual to individual, and from age group to age group. For example, an experienced old customer may not spend much time in deciding about the product he purchases, when compared to an inexperienced young-adult who goes through the buying process. The process thus varies from age group to age group. Again, an educated customer analyzes a product more carefully and collects more information about it. Another factor that plays a crucial role here is the income. Someone from the higher income group may not take all the steps in the decision-making process compared to a customer from the lower income group. Thus we can say that the decision making process varies from one group to another.

Mainly there are three types of decision-making processes-- extended decision making, limited decision making, and routine decision making.

***Extended decision-making:*** Extended decision-making happens when a consumer goes through all the steps of the decision making process. Here the customer spends a lot of time on gathering information and evaluating the alternatives. Moreover, cognitive dissonance is high in case of such customers. Even the perceived risk is high in case of such consumers. This is because these customers are involved in buying expensive goods or services.

In extended decision-making, the age group, education, family status and income play a crucial role. Moreover, the consumer may stop the buying process any time during the decision- making process.

Customers undertake extended decision-making while purchasing expensive products like furniture, jewelry, cars or real estate. In this case, the retailer can provide the customer with additional information by emphasizing on personal selling, brochures etc.

***Limited decision-making:*** Limited decision-making occurs when a consumer goes through all the steps of the purchase process, but does not spend a great deal of time on each of them. Here the consumer has purchasing experience and hence the time spent in shopping is comparatively less. The consumer has a fair idea about the product that he has to buy and from where he has to buy it. Based on past experience, the customer evaluates the buying process. Here the perceived risks are comparatively low.

***Routine Decision-Making:*** Routine decision- making happens when consumers buy products regularly and skip several steps in the purchase process. Here the customers spend very little time in taking decisions as they generally repurchase the same brand. The perceived risk is very low for these commodities, and the consumer takes the purchase decision on the basis of experience.

The main criterion for this purchase is that the customer has to identify the need of the product. These types of purchases are common in supermarkets, at dry cleaners, fast food outlets, etc. The major influencing factors in such cases are the store location, the timing of the stores, clear in-store displays and product availability.

## Buying scenes –Where do they buy?

Finding out the customer's preferred places of purchase is the last step in understanding his buying behavior. The buyer has a choice of buying scenes (places of purchase) - shops/stores, buyer's home, buyer's workplace and parasite point. Most of the buyers make their purchases by visiting a store, which may be a retail store or a multipurpose shop. Some customers also buy the required merchandise from vendors who sell from door to door. Buyer's workplace is the buying scene where items like food are purchased from vendors supplying to office. Parasite points are places where vendors establish their shops (typically magazine stalls, pan shops, etc.) next to a restaurant or theater and then attract buyers who frequent these places. Even the pull-carts of many reputed brands of ice-cream manufacturers come under this class.

The buying scene is also dependent on the nature of the purchase made. Consumers do not prefer the same buying scene for all the purchases they make. They select the place of shopping as per their perception of the various buying scenes for a particular product that they intend to buy.

## SUMMARY

Any organization's growth and survival in the highly competitive market depends on how well it understands its customers and responds to their current and potential needs. In the retail industry, understanding the retail customers plays an important role in the success of a retail store. The development of technology and globalization has led to a new era of consumerism where retailers focus completely on meeting the needs, wants and priorities of the consumer. In this chapter, we discussed about the market and the various factors influencing the buying behavior of a retail customer.

To understand the nature of the retail market, a retailer should analyze various factors like population, demography, and the geography of a particular area. Population analysis helps the retailer to understand potential markets. The population of an area is based on various parameters, like immigration and emigration rates, race and ethnicity. Immigration and emigration rates help the retailer to understand the actual population of a particular area. Race and ethnicity help the retailer to understand the choices and buying patterns of the consumers.

Under demographic analysis, the retailer classifies customers on the basis of their age, gender, education, income, occupation, race, nationality, etc. This allows the retailer to understand the customers in a better way and customize its products and service accordingly.

Geographic analysis allows the retailers to understand the buying population, based on the total population. Moreover, the population is classified on the basis of region - metro and non-metro - which helps the retailer to have more accurate data about the buying population.

At the end of the chapter, we discussed various factors relating to consumer buying behavior and the buying process.

# Part II

# Retailing Strategy

# Chapter 4

# Retail Market Strategy

**In this chapter we will discuss:**

- Definition of Retail Market Strategy
- Target Market and Retail Format
- Building Sustainable Competitive Advantage
- Achieving Strategic Positioning
- Nature of Strategic Planning
- Retail Strategic Planning Process

## INTRODUCTION

In this era of globalization and increasing competition, retailers are showing a keen interest in formulating well-designed strategic plans that could attract and retain customers by understanding and catering to their needs and changing interests. An effective strategy enables the retailer to not only stay in the market but also to grow and prosper.

The strategic plan of a firm should be formulated by assessing the external environment affecting the working of the firm and capitalizing on the opportunities available after assessing its own strengths and weaknesses. However, no strategy can be effective, if it is not implemented properly. Thus, retailers should take steps to implement the strategy effectively and monitor it from time to time. This chapter focuses on developing effective strategies for retailers in order to establish themselves in the market and gain competitive advantage.

## DEFINITION OF RETAIL MARKET STRATEGY

A retail market strategy is a statement, which defines the orientation of the firm in terms of the target market that it wishes to cater to, the retail format that it proposes to build, and the retail mix variables that it chooses to gain decisive competitive advantage and sustain its position in the retail market. The retail format takes into consideration factors like the nature of the merchandise, assortments, the services offered, objectives of the promotional campaigns, pricing, store design and visual merchandising, location and number of stores, etc. To formulate a good market strategy, the retailer should first understand its target market and its retail format.

## TARGET MARKET AND RETAIL FORMAT

A retail strategy cannot be formulated in isolation or by considering the aspirations and resources of the organization alone. Customers and competitors are also considered. Retailers should not only satisfy the needs of the target market but also perform better than the competition. The retail format should be so chosen that the retailer is in a position to provide the retail mix that its target customers look for.

Traditionally a ‘market’ was a place where buyers and sellers met to bargain and exchange products and services. However, in the modern market place, the sellers and buyers do not need to meet one another. Customer can directly place orders with the retailer through the retailer’s website using the Internet and make payments online.

Hence, a ‘retail market’, in present times, refers to a group of customers who have common or similar needs, which can be collectively addressed by a retailer who chooses to cater to the same group or customer segment.

The retail format is thus chosen on the basis of target group (any customer segment based on the demographics, lifestyle, buying situation, benefits, etc.) that the retailer wishes to cater to. Departmental stores, specialty stores, discount stores and hypermarkets are some of the retail formats. Within each product segment like apparel, groceries, toys, etc., a retailer can choose a different target market. For instance, the same retailer can target high-income customers for its apparel section while it may target middle-income customers for its grocery section. Thus, each retailer can choose a different retail mix.

## BUILDING SUSTAINABLE COMPETITIVE ADVANTAGE

After establishing the retail format and defining the target market, the retailer should formulate a retail strategy that would help it differentiate its store from its competitors. For example, the success of Wal-Mart is attributed to its strong competitive strategy (described in Exhibit 4.1). The retail strategy is chiefly guided by the five dimensions of price, location, merchandise, service and communications. Customers form an image of the store on the basis of these core dimensions. The core dimensions are supported by the everyday store functions of operations, purchasing/logistics, market research, financing and technology. The pictorial representation of all the influencing dimensions and functions can be seen in Figure 4.1.

### Exhibit 4.1

### Wal-Mart's Competitive Strategy

Wal-Mart, the world's largest retailer, derives its competitive advantage from its geographic location, its inventory management strategy, its flexible pricing policy, its operations strategy, its hub and spoke distribution network, its vendor relations and its organizational culture.

**Choice of geographic location:** In rural areas and small towns, where there were no retailers, Wal-Mart has the first mover advantage. As the sole discount retailer in those areas, it could attract customers by offering them the same or better prices than they could get at stores in nearby cities (which involved long drives).

**Inventory management strategy:** Wal-Mart has always been known for its new and cost effective methods of inventory management. The company does not have a common corporate policy on merchandising. Instead, it gives its local store managers the autonomy to choose products and allocate shelf space because they are the ones who are familiar with customer preferences and local needs.

**Flexible pricing policy:** The pricing of products is left to the store manager. Prices are thus set according to local demand and the number of competitors in a particular area. This local control maximizes sales and inventory turnover while minimizing expenses. This type of pricing policy gives Wal-Mart the flexibility to price competitively in areas where it is located close to competitors and price reasonably in areas where it is the only retailer operating.

**Operations strategy:** Wal-Mart's operational strategy enables it to achieve maximum efficiency at lower costs. Because of its multiple distribution centers, its inventory occupied only 10% of total store space while that of its competitors occupied 25% of store space. This means increased store space for displaying more goods and, consequently more sales. Instead of individual product labeling, Wal-Mart practices shelf labeling, which minimizes the handling and reduces costs. The company invested early in automated technology like electronic scanning and satellite systems to achieve maximum efficiency while keeping prices lower than competitors'. Wal-Mart uses UPC scanners and hand-held bar code scanners to electronically track the items being sold and send information to the computerized inventory system. This lowers inventory costs and ensures the timely replacement of goods so as to better meet local needs. The sales data is collected through the satellite network and analyzed for better inventory management, thus avoiding deep discounting (because of overstocking).

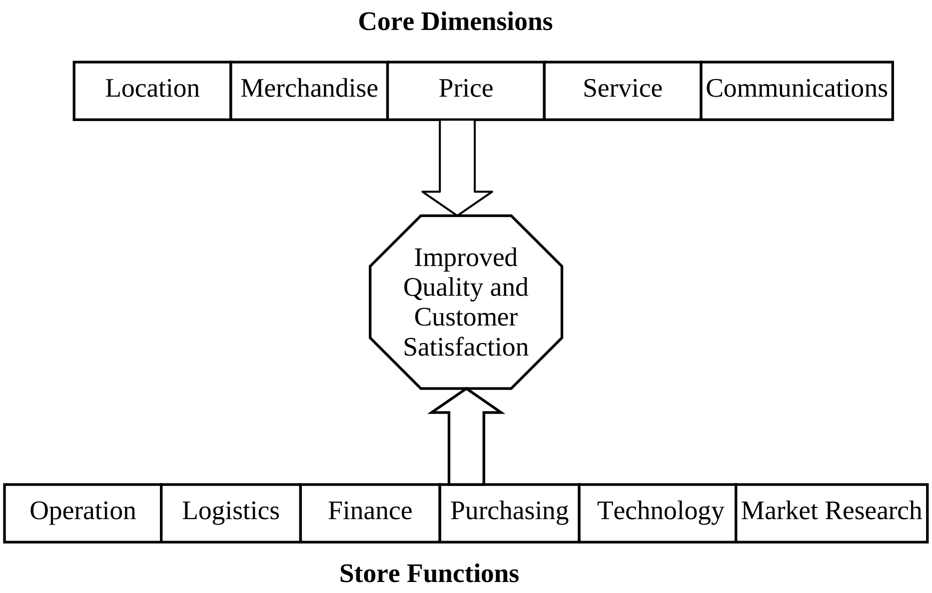
**Hub and spoke distribution network:** Wal-Mart also derives a competitive advantage through its sophisticated distribution network. The merchandise received by the distribution center is sorted within 1-2 days and made ready for delivery. Then, merchandise is delivered through cross docking, thus minimizing inventory storing costs and allowing "just-in-time" delivery. Wal-Mart's inbound logistics costs are less (3.7% of its sales) than that of its competitors (4.8% of sales). At Wal-Mart's highly automated distribution centers, work continues round the clock. The company ships most of its merchandise (80%) from its own distribution centers (unlike Kmart's 50%). By doing so, it gained control over its inventory and reduced its dependence on suppliers. Its inventory tracking system sends inventory data to the supplier's system immediately, thus reducing the lead time.

**Vendor relations:** Wal-Mart maximized revenue, increased efficiency and reduced costs through its vendor relations. The company reduced the bargaining power of suppliers by not purchasing more than 2.4% of its requirements from any single supplier. It further realized a cost saving of 3-4% by keeping out manufacturers' representatives. Wal-Mart communicates with its 3600 vendors regarding purchase orders, forecasting and planning and replenishments via electronic data interchange. It even transfers funds electronically. Wal-Mart has transformed its large key suppliers (P&G, GE) into partners and shares its strategic plans and expectations with them. These vendors have appointed teams specifically to manage products for Wal-Mart. They also use vendor managed inventory systems, which increase their sales and reduce Wal-Mart's inventory costs.

**Wal-Mart's culture:** Another competitive advantage of Wal-Mart lies in its culture. The emphasis on customer service, open book policy and frugality from the early years established a unique culture at Wal-Mart that builds loyalty among its personnel, its suppliers and its customers. The employees, are called 'associates', and thrive on recognition along with responsibility. Employee involvement is encouraged and employee suggestions are implemented. Such suggestions have often resulted in cost savings - about $85 million from 650 suggestions in 1993. The identification of training needs is the responsibility of the local managers. Employees are given cross-cultural training to sensitize them to local customs. A part of employee compensation is linked to profitability. Other than that, the profit sharing and stock ownership plans act as an incentive for employees to perform better. Company goals and strategies are shared with employees at weekly meetings to help them understand the company's vision and work towards achieving it.

*Adapted from the case analysis of "WALMART STORES, INC." By Megan R. Busse, Visiting Assistant Professor at Birkeley University*

**Figure 4.1: Positioning the Retail Store**




*Source: Icfai Center for Management Research.*

The effect of each of the dimensions can be understood by a careful examination and analysis of the retailer's position with regard to that of its competitors. Thus, the dimensions that influence the business most and win over the competition should be given utmost importance.

## Location

Many customers and retailers have realized the benefits of competition. Healthy competition encourages them to perform better and provide better bargains for the customers. However, some retail markets and locations are so appealing that they lure too many operators, thus resulting in too many competitors competing for a limited market. With so many players aspiring for a small market share, each retailer would eat into the sales volume of another. As a result, none of them would enjoy the benefits.

Very few retailers have the drawing power that would make the customer travel an extra mile only to visit the store. Generally, unless a retailer has high drawing power, it is the location that determines the customer traffic for a store and the customer traffic for an area broadly remains the same irrespective of the existence of a particular store. Hence, location strategy of stores with low drawing power is aimed at attracting the customer traffic that is directed to a particular location.

The presence of a number of stores in a particular locality can prove beneficial due to the increase in customer traffic. By taking competition in good spirit and making efforts to address the unfulfilled needs of customers, all retailers can make considerable profits. Retailers can sell complementary products in their stores so that the location is viewed as a complete shopping area and attracts more customer traffic.

## Merchandise

Merchandise mix refers to the total range of products that a store offers to its customers. The merchandise being offered by a store determines the perception of the customers with regard to the store. It is not necessary for retailers to follow low-price and bargaining patterns if they maintain merchandise that is unique.

The identity of the stores is often linked to the merchandise they offer. Retailers can cater to the needs of their target customers and retain their identity by formulating a detailed merchandise plan.

Retailers also differentiate themselves from others on the basis of the merchandise they offer by creating in-house brands of merchandise. This concept is highly popular in UK and to an extent in the US. Other than national brands and store brands, proprietary brands are on the rise in the US. Proprietary brands help the retailers establish a strong store image, create loyalty and realize more profits.

The merchandising strategy adopted by a store can be examined by mapping the store's assortment with the offered variety[1]. Some retailers like Wal-Mart and Kmart prefer to offer their target customers a large variety of products though with shallow assortments while some other retailers like Toys 'R' Us prefer to keep deep assortments with less variety. Retailers have to make a choice between maintaining a wide variety or deep assortment because opting for both would increase the inventory costs undesirably, making the firm uncompetitive. However, some big retailers like Sears and JC Penney manage to equip their stores with both wide variety and deep assortments.

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[1] Variety of products refers to the number of different products being stored by the retailer while assortment refers to the depth of the product line or the choice offered within the product category.

## Price

The relative strategic positioning of a retailer can be determined by its margin-turnover proportion. It is very difficult for a retailer to achieve high turnover and high margins simultaneously because if it increases the price, its customers will drift away to other retailers. Similarly, it is not possible for a retailer to sustain in the market place (in spite of low margins) if it has a low turnover. This leaves the retailers with only two choices -- either to maintain high turnover by keeping low margins or to keep higher margins in spite of the low turnover. Wal-Mart is a good example for the former while JC Penney adopts the latter practice.

Generally, retail stores, which, by the nature of their merchandise experience low turnover, try to maintain profits by keeping high margins on the products they sell. Specialty stores and high-end fashion stores like Nordstrom in the US come under this category. On the other hand, discount retailers try to attract customers by keeping low margins, and making profits through high turnover.

However, these pricing strategies have their disadvantages. Some retailers, who choose to maintain high margins sometimes, do not realize any profit due to low turnover. At the same time, retailers who aim at high turnover through low margins may sometimes need to sell the merchandise at lower margins as their customers get used to discounts and sales and tend to postpone the purchase till another sale.

## Service

The kind and extent of service appropriate and feasible for each store would be different and should be determined by the managers in a particular store. The quality of both the basic and associate services (gift wrapping, mailing, etc.) being offered by the retailer are important.

Retailers need to spend considerable amounts of money to offer good customer service. These amounts are justifiable only if the high service being offered results in some kind of payoff for the retailer. The payoff could be in the form of retained customers or in the form of increased sales. However, retailers should always ensure that their service strategy is aligned with their market strategy. Retailers should identify specific service areas according to their market strategy. This will provide a differential advantage to the retailer.

## Communications

The retailer should determine well in advance, the level of service he wishes to provide for particular merchandise. If a retailer chooses to provide service which involves high costs for a low-priced merchandise, it would not provide any advantage to the retailer. Likewise, if a retailer does not provide good service for high-priced items, customers would not be satisfied and this would work in favor of the competitors. However, if a retailer selling high-end merchandise provides good/superior service, customers would be delighted and would become loyal customers for the retailer. Thus, the retailer can gain strategic advantage over its competitors by offering good customer service. However, retailers selling low-priced merchandise need not necessarily provide additional or a wide variety of services. Such retailers can minimize service costs by providing just basic services and keeping the customers happy both price wise and service wise.

The market strategy of a retailer would be incomplete and ineffective if no effort is made to reach out to the potential customers. While designing the communication policy, a retailer must take care of four strategic dimensions: reach, frequency, content and personalization. Reach refers to the number of people who see an advertisement at least once. Frequency is the average number of times that a customer sees the advertisement. Content refers to the image the retailer wishes to project. Personalization is the ability to provide customized communication to customers through direct mailers or telephone using customer database.

## ACHIEVING STRATEGIC POSITIONING

After examining the factors that help build competitive advantage, we need to understand the concept of strategic positioning. The supporting dimensions mentioned earlier (i.e., operations, purchasing/logistics, market research, financing and technology) help the retailer in strategic positioning. Let us consider each of these factors separately and evaluate/analyze how each of them lend strategic advantage to the firm.

### Operations

The day-to-day functions in a retail outlet (staffing, maintenance and general management) should be carried out efficiently. The appearance of the stores should be appealing and the store personnel should provide good service, which is consistent with the strategy and image of the store.

### Purchasing/Logistics

Retailers today are trying to exploit the purchasing and logistics distribution channels in order to gain competitive advantage. The image of a store primarily depends on the kind of merchandise and the availability of stock. Thus, it is essential for retailer to stock the right kind of merchandise that the consumers would seek and buy.

The decisions regarding logistics also play a significant role in helping the retailer achieve competitive advantage. One such logistics decision is cross docking[2]. Cross docking not only helps retailers to reduce their inventory and logistics costs but also enables them to reduce the lead times, thereby gaining a competitive advantage. Better control over the retailer’s distribution channels helps the retailer reduce the cost and provide better service to its customers.

### Market Research

It is important for a retailer to have a good understanding of the customers’ expectations, needs, wants and behavior. The merchandise in the store should reflect the customer's choice and not the retailer’s interests and assumptions. To understand the customer, the retailer should conduct market research programs from time to time. The changing preferences and trends in the market can thus be tracked and analyzed and used to the advantage of the business.

### Financing

The importance of financial planning is often underestimated by many retailers. Short-term debt financing often causes problems to the small retailers when it comes due. The retailers should give due consideration to the return on debt and equity. By planning the finances of the firm properly, retailers can have enough capital for financing various store operations.

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[2] The distribution system wherein the merchandise is pre-packed by vendor in the quantity required by the store, thus requiring limited or no interim storage. Cross docking is explained in greater detail in chapter 17.

## Technology

In small retail stores, technology plays a supporting role but for large retailers with multiple stores, technology plays a very important role. In fact, the use of technology is now considered a strategic decision. Technology enables smoother and hassle-free communication between the store managers and the top management. Technology provides vast amounts of information to all people concerned, which can be used to manage the store more efficiently. For example, efficient use of such information by store managers can help reduce inventory costs.

## NATURE OF STRATEGIC PLANNING

Strategic retail planning is the process by which a retailer plans the future actions of a firm by anticipating the environmental changes and business patterns. It helps the retailer to anticipate the opportunities and threats that the retail firm may encounter and take suitable and timely action. Strategic planning is futuristic in nature and tends to prepare the firm for future challenges.

Window-driven planning is a strategic initiative that involves predicting the customer's demands, tastes and preferences so that the merchandise can be made available in the stores right in time i.e., before the customers move away to the competitors' stores or before their preferences change again. This helps the retailers gain maximum advantage from the fads prevailing at a particular point of time. Depending on the nature of the opportunity (window), the retailers can choose whether or not to respond to it. Retailers generally respond to those opportunities that are either expected to last for a long period of time or those that are small but attract large number of customers. Time plays a crucial role in window-driven planning. It is essential for the retailer to identify opportunities in time. If he fails to do so, he loses competitive advantage. However, before taking up new business opportunities, it is important to analyze the situation well.

Strategic planning requires a coordinated approach and therefore all departments of the retail organization should be well coordinated. Horizontal information sharing[3] should be encouraged. This would ensure that each group would have an understanding of what the rest of the organization is doing or is planning to do. Vertical information sharing[4] is also essential as it generates interest in all employees of the store. It can help reduce inconsistencies between lower-level planning and upper-level planning.

Strategic planning is generally done annually. However, with increasing competition, there is growing need to take up strategic planning more frequently. Moreover, due to the changes in customers' buying patterns, economy and business dynamics, the retailer may need to re-plan its strategies. However, irrespective of the frequency of planning, strategic plans should be comprehensive and realistic.

Some retailing strategies adopted by retailers are: immediacy merchandising, which involves lowering the prices of products to facilitate fast movement of merchandise and relationship retailing, in which the retailer tries to attract and retain its customers by building a long-term relationship with them by special promotional offers, discounts, etc.

[3] Information sharing among all the departments and store groups.

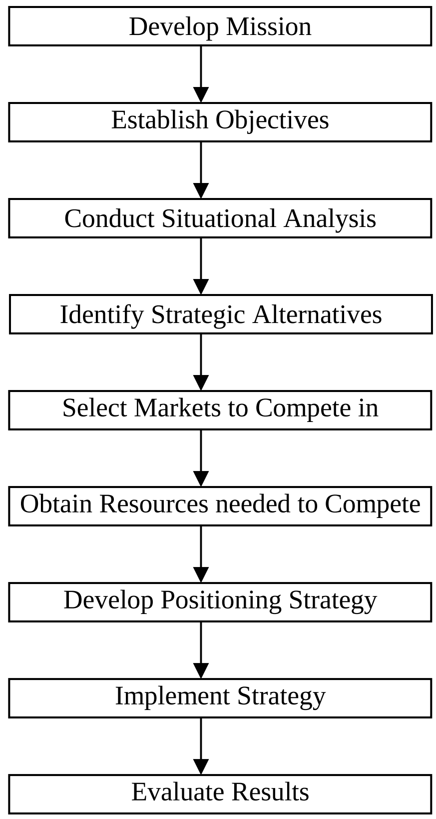
[4] In vertical information sharing, the top management takes inputs from the employees who are in direct contact with customers like salespersons.

## RETAIL STRATEGIC PLANNING PROCESS

The success of a retail strategy depends as much on its actual implementation as it does on how well it is designed to meet the needs of the customers. In order to sustain and grow in the highly competitive market, retailers should plan their retailing strategies carefully.

The various stages of the planning process are depicted in Figure 4.2. A detailed study of these stages has been provided below:

**Figure 4.2: Retail Strategic Planning Process**




*Source: Icfai Center for Management Research.*

### Developing the Mission

The mission of a retail firm reflects the basic purpose of its existence. A carefully developed mission statement includes such details as the products and services to be offered, scope of business, target customers, growth plans, the kind of customer service to be provided, and the attributes for competitive advantage. There is often a more detailed mission statement provided to the employees of the retail firm than the one that is publicized outside the firm. The mission statement distinguishes the retail firm from others, reflects the values that the firm believes in and provides a sense of direction to the retail personnel.

The mission statement reflects the philosophy of the top management and also guides the corporate culture. The stakeholders can gain an understanding of the firm’s philosophy by looking at its mission statement. For example, McDonald’s mission statement, “Quality, Service, Convenience and Value,” emphasizes on delivering value to its customers by providing quality service and convenience. McDonald’s makes sure that every employee understands the spirit of the statement right from the day he/she joins the organization.

The mission statement of a firm is the basic foundation of the whole planning process and hence, should be precise and reflective of the firm's attitudes and philosophy. Moreover, the plans in the subsequent planning stages should be consistent with the mission statement.

## Establishing Objectives

After the basic purpose of existence of the retail firm is known, retailers decide the objectives of the firm. The objectives are the formal statements of what the firms seek to achieve in terms of sales volume, profitability, market share, quality levels, etc. Although profit is the prime objective for the existence of the firms, some firms incorporate social objectives as well. This helps them establish a good image in the community.

Objectives are set for the short-term as well as the long-term. Short-term objectives are generally set for short periods (one to two years) while the long-term objectives are set for longer periods of time. The long-term objectives are not as specific as the short-term ones, but they include the strategic dimensions of the retail firm. In retailing, the long-term objectives do not stretch beyond five years owing to the highly fluid market dynamics.

Objectives should be time-specific, measurable, attainable and indicative of the business priorities. If the objectives are specific and measurable, they motivate the employees to perform better. Similarly, objectives that are not attainable discourage/ frustrate the employees. However, objectives would not serve their purpose unless they are reviewed and evaluated periodically.

## Situational Analysis

Before implementing a strategy, a retailer should have a clear understanding of the internal and external environments. So, the retailer should conduct a thorough analysis of the strengths and weaknesses of the firm and also assess the opportunities and threats in the environment. The assessment of the internal and external environments is known as ‘situational analysis’ or ‘SWOT analysis’. It helps the firm make maximum use of the existing assets of the firm and take adequate measures to correct the weaknesses.

The supply of timely and accurate information has enabled the retail firms to take more efficient and appropriate decisions. The information about the external environment and the analysis of upcoming trends by experts round the globe are very useful for the retailer.

### Strengths and weaknesses

Strengths and weaknesses are internal to the firm and can be largely controlled by the management. The financial resources, physical assets, management skills, sales force, merchandise, employees' attitude toward the company, etc. are examined to identify the strengths and weaknesses of the firm. While strengths can be optimally utilized to achieve the firm’s objectives, strategies can be developed to overcome weaknesses by employing an external consultant with an expertise in weak area or by training the store personnel or by studying similar cases in other firms.

The retailer can also make use of the information collected from employee surveys, customer complaints, accounting reports, focus groups, customer surveys, supplier surveys, etc. to assess the strengths and weaknesses of the firm more thoroughly. It also offers a critical analysis of the various practices followed by the retailer like maintaining vendor relations, designing ad campaigns, kind of merchandise being offered and the HR practices being followed.

While assessing the strengths, the retailer pays maximum attention to the financial performance of the firm. The financial aspects of the firm like the costs incurred, profits, sales, assets, liabilities and net worth are regularly and completely monitored by the retail managers. Most firms limit their internal assessment to the analysis of the financial statements and reports and do not pay heed to other functional areas of marketing, purchasing & logistics, human resources. However, this should be avoided.

A major strength for a retailer could be the operational efficiency it has achieved over time. Operational efficiency is the ability of the firm to cut costs as the volume increases. The efficiency achieved due to high volumes that a firm churns is referred to as 'scale economies'. As the retailer gains experience in retailing, it becomes more efficient in all its operations - be it purchasing, handling or selling. Operational efficiency is certainly a factor that gives the retailer an advantage over its competitors due to the lower operating expenses it incurs. Such retailers (like Wal-Mart) often pass on a part of these savings in operating expenses to their customers, thereby attracting more customers.

The relationship with suppliers is a factor that should be given due consideration while assessing the firm's strengths and weaknesses. Due to the improvements in technology, suppliers today have greater access to information regarding the retailers. Hence, while assessing the strengths and weaknesses of the firm, their opinions should be given due consideration. Similarly, it is important to consider the customers' perceptions of the firm's strengths and weaknesses.

### Opportunities and threats

Opportunities and threats are the factors external to the firm over which the retailer has little or no control. A firm is a part of a much bigger sphere i.e., the business environment, the social environment, the natural environment, economic environment and the political environment. Hence, the firm needs to keep track of the external environmental constraints and responsibilities before taking any internal business decisions. The knowledge of existing rules and regulations and upcoming trends in the legal, economic, social, and technological areas can help the retailer determine favorable changes that could be grabbed as opportunities as well as unfavorable changes that could pose a threat and need to be kept under check.

### Economic conditions

The economic situation prevailing in the country determines the purchases that consumers make and the amount of money they are ready to spend. In times of economic downturn, it becomes difficult for a retailer to register any year on year sales growth. In such times, rather than attempting to induce the customers to spend more, the retailers should make efforts to gain a larger share of the market using innovative strategies. It can also do so by venturing into new markets. Weak and uncompetitive retailers are pushed out of business when the economic conditions are challenging. When economic conditions leave little or no chance for sales growth, it is referred to as ‘stagnant economy’.

However, some retailers not only manage to sustain their operations under economic pressure but also manage to grow. As customers tend to cut their purchases and the amounts spent during tough times, discount retailers take advantage of the situation and attract customers from specialty and high-priced retail stores, registering sales growth. Thus, even hard times provide opportunity for some retailers, though sometimes at the cost of other retailers.

### Technological developments

Technological innovations have had a tremendous impact on the way businesses are run. Tele marketing and e-marketing have made it possible for retailers to sell their merchandise to customers without even meeting them face to face. Technology has made transactions more simple and convenient. Credit cards have efficiently replaced cash transactions. Customers can transfer money from their account directly into the retailer's through 'Electronic Funds Transfer'.

Technology has enabled vendors and retailers to keep a track of their own as well as each other's inventory levels and schedule the selling/ manufacturing/distribution activities accordingly. By holding minimum inventory, both vendors and retailers can save on the cost incurred in maintaining a huge inventory and can utilize the funds for other purposes. Moreover, retailers can place their orders instantly and vendors can deliver them in a few days. Thus, the order fulfillment which once took weeks now takes only a few days.

Technological changes can also be observed in the way shopping is done. Using kiosks, customers can learn about the product features and the benefits that it offers. The advent of 'Smart Carts' has made shopping a pleasant experience. Smart carts are shopping carts equipped with technology which helps them track the contents added to the cart and total the amount of the purchases automatically with every element being added to the cart.

### Competitive environment

With globalization, there has been considerable increase in competition. The number of stores is constantly increasing while the sale per store is decreasing. Although retailers are trying to woo customers using all means, the sales have continued to decline. The retailer should be widely aware of the competitive environment and assess its competitors' moves on a regular basis. In Exhibit 4.2, the detailed process of assessing the competition is explained.

**Exhibit 4.2**

**Assessing Competition**

Assessing the competition forms a critical part of the strategic planning process. Knowing the competitors helps the retailers to position themselves and better gain competitive advantage. Retailers can gather information about their target customers online or through physical environment. Some of the basic questions that the retailers would need to answer are;

**Who are the consumers?**

While defining the target and secondary consumer segments the following attributes should be checked:

- Gender (male, female)
- Age segments (children, teenagers, young, old)
- Socio-economic level (low, lower middle, upper middle, high)
- Taste level (classic, classic update, contemporary, leading edge)
- Interests (sports, hobbies, cars, house they own)
- Geographic reach (neighborhood, town, city, state, country, global)

**What are the options?**

Once the retailer knows his target customers, he needs to consider the options available and select the best option on the basis of the following parameters:

- Product – National brands or private labels, exclusively or widely available, wide variety or deep assortment
- Pricing – Regular, clearance only, everyday low price, discount every day, lowest price guaranteed
- Positioning – Niche or dominant player in a category, discount, classic or contemporary
- Service Level- Service offered is self-serve, full-service or assisted self-serve. On the Web, service can be relatively full-service defined as multi-access (i.e., fax, phone, e-mail), 'live' service representatives round the clock and year or assisted self-serve via e-mail on week days and working hours

**Where to sell?**

A retailer needs to understand the customer expectations and choose the channels to reach its target customer

- Traditional Store(s) – street, mall, urban, secondary markets, shop/kiosk within a store, direct Marketing through catalogue, mailings, telephone, fax, e-mail
- Online – National, International

**Why should the consumer shop here?**

The retailer should be able to clearly define, the unique advantages that it provides to its customers over its competitors. Some of these have been listed below:

- Exclusive products
- Wide assortment in a specific category
- Lowest prices on national brands
- Satisfaction guarantee on purchases for a specific period (Ex: up to one year)
- Specialized information, tips and linkages that are useful for customers and encourage them to make return visits to the site
- High degree of convenience

**How to trace competitors?**

A retailer can conduct basic market research (i.e. track who its competitors are, what their strengths and weaknesses are, what kind of bargains they are offering to their customers, etc.) by employing any of the following methods;

- Listening to its current and potential customers, family and friends
- Taking vendors' opinions on the best retailers and best e-retailers for the same offerings as the retailers'
- Attending trade shows and sessions organized by other retailers and e-retailers
- Keeping itself updated with regard to fast growing product categories, changes in Internet industry etc. through articles in trade publications, magazines and retail web-sites
- Learning the changing lifestyles of customers and changes in their spending of disposable income so that the retailer can stock merchandise according to their reallocation of expenditure
- Surfing the Net for global competitors and successful strategies (through search engines)
- Touring the newest malls and unique stores in trendy neighborhoods

*Source: www.retailinteractive.ca*

## Identifying Strategic Alternatives

The result of situational analysis forms the basis on which the retailer evaluates the strategic alternatives. The four strategic alternatives that a retailer considers are: market penetration, market development, retail format development and diversification as shown in Figure 4.3. The retailer may also refine its existing strategies for productivity improvements.

**Figure 4.3: Major Strategic Alternatives**

| | | Market Segment | |
|---|---|---|---|
| | | Current | New |
| Retail Format | Current | Market Penetration | Market Development |
| | New | Retail format Development | Diversification |

### Market penetration

Market penetration helps the firm compete in the existing market segments with existing format by a strong market presence. Market penetration defers the firm's saturation point and builds on the existing strengths of the firm like thorough knowledge of the merchandise, huge databases about customers and their preferences. This strategy is adopted by retailers who intend to concentrate on the existing market segment and helps the retail firm increase its: number of customers, quantity purchased, and purchase frequency.

***Increasing the number of customers***

An increase in the number of customers results in more sales and increased profitability. The number of customers can be increased by opening new stores, making the existing stores more attractive, modifying the offerings of the existing stores by reviewing the merchandise, adding more brands, allocating more space to certain merchandise like apparel, etc. To increase the market penetration and maintain market share, retailers add more stores. The retailing mix variables can be used to attract the customers by:

- Offering the lowest prices in the existing market area
- Offering a wide variety of consumer goods from groceries to decorative items
- Providing better service and facilities to customers like parking facilities, convenient shopping hours and location, wide variety, systematic arrangement of merchandise, shopping carts, single-floor stores or direction signs for the different sections of merchandise at frequent locations.

*Increasing the quantity purchased*

Retailers try to create a retail atmosphere that lures consumers to buy more. They spend substantial amounts to create such an atmosphere. This is generally done by improving the layout of the stores. Some retailers have set up fast food joints and coffee parlors to increase the customers visiting the stores, thereby resulting in increased purchases.

Another approach to increase the quantity purchased is to adopt cross selling. In cross selling, salespersons from one department try to sell complementary products from the same or other departments, thus increasing the overall purchases in the store. For example, a customer who purchases a lipstick can be persuaded to buy the matching lip-liner.

### *Increasing purchase frequency*

Stocking a wide variety of merchandise in the stores all through the year creates an impression among the customers that they would easily get what they are looking for. For example, the wide variety of toys offered by Toys 'R' Us all through the year assures the customers that they would have a good choice of toys even when they come to exchange the toys later. Toys 'R' Us registers round the year sales for video games and toys in the low to medium price range. Furthermore, high impulse buys like hobby kits and die-cast toys ensure high customer traffic at the stores.

The purchase frequency can also be increased by offering discounts on selected products at particular times. The discounts lure the customers to purchase the product that is presently being offered even if they did not intend to buy the product earlier.

## Market development

Market development is a bold strategic shift that involves more capital and is more risky than market penetration. Market development strategy can be executed by reaching new market segments or by expanding the existing markets.

### *Reaching new market segments*

Retailers, especially food retailers try to tap new segments in existing markets by offering 'something more' to the existing merchandise/items. For instance, by adding low calorie, non-fried items to its menu, the food-chain retailer, McDonald’s has attracted the nutrition conscious customers to its outlets. Coffee chains offering sandwiches and other food items, fast food restaurants adding soups and doughnuts to their menu are good examples of strategies retailers adopt to broaden the existing product lines and attract new customer segments.

New market segments can also be targeted by opening up new outlets at non-traditional locations like hospitals and railway stations. The toy retailer, Toys ‘R’ Us has expanded its offerings by adding a ‘Baby Boutique’. The baby boutique sells high-end nursery items, thus reaching a new segment of expectant parents.

### *Market expansion*

Market expansion based on geographic spread is a strategy that has been successfully adopted by retailers for a long time. A store concept that succeeded at one place is generally expected to work at other places. Such a strategy is most often followed by franchise retailers. Retailers even go in for cross-border expansion when their home market gets saturated. For example, the Spanish retailer Zara, which, a decade ago had its operations only in Spain and a few stores in Portugal, now has stores all over the world. Retailers can also go for market expansion by catering to new markets. For example, a retailer could expand by introducing a low-priced merchandise in the same store. The market expansion can extend to establishing an online store. Many grocery retailers have realized the importance of an online presence for penetrating deeper into the existing markets, developing individual customer relationships and increasing the return on investment. The global expansion of Tesco.com is given as Exhibit.4.3.

**Exhibit.4.3**

**Tesco.com**

The UK based food retailer, Tesco has tasted success with its online grocery service, tesco.com. Tesco.com attained 1.5 percent penetration in its market area that amounted to a customer base of 300,000. In terms of volume, it translated into 72,000 orders a week with an average spending of $125 per order. The success of an online retailer depends on multi-channel business model. Tesco’s online store acquired good customer knowledge though its brick-and-mortar outlet. Moreover, the model of store-based picking and delivery minimized its capital investment.

Tesco.com now intends to enter the US market by partnering with a US food retailer and replicating its strategy there. Generally, pure online retailers have to invest significantly in distribution centers and put in lot of marketing effort to attract customers. To avoid such huge investments, Tesco is looking for an established food retailer so that it can leverage that retailer's the brick-and-mortar store's infrastructure investment and customer relationships in the existing markets.

*Source: http://www.retailsystems.com*

### Retail format development

Retail format development is done either by introducing a new retail format or by polishing/developing the retail format that is in existence presently. The retail format may be developed either to adapt to a particular geographic dynamics or because it is convenient to adopt. For instance, the limited menu offered by food retailers like McDonald’s outlets in big stores is a form of retail format development. The new format expansion plans of the coffee retailer, Qwiky’s (Chimayo Chains) is shown in the Exhibit 4.4.

**Exhibit 4.4**

**Chimayo’s Retail Formats**

In 1999, Chimayo Chains Pvt Ltd., the franchisee of Qwiky corporation, USA set up India’s first coffee pub in Chennai, a city in South India. Apart from the wide variety of coffee offered, Qwiky’s also serves sandwiches, snacks and desserts. T-shirts, cards, gifts, caps and toys are also sold at Qwiky’s. It plans to sell ready-to-drink coffee sachets in future. The company has recently set up a 'food service division' to reach out to all areas and market segments that its coffee chain cannot reach.

Qwiky’s has adopted multi-level growth format and is experimenting with various retail formats like shop-in-shop, co-location, co-branding and joint development. It is also developing new retail formats like mobile coffee kiosks and coffee carts.

Chimayo Chains launched ‘Aroma Gourmet’---- an automatic remote-controlled hot and cold gourmet coffee dispensing machine, which it intends to market to restaurant chains, department stores, music stores, ice-cream parlors, movie theater's etc. Qwiky’s already has tie-ups with brands like Hidesign (a leather goods manufacturer) and retailers like Wills LifeStyle (an Indian fashion store retail chain), Music World (an Indian music and home video retail chain) and Ebony (an Indian fashion and lifestyle retailer). It is planning to target corporates by offering total coffee solutions.

Qwiky’s has also entered into a national alliance with Bharat Petroleum Corporation Limited (BPCL), a major refiner and marketer of petroleum products in India, to set up its coffee kiosks at select BPCL outlets. For now, it has a limited presence with about 20 kiosks at various BPCL stations in major Indian cities like New Delhi and Mumbai.

With the competition in the retail coffee market intensifying, Qwiky’s is adopting the franchise route along with company-owned coffee pubs. Franchisee operated outlets are being started in New Delhi and some south Indian states.

*Source: http://www.magindia.com*

Another form of retail format development is to introduce new forms of selling like electronic or catalog retailing to improve the convenience to the customers or to attract new customers.

### Diversification

Diversification is an overall shift in focus. A retailer can enter into new markets with an entirely new retail format. The diversified retailer serves new customer groups by offering products or services that it had never offered before. For instance, Toys-R-Us entered the kids' apparel market with its Kids-R-Us chain. This is an example of diversification into a related area.

### Productivity improvement

By adopting this strategy, retailers aim to improve productivity. Firms generally go for productivity improvement strategy when they are in the mature or decline stages of the lifecycle. The main objective of firms in mature or decline stages will be to extract as much profits as possible from the existing formats and markets by refining their existing strategies (without making any further investments). For example, in areas where Wal-Mart reaches saturation, it closes down its smaller stores in surrounding towns and opens regional "Superstores" that offer groceries, auto repair, and other services. Retailers can increase the productivity by undertaking cost reduction, increasing merchandise turnover or prices and margins.

#### *Cost reductions*

When trying to achieve improvements in productivity through cost reductions, retailers try to implement self-service schemes so as to reduce the labor requirements. Some other ways for reducing costs are: reducing the store hours, making better use of the part-time helpers and cutting on customer services. The emergence of sophisticated technologies help retailers in cost reduction planning by providing information on individual contributions of each of the items in the merchandise towards the total profitability of the firm. The merchandise can thus, be planned according to the merchandise movements. This helps cut down inventory costs without compromising on the availability. Technological innovations also help cut costs. For example, using electronic data interchange with suppliers saves costs by eliminating the need for paper-based transactions.

#### *Increasing merchandise turnover*

Better merchandise mix results in increased merchandise turnover and increased turnover, in turn, results in improved productivity. The merchandise mix can best be improved by having access to real-time information from the point-of-sales terminals. The retailer, can thus ensure the right merchandise mix that not only helps in protecting its desired/established image but also improves the productivity through increased customer satisfaction. Some retailers encourage store managers to introduce certain items on a trial basis so that they gain an understanding of changing market demands. Another way to improve the merchandise mix is to broaden the mix. This is done by storing a broad variety of items in the merchandise.

#### *Increasing the prices and margins*

While formulating productivity-based strategies, retailers need to pay special attention to the aspects of prices and margins of the merchandise. The retailers cannot afford to raise the prices of all products it offers because doing so would compel the loyal customers to withdraw. But the retailer can select a few low-visibility items or items which are not purchased often and retain higher margins on those items. Or the retailer can simply add high-margin items to its merchandise like superstores do. Retailers can also charge certain sums for installations or deliveries on the basis of the total purchase amount.

## Selecting the target markets

After evaluating all the strategic alternatives, the retailer selects the one that promises maximum profit and offers the best scope for growth. Once this is done, the retailer would need to select the target market that it wants to cater to. The retailer should first segment the population and identify the target markets.

### Segmenting the market

A *market segment* refers to a group of customers whose needs will be satisfied by the same retail offering because they have similar needs and go through similar buying processes. Retailers define and determine each group of people who have some common attributes. These attributes could be demographic in nature i.e., based on age, income, occupation, etc. or based on psychographics i.e., the activities, interests, opinions, etc. Retailers basically use demographics for segmentation while they use psychographics to supplement the demographic segmentation.

While segmenting the markets, the retailer should ensure that the market segments are:

*Measurable:* The segments should be identifiable and quantifiable.

*Accessible:* The marketing efforts should be directed towards the selected segment and the marketing efforts should have a positive impact and produce the desired outcome.

*Economically Viable:* The chosen market segment should be big enough to be economically viable for the retail firm to focus its marketing efforts on them.

*Stable:* The selected attributes of segmentation should be reliable indicators of market potential.

While developing the market strategy, depending on the products offered, the retailers can perceive customers in one of the following ways:

*Similarity:* The retailers perceive that the consumers are all similar and that a standard product will satisfy the needs of most of the customers. Though age, needs, income, preferences etc. differ among various customers, the basic premise is that these attributes do not influence the purchases they make. For example, all the convenience stores primarily focus on providing convenience to the customers by offering a good merchandise mix, wide variety and good assortments. They assume that all customers look for convenience while shopping. They do not look into the differences in thinking that may exist in a few customers, for whom convenience may not be the primary concern.

*Differences-similarities:* The market demand is influenced by the differences and similarities in consumer preferences. Customers are grouped on the basis of these differences (or similarities) and then the aggregate of these groupings is used as the base by the retailers to focus on their target customers. For instance, young fashion-conscious women in mid-income group could be segmentation for an apparel retailer.

*Uniqueness:* Every customer is different from the other and this difference is what makes a customer unique as an individual. Hence a standard product cannot appeal to all the customers alike. However, customers with somewhat similar preferences can be included in one segment and retailers can make tailor-made offers for such groups.

### Target markets

Target markets are the market segments that the retailer wishes to serve. Market positioning of a retailer reflects the kind of image the retailer wants to establish among its target group and the group of retail firms with which it wishes to compete and coexist. When trying to build an image in target customers' minds, retailers should look into the attributes that constitute the image of stores. These attributes vary along the different age groups. Exhibit 4.5 shows the way the aging process affects the perception of customers' image of retail stores.

**Exhibit 4.5**

**Influence of Age on the Store Image**

The aging of customers will have an affect on their perception of the store's image.

With the passage of time (biological aging), the customers considerably change their perceptions about the image of the store. This is because the importance of the attributes (like bright lighting, large lettering) that they associate with a good store image changes with age.

The perception of store is also affected by sociological aging, which refers to the changing social relationships at different stages in an individual's life. The changing social status and changing roles of the consumer as an individual have influence on the manner in which he/she perceives the store.

Psychological aging also has an impact on the image of a store. The consumer's evaluation of a store's image depends on his/her personal experiences in early life (such as the interiors of the store that he/she visited earlier in life or the music played there). Such impressions could remain in the person's mind and have an influence on his perception of the store even as he grows.

The perception change in does not take place as rapidly as change in the retail environment. It changes rather slowly. As a result, the middle-aged and old consumers are generally less positive about the new and less familiar stores than younger customers. The older consumers rank store characteristics like service quality, helpfulness and overall store impression of newer retail stores lower than people in the younger age group.

Younger consumers welcome stores with contemporary formats. Therefore, to attract younger customers, retailers should redesign their stores to project a contemporary image. But, to retain older customers, they should try to maintain the kind of store environment that the older generation consumers are pre-disposed to.

Retailers should try to design their store environments such that the consumer's perception of the store image is enhanced. Creating such an environment involves considerable resources and so the retailers should consider the age-related behaviors of consumers while designing the store layout. Striking the right balance of different age target markets is a challenge for the retailer.

*Source: http://www.managementfirst.com/articles/grocery.htm*

### Target market selection

To finalize the target market, the retailer first takes the entire market into consideration. The size of the market as a whole and the different customer segments that it could serve or who would be interested in the retailer's offerings are short-listed. Then, the segments that the retailer could best appeal to and serve most effectively are chosen as the possible target markets.

These possible target markets are evaluated further to finalize the target markets. Evaluation is done on the basis of attributes like future growth potential. These are shown in the Table 4.1. Final target markets are thus selected based on the best match of these attributes with retailer's interests.

**Table 4.1: Market Attractiveness Evaluation**

| Factor | Weight (a) | POTENTIAL TARGET MARKETS | | | | | |
|---|---|---|---|---|---|---|---|
| | | **Young Professionals** | | **Teens** | | **Middle Age** | |
| | | Rating (b) | Score a × b | Rating (c) | Score a × c | Rating (d) | Score a × d |
| Future growth potential | 25 | 7 | 175 | 9 | 225 | 5 | 125 |
| Present style | 15 | 6 | 90 | 6 | 90 | 8 | 120 |
| Investment required | 5 | 7 | 35 | 7 | 35 | 6 | 30 |
| Strength of competition | 15 | 7 | 105 | 7 | 105 | 8 | 120 |
| Ability to meet the needs of market | 15 | 8 | 120 | 9 | 135 | 6 | 90 |
| Profit potential | 25 | 5 | 125 | 6 | 150 | 4 | 100 |
| Total Score | **100** | **650** | | **740** | | **585** | |
| Rating is on a scale of 1 to 10 where 1 is very unattractive and 10 very attractive | | | | | | | |

Each of the attributes is given certain weightage and each possible target market is rated against it. The product of these weights and ranks gives the total score for each possible target market. This score enables the retailer to evaluate the attractiveness of each target market objectively and select the final target market(s).

After finalizing the target market, the retailer focuses on developing strategies to draw customers by in-depth study of their behaviors, values, motives and expectations. The retailer also tries to understand the decision making process of the customers.

## Obtaining Resources Needed to Compete

The retailer can choose to enter the retail business either by starting a new firm, by acquiring an existing business, by entering into partnership with an operating firm, through a joint venture with a successful retail chain abroad or through franchising. The decisions regarding obtaining the resources depends on the way the retailer chooses to enter the retail business. If the retailer chooses to acquire an existing firm, it may not need to arrange physical resources, as they are already available. The retailer can thus focus his entire attention on acquiring financial and human resources. Financial and human resource planning should be in line with the firm's overall strategy. These have been explained in the subsequent chapters.

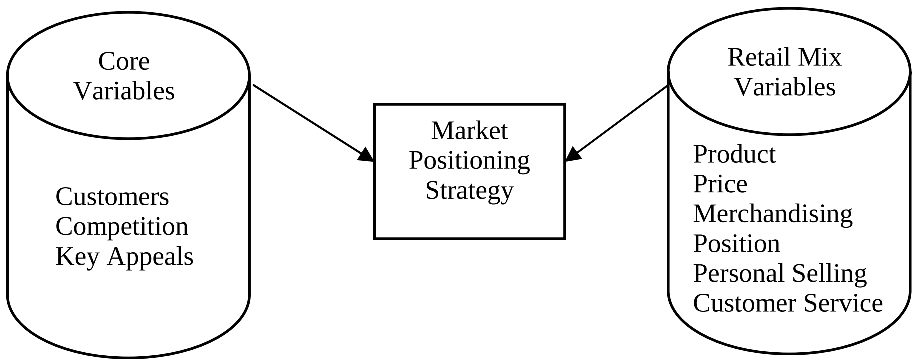
Once the necessary resources have been obtained, the firm needs to position itself in the market. Through positioning, the retailer tries to create a strong image of the firm in the minds of the target customers and thus invoke the kind of response that the retailer desires. Positioning should be such that the consumers should be able to clearly distinguish the retailer's stores from that of the competitors'.

## Developing a Positioning Strategy

In these days of intense competition and diminishing differentiation among various retail firms, the importance of positioning has increased. Retailers use 'Positioning Map' to understand the position of other firms in the market place. A positioning map is a two-variable map drawn on the basis of some selected attributes. For example, for apparel retailers the two attributes would be fashion vs. assortment, for departmental store they would be quality vs. price. The positioning map gives the retailer a clear picture of the relative positioning of the firm with regard to its competitors. Thus, retailer can decide whether to reformulate its positioning strategy or to improve the existing strategy. Repositioning can be done by broadening the assortments, re-pricing, etc.

The various variables that affect the market positioning of a retail firm are depicted in Figure 4.4. There are two types of variables: core variables and retail mix variables. Both sets of variables together form the positioning strategy for the retail firm. The retailer takes certain decisions with regard to the retail mix variables, some of which are:

**Figure 4.4: Market Positioning Strategy**




*Source: Icfai Center for Management Research.*

*Product:* Decisions relating to the width, depth and assortments, brands (company brands or store brands or generic brands), selection of suppliers, choice of inventory levels

*Price:* Decisions regarding the store’s pricing policy in relation to market prices, price adjustments, price levels

*Merchandising:* Decisions regarding the store design and layout, presentation of the merchandise

*Promotion:* Decisions concerned with the allotment of budget for advertising, sales promotions, public relations

*Personal Selling:* Decisions on the number of salespersons employed, training, compensation

*Customer Service:* Decisions of the services to be offered, return and exchange policy, credit policy

## Strategy Implementation

The efforts undertaken by the retailer in thinking, researching and planning can be futile if the strategy is not implemented properly. The implementation process involves developing action plans and assigning the ownership, establishing critical paths and linking the action plans to operating plans. The main objective of all these strategies is to create value for customers.

The practices of the firm should be customer-oriented. The merchandise sold should be attractive and advertising and promotions should appeal to them. Salespersons and other stores personnel should be knowledgeable and friendly.

## Evaluating Results and Controlling Operations

The effectiveness of a strategy can be known only by measuring the performance of the implemented strategy. Once the plan is implemented, it is essential to monitor the various activities to determine how effective the plan has been. If the objectives are not achieved as targeted, a re-analysis needs to be done either by revamping the strategy (if the problem is found to be with improper planning) or by re-implementing the plan (if the implementation was not carried out properly).

Periodic evaluation of the strategies implemented will help the retailer in understanding their suitability in the changing market situations so that it can revamp its strategies at an early phase. The overall aspects of the plan i.e., the merchandising plan, financial plan, pricing plan, distribution and sales support plan, human resources plan should all be considered while evaluating the firm's strategy. The merchandising plan, financial plan, pricing plan, advertising and promotional plan, information systems plan, distribution plan, human resources plan should all be reviewed. Such an overall evaluation guarantees that the changes in individual plan that are made periodically do not disrupt the overall strategy of the retail firm. It also helps the retailer plan the individual variables in a way that would strengthen the overall competitive strategy.

## SUMMARY

The importance of formulating a retail strategy is understood by all small and big retailers. To build a competitive advantage that can be sustained, retailers need to pay special attention to aspects like price, location, merchandise, service and communications. Operations, purchasing/ logistics, market research, financing and technology, which determine the strategic positioning of the firm are also equally important. In this chapter, we discussed how each of these factors affects the firm's image. To utilize the limited human, financial and physical resources optimally, retailers should have a well-planned strategy. Thus retailers should follow a systematic step-by-step planning process for formulating and implementing the strategy. All the efforts of retailers are directed at the customers. So they should take every care to ensure that the customer gets the right impression and image of the stores. Periodic reviews and evaluations will help the retailer to take corrective actions either by re-planning the strategy or by implementing it more effectively.

# Chapter 5

# Financial Strategy

**In this chapter we will discuss:**

- Strategic Profit Model-An Overview
- Income Statement
- Balance Sheet
- Strategic Profit Model
- Setting Performance Objectives
- Performance Measures

## INTRODUCTION

The income statements and balance sheets of all retailers contain information regarding the performance of their stores. However, only a few retailers take the time to understand and analyze these financial figures to measure the performance of their retail stores. Retailers who do take the time to study these figures are able to develop business models and generate more profits than other retailers who operate in similar environment. This is because these retailers focus their resources on areas which are most important for profit generation. By so doing, they earn a higher return on investment.

Retailers use various financial ratios like gross margin, net profit margin, asset turnover, and financial leverage to measure the performance of their stores. The strategic profit model, a comprehensive framework based on all these ratios, can be used to understand the ability of various financial strategies to achieve a retailer's profit objectives.

In this chapter we will examine the strategic profit model and two important financial documents, the income statement and the balance sheet. We will then discuss how a retailer can measure the performance of his store using the strategic profit model. The performance objectives of retailers and the various performance measures used by them will also be discussed.

## STRATEGIC PROFIT MODEL – AN OVERVIEW

Generally, most businesses operate on the premise that they need to get a good return on investment. The retailing business is no exception. Though retailers adopt different strategies, they pursue same financial goal, i.e., earning a good return on investment. The strategic profit model (SPM) is a tool for planning and evaluating the financial performance of retailers. It combines information from the income statement and balance sheet into a single, comprehensive framework. The strategic profit model establishes a mathematical relationship among net profit margin, asset turnover, and financial leverage. By so doing, it arrives at two important performance measures for return on investment- return on assets and return on net worth. This model regards return on net worth as an important indicator of the performance of a firm. Return on net worth measures how much income was generated on the investment made by the owners of a firm. It thus shows how much value a company has created for its shareholders.

The performance ratios required to calculate the return on net worth are net profit margin, asset turnover, return on assets, and financial leverage. Exhibit 5.1 shows different components of the model.

Return on Net Worth (RONW) can be calculated as follows:

RONW = Net Profit Margin x Asset Turnover x Financial Leverage

= Return on Assets x Financial Leverage

(Return on Assets = Net Profit Margin x Asset Turnover)

Figure 5.1 gives a graphic representation of SPM. The various performance ratios shown in the strategic profit model can be calculated from the financial documents (income statement and balance sheet) prepared by retailers. While the profit margin can be derived from data provided by the income statement, asset turnover and financial leverage can be derived from data provided by the balance sheet.

**Exhibit 5.1**

**Different Components of Strategic Profit Model**

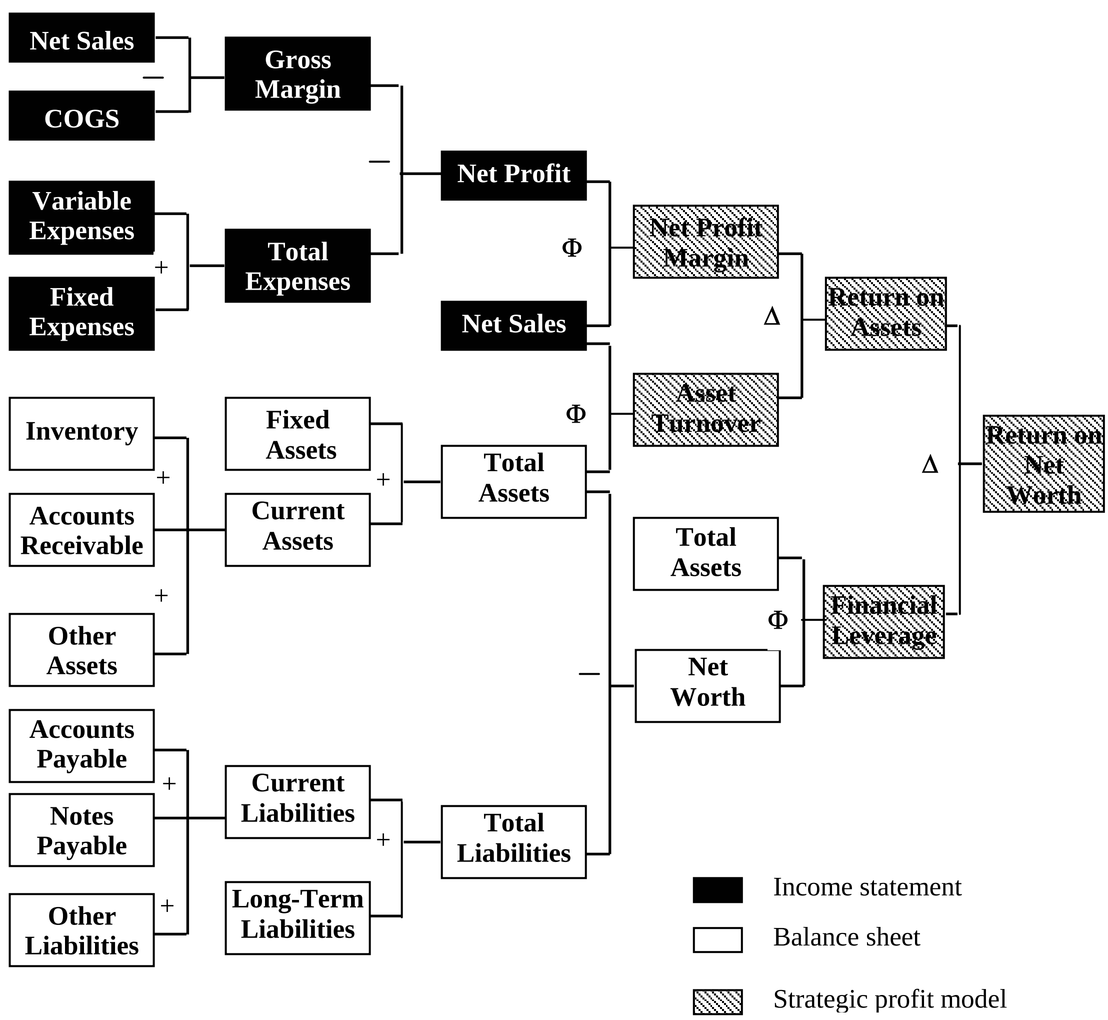
Net Profit Margin = Net Profit / Net Sales

Asset Turnover = Net Sales / Total Assets

Return on Assets (ROA) = Net Profit / Total Assets

Financial Leverage = Total Assets / Net Worth

**Figure 5.1: Understanding the Strategic Profit Model**




## INCOME STATEMENT

The income statement is one of the important financial statements prepared by retailers to keep track of the performance of their retail stores. It summarizes the financial performance of a company for a given accounting period (usually one year).

The statement shows how much revenue the company earned through its operations, and the expenses associated with bringing in that revenue. The difference between the revenue and the expenses gives the profit earned by the company. Thus, the statement shows how profitable the organization is. The income statements can also be broken down by division, by department, by branch, and by geographic segment thus giving the retailer detailed information on the performance of each micro unit of the firm. The data can be compared with industry benchmarks to give the retailer an idea of the firm's position with reference to its competitors. Table 5.1 shows the income statement of a hypothetical store ABC Ltd.

**Table 5.1: Income Statement of ABC Ltd. (Rs in '000s)**

| | |
|---|---|
| Net Sales | 578,269 |
| *Less: Cost of Goods Sold* | 350,421 |
| Gross Margin | 227,848 |
| *Less: Operating Expenses* | 141,544 |
| *Less: Interest Expenses* | 6,423 |
| Total Expenses | 147,967 |
| Net Profit Before Taxes | 79,881 |
| *Less: Taxes* | 31,438 |
| Net Profit After Taxes | 48,443 |

Thus ABC Ltd's gross margin% = = $\frac{227,848}{578,269}$ 39.4%

## Sales

The total revenue received from the sale of merchandise is known as gross sales. Net sales are arrived at by subtracting the returns and allowances from the total revenue received. The term returns refers to the value of the merchandise that has been returned by customers (Goods are returned either because they are defective or because they did not satisfy the customer). The term allowances refer to the additional discounts and price reductions that are given to customers by the retailer.

Thus,

Net Sales = Revenue received – Returns – Allowances.

Sales are an important indicator of the performance of a firm. Sales figures, which all retailers strive to increase, show how active a firm is in the marketplace. If sales are higher than those achieved in the previous year, the firm is on growth path. If sales are less than those achieved in the previous year, the firm is in trouble. To stem the decline in sales the retailer must take corrective measures or change its present strategy.

## Cost of Goods Sold

The cost of goods sold includes the direct cost associated with manufacturing/procuring the merchandise for the store. These costs include transportation costs and costs which are directly related to producing or purchasing the goods. Simply put, it is the price paid by the retailer to produce or acquire goods for sale.

## Gross Margins

The gross margin refers to the difference between net sales and the cost of goods sold. It is also expressed as a percentage of net sales.

Gross Margin = Net sales – Cost of Goods Sold

Gross Margin % = Gross Margin/Net Sales

The gross margin indicates the profitability of a company. It shows how much money is available for providing a profit and covering the retailer’s expenses. Thus, a high gross margin indicates high revenues and the financial ability to improve the business operations (like marketing, new product development). Retailers can use gross margins to compare the performance of two product lines or stores. A higher gross margin also implies that the store is efficient in procuring and selling merchandise.

## Expenses

There are two major type of expenses, interest and operating expenses. Interest expenses refer to interest payments that have to be paid periodically for financing provided by lenders like banks. Operating expenses refer to expenses incurred by stores for their day-to-day operations.

There are three main categories of operating expenses: selling expenses, general expenses, and administrative expenses.

Selling Expenses include salaries of sales staff, commissions etc.

General Expenses include rent, utilities, and other miscellaneous expenses.

Administrative expenses include salaries of staff other than salespeople and expenses like office supplies, postage etc.

Usually expenses of department stores are higher than those of discount stores and warehouse clubs. This is because department stores are located in prime areas where rent and other expenses are high. In addition, to provide a high level of customer service, department stores incur expenses for retaining experienced sales persons and maintaining a good store ambiance. The expenses of discount stores are lower because they are located in less expensive areas, and they offer minimal customer service.

## Net Profit

The term net profit is more popularly known as “bottomline” in business circles. It is derived by subtracting the cost of goods sold and expenses from net sales. Net profit can be either expressed as before taxes or after taxes.

Some analysts are of the opinion that profit before taxes should be considered for decision making as taxes are not in the control of the retailer. But generally, profit after taxes is considered for decision making as that is the amount which a retailer is left with for distribution to shareholders, for reinvestment in the company or to repay the debt.

Net profit = net sales – cost of goods sold – expenses

The net profit margin is expressed as a percentage of net sales:

Net profit margin % = Net profit/Net sales

Net profit margin% of ABC Ltd. is = = $\frac{48,443}{578,269}$ 8.38% ---eqn 5.1

A company must make a profit to survive and compete in the marketplace. The net profit is one of the key indicators of a company’s financial performance. If a company shows low profits or losses, either the company's costs are exceeding its revenues or it is not achieving an adequate volume of sales. Thus net profit acts as a yard stick for gauging the performance of the company. The net profit margin is one of the components of SPM.

## BALANCE SHEET

While the income statement provides the results (revenue and expenditure) of a store’s business operations for a particular period of time, the balance sheet indicates the financial status of the store at a particular point in time (usually at the end of the year). The balance sheet consists of three components: assets, liabilities and owner's equity (net worth). The balance sheet is based on a simple concept, i.e., in order to acquire assets, a firm (retailer) must pay for them with either debt (liabilities) or with the owners' capital (shareholders' equity). Thus, in a balance sheet, assets should balance with the liabilities and owner's equity:

Assets = Liabilities + Owner’s equity

Assets are the items owned by the firm (retailer) that have an economic value and are expected to produce some economic benefit to the firm. Assets include land and buildings, equipment, inventory, cash, patents, and accounts receivables. Liabilities are the obligations that the firm owes to outside parties. Liabilities include bank loans, debts to suppliers, and debts to employees. Owner’s equity is the difference between the assets and liabilities. It generally includes the amount of capital the owners invested plus the profits that have been reinvested in the firm.

Lets examine the elements that constitute the assets, liabilities, and owner’s equity. Table 5.2 provides the balance sheet of ABC Ltd.

### Assets

Assets represent the resources available to the firm that can be used for generating revenue and also everything owned by the firm that has value. Assets can be divided into two types on the basis of their level of liquidity. Current assets refer to those assets, which can be converted into cash within a short period of time; fixed assets are those assets, which cannot be converted into cash within a short period of time. For retailers, current assets determine the survival of the firm. In retail business current assets form a major portion of the total assets, while fixed assets like buildings and fixtures constitute a minor portion of the total assets.

**Table 5.2 Balance Sheet of ABC Ltd.(Rs in '000s)**

| | |
|---|---|
| **ASSETS** | |
| **Current Assets** | |
| Cash | 232 |
| Marketable securities | 147,566 |
| Accounts receivable | 3,523 |
| Inventories | 66,528 |
| Others | 5,270 |
| **Total Current Assets** | **223,119** |
| Total fixed assets less depreciation | 129,039 |
| **Total Assets** | **352,158** |
| **LIABILITIES** | |
| **Current liabilities** | |
| Accounts Payable | 15,244 |
| Accrued expenses: | |
| Payroll and payroll related | 2,771 |
| Worker's compensation | 5,534 |
| Due to shareholders | 1,655 |
| Others | 3,613 |
| **Total Current Liabilities** | **28,817** |
| **Long term liabilities** | **3,698** |
| **Total Liabilities** | **32,515** |
| **Owner’s Equity** | |
| Common stock | 156,154 |
| Retained earnings | 163,489 |
| **Total Owner's Equity** | **319,643** |
| **Total Liabilities and Owner's Equity** | **352,158** |

### Current assets

In retailing, current assets are calculated as follows:

Current assets = Accounts receivables + Merchandise inventory + cash + other current assets

### Accounts receivables

Accounts receivables refer to the amount that is due from customers. Receivables arise because the company sells goods to customers on credit (apart from cash sales). If a company insists on cash sales only, it may lose customers to competitors who offer credit sales. Thus, from the marketing and customer service point of view, it is important to provide credit sales. But having a large amount of accounts receivables is also not advisable since the proceeds of the sales are blocked in these receivables and this affects the retailer's ability to invest in other productive activities.

Some retailers, e.g. Sears and JC Penney, offer credit to their customers through their own credit card system. These stores charge the customer lower interest rates for providing credit. Such a credit card system has its advantages: It ensures the loyalty of the customers towards the stores and earns interest income for the retailer (the retailer charges interest for giving credit).

If not managed properly the receivables can strain the financial position of the retailer. Cash, which is a scarce resource, is being locked up in the receivables, thus decreasing investment opportunities. Moreover there is a high risk of receivables becoming bad or unrecoverable. Stores should take preventive measures to reduce the financial burden arising due to receivables. One such measure is factoring. Factoring, also known as "cash for receivables," is the conversion of accounts receivables into immediate cash by the outright purchase of its receivables at a discount by financial services companies called factors. Factoring enables retailers to receive cash for the value of accounts receivables within a short period of time. The factor will assume the responsibility of recovery of the receivables. Thus not only will retailers be relieved of the collection of the receivables, they will also not have to deal with the risk of the receivables becoming bad. Another option for dealing with the receivables is to accept third party credit cards like Visa Card and MasterCard. By accepting such cards, retailers are completely relieved of the process of offering credit from their own resources. Retailer should also encourage cash sales through discounts on cash purchases.

### Merchandise inventory

This is the most important asset from a retailer's point of view. It constitutes the major part of the total assets of any retailer. For ABC Ltd., it constitutes nearly 20% of its total assets.

$$\text{Inventory to Assets ratio} = \frac{\text{Inventory}}{\text{Total Assets}}$$

$$\text{For ABC Ltd., Inventory to Assets ratio} = \frac{66{,}528}{352{,}158} = 18.8\%$$

### Inventory turnover

Inventory turnover refers to the ratio of net sales to average inventory.

$$\text{Inventory Turnover} = \frac{\text{Net sales}}{\text{Average Inventory}}$$

$$\text{[Where Average Inventory} = \frac{\text{Inventory}}{\text{(1-Gross Margin)}}$$

For ABC Ltd. Average Inventory = 66,528 ÷ 0.61 = 109,062]

For ABC Ltd., Inventory Turnover = $= \dfrac{578{,}269}{109{,}062}$ 5.3 ---eqn 5.2

The inventory turnover indicates the speed at which the inventory is moving out of the stores. It is used to evaluate the efficiency of an organization in managing its investment in inventory. The inventory cycle usually consists of ordering of inventory, stacking in the store, and selling to customers. The inventory turnover refers to the number of times (on an average) inventory sold in a year. If the inventory turnover is 6, it indicates that, on an average, the retailer turns over or sells his inventory every two months. For ABC Ltd., the inventory turnover is 5.3, implying that inventory is sold every two and half months (approx.). Discount stores and wholesale clubs have a higher inventory turnover than department stores. This is because wholesale clubs stock the most common commodities (like groceries) at competitive prices. Such commodities sell quickly and lead to high inventory turnover. In addition the product mix is limited in wholesale clubs, thus leading to lower inventory. Department stores carry all types of goods, including specialty goods, which slow down inventory turnover. To cater to a wide range of customers, department stores have a wide product mix which makes it difficult for the retailer to have proper inventory control.

### Cash and other current assets

*Cash* includes money in hand, marketable securities like treasury bills, and money in bank accounts to which the retailer has ready access.

*Other Current Assets* consist of prepaid expenses and other miscellaneous assets. Prepaid expenses refer to expenses paid in cash and recorded as assets before they are used or consumed, e.g., insurance. The insurance premium is paid prior to the receipt of the benefit. Prepaid rent is also an example of a prepaid expense.

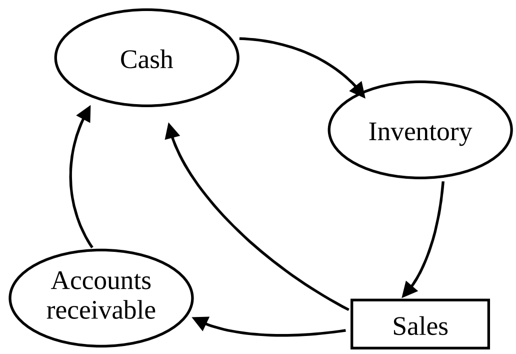
### Operating cycle

Cash invested in retail businesses takes various current asset forms (inventory, accounts receivables) before it is converted into liquid cash (which includes profits). This cycle of cash-inventory-sales-accounts receivables-cash is known as the operating cycle or the current asset cycle. Fig 5.2 depicts the relationship between various current assets in an operating cycle. Retailing businesses aim at making profits by selling goods and services. In this process, retailers invest cash for procuring various goods, which would be later sold to customers for cash or on credit. Cash received from the sales along with the cash that was collected from accounts receivables will be used to purchase the inventory. The profitability of the retailer depends on the productivity of various current assets (i.e. inventory, accounts receivables, and cash) and the number of times cash is rotated in the operating cycle. Inventory is a key asset for retailers. The inventory should be maintained at an optimal level to minimize the possibility of excess inventory or no stock. While accounts receivables are necessary for retailers from the marketing and customer service point of view, steps should be taken to minimize the risk of receivables becoming bad through factoring, use of third party credit cards, etc.

### Fixed Assets

Fixed assets represent those assets, which require more than one year to be converted into cash. They include buildings, furniture and fixtures, equipment, land etc. Fixed assets will have a limited useful life. Over the years the value of these assets depreciate or reduce. This reduction is factored as depreciation while assessing the value of fixed assets.

**Figure 5.2: Relationship between Current Assets in an Operating Cycle**




*Source: ICFAI Center for Management Research*

When assessing the value of a fixed asset, its cost is spread over the useful life of the asset. The value of the fixed asset is arrived at by subtracting the depreciation from the cost of the asset. [Buildings will have useful life of 25 years whereas fixtures and equipment will have a useful life between 2 to 5 years.]

### Asset Turnover

Asset turnover refers to the ratio of net sales to total assets.

$$\text{Asset Turnover} = \frac{\text{Net sales}}{\text{Total Assets}}$$

$$\text{For ABC Ltd. Asset turnover} = \frac{578{,}269}{352{,}158} \quad 1.64 \text{ ---eqn 5.3}$$

This ratio measures how effectively managers use their assets. If the asset turnover is high, the retailer is using assets efficiently. Though retailers attach more importance to current assets than fixed assets, they should not overlook the role of investment in fixed assets. When deciding to invest in any fixed assets, they should evaluate how much sales can be generated from the proposed investment. For example, if a retailer wants to set up new fixtures in a store, he must examine how much increase in sales can be achieved through the proposed investment.

## Liabilities and Owner's Equity

Liabilities refer to items that a company owes to creditors and suppliers. On the balance sheet, liabilities are generally broken down into current liabilities and long-term liabilities. Owner's equity, however, includes the amount of capital the owners invested plus any profits that the retail firm reinvested in the firm. Let us now examine each component of liabilities and owner's equity.

### Current Liabilities

Current liabilities refer to debts that need to be paid within one year. Non-payment of these liabilities may lead to insolvency of the retailer. Some of the common current liabilities of a retailer are accounts payables, notes payable, and accrued expenses.

### Accounts payables

The amount owed to vendors or suppliers of merchandise is referred to as accounts payables. Vendors offer goods to retailers on a credit basis. Retailers take advantage of such offers so as to control costs. Vendors give credit for a period of time, depending on their relationship with the retailer, the financial status of the firm, the value of the consignment, and the credit history of the retailer. By using bargaining skills and developing an understanding of the market, a retailer can get goods at best terms. Since credit is generally interest free for the period the credit is given, it is cheaper than the short term loans that are provided by financial institutions. If utilized properly, the retailer can save a substantial amount in the form of interest savings. Thus accounts payable is one of the important forms of short-term financing.

### Notes payable

The current liabilities which a company owes to financial institutions are referred to as notes payable. It includes the principal and interest payable to lenders like banks within one year.

### Accrued expenses

Accrued expenses occur when expenses are recognized before cash is paid. Accrual accounting requires expenses incurred during a period to be recorded in that period even if the cash is paid later. Assume that a company advertised during December 2002 but has not received a bill or paid for the advertisement, which cost Rs.50,000. The advertising costs incurred during the year 2002 must be recorded as an expense for that year, even if the payment is made in a later period. Hence, an advertising expense of Rs 50,000 is accrued on December 31, 2002. Since a payment of Rs. 50,000 must be made in the future, a liability is recognized for this amount.

### Long term Liabilities

Long term liabilities refer to obligations that will be paid after one year. They include bonds, mortgages on real estates, and long term loans.

### Owner's Equity

Owner's equity represents the share of the owner's investment in the business. In accounting framework it is given by

Owner's equity = Total Assets – Total Liabilities

Two common elements of owner's equity are

- Common Stock
- Retained Earnings

### Common stock

This type of stock is issued by most corporations. Owners of common stock have certain benefits and rights. They have the right to vote to elect the members of the board of directors and they are entitled to a share in the profits of the company in the form of dividends.

### Retained earnings

Retained earnings are a part of profits that are not paid as dividends to shareholders but are retained to reinvest in the business. The percentage of earnings that should be retained and the percentage that should be distributed to shareholders depend on the growth potential of the company. If the firm has opportunities for growth, a major portion of the earnings should be reinvested to earn high returns for the share holders. If opportunities are few or nil, it would be prudent to distribute the earnings as dividends among the shareholders.

### Financial leverage

One of the important ratios which determine the extent of share of owner's investment in assets is financial leverage.

$$\text{Financial Leverage} = \frac{\text{Total Assets}}{\text{Owners Equity}}$$

$$\text{For ABC Ltd. Financial Leverage} = = \frac{352{,}158}{319{,}643} \quad 1.10 \text{ ---eqn 5.5}$$

This ratio measures the extent to which a retailer is using outside finances (debt) in its capital. It indicates the total asset value in relation to the value of owner's equity. The leverage ratio of ABC Ltd. is 1.10. This indicates that for every Rs.1.10 in total assets, the owners put up Rs. 1.00 and the remaining Rs. 0.10 is put up by outsiders. The greater the ratio, the higher the level of outside financing.

Too much debt may result in the insolvency of a firm as liabilities may exceed the paying ability of the firm. A low financial leverage ratio indicates the inefficient use of alternative sources of financing by the firm.

Asset turnover and financial leverage are two performance ratios that are derived from the balance sheet of a firm. These ratios form a part of the SPM framework.

## THE STRATEGIC PROFIT MODEL

In the previous sections we examined the income statement and the balance sheet. We also studied the important performance ratios derived from these statements. As some of these ratios are interrelated, examining them in isolation can be confusing. Moreover, it is difficult to compare the performance of a retailer with that of other retailers using individual ratios because different firms employ different strategies and consequently have different operating characteristics. The strategic profit model combines the different performance ratios- net profit margin, asset turnover, and financial leverage to give a single comprehensive framework for easy and accurate comparison. The strategic profit model gives two important returns on investment measures, return on assets and return on net worth.

Return on Assets = Profit Margin x Asset Turnover

Return on Net Worth = Return on Assets × Financial Leverage

## Return on Assets

Return on assets is the combination of profit management and asset management. It is given by

Return on Assets (ROA) = Net Profit Margin x Asset Turnover

$$= \frac{\text{Net Profit}}{\text{Net Sales}} \times \frac{\text{Net Sales}}{\text{Total Assets}} = \frac{\text{Net Profit}}{\text{Total Assets}}$$

By

Using the results of eqn 5.1 and 5.3 in the above equation we get

ROA = 8.38 × 1.64 = 13.7% ---eqn 5.4

The ROA is 13.7% for ABC Ltd. In other words, for every rupee invested in assets Rs. 0.13 returns are generated. This ratio is important for measuring the economic viability of a firm. It determines how much profit can be generated from the retailer's investment in assets. When investing in assets, a retail firm should evaluate whether the returns exceed the investment and give far greater returns to satisfy the firm's objectives.

## Return on Net Worth

This is the ratio the owners of a business are more concerned about.

Return on Net Worth = Return on Assets x Financial Leverage

or

Return on Net Worth = Profit Margin × Asset Turnover × Financial Leverage

$$= \frac{\text{Net Profit}}{\text{Net Sales}} \times \frac{\text{Net Sales}}{\text{Total Assets}} \times \frac{\text{Total Assets}}{\text{Net Worth}}$$

$$= \frac{\text{Net Profit}}{\text{Net Worth}}$$

RONW is a combination of three ratios, profit margin, asset turnover and financial leverage

From eqns 5.4 and 5.5 for ABC Ltd.

RONW = 13.7 x 1.10 = 15.07%.

By measuring the return on net worth, a retailer can decide whether a strategy is worth pursuing. ABC Ltd's RONW is 15.07%. If ABC Ltd. plans to open a new music store chain and the projected return on net worth is less than what the company currently earns (15.07%), the company should consider alternative investment options. Return on net worth is the combination of three ratios, profit margin, asset turnover, and financial leverage. Improving each of these ratios can have positive affect on the return on net worth.

## Improving Financial Performance

Now let us look at how the strategic profit model can be used as tool for assessing the performance of a retailer and how the model can be used to improve the financial performance. Generally there are three paths to improve financial performance

- Profit Management.
- Asset Management
- Debt Management

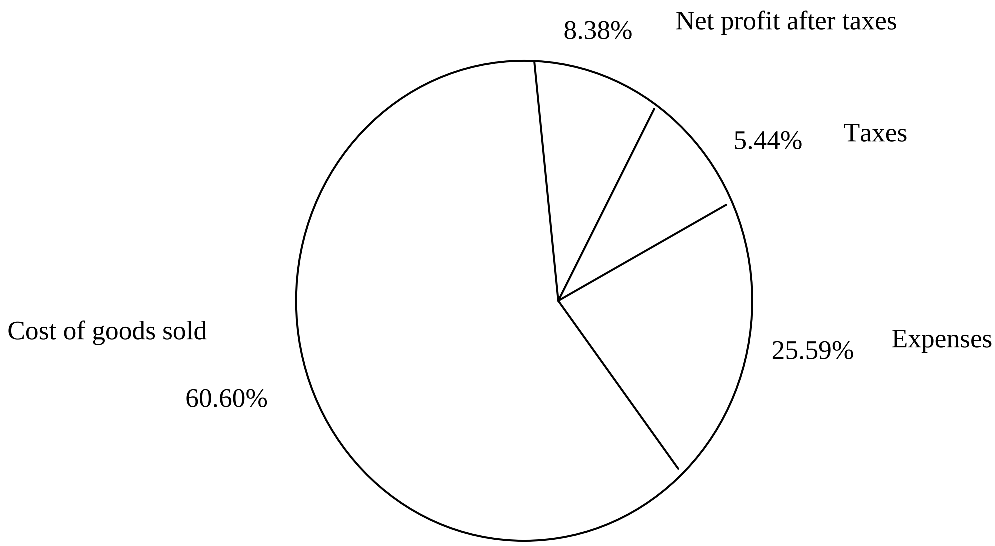
Let us examine each of these methods in detail.

### Profit management

Profit management is one of the most important components of the strategic profit model. The net profit margin is used to evaluate how well a company is controlling its costs in relation to its generation of revenues. Profit management is an essential task for all retailers. The main focus of profit management is sales productivity and expense control.

Figure 5.3 provides an overview of the components that affect the profits of ABC Ltd. The pie represents the total sales revenue of ABC Ltd. The net profit is the slice of the pie that remains after slicing out parts of the pie for the cost of goods sold and the total expenses of ABC Ltd. Hence, the net profit margin depends on the cost of goods and the operating expenses. In the figure, the net profit margin is 8.38%. This indicates that, on an average for every rupee of sales, Rs 0.083 net profit is earned.

**Figure 5.3: Profit Margin for ABC Limited**




The chart shows the components of profit management. Any changes in the values of net sales, cost of goods sold, and expenses can bring about change in the net profit margin. The profit margin can be increased by increasing sales, and keeping expenses constant; or bringing down expenses, without changing the level of sales or; by increasing sales as well as bringing down expenses.

Let us examine how management can increase sales. Management can bring about an increase in sales by increasing the prices of goods. But increase in prices may hurt the sales volume. Only the prices of selected merchandise should be increased so that there is no decrease in sales volumes. The prices of items (luxury goods) for which the demand is not very price sensitive should be increased. Although an increase in sales is a good measure of marketing success, a retailer can gain from the increase only if sales outpace expenses. This can be done by increasing sales without incurring a corresponding increase in expenses. But in reality, an increase in sales is always associated with an increase in expenses.

In the Table 5.3 we see the impact of a change in sales on profits.

From the third column of Table 5.3 we can see that a 4% increase in sales without a corresponding change in expenses brings about an extraordinary increase in profits from 8.38% to 10.38%. Data in the fourth column shows that even if there is a corresponding 2% increase in expenses there is a comparable increase in profits because the increase in sales outpaces the increase in expenses.

**Table 5.3: Impact of Sales on Profit Margin**

| | Present Scenario | 4% increase in sales without corresponding rise in expenses | 4% increase in sales with corresponding 2% rise in expenses |
|---|---|---|---|
| Net Sales | 578,269 | **601,399** | **601,399** |
| Less: Cost of Goods Of Sold | 350,421 | 350,421 | 350,421 |
| Gross Margin | 227,848 | 250,978 | 250,978 |
| Less: Operating Expenses | 141,544 | 141,544 | **144,374** |
| Less: Interest Expenses | 6,423 | 6,423 | 6,423 |
| Less: Total Expenses | 147,967 | 147,967 | 150,797 |
| Net Profit Before Taxes | 79,881 | 103,011 | 100,180 |
| Less: Taxes | 31,438 | 40,586 | 39,471 |
| Profit After Taxes | 48,443 | 62,425 | 60,709 |
| Net Profit Margin | 8.38% | 10.38% | 10.09% |

Profit can also be increased through cost control. Cost of goods sold includes the cost of merchandise, transportation costs and other costs that are directly related to producing or acquiring merchandise that is for sale.

The reduction of cost of goods sold depends on the management's buying skills and the ability to reduce transportation costs. Management can negotiate with vendors for favorable terms like volume discounts and product discounts. Product discounts, volume discounts are deducted from the cost of goods sold. Big retailers like Wal-Mart can negotiate with vendors for favorable terms. Costs can also be reduced considerably by managing transportation effectively. The management can cut transportation costs by studying cheaper alternate shipping means. It can consider closer suppliers for easy and cheaper transportation.

Table 5.4 shows the impact of a 2 % reduction in costs on the profit margin, other factors remaining constant. Here, a 2% reduction in the cost of goods sold contributes to a 0.73% (9.11-8.38) increase in the net profit margin. Thus, through tighter cost control, retailers can increase their profit margins.

An increase in profits can also be generated through a reduction in operating expenses. Such expenses should be brought down without tinkering with the image and overall profitability of the concerned firm. Under certain circumstances measures like lowering of wages and salaries, laying off employees, and eliminating free home delivery services may harm the image and hence the profitability of the firm. Lowering of wages and salaries, and laying-off quality employees may de-motivate employees. De-motivated and dissatisfied employees may have a negative impact on sales as well as customer relations. And if the company stops providing value added services like free home delivery, then it may not live up to customer expectations. Thus those services and expenses that have a direct impact on the customers need to be maintained, and in some areas retailers can decrease costs by exploring alternatives to improve efficiency. For example, lighting expenses can be reduced by installing the latest energy saving lighting systems without compromising on the ambiance of the stores.

**Table 5.4: Impact of Reduction of Cost Of Goods Sold on Profit Margin**

| | **Present Scenario** | **Reduction of 2% in costs of goods sold** |
|---|---|---|
| Net Sales | 578,269 | 578,269 |
| *Less: Cost of Goods Of Sold* | 350,421 | **343,412** |
| Gross Margin | 227,848 | 234,856 |
| Less: Operating Expenses | 141,544 | 141,544 |
| Less: Interest Expenses | 6,423 | 6,423 |
| Less: Total Expenses | 147,967 | 147,967 |
| Net Profit Before Taxes | 79,881 | 86,889 |
| Less: Taxes | 31,438 | 34,234 |
| Profit After Taxes | 48,443 | 52,654 |
| Net Profit Margin | 8.38% | 9.11% |

Table 5.5 shows the impact of a reduction in expenses on the profit margin. A 3% reduction in expenses results in a 0.44% increase in the profit margin.

If there is an increase in sales as well as a decrease in expenses, a considerable increase in profits occurs. The fourth column in Table 5.5 shows this change.

Profit management is thus an important tool for improving the profitability of a retailing firm.

**Table 5.5: Impact of Reduction in Expenses on the Profit Margins**

| | **Present Scenario** | **3% decrease in expenses** | **3% reduction in expenses coupled with 4% increase in sales** |
|---|---|---|---|
| Net Sales | 578,269 | 578,269 | **601,399** |
| Less: Cost of Goods Sold | 350,421 | 350,421 | 364,437 |
| Gross Margin | 227,848 | 227,848 | 236,961 |
| Less: Operating Expenses | 141,544 | **137,297** | **137,297** |
| Less: Interest Expenses | 6,423 | 6,423 | 6,423 |
| Less: Total Expenses | 147,967 | 143,720 | 143,720 |
| Net Profit Before Taxes | 79,881 | 84,127 | 93,241 |
| *Less: Taxes* | 31,438 | 33,146 | 36,737 |
| Profit After Taxes | 48,443 | 50,981 | 56,504 |
| Net Profit Margin | 8.38% | 8.82% | 9.4% |

### Asset Management

A retailer can improve financial performance through effective utilization of assets. Asset management is a key component of the strategic profit model. A common measure for assessing the asset management is the asset turnover ratio. It indicates the sales generated in relation to the amount invested in assets.

From eqn 5.3 we know that the asset turnover of ABC Ltd. is 1.64. This indicates that for every rupee invested in assets, Rs 1.64 worth of sales are generated. The key to asset management is to utilize resources optimally in order to generate sales volumes and profits. The asset turnover ratio of a firm cannot be compared meaningfully with that of other firms in the industry because retail firms adopt different strategies for asset management. For example, discount stores and warehouse clubs have higher asset turnover ratio than department stores and specialty stores.

Cross industry comparisons of financial performance require that asset productivity be measured in terms of profits. This can be achieved through the return on assets (ROA) ratio. The ROA combines two ratios, net profit margin and asset turnover. So it combines two components of the strategic profit model to give a common measure for an easy and comprehensive analysis of the financial performance of a retailer. We have already discussed ways to improve profit margin performance, which would also improve return on assets. So let us focus on how we can improve upon the asset turnover to increase the return on assets. One way to improve the asset turnover is to increase the sales without making a corresponding increase in investments in assets. Another way is to reduce assets while keeping sales constant. The current assets constitute major part of assets for any retailer. Effective control of current assets can reduce the assets base without causing a decline in sales. Cash, inventories and accounts receivables are the key current assets. Of these, inventory represents a sizable investment for a retailer. So inventory control is a major step in asset management. Inventory control not only affects asset productivity, but also sales productivity and the financial stability of the retail entity.

From eqn 5.2 for ABC Ltd., inventory turnover is 5.3. This indicates that the inventory is moving out of the store every 2 ½ months (approx.). Excessive inventory can tie up too much cash, thus affecting the financial stability of the firm. If the level of inventory is very low, then no stock or stock out situations can occur, which will impact the profit of the firm through lost sales opportunities. So the firm must strive to achieve an optimal level inventory.

To achieve better inventory performance, retailer must

- Buy in proper quantities
- Tie up with fewer suppliers for easier management.
- Invest in inventory control systems which can give accurate information, resulting in better monitoring of inventory.
- Remove slow moving items from the product mix to reduce inventory carrying costs.

Cash is an important component of current assets. Firm must have optimal cash in hand to meet emergency and short term needs. Too much cash in hand can make firms forego opportunities for investment in merchandise, thus hampering their growth prospects.

Accounts receivables must be regularly reviewed to ensure that they are not going bad. While providing credit is important from point of view of customer satisfaction, retailers must ensure that it does not have a negative effect on their asset position.

### Debt Management

Return on assets is a good measure of how effectively retailer is using the firm's resources. A more effective measure of performance is return on net worth or owner's equity. The leverage ratio is the link between return on assets and return on net worth. It explains the owner's contribution in the firm's investment. In other words financial leverage ratio reflects the extent to which a firm has financed its assets with debt. It is computed as follows:

$$\text{Leverage ratio} = \frac{\text{Total Assets}}{\text{Net worth}}$$

The leverage ratio for ABC Ltd., is 1.10. Thus we can infer that for every Rs. 1.10 worth investment in assets, owner's contribution is Rs. 1 and debt is Rs. 0.10. Increase in debt increases the return on net worth of the retailer. The reason is owners need to invest less funds from their resources and can utilize more outside funds and thus owners can get more returns with less investment. Before deciding on financial leverage, the retailer should examine some aspects. He should evaluate the financial position of the firm and determine whether the debt option will increase the RONW. If yes, the retailer must determine the level of debt the firm can afford. High debt may burden the balance sheet and increase the risk of financial instability.

Another aspect is the interest rate scenario. If the interest rates charged by lenders are higher than the return to the owners, additional debt will reduce the return on net worth. Under such circumstances outside financing is not a viable option. There are three types of financing: short-term financing, intermediate, and long-term. Short term financing refers to funds that retailers can borrow for less than one year. The retailer uses short-term loans for purchasing merchandise for the next festival season or repaying dues to suppliers etc. Intermediate loans are usually offered for a period of more than one year but less than five years. These funds are used for refurbishing stores, buying new equipment and fixtures etc. Long term loans are generally secured by retailers for periods longer than five years. These loans are used by retailers to buy fixed assets like buildings and land.

## SETTING PERFORMANCE OBJECTIVES

Setting performance objectives is the first and most important part of any strategy planning process. A clear set of objectives will help the organization focus on the changes that need to be made to achieve those objectives. Some guidelines for setting objectives are given below:

- Objectives should be clear and specific
- Objectives should be measurable
- Objectives should be realistic and attainable
- Objectives should be time bound

For example, financial objectives can be:

- "To achieve sales growth of 35% for the year ending 2003."
- "To generate profit of 20% on the investment of Rs 50 crores for the year 2002-2003."

Setting objectives for a retail firm requires a combination of top-down and bottom-up approaches to planning.

The top-down approach involves setting of overall goals by top management. These goals are then narrowed down to store levels.

In top-down planning, top managers set the overall strategy on the basis of their analysis of changes in external environmental factors like economy, competition and consumer trends. On the basis of the overall strategy the overall organizational objectives are established. Then these objectives are broken down into specific objectives at various merchandise category levels and store levels.

The objectives set for the merchandise category level determine the width of category, depth of the assortment, the product availability, the level of customer service, the floor area, and the location within the store. Once the broad objectives are set for a merchandise category, the merchandise manager makes decisions regarding each item of merchandise within a category. These objectives are further broken down to set goals for category managers and buyers down the hierarchy.

The store level objectives are used to set the performance objectives of the regional store managers. The regional store managers in consultation with the store managers set performance goals for each individual store.

Thus, in the top-down approach, organizational objectives are broken down until performance goals are set for the department level.

The bottom- up approach complements the top-down approach. In the bottom-up planning approach, lower level managers propose the objectives. These estimates are passed onto higher level. They flow up to the top management. Based on these estimates the overall objectives are set by the top management.

But frequently there are differences between the objectives that are set by top management and those set by lower level employees. To iron out such differences top management should negotiate with managers at the operational level and arrive at a solution that is acceptable to both parties.

However good a strategy may be, the organization will not get the desired results if the employees who have to implement those strategies are not motivated and are not accountable for their actions.

Accountability measures the progress and the results of the strategy that has been implemented. It involves the setting of guidelines, regular monitoring and periodic review of the progress. Monitoring and review enables retailers to compare the progress with the objectives and identify the reasons for the differences between the actual and proposed results.

Every manager at each level of the hierarchy should be made accountable for the objectives that are set for that level. Managers should not be made accountable for factors that are beyond their control. Suppose the profit target for a certain department is 20%. If top management decides to cut prices in response to competitive pressures, the profit margins may decrease. The concerned department may not achieve the profit target due to this change in policy. Thus, when assessing the performance of each operational level, top-management should consider all aspects that affect the performance to ensure a fair assessment of performance.

## PERFORMANCE MEASURES

Performance measures are used to measure the performance and evaluate the progress of strategic plans. Since numerous factors influence the performance of a firm, no single measure can give a complete picture of its performance. Multiple measures should therefore be used to assess the performance. The selection of measures depends on the level at which performance is being measured and the resources that are controlled on that level.

### Types of Performance Measures

Retailers use a host of performance indicators to measure growth, efficiency, etc. The most common measures are input, output, and productivity measures.

Input measures identify the amount of resources needed to provide a product or service. For retailers, inventory, and cost of goods sold are examples for input measures. Output measures track the results of company activities. Sales and net profit are the key output measures used by retailers. Productivity measures assess the output achieved in relation to the inputs used. Return on assets and return on net worth are the key productivity measures that are used by retail businesses. Table 5.6 shows the various input, output and productivity measures used by retailers. Some productivity measures, like the average bill size, and gross margin ratios are unique to the retail industry. See Exhibit 5.2 for the various gross margin ratios used by retailers.

**Exhibit 5.2**

**Gross Margin Analysis**

Gross profit margin indicates how efficient a company is at selling its goods. The difference between net sales and the cost of goods sold is the gross profit margin. Gross margin analysis is an important method for tracking financial performance. The gross margin is used to obtain following ratios: gross margin return on investment (GMROI), gross margin return on space (GMROS) and gross margin return on labor (GMROL). These ratios are widely used measures of productivity for analyzing the efficiency of firms.

**Gross margin return on investment (GMROI)**

GMROI measures the gross margin on each rupee invested in inventory. GMROI can be used to compare each industry, product line, department, or individual product with others. It is given by

$$\text{GMROI} = \frac{\textit{Gross margin}}{\textit{Average inventory cost}}$$

If the ratio is 1.20, it indicates that for each rupee invested in inventory returned Rs. 1.20 worth of gross margin.

**Gross Margin Return on Space**

This measure is used by store managers to determine the margins generated for each square foot area of space. It is given by

$$\text{GMROS} = \frac{\textit{Gross margin}}{\textit{Sqft of selling space}}$$

If the ratio is 250, then it indicates that for each sq.ft area of the store, the margin is Rs.250. Using this measure, a firm can find ways to maximize the margins keeping the store space constant. GMROS can be used to compare the performance of different stores and to identify the stores that have low GMROS.

**Gross Margin Return on Labor**

GMROL is an employee productivity measure. It measures gross margins in relation to employee payroll. It is given by

$$\text{GMROL} = \frac{\textit{Gross margin}}{\textit{Employee payroll}}$$

GMROL measures the gross margin generated by each rupee of payroll. If the GMROL is 1.5, it indicates that each rupee cost of payroll returned Rs. 1.5 worth of gross margin.

*Adapted from: Ron Hasty and James Reardon, "Retail Management" (McGraw-Hill, 1997) p.348-350.*

Generally to estimate the popularity of a store, managers count the number of people who visit the store. In retail jargon the number of people who visit the stores are referred to as "footfalls". Footfalls are linked to sales to get the conversion ratio. The conversion rate is given by the number of sales receipts as a percentage of footfalls. Thus, the conversion ratio determines rate at which visitors turned into customers. If the ratio is 20%, it indicates that 20% of the total number of visitors purchased goods from the stores. The average bill size is arrived at by dividing total value of sales receipts by number of sales receipts. These ratios help retailers gauge their performance and develop plans for improving these measures to make the firm more productive.

**Table 5.6 Examples of Performance Measures used by Retailers**

| **Output** | **Input** | **Productivity** |
|---|---|---|
| Net sales | Inventory level | Return on assets |
| Net profits | Cost of goods sold | Return on net worth |
| Gross margin | Expenses | Asset turnover |
| | | Inventory turnover |
| | | Gross margin return on investment |
| | | Gross margin return on space |
| | | Gross margin return on labor |
| | | Average bill size |
| | | Conversion ratio |

## SUMMARY

In this chapter we understood the elements of a financial strategy. We examined two important financial documents: the income statement, and the balance sheet. We saw how they are important for retailers in evaluating financial performance. Later, we analyzed the strategic profit model and examined its components. The strategic profit model uses return on net worth as key performance measure for evaluating financial performance. Through an example we saw how using the SPM can improve the financial performance of a retailer. We then discussed the way in which financial objectives are set. The setting of financial objectives requires a combination of top-down and bottom-up planning approaches. Finally we took a look at the various measures used by retailers for measuring performance.

# Chapter 6

# Store Location and Site Evaluation

**In this chapter we will discuss:**

- Selecting the Store Location
- Market Area Analysis
- Trade Area Analysis
- Site Evaluation and Selection

## INTRODUCTION

Location is a top priority for all businesses. For the retailer, location means being at the right place at the right time. Whether it is the first store or the hundredth store, retailers must spend time and money on the process of store location and site evaluation. This is because location decisions cannot be changed easily once a store has been established. Moreover, the choice of store location has a profound affect on the entire business life cycle of a retail operation. Location helps retailers gain a competitive advantage, as it is a unique asset. Once a site has been selected and occupied by a retailer, it cannot be used by any other store. Thus location is the only strategic advantage that competitors cannot copy or imitate easily. To be precise, location and site selection comprise the most strategic and crucial decisions made by retailers.

The complexity of selecting a location increases when there is a dearth of prime properties available at reasonable prices. Selecting a store location involves evaluating a series of trade-offs concerning the cost and value of the site for a specific retailing format. The selection of a store location depends on the type of retailer, the kind of store being set up, the type of merchandise that would be sold, the price at which it would be sold, the type of customers being targeted, the expectations of customers in terms of price, service, and convenience, and the financial strength of the retailer. The retailer's image and constraints will help limit the number of store locations being considered. Once the store concept has been determined, the retailer can shortlist and consider those locations that are in tune with the image of the store.

## SELECTING THE STORE LOCATION

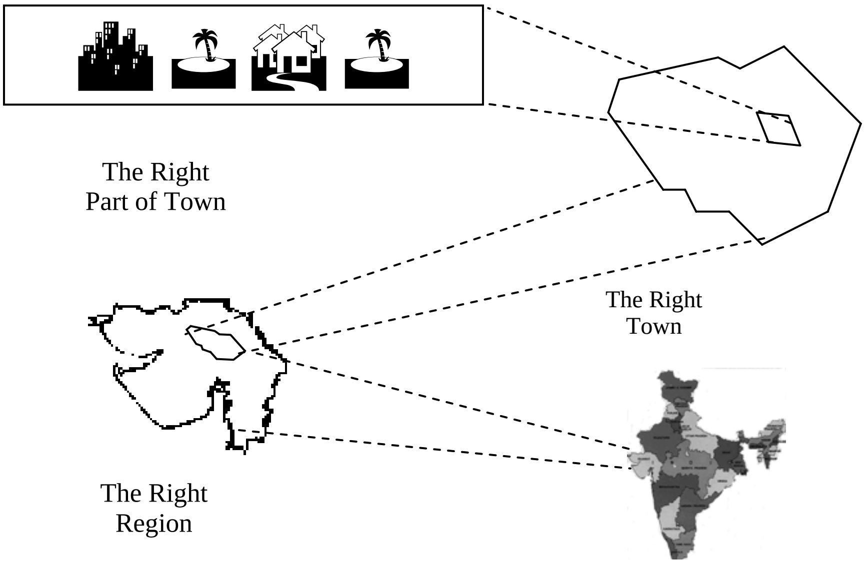
When selecting a location, the retailer must analyze regional and local markets to determine the area that seems to offer the highest market potential. Such an assessment is called market area analysis. Demographics, business climate, and the level of competition are considered during market area analysis. Then the retailer must examine specific areas within those market areas called trade areas. Trade areas refer to the areas from which most of the customers are drawn. The process of selecting trade areas is known as trade area analysis. Finally, the retailer must select the most suitable site within the preferred trade area, i.e., the one that satisfies the firm's objectives and meets customer needs. The process of choosing the best site is known as the site selection process. In this chapter we will examine each of these steps in detail. (Figure 6.1 depicts the store location process).

## MARKET AREA ANALYSIS

An attractive location is a key factor for the success of any retailer or retail store chain. The best regions are those that generate the highest demand or sales for a retailer.

A market area analysis consists of regional area analysis and local area analysis. The retailer must analyze regional differences across domestic or international markets. After selecting a particular region, the retailer has to analyze one or more local markets within that region. After identifying some promising market areas, the retailer should estimate their sales potential so as to choose the market area with the highest sales potential.

**Figure 6.1: Identification of Regional and Local Market Areas**




## Factors Affecting the Attractiveness of Market Areas and Trade Areas

When analyzing market areas, a retailer must assess various environmental and market conditions, to identify the market area that matches the firm's objectives and strategy. Although market area analysis is distinct from trade area analysis, the factors that make market areas and trade areas attractive are the same. Let us examine some of the important factors for selecting the market area. (Exhibit 6.1 lists the major factors that influence the selection of a market area or trade area.)

### Demographics

Demography refers to the study of population characteristics. The various demographic variables that retailers can access are the consumer's age, gender, income, education, family background, and occupation. Different types of information on the population can be obtained from studies conducted by research organizations. These demographic variables can be used to identify target markets for retailers. The analysis of demographic changes will help retailers to track consumer trends. Demographics studies thus provide retailers with information that help them locate and define the required customer base.

### Economic

All businesses operate in an economic environment and many of their decisions are based on economic factors. Retailers must examine the following factors in great detail:

- Per capita income
- Interest rate
- Employment rate
- Business cycles

**Exhibit 6.1**

**Factors Affecting the Attractiveness of Market Areas and Trade Areas**

| | |
|---|---|
| **Demographics** | - Total size and density<br>- Age distribution<br>- Average level of education<br>-Percentage of population having own houses<br>- Occupation distribution<br>- Trends |
| **Proximity to supply sources** | - Cost of delivery<br>- On time delivery<br>- Number of manufacturers and wholesalers<br>- Availability and reliability of product lines |
| **Economic Base** | - Dominant industries or companies<br>- Employment rate<br>- Total and per capita disposable income<br>- Growth forecasts<br>- Economic and seasonal fluctuations<br>- Access to credit and financial facilities |
| **Competition** | - Number and size of the competitors present<br>- Availability of transportation<br>- Long term versus short term outlook<br>- Saturation levels |
| **Store Locations and its availability** | - Number and type of locations<br>- Availability of transportation<br>- Own versus leased locations<br>- Costs of occupancy and operation. |
| **Regulations** | - Licensing procedures<br>- Operational procedures<br>- Minimum wages prevalent<br>- Zoning<br>- Tax structures |

The higher the per capita income, the higher the spending power of the consumers. And the lower the interest rates the easier it is to set up stores (due to the availability of cheaper funds, at low interest rates).

### Cultural

Culture has a significant impact on the way consumers shop and the goods they purchase. Different people hold different values and lead different lifestyles. These differences affect their shopping preferences. Moreover, consumers like to be comfortable in the environment in which they buy goods. To provide a comfortable shopping environment to consumers, retailers should understand the culture and language of their customers. In a country with multiple languages, retailers should hire employees who are fluent in multiple regional languages. Retailers should also understand the various aspects of culture that would influence their locational decision

### Demand

The demand for a retailer’s goods and services has a significant impact on the retailer’s store location. Not only should customers want to buy the goods, they should also have the purchasing power. Demand is a function of the population and the purchasing power of the consumers living in a particular location, which the retailer is targeting. Population and income statistics can be obtained from the published sources of information like census data. These statistics help retailers compare populations and determine the one, which would be able to purchase the merchandise carried in their stores. The characteristics of demand determine whether a retailer should sell high-priced goods – like durables, furniture, jewelry and electronics or low-priced goods like apparel, toys, and groceries.

### Infrastructure

The nature of the infrastructure required depends on the basic framework of the business. Different types of retailers require different types of channels to deliver goods and services to customers. The distribution of goods is highly dependent on existing infrastructure such as highways, roads, railways, and airways (depending on the transportation used). Legal infrastructure like laws and regulations, and technical infrastructure like computerization, communication and power distribution, also influence store location. The quantity and quality of infrastructure varies significantly across countries and regions. Retailers whose operations depend heavily on computerization and telecommunications, should not consider those areas that do not meet their minimum specifications of these criteria.

## Estimating Sales Potential

After identifying some promising market areas, retailers should measure the sales potential of these areas. An accurate appraisal of sales potential is necessary to determine the amount of inventory to be procured, the number of employees needed, and the expenditure required. Retailers generally use population statistics to determine the sales potential. The factors that determine the sales potential of an area are area sales activities, and level of competition.

### Area sales activities

The sales potential can be determined through the use of sales activity index. The sales activity index (SAI) is a measure of an area's per capita retail sales in relation to the per capita sales for the entire country. It can be calculated as follows

$$\text{SAI} = \frac{\left[\dfrac{\text{Area's total retail sales}}{\text{Area's total population}}\right]}{\left[\dfrac{\text{Entire country's retail sales}}{\text{Entire country's population}}\right]}$$

$$= \left[\frac{\text{Area's total retail sales} \times 100}{\text{Area's total population}}\right] \times \left[\frac{\text{Entire country's population}}{\text{Entire country's retail sales} \times 100}\right]$$

$$= \frac{\text{Area's percentage of country's retail sales}}{\text{Area's percentage of country's population}}$$

The SAI should be used with caution as a high SAI coefficient does not always imply a high sales potential. Factors like non-area resident buying, and corporate sales may inflate the SAI.

### Level of competition

Competition varies from nation to nation and region to region. In some areas the competition is stiffer than in other areas. Generally the level of competition increases with the level of industrialization of a country.

The level of competition in a region has an impact on the merchandise decisions of a retailer. A retailer should have a thorough knowledge of both its direct and indirect competitors in the market, the goods and services offered by them, and the consumer perception of these stores. Depending on the level of competition, market areas can be classified into saturated, under-stored or over-stored market areas. A saturated market area has optimum number of retail stores to meet customer demand. In these areas, customers are offered a good range of goods and services and retailers are able to make good profits. Since customers are attracted towards these areas because of the variety of merchandise offered, retailers who can offer a superior retail format to customers in terms of merchandise, prices or service choose these areas. An under-stored market area has very few stores, which offer goods, or services that satisfy the needs of the population. Any retailer establishing a store offering the right products in such an area would certainly have a first mover advantage. The initial success of Wal-Mart can be attributed to its strategy of opening stores in small towns that were comparatively under-stored. An over-stored market area has more retailers than are required to meet customer demand. As a result some of the retailers are unable to make sufficient profits.

Some forms of competition increase the chances of success of retailers. For instance, if a store is located near an anchor store it will be able to draw the crowd that visits the anchor store. Such a location would not be an advantage if the people visiting the anchor store did not constitute the target segment of the store. Small retailers usually perform well when they are located near large stores, but only when they sell merchandise that complements the merchandise sold in the large store. Large stores, on their part need to carefully evaluate the number of competitors offering similar merchandise, or merchandise that customers tend to compare before making a purchase decision. The degree of competition in a location is measured with the help of the index of retail saturation.

The index of retail saturation (IRS) measures the level of demand in a particular market on the basis of the population, consumer expenditure, competing retail space and a particular product or product area.

The index of retail saturation can be calculated as follows:

$$IRS = \frac{POP \times EXP}{CRS} = \frac{[\text{Demand}]}{[\text{Current Retail Selling Price}]}$$

IRS - Index of retail saturation in area for products

POP - Population in area which is likely to buy the products

EXP - Per capita retail expenditure in area on products

CRS - Current retail space (sq ft) in area selling products

IRS measures the level of demand in a market that the retailer expects to break into, or is perhaps already attained. The IRS provides an index of the attractiveness of the trade area for a specific product line or product category. The higher the index, the better the retailer's chances of success. A low index indicates that the area is saturated with similar competitors. In a saturated market area, the volume of retail equals the amount being consumed by the population. In an over-stored market area the volume of retail exceeds the volume required by the population, and in an under-stored market area, the volume of retail is insufficient for the potential customers. After selecting a suitable market area the retailer must identify a specific trade area.

## TRADE AREA ANALYSIS

Trade area analysis provides retailers with vital information such as store patronage, local market opportunities, competing businesses, and barriers that would dissuade consumers from visiting the site.

A trade area is a geographical area containing the customers of a particular firm or group of firms for specific goods or services. A trade area can also be defined as a district, whose size is generally determined by the boundaries within which it is economical, in terms of volume and cost, for a retailer to sell and/or deliver a good or service.

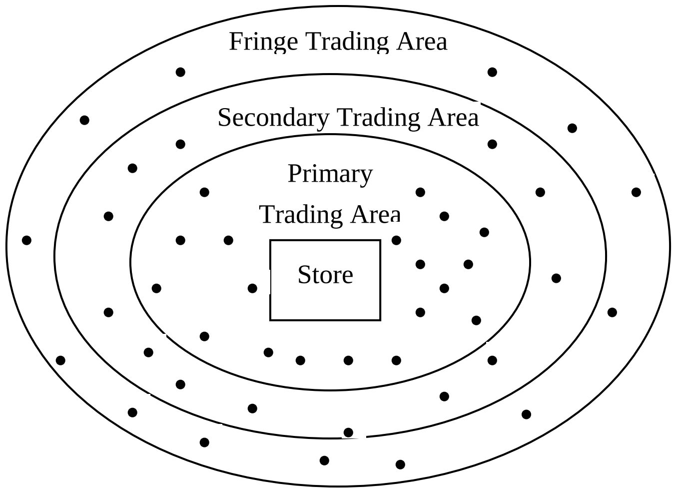
The first step in trade area analysis consists of describing and analyzing alternate trade areas and deciding on the most promising one. Once a trade area has been selected, it should be examined on a regular basis to keep track of changes occurring in the area.

### Size and Shape of Trade Areas

Every trade area consists of three parts: primary, secondary and fringe. The primary trade area contributes 50 percent to 80 percent of the store's customers. This area is nearest to the store, has a higher percentage of customers, and contributes the highest per capita sales. The secondary trade area provides another 15 to 25 percent of the store's customers. This trade area is situated beyond the primary trade area and the customers in the area are dispersed more widely than in the primary trade area. A fringe trade area consists of all the other remaining customers. These customers are the most widely dispersed. Fringe trade areas usually contain out shoppers, who travel great distances to patronize a particular store.

A retail store could have a primary trade area of three kilometers, a secondary trade area of seven kilometers, and a fringe trade area of nine kilometers. The greater the primary and fringe trade areas, the better it is for the retailer[1]. A diagram of the parts of trade areas is given in figure 6.2. In practice, trade areas do not take the concentric pattern shown in the figure. They adjust according to the environment.

**Figure 6.2 Parts of Trade Area**




- Customers

A number of different factors determine the size and shape of trade areas. Some of them are

- Store type
- Store size
- Merchandise type
- Location of competition
- Housing patterns
- Travel time

### Store type

Two types of stores in the same shopping mall can have trade areas of different sizes. One store might offer a better product assortment; have heavy promotions, and a stronger image. Such a store, referred to as a destination store, has a much larger trading area than a competitor with a less unique appeal. Some outlets do not have a trading area of their own and even do not have their own traffic. Such outlets are dependent on customers who are pulled towards the area for some other reasons. For example, restaurant at a shopping mall or a florist in the lobby of a hotel depend on the customers pulled to the shopping mall or hotel.. Such a store is referred to as a parasite store.

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[1] Edward M.Mazee, Identifying the Key Factors in Retail Store Location, Journal of Small Business Management, Jan1972, p18.

### Store size

The size of the trade area of a store is influenced by the size of the store itself. The trade area tends to increase with the increasing size of the store, but this increase may not be in proportion to the increase in the size of the store. This relationship between the size of the store and the size of the trade area can be attributed to the assortment of goods and services offered to the customer. For example a hypermarket, which provide a large assortment and variety of products under one roof, have larger trade area, whereas supermarket which have a smaller store size and carry less merchandise have smaller trading areas.

### Merchandise type

The type of merchandise offered by a retail store also affects the size of the trade area. Merchandise can be classified as convenience goods, specialty goods, and shopping goods.

Convenience goods refer to products that customers buy frequently, such as fruits, vegetables, groceries. These are purchased from neighborhood mom-and-pop stores and roadside stalls. Thus, in such cases, the trading area is small. Other types of convenience goods, such as staple foods like rice and pulses and groceries like soaps and detergents, require little pre-purchase planning. These goods are generally bought on a monthly basis. The trading area for supermarkets is larger than the trading area for mom-and-pop stores.

Shopping goods are bought less frequently than convenience goods. These goods include clothing, and electronic goods. Since the investment in such goods is high, customers are willing to spend time comparing products in a number of different stores before purchasing. Stores selling such shopping goods have a relatively large trade area.

Specialty goods possess unique characteristics, but require a considerably high investment and time, for example, cars, two-wheelers, and luxury goods. Customers buy such goods only after a lot of pre-purchase searching and planning. Stores carrying such type of goods have a greater trading area than shopping goods stores.

### Location of competition

The number of competing stores in an area and the distance between the stores also influence the trading area. Two types of competition take place: inter-store competition and intra-store competition. Intra-store competition refers to competition between two retailers selling similar merchandise. In such cases trading area is often reduced for each. Suppose Food retailer A and Food retailer B were located in the same area, customers could choose to go to either one of the stores. As a result, the trade area of each store would shrink. Inter-store competition or competition among retailers selling dissimilar merchandise increases the range of goods and services offered at a particular location. If four different speciality stores: an apparel store, a gift store, and a coffee vendor were located in the same area customers would benefit from the availability of a wider range of goods and services. Consequently, customers from greater distances would be pulled to these areas thus expanding the size of their trade area. Also, a new store's entry into a particular location can affect the size and shape of the trade area of the established stores at that location.

### Housing patterns

The trade area of a retail store is influenced by the housing patterns of the people in a region. People in urban areas generally reside in multiunit housing structures close to prime commercial areas. In suburban areas, people live in individual houses that are spread out geographically. In such areas, the retailer has to pull consumers from greater distances to generate a sufficiently high sales volume.

**Exhibit 6.2**

**What are Geographic Information Systems?**

As retail shopping habits and patterns fluctuate quickly, people in the retail and shopping center industry find it difficult to assess market changes. One of the important analytical tools used by retailers and the shopping center industry is the Geographic Information Systems.

So what exactly is a Geographic Information System? GIS can be defined as any combination of computer hardware and software, which is used for spatial analysis. GIS applications may range from a simple atlas program on a single user PC to a complex application where several users can work in an integrated environment on a network. The key factor in defining a Geographic Information System is that it manipulates data on a spatial level, through a computer.

Atlas GIS (Strategic Mapping, Inc.) and MapInfo (MapInfo Corporation) are the two more commonly used GIS software packages.

**GROWTH**

Several factors have promoted the growth of GIS in the shopping center industry. Advances in computer hardware and software, along with affordable prices, have made GIS applications available to a wide range of users. The technology that once limited GIS use to public agencies operating on large mainframe computers has been replaced by the proliferation of desktop GIS packages.

**APPLICATIONS**

GIS systems can be used for a variety of analyses. In the shopping center industry, GIS can be used to evaluate market demographics, assess customer and competitive locations, define trade areas, and assist in a variety of other market issues. There are many levels of analysis when using a GIS. GIS analysis can be categorized as: basic mapping and report generation, low-level spatial analysis, and high-level analysis and customization.

Basic mapping and report generation is probably the most common use of GIS software. GIS can represent a variety of data spatially. Retailers can map demographic factors like income and show the locations of stores and customers on the same map.

While basic mapping can provide many answers, GIS can also provide some more advanced analytical tools. GIS software provides many functions that assist in complex analysis like defining trade areas in an over-stored area, aggregating sales data, calculating distances, and estimating market share for a new store etc. The level of functionality will depend on the software itself.

GIS software gives retailers the ability to develop and perform highly complex spatial analyses. This may include developing and integrating a sales projection model within a GIS package.

GIS is indeed a powerful analytical tool, whether used on a basic or complex level. However, it is important that users recognize it as only a tool, not an end in itself. The results depend upon on the management’s ability to use the technology and analyze the situation properly.

In today’s competitive and rapidly changing retail environment, quick and efficient analyses are no longer simply helpful, but required. Retailers and shopping center developers and management need to know who their customers are, where they are, and how to optimize their potential. A well-used and maintained Geographic Information System can help to do just that.

*Adapted from http://www/thestrategicedge.com/Articles/gisnews.htm*

### Travel time

This refers to the time taken by the customers to travel to retail stores. The greater the distance between their point of origin to the store (destination point) the greater the travel time and the greater the trade area.

## Measurement and Definition of the Trade Area

The process of measuring and defining a trade area is one of the important components of retail store location analysis. The objective of measurement and definition is to determine the trade area that has the highest probability of attracting customers within the selected market area.

Retailers use a variety of techniques to define a trade area. The most popular methods are gravity models, trend analysis, analog models and regression models. Geographic information systems are also widely used to measure and analyze trade areas. With advances in computers GIS applications have became very sophisticated. At the same time, they have become cheaper, thus leading to an increase in the use of GIS by the retail industry. Globally, mapinfo.com and Tactician Corporation are the major companies that develop and market GIS software applications.

### Defining the trade area of an established store

The size, shape and characteristics of an established store's trade area can be defined accurately and easily. The trade area can be measured either with the help of secondary data (store records) or primary data (by conducting a special study). Store records can provide the addresses of customers who bought the goods and services on a cash or credit basis. Using these addresses primary, secondary and fringe trade areas can be described in terms of the

- Frequency of shopping at a particular retail outlet by people from different geographic locations
- Average billing amount at an outlet by people from a particular geographic location
- Presence of an outlet's credit card holding customers in a particular geographic location

Though it might be easy to obtain information on the customers having/using credit cards, the retailer should not arrive at any conclusion until the information on cash customers is also included. Analysis of only cash customers or only credit customers might result in overstatement or understatement of the total number of customers from a particular area. The retailer can also gather primary data to get a clearer picture of the store’s trade area. To obtain demographic and lifestyle data of its customers the retailer can conduct a primary research on its own or with the help of a market research firm. Primary research can be done through in-store surveys. Using an in-store survey, the researcher undertakes a sample within the store, with the interviews being conducted in proportion to the store sales on each day of the week. Sample sizes need to be optimal to allow for analysis of results by different potential geographic areas from which people will visit the stores. The results of an in-store survey can be tabulated to indicate which geographic areas provide what proportion of the customers. Irrespective of the manner in which the trade area is defined, the retailer should take the time bias into account, since customer inflow varies with time like shopping centers near parks and entertainment centers have a heavy influx at night and weekends, whereas the stores in main centers have more customers during festivals and special occasions.

Once the trade area has been defined, the retailer must map the locations and density of customers in the trade area, either manually or through GIS. In the manual process, a paper map representing the area surrounding the store is used. Colored dots or pins are placed on the map to indicate population densities, income levels and other related factors. After this has been done customer locations and densities are indicated, then primary, secondary and fringe trade areas are marked along with their pin/zip codes. GIS integrates all the important customer information with other sources of information like the census data and develops digital maps representing primary, secondary and fringe trade areas.

## Defining the Trade Areas of a New Store

A new retailer planning to set up a store in a well established trade area can define its trade area in a manner similar to that of an established store. The process of defining the trade area of a new store would differ when the trade area has less well-defined purchasing and traffic patterns. The potential trade areas of a new store should be analyzed frequently by examining the opportunities offered by the market, existing customer profiles, and traffic patterns.

There are four commonly used methods for delineating the trade area of a new store.

- Trend Analysis
- Analog models
- Regression Models
- Gravity models

### Trend analysis

Trend analysis involves predicting the future based on the past, analyzing government and other data pertaining to predictions regarding the location of the population, automobile registrations, housing development, public transportation, etc. Consumer surveys are also used to collect information on the time and distance people are ready to travel for different possible retail locations; the features that pull the consumers to the store. Based on the data the new store trading area is determined.

### Analog model

This is the most famous and simplest trade area analysis model. It estimates the potential sales of a new store on the basis of the revenues of existing stores in identical areas, the competition at a prospective location, the expected market share of the new store at the proposed location, and the size and density of the primary trade area of the location.

### Regression model

This model develops a series of mathematical equations representing the relationship between the potential sales of the store and the various independent factors of each location. The regression model helps retailers examine the impact of independent variables on the potential sales of a new store: the size of the population, average income levels, the number of households, competitors close-by, transportation problems and traffic patterns.

### Gravity model

These models are based on the fact that people tend to shop at stores that are closer and more attractive than their competitors. They take into consideration factors like distance between the consumers and the competitors, distance between the consumers and a particular store location and the image of the store in the consumer’s mind. Reilly’s model and Huff’s model are two important gravity models used by retailers.

### *Reilly's Law of Retail Gravitation*

Inspired by the formula for gravity, Reilly proposed[2] that "two cities attract the retail trade from an intermediate city or town in the vicinity of the breaking point in direct proportion of the population of the two cities and inversely proportional to the square of the distance from these two cities to the intermediate town." Simply put, a customer will travel a distance to shop depending on the population of the shopping area and the distance between areas. Reilly's model suggests that greater shopping center mass (size) increases consumer utility, thus increasing the gravitational pull of a center; and that distance to the center decreases consumer utility, which exponentially decreases the gravitational pull of the center.

It is given by

$$\frac{T_a}{T_b} = \frac{P_a}{P_b}\left(\frac{d_b}{d_a}\right)^2$$

where $T_a$ and $T_b$ represent the proportion of trade drawn to the centers A and B

$P_a$ and $P_b$ represent the population sizes of cities A and B

$d_a$ and $d_b$ represent the distance from the intermediate town to cities A and B.

The original model has been reformulated in order to determine the position of an intermediate area where trade becomes split between two competing centers.

$$D_{ab} = \frac{d}{1+\sqrt{\frac{P_b}{P_a}}}$$

where, $D_{ab}$ = Breakpoint of A

d = distance between A and B

$P_a$ = Population of city A

$P_b$ = Population of city B

Thus formula determines the point of indifference between two cities or locations, in order to determine the trade area of each location. The point of indifference refers to the geographic breaking point between two locations at which consumers would be indifferent about shopping at either locations. According to Reilly's law, the majority of the consumers would get pulled towards the larger location because of the greater availability of merchandise and facilities, which would make the increased travel time worthwhile.

Based on this formula, a city (A) with a population of 12,00,000 population attract people from twice the distance that to a city (B) with a population of 3,00,000. If there was a distance of 15km between the cities, the point of indifference for the bigger city (A) is 10 km and for the smaller city (B), it is 5km.

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[2] William J. Reilly, Methods for the Study of Retail Relationships, University of Texas Bulletin 2944 (Austin: University of Texas, 1929; reprinted, 1959).

d = 15 km

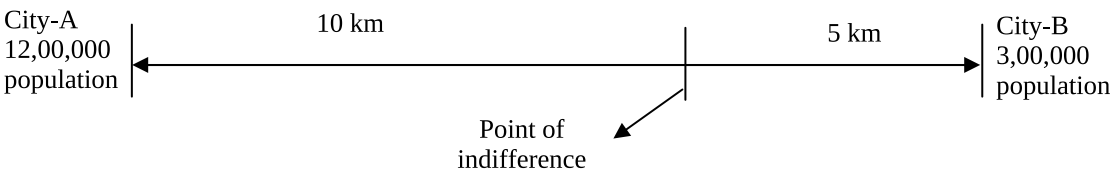
$P_a$= Population of bigger city (city A) = 1200000

$P_b$ = Population of smaller city (city B) = 300000

Substituting these values in the formula, we get

$$D_{ab} = \frac{15}{1 + \sqrt{\frac{3,00,000}{12,00,000}}}$$

= 10 km




So city A can pull people from a distance of 10 km, whereas city B can draw only those people who reside within 5km. Suppose a builder owned shopping centers in City A and City B. He can charge a higher rent for shopping space in city A than for shopping space in city B because, according to Reilly's gravity model, shopping space in city A will draw more customers than shopping space in city B.

Reilly's law is based on two major assumptions:

- Two competing areas will be equally accessible from a major road
- Retailers in two areas are equally competitive

Other factors that affect customer preferences are ignored or held constant. Reilly's law of retail gravitation has made a significant contribution to the analysis of trade areas. The data required by the model is easily available and inexpensive to collect. Retailers can integrate Reilly's law with other tools to find out whether the trade area being considered is the most appropriate.

In spite of the advantages it offers, Reilly's law of gravitation also has two major limitations:

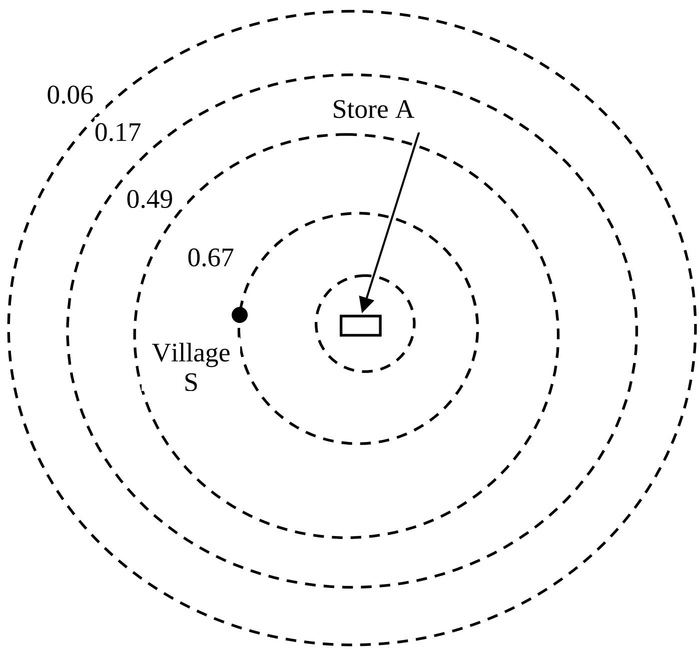
- The distances measured are limited to the major roads; they do not consider streets. Many people would travel short distances along the streets, which might not be taken into account.
- The exact distance to a store might not be in agreement with the consumer's perception of distance.

### *Huffs Law of Shopper Attraction*

Huff's Law of Shopper Attraction is a gravity model (Huff 1964) similar to Reilly's law. It can be used to define a store's trade area. Huff's law was developed in an attempt to overcome some of the limitations associated with Reilly's model. It is based on the assumption that not everyone within a trade area will travel to the store or shopping center. Huff's model provides a series of probabilities of consumers choosing to visit one center as opposed to another in terms of the attractiveness of each center (measured by floor space) and a deterrence factor (measured by traveling time to the center). That is, it gives the probability of how likely it will be for a customer to travel to a particular store/shopping center.

Huff's model enables the probability values for a series of areas to be calculated and plotted on a map for easier analysis. The simplest way of interpreting Huff's model is to think of it as a geographical map representing the contours of demand around a store. Figure 6.3 shows the contours that stretch out from a store (like the contours of route map). Each contour in the figure is given a probability value. This value indicates the likelihood of a consumer within that area shopping at that store instead of traveling to a different location. Since a consumer living in the village S would go to shop at store A, 67 percent of the time, the 0.67 contour crosses village S.

**Figure 6.3: Contours of Customer Demand**




Huff's model takes into account the pulling power of store A relative to the total pulling power of all other stores in the region. The pulling power of a retail store depends on the size, distance and types of products it offers. Therefore, three factors are used to calculate probability contours:

*The size of the stores in the regio*n. Large stores attract more consumers than small stores because they offer a wider selection of goods.

*The time taken to travel to each store*. Stores located in remote areas tend to be less attractive than those located close by because of the time consumed by traveling and the inconvenience of doing so.

*The type of product*. People are prepared to travel further for certain types of products (like quality furniture) than for other types of merchandise. The type of product being purchased has an influence on the way consumers balance the attraction of store size against the inconvenience of traveling a long distance to a store.

Huff's model helps in identifying the number of shoppers from surrounding towns or cities that may shop at a particular site or location. This model might also take into account the percentage of potential customers that would like to travel through the area to patronize retailers in other shopping centers in the locality. These percentages are included in the calculation.

Huff's law of shopper attraction defines trade areas on the basis of the product assortment (desired by the consumer) offered at different shopping locations, time taken to travel from the consumer's residence to alternative shopping centers, and the sensitivity of shopping to travel time. The product assortment variable is measured by total area (sqft) selling space a retailer expects all other firms at a shopping location to assign for a particular category. Sensitivity towards the kind of shopping describes the purpose of the trip – for restocking or for shopping and the type of goods or services being sought (like furniture, apparel or groceries).

Huff's law of Shopper Attraction can be given as

$$P_{ij} = \frac{\dfrac{s_j}{(T_{ij})^{\lambda}}}{\displaystyle\sum_{j=1}^{n} \dfrac{s_j}{(T_{ij})^{\lambda}}}$$

Where,

$P_{ij}$ = Probability of consumer's traveling from home i to shopping location j

$s_j$ = Square feet of selling space in shopping location j containing a particular merchandise category

$T_{ij}$ = travel time from consumer's home i to shopping location j

$\lambda$= parameter used to estimate the effect of travel time on different kinds of shopping trips

n = number of different shopping locations

$\lambda$ is usually determined with the help of research or a computer program. The application of this formula is illustrated by the following example:

A company manufacturing cosmetic products is planning to set up a leased department at a retail store at a specific shopping location. The company is studying three prospective shopping locations A, B and C. All the retailers in these areas are expected to assign 600, 350 and 250 total square feet of store space respectively in their stores to the company's cosmetic products. Potential customers reside 13 minutes from location A, 6 minutes from location B and 9 minutes from location C. From the research conducted earlier, the company estimated the effect of travel time to be 2.

$$P_{iA} = \frac{(600)/(13)^2}{600/(13)^2 + 350/(6)^2 + 250/(9)^2} = 21.7\%$$

$$P_{iB} = \frac{(350)/(6)^2}{600/(13)^2 + 350/(6)^2 + 250/(9)^2} = 59.4\%$$

$$P_{iC} = \frac{(250)/(9)^2}{600/(13)^2 + 350/(6)^2 + 250/(9)^2} = 18.8\%$$

Therefore, the probability of consumers shopping for cosmetic products at location A is 21.7%, at location B is 59.4%, and 18.8% at location C. If 100 people reside 6 minutes from location B, then 59 of them will shop there.

To determine the overall trading area for location B, similar calculations should be done for consumers living 5, 10, 20, 25 minutes away and so on. The number of consumers at each distance who would shop there must be added. This will enable all the stores at location B to estimate the total market, size of trade area, and primary, secondary and fringe areas for a specific product category.

Huff’s law can be applied only after taking into account the following factors:

- If more selling space is added for a particular product category at a location, the percentage of population residing at every travel time who shop at the store increases.
- The probability of consumers shopping at a specific location depends mainly on the influence of travel time (for that specific product category).
- Huff's model is highly product specific, so it gives different trade areas for different product categories.
- The variables in the model are difficult to calculate. For example, travel time should be converted to distance in miles for the purpose of mapping. Moreover, travel time depends on the type of transportation used.

## SITE EVALUATION AND SITE SELECTION

After identifying a particular trade area, the retailer must select a site for the store. To do so, the retailer must carry out a site evaluation and selection process.

### Types of Locations

The retailer can choose from three types of locations: the isolated store, the unplanned business district, and the planned shopping center. The number of customers visiting a store and the business generated by that store depends on the location of the store. (See Exhibit 6.3 for the advantages and disadvantages of various locations.)

#### Isolated store

The isolated store is a freestanding retail outlet situated either on a street or a highway. Stores of this kind do not have any retailers in their vicinity with whom they have to share consumers.

Usually, consumers are more aware of unplanned business districts and planned shopping centers than isolated stores. As a result stores at unplanned business districts and planned shopping centers generate a major chunk of retail sales.

The isolated store location is not suitable for small retailers as customers would not be willing to travel to small stores, which do not offer much variety and have a shallow assortment of merchandise. But large retail stores like Wal-Mart can afford to select an isolated location, as they are capable of pulling and retaining consumers.

#### The unplanned business district

Unplanned business districts are retail locations in which two or more stores are either situated together or closely in a manner that the total arrangement in that particular district was not planned in the initial long range planning. The stores are situated depending on what suits them best, but not on the basis of the district. Consequently, in a particular area all the stores may sell similar or related products. Unplanned business districts can be categorized into four types

**Exhibit 6.3**

**Advantages and disadvantages of various retail locations**

| Locations | Advantages | Disadvantages |
|---|---|---|
| Isolated Store | - Low rents<br>- Lack of competition<br>- Operational flexibility<br>- Good parking space | - Promotion driven<br>-Hard to attract customers |
| Central Business District | - Easy accessibility<br>- Good assortment of products and services<br>- High pedestrian traffic | - High rents<br>- Parking problems<br>- Traffic congestion |
| Secondary Business District | - Decent product assortment<br>- Proximity to residential areas | - Parking problems<br>-High rents |
| Neighborhood Business District | - Low rents<br>- Good parking facilities<br>- Less congestion<br>- Long working hours | -Limited assortment of goods and services<br>-Limited traffic |
| Planned Shopping Center | - Good product assortment and services<br>- Ample parking space<br>- High suburban population<br>- One-stop shopping center<br>- Sharing of common costs | - Land-lord imposed regulations<br>- High rents compared to isolated locations<br>-Competitive environment<br>-Domination by large anchor stores |

- Central Business District
- Secondary Business District
- Neighborhood Business District
- String

### *The Central Business District*

A central business district (CBD) is the traditional center for retailing in a city. It is the largest area for shopping in a city. A CBD has a high concentration of department stores and large offices; railway and bus stations; entertainment facilities like pubs, clubs, and cinemas; and a town hall. Generally, main roads converge into a CBD resulting in a high level of pedestrian and vehicular traffic. Real estate is very expensive in a CBD.

CBDs usually pull in consumers of all classes and ethnic groups from the whole city. A CBD contains at least one major department store and a group of specialty and convenience stores. The arrangement of stores in a CBD does not follow any specific format. Usually, early entrants occupy the central part.

Though CBDs are known for retailing activities, overall sales of outlets located in CBDs has been decreasing substantially compared to sales of outlets located in planned shopping centers. This has happened because many residential areas have shifted to the suburbs. In many major cities most of the people in middle and upper income groups have moved to the suburbs, where they are provided with planned shopping centers.

#### *Secondary Business District (SBD)*

An SBD is an unplanned shopping center in a city, which is generally bounded by the junction of two major streets. Big cities like New York in the US, London in the UK or Mumbai in India usually have many SBDs, each containing at least a mini department store, a variety store, and some big specialty stores apart from many small stores. The significance of this type of shopping location has been increasing because of the expansion of cities over large geographic areas. Stores located in an SBD are small outlets, which offer a limited variety of products with a shallow assortment. In addition they have a smaller trade area than that of the stores in CBDs. However they offer greater proportion of convenience goods than stores in CBDs.

#### *Neighborhood Business District (NBD)*

An NBD is an unplanned shopping center that caters to the convenience shopping and service needs of a particular residential area. An NBD typically consists of a small grocery store, stationery store, a bakery, a restaurant, a vegetable store etc. NBDs are usually situated on the main streets of residential areas.

#### *String*

A string is an unplanned shopping center, consisting of a group of retail outlets, generally offering similar or related products, situated along a street. Car accessory stores and jewelry stores are often found in a string.

### The planned shopping center

A planned shopping center consists of a set of architecturally similar commercial establishments constructed on a site which is owned and managed centrally, operated and designed as a single unit, has a balanced tenancy, and has access to good parking facilities. Generally, a planned shopping center contains one or more anchor stores along with a variety of smaller stores. Balanced tenancy helps the stores in a planned shopping center complement each other in the quality and the range of products offered, which enables them cater to the overall needs of the population in the trade area. To ensure balanced tenancy, the management of a planned shopping center stipulates the proportion of total space that each type of retailer may occupy, specifies the product lines that each of the different retailers may sell, and specifies the type of retailers who can obtain unexpired leases for stores in that shopping center. There are three types of planned shopping centers: regional shopping center, community shopping center and neighborhood shopping center.

#### *Regional shopping center*

A regional shopping center is a planned shopping center catering to a geographically dispersed market. It usually consists of at least one big department store and 50 or more small retailers. Regional shopping centers offer a very broad and deep assortment of products and services that are aimed at enhancing the shopping experience of consumers. A typical regional shopping center's target market consists of around 1,00,000 people, residing or working at a half hour's driving distance from the shopping center.

#### *Community shopping center*

A community shopping center is a medium sized planned shopping center consisting of the branch of a department store, a variety store, a category killer store, and many more small stores. It caters to the needs of consumers coming from one or better-populated residential areas located close-by. This type of center offers a moderate assortment of both shopping and convenience products and services. A community shopping center usually serves about 20,000 to 100,000 people residing or working within a 10 to 20 minute driving distance from the shopping center. Establishing a community shopping center requires long range planning.

#### *Neighborhood shopping center*

A neighborhood shopping center is a planned shopping center, which aims at providing convenience products that meet the daily needs of customers in a particular neighborhood. Such a center has a supermarket or a drugstore, which would be the largest store in the neighborhood. The other stores in the neighborhood shopping center are a bakery, a dry cleaner, a stationery store, a barber store, a beauty salon, a grocery store, a hardware store, and a restaurant. A neighborhood shopping center offers convenience goods and services to customers residing or working in the immediate vicinity. It typically serves 3,000 to 50,000 people who are located within a 15 minute driving distance. A neighborhood shopping center is planned carefully with balanced tenancy when developed initially. But with the passage of time, the planned aspects of this shopping center may disappear and the prospective new occupants of the store may face very few restrictions.

After identifying different types of locations, the retailer must select a location for its store. The decision to situate a store at a particular location is based on the strategy adopted by the retailer and a proper analysis of the strengths and weaknesses of every alternative location. Once the merits and demerits of the available alternatives have been analyzed, a broadly defined site for setting up the store can be identified. A retailer takes two decisions at this juncture, i.e., defining the general location type and identifying specific site at such a location.

## Choosing a General Location

The general location type could be like a "site on a highway in an isolated location" or a "neighborhood shopping center." Once the general location has been defined, the retailer has to identify the specific site in a city/region that matches the predefined site location.

### Assessing site evaluation criteria

Retailers should conduct extensive analysis to assess every general location and the specific sites present within them. Selecting the site for a retail store is as critical as the selection of a retail area, particularly for stores that depend on the traffic patterns of customers for generating business. In any area, the best site for a specific store is referred to as the 'one hundred percent' location. As different types of retailers require different types of locations, a location that is 'one hundred percent' for a particular retailer may not be the best location for another type of retailer. (Exhibit 6.4 represents the process of site selection and evaluation.)

**Exhibit 6.4**

**Location and Site Selection Process**

Shoppers' Stop, Lifestyle, Pantaloons, Westside, the new retail biggies of India, conduct thorough market research before establishing their store in a new region. Shoppers' Stop strictly follows three steps when setting up a new store: it determines the size of the market and (continuous to do so every six months), then it moves further by preparing a master plan, and finally it designs a merchandise assortment. All these functions are taken care of by the company's projects division. The first step projects division takes is to identify the city for setting up store. Since organized retailing is conceptually new to the Indian consumer, identifying a city for locating a store is usually not a tough decision to take.

Most of the new Indian retailers identified the big metros (Delhi, Mumbai, Kolkata, Chennai and Bangalore) and Class A cities as target cities for locating their stores. The most significant factors for selecting cities were urban population, average household income levels, regional bank deposit levels, sales of other consumer goods, and the penetration levels of credit cards. Depending on the results of studies conducted on these parameters, retailer identified different retail locations in a city. They then invited quotations for their lease or selling rates.

The projects division then estimates the size of the market at different locations with the help of ORG-MARG (an independent market research firm). To estimate the size of the market, the market research firm analyses the different consumer profiles at each prospective location, using data on product sales in various stores. This type of a study is referred to as the micro profile analysis of trade areas. Focus of the analysis is on the retailer's target segment – SEC class A, B1, B2 consumers. Towards the end of this study, the retailer is in a position to decide the site for situating the store. Shoppers' Stop generally targets a broad trade area, which usually spans the entire city, except in Mumbai, where it has three stores. This is probably because in most cities, Shoppers' Stop has been one of the very few contemporary, big size shopping centers available. Because of its novelty value, it can pull the customers from all over the city.

Lack of good large size retail locations, along with increasing competition in the market has taken away the freedom of retail companies to conduct major market research studies before selecting a particular location or site. Another hurdle in the process of selecting a location is rental costs. Shoppers' Stop also checks whether the property has a clear title, whether it is accessible, and whether it has parking facilities. The company might also have to follow certain basic guidelines when selecting the site. It might have to follow structural parameters like the height of the ceiling, gap between the pillars, width of the aisles, and so on. The size and location of a store also depends on the business plan of the chain. To ensure that its store size and merchandise mix fits into its business plan Shoppers' Stop usually carries out a wardrobe audit of the customer base in the concerned trade area. The researchers do detailed study of the garments purchased by these customers. A study of the brand usage is also carried out. These studies helps store estimate size of the trade area. A study of the target share-of wallet of the customers is also undertaken in the trade area. This helps the chain predict the sales potential of the concerned trade area.

*Adapted from The ET Knowledge Series RETAIL 2000-01, 54.*

Generally, a retail site is evaluated on the basis of the sales potential and the cost of doing business at that site. The following factors must be considered when selecting a site:

- Sales potential of the site
- Access to the site
- Access for pedestrians
- Synergies from nearby stores
- Leasing and occupancy terms

- Nature of the site
- Legal and political environment

The *sales potential* of a site is determined by demographic, economic and competitive factors and the strategies through which the retailing firm wishes to create a competitive advantage. When evaluating the sales potential, a retailer should also consider the growth potential for a store in that prospective location.

*Accessibility* to the site refers to the ease with which a customer can approach or leave a store located on a specific site. This depends on road patterns, their condition, the number of traffic signals on the way to the site in the primary trade area, parking facilities etc.

*Pedestrian accessibility* refers to the ease with which pedestrians can navigate their way towards the store or walk through the mall. This depends on the congestion on the roads, the congestion within the mall where the store is located, and visibility of the store.

The *synergies* that a store can derive from being located next to other stores also play a crucial role in site selection. Complementary retail stores at a particular shopping center help each other. When all the stores in a shopping center have similar strategies for retailing in terms of merchandise assortment, quality, prices, services and the shopping environment, they derive a cross shopping benefit.

The terms of *lease and purchase contracts* have a significant impact on a retailer's site selection decision. The occupancy rate in the immediate or surrounding locality is also a critical factor. For instance, a low occupancy rate at a particular shopping center can increase the retailer's negotiating power as the real estate developer would be eager to fill the vacant space. But, a low occupancy rate can also be an indication of poor access and poor market variables. If the low occupancy rate does not indicate poor economic viability, it can attract unwelcome competitors.

The *legal and political environment* also has an influence on site selection. In most countries, the setting up and development of retail outlets is governed by a set of regulations. Generally, these regulations determine the location of retail stores, space needed to be left, the height of the building, the permissible floor space, the availability of parking space in relation to the floor space, the presence of fire protection systems and the standards of structural safety. Evaluating the legal and political environment before locating in a foreign country is important, as the future operations of multinational retailers are more vulnerable to the political changes.

The nature of the site and its surrounding areas must not be ignored, whether it is open land or an already existing structure. The physical specifications and features of the site must be in accordance with the needs of the retailer. Many factors are critical to the retailer's business plan: traffic flow during the day time, number of cars that can be accommodated in the parking space, and, most important, the room for expansion. A site which is functional today might not be functional at a later date with the growth of the business.

## Multi-Attribute Weighted Checklist

Most of the retail outlets integrate all site evaluation factors with the help of management's judgment. At the ground level, a checklist for all significant factors is prepared and the site is evaluated according to the degree to which the site meets the desired characteristics.

Table 6.1 gives a model multi-attribute weighted checklist that can be used for evaluation of sites. The left side column displays certain attributes which the management considers important. The top row comprises a list of possible sites. Each attribute is given weightage (from 1-5) according to its importance for a proposed store. Then each attribute is assigned a number, depending on the extent to which the attribute is present at each of the sites mentioned. The final score for each attribute at a particular site is arrived at by multiplying this number with the weightage given by the management. The sum of the total scores of all the attributes gives the total score of each site. Thus, to take a decision with respect to the setting up of a store, the management can select the site with the maximum score.

**Table 6.1: A Multi-Attribute Weighted Checklist**

| **Attribute** | Management Importance | Existence | | | | Score = importance Δ existence | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Shopping Center | CBD | Isolated Location | Strip Mall | Shopping Center | CBD | Isolated Location | Strip Mall |
| **Traffic Flow and Accessibility** | | | | | | | | | |
| Access of Vehicular traffic | | | | | | | | | |
| Access to Pedestrian traffic | | | | | | | | | |
| Availability of mass transit | | | | | | | | | |
| **Retail Competition** | | | | | | | | | |
| Number of stores in the area | | | | | | | | | |
| Competitiveness of other retailers | | | | | | | | | |
| Possibility of joint promotions with local retailers | | | | | | | | | |
| **Site Characteristic** | | | | | | | | | |
| Number of parking spaces available | | | | | | | | | |
| Visibility of the site | | | | | | | | | |
| Compatibility of neighboring stores | | | | | | | | | |
| **Cost Factors** | | | | | | | | | |
| Easy terms of lease/rent agreement | | | | | | | | | |
| Basic rent payments | | | | | | | | | |
| Length of lease | | | | | | | | | |
| Local taxes | | | | | | | | | |
| Operation and maintenance cost | | | | | | | | | |
| Restrictive clauses in lease | | | | | | | | | |
| **Total** | | | | | | xxx | xxx | xxx | xxx |

## SUMMARY

Retailers desire to set up their outlets in the best possible locations. The optimum store location for a retailer is based on many factors like the type of industry, the product category being sold, and the degree of competition. Retail stores are located where the opportunities offered by the market are at a maximum.

Retailers usually go through four step process to select a store location: a) analyzing alternate trade areas; b) determining the most beneficial type of location; c) selecting a general site and; d) selecting a specific site. A trade area refers to the geographical area from which retailers attract customers. When two or more shopping centers are situated close to each other, then their trade areas would overlap. Every trade area consists of three parts, primary, secondary and fringe. The size and shape of the trade area depends on the size of the store, the type of the store, competitor's placement, and the time taken to travel to the store. Reilly's Law and Huff's model help retailers define their trade area. Globally, retailers use geographic information systems to analyze and delineate their trade areas. And three major factors that help retailers analyze their trade areas accurately: the characteristics of the population, the characteristics of the economic base, the competition and the level of retail saturation.

There are three types of locations that a retailer can consider for locating its store – isolated store, unplanned business districts and planned shopping centers. Important factors that are considered when selecting a site are: sales potential; accessibility; pedestrian traffic; terms of occupancy; and the legal and political environment.

The retailer must go through all these steps of location and site evaluation to find the "one hundred percent location".

# Chapter 7

# Retail Organization and Management

**In this chapter we will discuss:**

- Designing a Retail Organization Structure
- Principles of a Retail Organization
- Forms of a Retail Organization
- Retail Organization Structure
- Legal Forms of a Retail Organization

# INTRODUCTION

A retail organization is a formal collection of people and other resources to accomplish a set of goals. Retail organizations use various resources like people, merchandise, machines, money, information and stores to cater to the needs of their target customers. Retail establishments should design an organization structure that helps them achieve their goals in an effective and efficient manner.

The organizational structure depicts an organization’s managerial, administrative, and operational relationships. It also represents the authority, responsibility, and accountability of the store personnel working at various levels of a retail organization. A retail organization structure groups various activities in the retail store for better administration and control.

The organization structure differs from store to store. It depends on various factors: the number of retail outlets and their size, the nature of the merchandise, the breadth and depth of the merchandise offered, the level of customer service, the positioning of the store etc.

The organization structure determines how well a retail store can function efficiently and effectively in a given competitive environment by satisfying the needs of its target market segment. Retail organizations can use various structures depending on the goals of the organization and its approach to store management. This chapter discusses the various aspects of designing an organization structure and managing a retail store to serve the needs of its customers efficiently and effectively.

# DESIGNING A RETAIL ORGANIZATION STRUCTURE

A retail organization structure helps in identifying the reporting relationships and decision-making authorities in a particular retail organization. It also describes the flow of information and communications in an organization. Thus, designing an organization structure is essential for ensuring the smooth functioning of a retail store. Before deciding on the structure, a retailer should define the objectives of the retail organization and identify the various organizational tasks that are required to achieve those objectives.

## Defining Organizational Objectives

Organizational objectives are the important ends towards which an organization's and its employees’ efforts are directed. A well defined set of objectives would help a retailer answer the following questions: what is the retail store planning to achieve? How would the store achieve those ends? In which direction is the store heading? Apart from helping the retailer answer these questions, organizational objectives also set guidelines for developing a retail plan.

Generally, every retail organization has three levels of objectives:

- Strategic objectives
- Operational or administrative objectives
- Functional objectives

### Strategic objectives

The top managers of a retail organization formulate its strategic objectives. These managers have expertise in different fields: human resource management, finance, accounting, management information systems, distribution etc.

### Operational objectives (administrative)

On the basis of the strategic objectives, middle level managers formulate the operational objectives of a retail store. These managers are called administrative/operational managers.

The operations manager handles the merchandising and store management activities in a retail store. He implements the strategic plans of the organization with the help of the administrative staff.

### Functional objectives

Front line managers are responsible for achieving the functional objectives of a retail store. The functional objectives are task specific and are related to store functions like merchandising, sales, logistics etc.

## Identifying Organizational Tasks

To achieve organizational objectives, a retail store has to entrust various tasks to its employees. Organizational tasks vary from one retail store to another. Some of the general tasks performed by retail store personnel are given in Exhibit 7.1

**Exhibit 7.1**

**Tasks Performed in a Retail Firm**

| | |
|---|---|
| **Strategic Management Tasks** | Develop a strategy, identify the target market, determine the retail format, design organizational structure, select locations. |
| **Merchandise Management Tasks** | Buy merchandise – Locate vendors, evaluate vendors, negotiate with vendors, place orders.<br>Control merchandise inventory – Develop merchandise budget plans, allocate merchandise to stores, review open-to-buy and stock of position.<br>Price merchandise – Set initial prices, adjust prices. |
| **Store Management Tasks** | Recruit, hire and train store personnel, plan work schedules, evaluate performance of store personnel, maintain store facilities, locate and display merchandise, sell merchandise to customers, repair and alter merchandise, provide services such as gift wrapping in delivery, handle customer complaints, take physical inventory, prevent inventory shrinkage. |
| **Administrative Management (Operations) Tasks** | Promote the firm, its merchandise and services – plan communication program, develop communication budget, select media, plan special promotions, design special displays, manage public relations.<br>Manage human resources – develop policies for managing store personnel, recruit, hire, train managers, plan career paths, keep employee records.<br>Distribute merchandise – locate warehouse, receive merchandise, mark and label merchandise, store merchandise, ship merchandise to stores, return to merchandise to vendors.<br>Establish financial control – provide timely information on financial performance, forecast sales, cash flow, profits, raise capital from investors, bill customers, provide credit. |

*Source: Icfai Center for Management Research.*

## PRINCIPLES OF RETAIL ORGANIZATION DESIGN

Retail organizations should follow certain principles when designing the organization structure to avoid duplication of work and ambiguity in the line of authority. The organization structure developed around such principles (listed below) would clearly explain the functions and responsibilities of each employee in an organization.

Retail store management involves various tasks concerned with strategic management, merchandise management, store management, operations management and promotion management. Managers should use various principles to classify employees into groups and allocate the responsibility of completing tasks. Some of the principles that retailers use when designing a retail organization structure are

- Specialization and departmentalization
- Line of authority and responsibility
- Unity of command
- Span of control

### Specialization and Departmentalization

Once a retail organization identifies the activities that are necessary to achieve its objectives, it must split those activities into specific tasks that can be performed by individual employees. This division of labor into small, specific tasks and the assignment of specific tasks to individual employees is called specialization. Job specialization allows individual employees to concentrate on a particular task. By specializing in some activities, employees can improve the quality and speed with which they serve the customer.

After assigning tasks to employees, a retail manager should group the tasks into small sets. Employees performing certain tasks can be grouped together into units or departments. Many retailers use departmentalization to enhance productivity. Some of the ways in which employees are divided into groups are discussed below:

***Departmentalization by Function*** involves grouping of jobs that relate to the same organizational activity. For example, all employees performing tasks concerned with merchandise management are put in one department.

***Departmentalization by Product*** involves grouping of jobs that relate to a particular product or service. A retailer may group employees into departments like apparel, home furnishing, footwear etc.

***Departmentalization by location*** involves grouping of jobs that are performed in a geographic area. A chain store may consider each of its retail stores, warehouses etc. as separate departments.

***Departmentalization by customer*** involves grouping of employees on the basis of the customers they serve.

**Authority and Responsibility**

For the efficient functioning of the store, employees should be given the authority and responsibility to perform tasks without any assistance from senior officials. The store manager is responsible for maintaining service standards, while the sales manager is responsible for ensuring that customers receive prompt service. These managers can perform well only when they are given complete authority and responsibility to carry out their specific functions.

Store personnel working at various levels of the organization may share a ‘Line relationship’ or a ‘Staff relationship’. Line relationships exist between employees working at various organizational levels. Here the manager has direct control over his immediate subordinates. Staff relationship is advisory in nature.

### Unity of Command

According to the principle of unity of command, employees (in a retail organization) should be answerable to only one immediate superior for a particular task at any given point in time.

The efficiency of retail store employees decreases when they have to report to or follow the instructions of more than one supervisor. By implementing unity of command in a store, management can help employees perform better.

### Span of Control

The efficiency with which a store supervisor/manager handles his subordinates decreases when the number of subordinates increases beyond a particular level. Hence, every retail organization should determine the optimal number of subordinates a manager can handle efficiently. The principle of span of control gives guidelines for determining the number of subordinates a superior should control, depending on his position within the organization and the nature of the tasks being performed by his subordinates. These guidelines are based on the following principles:

- Supervisor’s span of control becomes narrow when employees’ tasks are ambiguous and not standardized.
- Supervisor’s span of control broadens when employees and the supervisor are competent.
- Manager’s span of control increases when subordinates work at a single location.

# FORMS OF RETAIL ORGANIZATION

A retail store designs its organization structure in a way that ensures its smooth functioning. An appropriate organization structure is one that helps a retail organization understand and meet the requirements of its target market.

In a retail organization, the structure or design should be communicated to employees. An organizational chart can be used this purpose. Organizational charts/maps help employees to understand the formal relationship between the various departments of the organization.

Prior to designing the organization structure, a retailer should decide on

- the number of hierarchical levels required in the organization for its successful and efficient operation
- the classification of various tasks into different areas and the number of such areas required

## Levels of Organization

The number of levels in a retail organization equals the number of positions separating the highest official (CEO) from the lowest employee (sales personnel). Retail organizations adopt two types of organizational structures, flat organizational structure and tall organization structure.

### Flat organizational structure

In a flat organizational structure, there are one or two management levels with a wide span of control. This type of organizational structure is commonly used by independent and small retailers to reduce operational costs. A flat organizational structure ensures speedy redressal of employee grievances. The number of employees reporting to a manager are higher than in a tall organizational structure.

### Vertical or tall organizational structure

In a vertical structure there are many organizational levels. This type of organizational structure is commonly found in department stores and chain stores. There are some drawbacks to a vertical organization structure. In a vertical organization structure, the rigid structure is the major drawback. In addition, there is no direct communication between managers and subordinates. The presence of many layers of management makes it difficult for an organization to take quick decisions regarding the provision of goods and services that meet the changing needs of the customers.

### Organizing by areas of responsibility and task

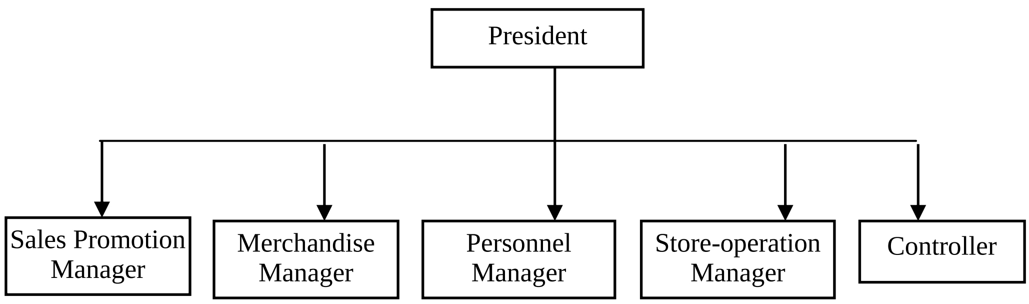
An organization can be structured according to the way in which tasks and responsibilities are assigned to employees. For designing an organization structure based on tasks and responsibilities, retailers can use one of the following approaches:

- Functional approach
- Geographic approach
- Product approach

#### *Functional approach*

In this approach, jobs are grouped according to functional areas. The functional areas of a store are store operations, buying and selling of merchandise, promotional activities, recruitment and training of store personnel etc. Generally, small retailers use a two function (merchandising and store operations) organization structure. They add some more functions in the structure as the business grows. Figure 7.1 shows a functional organization chart.

**Figure 7.1: Functional Organization Chart**



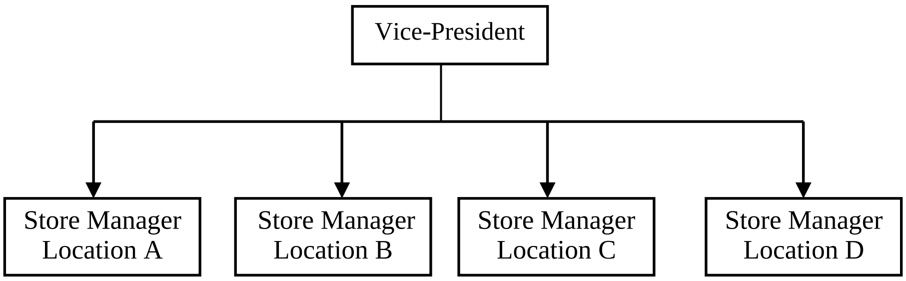

#### *Geographic approach*

In this approach, work is allocated on the basis of the geographical location of the organization. Chain stores use the geographic approach to allocate work to achieve economies of scale. Depending on the geographical location, the organization decides on the levels of hierarchy and the degree of specialization required for a particular store. Figure 7.2 depicts a geographic organization chart.

#### *Product approach*

In this approach, a retailer organizes the store according to the products he sells. This organization structure is designed to satisfy the needs of the customers buying these products. Figure 7.3 provides the product organization chart of an apparel-retailing store.

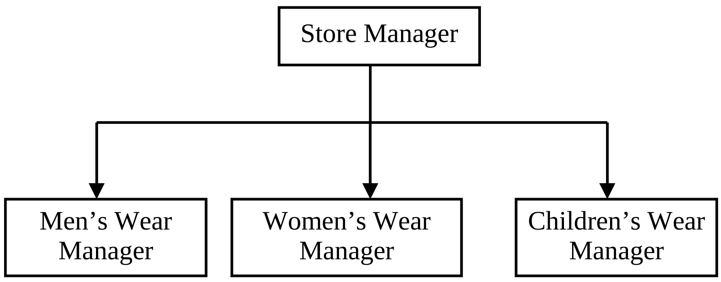
**Figure 7.2: Geographic Organization Chart**




## RETAIL ORGANIZATION STRUCTURES

Retailers can be classified into three major groups on the basis of their size and nature: independent retailers, department stores and chain stores. The retail organization structures used by these retailers are discussed below. Exhibit 7.2 and Exhibit 7.3 depict the organization structures of Carrefour, a French retail group, and Wal-Mart respectively.

**Figure 7.3: Product Organization Chart**




### Independent Store Organizational Structure

An independent retailer establishes a store with very few employees. All the activities of the retail store are managed by the owner himself.

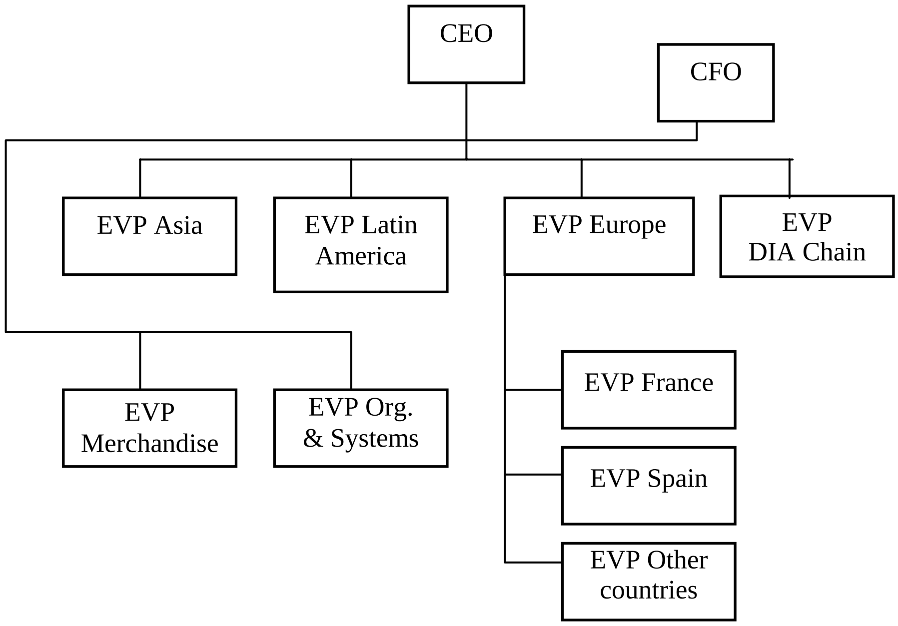
As the store expands, the retail owner hires a few more employees. The coordination and control of the business is easy as the owner manager allocates the works to his employees and monitors them personally. As sales increase, the retailer (owner) hires supervisors who have specialized in the field of merchandising and operations. Even at this stage, critical store management activities like planning, execution and control are carried out entirely by the owner. Moreover, he also controls the financial activities of the retail store.

The merchandise manager is responsible for developing, procuring, controlling, pricing, promoting and selling the merchandise in the store.

The operations manager is responsible for recruiting and supervising store personnel, planning information systems, designing and maintaining store facilities, and ensuring the store security.

**Exhibit 7.2**

**Organizational Structure of Carrefour**




*Source: Annual Report Carrefour, 1999.*

## Department Store Organizational Structure

Department stores have more complex and taller organizational structures than independent stores. Traditionally, department stores were family-owned businesses and the entire store was supervised by the family members. The organization structure and the executive positions in such stores were designed to accommodate the family members in the store. Gradually, with advances in technology and increase in competition, the organization structure of these stores changed. Most modern department store organization structures are inspired by the functional organization structure proposed by Paul Mazur in 1927. This organization structure is popularly known as the Mazur plan.

### Mazur plan

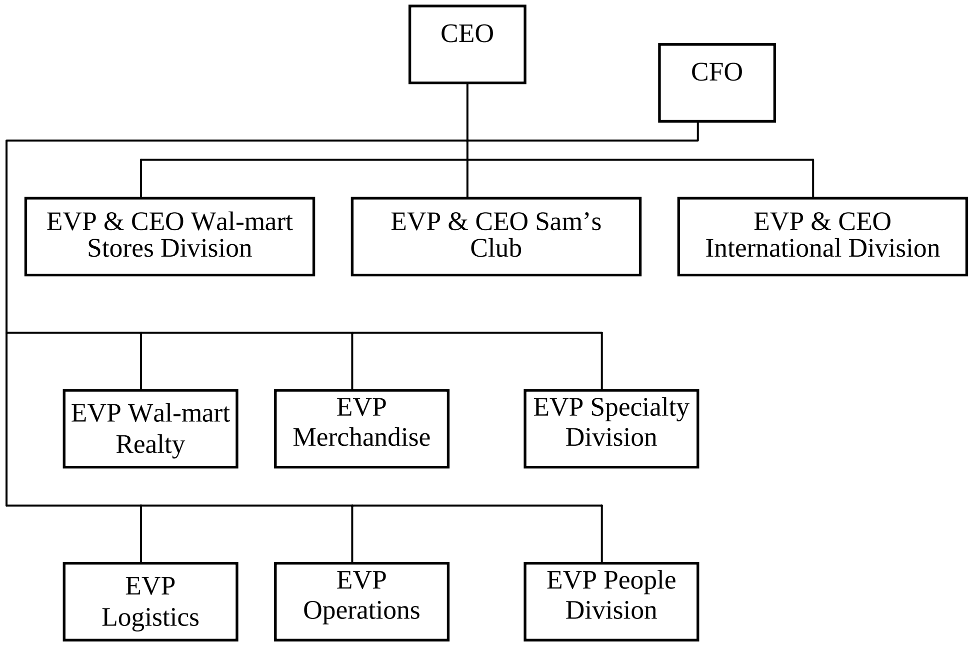
The Mazur plan divides all retail activities into four functional divisions/areas: finance (accounting and control), merchandising, promotion, and store operations (Figure 7.4 depicts a basic Mazur organization plan for department stores). Each division is handled by a manager. The responsibilities of the different managers are given below.

The finance manager is responsible for the efficient management of a firm's assets. He should also ensure adequate working capital for the smooth functioning of all the divisions in the retail store. The finance manager is also responsible for

- Designing and updating various accounting and control systems.
- Preparing budgets for physical inventory, merchandise and expenses of a retail organization.
- Preparing financial reports for the various stakeholders of the firm, like top management, government agencies and trade organizations

**Exhibit 7.3**

**Organizational Structure of Wal-mart**




*Source: Annual Report Wal-mart, 1999.*

The merchandising manager supervises the buying and selling activities of the retail organization. He also has to ensure that quality, fashion, assortment, and pricing of merchandise are in line with the overall retail strategy of the firm. He has to coordinate all the activities of the retail organization e.g. regarding finance, promotion and operation.

The general merchandising division plays a central role in a retail organization as it carries out activities that are aimed at satisfying the customer.

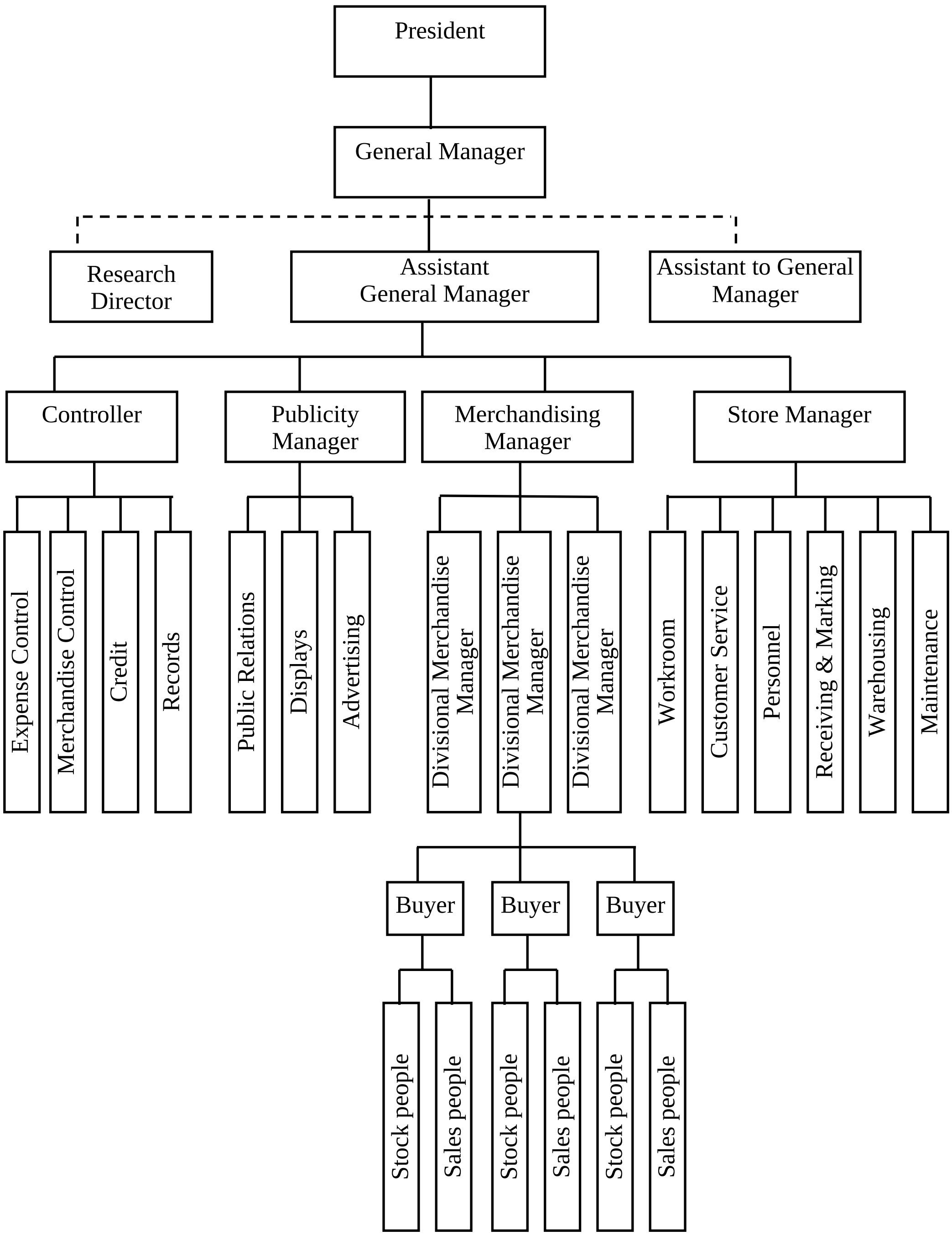
The promotion manager is responsible for all the promotional activities of a retail organization. These activities include advertising, sales promotions, interior and window displays, public relations and publicity. He is also responsible for collecting feedback from customers and passing it on to the marketing wing, which handles advertising for the retailer.

The physical operation of a retail store comes under the jurisdiction of the retail operations manager. He is responsible for the development and maintenance of facilities; customer service and assistance; credit and collections; procuring, checking, marking and stocking of incoming merchandise; store security and general store keeping. Sometimes an operations manager acts as a proxy personnel manager, handling activities like recruitment and training and evaluation of store personnel.

### *Modifications to the Mazur plan*

Even though many retailers used the Mazur plan to design their organizational structures, they believed that it had some shortcomings. With the increase in the scale and complexity of retail store operations and the evolution of independent stores into chain stores, retailers felt that the Mazur plan required some modification. Consequently two types of modifications were made:

**Figure 7.4: Basic Mazur Organization Plan for Department Store**




*Adapted from Paul Mazur, Principles of Organization Applied to Modern Retailing. (New York: Harper & Brothers, 1927)*

- Functional Modifications
- Geographic Modifications

***Functional modifications*** to the Mazur plan changed the number of functional divisions. In the modified Mazur plan, an additional functional division was added to the existing four divisions. The new functional division could be personnel division or distribution or real estate and construction or catalog operations. Further, the buying and selling functions (which were earlier handled by the general merchandise manager) were separated. The reasons in favor of separation of the buying and selling functions are given below:

- The skills, talents and training required for buying and selling are very different. Salespersons should have good communication skills whereas merchandise buyers should have good bargaining skills to succeed in their respective fields.
- Buying activities take more time than selling activities. If one person is handling both functions, he would be away from the store for a long time. Moreover, if he focuses on buying activities, he will not be able to spend sufficient time on selling activities.
- Efficient handling of consumer feedback takes time and requires the manager's undivided attention. The store manager who is involved in many other activities cannot do justice to any single activity. The general merchandise manager who plays the roles of buyer, salesperson, and customer care executive cannot do justice to any of these roles.
- Flexibility decreases when a single person handles all the buying and selling functions and responds to consumer feedback. Efficiency and flexibility increases more when these functions are divided among two persons.
- The arrangement of merchandise in the store should facilitate the selling function.

Although many retailers favor the separation of the buying and selling functions, a few experts oppose this separation. Some of the arguments that support the clubbing of the buying and selling functions are given below:

- To understand customers better, the buyer should also handle the selling function. In other words, a single person should handle both the buying and selling activities in a retail store.
- If a single person handles both the buying and selling of products, customer satisfaction will increase. This is because the buyer would procure merchandise on the basis of first hand information about the tastes and needs of customers.
- Performance evaluation of various departments will be simplified if the buying and selling functions are carried out by the same person.
- The bundling of buying and selling functions would eliminate the conflicts that arise between the selling and buying personnel when both the functions are separated.

***Geographic modifications to the Mazur plan*** became necessary with the increase in the scale of retail operations of department stores and the establishment of outlets in different geographic locations. Retailers had to modify their organization structure to cater to requirements of stores operating in different locations. The Mazur plan can be modified on the basis of one of the following approaches:

- Main store approach
- Separate store approach
- Equal store approach

The relevance of geographic modifications increases with the growth of retail organizations.

***Main store approach:*** In this approach, the main store or the parent organization controls the operation of the branches. Functions like merchandise buying, promotion, personnel management, and operations are carried out by the same managers in the main store for all the branches. These managers operate from the main store. For example, in the main store, the store activities are handled by four divisional heads – the finance manager, the general merchandise manager, the promotion manager and the operation manager. These same managers will control the activities in the branches also.

The managers at the parent organization (main store) are responsible for all the activities in the branches. In the branch stores, sales activities are looked after by the branch sales manager, who reports to the sales manager at the main store. In the main store approach, branch stores are regarded as sales divisions of the main store.

This type of approach for designing the organization structure of a department store is advisable

- when it is in the initial stages of growth.
- when the markets in which these stores operate are similar and when all the stores sell the same range of merchandise.
- when the branches are located close to the main store. The geographical distance between the parent and the branch stores should be such that the management and the supporting staff can access and supervise the branch stores easily.

***Separate store approach:*** In this approach, each branch is treated as an independent operation within the organizational structure. In other words, there is no main store that controls the operations of the branches. All the functions (merchandising, finance and operational activities) are carried out separately by each branch.

The separate store approach is adopted by department stores

- When there are many branches, say five or more.
- When the size of all the stores is almost the same.

### Advantages

The separate store approach has the following advantages:

- Every store in the retail organization has a greater degree of freedom over its operation.
- The stores can offer customized products as each store can take its own decisions.

### Disadvantages

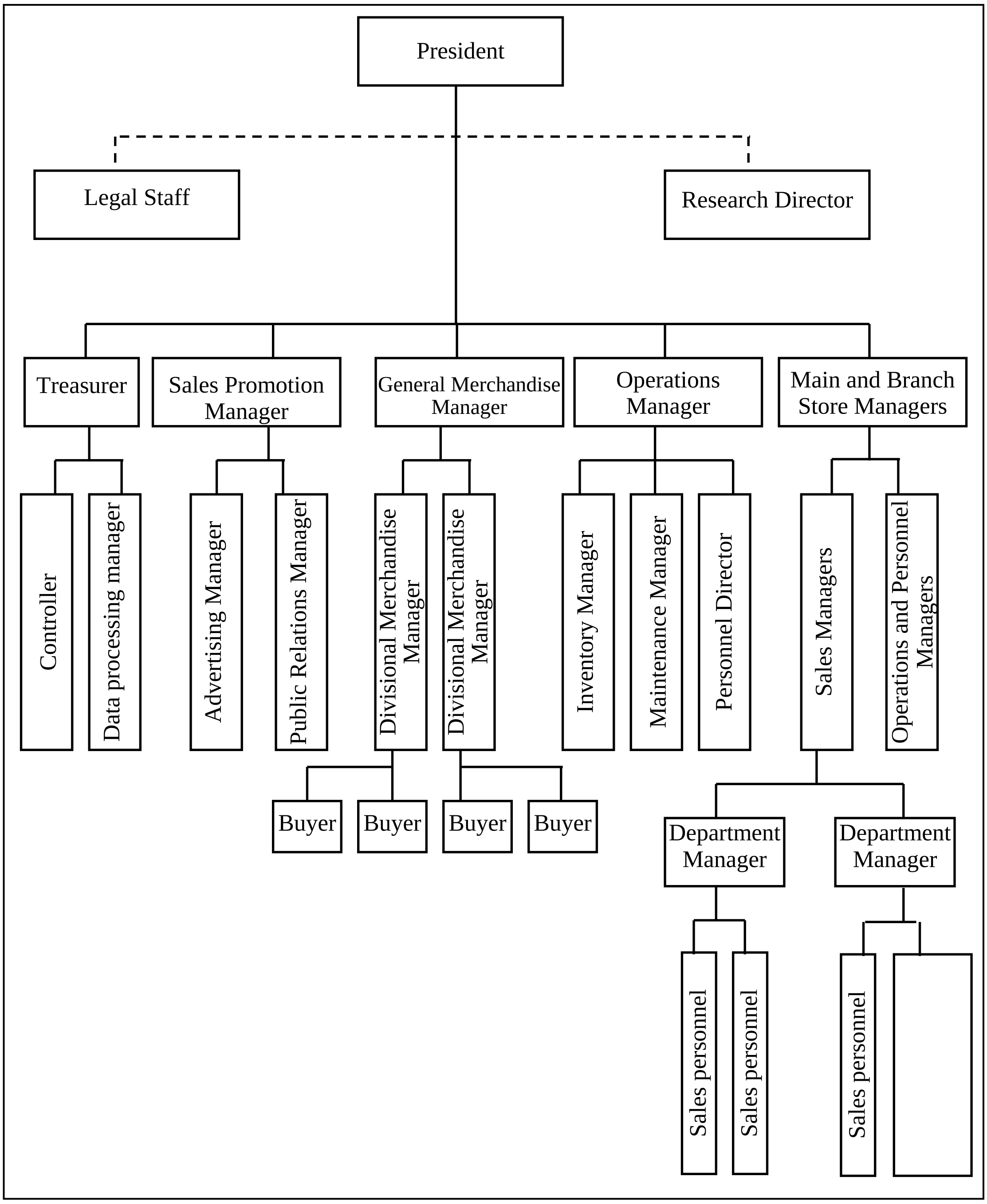
The disadvantages of the separate store approach are listed below:

- Diseconomies of scale in buying arise because each store has to buy its own merchandise and other supplies.
- Increase in operational costs due to employment of more people in each department.
- Difficulty in maintaining a consistent image across all branches.
- Difficulty in achieving coordination between the stores.

The main store approach is not responsive to local needs, but the separate store approach is costly and difficult to manage. So a new approach, called the equal store approach, was developed.

***Equal store approach:*** In the equal store approach, all the managerial functions are centralized and controlled by headquarters. Managerial functions like finance, merchandising, promotion and operations, are directly controlled by headquarters for all the branches. Figure 7.5 depicts an equal store organization structure used by many chain stores. This approach has two unique features:

**Figure 7.5: Equal Store Organizational Format (used by Chain Stores)**



*Separation of buying and selling activities:* Under the Mazur plan, both functions are handled by the general merchandise manager. But in this approach, the merchandise manager handles the buying function alone. The selling activities are decentralized and carried out by managers at individual stores.

*Equal treatment:* All stores (branches and main store) are treated equally as basic sales units of the retail organization.

Thus, the equal store approach has the advantages of both the main store and the separate store approach. Centralized buying generates economies of scale while the separation of functions allows individual stores to cater to the needs of the individual target markets.

### Chain Store Organizational Structure

The size, geographic spread, local markets, product mix and operating mix vary from store to store in a retail chain store organization. There are three factors that have an impact on the organization structure of a chain store organization:

- Centralization
- Specialization
- Standardization

Centralization refers to the degree to which authority for taking retailing decisions is delegated to corporate managers rather than to geographically dispersed regional, district, and store managers. A retail organization is said to be centralized when all policies and decisions regarding the operating and merchandising activities of its constituents are taken by headquarters or the home office.

Many chain stores adopt centralized decision making to keep transaction and overhead costs low. Some chain stores found that increased centralization can lead to slower decision making. Therefore, these stores explored various ways to achieve a balance between centralization and the need to meet local needs.

Specialization differentiates chain store organizations from other store formats. Chain stores group tasks into a number of specialized functions, which are greater in number than those specified in the basic Mazur plan. Specialized store functions include distribution, marketing, real estate and construction, personnel and industrial relations along with the four basic functional divisions finance, merchandising, operations and promotion.

A high degree of standardization for merchandising and operations is another special feature of chain store organizations. Standardization, in the case of chain stores, refers to the consistency of the merchandising and operating procedures practiced by geographically dispersed retail stores. Chain stores have effective monitoring and control systems for gathering information to achieve standardization. Chain stores use standardization as a tool to convey a consistent image.

## LEGAL FORMS OF RETAIL ORGANIZATION

The ownership of a business depends on the size of the business, requirement of capital and the methods used for protecting the owners from liabilities. As the organization grows, the form of ownership also changes. Legally, there are three types of ownership:

- Sole proprietorship
- Partnership
- Corporation

*Sole proprietorship:* Sole proprietorship is a common and simple form of ownership. In this type of ownership, the store is completely owned by a single person.

There are no formal legal requirements to set up a sole proprietorship firm. Only a license is required from the local jurisdiction (like municipal corporation or health department). A person starting a store using this method need not fulfill any other legal formalities other than complying with the laws governing the type of business the person is setting up. This method thus allows a retailer to quickly set up a retail organization with minimum costs. Here, the owner has the complete authority in decision-making and is entitled to all the profits from the retail operations. Many mom-and-pop stores are sole proprietary business entities.

*Partnership:* When two or more persons come together to start a business, without incorporating it, the business is called a partnership. Here, all partners take part in decision-making. They share the profits on the basis of the agreement made at the time of formation of the store.

There are two types of partnerships- general partnership and limited partnership. In a general partnership, all partners have equal authority and responsibility for the management of the business. In a limited partnership, more than one member may finance the business, but only a few members will manage the operations of the retail store.

*Corporation:* It is a legal business entity authorized by the law to operate as a single person, even though it may consist of a number of stakeholders.

An individual or a group can select any of the above ownership patterns for starting a retail organization. The ownership pattern should be selected on the basis of various factors like the scale of operations, desired level of risk and liabilities, capital, and skills required to manage the retail organization.

## SUMMARY

An organization is a formal structure of roles and positions put in place to achieve some specific goals. The structure of a retail organization defines the role of employees and the way in which the organization functions. This chapter discussed the steps involved in designing an appropriate retail organization structure to enhance a store's ability to serve its target markets. To design an effective retail organization structure, managers/ owners must define store objectives, identify the tasks, classify the tasks and jobs, and assign responsibilities and authority to various positions, and define the relation between them.

Organizations can have flat structures or vertical (tall) structures. A flat organization structure has only one or two levels of management, whereas a vertical organization has more than two levels of management.

Independent stores, department stores and chain stores use different organization structures to facilitate their operations. Department stores use the basic Mazur plan with some modifications to design their organization structure. This chapter also described various forms of ownership like sole proprietorship, partnership and corporation.

# Part III
# Merchandise Management

# Chapter 8

# Merchandise Assortment Planning

**In this chapter we will discuss:**

- Organizing the Buying Process by Categories
- Category Management
- Setting Financial Objectives
- Gross Margin Return on Inventory Investment
- Sales Forecasting
- Assortment Planning Process
- Product Mix Trends

## INTRODUCTION

The variety and assortment of merchandise offered by a store play a major role in attracting customers. The retailer must make decisions regarding the merchandise offered depending on the sales targets and financial objectives of the store. Merchandise comes in a variety of sizes, colors, makes and models. Retailers should be very careful while deciding on the amount of stock to be maintained in each category; if large stocks are maintained in a particular category, there may not be sufficient resources left for providing a deeper assortment of goods. Hence, the retailer should establish a trade-off between the types of categories or assortment and the inventories being maintained.

For a judicious mix of merchandise and its arrival in the store for sale at the right time, several individuals and functional departments such as purchase, warehouse, finance, store operations, etc. have to coordinate their activities. Managing merchandise properly is of great significance for any retail firm.

Retailers, big or small, take many decisions pertaining to thousands of individual products being offered for sale, sourced from hundreds of vendors. Therefore, retailers should adopt a well-organized and systematic merchandise buying process. A systematic merchandise planning process enables the purchaser to forecast with some degree of accuracy, what to purchase and when to make the goods available to customers. A good merchandise plan is important for a retail store to achieve its sales and gross margin goals.

This chapter explains how retailers can manage their different merchandise categories in order to achieve their objectives.

## ORGANIZING THE BUYING PROCESS BY CATEGORIES

A category is a retailer’s fundamental unit of analysis for making decisions pertaining to merchandising. A category is a distinct, manageable group of products or services, which are perceived by customers to be interrelated and\or substitutable. For example, men’s jeans and girls’ jeans are two categories, which have similar characteristics. The pricing and promotional aspects of these two merchandise categories are targeted at similar customers.

## CATEGORY MANAGEMENT

Category management is a process of managing all stock keeping units (SKUs) within a product category. It involves the simultaneous management of price, shelf-space, merchandise strategy, promotional efforts and other elements of the retail mix within the category, based on the firm’s goals, the changing environment and the consumer behavior. Thus, category management has two main objectives – satisfying the customer and increasing sales in each category.

In a majority of retail organizations, the responsibility for purchasing merchandise is shared by a category manager and a merchandise planner. Merchandise planning is an evolving concept in retailing and hence, this process is handled differently by different retailers.

Typically, it is the category manager who looks after all the functions of merchandise management. The responsibilities of a category manager include interacting with the vendors, merchandise selection, merchandise pricing and working with the advertising department for developing various promotion schemes. The responsibilities of a merchandise planner in a typical retail organization are more analytical and involve purchasing the right quantities of each merchandise category, assigning the merchandise to stores, looking after the sales activities and suggesting markdowns.

## The Category Management Process

Category management helps the retailer answer questions like: What type of merchandise should be offered to the customer? What quantities of merchandise should be made available? What pricing strategy should be adopted? In which stores should the merchandise be made available? Which part of the store should be assigned to particular types of merchandise? How much shelf space should be assigned to a particular merchandise category? What type of advertising strategy should be adopted?

A typical category management process is split into the following steps:

### Category definition

Defining a category is the first step in the category management process, in which the retailer classifies the products into different categories depending on the usage of the product by the consumer and its packaging.

### Role of category

Deciding on the role of a category is the second step in the category management process, in which the retailer decides the role of each category and determines its position in the category mix. In general, there are four category roles:

*Destination categories* are used by the retailers to position themselves as the preferred stores of customers through their superior service and better value offerings. For instance, the fresh foods (fruits, vegetables, bread, butter, etc) made available at a particular hypermarket make it a choice location for customers for food products.

*Routine categories* are products that are used by customers on a regular day-to-day basis. Products placed under routine categories include hair oils, detergent powders and cakes, shampoos, soaps, toothpastes and services like banking.

*Convenience categories* include products that are more conveniently purchased by customers from neighborhood retail outlets rather than from an outlet at a greater distance, carrying a wide range of products and lower prices.

*Seasonal categories* include products that are bought occasionally. Some retailers, who specialize in offering items classified under the seasonal categories, can change those particular products into destination categories in order to attract more number of customers during that season. For instance, certain departmental stores offer crackers during festive seasons at low prices, thus making them preferred place to shop for crackers.

### Category assessment

Category assessment is the third step in the category management process, in which the retailer conducts a detailed analysis of the sales, profits and return on assets and investments depending on the stock keeping units, sub-categories, brands, etc. The retailer also assesses the categories with the help of data on the consumers, vendors or competitors.

### Category scorecard

It is the fourth step in the category management process. This step involves developing bottom-line and setting targets to measure the performance of the categories. Retailers use a tool known as a category role matrix together with parameters like the sales volume and the Gross Margin Return on Investment (commonly referred to as GMROI) for measuring the performance of a category

### Category strategies

In the fifth step of the category management process, the retailer develops marketing strategies for the category. There are two types of strategies: demand-chain strategies and supply-chain strategies. While demand-chain strategies emphasize store traffic, profit margins, store image, cash and excitement, supply-chain strategies emphasize the flow of merchandise and the cost of transactions.

### Category tactics

This step in the category management process involves determining various tactics that ensure the smooth implementation of strategies. These tactics relate to assortments, pricing, promotion and supply chain.

### Implementation

Implementation is the last stage of the category management process where the action really takes place. In fact, implementing the category management process in the store is the most crucial element.

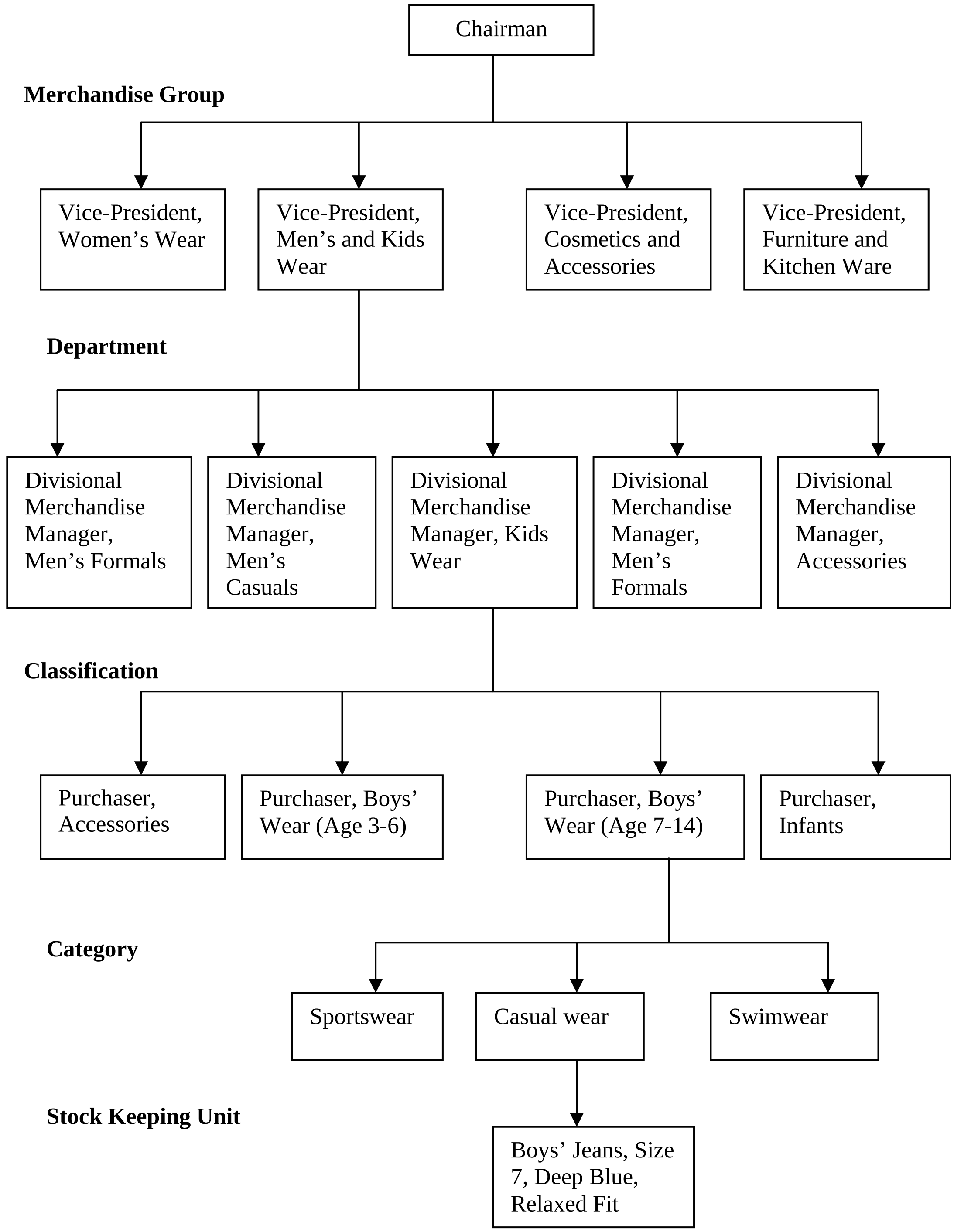
Retailers monitor and control the category management process regularly in order to ensure the maximum contribution to profits from every category.

## The Buying Organization

All retailers, including those having a single category manager who may be the proprietor of the store, should split their merchandise purchasing activities into categories so as to establish a systematic purchasing process. The merchandise classification pattern given in Figure 8.1 is popular among retailers, though they usually modify it a little to suit their individual situation. This pattern is also practiced by many international retailers like Wal-Mart and Toys ‘R’ Us.

Figure 8.1 shows the five levels in a buying organization – the merchandise group, department, classification, category and the stock-keeping unit. The merchandise group is the highest level of the buying organization, and consists of the vice-presidents of merchandise for different sections, like vice-president- merchandise for men’s toiletries, shoes and accessories. The vice-president is responsible for different departments. Departments form the second level of the retail buying organization and a divisional merchandise manager, working under the guidance of the vice-president-merchandise, heads each department. Classification is the third level of the retail buying organization. Purchaser, who reports to the divisional merchandise manager, manages the buying activities at this level. Category is the next level in a retail organization, where each purchaser (from the previous level) buys merchandise for a number of categories. For example, purchaser for boys’ apparel (aged 7 to 14) purchases different categories of merchandise such as outerwear, sportswear, casual wear and swimwear. Moreover, each one of these categories can comprise merchandise from one or many manufacturers (for each SKU). And this makes the fifth level of buying organization. But, defining levels is not as simple as it appears in the figure. It requires thorough market research, without which the retailer will not have a clear idea of how the consumer will perceive the merchandise. For instance, a manufacturer might perceive fairness creams and moisturizing creams as two different product categories, whereas a consumer might consider purchasing a fairness cream as an alternative to a moisturizer. Though fairness creams and moisturizers are products that cannot be substituted for each other, the consumer may use them in a similar manner. Hence, in order to improve sales of a particular category, retailers should understand how consumers perceive products and buy them.

**Figure 8.1: Levels of Buying Organization**




An SKU is the smallest classification available for controlling the inventory. For example at a Levi's jeans outlet, men's jeans of size 30 x 34, in classic fit, in the colors of dark blue, light blue and black, can be placed in one stock keeping unit.

Once the retailers understand the need for managing the merchandise through categories, they should analyze the various financial implications of merchandise management.

## SETTING FINANCIAL OBJECTIVES

The success of a retailer depends on how each of the merchandise categories contributes sales revenues to the store. Hence, stores should set financial objectives for each of the merchandise categories to measure their performance. Usually, the top management of the retail organization undertakes financial planning. The top management of a retail organization sets the financial objectives taking into consideration the overall performance of the organization and the strategic areas of thrust. These objectives are conveyed to the middle level managers (category mangers and merchandise planners) for them to work out further details. Category mangers and the merchandise planners take a still more detailed approach, by analyzing the previous performance of the categories, and market trends, and then projecting the merchandise needs for the coming seasons. The final merchandise plan is prepared by the merchandise planner and the category manager, in consultation with the top management about the changes made, if any.

The process of financial planning for a retailer, whether large or small, is the same, even if the retail organization does not have many levels of management. The planning process typically starts with the overall financial objectives of the retailer, which are then divided into objectives for various categories.

The merchandise plan developed as a result of the intensive planning of the top management and the category managers, acts as a financial blueprint for purchases in each category. A merchandise plan helps the category manager and the merchandise planner determine how much money should be spent on a specific merchandise category every month so as to meet the sales forecasts and other financial goals. After the merchandise plan has been developed, the category managers develop an assortment plan. The category managers work closely with vendors to select the merchandise, negotiate the prices and design promotional schemes. The merchandise planners split the merchandise financial plan based on category wise requirements and the needs of each store. Once the financial objectives of the merchandise have been set properly, the retailer will have to examine and measure the performance of the merchandise.

## GROSS MARGIN RETURN ON INVENTORY INVESTMENT (GMROI)

Managers at corporate level use ‘return on assets’ as a key parameter to plan and evaluate the performance of the operations of retail stores. In Chapter 5, we studied how to use the strategic profit model (SPM), which is based on return on assets, to evaluate and compare the performance of store managers across the chain. But SPM is not a good tool for evaluating the performance of merchandise managers. This is because merchandise managers and purchasers only have control over the gross margin and investment, but not on operating expenses and other assets. Therefore using performance evaluation tools/ratios that are based on return on investment would be more effective for measuring the performance of merchandise or merchandise managers instead of SPM, which is based on return on assets.

Gross margin return on inventory investment (GMROI) is one of the popular financial ratios used by retailers to measure the performance of investment in inventory/merchandise. GMROI gives the number of rupees earned by the retailer on every rupee invested in inventory. In other words, GMROI informs the retailer how much he got back from inventory investment in a year.

GMROI = Gross margin percentage x Sales to inventory ratio

= (Gross margin/ Net sales) x (Net sales/Average inventory)

= Gross margin / Average inventory

The average inventory used in GMROI can be expressed either in terms of retail price or in terms of cost. Though some retailers express average inventory at retail price, many retailers express the average inventory in terms of cost, as inventory in the denominator of a return on investment ratio is measured in terms of cost.

Thus,

GMROI (Rs.) = Gross Margin (Rs.) ÷ Average Inventory at Cost

GMROI (%) = (Sales ÷ Avg. Inventory at Cost) x Gross Margin (%)

GMROI for a category X can be calculated as shown in the table below. The steps are explained below:

I. Determine annual sales (in rupees) at retail for each department, product line, or category.

II. Calculate average inventory at cost by averaging the month-end inventories for the year.

III. Calculate sales-to-stock ratio by dividing annual sales by average inventory at cost.

| | **I** | **II** | **III** | **IV** | **V** | **VI** | **VII** |
|---|---|---|---|---|---|---|---|
| Merchandise category | Annual sales (in Rs) | Average Investment at Cost (in Rs) | Sales-to-stock ratio | Gross Margin % | Gross Margin (in Rs) | GMROI (In Rs) | GMROI % |
| | | | (I ÷II) | | (I ×IV) | (V÷II) | (III × IV) |
| Category X | 6,50,000 | 1,30,000 | 5 | 40% | 2,60,000 | 2 | 200% |

IV. Determine the gross margin percentage of each product line, department, or category

V. Calculate the gross margin in rupees by multiplying column I by column IV.

VI. To arrive at the GMROI in rupees divide column V by column II.

VII. To arrive at the GMROI percentage, multiply column III by column IV.

In the above example, the retailer gets Rs.2 for every 1 Re. (at cost) invested in Category X.

GMROI, like return on assets, combines the impact of both profits and turnover and it helps compare and evaluate departments with different margins and turnover profiles. For instance, in a department store, private label clothes have a high margin and low turnover, whereas branded clothing has a low margin and high turnover. If the management compares the performance of the department in private label clothing with that of the department with branded clothing, using inventory turnover only, the private labels will perform comparatively poorly. On the other hand, if the retailer compares them using the gross margin ratio, then private labels will show better performance.

GMROI, a profitability measure of return on investment, is used to compare and evaluate departments, merchandise categories, vendor lines and items. Though GMROI is a combination of gross margin and inventory turnover, the gross margin component of GMROI plays a vital role in deciding the pricing structure, whereas the inventory turnover component plays a more significant role when merchandise-related decisions are taken. GMROI cannot be calculated without measuring inventory turnover. The process of measuring inventory turnover and the various merits and demerits associated with a rapid rate of inventory turnover are discussed next.

## Measuring Inventory Turnover

Inventory turnover is defined as the number of times a particular unit of inventory has to be replenished in a store in a fixed period of time. Generally, in a store the purchaser orders some merchandise (say, a box of hair conditioners), which is displayed in the stock keeping unit till it is sold out. When this happens, an order is placed for another box. The inventory turnover for the product (hair conditioners) is the number of times, on average, that the box of conditioners is sold out, and the stock keeping unit is replenished with fresh supplies of one unit or box in a given period of time. Usually, retailers calculate inventory turnover for a period of one year. The faster a product comes into the store and moves out of the store (i.e. is sold), the higher is the turnover of the inventory.

Inventory turnover = Net sales ÷ Average inventory (at retail price) or

Cost of goods sold ÷ Average inventory (at cost).

Although both the formulas give same results, a majority of retailers use the first formula. However, no matter which formula is used, the retailer should ensure that both the numerator and the denominator are expressed in similar terms, either at retail price or at cost. Retailers usually represent inventory turnover rates annually rather than for specific seasons of the year. When the net sales figures used in calculating the inventory turnover is for a period of three months, the annual turnover is calculated by multiplying it with four. For instance, if the inventory turnover for the spring-summer season (three months) of a fashion boutique is calculated to be 2.1, then the annual inventory turnover rate can be represented as 8.4, which is four times 2.1.

## Calculating Average Inventory

Calculation of average inventory is done by dividing the sum of inventory for each of the various months by the total number of months.

Average Inventory = (M1+M2+M3+M4+..+Mn) /n

Where, M1,M2, M3 are inventories for different months and 'n' is the total number of months. But the number of months to be used in the formula and the process for determining the inventory for any particular month have to be decided. One procedure is to consider the end of the month (EoM) inventories for different months and divide it by the number of months. This procedure is explained through an illustration in Exhibit 8.1.

This procedure is applicable only if the EoM inventory figures do not fluctuate significantly from the inventory levels on any other day of the month.

The majority of retailers these days do not physically count the number of items to determine the average inventory. The point of sales (POS) terminals at the billing counters of the stores keep a track of the daily sales and subtract them automatically from the inventory on hand. Thus, retailers with POS terminals are able to get average inventory levels accurately by averaging the inventory on hand for each day in the year.

| Exhibit 8.1<br>Average Inventory Turnover | |
|---|---|
| Month | Retail Value of the Inventory (in Rs.) EoM |
| September | 2,00,000 |
| October | 1,50,000 |
| November | 2,50,000 |
| December | 1,50,000 |
| **Total Inventory** | **7,50,000** |
| Average Inventory = 7,50,000/4 = 1,87,500 | |

### Advantages of rapid inventory turnover

Retailers generally wish to have rapid turnover of their inventory, but not above a certain rate. Rapid inventory turnover is advantageous in the following ways:

*Increases volume of sales:* A rapid turnover of inventory enables the retailer to offer new/fresh merchandise on a regular basis. Availability of new merchandise increases sales as customers can buy the latest products.

*Reduces the risk of obsolescence and markdowns:* The value of certain goods like fashion and food products starts declining from the time they are put on display. If the merchandise sells quickly, the retailer need not stock merchandise for long, thus reducing the risk of product obsolescence and markdowns.

*Improves salesmen morale:* Stores with rapid inventory turnover restock new or fresh merchandise very often. Sales personnel therefore find it easy to sell the fresh merchandise. This leads to improved sales and hence high morale among the sales teams.

*Increases money for market opportunities:* Rapid turnover of inventory releases the money that is otherwise held up in the inventory, and this helps the retailer to buy more merchandise.

*Reduces operating expenditure:* Rapid turnover of inventory implies that a lower level of inventory supports a given level of sales. A lower level of inventory implies lower inventory carrying costs, and hence, a lower amount of interest payment on loans taken to maintain inventory levels.

*Increases the turnover of the assets:* As inventory is considered a current asset, the asset turnover increases if inventory decreases with an increase in sales or with same sales. This has a direct impact on the return on assets, a key measure of performance for a retailer.

### Disadvantages of rapid inventory turnover

Retailers should establish an ideal rate of inventory turnover. A rapid turnover of inventory can be counter-productive for the following reasons:

*Risk of loosing a customer:* Usually, retailers stock only fast-moving brands or products in order to increase the rate of inventory turnover. In the process, they limit the assortment in a product category. When a customer does not find a particular variety of a product in the store, he may shift to another store offering a wider variety and deeper assortment of goods.

*Increases the cost of goods being sold:* In order to achieve rapid turnover, the retailer purchases merchandise more frequently in small quantities, thereby reducing inventory without reducing the sales. But, by purchasing in smaller quantities, the retailer loses the benefits of quantity discounts and economies of scale in transportation.

*Increases the operating expenditure:* A retailer can gain economies of scale by purchasing large quantities. The category manager has to allocate the same amount of time in meeting vendors and processing orders, irrespective of the size of the order. All orders, big or small, consume same amount of time to print invoices, receive merchandise and pay invoices. These factors increase the overhead costs of merchandise retailing.

Though a rapid turnover of inventory is usually preferred to slow turnover, an important concern for a majority of merchandise managers in all retail organizations is that the turnover rate above a point may result in diminishing returns.

## SALES FORECASTING

Sales forecasting is an integral part of any merchandise assortment plan. There are many internal and external factors that affect the sales of a retailer, which he should be aware of. The external factors affecting sales are seasons, holidays, special events, competition, external labor movements, productivity fluctuations, births and deaths, changes in fashions, population changes, consumer earnings, political environment and weather conditions. The internal factors that affect sales are product changes, adaptability to prevailing fashions, product quality, service changes, shortages, production capacity, changes in promotional efforts, price fluctuations, inventory shortages, working capital shortage, distribution methods, changes in the credit policy and labor problems. Thus, without a proper sales forecast or sales forecasting technique on hand, retailers cannot determine how much merchandise to buy. The retailer should have detailed knowledge and understanding of category lifecycles in order to make realistic sales forecasts.

### Category Lifecycles

A sales forecast should be able to predict the effective salability of different product categories over a certain period of time. Typically, every product category follows a specific pattern of sales spread over its life cycle – introduction, growth, maturity and decline. The stages of the lifecycle are distinguished on the basis of their differing sales volumes – low sales in the introduction stage, steep increases in the growth stage, stagnant sales in the maturity stage, followed by a fall in the sales volume in the decline stage. Though every category follows the above pattern, the shape of the pattern varies significantly from category to category. Category-wise sales information helps the category manager understand customer preferences. It helps him understand the type of customers who are likely to buy the products, their expectations in terms of the variety of the products, the nature of competition, and the types of promotion and pricing decisions that will be suitable. When making a sales forecast, it is important for the retailer to know the type of merchandise on offer, i.e., whether it is a fashion, a staple or seasonal merchandise.

It is important for a retailer working on a sales forecast and merchandise strategy, to know at what point in its lifecycle a product category lies, as this has a significant impact on the target market, the variety of products to be offered, distribution, pricing and promotional strategies. Exhibit 8.2 outlines the importance of the position of a category in its lifecycle in terms of the target market, variety, intensity of distribution, price and promotion of the product.

**Exhibit 8.2**

**Sales Patterns - According to Category Lifecycle**

| Stages<br>Variables | **Introduction** | **Growth** | **Maturity** | **Decline** |
|---|---|---|---|---|
| Target market | High-income innovators | Middle-income adopters | Mass market | Low-income laggards |
| Variety | One basic offering | Some variety | Greater variety | Less variety |
| Distribution intensity | Limited or extensive | More retailers | More retailers | Less retailers |
| Price | Penetration or skimming | Wide range | Low prices | Low prices |
| Promotion | Informative | Persuasive | Competitive | Limited |

Retailers usually set high-income innovators as their target market for their newly launched categories. As the categories pass through the growth and maturity stages, they start offering the products to middle income and mass-market consumers. And finally as the categories reach the decline stage, they are made accessible to low-income customers also, who follow rather than lead fashions. During the introduction stage of a category lifecycle, a customer is usually offered a fairly small variety of the newly launched product. But the variety increases as the category passes from growth to maturity and is again limited as it reaches decline. The intensity of distribution refers to the number of retailers offering a particular category. In the introductory stage, the categories can be distributed either in a limited or an extensive manner, depending on the type and availability of the products in the category. Increasing popularity of the category in the growth and maturity stages usually increases the intensity of distribution. But when the category reaches the decline stage, very few retailers will be interested in carrying it because of its declining demand.

A newly launched category can be priced either according to the ‘skimming’ pricing strategy or the ‘penetration’ pricing strategy, depending on the type of the category and the intensity of distribution. A skimming strategy is adopted when the category is in short supply and is available through a limited number of dealers. As the category grows, reaches maturity and starts declining, the price usually declines as it is more readily available and as demand is declining. Promotion in the introductory stage of a newly launched category is aimed at informing the customer about the newly launched category. With the passing of the category into the growth and maturity stages, promotional strategies get competitive and are aimed at persuading the customers to patronize a specific store. Once the category reaches the decline stage, retailers decrease promotional support to the category and assign the same funds to categories that can generate more sales. Thus, the knowledge of the position of a category is in its lifecycle helps the retailer to forecast sales.

Though a majority of categories follow the basic structure of the category lifecycle – introduction, growth, maturity and decline -- there are some variations in category lifecycles depending on whether the category is a fad, a fashion, a staple or a seasonal product. The differentiating factors among these are the number of seasons for which a category lasts, the number of seasons for which a particular style sells and whether sales figures fluctuate significantly from season to season.

A fad is a phenomenon in which a merchandise category generates huge sales for a relatively short period of time – the period generally lasts less than a season. The most common examples are the apparels and toys, which become fashionable for a short period of time. Marketing fads are among the riskiest and toughest ventures to manage in retailing. Effective management of a fad lies in identifying the fad at the earliest possible stage and owning an exclusive distribution channel to sell it. Identifying the fad at the proper time alone will not be enough for the retailer to derive maximum benefit. He should also identify the peak period of sales for the merchandise considered a fad so that all the merchandise can be cleared and not left unsold in the warehouse when the fad ends.

A fashion is a phenomenon exhibited by a merchandise category that usually lasts for a few seasons with sales fluctuating significantly from one season to the next. The lifespan of a fashion is based on the type of category and the target customers. For example, wrought iron furniture may be a fashion which sells for a couple of years, while broken twill jeans and short sleeve shirts may be a fashion that last only for a couple of seasons.

A merchandise category can be referred to as staple if it enjoys a continuous demand over an extended period of time. For example, ‘blue jeans’ is a merchandise category that has enjoyed continuous demand over an extended period of time.

A merchandise category in which sales vary significantly at different times in a year is referred to as seasonal merchandise. Staple and fashion merchandise both have seasonal sales. Managing variations during the category lifecycle is a challenging job for the merchandise manager, as it involves thorough planning, without which the retailer would invest more than what is needed on inventory.

## Making a Sales Forecast

Retailers make sales forecasts by using previous sales records of the category and studying its lifecycle trends. The process of sales forecasting has not been streamlined in India so far. This job is usually assigned to someone from the top management and is usually done at the level of broad merchandise categories. Category managers, when making sales forecasts, usually consider several sources for collecting data. The sources of information are past sales records, published sources, and information from customers. The forecasts derived from such past data may have many errors when examined at the micro level and this is where the real problem lies. For instance, it is easier to forecast the sales of the trousers rather than the sales of casual Khakis. Category managers should be realistic while estimating future sales. Exhibit 8.3 outlines the steps in sales forecasting usually adopted by Canadian retailers. Exhibit 8.4 outlines the importance of accurate sales forecasting. Retailers should follow the guidelines given below in order to enhance the accuracy of their sales forecasts:

**Exhibit 8.3**

**Sales Forecasting for a New Business**

**Step 1: Developing a target customer profile and determining the industry trends.**

Retailers should make some basic assumptions about the customers in their target markets. Retailers can take up the popular 80-20 rule, according to which, 80% of a company's sales usually come from 20% of its customers. The retailer can start developing a profile of its major markets, if it can identify the customers who comprise this 20%. Retailers can determine trends by discussing with vendors or distributors what sells well and what does not. Retailers can also make use of the industry trade magazines and industry journals.

**Step 2: Determining the approximate size and location of the target trading area.**

The retailer should use the statistics available to determine the general characteristics of the trading area. Retailers can also seek information from local sources to determine unique characteristics of the trading area. At this stage, the retailer should try to answer questions like: How far will the average customer be willing to commute in order to buy from the shop? And, where should the product be distributed or promoted? The retailer can get an insight into the unique characteristics of its trade areas through business owners in the neighborhood, the local chambers of commerce, government agents and local newspapers.

**Step 3: Listing and profiling competitors selling in the trading area.**

Retailers should study their competitors by visiting their stores, analyzing their location, customer volumes, traffic patterns, business hours, high traffic periods, prices, quality of products and services, product lines offered, promotional techniques, and positioning.

**Step 4 Conducting research to estimate monthly sales for the first year.**

The retailer can take the average monthly sales of a similar-sized competitor in a similar market, as a basis for its sales forecast. Then the average monthly figures can be adjusted according the trends for the year. It must be ensured that retailers reduce figures by a start-up year factor of about 50% a month for the initial months. Retailers should know how well their competitors are satisfying the needs of their potential customers. This helps the retailer offer a better location, greater convenience, better prices, extended hours, better quality, and better service. The retailers should also consider the population and economic growth factors in their trade areas.

*Adapted from www.cbsc.org/osbw/salesfore.html*

- The products should be categorized into basics and fashionables. Sales of basic products or merchandise can usually be forecasted fairly accurately and the retailer need not check the sales forecasts a number of times.
- Retailers should develop top-down and bottom-up sales forecasts, and then derive a mean by clubbing these two figures.
- They should allow different individuals to develop sales forecasts.
- They should use feedback from consumer panels and research on the styles and colors of the merchandise being considered.

Once the retailer has all the financial and sales forecasts for a particular category of merchandise, the next step is to determine what type of merchandise to purchase.

## ASSORTMENT PLANNING PROCESS

Every retailer, in order to attain a sustainable competitive advantage, has to answer a basic strategic question – what type of a retail format should be adopted? Deciding the type of merchandise assortment that will be offered by the store forms a critical component of the choice of a retail format.

**Exhibit 8.4**

**Importance of Accurate Sales Forecasting**

Sales forecasting is a management function that is usually not considered as a key contributor to the success of a store. But, accurate sales forecasting helps retailer offer a high levels of service to its customers. Accurate demand forecasts which can be met in a timely and efficient manner, help satisfy both the channel partners and final consumers. Accurate sales forecasting helps retailers avoid out-of-stock situations, and prevent loss of customers to competitors. Moreover, the cost advantage of the accurate sales forecasting is phenomenal. It allows the retailer to purchase raw materials in a more cost-effective manner. Likewise, transportation services can also be obtained at a low cost with long-term contracts. The most important benefit offered by accurate sales forecasting is its impact on the inventory levels of the store, i.e., inventory is maintained to provide a buffer stock, in case of sudden demand. Thus, more the accuracy of the forecasts, the less is the level of inventory that the retailer has to carry.

*Source: Icfai Center for Management Research*

Decisions on merchandise assortment are generally constrained by the availability of space in the store and the availability of finances to spend on merchandise. Decisions pertaining to the variety and assortment of products and the product availability are based on the retailer's financial goals. It is essential for the retailer to understand the importance of variety, assortment and product availability and analyze the need for strategic trade-offs among them.

Variety refers to the number of different categories of merchandise within a store or department. Stores offering a large variety of merchandise are said to offer a good breadth, as the terms breadth and variety are used interchangeably. The assortment is the number of stock keeping units within a merchandise category. Generally, stores offering a large assortment of merchandise are said to offer a good depth, as the terms depth and assortment are used interchangeably. And finally, product availability indicates the percentage of demand that has been satisfied by a specific stock-keeping unit. Product availability is sometimes referred to as service level or level of support. For instance, if 100 people come into an apparel store to purchase broken twill blue jeans in the size 30-32 and the store is able to sell that item to only 75 customers, on account of limited stock, the product availability in this case is 75%. Exhibit 8.5 illustrates a concept (Efficient Consumer Response) that has recently been adopted by some Indian FMCG majors to tackle the issue of product availability.

## Need for Trade-off between Variety, Assortment and Product Availability

Establishing a trade-off between variety, assortment and product availability is the most challenging task for any retailer. It is the marketing strategy of a retailer that determines how the trade-off will be made. Retail strategy helps the retailer determine the target market to which the merchandise would be offered, the nature of the merchandise being offered to satisfy the needs of the target market, and the basis on which the retailer wishes to gain a competitive advantage. Thus, establishing a trade-off between variety, assortment and product availability assumes strategic importance for a retailer. Generally, variety stands out as an issue of the highest strategic importance, as it helps describe the retailer in the customer's mind.

In attempting to determine the appropriate variety and assortment of each category in a store, the category manager in a retail organization takes the following factors into account: merchandise mix, profitability, corporate philosophy on assortment, physical characteristics of the retail outlet, and the degree to which the merchandise categories complement each other.

**Exhibit 8.5**

**Efficient Consumer Response (ECR)**

ECR is a global movement in the FMCG industry, whose emphasis is on supply chain management. The manufacturers along with suppliers, wholesalers and retailers work together in order to satisfy the changing needs of the customers in a better manner, at a faster pace and at a lower cost. The ECR movement started first in the US in 1993, then in Europe in 1996 and then in Asia in 1996. The first meeting of ECR in India among representatives of various companies was held in December 1999. The concept of ECR was projected as a tool to enhance the efficiencies of supply chain management with the help of collaborative management practices. There are four different work groups under the Indian chapter of ECR, of which the first deals with out-of-stock issues of the retailers.

It is common that the consumers visiting a nearby retail store to buy a particular product may find it to be out-of-stock. Thus, stock-out has been the biggest problem faced by any manufacturer or a retailer. And the challenge is to make the merchandise available at the right time and right place – in order to satisfy the demand. As the Indian retailing sector is in a stage of evolution, where the traditional way of retailing is still dominant with negligible presence of information technology, measuring the impact of such loss of sale due to stock-out is very difficult. The Indian chapter of ECR took this issue as a challenge to measure the level of stockouts at the retailers and then develop a solution for this problem. The first pilot study is being conducted to calculate the level of stockouts of different products of various FMCG companies like Nestle, Hindustan Lever, Godrej, Colgate Palmolive, Johnson and Johnson, and Procter and Gamble.

*Source: Strategic Marketing July-August 2002, Narendra Ambani, pp. 42-45*

Since retailers have limited financial resources to spend on merchandise, and limited space to display the merchandise, they try to determine the most profitable merchandise mix. The category manager of a retail store, using its corporate philosophy on assortment, will be able to identify the number of styles and colors that are to be bought. Another key issue is that of expansion or contraction of a specific category of merchandise. Determining the amount of space to be allocated to a particular category of merchandise is also an important issue. The greater the number of styles and colors in the assortment, the greater will be the space required to display and stock the merchandise category. The retailer should also take into account the physical characteristics of the merchandise display area. While expanding the store’s assortment, retailers should consider merchandise that complements the existing merchandise.

Product availability is the third most significant issue in the process of assortment planning. As product availability indicates the percentage of demand that has been satisfied through a specific stock keeping unit, the greater the planned availability of the product, the greater is the amount of buffer inventory required, so as to ensure that the customer does not walk out due to the non-availability of the product. Determining an optimum level of buffer stock is critical for the success of the assortment planning process. A low level buffer stock might lead to stock-outs and the loss of customers, whereas a high level buffer stock might lead to unnecessary blocking of funds in inventory. The retailer should establish a trade-off between the investment made on inventory and the availability of the product. The actual investment on inventory depends entirely on the situation in the store. The factors that determine the level of buffer stock needed are:

i. The level of product availability that the retailer desires to offer

ii. The demand fluctuation (since, greater the demand fluctuation greater will be the need for buffer stock)

iii. The fluctuations in lead time (since, higher the fluctuations in lead time, the greater is the requirement of buffer stock)

iv. The product availability levels of the vendor

Once the retailer has set the financial objectives for the merchandise in the store and understood the relative significance of variety, assortment and product availability, the next step is to determine what merchandise to carry, using an assortment plan.

## Assortment Plan

An assortment plan depicts what should be carried in a specific category of merchandise. An assortment plan for a merchandise category based on fashion will not identify particular stock keeping units, because fashions vary from year to year and sometimes, from season to season. The more fashion-oriented the merchandise category is, the more necessary it is for the merchandise planner to accommodate changes in fashion, and hence, the lower the level of detail in the assortment plan. The starting point for developing an assortment plan for a given season is the historical data of a particular merchandise category. Apart from the assortment plan for a merchandise category in the previous season, sales, inventory turnover and GMROI figures are used to develop an assortment plan for the current season. The merchandise planner then makes the required changes according to his expectations of what products or fashions will be really significant for the coming season. Exhibit 8.6 represents a sample assortment plan for Men’s jeans. This plan describes general styles, price levels, fabric composition and colors. The process of developing an assortment plan can be quite complex, especially in multi-store chains. An effective assortment plan requires equal or more effective sales, inventory turnover and GMROI forecasts, to complement the experienced judgment of the merchandise planner.

**Exhibit 8.6**

**Assortment Plan for Men’s Jeans**

| Style | Straight-leg | Straight-leg | Straight-leg | Loose-fit | Loose-fit |
|---|---|---|---|---|---|
| Retail price (in Rs.) | 999 | 1399 | 1799 | 1299 | 1599 |
| Type of Fabric | Regular denim | Stone washed denim | Tinsel – Lycra based denim | Broken twill | Over dyed |
| Colors | Light blue | Dark blue | Light blue | Light blue | Blue |
| | Black | Indigo | Black | Black | Black |
| | | Black | Deep blue | | |

## PRODUCT MIX TRENDS

With increasing levels of competition in retailing across the globe, retailers are required to adapt the product mixes rapidly and creatively to meet the needs of the dynamic marketplace. Retailers should first determine the consumers’ emerging unsatisfied needs and design an innovative product mix strategy that best fulfills their needs. There are two emerging trends in the area of product mix. They are:

- Shotgun merchandising, and
- Rifle merchandising.

## Shotgun Merchandising

This is a marketing strategy that involves expansion of the merchandise being offered in a store in order to satisfy the increasing needs of the consumers. By expanding the number of product options, retailers attempt to increase their market size by catering to different sub-markets and trying to fulfill the specific needs of various individual target customers. In the process of product-mix expansion, a retailer adopting shotgun merchandising tries to develop a general product mix that satisfies the needs of a majority of the customers reasonably well. In order to develop a general product mix, a retailer can either include a new product item or a major product line. Including a new product item involves adding product items. Adding stationery, greeting cards, music software to a supermarket's primary product line can be considered as including new products. Adding a new product line involves combining two or more broad product lines with the regular product lines of the store. The reason for combining a major product line with the store's regular product lines is to offer the consumer the convenience of one-stop shopping.  Inclusion of a drugstore in a supermarket is referred to as combining product lines with the store's regular product lines.

## Rifle Merchandising

This is a marketing strategy that is aimed at targeting merchandise at a select group of customers. Though the stores using rifle merchandising strategy carry a very limited number of product lines, a large assortment of merchandise is made available in each product line. Thus, such a retailer follows a penetration strategy, emphasizing on all the product options in the limited product lines to fulfill all the individual needs of a specific market segment for a specific product line. In the process of emphasizing a limited product line, a retailer adopting rifle merchandising strategy, develops a product mix with a specific purpose that completely fulfills the specific needs of the target consumers for a particular product. Market positioning and Multiplex distribution are the two marketing strategies adopted by a retailer developing a specific purpose product mix. Market positioning of a retailer refers to the kind of image the retailer wants to establish among its target group and the group of firms with which it wishes to compete and coexist. Multiplex distribution is a marketing strategy that is aimed at various target markets.

# SUMMARY

Issues such as what merchandise to purchase and in what quantity, are of strategic significance to every retailer, especially for the multi-store retail chains of today. For decisions on these matters, a thorough plan called a merchandise assortment plan, has to be adopted. First, the merchandise is split into categories for the purpose of planning. The categories thus split are managed by purchasers and merchandise planners, as well as vendors.

Retailers have many tools that help them develop a merchandise plan – Gross Margin Return on Inventory Investment (GMROI), inventory turnover and sales forecasting. GMROI is a tool that helps the retailer plan and evaluate the performance of the merchandise. The GMROI for a specific category of merchandise is calculated on the basis of the overall financial objectives of the retailer, which are further assigned to specific categories. The gross margin percentage in combination with the inventory turnover evolves into a useful tool for managing merchandise. The most significant issue for a retailer is determining the inventory turnover and developing inventory turnover goals. Retailers should avoid the extremes in inventory turnover rates – extremely rapid and extremely slow turnover rates. Though rapid inventory turnover is necessary for the financial success of a retailer, any attempt of the retailer to push the level of inventory turnover to the maximum will lead to frequent stock-outs and increased costs.

When forecasting sales, retailers should identify the stage of the lifecycle of the specific category, and should also determine whether the merchandise category offered is a fad, a fashion, a staple or a seasonal item, so as to plan merchandising accordingly. When making sales forecasts for a specific merchandise category, retailers take information from various sources, such as past sales volume, published secondary data and customer surveys. Determining a merchandise strategy is a crucial issue for a retailer. It involves establishing a trade-off among the variety offered, assortment provided and the availability of the products. A thorough analysis of this trade-off helps the retailer answer the most significant question – what kind of store will it be? – a specialty store or a general store.

Thus, an assortment plan tends to be the amalgamation of the GMROI plan, the inventory turnover plan, sales forecasting, and assortment planning. The assortment plan provides the merchandise planner with a view of what the composition of a specific category of merchandise should be.

Retailers adopt marketing strategies like shotgun merchandising and rifle merchandising in order to cope with the dynamics of the market. A retailer adopting shotgun merchandising caters to a variety of market segments by expanding its product lines either by including a product item or product lines. A retailer adopting rifle merchandising caters to a specific market segment with a specific product mix, either by following a market positioning strategy or a multiplex distribution strategy.

# Chapter 9

# Purchasing Systems

**In this chapter we will discuss:**

- Merchandise Budget Plan
- Open-to-Buy
- Purchasing Systems for Staple Merchandise
- Assigning Merchandise to Stores
- Analyzing Merchandise Performance

## INTRODUCTION

A formal purchasing system helps the purchaser and merchandise planner to determine the quantity of merchandise to be purchased. Retailers generally use two types of purchasing systems – Fashion merchandise purchasing systems and Staple merchandise purchasing systems.

To forecast the sales of a particular stock-keeping unit, the purchasers must have the previous sales record. But, the previous sales records for fashion merchandise at the stock keeping unit level are not available at all times. Forecasting sales for staple merchandise is relatively simpler as compared to that of fashion merchandise. In case of staple merchandise, there are organized sales records for every stock-keeping unit and hence it is easy to use standard statistical techniques for forecasting sales.

In this chapter, we will be discussing the purchasing systems for fashion merchandise and staple merchandise. We then discuss the process of allocating merchandise among multiple stores of a retailer and finally the methods of analyzing the performance of merchandise, thus allocated.

## PURCHASING SYSTEMS FOR FASHION MERCHANDISE

Two kinds of systems are used to manage fashion merchandise: Merchandise budget plan and Open-to-buy. While a merchandise assortment plan provides a general view of the types of merchandise that should be offered in a store, a merchandise budget plan helps determine the amount of money to be spent every month on a specific fashion merchandise category. However, the merchandise budget plan cannot serve as a complete guide for purchasing as it does not indicate how much of a specific stock keeping unit to purchase.

While the merchandise budget helps the merchandise planner plan to purchase a specific category of merchandise that is to be delivered in a specific month, the open-to-buy system helps the merchandise planner to keep track of the merchandise flow in real time.

### Merchandise Budget Plan

The merchandise budget plan helps the category manager to determine the quantity of each product that should be bought every month. Generally, a merchandise budget plan is based on the sales forecasts, inventory turnover and the gross margin return on investment (GMROI) estimates. It helps the category manager identify if the merchandise is:

- selling well and is to be replenished
- not selling well and is to be marked down, and repositioned

A merchandise budget plan helps retailers establish merchandise objectives and plan financial issues of the business in terms of merchandise. However, this plan is not comprehensive as it does not talk about the kind or quantity of merchandise to be purchased. It only determines how much money should be spent every month in order to support the sales activity and accomplish the objectives of inventory turnover and GMROI. In order to calculate the amount of money to be spent on purchasing merchandise each month, the purchaser should have a thorough knowledge of various factors like:

- Monthly sales percentage distribution to season
- Monthly sales
- Monthly reductions percentage distribution to season
- Monthly reductions
- Beginning of the month inventory to sales ratio
- Inventory at the beginning of the month
- Inventory at the end of the month
- Monthly additions to stock

### Monthly sales percentage distribution to season

This is the first component of a typical merchandise budget plan. This gives the merchandise expected to be sold every month as a percentage of total sales for the season[1]. According to Table 9.1, 21 percent of the season's expected sales would take place in the month of July. The total of all monthly sales percentages in the season should add up to 100 percent. The percentage distribution of monthly sales is determined with the help of previous sales records. Usually, the percent sales figure of a particular month does not fluctuate drastically from the previous year's figures. However, it would be advisable to analyze every month's percentage sales contribution over a few years, so as to identify major fluctuations. The percentage distribution of sales sometimes shows considerable fluctuation. This could be due to the change in the marketing strategies of the merchandise planner or of a competitor.

## Monthly Sales

The sales of each month in a period should sum up to the total projected sales for that period, say six months as given in Table 9.1. Monthly sales must be calculated by multiplying the percentage sales distribution of every month with the total projected sales figure for the six month period.

## Monthly Reductions Percentage Distribution to Season

The merchandise planner should take into account all the factors that reduce the level of inventories in order to support the monthly sales projections. Though the level of inventory is generally reduced due to sales, other factors like markdowns, shrinkages and employee discounts can also reduce the level of inventory. Merchandise planners can predict markdown percentages by analyzing the previous year's plans. While projecting the markdown percentages, care should be taken to consider factors like changes in markdown strategies, competition and the state of the economy. Employee discounts refer to the special discounts provided to the employees on purchase of merchandise from the store. The amount of discounts usually depends on sales and the number of employees. Hence, the percentage of sales to employees and its value can be projected accurately with the help of previous sales records. Shrinkage is the result of poor book keeping, misplacement, damage, or shoplifting by the employees or customers. The merchandise planner calculates shrinkage by measuring the difference between the recorded value of the inventory and the physical inventory present in the stores and distribution centers. Generally, shrinkage is directly proportional to sales though it varies also by department and season.

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[1] The period of six months i.e., from July to December is considered as one season, throughout the chapter.

**Table 9.1 Merchandise Budget Plan**

| | | Jul | Aug | Sept | Oct | Nov | Dec | Total Projected |
|---|---|---|---|---|---|---|---|---|
| 1 | Monthly Sales % Distribution to Season (in percentage) | 21 | 12 | 12 | 19 | 21 | 15 | 100% |
| 2 | Monthly Sales (in Rs. Thousands) | 1365 | 780 | 780 | 1235 | 1365 | 975 | 6500 |
| 3 | Monthly Reductions % Distribution of Sales (in percentage) | 40 | 14 | 16 | 12 | 10 | 8 | 100% |
| 4 | Monthly Reductions (in Rs. Thousands) | 330 | 115.5 | 132 | 99 | 82.5 | 66 | 825 |
| 5 | BOM Inventory to Sales Ratio | 3.6 | 4.4 | 4.4 | 4 | 3.6 | 4 | 4 |
| 6 | BOM Inventory (in Rs. Thousands) | 4914 | 3432 | 3432 | 4940 | 4914 | 3900 | 4914 |
| 7 | EOM Inventory (in Rs. Thousands) | 3432 | 3432 | 4940 | 4914 | 3900 | 3280 | 3280 |
| 8 | Monthly Additions to Inventory (in Rs. Thousands) | 213 | 895.5 | 2420 | 1308 | 433.5 | 421 | 5691 |

## Monthly Reductions

A merchandise planner arrives at the monthly reduction value by multiplying the total projected reduction with the percentage of reduction for that particular month.

## Beginning of Month Inventory to Sales Ratio

The beginning of the month inventory to sales ratio is calculated with the help of the four steps given below:

### 1. Calculate Sales to Inventory Ratio:

To arrive at this figure, we begin with the planned GMROI, Gross Margin and the Sales to Inventory ratio, that are assigned to the merchandise category depending on the retailer's financial objectives.

GMROI = Gross Margin (%) x Sales to Inventory Ratio (for the season)

Sales to Inventory Ratio = GMROI ÷ Gross Margin (%)

### 2. Represent Sales to Inventory Ratio in terms of Inventory Turnover:

Inventory Turnover = Sales to Inventory Ratio x Cost of goods sold %

⇒ Inventory Turnover = Sales to Inventory Ratio x (100% - Gross Margin%)

The Sales to Inventory Ratio is represented in terms of Inventory turnover because the sales to inventory ratio defines sales at retail prices and inventory at cost prices, while inventory turnover defines both sales and inventory either at retail prices or cost prices. The inventory turnover is usually calculated for a six-month period.

### 3. Calculate Average Inventory to Sales Ratio:

Average Inventory to Sales ratio = 6 months / Inventory turnover

The average inventory to sales ratio determines the amount of inventory that should be in hand at the starting of the month in order to achieve the targeted inventory turnover and to support sales forecasts. While calculating average inventory to sales ratio, both the numerator and the denominator should be represented either at retail price or at cost price.

The merchandise planner must be very cautious while considering this ratio, as it is generally confused with sales to inventory ratio. But actually, there is significant difference between the two. Though sales are the same in both the cases, inventory in 'sales to inventory' ratio is the average inventory at cost prices over a period and inventory in 'average inventory to sales' ratio is the average inventory at the beginning of the month at retail prices. Moreover, the inventory in the 'beginning of the month inventory to sales ratio' is an average for all the months.

### 4. Calculate Monthly Inventory to Sales Ratios:

Usually, the monthly inventory to sales ratio is inversely proportional to the sales. The merchandise planner should consider the seasonal patterns for a particular merchandise category in order to determine the monthly inventory to sales ratio. In order to achieve the forecasted inventory turnover, the monthly inventory to sales ratios mentioned in the fifth component of Table 9.1 should average the beginning of the month inventory to sales ratio calculated in step 3.

A merchandise planner should thoroughly evaluate the past inventory to sales ratios while developing a merchandise budget plan for a category, especially the one that has most abundant sales records (Men's Suits, Women's Wedding Dress). The merchandise planner can assess the adequacy of the past ratios by determining whether the level of inventory was significantly low or high in any of the previous months. The planner can then make adjustments to the ratios, if required.

## Beginning of the Month (BOM) Inventory

Beginning of the month inventory, the sixth component of the merchandise budget plan can be defined as the amount of inventory planned for the beginning of the month. It can be calculated as

Monthly Sales x BOM Inventory to Sales Ratio

## End of the Month (EOM) Inventory

The BOM inventory of the present month becomes the EOM of the previous month because the end of the month inventory for the month of July is the beginning of the month inventory for the month of August. Thus, to calculate the EOM inventory, the merchandise planner should move the BOM Inventory to one box down and left as given in Table 9.1.

## Monthly Additions to Inventory

'Monthly additions to inventory' is the amount of merchandise to be ordered every month for delivery. Additions to the inventory can be denoted as:

Monthly Sales + Reductions + EOM Inventory – BOM Inventory.

**Table 9.2 Open-to-Buy Plan (in Rs Thousands)**

| | | *Jul* | *Aug* | *Sep* | *Oct* | *Nov* | *Dec* |
|---|---|---|---|---|---|---|---|
| BOM Inventory | Planned | 4914 | 3432 | 3432 | 4940 | 4914 | 3900 |
| | Actual | 4750 | 2975 | ? | ? | ? | ? |
| Monthly Additions to Inventory | Planned | 213 | 895.5 | 2420 | 1308 | 433.5 | 421 |
| | Actual | 175 | 350 | ? | ? | ? | ? |
| Monthly Sales | Planned | 1365 | 780 | 780 | 1235 | 1365 | 975 |
| | Actual | 1345 | ? | ? | ? | ? | ? |
| Monthly Reductions | Planned | 330 | 115.5 | 132 | 99 | 82.5 | 66 |
| | Actual | 82.5 | ? | ? | ? | ? | ? |
| EOM Inventory | Planned | 3432 | 3432 | 4940 | 4914 | 3900 | 3280 |
| | Actual | 2975 | ? | ? | ? | ? | ? |
| Projected BOM Inventory | Planned | 1228.5 | 2975 | 3329.5 | 4837.5 | 3503.5 | 2056 |
| Projected EOM Inventory | Planned | 2975 | 3329.5 | 4837.5 | 3503.5 | 2056 | 1015 |
| Open-to-Buy | Planned | | 102.5 | 102.5 | 1410.5 | 1844 | 2265 |
| On Order | Actual | 2250 | 900 | 2420 | ? | ? | ? |

## Evaluating the Merchandise Budget Plan

Sales forecasting, inventory turnover and GMROI are some of the tools that help a retailer to plan and control the merchandising activities of a retail store. Depending on the planning process adopted (Top-down/ Bottom-up), the merchandise planner arrives at sales forecasts, inventory turnover and GMROI goals. The planner then develops a merchandise budget plan by combining the sales forecasts, inventory turnover and the GMROI. The merchandise budget plan thus developed can be used to purchase the merchandise of a specific category, well in advance of the season (in the months specified by the plan).

Once the selling season is complete, the merchandise planner should evaluate the performance of the merchandise budget plan. If the actual sales, inventory turnover and the GMROI figures exceed the forecasted figures in the plan, then the performance is said to be better than expected. However, the merchandise planner should not base his evaluation only on one of these three parameters but should consider other parameters like open–to–buy.

## Open-To-Buy

An Open to Buy (OTB) system helps the category manager to adjust the inventories according to the fluctuations in the actual sales (from the planned sales), as the merchandise flow is recorded real time in this system. OTB is generally calculated on a monthly basis. For maximizing the profits (if the actual sales exceed the planned sales) and minimizing the markdowns (if the actual sales are less than the planned sales), these calculations must be accurate and timely.

To ensure the success of a merchandise budget plan, (i.e., to accomplish the sales forecasts, inventory turnover and GMROI goals), the merchandise planner should purchase the merchandise in such quantities and on such delivery dates that the actual EOM inventory of a month is equal to the projected EOM inventory. Table 9.2 illustrates the Open-to-Buy system for a category of merchandise as given in Table 9.1.

The approach of a retailer towards Open-to-Buy systems and its calculations varies depending on whether it is being calculated for the previous years, for the present period or for the forthcoming seasons.

The formula for calculating Open-to-Buy is given as

OTB = Projected EOM Inventory + Projected Sales + Projected Markdowns – Inventory on Order – Projected BOM Inventory

## Calculating Open to Buy for Previous Periods

Let us assume that the data in Table 9.2 is as on mid-August. According to the table, the actual EOM inventory for July is Rs.29,75,000, while for August it is not known. It is simple to calculate open-to-buy at the end of a period, as we know both the projected EOM inventory and the actual EOM inventory. In the above case, the open-to buy will be zero, as the actual EOM inventory in July is the same as the projected EOM inventory (29,75,000) for that month.

Since the planned EOM Inventory = actual EOM Inventory,

Open-to-Buy = 0

## Calculating Open to Buy for the Present Period

According to Table 9.2, the present period is August. The table shows a BOM Inventory of Rs.29,75,000 for August, while the EOM inventory is not given as the month is not yet complete. The projected EOM inventory plays a major role in calculating the open-to-buy for the present period. The merchandise planner has to pay greater attention to projected EOM inventory (as it is an improvement over the planned EOM Inventory). Moreover, this improved estimate considers the information, which was not available while developing the merchandise budget plan. Thus, the formula for the projected EOM inventory can be given as follows:

Projected EOM Inventory = Actual BOM Inventory + Actual monthly additions to the Inventory + Actual on Order – Planned Monthly Sales – Planned Reductions for the Month.

For example, Projected EOM inventory for the month of August = 29,75,000 + 3,50,000 + 9,00,000 – 7,80,000 – 1,15,500 = 33,29,500

The formula for calculating Open-to-Buy for the present month is simply the difference between the planned EOM inventory (obtained from the merchandise budget plan) and the projected EOM inventory (on the basis of information collected during the month)

Thus, Open-to-Buy is given as:

Planned EOM Inventory – Projected EOM Inventory

= 34,32,000 – 33,29,500 = 1,02,500

which implies that the retailer is left with having to place additional orders for Rs.1,02,500 worth of merchandise in the month of August, in order to meet the planned EOM inventory of Rs. 34,32,000.

## Calculating Open-to-Buy for the forthcoming periods

Calculating this is slightly complex as there is no actual data available for the forthcoming months except the actual inventory on order. The projected EOM inventory, in this case is calculated as follows:

Projected EOM Inventory = Projected BOM Inventory + Actual on Order – Planned Monthly Sales – Planned Monthly Reductions

Thus, the projected EOM inventory for the month of September =

33,29,500 (Projected EOM Inventory of August) + 24,20,000 – 7,80,000 – 1,32,000 = 48,37,500

Therefore,

Open-to-Buy = Planned EOM Inventory – Projected EOM Inventory

= Rs. 49,40,000 – Rs.48,37,500 = Rs.1,02,500

which implies that the merchandise planner must place additional orders for Rs.1, 02,500 in the month of September to match the planned EOM inventory of Rs. 49,40,000.

## Evaluating Open-to-Buy

The merchandise planner should carefully maintain the records of all the merchandise being purchased, or it could lead to too much or too little of purchasing. i.e., it would be delivered in greater quantities when it is not required or it would not be delivered when it is required. In such a situation, the sales and inventory turnover would get affected and all the efforts that went into developing a merchandise budget plan would be futile. Thus, developing an effective open-to-buy plan can be considered as the most critical aspect of the total merchandise management process.

# PURCHASING SYSTEMS FOR STAPLE MERCHANDISE

An entirely different and more routine inventory management system is used for managing staple merchandise. Staple merchandise are merchandise that form a typical order-receipt-order cycle. A majority of the merchandise categories follow this cycle. Purchasing systems used for planning staple merchandise are not compatible with systems used for planning fashion merchandise. This is because the purchasing systems for staple merchandise use past sales records to forecast future sales while there will be no historical sales data available for the fashion merchandise on particular stock keeping units. These days, retailers, big or small, are making use of several inventory management systems for managing the staple merchandise categories. Some of the most widely used inventory management systems are JDA, J D Edwards, and IBM’s Inventory forecasting and replenishment modules.

Staple merchandise purchasing systems consist of a number of programmed modules that determine how much to order and when. These systems help the merchandise planner to:

- monitor and determine the average existing demand at the level of stock keeping units
- predict the future demand of the stock keeping units with adjustments to accommodate seasonal fluctuations and trend variations
- make decisions pertaining to orders so as to have maximum replenishment

## Inventory Management Reports

An inventory management report helps the merchandise planner by providing information on sales frequency, availability of inventory, inventory on order, inventory turnover, sales forecasts and the quantity on order for each stock keeping unit. The inventory management report is presented to the merchandise planner at a particular time, depending on the frequency with which the planner desires to review the inventory and make purchases. Table 9.3 provides a sample inventory management report for Cello Plastic buckets at a retail store. The first four columns of the report in Table 9.3 represent the basic inventory list, with each stock keeping unit and inventory position. The basic inventory list provides information on aspects like inventory number, description of the item, quantity on hand, quantity on order and the sales figures for the last three months. The basic inventory list of fashion merchandise varies from that of staple merchandise because every stock keeping unit of fashion merchandise requires meticulous planning.

**Table 9.3 The Inventory Management Report for Cello Buckets**

| *Inventory No.* | *Description* | *Quantity on Hand (on Order)* | *Sales last 3months (1 month)* | *Inventory turnover Actual (Planned)* | *Product Availability (Buffer)* | *Sales forecast Current 1 month (Next 2 months)* | *Order Point (Order quantity)* |
|---|---|---|---|---|---|---|---|
| 5001 | Cello Frost | 6 (120) | 215 (72) | 9 (12) | 96 (20) | 94 (117) | 167 (42) |
| 5002 | Cello Clear | 0 (96) | 139 (56) | 5 (9) | 100 (17) | 58 (113) | 110 (96) |
| 5003 | Cello Green | 1 (60) | 234 (117) | 9 (12) | 95 (27) | 42 (196) | 200 (144) |
| 5004 | Cello White | 2 (0) | 41 (31) | 5 (9) | 95 (10) | 41 (131) | 58 (60) |

Looking at the first item in Table 9.3 (item number 5001, the Cello Frost bucket), we notice that there are six units in hand and 120 units on order, thus pushing the available quantity to 126. The sales figures for the past three months and one month are 215 and 72 units respectively. The basic inventory list is the most important component of any inventory management system. However, many retailers look far beyond this and derive the next four columns of Table 9.3 – inventory turnover, product availability, buffer stock, sales forecasts, and order point (order quantity).

Just like the merchandise budget plan, planned inventory turnover is dependent on the retailer's financial plan and is one of the most critical factors of the overall inventory management system. The 6$^{th}$ column of the table shows the product availability on a base of 100. For instance, for Cello Frost, the number 96 indicates that out of 100 customers who wanted to buy Cello Frost, only 96 could get the item. It means that 4 customers faced stock-out for this product. Hence, for making the product available to all customers, a significant amount of managerial judgment is required. To counter situations when demand exceeds forecasts or when merchandise is not received from the vendor on time, retailers maintain certain buffer stock (the level of inventory that is used to prevent stock-outs). The next column gives the forecasts. Forecasting sales for staple merchandise is relatively simple and mechanical when compared to that of fashion merchandise. While determining the sales forecasts of fashion merchandise, previous sales records and other issues like seasonal fluctuations, fashions and fads are considered, but for staple merchandise, sales forecasting is simply done by extending the sales trends of the past into the future.

Retailers can also use a sales forecasting technique called exponential smoothing, which analyzes the previous sales figures to forecast the future sales. Let us consider the data from Table 9.3 to illustrate how this is done. Suppose the average sales forecast of Cello Frost over the last few months was 100 units, while the actual sales during the last one month was 72 units. While determining the sales forecasts for the next one month, the merchandise planner may be tempted to consider 72 units as a target base instead of 100 units. However, he should be cautious while taking such decisions as the actual sales (72) reported in the last month is an exception to the overall sales trend. Therefore, the planner should respond to these changes after ignoring the exceptions. The following formula can be used to determine the sales forecasts:

New Sales forecasts = Old Sales forecasts + $\alpha$ (Actual Demand – Old Sales forecasts)

where, $\alpha$ is a constant that lies between 0 and 1, and measures the impact of actual demand on the new sales forecast. In situations where the demand fluctuates rapidly, a high $\alpha$ value like 0.5 results in a quick reacting forecast. However, when the demand is more or less stable, a low value like 0.1 should be assigned to $\alpha$. Considering the same example, the sales forecasts for Cello buckets (using both high and low values of $\alpha$) can be calculated as

New Sales forecasts = Old Sales forecasts + $\alpha$ (Actual Demand–Old Sales forecasts)

Hence, New Sales forecast = 96 + .1(72-96) = 94

(or) New Sales forecast = 96 + .5(72-96) = 84

But, determining the usage of a high or low value of $\alpha$ requires both expertise and experience. If the merchandise planner interprets the decrease in the previous period's demand as an actual shift rather than a rare happening, it would be better to use 0.5 $\alpha$ because it results in a much lower sales forecast of 84 units. Assigning a higher value of $\alpha$ usually leads to an unstable forecasting process because the sales forecasts hyper-react to even a slight variation in demand. On the contrary, a lower value of alpha results in sales forecast that is far behind or far ahead of the existing trend.

To ensure continuous availability of products on the shelves, retailers should have proper reordering systems in place. There are two types of reordering systems available for the retailer to determine the reorder point, the perpetual and the periodic. Under a perpetual reordering system, the inventory levels are tracked perpetually and a predetermined quantity of inventory known as Economic Order Quantity (EOQ) is ordered. An order point is the inventory level below which the item may face a stock-out problem. Under a periodic reordering system, which is used by many retailers, the review time is constant, but the quantity being ordered can fluctuate. Under a periodic reordering system, the purchasers need not review each product line every day. The formula for determining the order point in this system can be denoted as under:

Order Point = [Demand per Day x (Lead time +Review time)] +Buffer stock where lead time is the difference between the time taken for identifying the need to place an order and the time at which the stock arrives at the store and is made available for sale. The order point should be fixed such that the next consignment arrives before the buffer stock is depleted.

Reorder quantity refers to the quantity that is to be ordered when the existing inventory goes below the order point. The quantity to be ordered is the difference between the order point and the quantity available at hand.

## ASSIGNING MERCHANDISE TO STORES

The merchandise, either fashion or staple, once purchased must be assigned to the retail stores. Table 9.4 describes the pattern in which a merchandise planner assigns the addition in inventory (Broken twill-boot cut men's jeans in dark blue costing Rs.1750) of value Rs.75,00,000 among 15 stores. Retailers with multiple stores generally categorize their stores as A, B and C depending on their sales. As per the information given in Table 9.4, there are four stores that can be categorized under A, each of which is expected to have a sales potential of 10% of the total sales, amounting to Rs.7,50,000 per store. There are three stores categorized under B, each with a sales potential of 6.7% of the total sales, amounting to Rs. 5,00,000 per store and finally, eight stores under category C, each with a sales potential of 5% amounting to Rs.3,75,000 per store. The sales potential of each store has been derived on the basis of its past sales records for the same merchandise category.

**Table 9.4 Assigning Broken Twill-Boot Cut Men's Jeans to Stores of a Multi-Store Retailer**

| ***Store Category*** | ***Number of Stores*** | ***Sales Potential of Each Store in the Category (in percentages)*** | ***Sales per Store (Total Sales x Sales Potential per each Store) (in Rs.Thousands)*** | ***Sales per Store Category ( Number of Stores x Sales per Store) (in Rs.Thousands)*** | ***Unit Sales per Store ( Sales per Store / Rs.1750)*** |
|---|---|---|---|---|---|
| A | 4 | 10 | 750 | 3000 | 429 |
| B | 3 | 6.7 | 500 | 1500 | 286 |
| C | 8 | 5 | 375 | 3000 | 214 |

Though every retail chain has its own way of assigning the merchandise to its stores, the assigning pattern should be based on the number of stores present in the chain and their individual sales contribution to the chain. However, every store of the chain should offer a large proportion of the merchandise assortment similar to that offered by the largest store in the chain. Else, the consumer would be left with an impression that the smaller stores in the chain offer an inferior assortment of merchandise. Therefore, the inventory to sales ratio of the smaller stores must be higher than the average inventory to sales ratio of all the stores put together. The larger stores of the chain should have an inventory to sales ratio that is lower than the average inventory to sales ratio of all the stores put together.

Table 9.5 shows the merchandise distribution pattern adopted by a multi store department chain. It implies that if a store has 4% sales contribution in a particular store category of the chain, it should receive an equivalent inventory of four percent. Moreover, it has also been observed that stores with less than 4% of sales contribution require a relatively higher level of inventory, to avoid giving an impression to the customers that the store is not well stocked. On the other hand, it is found that store with a sales contribution greater than 4% requires relatively lesser level of inventory. The largest store in the chain with a sales contribution of 12% of the total sales requires only 10% of the inventory levels of the total category. Further, stores in this category can increase the inventory turnover rate by frequent reordering. Large stores, thus, can provide a visually appealing and well-stocked look even with less inventory, because of their high sales.

**Table 9.5 Assigning Merchandise to Stores of a Department Store**

| | Low Sales<br>More Inventory | | | | | | More sales<br>Less inventory | |
|---|---|---|---|---|---|---|---|---|
| **Percentage of total sales** | 1 | 1.5 | 2.5 | 3.5 | 4 | 6 | 8 | 12 |
| **Percentage of total Inventory** | 1.5 | 2 | 3 | 4 | 4 | 4 | 6 | 10 |

## ANALYZING THE MERCHANDISE PERFORMANCE

Retailers should evaluate the performance of the stock keeping units, vendors, merchandise categories and the departments so as to determine when to add or eliminate a specific stock keeping unit, vendor, merchandise category or department. There are three different types of procedures that are usually adopted by the retailers to analyze the performance of their merchandise.

- ABC analysis
- Sell through analysis
- Multiattribute method

ABC analysis, the first procedure for analyzing the performance of a particular merchandise, is a process in which the merchandise is ranked according to its sales to take inventory stocking decisions. Sell through analysis, the second procedure for analyzing merchandise performance, helps determine whether markdowns are required to sell the merchandise or whether more merchandise is required to fulfill the demand, by comparing the actual sales figures with the planned sales figures. The multi-attribute method evaluates the performance of the vendors by ranking them on various parameters.

### ABC Analysis

ABC analysis helps determine the items that should never be out of stock, items that can go out of stock occasionally and the items that should be eliminated from the stock. This is done by ranking the merchandise on the basis of some performance parameters. An ABC analysis can be conducted at any level of merchandise classification, starting from a stock keeping unit to a department. ABC analysis is based on the commonly used 80-20 principle, according to which, approximately 80 percent of the sales or profits of a retailer are derived from 20 percent of its products. This implies that the retailers should identify and stock products that generate maximum revenues for them.

The first step in ABC analysis is to rank the stock keeping units using one or more parameters. The most significant performance parameter that is required to be measured is the contribution margin, given as:

Contribution margin = Net Sales – Cost of Goods Sold – Other Variable Expenses (such as commission on sales)

As measuring different performance parameters provides different types of information, it is important for the retailer to conduct an ABC analysis using multiple performance measures. These multiple performance measures can be the amount of sales, sales units, gross margins and GMROI.

Retailers carry less profitable items like portable goods because of their high value, in terms of sales value, and their ability to attract customers to the store. By holding low-profit/ high-volume items, retailers benefit through the sales generated due to complimentary nature of that merchandise with existing merchandise. For example, selling batteries in a store selling cameras and similar equipment would complement each other.

The next step is to measure sales or gross margin per square foot. It is important because it helps estimate the profitability. For example, carrying a line of leather wallets in a department store might not seem profitable when compared with other lines of merchandise (like bathing soaps or shampoos) on parameters like contribution margins, sales volume or variety to carry. Though such items may not be particularly profitable, still, the performance per square foot may be quite high, owing to the little display space needed by such merchandise.

The next step in ABC analysis is to develop criteria to sort items based on their levels of profits or volumes. For example, consider formal trousers in a chain of men's department stores, in which the purchaser categorized the stock keeping units as A, B, and C by ranking on the basis of sales volume and the distribution of sales.

According to the purchaser, only 5% of the items can be categorized under A and they alone contribute to 70% of the total sales in the stock-keeping unit. Thus, items categorized under A should never go out of stock. It is relatively expensive to offer such items for sale, as a higher level of buffer stock is needed to manage the fluctuations in demand and lead times. For example, full sleeve and half sleeve white and all dark color plain shirts.

Items categorized under B represent 10% of the stock on the stock-keeping unit, with a contribution of 20% towards sales. These items consist of some of the best selling colors with combinations of checks and stripes. Some stock keeping units of B items can go out of stock occasionally, as the retailers do not maintain the same amount of buffer stock.

And, 65% to 70% of the items can be categorized under C and they represent only 10% of the SKU sales. The purchaser might wish to carry C items of particular size and would place such an order only when needed. Though it is common to consider only A, B and C categories of items, there is another category D that represents the remaining units of the SKU, which do not contribute to any sales. The retailers should get rid of such merchandise as quickly as possible, either by marking it down or by giving it away, because it distracts the consumer's attention from the main inventory and it also clutters the store.

## Sell-Through Analysis

A sell-through analysis helps determine the requirement for early markdowns or the requirement of more merchandise to fulfill the demand by comparing the actual sales with the planned sales. Table 9.6 provides a sell-through analysis for men’s T-shirts for the first two weeks of the summer season at a men's fashion store. According to the historical sales data, T-shirts have been fast moving, and hence, the purchaser may have to modify the purchase plan frequently according to the changing fashions.

As per the data given in the table, it is found that the small polo red T-shirts were expected to sell 40 units but the actual sales were 35 units. Thus, the actual to planned percentage for this item stands at –12.5%, which implies that the actual sales were less than the planned sales by 12.5 percent. But, the actual-to-planned percentage is negative for all polo red T-shirts and positive for all the V-neck basic printed T-shirts.

**Table 9.6 Sell-Through Analysis for Men's T-shirts**

| | | | Week 1 | | | Week 2 | | |
|---|---|---|---|---|---|---|---|---|
| | | | Actual-to-Plan | | | Actual-to-Plan | | |
| **Inventory No.** | **Size** | **Description** | **Planned** | **Actual** | **Percent** | **Planned** | **Actual** | **Percent** |
| 2210 | Small | Polo red | 40 | 35 | –12.5 | 40 | 20 | –50 |
| 2211 | Medium | Polo red | 35 | 25 | –28.5 | 35 | 20 | – 43 |
| 2212 | Large | Polo red | 40 | 20 | –50 | 40 | 20 | –50 |
| 2310 | Small | V-neck print | 25 | 50 | 100 | 25 | 35 | 40 |
| 2311 | Medium | V-neck print | 35 | 55 | 57 | 35 | 40 | 14 |
| 2312 | Large | V-neck print | 45 | 45 | 0 | 45 | 60 | 33.3 |

In such a situation, it becomes difficult to arrive at a decision. As there is no specific rule to determine the timing of a markdown and reordering of merchandise, the purchaser's decision depends on his experience in merchandise management. In this case, as the sales of polo red T-shirts are less than what has been planned, offering an early mark-down can be justified, in order to make sure that the inventory is sold out before the end of summer. On the other hand, though all the varieties of V-neck printed T-shirts are selling at a faster pace, the purchaser can observe the sales for some more weeks in order to establish a sales pattern. If the actual sales continue to show a significantly higher sales pattern, a reorder should be made accordingly.

## Multi-attribute Method

This method is used to evaluate the vendors by assigning a weighted average score for each vendor. The weighted average score is assigned on the basis of several parameters. Table 9.7 describes the multi-attribute method of evaluating an existing or a prospective vendor for women's ethnic wear.

Overall rating = $\sum_{i=1}^{n} I_j * P_{ij}$

where $\sum_{i=1}^{n}$ is the sum of expression

$I_j$ is the importance weight assigned to the $i^{th}$ dimension

$P_{ij}$ is performance evaluation for $j^{th}$ brand alternative on the $i^{th}$ issue

Vendor evaluation is done by following the steps given below:

i. A list of different parameters or criteria (product features, price, promotional assistance, service quality, etc.,) that are to be taken into account while evaluating a vendor is first prepared. The purchaser should take a balanced approach while developing the list. The list of issues being considered should neither be too short nor too long, (as a short list might overlook some significant issues, and a long list would make it complex). The purchaser must ensure that vendor's performance is not based on a single criteria that receives too much emphasis.

**Table 9.7 Multi-attribute Method of Vendor Evaluation**

| | *Performance Evaluation of Individual Brands* | | | | |
|---|---|---|---|---|---|
| | | **Brands of Ethnic Women Wear (P)** | | | |
| **Issues** | **Importance weights (I)*** | **Indi** | **Maya** | **Pavithr** | **Madhur** |
| Reputation of the Vendor | 9 | 5 | 9 | 4 | 8 |
| Service | 8 | 6 | 6 | 4 | 6 |
| On time delivery | 6 | 5 | 7 | 4 | 4 |
| Quality of Merchandise | 5 | 5 | 4 | 6 | 5 |
| Opportunity to Mark-up | 5 | 5 | 4 | 4 | 5 |
| Country of origin | 6 | 5 | 3 | 3 | 8 |
| Product fashionability | 7 | 6 | 6 | 3 | 8 |
| Selling history | 3 | 5 | 5 | 5 | 5 |
| Promotional assistance | 4 | 5 | 3 | 4 | 7 |
| Overall rating | | 280 | 298 | 212 | 341 |

* Where 1 - Not Important and 10 - Very Important

ii. The purchaser should assign weights for each criteria in consideration only after proper consultation with the merchandise manager. The weights lie on the scale of 1 to 10 (1 implies not important and 10 implies very important).

iii. The category manager along with the merchandise manager should then evaluate the performance of the individual brands on each and every issue being considered.

iv. Then, the overall performance of the vendor can be evaluated. This is done by combining the performance and importance weights. As per the data given in Table 9.7, vendor reputation (9) multiplied by the performance rating of brand Indi (5) gives 45 and the issue of vendor promotional assistance (4) on multiplication with the brand Madhur's performance rating (7) gives 28. The performance cannot be measured properly unless the importance weights are attached with the individual brand ratings. It is important that vendors score well on criteria that are perceived to be important by the customers. Though the vendor of Madhur brand scored well on promotional assistance, the purchaser did not rate this issue as important and hence it was ranked lower.

v. To determine the overall rating of a vendor, add the product of each brand on the basis of various performance criteria. According to the data provided in Table 9.7, the brand Madhur stands out to be a preferred vendor with highest overall rating of 341.

## SUMMARY

This chapter provides a description of the merchandise budget plan, and is an extension of what has been concluded in the chapter merchandise assortment planning. Sales forecasting together with inventory management helps in developing a merchandise budget plan for the fashion merchandise category. Sales forecasts for fashion merchandise are given on a monthly basis according to the previous sales patterns. The merchandise planner should purchase more merchandise in the months in which the sales forecasts are higher than the average.

The chapter also explains the open-to-buy system. Open-to-buy records the merchandise flows i.e., the merchandise purchased for delivery in each month. Open-to-buy also helps merchandise planners keep track of the money spent so that they can compare it with the money that they have planned to spend and also know what is left to spend.

The purchasing systems used to purchase staple merchandise are quite different from the purchasing systems of fashion merchandise. The purchasing systems of staple merchandise help determine the amount of stock to be purchased for each specific stock-keeping unit.

While assigning the merchandise to the stores, merchandise planners should chiefly consider the sales potential of the stores. They should also think of the impression of the stores that customers would take home if faced with inferior assortments.

After assigning the merchandise to the stores, the retailer must analyze the performance of the merchandise through various aspects like performance of vendors, classifications and SKUs. Three procedures that we discussed to evaluate the merchandise performance are: ABC analysis, Sell through analysis and Multi-attribute method. ABC analysis is used to rank merchandise categories and establish an inventory management philosophy. Sell through analysis helps analyze the performance of various SKUs. Multi-attribute method helps evaluate the performance of vendors.

# Chapter 10

# Merchandise Purchasing

**In this chapter we will discuss:**

- Merchandise Purchasing
- Branding Strategies
- Global Sourcing Decisions
- Managerial Issues in Global Sourcing Decisions
- The Merchandise Purchasing and Handling Process
- Merchandise Handling
- Ethical and Legal Issues in Purchasing Merchandise

## INTRODUCTION

Retailers should have a thorough knowledge of the merchandise purchasing process. In order to purchase merchandise, the category manager should have knowledge of the hundreds of products carried by the store, and should also be competent to test and evaluate the products being purchased. The sources of supply for the merchandise can be spread across the globe. The category manager should evaluate these sources in order to determine their ability to satisfy the retailer's needs. Before getting involved in the actual process of merchandise purchasing, the retailer should take one of the most important merchandising decisions – Branding. Customers generally evaluate a retail store on the basis of the brands it carries. Brands have a significant impact on the loyalty of customers towards a store and the image of the store. The brands carried by a retailer also have an influence on the retailer's margins and the retailer’s dealings with suppliers. Often, decisions regarding brands go hand-in-hand with decisions regarding global sourcing, especially for retailers considering private labels. The country of origin of a product, apart from representing its quality, also has a bearing on the cost and time for procuring the merchandise.

This chapter examines the branding options available to a retailer, the various sourcing decisions possible, the merchandise purchasing and handling process, and the various legal and ethical issues involved in purchasing merchandise.

## MERCHANDISE PURCHASING

The process of purchasing merchandise, either from domestic or from global markets, involves all the activities that are required for establishing a successful relationship with various vendors. Once the merchandise has been purchased, it should be brought safely into the store and placed on the shelves for sale. This process of getting the merchandise physically into the store and taking care of it till it is sold is referred to as merchandise handling. As the same vendor may supply the merchandise to a retailer over a period of time, a relationship is bound to develop between the vendor and the retailer. The retailer must strengthen this relationship to gain a competitive advantage. However, simply purchasing from a particular vendor will not give a retailer competitive advantage. Both the retailer and the vendor should establish a strategic partnership, which is based on trust, common goals and financial commitment, to gain a competitive advantage.

With the increasing number of transactions between retailers and various vendors across the globe, a number of legal and ethical issues can arise. Ignoring or overlooking the impact of these issues can be disastrous for the retailer.

## BRANDING STRATEGIES

The type of merchandise brands a store carries plays a major role in improving the image of the store and in attracting customers. Retailers should determine an optimum mix of manufacturers' brands and private brands to be offered at the store. Manufacturers’ brands are those products that are designed, produced and marketed by a manufacturer while private brands are those that are designed, developed and marketed by a retailer.

## Manufacturers' Brands

These brands are produced and controlled by the manufacturer. They are generally well known, backed by the manufacturers' advertising, and require minimum investment by the retailer. Manufacturers' brands have maximum sales in many categories. In the case of manufacturers' brands, it is the responsibility of the concerned manufacturer to develop the merchandise and build its brand image. Manufacturers promote their brands either by associating their name with the brand or by developing an individual brand.

As manufacturers usually spend a significant amount of money (and their resources) to generate demand for their brands, retailers do not have to spend much on selling and promoting manufacturers' brands. Some retailers even build some of their categories around some key national brands as it helps them purchase merchandise in a coordinated fashion based on a central theme. For example, purchasers in departmental stores take up the responsibility of the entire brand, like Nike rather than individual products like shoes. Purchasing manufacturers' brands helps enhance the image of the store, increase the foot falls and reduce the selling and promotional expenditure of the retailer. Retailers stock manufacturers' brands as they pull customers to their stores. But manufacturers' brands offer smaller margins than private labels, because there is heavy competition among retailers to carry manufacturers' brands and because the promotional costs for these brands are borne by manufacturers. As most retailers offer same manufacturers' brands, customers tend to compare the prices of these brands in different stores. Hence, to attract customers, some retailers provide considerable discounts on manufacturers' brands.

A retailer offering national brands can transform a customer's brand loyalty into store loyalty when these national brands are available in only a few stores. But when manufacturers' brands are made available through a large number of retailers, then the loyalty of customers towards a particular store will decline and retailers will find it difficult to stand out in the competition.

**Licensed brands** are another form of manufacturers' brands. In this type of brands, the owner (the licenser) of a popular brand name establishes a contract with another party (referred to as the licensee) to manufacture and sell the licenser's branded products. The licensee can be either a retailer or a third party that entered into a contract with the licenser to produce the merchandise and sell it to a retailer.

## Private Label Brands

Private label brands, also referred to as in-store brands, are products that are produced and marketed by retailers. Category managers generally develop the specifications for the merchandise to be offered as a private label and enter into a tie-up with a third-party to manufacture it. It is the responsibility of retailers to market their private brands. Moreover, the following factors are perceived to have enabled major manufacturers' brands to dominate the market and keep other new entrants at bay.

- The major manufacturers have developed high entry barriers through their strong distribution channels.
- Older brand names have better brand recall than the newer ones. It is difficult for new entrants to build such strong brands because of the fragmented media and cost involved.
- The removal of high import duties in many countries and liberalization of markets have enabled consumers to be aware of the quality of imported goods. As a result, they expect higher value from local retailers.

The popularity of private labels is significantly low for the following reasons:

- Retailers are not able to advertise as aggressively as manufacturers.
- Retailers are not able to achieve economies of scale in designing and manufacturing (unlike manufacturers).
- Retailers lack technical sophistication.
- Consumers regard private label brands as inferior to manufacturers' brands.

Since most customers want value for money, the success of private-labels is dependent on retailer's ability to offer quality products that cost less than the manufacturers' brands. However, only big retailers will be able to offer products that can compete with manufacturers' brands. During the past 20 years, international retailers like Wal-Mart, The Limited, and K-Mart, have grown and become stronger than manufacturers/vendors.

Before discussing the various aspects of private labels, let us try to understand the type of products that qualify as private labels. A product does not qualify to be a private label just because it carries a retailer's name. A private label must be produced by the retailer, not just packed by the retailer. Private label products should ideally have the following characteristics:

*A private label should be a unit package:* Assigning a specific character to a private label is a complex process. However, any commodity that is sold loose out of a big bag does not qualify to be a private label. For example, a retailer may sell 4 kilograms of onions from a 100Kg bag, however, the 4Kg pack of onions does not qualify as a private label.

*The product should be relabeled*: The unit package should carry the brand name of a specific retailer or the name of the other party which is authorized by the retailer to supply private label products.

Private labels are expected to increase the profitability of the categories being carried, enhance the retailer's negotiation power, and increase consumer loyalty. In developed markets, private labels are used as key differentiators.

Adopting a private label strategy is not a simple task for any retailer. It involves high levels of customization at every level – country, region and category. When making decisions regarding private label operations, a retailer should determine which products should carry private labels, understand how customers assess the value of a product, and identify the value gap if any.

The success of a private label strategy is doubtful if its sole aim is to satisfy the private agenda of a retailer or a manufacturer. Such an attempt would fail to deliver value to the consumer. Hence, in order to find an appropriate private label that delivers value to customers, the retailer should identify the gaps in consumer's expectation of value from the retailer. These gaps are generally referred to as 'value gaps.'

Determining the value gaps in consumers' value expectations from a retailer is not a simple task. The following are some key factors that help retailers determine the value gap:

- The retailer should have proper and well-organized data, derived from point of sale terminals. The store format determines the usefulness of the data. Retailers can find out consumer preferences by examining the sales records of a complete self-service format. Such records provide behavioral data. While deciding on private label brands, retailers should not use sales figures collected from a non-self service format stores as indicators of customer behavior, because in such stores, customer behavior is influenced by salespeople.

- Equation of Price Quality and Willingness to Pay (PQ&WP) is essential for determining the value gap. Consumers will reject a product if the quality of the product is below the minimum threshold level they are currently in. The retailer, while analyzing the PQ&WP equation, should not forget that consumers see value in the additional costs charged by manufacturers for increasing the quality of the product/service.
- The pricing strategies for groceries can be defined easily. The value delivery of merchandise can be enhanced by offering products with consistent quality at a low price. The retailer can increase the penetration level of a category by offering cheaper products in that category. Consumers always expect cheaper and better products with high value from the retailer. However, it has been found that categories that have less number of brands provide less value.

## Reasons for Launching Private Labels

The increasing emphasis given by major manufacturers to shareholder value over consumer loyalty has compelled retailers to launch private label brands.

Almost all the major retailers in the organized retail sector carry their own private labels. There are three main reasons for introducing private labels:

*i.* *The consumer does not see any tangible value in some of the manufacturers' brands offered by the store.* In such a situation, the retailer should offer a value that can be felt and experienced by the consumer. To do so, the retailer must offer store brands. Table 10.1 gives the private label brands of some of the major international retailers.

*ii.* *The retailer does not earn good margins through the sale of national brands*. Organized retailers get only a 6-10% margin from manufacturers or vendors, but they require a 20 percent margin to support their operations. Of late, there has been a significant increase in the number of manufacturers’ brands being offered. All of these brands might not sell well, leading to a further decline in the retailer’s margins.

*iii.* *Of all the purchase orders placed, the vendors fulfill only 60 to 65 percent of the orders*. The customers of a store expect the retailer to carry a substantial number of products on its stock keeping units. This means that the retailer should maintain a large inventory. With the available credit period of 7 to 10 days, storing large inventories has a negative effect on the return on interests on account of the paid inventory and a lower inventory turnover rate.

Because of these reasons, the retailer may have no option but to introduce private labels. Exhibit 10.1 gives the private label merchandising strategy of Kroger, one of the biggest retailers in the US.

Once a retailer decides on a suitable branding strategy (whether to carry manufacturer's brands or private labels) and determines an appropriate brand mix, he must identify the different sources for purchasing the merchandise. The retailer should then choose between global sources of supply and domestic sources of supply. If the retailer decides to use global sources, he must consider factors like fluctuations in foreign exchange, GATT and WTO regulations, free trade zones, and local and international laws.

**Table 10.1 Private Labels of Top International Retailers**

| *Retailer* | *Private Labels* |
|---|---|
| Wal-Mart | Sam's Choice Cola, Decadent Cookie, Better Homes and Gardens, Great Value |
| Kmart | Martha Stewart Everyday label, Route 66 clothing, Ora-Pure, Kgro, Jaclyn Smith |
| Sears | Kenmore, Diehard, Craftsman, Canyon, River Blues, Tough Skins |
| JC Penney | Arizona, Fox, Stafford, Hunt Club |
| Safeway | Shurfine, Empress |
| Target (formerly Dayton Hudson) | Archer Farms |
| Kroger | Private Selection, Kroger, Ralphs, King Soopers, For Maximum Value (FMV) |
| Costco Companies | Kirkland Signature |

## GLOBAL SOURCING DECISIONS

Bags, shoes, caps, cordless telephones and similar goods that are sold in the US are sourced mostly from China or South East Asian Countries like Philippines, Taiwan, Bangladesh. The decision to source merchandise from international sources is associated closely with branding decisions. A retailer should be careful while taking global sourcing decisions as the customers judge the quality of an imported product on the basis of the country of origin. For instance, like Japan is known for producing electronic goods, certain countries are well known for manufacturing certain products. Brazil is known for coffee, and France is known for wines. However, retailer's decision to source the merchandise from international sources would have many implications in terms of cost. Though sourcing merchandise from international regions might look cheaper, there could be many hidden costs. Hence, when making sourcing decisions, retailers should examine various cost related factors like

- Country-of-origin effect
- Foreign exchange fluctuations
- Tariffs
- Free trading zones
- Inventory carrying costs
- Transportation costs

### County-of-origin Effect

When making global sourcing decisions, retailers should compare the savings derived from sourcing merchandise from a low cost region with the prestige derived from sourcing merchandise from a country that is known for a particular product. Some countries are technically superior in manufacturing certain products and can hence offer those products in global markets at a lower price than other countries. Though such products may be offered at a higher price initially, the prices come down with the increasing efficiency of the manufacturers.

**Exhibit 10.1**

**Private Label Merchandising Strategy at Kroger**

The manufacturing department of the Kroger Company is one of the largest manufacturers of private label brands in the United States. Kroger produces more than 3,500 food and non-food products through its 41 manufacturing units. Kroger adopts a three tier marketing strategy in manufacturing and selling its private labels. Kroger's private labels are manufactured and sold in three levels of quality. The three tier strategy helps Kroger satisfy the needs of all its customers in their different markets of operation. All the three levels of quality products are value priced to offer big savings to its customers over the other premium, national and economy brands. **Private Selection** is the Kroger's premium quality brand, that is developed to match with the upscale national or regional brands. **Banner brands** like Kroger, Ralphs, and King Soopers, constituting the majority of the 7,500 items stocked in the Kroger's stores, are developed to be equal to or out-perform the national brands. Kroger supports these brands with the help of a guarantee scheme, Try It, Like It, or Get the National Brand Free. For Maximum Value (FMV) is the Kroger's value brand that offers good quality at an affordable price. Kroger has 41 manufacturing facilities that produce its Private Selection, Banner, and FMV brands. Kroger evaluates these facilities on a continuous basis to ensure their profitability and quality. Kroger also offers a variety of general merchandise private-label items for its customers. They include - Automotive - Moto Tech, Bath and Body - Splash Sport, Splash Spa, and Bath and Body Therapies, Kitchen appliances - Everyday Living and the upscale HD Designs and Office and School products - Office Works.

*Adapted from www.kroger.com/pdfs.sec4a.pdf*

## Foreign Exchange Fluctuations

Fluctuations in the value of foreign currencies must be considered by retailers when deciding on a global sourcing strategy. Changes in the foreign exchange rate will have a significant impact on the cost of merchandise being sourced. For example, frequent changes in the exchange rate of Indian and US currencies would increase or decrease the cost of merchandise for an Indian retailer sourcing products from the US.

## Tariffs/Duty

A tariff refers to a list of taxes charged by the government on imports. Governments generally use import taxes to protect domestic industries against foreign competition. These taxes also serve as a source of income for the government. As tariffs usually increase the cost of the merchandise being imported, retailers’ participation in channels like WTO, NAFTA and free trading zones, reduce these tariffs.

### General Agreement on Tariffs and Trade (GATT) and the World Trade Organization (WTO)

The General Agreement on Tariffs and Trade (GATT) was first signed in 1947. GATT was an international forum that encouraged free trade between member countries by regulating and lowering tariffs on traded goods. It also served as a mechanism for resolving trade disputes. In January 1995, GATT evolved into the World Trade Organization. The WTO monitors and arbitrates GATT agreements and supports all negotiations.

## Free Trade Zones

A free trade zone is a specially established zone in a country for warehousing, packing, inspecting, labeling, exhibiting, assembling, and fabricating goods or for shipping of imports without coming under the purview of that particular country's tariff rules. Retailers sourcing merchandise from international sources can reduce tariff rates with the help of free trade zones.

### Inventory Carrying Costs

Inventory carrying costs tend to be higher for products being sourced from foreign countries than for those sourced from within the country of operation. Inventory carrying costs are arrived at by calculating the average value of the inventory at cost and multiplying it by the opportunity cost of capital. The opportunity cost of capital is the rate (return) derived from the next best investment opportunity. There can be many possible reasons for higher inventory costs. For instance, longer lead times would require retailer to maintain high levels of inventory, thus increasing inventory carrying costs. Determining the exact lead times in global sourcing decisions is a difficult task. Inconsistent lead times also force the retailer to carry higher levels of buffer stock.

### Transportation Costs

In general, the cost of transportation is directly proportional to the distance the merchandise has to travel, irrespective of the mode of transportation. For instance, the cost of shipping a container from Japan to Dubai will certainly be higher than shipping the container from Dubai to Mumbai. .

## MANAGERIAL ISSUES IN GLOBAL SOURCING DECISIONS

Managerial issues like quality control and strategic alliances must be considered when making global sourcing decisions. While sourcing merchandise from different parts of the world, the retailer faces the challenge of maintaining quality standards. Quality problems are likely to occur if the sourcing destinations are located in under-developed countries. The poor quality detected at the source may lead to rework, and this, in turn may lead to delayed shipping of merchandise to the retailer. This may force the retailer to stock more merchandise as buffer. Thus, quality problems may have an impact on other store activities.

Establishing a strategic alliance with vendors is the most crucial part of retail supply chain management. It would be difficult to establish an alliance with vendors in foreign regions, especially if they are located in distant under-developed nations. Establishing a proper communication channel is a difficult job in a global setting. Language and culture are the most prominent barriers in such a setting. Building and maintaining vendor's trust is also difficult when dealing with vendors in foreign countries.

## THE MERCHANDISE PURCHASING AND HANDLING PROCESS

Purchasing merchandise in a retail environment involves the process of identifying, evaluating and selecting merchandise for resale to end consumers. The process of merchandise purchasing involves all the activities that are required to establish a successful relationship with the different sources of supply and source the retailer's merchandise in an efficient manner. The process of merchandise handling involves all the activities pertaining to the procurement of merchandise. In other words, it involves getting the merchandise physically into the store and onto the shelves.

### The Merchandise Purchasing Process

Purchasing the merchandise is the retailer's first step in bringing the merchandise to the store. To purchase merchandise, the retailer must:

- identify the available sources of supply
- contact and evaluate the different sources of supply
- negotiate and purchase from the best sources of supply

## Identifying the sources of supply

This is the first step in the merchandise purchasing process. The retailer should find out the available sources of supply, and then identify the channel through which each merchandise line would be obtained. In some cases, retailers prefer to use a direct channel to the manufacturer or the actual producer (in case of agricultural products). Retailers also use indirect channels with one or more intermediaries, depending on the situation and the type of product. A retailer can use any of the following four sources of supply, or a combination of these sources of supply:

i. Raw resource producers

ii. Manufacturers

iii. Intermediaries

iv. Resident purchasing offices

### *Raw Resource Producers*

Retailers, especially food retailers, may choose to obtain merchandise directly from raw resource producers. Big retailers selling food or food based products would like to avoid intermediaries and instead obtain fresh vegetables and fruits and other raw-materials for their private labels. Selecting a direct channel to the raw-resource producer increases the speed of delivery, and minimizes handling. As a result, perishable goods like vegetables reach the store with minimum damage. Retailers may also adopt this direct channel to obtain non-perishable goods like construction goods and heavy equipment to reduce costs (intermediaries would charge a higher price).

### *Manufacturers*

Big multinational retailers like Wal-Mart prefer to purchase directly from the manufacturer, as they deal in huge volumes. Purchasing directly from manufacturers offers many benefits to retailers, such as delivery of fresh products, faster delivery and quicker processing of initial orders, and lower prices (due to elimination of intermediaries). In addition, the manufacturer can provide more reliable information on product lines than intermediaries. Apart from the above mentioned benefits, the relationship between the manufacturer and retailer can also result in flexible adjustment policies and faster adjustment responses to products that are returned by the retailer's customers. Further, purchasing merchandise directly from manufacturers allows the retailer to order and obtain goods as per his specifications.

### *Wholesale Intermediaries*

Wholesale intermediaries are those who act as intermediaries between the manufacturers and retailers. They facilitate the transfer of goods from the manufacturer to the retailer. Their role in the chain varies according to the nature of their operations and the services provided by them. Most wholesale intermediaries do not offer all wholesaling services such as purchasing, selling, breaking bulk, developing assortment, storing, delivering, extending credit, providing information, consultation and title transferring. Generally, intermediaries specialize in offering one or few services. Wholesale intermediaries can be classified into different groups, depending on the number and nature of services being offered. Retailers can select any of the intermediaries given in the Table 10.2 depending on their requirements.

### *Resident Purchasing Offices*

These offices are owned by the retail store or by an independent organization. They specialize in providing purchasing services to retailers. Providing information and assisting purchasers are two key services. They provide information on:

a. product availability

b. supplier reliability

**Table 10.2: Types of Wholesale Intermediaries**

| ***Category of Wholesale Intermediaries*** | ***Type*** | ***Description*** |
|---|---|---|
| Merchant Intermediaries | General Merchandise (full function) | Carries a number of different product lines, usually unrelated, without a single dominant product line. |
| | Single line (full function) | Carries one general product line, like groceries or cosmetics. |
| | Specialty line (full function) | Carries only one specialty product line within a general product line. |
| | Cash and Carry (limited function) | Discount supermarket of wholesalers, visited by the retailers who select the order, assemble it, pay for it and ship it. |
| | Drop shipper (limited function) | Distributes heavy and bulky products, like construction material. |
| | Truck Distributor (limited function) | The driver travels a particular route by truck and performs both the sales and distribution jobs. |
| | Rack Jobber (limited function) | Furnishes shelves for display, stocks the shelves, creates attractive displays and prices the merchandise. |
| Agent Intermediaries | Broker (limited function) | Closes the transaction by bringing together prospective purchasers and sellers. |
| | Sales agent (limited function) | Takes up the total marketing activity of the manufacturer. |
| | Manufacturer's agent (limited function) | Acts as a sales organization for many manufacturers, within specific market areas carrying complementary product lines. |
| Commission Merchant | Assumes physical possession of the merchandise, offers storage and handling facilities. | Commission merchant. |
| | Auction houses | Special type of agent intermediaries, that sell products like used furniture, used cars, and agricultural equipment. Provides physical facilities for manufacturers to display their merchandise (for retailers to inspect). |
| Contractual Intermediaries | Cooperative Group | Operated by a group of participating retailers. The group provides retailers with merchandise at lower prices, depending on the quantity of the merchandise being bought by the member retailers. |
| | Voluntary Chain | Retailers may join voluntarily. |

c. market and supply trends

d. special offers, services, prices and promotion offered by various suppliers

Services aimed at assisting purchasers include identifying the sources of supply, contacting the suppliers, helping with sales negotiations by acting as the representatives of several retailers, providing delivery services, and scheduling payments and ensuring quick and timely delivery of the merchandise to the retailers.

## Contacting the Sources of Supply

This is the second step in the merchandise purchasing process. Though most retailers have their own sources of supply, they should have as many contacts as possible with different sources of supply. This process of contacting can be categorized into supplier-initiated contacts and retailer initiated contacts, depending on the party that initiated the contact.

Visits by vendors' sales representatives and solicitations through telephone and mail orders are all types of supplier-initiated contacts. Making sales call at a retailer's store is the most commonly used way of selling staple merchandise. This method helps the retailer in the following ways:

a. It saves time and money.

b. It simplifies the market search process.

c. It facilitates easy access to inventory and sales records.

d. It allows consultation with other personnel in the store prior to placing an order.

Some suppliers use the telephone or the mail to fix appointments with prospective retailers to visit their store, to follow-up orders, and to find out the needs of present customers.

Visits to central markets, resident buying offices, and merchandise exhibitions and inquiries through telephone and mail, represent retailer-initiated contacts. Many suppliers locate their selling offices and merchandise showrooms in a central market, so that a retailer can visit them and analyze and compare the merchandise being offered by different vendors. Vendors usually help retailers evaluate the merchandise by displaying it permanently at the central markets. A group of vendors may come together to host a trade fair for a certain period, in which they display their merchandise for the retailers to evaluate.

### *Evaluation of Source of Supply*

Once a retailer has identified and contacted various sources of supply, he must evaluate the vendors on the basis of their operational consistency. To evaluate vendors, the retailer should ideally have an evaluation criteria and a procedure for ranking the abilities of each and every supplier in satisfying the retailer's requirements.

***Evaluation criteria:*** The various criteria on which potential vendors are evaluated are related to merchandise, distribution, pricing, promotion and service.

Merchandise is the primary consideration in the evaluation of potential vendors. The most common factors on which merchandise is evaluated are the availability, suitability and adaptability of the merchandise carried by the vendor. The suitability of merchandise refers to how well the vendor's merchandise suits the requirements of the retailer's customers and the retailer's image in the market. Suitability is evaluated on the basis of a variety of factors like brands, style, and pricing, and other factors such as uniqueness, originality, durability, quality and aesthetics. To evaluate the availability of the merchandise, the retailer should determine whether the vendor will take the order. The retailer should also determine whether the vendor can offer the merchandise in different quantities, sizes, styles and colors. The adaptability factor refers to the vendor's ability to make the required changes in the merchandise so that it meets the requirements of both the retailer and its customers. The following parameters are used to judge the adaptability of the vendor:

- Ability to produce products according to the retailer's specifications.
- Willingness to place retailer's store label on the merchandise.
- Ability to manufacture merchandise in different colors, sizes, and styles, so that the retailer can introduce new trends in the merchandise lines being carried currently.

Distribution is another significant criteria for evaluating the vendor. Retailers usually analyze a vendor's past performance to determine his future performance. The degree of exclusiveness offered by a vendor can be a deciding factor for many retailers. Offering a product exclusively for a particular retailer, or for selected retailers or for many retailers, would be a deciding factor for selecting a particular vendor. Apart from the above criteria, there are some distribution policies that should be considered by retailers when evaluating a vendor – terms and conditions of delivery, constraints on size of the order and assortments, time taken for processing initial orders and reorders, and the ease and flexibility of placing an order.

When evaluating a vendor on the basis of pricing, the retailer considers the price offered to the end consumer as well as the price offered to the retailer. When evaluating on the basis of the price offered to the consumer, the vendor should be evaluated on the basis of the appropriateness and maintenance of price. The selling price of the merchandise should suit the concerned retailers' target market. A retailer situated in a low end locality cannot sell its merchandise at a premium price. The price appropriateness for a premium lifestyle retailer refers to selling high-quality merchandise at a premium price. Price maintenance refers to a vendor's policy to maintain or retain the selling price at or over a certain level. When evaluating a vendor, the retailer must also determine the price that the retailer should pay to the vendor for the merchandise. The price paid by the retailer should allow him to operate profitably and retain his competitiveness in the market.

The type and amount of promotional assistance given by a vendor is also a key criteria for evaluating the vendor. The vendor can provide promotional assistance to the retailer in many forms: providing allowances in advertising, offering cooperative advertising, making in-store demonstrations, allowing free display of equipment and making other offers like coupons, contests and samples that attract consumers. The degree of support extended by vendor for selling merchandise, with the help of national or local advertising, is a key factor when evaluating and selecting a vendor. The following additional services are provided (fully or partially) by some vendors:

- Warranty and repairs
- Exchange facilities
- Finance and credit services
- Training of sales personnel
- Accounting services
- Planning and controlling inventory
- Designing store facilities
- Providing display units, fixtures and signs

Though these services can help a retailer lower its operational costs or capital investments, they can also increase the dependence of the retailer on its vendors.

### *Methods of Evaluation*

To evaluate alternative sources of supply, retailers should evaluate each vendor using the weighted rating method. In the weighted rating method, weights are assigned to each evaluation criteria. According to John S. Barens's decision matrix approach to vendor selection, a retailer should ideally go through five steps when selecting an appropriate vendor. These five steps are given below:

*Selecting the criteria*: In this step, the retailer selects the appropriate criteria for evaluating the sources of supply. Retailers can consider different criteria for evaluating vendors, as given in Table 10.3.

**Table 10.3 Criteria used for Evaluating Vendors**

| ***Criteria*** | ***Description*** |
|---|---|
| Reliability | Vendor's ability to satisfy all written promises. |
| Price Vs Quality | Vendor's ability to provide best merchandise at the least possible price. |
| Time for processing orders | Speed in delivering the merchandise. |
| Exclusive selling rights | Vendor's ability to provide exclusive selling rights to the retailer. |
| Services provided | Vendor's ability to provide services like shipping and storing, if required. |
| Information | Vendor's ability to provide any significant data pertaining to goods and services. |
| Guarantee | Vendor's support for its goods. |
| Credit | Vendor's ability to provide credit purchases to the retailer. |
| Ethics | Vendor's ability to stick to all its verbal promises. |
| Long term relationship | Availability of the vendor over an extended period of time. |
| Reorder filling capacity | Vendor's ability to fill reorders on time. |
| Markups | Vendor's ability to provide sufficient markup or price margins. |
| Innovativeness | Innovativeness of the vendor's product line. |
| Advertising support | Advertising support provided by the vendor. |
| Investment costs | The size of the vendor's total investment cost. |
| Risk Involved | The amount of risk involved in dealing with the vendor. |

*Weighing the criteria*: The retailer assigns predetermined weights to each evaluation criteria. Then these criteria are ranked in descending order, depending on their importance to the retailer.

*Selecting the vendor*: In this step, the retailer uses a set procedure to identify the potential vendor for evaluation.

*Rating the vendor*: In this step, the retailer ranks each vendor being considered on the basis of each evaluation criteria. The retailer can assign appropriate weight age to each vendor, by comparing each vendor with every other vendor in the list on each evaluation criterion.

*Weighted rating*: The retailer multiplies the weights of each vendor by the weight assigned to the criteria in step two to obtain the weighted rating for each vendor. And to determine the overall weighted rating for each vendor, the retailer should just add the weighted rating of each evaluation criteria.

The evaluation procedure starts with the retailer selecting the vendor who was assigned the maximum weighted rating. Then the retailer tries to obtain the necessary commitments from the vendor. And if the retailer requires more than one vendor or if there is no vendor with maximum weight age, then the retailer should repeat the process until all the required sources of supply are found.

### Negotiating with the Sources of Supply

Negotiating with the sources of supply is the fourth step in the process of purchasing merchandise. It involves active negotiation with potential vendors (who were identified through evaluation). Through negotiation, retailers can get the best merchandise for the least possible price, and with the best services.

Price negotiations generally begin with the basic list price of the vendor. The basic list price of a vendor plays the most significant role in determining the final price the vendor offers the retailer. Generally, vendors provide retailers with ‘list prices’ of the different merchandise they deal in. Vendors arrive at a final price after giving some discounts on the list price. This ‘final price’ depends on how well the retailer negotiates with the vendor. Therefore, the ‘final price’ offered to the retailer is given by the following equation:

Final Price = List Price – negotiated discounts and allowances

A trade discount is a price discount that is available only to some classes of purchasers, like wholesalers or big retailers. It is typically quoted in a series and is represented as a percentage decrease from the basic list price given by the vendor. Even though a trade discount is used, the invoice shows only the retail price. For example, if the trade discount of a certain manufacturer is quoted as 12%, 6%, and 4% to its wholesalers, then the 12% discount goes towards handling and credit costs, 6% towards selling effort, and the remaining 4% towards profits. Vendors use trade discounts for the following reasons:

- They offer a simple method for changing prices to meet changing market conditions. Instead of publishing the changed price of each individual product, vendors just publish the change in the discount rate, whenever there is an increase or decrease in the prices.
- They help vendors have some control over the retail price of merchandise, by mentioning the price on the invoice and then quoting a series of discounts. This helps retailers make up a certain margin.

A quantity discount refers to a discount that is offered to retailers by vendors upon the purchase of a specific quantity of merchandise. A seasonal discount refers to a discount that is offered to retailers for ordering or receiving the merchandise prior to the starting of the normal selling period. Seasonal discounts are regarded as the vendor's attempt to encourage retailers to purchase early. These discounts also help vendors secure business even during slack periods.

Vendors give retailers cash discounts to show appreciation for prompt payment. To encourage retailers to pay their bills before the due date, vendors allow the retailers to deduct a set percentage from the net amount in the invoice (total invoice value minus all discounts like trade, quantity). Retailers have to consider three factors when negotiating cash discounts with vendors: net invoice price, amount of discount, and the dating terms. Dating terms specify the time allowed for retailers to claim the cash discounts. They also specify the due date for paying the invoice. There are two types of dating terms, immediate dating and future dating. Immediate dating permits no additional time for claiming cash discounts. Future dating provides the retailer with more time to pay the bill and receive the cash discount.

Vendors use future dating to encourage retailers to purchase merchandise prior to the beginning of the normal selling season. Future dating allows the retailer to reduce inventory costs, because the retailer does not pay for the inventory for a specific period.

There are five important terms that a retailer must be familiar with when purchasing merchandise:

- Net: This refers to the net number of days from the date of invoice within which the retailer has to make the payment. For instance, Net 30 implies that the payment must be made within a period of 30 days from the date of invoice.
- Free on Board (FOB): FOB implies that the goods are placed on board a truck, ship or an aircraft. The ownership of the goods is transferred from the vendor to the retailer at the point of FOB. And till the ownership is transferred from the vendor to the retailer, the merchandise on board is the responsibility of the vendor.
- Free Alongside Ship (FAS): FAS at a recognized port implies that the vendor specifies a price for the merchandise, including the delivery costs, alongside a vessel. The vendor/seller bears the loading costs, while the buyer (retailer or the wholesaler) bears the costs of unloading, sea transportation and insurance.
- Cost, Insurance and Freight (CIF): CIF to a particular place implies that the vendor specifies a particular price that includes transportation, insurance and other miscellaneous costs.
- Cash on Delivery (COD): The vendor might insist on COD when the retailer is unfamiliar or when he has a poor credit record.

In order to obtain retailers' cooperation for promotional programs, vendors usually offer a promotional allowance to retailers. A promotional allowance decreases the price paid for the merchandise by the retailers to the vendors. It consists of advertising allowances, preferred selling space, free display materials and merchandise offers.

The actual cost of merchandise for a retailer also depends on the transportation and handling costs. Therefore, when negotiating the terms of transportation and handling, the retailer should consider which party will bear the transportation costs, which party will be responsible for filing claims, and what will be the terms of exchange.

Apart from negotiating on price discounts, the retailer should also negotiate on the different types and levels of services offered by the vendor. Services, in some cases, are almost standard (with some minor differences), while in other situations the services offered are highly negotiable.

## Purchasing from the Sources of Supply

This is the final step in the process of purchasing merchandise. In this step, the actual purchasing takes place. The retailer should consider two major issues when purchasing merchandise: purchasing strategies and purchasing methods.

### *Purchasing Strategies*

The retailer can adopt a concentrated strategy or a dispersed strategy when deciding on the number of different vendors to use for obtaining merchandise.

In concentrated strategy, the retailer uses a limited number of vendors, thinking that it reduces the total costs and allows him to get a preferential treatment. Through concentrated buying, the retailer can reduce the cost of goods with the help of quantitative discounts and reduced transportation costs. The retailer can also reduce operational costs because of the increased efficiency in merchandise ordering, delivering, and processing by few vendors.

Retailers adopting a dispersed strategy believe in using a large number of vendors, as it helps them:

- secure a greater variety of goods or merchandise.
- gain awareness of 'hot selling' goods.
- develop a buffer for the sources of supply.
- develop a competitive spirit among the various sources of supply (to improve service).

Generally, retailers handling fashion merchandise adopt a dispersed purchasing strategy, while retailers handling staple merchandise adopt a concentrated purchasing strategy.

### Purchasing Methods

The use of various purchasing methods by retailers depends purely on the situation. The various purchasing methods considered by retailers are regular, consignment, memorandum, approval and specification purchasing.

Regular purchasing involves the organized issuing of purchase orders and reorders. The total purchasing process is dependent on the type of merchandise. Regular purchasing is usually used to purchase most staple merchandise and many fashion merchandise items.

In consignment purchasing, the vendor remains the owner of the merchandise even after shipping it to the retailer. The retailer then offers the merchandise for sale, sells the merchandise to the final consumer, retains the predetermined percentage commission, and transfers the remaining money to the vendor. This type of purchasing is generally adopted, when the merchandise being sold is new or expensive, or when the risk involved is so high that it is relatively difficult to determine the degree and duration of the demand.

Memorandum purchasing is quite similar to consignment purchasing, except that the ownership is transferred to the retailer when the merchandise is shipped. The retailer can return any unsold merchandise to the vendor and is allowed to pay for the merchandise only after it is sold.

In approval purchasing, the merchandise purchased is subject to the retailer's approval. The merchandise is shipped to the retailer even before the retailer makes the final decision to buy. But the retailer should obtain the ownership before selling the goods to the final consumer. This type of purchasing allows the retailer to examine the merchandise prior to making the purchasing decision. This method also allows the retailer to alter his purchasing decisions till he takes physical possession of the merchandise.

In specification purchasing, the retailer can purchase merchandise according to his specifications. The extent of specifications can vary from minute changes in the present merchandise lines to complete changes in raw material, design, quality, labels and packaging.

## MERCHANDISE HANDLING

Merchandise handling refers to the physical handling of the merchandise by the retailer. The merchandise handling process consists of different activities like receiving and stocking merchandise, pricing and marking inventory, setting up displays, determining on-floor quantities and assortments, completing customer transactions, providing delivery and pickup of goods (for customers), processing goods that are damaged, processing returns and exchanges, monitoring pilferage and merchandise control. The effective management of distribution is crucial during this stage, whether distribution is done through retail centers or through direct store delivery. According to a recent study conducted in the US on many retail formats (such as grocery stores, department stores, category killer stores, the specialty stores and mass merchants), over 80% of them had at least one distribution center. But, over 25% of the retailers had received at least some of the merchandise directly from the vendor. It was found that around 10% of merchandise in specialty stores and around 80% of merchandise in category killer retail outlets come directly from the vendor. The following is the merchandise handling process adopted by many retailers:

i. The vendors ship the merchandise either to the warehouses for storing and distributing or to the retailer's store directly.

ii. Retailers mark the prices and inventory information on the merchandise being received. There are several ways in which retailers mark prices and place inventory information on the merchandise. Small retailers may maintain inventory records manually and mark the prices by pasting them manually. Some retailers might use computer-generated price tags to mark prices on the merchandise. They maintain inventory records with the help of the barcodes provided on each product being sold. Retailers may even purchase tags containing price and inventory data from the vendors, which can be read both by machines and humans.

The efficiency of an inventory control system is directly proportional to the information on the labels and tags. The type of retailer and the type of merchandise being carried determines the store displays, on-floor quantities and assortments being offered. Supermarkets generally store most of their inventory on the selling floor, through bins and rack displays. Department stores generally have ensemble displays and store most of their inventory in the storeroom, which is off the sales floor. (Chapter 14 on Store Design, Layout and Visual Merchandising will discuss issues regarding displays and on-floor merchandising at length).

The process of merchandise handling cannot be regarded as complete unless the customer purchases the merchandise from the store and receives it from the store. Purchasing and receiving the merchandise from the store is usually a process represented by taking an order, receiving cash or credit payment, packing, and delivery or receipt of goods. The performance of retailers in each of these areas has improved significantly because of computerization and automation.

Once customer purchasing systems are established, the merchandise handling process should develop a procedure for handling returns and damaged merchandise. Specifically, the retailer should identify the entity responsible for the goods returned by the customers (the vendor or the retailer) and the terms and conditions under which the damaged merchandise would be taken back for a refund or exchange. For example, many products come with a warranty, which will be honored only for a limited period.

## Re-ordering Merchandise

Merchandise controlling is a process for evaluating revenues, profits, turnover, shortage of inventory, seasonal fluctuations and costs for each product in the merchandise category being offered by the retailer. A retailer can exercise control over the inventory by creating and maintaining a perpetual inventory data and then conducting a physical inventory count to measure the accuracy of the perpetual data, on a timely basis. While counting the inventory physically on a timely basis to measure the accuracy of the perpetual data, the retailer should take into account factors like damaged merchandise, inventory pilferage, goods returned by customers, and other similar factors.

Retailers should have a reordering plan for merchandise that has to be purchased more than once. To develop an effective reordering plan, the following four critical factors must be considered: order and delivery time, inventory turnover, financial implications, and inventory versus ordering costs.

Retailers should first determine the time required to process the order and the time required for a vendor to deliver the order. In some items, the retailer may have to reorder when the level of inventory is still high because of lengthy delivery times. But for some items, vendor may offer overnight delivery.

Retailer should also determine how long it would take to sell the inventory being carried. Fast selling merchandise allows retailers to order a large quantity of merchandise and expand the reorder points, or carry a low level of inventory and have shorter reorder periods. Slow moving merchandise might make retailers lower their initial levels of inventory and expand the reorder periods.

Retailers should take into account the financial implications of the different purchasing options. A big reorder with a quantity discount requires considerable cash expenditure. A smaller reorder would lead to reduced total costs because of carrying a lower inventory.

Lastly, retailers should weigh the benefits of inventory holding versus ordering costs. Holding large inventory levels offers many benefits like increased customer satisfaction, quantity discounts on purchases, reduced shipping costs per-item, and ease in controlling and handling merchandise. On the other hand, there can be disadvantages like high levels of investment, high probability of obsolescence and damage, high inventory carrying costs, and high insurance and opportunity costs. Holding low levels of inventory and reordering frequently offers many advantages like reduced investments, reduced opportunity costs, reduced inventory carrying costs and less damage and obsolescence. The disadvantages of carrying low levels of inventory are increase in the probability of stock-outs (thus disappointing customers), increase in per-item costs, delay in filling orders, increase in the need for partial shipments, increase in service charges, and greater difficulty in handling and controlling merchandise. Retailers generally try to strike a balance between inventory costs and ordering costs by carrying inventory that is sufficient to meet customer needs and at the same time does not to lead to surplus inventory. Quick Response Delivery System (QRDS) helps retailers lower both inventory costs and ordering costs by establishing a closer relationship between vendors and retailers.

### Regular Re-evaluation

After establishing a well-integrated plan for purchasing and handling merchandise, retailers should not only follow it but also re-evaluate it periodically. The top management of the concerned retail organization should review the purchasing and handling processes. Retailers should also monitor the procedures for handling services.

## ETHICAL AND LEGAL ISSUES IN MERCHANDISE PURCHASING

Retailers should consider the many ethical and legal issues that may arise due to the transactions that take place between retailers and vendors. Retailers should not misuse their power in the marketing channel. From a retailer's perspective, slotting allowances and commercial bribery are areas of concern. Retailers, to protect their image and the interests of consumers, should determine whether the merchandise being procured is genuine or a gray market product. The basic issues of concern from the vendor's perspective are exclusive territories, exclusive dealing agreements, tying contracts, refusal to deal, and dual distribution.

## Slotting Allowances

Slotting allowances, also referred to as slotting fees, can be defined as the fees paid by a vendor for securing space in a retail outlet for its products, usually for displaying its merchandise. Slotting allowances, though currently not considered illegal, can be regarded as unethical in some situations. For instance, a fast moving consumer goods company may pay high slotting allowances to retailers for displaying its products on their shelves. The fees paid by the vendor would vary significantly, depending on the retailer's power in the marketing channel and also on the type of the product being displayed or introduced. Vendors usually tend to pay high slotting allowances for products that have low consumer loyalty. Though some retailers defend the practice of paying slotting allowances as efficient use of valuable retail space, some producers and vendors see it as a coercive practice.

Slotting allowances, though used by some retailers as a short-term method for generating profits, can have an impact on long-term customer relationships. Some producers and vendors, in order to develop strategic partnerships with retailers, avoid slotting allowances. Instead, they work closely with retailers and share the financial risk of carrying new products if they fail to perform well.

## Commercial Bribery

Vendors or their agents usually offer to pay purchasers in order to influence their purchasing decision. Such a practice is referred to as commercial bribery. For instance, the vendor of premium cosmetic products might offer a liquor party to the category manager of a department store at one of the luxury hotels in the city (or town) and/or a three night two day stay at a luxury hotel. Such gifts can be referred to as kickbacks or bribes and are considered illegal.

To avoid such problems, many retailers forbid their employees from receiving gifts or favors from vendors or their agents. Though most organized large retailers have developed a code to prevent their employees from taking bribes, many retailers either do not have any such policy in place, or even if they have such a policy, it is not followed by most employees. Ideally, retailers should permit employees to accept small token gifts such as flowers, cakes, cards, diaries etc., that are of nominal value, but not expensive gifts that could influence their purchasing decision.

## Counterfeit Merchandise

Counterfeit merchandise can be defined as products that are manufactured and sold without the permission of the owner of the trademark, copyright or patent which is legally protected in its country of operation. Though consumer goods with strong brand names tend to have many counterfeit products, even high technology products like CD-ROMs, DVD players, software and mobile phones are counterfeited. The act of selling counterfeit merchandise is both illegal and unethical. There are four ways in which retailers and vendors can seek protection against counterfeit merchandise – product registration, legislative action, bilateral and multilateral negotiations and organizational measures.

The manufacturer, vendor or the retailer should patent, trademark or copyright the product being sold in a country. There are several laws that protect organizations against counterfeit merchandise. In the US, the government has tried to reduce the manufacture of counterfeits through bilateral and multilateral negotiations. For example, GATT has formulated some rules for the protection of intellectual property rights. Organizations also develop measures to protect themselves from counterfeit merchandise. And the International Trademark Association (INTA) is the result of one such organizational measure. INTA, a 123-year-old non-profit organization, consists of over 4,000 member organizations representing more than 150 nations. The members of INTA come from all industries and include manufacturers, licensing entities and retailers. INTA respects the role of trademarks in the promotion of effective commerce, protection of consumer interests, and the development of free and fair competition. In the US, INTA's close association with Congress has led to the passing of the Trademark Counterfeiting Act of 1984 and the Anti-counterfeiting Consumer Protection Act of 1996. Exhibit 10.2 provides information on the counterfeit merchandise and a few methods for eliminating counterfeiting.

**Exhibit 10.2**

**Counterfeit Merchandise**

According to the International Trademark Association (INTA), a trademark can be defined as a word, logo, slogan, package, design or other source indicator, or a combination of them. A trademark is a very important marketing tool. Trademarks are simple modes of communication used by organizations to differentiate their products and services from those of their competitors. Moreover, a trademark conveys the message of quality, consistency, safety, and predictability in an easy-to-understand manner to customers.

Counterfeiting of trademarks has a significant impact on trademark owners, consumers and national economies. The following are some of its effects:

- Loss of customs and tax revenues (for the economy).
- Hampers the goodwill of the trademark owners and reduces their profits, leading to missed opportunities to create jobs and even causing job cuts. According to estimates given by the European Commission, counterfeiting and piracy has led to the loss of 120000 jobs in the United States.
- Has a negative influence on consumers who purchase counterfeit merchandise made of cheap materials, especially when it is made of components that create serious health and safety hazards. For example, counterfeits of food items, pharmaceutical products, personal care products, and spare parts of automobiles.

The extent of intellectual property counterfeiting is becoming an increasingly serious issue these days. According to estimates provided by the International Chamber of Commerce (ICC), trademark counterfeiting and copyright piracy have grown significantly, amounting to five to seven percent of world trade. The increasing levels of trademark counterfeiting indicates the increasing desire of consumers for branded products, the ability of counterfeiters to adapt to consumer needs and the huge profits generated by selling counterfeit merchandise.

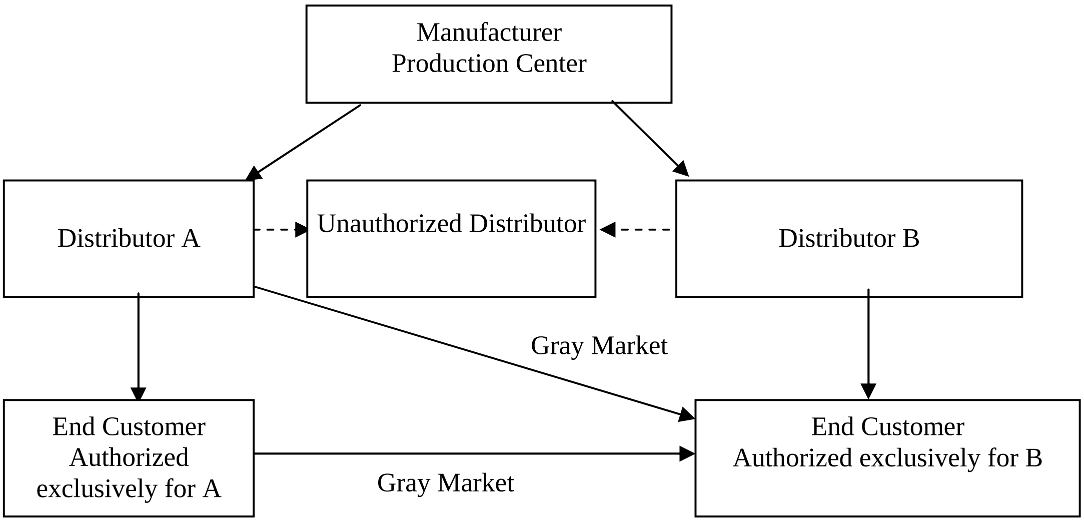
Preventing counterfeiting of trademarks can be a dangerous task. Counterfeiting operations are usually conducted by the people armed with weapons, who are not reluctant to use them. Customs and other law enforcement bodies have to be trained exclusively for armed raids on counterfeiters' warehouses and manufacturing facilities. To make matters worse, the Internet has helped counterfeiters spread their operations across national and international borders. The Internet provides the suppliers of counterfeit merchandise, a huge market at the click of a mouse.

Individual countries can reduce trademark counterfeiting significantly by establishing tough criminal and civil penalties, punishments and providing more funds to law enforcement bodies. However, as counterfeiting operations are spread across national and international borders, the ultimate solution to this problem must also be a global one. According to the INTA, nations should come together and exchange information and ideas that would eliminate the threat posed by counterfeit merchandise to original trademarks.

## Gray Market Merchandise

Gray market merchandise can be defined as products that carry a valid trademark, but are manufactured in a foreign country and imported into another without the permission of the owner of the trademark. Gray market merchandise cannot be referred to as counterfeit merchandise. Figure 10.1 illustrates the flow of merchandise through cross channels of distribution in gray market activities. The quality of merchandise made available through gray markets is the same as that of merchandise that is sold legally in the country. The major disadvantage of gray market merchandise, from the point of view of traditional retailers, is that consumers have a negative image of the merchandise, as it is not accompanied by a warranty. Gray market merchandise also has the potential to dilute the image of a trademark. More significantly, a product bought from the gray market can be an obsolete one or may not work properly in another country, because of inappropriate specifications. Exhibit 10.3 provides information on handling gray market merchandise.

**Figure 10.1: The Flow of Merchandise in a Gray Market**




*Source: www.grad.umn.edu/oeo/pdf/Juan/summarypdf*

## Diverted Merchandise

Diverted merchandise is the same as gray market merchandise, except that it might not be distributed across international borders. For example, mobile phone manufacturers might assign an exclusive territory for a particular retailer and a distributor at another close-by area can buy the merchandise from another wholesaler in a different place and sell the merchandise at a discounted rate. The merchandise in this case, is diverted from its legal distribution channel by the wholesaler, who is referred to as the divertor.

Many retailers have been forced to cut prices (thus reducing their margins) because of stiff competition from gray markets and diverted merchandise. Manufacturers and vendors can adopt the following measures to protect themselves against gray markets and diverted merchandise:

- Make all retailers and wholesalers sign a contract which specifies that they will not deal in gray market merchandise

- Ensure that producers and vendors stop dealing with a retailer found dealing in gray market or diverted merchandise.
- Manufacture different models of products, in different versions for different regions

## Exclusive Territories

Vendors usually assign exclusive geographic territories to retailers. No other retailer in that territory is legally permitted to sell that particular product in that area. Assigning exclusive geographic territories to retailers can benefit vendors. If there is a limited supply of merchandise, adopting this strategy would ensure that the inventory is sufficient to display in a decent manner and provide the customer with better choice. Having exclusive territories is an advantage for retailers also, as it offers them a monopoly for that particular product. In addition, they have a strong incentive for selling the vendor's merchandise. The profit margins of retailers with exclusive territories are protected as there are no competing retailers to cut prices. Such retailers usually can gain additional benefits by carrying more inventory, advertising more, personal selling, sales promotions, special displays, and offering special services to the consumers.

Some countries regard exclusive territories as illegal as they hinder competition. Competition is said to be curtailed when other retailers cannot access the same products.

## Exclusive Dealing Agreements

Exclusive dealing agreements refer to agreements between manufacturers or vendors and retailers that restrict retailers to sell only their merchandise and not that of competitors or competing vendors. For example, cola majors Pepsi and Coca-Cola may restrict their retailers to carry only their merchandise and nothing from the competitor's. The legality of these agreements is determined by their impact on competition. This practice is usually not regarded as illegal if it does not affect the competition and the competitors have many other alternative retailers. But these agreements are considered illegal if they hamper competition.

## Tying Contracts

A tying contract refers to a contract between a vendor and a retailer. In such a contract, the retailer accepts a product that is not essentially required, so as to be able to purchase a product that is actually required. Tying contracts are considered illegal if they have the potential to reduce competition and create a monopoly. Vendors are allowed to develop tying contracts to protect their brand image and reputation for quality.

## Refusals to Deal

Generally, both retailers and vendors have the authority to accept or refuse to deal with each other. But if this practice affects the competition, then it is considered unethical/illegal. A producer can refuse to deal with a specific retailer, but it cannot refuse to deal just for the sake of benefiting a competing retailer.

## Dual Distribution

Dual distribution occurs when a manufacturer or a vendor competes directly with the retailer. A dual distribution system develops when a vendor decides to adopt vertical integration by taking up retailing activities. In a dual distribution, competition and trade suffers, if vendors quote higher prices to independent retailers than to the retail chains owned by them. Such an act would lead to a severe and continual decrease in competing retailers. Clearly, many legal and ethical issues can crop up when two parties interact.

## SUMMARY

Retailers can source their merchandise from manufacturers or produce their own store brands (referred to as private labels). Both manufacturers' brands and private labels have their own advantages. Selecting brands and choosing a branding strategy are components of a retailer's process of merchandise assortment planning. The most complex task for a retailer is to decide whether to source the merchandise from within the country or to source it from global sources.

The merchandise purchasing process consists of five steps: identifying the sources of supply, contacting the sources of supply, evaluating the sources of supply, negotiating with the sources of supply, and purchasing from the sources of supply. The first step in the merchandise purchasing process deals with determining the type of channel to be used for purchasing each line of merchandise. The retailer can consider different sources of supply: raw-resource producers, manufacturers, wholesalers and resident purchasing offices.

The second step in the merchandise purchasing process involves contacting the various sources of supply. Both the vendor and the retailer can initiate the contact process. Contacts initiated by vendors involve store visits by vendors' sales personnel or mail or telephone inquiries. Contacts initiated by retailer include visiting central markets, resident purchasing offices, and merchandise trade shows, and making telephone and mail inquiries.

The third step in the merchandise purchasing process deals with the evaluation of several prospective vendors. Retailers evaluate vendors on the basis of a) suitability, availability and the adaptability of the merchandise being offered, b) the exclusiveness of the merchandise offered and the vendor's distribution policies, c) the appropriateness of the vendor's price, d) the type and amount of promotional support offered by the vendor, and e) the type and amount of additional services provided by the vendor. Retailers can use a weighted rating method to evaluate vendors.

The fourth step in the merchandise purchasing process involves negotiating with the sources of supply. Retailers usually negotiate on price and service issues. Retailers should also consider the various transportation and handling issues that influence the cost of sourcing new merchandise.

In the fifth and final step of the merchandise purchasing process, the actual purchasing takes place. Retailers can purchase all the merchandise from a few vendors or from a number of different suppliers. They can also choose from different purchasing methods like regular, consignment, memorandum, approval or specification.

The merchandise handling process is as important as the merchandise purchasing process. This process involves developing a plan to get the merchandise carefully into the store and place it on the shelves for sale. Merchandise handling includes processing, receiving and storing merchandise, pricing and marking the inventory, arranging displays and on-floor assortments, customer transactions, delivering the goods, handling the goods that are returned by customers, taking decisions regarding damaged merchandise, and finally, controlling and monitoring losses due to merchandise pilferage.

Once a retailer develops a strategy for handling merchandise, a reorder procedure must be developed. This procedure depends on various factors like the time taken by the retailer to process the order, the time taken by the vendor to fulfill the order, the inventory turnover rate, the financial expenditure and the cost of holding inventory versus the cost of ordering merchandise. The retailer should re-evaluate the complete merchandising process periodically.

The hundreds of transactions that take place between retailers and vendors can give rise to a number of ethical and legal issues. These issues must be addressed by both retailers and vendors.

# Chapter 11

# Merchandise Pricing

**In this chapter we will discuss:**

- Setting the Retail Price
- Pricing Strategies and Practices
- Methods of Setting Prices
- Adjustment to the Initial Retail Price
- Laws Governing Retail Pricing

## INTRODUCTION

Pricing of merchandise should accomplish three objectives: get the product accepted in the market; maintain the market share as competition increases; and earn profits. Clearly, the pricing strategy plays an important role in retail organizations.

The pricing policy offers potential customers important cues regarding the firm's overall image. So when developing a marketing approach to pricing, retailers must establish prices that are compatible with what the target customers expect and are willing to pay for their merchandise. Too often, retailers *underprice* their goods and services, in the belief that low prices are necessary for achieving a competitive advantage. They do not realize that convenience, service, and quality give their customers extra value and play a major role in determining the amount they are willing to pay for the merchandise.

An important part of setting appropriate prices is tracking competitors' prices regularly; however, what the competition is charging is just one variable in the pricing mix. When setting prices, retailers should try to match the competitors prices or even beat them. But retail stores that offer customers extra quality, value, service, or convenience can charge more than the competitors as long as customers recognize the "extras" they are getting.

This chapter examines methods for setting prices and its objectives. It also discusses the various pricing strategies used by retailers and examines the legal issues governing the pricing activities of retailers.

## SETTING THE RETAIL PRICE

Price plays a significant role in retailing since it is the only retail mix element that generates income. So when fixing the price of a good or service in a retail store, decision makers should set a price that meets the objectives of the store and the expectations of the customers.

A retailer cannot arbitrarily fix a high or low price for a product. Price is one of the factors that determine the image of a retail store. So a retailer who wants to have constant traffic flow at the store should fix the appropriate price for the merchandise offered in the store. A retail store which prices high will be perceived as an expensive store. And a retail store that prices low will be perceived as a store carrying low quality merchandise. Thus pricing the merchandise plays a major role in conveying the image of a retail store to customers.

### Price Setting Objectives

Price plays a major role in attracting and retaining customers. When setting the price of a product, the retailer should meet the needs of customers. Pricing should also be in line with the firm's mission, merchandising policies and other store decisions. So, before establishing pricing policies, the retailer should develop certain objectives that the store should achieve. These objectives can be classified as:

- Sales objectives
- Profit objectives
- Competitive objectives

### Sales objectives

Setting the right price for the products or services offered can increase the volume of the merchandise sold by the retailer. The volume sold affects the total revenue and the profit of the retail store. The right price for the product is the price that the consumer is willing to pay for the product. Hence, correct pricing decisions are essential for successful retail management. In a retail store, sales objectives should be considered while formulating the pricing strategy. Sales objectives are expressed in two ways:

- Sales volume objectives
- Market share objectives

Sales volume objectives aim to achieve the future sales target of the retail store as well as to maintain the existing levels of sales of the store. Market share objectives aim to increase and maintain market share of the retailer. Market share objectives allow the retailers to judge their performance against that of their competitors and hence are preferred over sales volume objectives. Market share growth is justified in new and growing product markets because it allows retailers to compare their performance with that of their competitors.

### Profit objectives

Another factor that retailers should take into consideration when setting the retail price is profit. When setting the price, a retailer sets his profit objectives in terms of: profit maximization, target return on investment and net sales.

Under the profit maximization objective, the retailer tries to maximize the profit of his retail store though pricing and other merchandise activities. Working to achieve this objective may prove counter productive in the long run as profit maximization may strain the relation between the retailers and the customers. Retailers at times state their profit objectives as expected target returns on investment i.e. the return the retailer expects on the capital invested in various assets like inventory, store fixtures, inventory etc.

### Competitive objectives

A retailer pursues various competitive price objectives like meeting competitor's prices, preventing an increase in competitors, or working towards non price competition.

## Price -Setting Determinants

Some retailers set their price by following the pricing of their major competitors or the market leader so that the competitor will not have a price advantage. Some retailers aim at preventing an increase in competition by setting low prices. This makes the market less attractive to the new players planning to enter retailing business. Retailers who want to avoid price competition will compete on the basis of the quality of products, or services offered, the location of the store, the facilities offered to customers, and greater promotional efforts.

When setting the price of the merchandise, retailers should bear in mind certain factors that affect the demand of goods or service:

- Demand factor
- Competition factor
- Cost factor
- Product factor
- Legal factors

## Demand factor

Customer behavior can always be related to the law of demand. Law of demand refers to the tendency of customers to buy products in a greater quantity when the price is low, and buy less or reduce consumption of the product when the price is high.

Retailers should assess the consumer demand for a particular product at different prices. The change in demand of a product on the basis of its price can be better explained with the help of price elasticity of demand. The price elasticity of demand is a measure of the effect a price change has on consumer demand. Price elasticity gives the relationship between the percentage change in quantity demanded and the percentage change in price.

The elasticity of demand is higher for stock-up items (non perishable goods) than for perishable goods. The demand for a product is said to be inelastic when a change in its price has no influence on the demand for the product. Similarly, the demand for a product is considered to be elastic when a change in price causes a noticeable change in demand.

Therefore, when pricing the merchandise, a retailer should consider the concept of elasticity of demand. Inelastic demand for a product implies that the consumers will not be sensitive to any change in price. Under such conditions the retailer can increase the price without worrying about a fall in demand for the merchandise. But if the demand for the merchandise is elastic, the retailer should be careful when increasing the price of that merchandise. This is because customers are highly sensitive towards an increase in the price of that particular merchandise. A small percentage increase in the price can lead to a huge reduction in the demand for that merchandise.

The retailer should also take into consideration the cross-elasticity of demand for a particular merchandise. In some cases, a small rise in the price of a particular product may lead to a fall in the demand for other merchandise. In other words, the cross elasticity of demand signifies that the change in the price of a particular merchandise may reduce the demand for other merchandise. This situation arises in the case of complementary products.

### Competitive factor

The success of a retail pricing strategy depends on its ability to give the retail store an advantage over its competitors. Retailers should monitor the prices of competitors when setting prices for their merchandise. Even though retailers need not copy the same prices set by their competitors, it is wise to set a price which is in line with the competition. Variation in price should reflect the quality of the service provided, the nature of the location, and other retail mix factors. A retailer should think carefully before entering into a price war with competitors, as a continuous price war may lead to losses for both the retailer and its competitors.

The pricing of the merchandise depends on the competitive position of the retailer in the market. The competitive position in the market is based on the retail mix of the retailer, the loyal customer base, the image of the store etc. The stronger the competitive position in the market, the greater the freedom in deciding the price of the merchandise. If the retailer has a weak competitive position in the market, the freedom for setting the price is limited. The retailer should closely study the prices set by its competitors for high value items because for such items, customers always compare prices.

## Cost factor

Cost has a major influence on the pricing decision of a retailer. The total cost of merchandise includes the actual cost of the merchandise along with the cost incurred in getting the merchandise to the store and preparing it for the sale. Cost forms the basis of pricing for retailers who adopt cost-oriented pricing, which is explained in detail in the latter part of the chapter.

### Product factor

Another major factor that has to be taken into consideration when setting the price is the nature of the product. Product characteristics like perishability, durability and seasonal appeal have an impact on the price that the retailer can quote for a product. For example, woolen clothes move well in winter and raincoats in the rainy season. Similarly, fruits can be priced high when they are fresh, but need to be marked down as time passes. Fashion merchandise is also affected in the same way. Customers are willing to pay high price for new fashion garments, but are reluctant to spend a lot of money on clothes that have gone out of fashion. Thus, retailers should be aware of various product characteristics and their impact on the consumer buying process when pricing merchandise. They should build-in appropriate markups into the initial merchandise price to offset the cost of markdowns when required. In the context of retail goods, there are three types of perishability - physical perishability, style or fashion perishability, and seasonal perishability.

*Physical perishability of the product*: Products deteriorate over time or are damaged during transportation. These products cannot be marketed, and constitute a loss for the retailer. Loss that would be incurred due to the damage or deterioration of the product should be taken into account when pricing physically perishable merchandise.

*Style or fashion perishability*: The marketability of products like apparel depends on the style and fashion of the day. Once a particular style or fashion becomes obsolete, the product becomes difficult to market. When pricing the product, the retailer should take into consideration the perishability cost that can be caused by a change in style or fashion.

*Seasonal perishability*: The demand for some merchandise changes due to changes in season. For example, woolen cloths are in demand only in the winter season. So when pricing a product, the retailer should consider its seasonal perishability.

Product quality is another factor a retailer should consider when pricing a product. Before pricing a good, the retailer should consider the quality with regard to price that he wants to project for a product.

Moreover, the retailer should analyze the nature of the product and its availability. If the product is unique in nature, the retailer can charge high a price. Customers looking for unique products are not price sensitive, and are willing to pay high prices to obtain them.

### Legal consideration

The pricing function of a retail business is greatly influenced by the legal system of a country. Hence, when pricing merchandise, a retailer should consider the laws and regulations of the country and the state. According to the law in most of the countries, pricing activity that aims at restricting or killing the competition is illegal.

## PRICING STRATEGIES AND PRACTICES

Retailers adopting an everyday low pricing (EDLP) strategy strive to sell goods and services at consistently low prices throughout the year. Such retailers will price their goods between the regular non-sale price and the deep discount price offered by competitors. Retailers following the EDLP strategy do not offer discounts to customers. Such retailers maintain a stable, every day price. Everyday Low Pricing strategy is popular among grocery retailers and general merchandise retailers.

## Everyday low pricing

Retailers who follow the EDLP strategy simply try to "Keep costs low, sell more merchandise, lower prices further and sell even more". Leading retailers like Wal-Mart, Office Depot and Toys 'R' Us follow the EDLP pricing strategy.

Retail stores that follow the EDLP strategy carry a large number of items but a smaller selection of brands, have a less convenient format and very small fluctuations in prices. Such retailers do not have many promotional activities.

"Every Day Low Price" formats generally appeal to the cost-conscious buyer. People who shop at EDLP stores often buy a large number of items each trip and shop less frequently. (Refer to Exhibit 11.1 for a brief note on EDLP in Canadian retail stores).

**Exhibit 11.1**

**EDLP in Canada**

The practice of EDLP in Canadian retail stores started in 1994 when Wal-Mart entered the Canadian market. Before 1994, high-low pricing prevailed, with weekly fliers, loss leaders and specials. EDLP created a "market spoiler effect" and changed the shopping preferences of customers in Canada. Now, shoppers in Canada are no longer attracted by periodic sales and promotions. So, to counter Wal-Mart, retailers in Canada have started offering EDLP.

The department store leader, Bay, which thrived on scratch-and-save purchase discounts, has come up with "Bay Value" deals. Under this deal, Bay offers 180 moderately priced items of daily consumption at everyday low prices. This pricing system is intended to address the needs of financially constrained customers who would like to avoid the weekend rush for a sale.

Zellers in Toronto, however, has moved most of its inventory (96%) to the EDLP system. It emphasizes pricing in its marketing efforts.

In Canada, Sears has introduced EDLP on selected products in response to customers' unwillingness to wait for sales. Though Sears feels that sales have not lost their credibility, it believes that EDLP has an advantage. It feels that it is easier to offer merchandise on EDLP rather than periodic sales, which require advertising and involve the mounting and de-mounting of displays.

Retailers in Canada are aware that offering low prices alone will not provide value to customers. They are therefore coming up with ways to enhance customer value. Zellers is doing so by carrying enough stock and broadening its merchandise (to include offerings such as furniture). Bay is redesigning its store layouts to enhance customer service. It is reducing the number of check-outs from 40 to 4 to deploy more staff on the floor. Both retailers claim that they will continue to use sales as a part of their marketing programs.

*Source: http://www.icsc.org/srch/sct/page117.html*

## High -Low Pricing

Retailers who use a high-low pricing strategy charge higher than EDLP retailers. Such retailers occasionally reduce prices deeply (for a short period), much below the EDLP level. To attract customers, these retailers advertise frequently.

Retail stores which follow this strategy provide a high fixed utility to customers with a convenient format, high quality service, and a good assortment of products. Customers visit such stores frequently as they buy in small quantities. Since the price often fluctuates in such stores customers defer the purchase of high priced product till the price falls. When the price falls they stock up on the item. High/low price retail stores are suitable for customers looking for shopping convenience, good service and large assortments.

## Coupons

Coupons are documents that entitle the holder to a percentage price reduction from the actual purchase price of a product or service. The retailer or the manufacturer issues these coupons in newspaper, with the products, at the cash register or through the mail.

Coupons induce people (first-time customers) to try particular items of merchandise sold by a store. If the customer likes the product, he becomes a frequent user and increases the sales of the store.

Coupons have a mixed impact on retail stores. They generate positive sales in the short run, but in the long run, the net sale increase is negligible if the coupons do not bring in new customers. For example, if a supermarket issues coupons for grocery items, people will be encouraged to buy more and stock up. This will lead to an increase in the sales, but this increase is likely to be short -term in nature.

Retailers use coupons to lure the customers away from rival retailers. But most of the time, coupons are used by the regular customers of retailer to make bulk purchases. Thus coupons do not help retailers to increase sale. Instead, retailers end up paying for the redemption of coupons. Thus, the use of coupons can lead to an increase in expenditure instead of an increase in sales.

## Rebates

In rebates, a portion of the purchase price is returned to the buyer. After making a purchase, the customer has to send the proof of purchase to the manufacturer. Upon receipt of the proof of purchase, the manufacturer mails the rebate to the customer. Rebates increase the sales volume of retailers, but not the costs since the retailers do not have to process the rebates.

## Leader Pricing

Leader pricing involves selling a product (leader) at a substantially low price to generate customer traffic and increase the sale of complementary products in the store. Usually, retailers regard these low priced products that are often sold below cost, as loss leaders. But, leader pricing need not always involve pricing loss leaders below cost price. The products selected for leader pricing should be those that are frequently bought by target customers. Many retailers select items like onions, eggs or sugar as price leaders to attract customers.

## Price Bundling

In price bundling, distinct items, generally from different lines of merchandise, are offered together at a special price. This can increase the volume of sales as well as the traffic at the retail store. This kind of offer can also help the retail store remove less desirable merchandise from the store (by offering it as a part of a package). Price bundling is common in the service retail industry, e.g. a complete holiday package is offered to customers, including the cost of air fare, hotel charges and food.

## Multiple-Unit Pricing

Multiple-unit pricing occurs when the price of each unit in a multiple-unit package is less than the price of each unit if it were sold individually. Customers who buy in bulk benefit from such offers. General merchandise and apparel retailers commonly use this multiple pricing strategy. For example, if an apparel retailer offers three shirts as a bundle for certain price (Rs 1,000), which would be less than three such shirts bought separately (399 x 3). Multiple-unit pricing increases the volume of sales of the retailer as well as the profit of the store. This pricing strategy is used to clear out goods as well as end-of-season merchandise.

### Price Lining

Price lining involves establishing a specific number of price points for each merchandise classification.  Suppose kids wear is priced at Rs 550, Rs 750, Rs 950. Each price represents a price line or price point. There should be a significant difference between different price points so that the customers can relate the monetary difference with the value difference. If the difference in the price points is sufficiently large, the salesperson can engage the customer in trading up or trading down.

The price line helps customers by reducing shopping confusion and making it easy to identify price ranges that suit them. It also helps retailers, by simplifying the purchase and accounting functions; increasing the likelihood of the customer trading up to the next price point; and projecting the depth of the merchandise.

### Odd Pricing

Odd pricing refers to the practice of setting retail prices that end in an odd number or just under an even rupee value. For example, the merchandise in Bata (a global manufacturer and retailer of footwear), showrooms are priced at Rs.99.95, 299.95, etc. Through odd pricing, retailers try to make customers feel that they are paying less for the merchandise.

## METHODS OF SETTING PRICES

The pricing of products/services is a critical decision in any business. In a retail store, price influences the quantities of various items that consumer’s purchase, which in turn affects total revenue and profit. A good pricing decision is essential for successful retail management.  There are three ways of setting prices:

- Cost oriented pricing
- Demand oriented pricing and
- Competition oriented pricing

### Cost Oriented Pricing

In the cost-oriented pricing approach, a retailer sets the minimum price that is necessary for the store to achieve a predetermined profit goal. To arrive at this price, the retailer usually computes merchandise and retail operating costs and adds a profit margin to these figures. When computing cost, the retailer considers not only production costs (materials, labor, overhead) and freight costs, but also a pre-determined gross margin. This approach is commonly followed by retailers who sell many products because it is not possible to determine the demand for each product.

#### Markup Pricing

In the cost oriented approach, the retailer uses the markup technique to calculate the retail selling price. The difference between the cost of the merchandise and the retail selling price is known as the markup. Retailers usually set a markup amount that ensures a specified profit for the store after covering all the selling costs. Markups can be of two types i) Rupee markup and ii) Percentage markup. In *Rupee markups* a rupee value is added to the cost of the merchandise to cover all the selling expenses and provide a profit. For example, a jewelry retailer may add Rs 1,000 as markup to set the retail price of any jewelry item above Rs 10,000 (cost price). A grocer may add Rs 5 to the per kilogram cost of the pulses sold in his store. *Percentage markups* are expressed as a percentage of the merchandise cost added to the unit merchandise cost. For example, a hardware store setting retail prices for all items that have wholesale prices of Rs 100 to 300 may add a markup of 60 percent, resulting in retail prices ranging from Rs 160 to 480.

Although the rupee markup method of pricing seems to be simple, it does not permit comparisons between merchandise lines and departments. Hence, many retailers use the percentage markup pricing method to set retail prices.

Retailers calculate the markup percentage on the basis of the cost price or the retail price.

Markup percentage (at cost) = (Retail selling price – Merchandise cost) ÷ Merchandise cost

Markup percentage (at retail) = (Retail selling price – Merchandise cost) ÷ Retail selling price

Although retailers can calculate the markup on the basis of the cost price, they generally calculate it in terms of the retail selling price for the following reasons:

- Retail expenses, markdowns and profits are expressed as a percentage of sales.
- Manufacturers quote their selling and discount prices to retailers as percentage reductions from the retail price list.
- Retail selling data is available more easily than cost data.
- Profitability statistics appear to be smaller if expressed on the basis of retail price instead of cost; this can be useful when dealing with the government, employees and consumers.

Retailers should have a clear understanding of terms like initial markup, maintained markup and gross margin.

*Initial markup* can be defined as the initial retail selling price based on the merchandise less the cost of merchandise sold:

Initial markup = Initial retail selling price – Cost of the merchandise

But, in practice, retailers rarely realize the full initial markup on all the merchandise on display. This is because of various retail reductions that reduce the actual price received by selling the merchandise. These reductions can be due to markdowns, special customer and employee discounts, and inventory shrinkage’s because of shoplifting and damages.

*Maintained markup* can be defined as the actual price received for merchandise sold less merchandise cost. In other words, maintained markup can be stated as the initial markup less all the retail reductions.

Maintained markup = Actual prices received for merchandise sold during a time period – Merchandise Cost

The initial markup and the maintained markup percentage can be calculated using the following equations

Initial Markup Percentage = (operating expenses % + operating profit % - cash discounts % + alteration cost % + retail reduction %) ÷ (net sales % + retail reductions %)

Initial Markup % = (maintained markup % + retail reduction %) ÷ (net sales % + retail reduction %)

Maintained Markup % = Initial markup % - [retail reduction % x (100% - Initial markup %)]

Gross margin is the difference between net sales and the total cost of goods sold. A retailer can calculate the gross margin as,

Gross margin = Net sales – Total cost of goods

The relationship between gross margin and maintained markup is given in the following equation

Gross margin = maintained markup – alteration costs + cash discounts

Maintained markup = gross margin + alteration cost – cash discounts

## Demand Oriented Pricing

In demand oriented pricing, a retailer fixes the price on the basis of customer demand. Retailers try to work backwards starting from the products' perceived value to the buyer, rather than starting from the costs. Retailers adopting demand oriented pricing consider a range of prices that are acceptable to target customers and try to determine a price which maximizes profits.

This pricing approach is used by retail organizations which strive to gain sales volumes and market share. It allows retailers to estimate the quantity of goods that customers' demand of various products at different levels of price, thereby enabling them to fix the price that would help them achieve the stated sales goals. Retailers who rely on cost-oriented pricing fix the price of the merchandise on the basis of the cost of the retail store, whereas, retailers who use demand oriented pricing fix the price on the basis of customer demand.

Retailers using the demand oriented pricing approach should understand the psychological implications of the retail price on customers. Psychological pricing takes into consideration:

- Price-quality association
- Prestige pricing

Customers who make price-quality associations may perceive a high priced product as a high quality product and a low priced product as low quality product. Price becomes a major decision variable when a customer finds it difficult to distinguish between similar merchandise offered by different retailers.

Prestige pricing is based on the assumptions underlying the price-quality association. Retailers using this pricing approach target customers who do not shop in stores offering low value goods and services. These retailers will not keep low priced merchandise in the store, as their customers may perceive the store to be of a low quality and low status.

Before adopting a prestige pricing strategy, retailers should carefully study their target market. This is because many customers are economizers and they tend to look for discounts. Prices based on price-quality associations or prestige pricing do not appeal to such customers.

### Factors that affect customer's sensitivity to price

Before setting the initial retail price of a product, retailers should understand their customers' sensitivity towards the price of the merchandise. They must determine whether the customers are price sensitive or not. Some of the factors that influence the sensitivity of customers towards price are:

### *Awareness about substitutes*

Customers become very price sensitive when a large number of substitutes are available for a particular product in a given trade area. In some cases, within a particular area different stores with different formats sell the same product. In such a market, it is very difficult to differentiate the product through price. Retailers therefore try to differentiate on the basis of fashion, color and design of the products.

### *Volume of expenditure*

Customers become price sensitive, when expenditure is high in terms of rupee value or as a percentage of income. Therefore, customers will be price sensitive when buying high priced goods like furniture, consumer durables, automobiles etc. Retailers dealing in such items should set prices in line with the competition.

### *Difficulty in Comparison*

Customers are more price sensitive when they can easily compare the merchandise offered by the competing retailers. To avoid such comparisons, retailers should stock unique merchandise. But sourcing unique/exclusive merchandise is not an easy proposition. To tackle this problem, retail stores stock store/proprietary brands in many product categories.

### *Benefit/price relationship*

Customers' sensitivity to price is determined by their expectations of a product with regard to its price. For example, a customer who wants to acquire a specific image or unique benefit through a product will be less sensitive to the price. Such customer will pay far more for a designer watch at a premier watch showroom than for a watch offering similar performance elsewhere.

### *Situation*

The store atmosphere or the buying situation also determines the price sensitivity of customers. Depending on the situation, the price of the same product can vary. In certain situations people are willing to pay a premium price for a particular product, even though the same product is available at a lower price in some other store/location. For example, customers are willing to pay more for a soft drink at an amusement park than at a department store.

## Competition-Oriented Pricing

In competition- oriented pricing, retailers fix the price on the basis of their competitor's price. They do not consider cost and demand for the merchandise as criteria for fixing the price. And they do not alter the price even though there is a change in demand or an increase in the cost of the merchandise. Competition- oriented retailers can fix the price below the market price, at the market price or above the market price.

Retailers can charge higher than the market price, only when the location of their stores is convenient for customers, and their stores offer good customer service, wide assortments, a favorable image and an exclusive brand. Retail stores with an inconvenient location and self-service formats should charge less than the market price.

Competition-oriented pricing is easy and simple in nature. It does not require calculations based on the demand curve or the price elasticity. Moreover, competition-oriented pricing does not lead to retaliation as prices are based on those already existing in the market.

## ADJUSTMENT TO THE INITIAL RETAIL PRICE

In a competitive marketplace, retailers make price adjustments to adapt to changing internal and external factors like competition, seasonality, demand patterns, merchandise costs and pilferage. Retailers adjust the initial merchandise prices upward or downward to sell their goods and services and achieve the required profit margins. These adjustments can be classified into:

- Markdown
- Markdown cancellation
- Additional markup
- Additional markup cancellation

### Markdown

A markdown is a reduction from the original retail price of an item to match the lower price offered by competing retailers, to adapt to inventory overstocking, to clear out shopworn merchandise, to reduce assortments of odds and ends, or increase customer traffic. Retailers often mark down the merchandise price to achieve two objectives:

i. reduce the merchandise (old) in the retail store (clearance sale) and

ii. attract more traffic flow and generate sales (promotion sale).

At a clearance sale, retailers offer substantial markdowns on the initial retail selling prices. Such sales are aimed at pushing slow moving and obsolete (fashion goods) merchandise and end of season goods. Hence, clearance sales save the retailers from the loss resulting from carrying obsolete merchandise. Markdowns also generate cash by liquidating the merchandise at a faster rate. The retailer can use the money generated to invest in new merchandise that can attract more customers.

In promotional sales retailers offer markdowns on some lines of merchandise only. The aim of such sales is to draw crowds to the store and thereby increase the sales of other lines of merchandise.

#### Reducing the Cost of Markdown

Markdowns help increase the sales of a store. But offering merchandise at markdown price for a prolonged period may affect the profitability of the store. So, to remain competitive in the long run, retailers should find ways to reduce the amount of markdowns. The following steps help retailers reduce the cost of markdowns to the store:

- Increase coordination when buying various categories. Since it is difficult to sell unrelated lines of merchandise, the store will be forced to push the odd merchandise through high markdowns.
- Concentrate on reducing lead times. Reduced lead times allow the retailer acquire merchandise according to the changing preferences of customers, thus reducing the need for markdowns.
- Buy the new merchandise in small quantities and observe the response of the market before deciding on future order quantities.
- Avoid the early delivery of goods by suppliers. If the retailer buys fashion apparel before the season starts it may be shopworn by the time the season starts.
- Retailers should also try to avoid late delivery of merchandise. If retailers receive the merchandise late in the season, they may have to put the entire stock of merchandise on sale.

To reduce markdown costs, retailers should have a quick response (QR) inventory system. This will help retailers reduce the lead-time for getting the merchandise. It will also help them observe changing trends in customer demand, which, in turn, will help them reduce markdown costs drastically.

To reduce the lead-time and to monitor the changes taking place in the market, retailers can take the help of vendors. If retailers maintain good relations with their vendors, the vendor will have a vested interest in the success of the retail store. Since vendors have considerable knowledge of the market and the competitive situation, and they can help retailers select suitable stock for the store. Thus, to reduce markdown costs, retailers should work closely with their vendors and use their understanding of market and competition when making merchandising decisions. Retailers sometimes also get support from their vendors/manufacturer in covering the losses incurred from stocking particular merchandise. But when circumstances dictate a markdown, retailers should decide on the timing of the markdown on the basis of their past experience. Sometimes retailers panic and markdown the merchandise even though there is a fair chance of demand picking up for that merchandise.

### Timing of the markdown

The timing of the markdown is a tricky decision. Retailers sometimes announce a markdown too early in the season, when the demand is still good. This is known as *early markdown*. Such markdowns increase the sale of the retail store, free up selling space for new merchandise, and improve the store's cash flow position. Moreover, retailers giving early markdowns need not discount their merchandise as much as those retailers who offer markdowns late in the season.

Retailers going in for a late markdown maintain the initial selling price till the end of the season. They announce a clearance sale either when the season is over or if there is a remarkable decrease in the sales of a particular merchandise. Normally, the late markdown pricing approach is used by upscale department and specialty stores. Seasonal merchandise will also benefit from late markdown pricing. This type of pricing will gives retailers a longer time to sell the merchandise at the regular price. Recently, retailers have started using a combination of early and late markdown pricing strategies.

### Liquidating Markdown Merchandise

Though retailers may use markdowns to liquidate their merchandise, it is not possible to completely liquidate all the merchandise. Retailers can choose to i) pass on the remaining merchandise to another retailer, ii) consolidate the marked-down merchandise, iii) or carry the merchandise over to the next season.

Retailers generally sell the remaining markdown merchandise to a discount store operator. This allows the retailer to bring down the time needed for liquidating the merchandise as well as provide shelf space for new merchandise in the store. Retailers can liquidate the marked-down merchandise in three ways:

- Consolidate the marked down merchandise of one or few retailers
- Transfer the markdown merchandise to other stores (with different formats) owned by the same company
- Ship the mark-down merchandise to a distribution center for final sale

The consolidated sale of merchandise attracts customers as it provides a better selection than that found in individual retail stores. The merchandise can also be carried over to the next season. This strategy is used only in the case of high price non-fashion merchandise like traditional clothing and consumer durables.

### Markdown Cancellation

A markdown cancellation refers to the amount by which the retail price is raised after a markdown is announced. Usually, retailers offer markdowns to liquidate merchandise that is unsold or to promote their stores. If a retailer has marked down the merchandise with the aim of liquidating it, a cancellation of the markdown would defeat the very purpose of the markdown

A markdown cancellation makes sense only if the retailer used the markdown for promotional purpose. If a retailer finds that the merchandise is moving well in the market, he can opt for markdown cancellation.

### Additional Markups

An additional markup refers to an increase in the retail price after the initial markup percentage has been applied, but before the merchandise is placed on the selling floor. The additional markup price depends on the price elasticity of the product.

Suppose a retailer got a particular product at a low price and is selling it for only Rs.10. If competitors are selling the product for Rs.11, and demand for the product is inelastic, the retailer can increase the retail price to Rs.11, i.e., have an additional markup of Rs.1/-.

### Additional Markup Cancellation

An additional markup cancellation refers to the amount by which the retail price is lowered after an additional markup. This usually happens because of severe competition in the market. A retailer uses an additional markup cancellation strategy to match its competitor’s prices. The purpose underlying additional markup cancellation and markdown cancellation is the same.

## LAWS GOVERNING RETAIL PRICING

When fixing the price, retailer should take in to consideration the laws and regulations of the country they are operating in. Many countries enforce sophisticated laws to protect customers and stop retailers from using unfair trade practices to kill the competition and gain monopoly control over the market.

In the US and European Union, antitrust laws and competition policies control the business environment. Laws governing retailing have an impact on retailers as well as consumers. Laws dealing with the buying of merchandise are concerned with price discrimination and vertical price-fixing. Laws designed to protect customers are concerned with horizontal price fixing, predatory pricing, comparative price advertising and bait and switch tactics. The laws governing various retail pricing activities are discussed at length in chapter 18.

## SUMMARY

Price plays an important role in retailing as it explains the interrelationship between the objectives of the retail store and the components of the retail mix. A pricing strategy should help retailers earn a profit and, at the same time, benefit the customers.

In this chapter we examined how retailers set prices. We also studied the numerous determinant of pricing. When setting the price of a product, retailers keep in mind three objectives; sales objective, profit and competitive objective.

We also discussed the various pricing strategies used by retail organizations like every-day low pricing, high low pricing, coupons, rebates, price bundling, multiple unit pricing, price lining etc. After that we examined the methods of price setting: cost oriented, demand oriented and competition oriented pricing.

# Chapter 12

# Retail Promotion Mix

**In this chapter we will discuss:**

- Promotion
- Role of Retail Promotion Program
- Planning Retail Communication Program
- Assigning the Promotion Budget
- Implementing Advertising Programs
- Evaluating the Effectiveness of Advertisements
- Implementing Sales Promotion Programs
- Implementing Publicity Programs

## INTRODUCTION

Unlike many businesses, retail organizations usually do not take their merchandise to the marketplace. Their sales depend on the customer’s initiatives like visiting their store or placing an order through telephone or mail. The retailers have to motivate the customers to visit their stores. A customer would visit a particular store only when he knows about its presence, its location and the merchandise they offer. The customer would also like to have information on the prices, modes of payment (like cash and credit cards), availability of various services (like free home delivery of the goods purchased), the store timings, and so on. Retailers generate sales by making its target customers aware of the merchandise they offer through promotional activities. There are five channels through which retailers communicate with their target customers - advertising, sales promotion, public relations, personal selling, and enhancement of the store atmosphere and visual merchandising. (As the store atmosphere and visual merchandising, and personal selling are discussed at length in separate chapters, this chapter does not discuss those topics elaborately). In this chapter, we will discuss the role of the retail promotion program, planning retail communication program, allocating the promotion budget, implementing advertising, sales promotion and publicity programs and evaluating the effectiveness of advertising.

# PROMOTION

Promotion involves providing information to the consumer about the retailer’s store, its merchandise and services it offers, and influencing the perceptions, attitude and behavior of the consumers towards the retailer. Promotion consists of four components - advertising, public relations, personal selling and sales promotion. Though each of these components is an individual function, a good promotional strategy usually integrates all these components, depending on the retailer's overall strategy.

Retail promotion can be defined as any communication (initiated by the retailer) between the retailer and his target customers that informs, persuades, and/or reminds the latter about anything related to the store. Retail promotion is a process that has both informative and persuasive communication roles. Therefore, it can be understood better by knowing the various steps involved in a typical communication process. Exhibit 12.1 illustrates the process of communication. It is important for the retailer to observe that the process of communication moves beyond the components of promotion mix mentioned earlier here. The design, price, shape, color, packaging, the graphics on a product and the ambiance of the store offering that product - all communicate something or the other to the consumer.

## ROLE OF RETAIL PROMOTION PROGRAM

The goal of a retail promotion program is to generate sales. And the retailers, in order to achieve this goal, adopt various methods like informing, persuading and reminding its target customers about their existence and their products and/or services. Thus, informing, persuading and reminding are the key functions of a retail promotion program.

***Informing:*** This is the primary function of the retail promotion program. Retailers provide information to the customers about themselves and the products and services they offer. For instance, the most common tool for disseminating information is the advertisements placed by supermarkets in the newspapers that inform us about the special discount prices on its groceries.

**Exhibit 12.1**

**The Communication Process**

The communication process involves the transmission of meaningful messages to the target market by the retailers. Typically, a communication process consists of the following elements:

**Sender:** The retailer sending the message to its target customers or target audience.

**Encoding:** The process of representing the message in the form of words, illustrations and images.

**Message:** The set of symbols transmitted by the retailer - the advertisement.

Media: The communication channel through which the retailer transmits the message to its target customers, like TV, newspapers, magazines, etc.

**Decoding:** The process through which the target customers interpret or understand the symbols transmitted by the retailer. Ideally, the decoded message should be the same as the encoded message.

**Receiver:** The party to whom the retailer's message is targeted -- typically, the target customers.

**Response:** Reactions of the target customers after receiving the message.

**Feedback:** The target customer’s response that is transmitted back to the retailer. The feedback about the message, product or service can be positive or negative.

**Noise:** The distortion during the process of communication, that leads to customers receiving a different message than the one originally transmitted. Noise can arise because of a number of reasons like poor TV reception, distraction by someone, or the competitors' message.

*Source: www.educationsupport.co.uk/downloads/rjh/nineelementmodel.pdf*

***Persuading:*** This is an important function of the retail promotion program. It involves asking people to visit the store and purchase its merchandise and/or services. For instance, a supermarket might offer discount coupons to customers through a newspaper and motivate them to buy its products.

***Reminding:*** It involves reminding its customers frequently about its products and its benefits, so that customers may purchase them again and develop customer loyalty towards the store. Though a retailer may be liked by customers, it could be very difficult for the former to retain its customers due to its competitors’ appeals. Hence, an increasing number of retailers, as a part of their reminding task, are developing promotional strategies like loyalty programs or frequent shoppers programs for their customers. This may ensure the retention of most of its customers. Exhibit 12.2 gives the loyalty programs of various companies in different industries.

**Exhibit 12.2**

**Loyalty Program at Shopper's Stop**

First Citizens’ Club, the rewards program of Shopper’s Stop (a large Indian retail chain), is one of the leading relationship management programs in the country. The club has over 0.2 million First Citizens. This is a specially designed program for its customers that help them get the most out of shopping at Shopper’s Stop. The members of the First Citizens club get reward points on every purchase. The members are updated on exclusive offers at the store. They are allotted exclusive cash counters, which allow them to spend more time on shopping, rather than on waiting in a long queue to pay the bill. The club members do not need to pay for parking their vehicles. The club members can earn reward points as they shop at any Shopper’s Stop store in the country. They need to show their First Citizenship Card at the billing counter (at the time of purchase), and the reward points will be added to their account.

**The Passport Program at Hero Honda**

Hero Honda, a leading manufacturer of motorcycles in India, has developed its own unique loyalty program known as the Hero Honda Passport Program. This program was the first Customer Relationship Program in the Indian two-wheeler industry. It has been designed to establish and strengthen the company’s relationship with its customers.

Currently, it has over half a million members. The Hero Honda Passport Program offers the members a number of benefits. Upon their enrollment into the program, the customers get a chance to win a Hero Honda Splendor motorcycle or Rs. 40,000/- in the event titled **Winner of the Month**. They are offered special discounts on spare parts of and free services for their Hero Honda motorcycle, apart from the attractive gifts at various reward points. The company, as a part of its effort to keep in constant touch with its members, sends a quarterly news-letter, Suhana Safar, to its members that provides them with an insider's view of the company. Apart from what is already included in the passport program, the company also provides some exclusive offers on the best brands of the country. The active members of the Hero Honda Passport Program can get invitations to special events like music shows, movie screenings, award shows, etc. Above all this, the moment a customer becomes a member of the Hero Honda Passport, he is automatically entitled to a free personal accident insurance policy for one year for an amount of Rs.100, 000.

### The Frequent Flyer Program at Jet Airways

Jet Airways (India's largest airline), in its efforts to provide its customers with the best possible travel experience, has designed a frequent flyer program titled Jet Privilege, to suit the needs of its customers. Jet Privilege, considered to be one of the world's most rewarding frequent flyer programs, is also the only one in the country to have a three-tier frequent flyer program - Blue, Silver and Gold – on the basis of the number of flying points accumulated from the flights taken.

The members can have access to the lounge, tele check-in and upgrades to Club Première facilities, depending on their membership status. They can redeem their accumulated JPMiles for free flights anywhere in the world on British Airways, KLM and Northwest Airlines. A JP Gold member can avail lounge access anywhere in the world. A Jet Privilege member, apart from earning JPMiles every time he/she takes a Jet Airways flight, can stay at any of the Jet Airways partner hotels or use its partner car rental services too, while flying its partner airlines – British Airways, KLM and Northwest Airlines.

*Compiled from www.jetairways.com, www.sap.com/asia/ads02/pdf/herohonda.pdf, www.max.motors.com/offer.html*

## Methods for Communicating with the Customers

The communication methods of a retailer can be classified as impersonal or personal, and paid or unpaid, on the basis of the functions of the promotional program - informing, persuading, and reminding. Thus, there are four types of communication – paid impersonal, paid personal, unpaid impersonal and unpaid personal.

As discussed earlier, promotion consists of four key elements: Advertising, Sales promotion, Public relations and Personal selling. A good retail promotion mix effectively combines all these components. The quality and status of the merchandise and the store conveyed by advertisements must be equally reflected in the other elements of the retail promotion. Else, the customers might receive contradictory messages about the retail store, which might create confusion among the customers and eventually loss of customer loyalty.

Advertising, sales promotion, and the store atmosphere are some forms of paid impersonal communication. Advertising is a paid form of communication through an impersonal mass media that encompasses newspapers, magazines, broadcasting, and the Internet.

Sales promotion is a paid form of impersonal communication. It provides the customers with an incentive for visiting the store and/or purchasing its merchandise during a particular period. For instance, many departmental stores offer discounts for a short period during their annual clearance sale or during occasions of festivity. Though direct sale is the most prominent sales promotion tool, retailers also use special tools like holding in-store demonstrations, offering coupons and organizing contests. Usually, sales promotion tools are used to influence the behavior of the consumer for a short duration. Though sales promotion activities are effective tools for generating short-term sales, they do not help establish long-term customer loyalty. Customers who are influenced by sales promotion programs are generally interested in the merchandise being promoted, not in the store selling them. However, there is a possibility that the customers who are influenced by a retailer's sales promotion program might revisit the store. Table 12.1 describes the various types of sales promotion techniques.

**Table 12.1: Sales Promotion Techniques**

| Sales Promotion Technique | Description |
|---|---|
| Point-of-Purchase | Displays on the floor, counters and windows remind the customers about products and stimulate their buying impulse. Sometimes displays are provided by the manufacturers. |
| Contests | Customers compete for prizes by writing slogans. |
| Sweepstakes | The participants fill an application form and a winner is chosen randomly. |
| Coupons | Special discounts are advertised (mostly in print), and customers can get discounts against these advertisements. |
| Frequent shopper / Frequent flyer programs | Retailers offer points or discounts to customers, depending on the amount for which they have bought goods. The customers can even exchange points with goods or services. |
| Prizes | Unlike the frequent shopper programs, the customer receives the prizes immediately after the purchase of goods of a certain value, for example, glassware, casseroles etc. |
| Samples | Free samples are offered to the customers. Usually, big departmental stores and supermarkets have sample perfumes for testing. |
| Demonstrations | One instance is the demonstration of the use of vacuum cleaners |
| Referral gifts | Retailers offer gifts to their customers for bringing in a new customer. |
| Pencils, calendars, diaries, wallets, etc. | Products carrying the retailer's name are given to the customers on purchasing their products. |
| Special events | Retailers may organize many special events like fashion shows, autograph sessions with celebrities, or theme festivals. |

## Advertising

Advertising can be defined as any paid form of non-personal communication, and promotion of goods or services by an identified sponsor. Certain media for advertising are the print (newspapers and magazines), broadcasting (television, radio and

Internet), and displays (billboards, signs, posters, etc.). Advertising is generally intended to present a consistent and enduring image of a product or the retailer in order to reinforce its positioning on a continuous basis.

## Sales Promotion

Sales promotion can be defined as the technique of offering short-term incentives to customers, so that they are motivated to purchase the retailer's products or services. Sales promotions are generally communicated to consumers through the in-store displays or packaging labels. Premiums, discounts, coupons, cash rebates, free offers and demonstrations are sales promotion tools a retailer may use. Though this is a non-personal form of communication, the objective of most sales promotion programs is to arouse consumer interest in the product or service being promoted. Sales promotions are not only targeted at the final consumers, but also at the retailer's employees and the members of the distribution channel.

## Public Relations

Public relations is a form of unpaid impersonal communication. It is the process of reaching the target customers through an unpaid and impersonal channel, such as an article about the store or its products in a leading newspaper. These tools are aimed at establishing good relations with the consumers and other people through publicity, a good corporate image, and management of unfavorable rumors or issues. Public relations has many unique features. It is highly credible -- news items and features appear more realistic to the consumers than advertisements. Public relations enable the store to reach out to many target customers who cannot be accessed by salespersons or advertisements or those potential consumers who avoid meeting sales personnel and looking at advertisements. The message is conveyed to the target customers as news rather than a sales-related communication.

The most effective unpaid personal communication tool is word-of-mouth. Retailers can use this tool effectively only by providing high-quality service to the customers. However, if the word-of mouth amounts to negative communication, it can have a significant negative impact on the retailer.

## Personal Selling

Personal selling is a form of paid personal communication, wherein the sales personnel satisfy the customers' needs, by exchanging information through personal interactions. It is a two-way communication process aimed at selling products and/or services and building relationships with customers and other people. This promotional tool is personal in nature and it thus enables the retailer to modify its services as per the customer's needs. It also enables the retailer to get customer feedback and ideas to improve customer service immediately. The sales personnel can modify the product-related information according to the customer's needs and present the same in a more effective manner. Sales presentations, trade shows and incentive programs are all forms of personal selling.

### Store Atmosphere

Maintaining a good store atmosphere is a paid form of impersonal communication. It involves all the attributes of the store like its architecture, layout, design, displays, color scheme, lighting, temperature control, music and fragrance. These elements are referred to as atmospherics.

The retailer must be careful while using any of these methods of communication, which have their own advantages and disadvantages. Table 12.2 shows the objectives, advantages and disadvantages of the different communication methods. The advantages and disadvantages of these communication methods can be analyzed on the basis of four factors – control, flexibility, credibility and costs.

**Table 12.2 Objectives, Advantages and Disadvantages of Various Communication Methods**

| | |
|---|---|
| **Advertising** | **Objectives:** Increase short term sales, increase customer traffic, reinforce the retail image, inform the target customers about the merchandise and services offered, ease the salesperson's job, create demand for its private labels.<br><br>**Advantages:** Ability to attract a large audience, low cost per reader, listener or viewer, availability of a number of alternative media vehicles, control over the content, timing and length of the message.<br><br>**Disadvantages:** Inability to tailor the message according to the tastes of the target customers, inability to emphasize the individual customer's needs, need for huge investments for some types of advertisements, brevity of the advertisements often limiting the information conveyed, direct mails and pamphlets being discarded without even reading the message. |
| **Sales Promotion** | **Objectives:** Increase short term sales volume, sustain the loyalty of the customer, focus on novelty, support other promotional tools<br><br>**Advantages:** Highly attractive, uniqueness of the themes and tools used, ability to provide the customer with additional value like free gifts/merchandise, attract customers and sustain customer loyalty, increase impulse buying, customers can participate in the contest and enjoy the demonstrations.<br><br>**Disadvantages:** Difficulty in pulling back certain promotions without adverse reaction from customers. Using routine promotional schemes may hamper the image of the store. Sometimes retailers might emphasize on some trivial points rather than the merchandise offered, additional services provided, and the prices. Short term influence can be used only along with other promotional tools |
| **Personal Selling** | **Objectives:** Persuade the customers to buy the merchandise, complete transactions with customers, create awareness about merchandise through in-store selling and telemarketing, provide feedback to the top management of the retail organization, provide required customer service, ensure customer satisfaction.<br><br>**Advantages**: Ability to modify the message according to customer needs, flexibility of the salespersons in addressing the various customer needs, increased attention of the customer to the message being conveyed, greater response of the customers to personal selling than to advertisements, ability to provide immediate feedback<br><br>**Disadvantages:** Reach is limited to a small number of target customers at a particular time, high costs of interaction with each customer, inability to attract customers to the store initially, may replace self-service (which may be preferred by many customers). some customers may regard sales personnel to be aggressive. |
| **Public Relations** | **Objectives:** Increase awareness about the retailer and its strategy, improve the retailer's image and project the retailer as a contributor to the quality of people's life. Show innovativeness, convey a favorable message in a credible manner, and minimize the promotional costs.<br><br>**Advantages:** Enhances the store image, establishes credibility through an objective source. It comes free of cost, targets and addresses mass audience, news coverage receivers more public attention than advertisements.<br><br>**Disadvantages:** Some retailers might not spend money on building up their image, less control over the message, its timing and its location, greater short term suitability, retailers might have to bear the costs of public relations staff. |

*Control:* Retailers have a greater control over paid forms of communication than over unpaid forms of communication. In case of advertising, sales promotion and enhancing the store atmosphere, retailers can determine the content of the message and the time of its delivery. But they have relatively less control over the other forms of paid communication, because every salesperson might communicate a different message. Further, the retailer can exercise a very little control on the content of the message sent through public relations and word of mouth.

*Flexibility:* Personal selling is the most flexible method of communication between the retailer and the customer. As it involves the interaction of the sales personnel with each customer, identifying the specific needs of the customers and tailoring the product or service as per the customer's needs becomes convenient. The other methods of communication are not so flexible. For instance, advertisements convey the same message to every target customer.

*Credibility: C*onsumers consider the information that is conveyed through publicity and word of mouth communication more credible when compared to the information conveyed through paid communication. For instance, the information given by a friend on a newly opened food joint would influence an individual more than the advertisements or the information given by its sales personnel.

*Costs:* Though publicity and word of mouth are referred to as unpaid forms of communication, retailers generally incur significant costs in organizing an event that would make a good news item.

The effectiveness of the various communication methods in fulfilling their tasks shows considerable variation because of differences in cost, credibility, flexibility and control mentioned earlier here. However, advertising and public relations have been found to be the most cost-effective methods of communication between the customers and the retailer about the merchandise or services offered by the retailer. In order to persuade the customer to buy the merchandise, retailers use promotional tools like personal selling, sales promotion, store atmosphere and visual merchandising. Retailers remind the customers about their products and incite them to repeat purchases, by adopting the image advertising strategy.

The retailer should ideally make all these individual elements of communication work together so that they reinforce each other, for accomplishing its overall communication objectives. Exhibit 12.3 illustrates the guidelines for developing a promotional strategy. Instead of developing separate programs for sales associates, advertising and sales promotion, the retailers should combine all these activities into a single communication program, usually referred to as an integrated marketing communications program. The absence of an integrated marketing communications program might lead to the individual communication methods working at cross-purposes. Thus, an integrated marketing communication program can be defined as the strategic integration of various methods of communication to develop a comprehensive and consistent message.

## PLANNING RETAIL COMMUNICATION PROGRAM

A well planned retail communication program plays a pivotal role in the retailer's effectiveness in communicating with the customers. Some of the common steps in planning a retail communication program are:

- Establishing the communication objectives.
- Determining the promotional budgets.
- Assigning the promotional budgets to various communication activities.
- Implementing and evaluating the communication program.

**Exhibit 12.3**

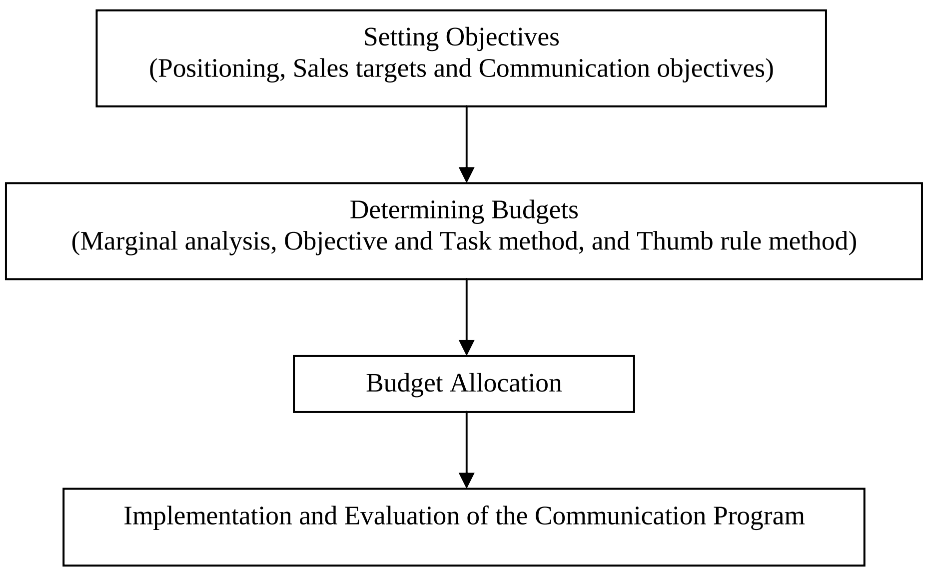
**Guidelines for Adopting a Promotional Strategy**

1. Retailers should use only those promotional tools that are pertinent with, and enhance, the image of the store.
2. Retailers, in order to develop effective promotional strategies in the future, should evaluate the success and failure of every promotional tool, which they use.
3. Retailers should evaluate new promotional tools prior to making any big investments and using them on a large scale.
4. Retailers should use tools that appeal to their target customers and are realistic to fulfill.
5. Retailers should ensure that their objectives are measurable and achievable.
6. Retailers should develop not just advertisements but complete promotional campaign.
7. Retailers should note that new stores or outlets require higher promotional budgets than the established ones.
8. Retailers should note that the stores or outlets located in isolated or standalone places require more promotional activities than the stores in more noticeable locations.

*Source: http://ag.arizona.edu/fcs/rcsc/underclass/114/powerpoint/chapter11.ppt*

Figure 12.1 illustrates the steps for developing a retail communication program.

**Figure 12.1: Steps for Developing a Retail Communication Program**




## Establishing Objectives

Establishing clearly defined communication objectives is the first step in developing a successful promotional program. This gives proper direction to people handling the implementation of the communication program. It forms a basis for measuring the effectiveness of the program. While some of these programs (aimed at developing an image of the retailer in the customer’s view or changing the consumer's perception of the retailer) have long term implications, some other programs (for example, aimed at increasing the customer traffic in the store during holidays or festivals) have short term implications. However, promotional objectives, in a broad sense, include increasing sales, stimulating impulse buying, increasing customer traffic, generating leads for the sales personnel, reinforcing the store image, informing the customers about the products, increasing the popularity of the new stores, strengthening the manufacturer's support, providing quality customer service, strengthening customer relations, and building and maintaining customer loyalty. While developing a promotional strategy, retailers should decide upon their promotional objectives from the ones mentioned above. Retailers should state their promotional objectives as precisely as possible. Hence, aiming at increasing the store's sales is not enough. It is essential to set an objective that is measurable in quantitative terms. For instance, the objective of a retailer may be to increase its sales by 20 percent. With this kind of a promotional objective, the retailer can then measure the effectiveness of its promotional plan. The three main factors that a retailer should consider while setting objectives are positioning, sales targets, and communication objectives.

### Positioning

Positioning can be defined as the process of developing and implementing a retail communication program that creates an image of the retailer in the mind of the consumers, against the backdrop of the images of its competitors. Positioning gives the retail store long term competitive advantage. Generally, positioning helps the customers associate a retailer with the particular merchandise category or a benefit it offers. Retailers also set for themselves some specific positioning objectives, as explained in Exhibit 12.4.

**Exhibit 12.4**

**Specific Positioning Objectives of Retailers**

1. Merchandise Category: Retailers usually try to become as unique as possible in the merchandise category offered.
2. Price and Quality: Some retailers position themselves as selling high fashion goods at high prices, for example, stores offering the collection of apparel designed by top fashion designers. Some retailers may position themselves as selling good merchandise, service and good value at low prices.
3. Retailers can associate their stores with some special attributes like service or convenience, for example convenience stores.
4. Sometimes retailers can associate their stores with particular lifestyles, activities or products. For instance, a retailer might offer computer books only. For example, Home Depot in the US offers building materials and products for constructing houses.

### Sales Targets

Increasing the sales for a specific period is the most common short term objective of retailers. For instance, retailers generally offer a sale during which all or part of the merchandise present in the store is sold at a discount price. Supermarkets frequently advertise their money saver offers.

### Communication Objectives

Though the final objective of retailers is to derive long term profits and short term sales, they generally set communication linked objectives for planning promotional programs and measuring their effectiveness, instead of sales objectives or targets. Communication objectives usually relate to specific goals. These goals are concerned with the effect of retail promotion mix on the consumer decision-making process. In order to implement a communication program and to measure its effectiveness, retailers should state their communication objectives clearly in quantitative terms. The retailer should also clearly mention its target customers for the promotion mix with the expected degree of change (in the sales target percentages) and the time to realize this change. Once the communication, positioning and sales objectives have been established, the next step is to determine the promotional budget.

## Determining the Promotional Budget

A retailer can determine the promotional budget through the marginal analysis method, objective and task method or the thumb rule method. The marginal analysis method is economically the most accurate method. The problem is that retailers generally do not have sufficient information to conduct a complete marginal analysis. However, the marginal analysis method provides a direction to managers in setting a promotional budget.

### Marginal Analysis Method

Organizations may increase their promotional costs as long as the return on investment is more than the investment itself. This economic principle forms the basis of the marginal analysis method. Table 12.3 illustrates how a specialty men's suit store determines its promotional budget for the coming months/seasons. For the various levels of promotional expenditures (A), the retailer has to determine the sales of its stores (B), gross margin (C), rental costs (D), and personnel costs (E). The sales contribution prior to the promotional expenditure (F) is calculated. The profits after deducting the promotional expenditure (G) are also calculated. The retailer might have estimated the sales generated at various levels of promotional expenditure either through judgment and experience, or by analyzing the past trends in establishing a relationship between the promotional expenditure and the sales generated. Analyzing existing data can help the retailer gather information about the gross margin and other expenditure as a percentage of sales. Table 12.3 shows that at low levels of promotional expenditure, an additional promotional expenditure of Rs.250,000 resulted in a more than Rs. 250,000 of incremental contribution to sales.

A Rs.250,000 increase in the promotional expenditure of Rs.750,000, has led to an increase in sales worth Rs.540,000 (Rs.2,420,000- Rs.1,880,000). At the promotional expenditure level of Rs.3,250,000, an increase of Rs.250,000 has been found to generate less than Rs 250,000 of the incremental contribution. For instance, an increment of Rs.250,000 in the promotional budget of Rs.3,250,000 has led to an incremental contribution of Rs.202,500 only. In this example, a promotional budget of Rs 3,250,000, seems to have generated maximum profits. But, it is also found that the promotional budget levels from Rs.2,750,000 to Rs.3,500,000, have generated almost similar profits. Therefore, the retailer may adopt a conservative approach and decide to allocate Rs.2,750,000 to its promotional budget. In many situations, it may be very difficult for managers to conduct a marginal analysis because of the complexity of connecting the promotional budgets and the sales generated. In some cases, retailers conduct experiments to get a clear picture of the relationship between the promotional budgets and the sales generated.

The other methods that retailers use to determine promotional budgets are the objective and task method, and thumb rule methods such as the affordable method, percentage of sales method and competitive parity method. These methods are less sophisticated than the marginal analysis method, and are simple to use.

**Table 12.3: Illustration of Marginal Analysis**

| | Promotional expenditure<br>A | Sales<br>B | Gross Margin<br>C | Rental costs<br>D | Personnel Costs<br>E | Contribution prior to promotional expenditure<br>F = C – D –E | Profit<br>G = F – A |
|---|---|---|---|---|---|---|---|
| | 0 | 12000 | 4800 | 2200 | 2610 | –10 | –10 |
| | 250 | 14000 | 5600 | 2400 | 2670 | 530 | 280 |
| | 500 | 16500 | 6600 | 2650 | 2745 | 1205 | 705 |
| | **750** | 19000 | 7600 | 2900 | 2820 | **1880** | 1130 |
| | **1000** | 21000 | 8400 | 3100 | 2880 | **2420** | 1420 |
| | 1250 | 23000 | 9200 | 3300 | 2940 | 2960 | 1710 |
| Last Season | 1500 | 25000 | 10000 | 3500 | 3000 | 3500 | 2000 |
| | 1750 | 27000 | 10800 | 3700 | 3060 | 4040 | 2290 |
| | 2000 | 28500 | 11400 | 3850 | 3105 | 4445 | 2445 |
| | 2250 | 30000 | 12000 | 4000 | 3150 | 4850 | 2600 |
| | 2500 | 31250 | 12500 | 4125 | 3187 | 5188 | 2688 |
| | 2750 | 32500 | 13000 | 4250 | 3225 | 5525 | 2775 |
| | 3000 | 33500 | 13400 | 4350 | 3255 | 5795 | 2795 |
| Best Profits | **3250** | **34500** | **13800** | **4450** | **3285** | **6065** | **2815** |
| | 3500 | 35250 | 14100 | 4525 | 3307 | 6268 | 2768 |
| | 3750 | 35750 | 14300 | 4575 | 3322 | 6403 | 2653 |
| | 4000 | 36250 | 14500 | 4625 | 3337 | 6538 | 2538 |
| | 4250 | 36750 | 14700 | 4675 | 3352 | 6673 | 2423 |
| | 4500 | 37250 | 14900 | 4725 | 3367 | 6808 | 2308 |
| | 4750 | 37500 | 15000 | 4750 | 3375 | 6875 | 2125 |
| | | | | | | | |
| ***All units in Rupees Thousands*** | | | | | | | |

## Objective and Task Method

Retailers use the objective and task method to determine their promotional budget, which is required to take up a particular task for achieving its communication objectives. The retailer should first establish its communication objectives in order to use the objective and task method. Once the communication objectives are established, the required tasks for achieving them and their costs should be determined. The sum of the costs of all the tasks required to achieve the communication objectives is the promotional budget.

## Thumb Rule Method

While the marginal analysis method and the objective and task method help the retailer determine its promotional budget by measuring the effect of the promotional activities on its communication and sales objectives, the thumb rule method uses historical data about the retailer's sales and promotional activities to determine the current promotional expenditure. There are three types of thumb rule methods:

- Affordable method
- Percentage of sales method
- Competitive parity method

Retailers using the affordable method should first determine their sales targets and their expenditure for that budgeting period (without taking the promotional expenditure into account). The difference between the sales targets and the other expenditure is then added to the projected profits, which gives the promotional budget. Thus, the affordable method helps determine what amount of money is available for promotional activities after budgeting for profits and operational expenditure. However, the major drawback of this method is that it is based on the assumption that the promotional expenditure does not influence the sales and profits generated. Though promotional expenditure is regarded as the cost of running a business, retailers using affordable method generally cut the unnecessary promotional costs if the expected sales are not generated.

In *percentage of sales method*, the promotional expenditure is a fixed percentage of the predicted sales. In this method, the retailer decides on a promotion-to-sales ratio, and then the value of the promotional budget is worked out on the basis of the expected sales for the next year. Promotional budget can be calculated using the following equation.

Promotional budget = Expected sales (in Rupees) x Promotion-to-sales ratio (in %)

For instance, if a retailer has decided on a 10 percent promotion-to-sales ratio, and the expected sales for the next year is Rs.5,000,000, then the promotional budget according to the percentage of sales method would be the following:

Promotional budget = 5,000,000 x 10% = Rs. 5,00,000

The main drawback of this method is that the promotional budget is calculated on the basis of the percentage that was used in the past or on the percentage that is being used by its competitors. But, using same percentages as their competitors might not be appropriate for several reasons. The retailer's stores might be situated in a better location than its competitors due to which customers might be more aware of the retailer's presence. In this case there would be no need to spend heavily on promotion, unlike the case of the competitors situated in remote locations. The major advantage for a retailer, while determining the promotional budget using percentage of sales method, is that its promotional budget will not exceed its capacity. Since the promotional expenditure is determined on the basis of its sales forecasts, promotional costs would increase only when its sales increase. Though an increase in sales would permit the retailer to communicate with its customers more aggressively, a slight decline in sales will cause a proportional decrease in the promotional costs, which can speed up the sales decline. Table 12.4 illustrates the percentage of sales method of determining the promotional budget.

Retailers using *competitive parity* method change their promotional budget, depending on the actions taken by their competitors. For instance, a leading retailer located in a particular area reduces its promotional expenditure by 5%, then all the other retailers in that area reduce their promotional expenditure by 5%. The major merits of this method are that it is based on comparison and it is market driven and conservative. Its demerits are that it is a follower's strategy, and that it is difficult to obtain detailed information about competitor’s strategies. Above all, it is based on the assumption that the competitors are similar with regard to many micro factors like the size of business, the target customers, the location, the merchandise and services offered, and the pricing strategies. As no two retailers can be similar in all these aspects, they would require different promotional strategies and hence, different promotional budgets.

**Table 12.4 Illustration of Setting Promotional Budget as a Percentage of Sales**

| **Estimated Sales (in Rupees)** | **5,000,000** |
|---|---|
| Percentage of sales towards promotional budget | 5% |
| Promotional expenditure in Rupees | 250,000 |
| **Promotional Expenses in Rupees** | |
| Newspaper advertisements | 75,000 |
| Magazine advertisements | 50,000 |
| Brochures | 25,000 |
| Samples | 35,000 |
| Event sponsorships | 40,000 |
| Danglers and display material | 25,000 |
| **Total Promotional costs** | **250,000** |

## ASSIGNING THE PROMOTIONAL BUDGET

Once the promotional budget is determined, the next step in the process of promotional planning is to assign the budget to specific communication elements, product categories and geographic areas. Assigning the promotional budget effectively is more important than determining this budget. Retailers can accomplish their communication objectives even after reducing the promotional expenditure by effectively assigning the promotional budget to different communication elements. To do this, the retailers should distribute the promotional budgets judiciously among all the geographic areas in which they are located and all the merchandise categories. But this technique does not maximize the profits as it does not consider the fact that promotional programs can be more effective for some product categories, and in some geographic areas. Retailers can adopt another approach for assigning the promotional budget – allocating the promotional budget on the basis of estimated sales or the contribution of each merchandise category to the overall sales. While taking budget allocation decisions, retailers should apply the principles of marginal analysis. A major portion of the budgets must be assigned to those geographical areas that give maximum returns for every rupee spent. This approach is sometimes referred to as the 'high assay principle'.

## IMPLEMENTING THE ADVERTISING PROGRAMS

Retail advertising helps in creating an image of a retailer and reinforcing it. It informs the target customers about the merchandise offered by the retailer and their prices, and sale periods. Though some big retailers aim at image building through advertising, most of the small-time and medium retailers take up advertising for achieving short term objectives. But retailers, while using advertisements, must keep in mind the legal issues that may arise. These may include deceptive advertising tactics like bait-and-switch, advertising substantiation, corrective advertising, price comparison and puffery. All these issues are discussed at length in Chapter 18 (Legal and Ethical Issues in Retailing). Retailers, while implementing advertising programs, should decide upon the message they intend to convey, identify a particular media to transmit the message, and then determine the timing and frequency of the message.

### Creating the Message

Many retailers often develop advertising messages that have an immediate impact though is short-lived. The need for creating an immediate impact requires an ad copy writing style that would catch the attention of the target customers. Retailers seek help from various sources in developing an ad-campaign - co-operative advertising, advertising agencies, and the local media.

#### Co-operative advertising

Co-operative advertising involves two or more parties sharing costs and the responsibilities of making decisions. In general, manufacturers support retailers by sharing the costs of advertising their products. It is a form of incentive given by the manufacturers to the retailers, to encourage them to promote and advertise a particular product. This cooperative support is offered mostly by manufacturers of consumer goods. Retailers in some places contribute collectively to each others advertising programs. Based on this, co-operative advertising can be categorized as vertical cooperative advertising and horizontal co-operative advertising. Under *vertical cooperative advertising*, the advertising costs are shared by the retailer and the manufacturer or the wholesaler, whereas in a *horizontal cooperative advertising*, the advertising costs are shared by a group of retailers.

Manufacturers have many motives behind providing cooperative support to retailers regarding advertising expenditure. This increases the manufacturers' local exposure. Manufacturers may like to leverage the image of the retailer. Retailers can derive significant promotional advantage through cooperative advertising, as long as they are careful in selecting the opportunities. But, the retailer has to accept some terms and conditions laid down by the manufacturers or the wholesalers. Retailers can increase their advertising expenditure through cooperative advertising. Apart from reducing costs (because advertising costs are shared by vendors), co-operative advertising helps the retailer associate its name with popular national brands.

However, co-operative advertising has some drawbacks. Conflicts may arise between the manufacturers/vendors and the retailers while advertising their own products. This conflict in goals may have a significant impact on the effectiveness of cooperative advertising for a retailer. Further, the advertisements developed by the manufacturer/vendor are frequently used by various competing retailers as the advertisement features a list of names and addresses of all the retailers that sell the manufacturer’s brands. Thus, retailers cannot distinguish themselves from their competitors if they use co-operative advertising.

## Advertising agencies

Large retailers generally have specialized departments that take care of their advertising needs. These departments or agencies create advertisements aimed at building the image of the store. Sometimes, small retailers too engage local advertising agencies for planning and developing their advertisements. Such advertising agencies are generally more proficient in planning and developing their advertisements than the retailer's employees. Such agencies also help retailers develop special promotional programs like contests.

Apart from selling space in newspapers and broadcast time in radio and television, the advertising media/agencies offer(s) various services to the local retailers. The services offered might range from planning an advertising program to designing the advertisement and copy-writing. As media organizations conduct market research on their readership, they can provide retailers with information about the shopping habits of people in a particular area.

## Selecting Advertising Media

The advertising message of a retailer must be carried to its target customers through a communication vehicle - the media. The most common media used for retail advertising are newspapers, magazines, direct mail, radio, television, hoarding and other outdoor media. From a managerial perspective, newspapers and television are considered to be mass media that target the total market, while other media like the radio, magazines, direct mail and the Internet are used for targeting specific markets. The following are the merits and demerits of the various media.

*Newspaper advertising* is the most frequently used medium by a retailer for the following reasons:

- Newspapers are locally based, and hence, they have a stronger influence on people in the local trade areas of the retailer.
- Developing newspaper advertisements does not require excellent technical skills.
- Newspaper advertising is advantageous, especially for the small retailers.
- There is very little lead time between the creation of the advertisement and its publication.

The following are the disadvantages of newspaper advertising:

- The target consumer may read a newspaper in which the ad is published, but may not notice the advertisement.
- The life span of an issue of a newspaper is very short and so is the case with advertisements published in it.
- The poor print quality of newspapers makes the advertisements unappealing.
- As newspapers have a wider reach they do not target specific groups of customers. This way, it actually does not do justice to the money spent by the retailer on advertisements.

In spite of all these disadvantages, newspapers have been the primary choice of advertising medium for many retailers.

Many retailers have also been using television as their advertising medium. It has been found through observations over time that visual advertisements stay for a longer period in the consumer's memory, when compared to the verbal messages conveyed by any other media. Although advertising on the television is more effective than any other method, it has its own limitations. Some of these are as follows:

- Television advertisements are so expensive that a few well-designed advertisements can consume the entire advertising budget of a retailer.
- The reach of a television advertisement can be much beyond the trading area of a small or a medium sized retailer
- Nowadays, too many ads are telecast (very frequently) on television, due to the heavy competition between companies to catch viewers' attention. The target audience may leave the room or switch to another channel during the commercial breaks in a program. Such behavior of viewers has become a complex problem for the concerned retailers, with increased (and increasing) number of channels on cable and satellite television. Due to this increase in the number of channels, television advertising may catch the attention of a specific audience and not the mass.

In spite of its disadvantages, advertising through the television has been a powerful tool for generating sales volumes. Also, the constantly expanding cable television is becoming an attractive medium for many small retailers.

Some of the retailers use *radio* as their advertising medium because of its ability to transmit the retailer's messages to a selected audience. As a communication medium, radio allows retailers to use various tones and sounds in their messages. This helps retailers develop messages that appeal highly to its target customers. Although the radio is an efficient medium, many local radio stations do not have the creativity required to cater to the advertisement needs of a retail store. Also, the advertisements on the radio cannot be reused as print advertisements. Further, the radio being a non-visual medium lacks the ability to display the merchandise it is promoting.

Generally, it is the local retailers who advertise in magazines that are popular with people in the retailer's local trade area. Only large retailers can afford to allocate some of their advertising budget for magazine advertising. And generally, such advertisements are institutional advertisements. Advertisements through magazines can be highly effective, when compared to newspaper ads. These advertisements have longer exposure time, and are better in terms of reproduction quality. However, magazine advertisements have long lead times.

*Direct marketing is* regarded as the most powerful tool in a retailer's promotion mix. Direct mail (a form of direct marketing), allows the retailer the flexibility to tailor its message according to the requirements of its target customers. The performance of direct mail can be measured easily, as it usually provides feedback to the retailer. However, direct mailing is more expensive than media in terms of the cost per contact. Also, it is the quality of the direct mail that determines its ability to reach the target audience.

With the number of *Internet* users increasing phenomenally across the globe, the Internet is likely to emerge as a powerful advertising media in the near future. Internet advertisements help customers get a better idea of the various types of products or services available with the retailer. Also, the prices of the goods and services sold through the Internet may be lower than those of goods or services sold traditionally at stores. However, online advertising has some drawbacks, especially for retailers.

### Criteria for selecting an advertising media

When the retailer has understood the merits and demerits of various media, he should select an appropriate medium depending on characteristics of these media. The characteristics may be described as follows:

*Communication effectiveness:* It is the ability of the media to create the desired impact on the target audience. The print media use pictures and words for the target customers to see and read. Radio advertising helps the target customers 'hear' the message. Television enables the target customers to watch and listen to the retailer's message.

*Geographic selectivity:* It is the ability of the media to appeal to a particular geographic area. As the target customers of a majority of retailers come from a particular trading area, the media should be able to create a significant impact on the target customers in that particular area, depending on the characteristics of their viewers or readers.

*Audience selectivity:* It is the ability of the media to convey the message to a specific target audience within a larger population. Advertising in special magazines target a specific audience with special interests. (For example automobile and electronics magazines)

*Flexibility:* This pertains to the ability of the media to allow the advertiser perform several functions simultaneously. For instance, using direct mail will allow the retailer to send coupons, gifts, postage paid envelopes, etc., to the customer, along with the actual message.

*Impact:* The media can stimulate certain behavioral responses in its target customers. For instance, television and magazines are the most preferred media for building store image.

*Prestige:* Media advertisements help retailers establish themselves as prestigious firms. Consumers generally perceive ads in the print media (certain magazines and newspapers) as high status symbol rather than the electronic media.

*Immediacy:* This is related to the ability of the media to convey messages on time. For instance, advertisement messages can be prepared and aired within a day on the radio. However, the lead time is generally high in case of magazine and television advertisements.

*Message life:* This is the duration that the message is available for the target customers. The duration of television advertisements is generally 10 seconds and hence, they should be repeated frequently for building a store recall. Newspaper advertisements are alive for many hours, while magazine advertisements are available for some days.

*Coverage:* This is the percentage of a specific target market that the media is able to reach. For instance, the coverage of a particular magazine can be 55%.

*Cost:* This pertains to the ability of a particular media to reach a particular market in the most cost-effective manner.

Retailers should measure the efficiency of all the media, before selecting one of them. The efficiency of a medium can be determined by measuring the cost of reaching a certain number of target customers, through ‘cost per thousand method’. The ‘cost per thousand method’ is a technique used to measure the effectiveness of advertisements in various media, depending on their cost and reach. Generally, the costs of advertisements in the media are represented in terms of cost per 1000 readers/ viewers / listeners. Thus,

$$\text{Cost per thousand} = \text{Cost per message} / (\text{Circulation}/1000)$$

$$= (\text{Cost per message} \times 1000) \div \text{Circulation}$$

*Frequency:* This is the number of times that the media reaches the same target customer with the same advertisement. In other words, this is a count of the exposure of the same viewer to the same advertisement.

*Lead times* are different for different media. For example, a retailer can place an ad in a newspaper a little while before the publishing of the paper, but in order to place an advertisement in a magazine, he would have to submit it weeks or months in advance. Also, deciding on the content of the advertisement is extremely important. Whether the message is written or spoken, or it is delivered personally or otherwise, the message is the most important aspect of advertising. While developing advertisements, retailers (or the agencies they hire) should think about the most appropriate themes, words, headlines, captions, colors, size, layout and position.

### Determining the Frequency and Timing of the Advertisements

Retailers advertise their store and the merchandise offered throughout the year. The frequency at which these advertisements appear varies, depending on the purpose of the advertisements. But, retailers should understand that the timing and the frequency of the advertisements would determine how frequently the target customers notice their message. Therefore, the effectiveness of an advertisement campaign in drawing the attention of a customer depends on the frequency and timing of the advertisements. *Frequency* can be defined as the number of times a target customer is exposed to the advertisement. Deciding the appropriate frequency depends on what the retailer wants to achieve through the advertisement. Generally, frequent exposure to ads influences the customer's buying behavior. Thus, advertisements are intended to positively influence the consumers' buying behavior, rather than building store awareness. Further, *timing* the publication or broadcasting the advertisement properly is important for getting a good return on an ad investment. Typically, an advertisement should be published or broadcast immediately before the day on which consumers are most likely to purchase the goods and/or services. Exhibit 12.5 provides some guidelines that retailers should follow for scheduling an advertisement appropriately.

**Exhibit 12.5**

**Guidelines for Scheduling an Advertisement**

A retailer, while scheduling advertisements should follow the guidelines given below:

1. Advertisements should be broadcast or published on or just before that day on which customers are most likely to purchase the goods or services.
2. Advertisements should appear during those days when the target customers receive their salaries.
3. Retailers with limited advertising budgets should advertise during periods of highest demand.
4. Retailers should advertise during the time that has the optimum cost per thousand.
5. Retailers should understand that advertising in critical situations, is ineffective as its timing is not decided well in advance.

## EVALUATING THE EFFECTIVENESS OF ADVERTISEMENTS

The ability of advertisements to generate positive results depends on how well they are designed and how appropriate are the decisions that were taken regarding these ads. A retailer can make good advertising decisions only when it plans its advertising program effectively. Some retailers have a systematic procedure for measuring the effectiveness and efficiency of their advertisement programs.

Advertising effectiveness can be defined as the degree to which the advertisements have produced the desired results or helped the retailer accomplish its advertising goals. It can be also defined as the technique of achieving the desired advertising results with the minimum possible expenditure. The efficiency or effectiveness of retail advertising can be measured subjectively. Retailers should ask themselves whether they are satisfied with the returns from their advertising programs and whether they believe that the returns were generated with the minimum expenditure.

Retailers can measure the effectiveness of their advertising programs consistently by

- Publishing the same advertisement in two different media, with a mark on each of them to distinguish one from the other. Customers should get a discount or a free sample of a product on bringing the advertisement to the retailer. The retailer will be able to understand which advertisement worked better by looking at the distinguishing marks on the ads, or the mail addresses.
- Advertising a product at slightly different prices in different media or publications. This test will prove whether the consumers will buy the product at a higher price.
- Advertising a product only through one advertisement without promoting or display the product in the store. The retailer should then count the number of calls or solicitations for that product. The higher the number of calls or solicitations for that product, the higher is the effectiveness of the advertisement.
- Not publishing or broadcasting a regularly published or broadcast ad for some time and checking for any effect on the sales.
- Measuring the sales volumes whenever the advertisement is placed for the first time.

However, the retailer cannot expect immediate returns from an advertisement, as consumers take some time to notice the advertisement and learn about the retailer. It has been found that an individual becomes a customer after he has been exposed nine times to an advertisement of a new company. Moreover, every three times a prospective customer is exposed to the advertisements, he comes in contact with the advertisement only once. This implies that a retailer has to expose the advertisement to a prospect for an average of 27 times before he or she becomes a customer.

## IMPLEMENTING SALES PROMOTION PROGRAMS

Discount sales combined with advertising are the most common sales promotion programs adopted by the retailers. Retailers may adopt other forms of sales promotion programs like demonstrations, coupons, games, sweepstakes and contests. Table 12.1 gives a list of various promotional tools used by retailers and their description. *Sale* is the most common promotional tool used by a retailer to increase the customer traffic and to clear the old merchandise. A sale can be promoted either through advertisements or through displays within the store. Retailers may also offer special end-of-the-season sale to clear the merchandise that is still on the inventory.

## IMPLEMENTING PUBLICITY PROGRAMS

Generally, publicity is aimed at creating awareness, improving the store image, helping the community and improving the community members' goodwill for the store. Retailers can generate publicity by organizing events within the store and/or by sponsoring events outside the store or any other community related activities. Retailers generally organize fund-raising programs for charitable purposes. There are many publicity tools that retailers use, in order to get a favorable coverage for the events they organize - press releases, press conferences, by-lined articles and speeches.

A press release is a statement of facts that a retailer wants to publish in a reliable medium. Special events like fashion shows, opening a new outlet, a festival sale, or any modification in its routine operations are all events that can be published as a press release. Typically, a press release is supposed to contain all the information that a journalist would seek – who, what, when, where, why and how. Press releases are generally one or two pages of matter printed on the retailer's letterhead. Big retailers have their own public relations departments that create press releases for the news media.

A press conference is a meeting with the media representatives called by the retailer. Press conferences are usually meant for advertising major news events like the merger of two big retail organizations, or a tie-up with any retail chain for overseas expansion. The news media gets more information through a press conference than from a press release.

Bylined articles are the articles written by any of the most efficient employees of the retailer on a particular issue of the retail industry. For example, the operations head of a retailer can write an article on the category management practices of the industry, with special reference to its own store. These articles are usually published in trade magazines.

Speeches are publicity tools that help retailers express their opinion in a public forum, conference, business gathering, or industry group. Most of the speeches are usually covered by the press to generate more publicity.

As advertising is used to target most of the potential customers, publicity is used to reach more people. Favorable publicity is said to boost employees' morale and improve their performance. Though much of the publicity is generated by internal newsletters, magazines, bulletin boards and handbooks, advertising through newspapers, TV and the radio has a greater impact on the employees than internal sources. Like customers, employees rely more on the external sources than on the internal sources. Publicity also has a significant impact on many stakeholders.

## SUMMARY

Advertising, sales promotions, store atmosphere, public relations, personal selling and the word of mouth are the tools used by retailers to communicate with their target customers. All these components of the promotion mix must be combined properly to develop an integrated marketing communication system, for customers to have a clear and distinct image of the retailer.

Retailers develop a promotional mix in order to accomplish several objectives, such as positioning of the retailer, increasing the customer traffic, increasing the sales, announcing special events and providing information about the store location and the merchandise offered.

Determining the promotional budget is a significant task of the retailer. Retailers should use the marginal analysis method for determining the promotional budget, as it is the most appropriate method for determining this budget, which can accomplish the objectives of the retailer. The marginal analysis method helps to find out the level of promotional expenditure that maximizes the profits generated by the promotional mix.

Retailers spend the largest portion of their promotional budget on developing advertisements and on sales promotion activities. The retailer has a wide choice of media for advertising itself, its products and its services. While every medium has its own merits and demerits, advertising through newspapers is effective for announcing 'sales' and reaching a larger population, and advertising through TV facilitates the building up of a retailer's image. Generally, sales promotion activities are intended to meet short term objectives, like increasing the customer traffic in the store during weekends. Though promotional tools like publicity campaigns and word of mouth provide the most reliable information to the target customers, these two are very hard to control.

Retailers usually follow a six-step process in developing their advertising campaigns. It involves developing the advertising objectives, determining the advertising budget, developing the message, selecting the media, scheduling the advertisements and measuring the effectiveness of the advertisements. Most of the retailers generally adopt the Cost per Thousand Method for measuring the effectiveness of advertising in the various media activities.

However, the sales promotion activities and publicity campaign of a retailer must be in complete agreement with his overall promotional objectives.

# Part IV
# Managing the Retail Store

# Chapter 13

# Store Management

**In this chapter we will discuss:**

- Store Management – Role of the Store Manager
- The Retail Personnel Management Process
- Legal and Ethical Issues in Managing the Store Personnel
- Cost Control

## INTRODUCTION

Most retailers believe that location, merchandise, price and promotion are the most important factors for the success of a retail store. They fail to realize that even the best product in the world, offered at the best location and price, doesn’t sell by itself but is sold by the staff working on the shop floor.

People working for the store can make or break the future of a store. Many stores lose sales due to the store personnel's poor service, lack of product knowledge, indifference towards customers, and limited selling skills. Thus, it is important for retailers to take time to build a winning team and harness its power.

This chapter analyzes various legal and ethical issues that are to be considered in store personnel management and the role of a store manager in building a winning team of store personnel, which is dedicated to providing quality customer service.

## STORE MANAGEMENT – ROLE OF STORE MANAGERS

The success of a retail store manager depends on how effectively and efficiently he manages the stores’ personnel and assets. The merchandise purchaser (buyer) procures the right kind of merchandise for the store and it remains the responsibility of the store manager to assign the right people to display and sell them. Exhibit 13.1 lists the responsibilities of a retail manager in Carrefour, one of the largest retail chains in the world.

The retail store manager should take the responsibility for the conduct of the store personnel and maintenance of service standards of the organization as well as protection of the merchandise in a retail store. The responsibilities of a store manager can be broadly divided into four categories:

- Managing the store personnel
- Minimizing the costs of the retail store
- Managing the buying and selling activities of the retail store
- Providing good customer service

All the four major functions of the retail store manager are aimed at increasing the productivity of the store.

### Managing the Store Personnel

A store manager can increase the productivity of the store by managing the store’s human resources effectively and efficiently. To increase the productivity of the store personnel, a store manager should:

- Recruit and select efficient people
- Improve their specific skills through training
- Motivate the store personnel
- Evaluate their performance at regular intervals
- Reward them on the basis of performance

These aspects would be dealt at length later in this chapter.

**Exhibit 13.1**

**Responsibilities of a Carrefour Store Manager**

Carrefour is one of the largest retailers in the world. It includes three major retail formats-supermarkets, hypermarkets and discount stores. The responsibilities of the retail store managers at Carrefour have been listed below along with the skills required to carry out these responsibilities.

**Responsibilities**

- Formulate strategy for the entire store
- Set targets for all the sections of the store which include the food and nonfood sector, accounting, payroll, decoration, security, maintenance and the reception
- Train and manage a team of 8-12 managers
- Administer the store's budget and finance
- Communicate with the headquarters and external agencies

**Required Skills and Managerial Abilities**

- Possess managerial experience from an international company
- Possess good analytical and communication skills
- Have the ability to think strategically
- Have the ability to solve problems and take quick decisions
- Have a charismatic stong personality
- Should be able to work in a team
- Should be flexible and adapt himself to new technologies/ stiuation
- Should be an open minded person with a cheerful disposition

*Source: www.synergie-recruitment.cz/cesky/job_show.php3?jobid=1159&lang=CZ*

## Minimizing the Cost of the Retail Store

The payment of salaries and other compensation benefits to employees constitute a major part of the cost of a retail store. Other costs of the store include cost for control and maintenance and inventory loss due to shoplifting and employee theft. The store manager should try to reduce these costs by efficiently managing the store personnel as well as providing security and maintenance to the store. (This has been discussed in detail in the later part of this chapter.)

## Managing the Buying and Selling Activities

A retail store can manage the buying and selling activities through displays and visual merchandising. The retail store manager can work along with buyers and suggest new merchandise plan and manage special events, and, decide on markdowns to increase the sale of merchandise. The merchandise purchase activities have already been discussed in Chapter 10. Retail selling will be discussed in Chapter 16.

## Providing Customer Service

To retain customers and increase traffic flow in a retail store, the store manager has to provide customized services, which add value to the merchandise sold. Chapter 15 discusses the various ways of providing good customer service.

## THE RETAIL PERSONNEL MANAGEMENT PROCESS

The success of a retail organization depends on the management of store personnel. Some of the steps in the process of retail personnel management are:

- Job analysis
- Recruitment
- Selection
- Socializing and training
- Motivating
- Evaluating
- Compensating

### Job Analysis

Job analysis is the systematic analysis of an existing or proposed position or group of positions within an organization. While performing a job analysis, a retailer collects information relating to areas like:

*Duties and Tasks*: This may include all information related to frequency of tasks and duration of the job, effort and skills required, the level of complexity, equipment to be handled, standards to be maintained, etc.

*Work environment:* Hence, job analysis should concentrate on listing out all the aspects relating to the work environment, which would have an impact on the performance of an employee. For example, at times the retail work environment may require the salesperson to attend to hostile and aggressive customers.

*Tools and Equipment:* Some duties and tasks in a retail store may require the store personnel to work with specific equipment and tools like barcode readers/scanners, computers, security gadgets etc. Therefore, information related to these aspects should be clearly specified.

*Relationships:* While performing their jobs, store personnel may need to maintain relationships with people both internal and external to the store. All information pertaining to this should be clearly mentioned.

*Requirements:* A job analysis should specify the minimum knowledge, skills, and abilities required to perform a particular job.

Thus, a good job analysis would enable a retailer to understand the various retail jobs better. Job analysis forms the basis for preparing a job description (what has to be done) and job specification (what qualifications are needed to do the job). Figure 13.1 depicts the role of job description and job specification in job analysis. On the basis of information collected during job analysis, other activities like recruitment, selection, training, compensation etc., are undertaken. Exhibit 13.2 explains the use of job analysis in each of these areas.

### Job Description

A Job Description is a clearly written statement that explains the duties, responsibilities, qualifications and performance expectations of a particular retail employee. It enables an applicant to gain a clear understanding of the job requirements and skills needed to successfully achieve the objectives of the job. The job description allows the retail manager to identify and select the prospective candidate for a particular job. Exhibit 13.3 shows the job description for a Loss Prevention Associate at Kmart.

**Exhibit 13.2**

**Uses of Job Analysis**

Job analysis can be used for various HR management activities:

*Recruitment and Selection :* Job analysis gives a detailed description about the job and the skills required to perform it. Detailed job descriptions and specifications help the management develop job-related selection and screening tools such as interview questions to select suitable people.

*Compensation:* Information available from job analysis helps the top management evaluate the value of each and every job and decide upon the compensation required at each level. The compensation can be in terms of salary or bonus, depending on the nature of the job and the skills required, qualification, safety hazards, degree of responsibility, etc. Thus, job analysis helps the top management to decide upon the relative worth of each job and provide compensation accordingly.

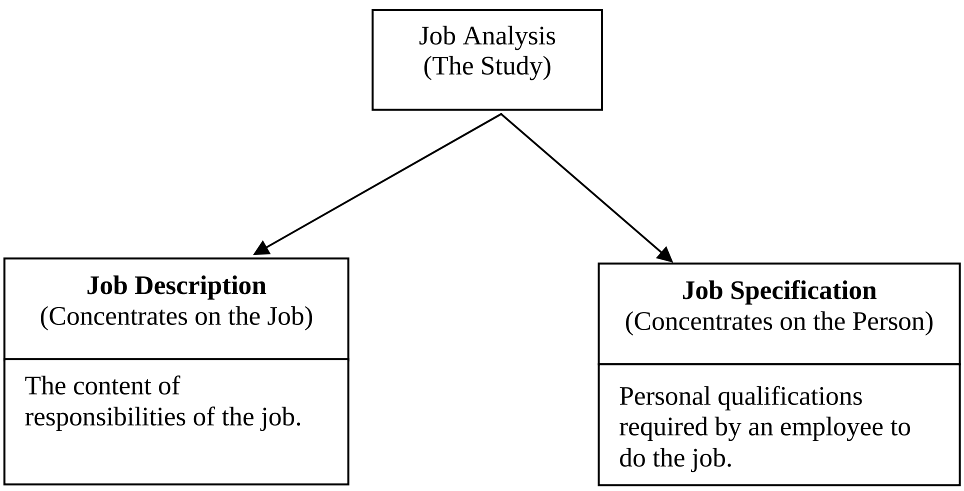
*Performance Appraisal:* Job analysis helps the supervisor and the employee to have a shared understanding about the nature of the job. Thus, the process becomes more transparent and supervisors can therefore appraise the employees more accurately.

*Training:* A job analysis provides a clear description of the activities and skills required for performing a particular job. The store manager can identify the training needs and develop objectives, standards and curricula for individual and group training.

*Understand the Career Ladders:* Job analysis provides the store personnel with a detailed description of the job and its relation to other jobs. This helps the store personnel to undertake the required training which will help them to climb up the career ladder.

*Source: Icfai Center For Management Research*

**Figure 13.1: Relationship among Job Analysis, Job Description and Job Specification**




## Job Specification

A job specification is an official document, which describes the duties, skills and abilities, minimum qualification and knowledge required to perform a job. Thus, a job specification gives the actual requirements of the job, along with the expectation and standard of performance.

**Exhibit 13.3**

**Job Description**

| **Company Name:** | **Kmart** |
|---|---|
| Location: | #7676 Sydney , NY |
| Position: | Loss Prevention Associate |
| Job Category: | Store Level |
| Salary Range: | Not Specified |
| Reference Code: | 5779 |

### Job description

Assists the Loss Prevention Manager in detecting, reporting, and resolving all issues related to loss prevention and inventory shortage. Directly involved in training store associates on all shrink reduction and inventory preparation programs

*Essential Functions*:

1. Detect and respond to external theft incidents and report internal theft incidents to the Store Loss Prevention Manager, taking action only as instructed by the Loss Prevention Manager
2. Monitor areas of visible shrinkage and assist in and/or correct deficiencies found as directed by the Loss Prevention Manager in order to reduce shrinkage.
3. Assist in training store associates in the area of loss prevention, including shrinkage control procedures. Communicate with store associates regarding loss prevention issues in order to assist associates in their understanding of loss prevention.
4. Assist in managing the inventories and completing required audits as directed by the Loss Prevention Manager, in order to control expenses.
5. Assist in reporting and following up customer accidents in order to resolve and reduce the number of accidents.

*Knowledge, Skills, and Abilities Required:*

1. Basic reading, writing, oral and arithmetic skills
2. Six to twelve months retail, Loss Prevention experience or equivalent
3. Ability to make appropriate decisions in stressful situations
4. Ability to understand and follow oral and written instructions.

*Source: www.lpjobs.com*

## Recruitment

Recruitment is the process whereby an organization induces suitable people to apply for employment vacancies by making them aware that such vacancies exist. The primary purpose of recruitment is to develop a pool of qualified applicants that is large enough to enable the organization to make selective hiring decisions. Some of the steps in the recruitment process have been discussed below;

### Identifying prospective employees

Identifying the right employee becomes a problem for any retail organization due to the demographic changes that reduce the size of the labor pool. The prospective employees for any job are the people who respond to the advertisement. They could be employees of a competitor store, friends of the employees, referrals from employment agencies etc.

Based on the requirement of the retail store, the store manager can choose the employees. For example, some stores prefer to hire elderly applicants as they believe that they possess a higher work ethic when compared to younger applicants.

### Screening applicants

The applicants are screened on the basis of job description and job specification. Based on the minimum requirements of the retail store, the initial screening of employees is done by the store personnel themselves. The minimum requirements include educational qualification, oral and written communication skills, experience of the applicant etc. Apart from the above mentioned criteria, retailers also consider certain physiological, psychological and motivational attributes of an applicant.

## Selection

Once a retailer gets a list of eligible employees, he should select the candidate who matches the job requirements best. Retailers should gather additional information like personal attributes, skills, past performance regarding the applicant to verify his fit to a particular job. For an error free selection procedure, the store managers use various selection methods like:

- Application forms
- Reference checks
- Personal interviews
- Testing instruments
- Physical examinations
- Final selection

## Exhibit 13. 4
## Application Blank

Name: ____________________________________________________________________________
(Last/First/Middle)

Address: __________________________________________________________________________
(Street No./City/State/Zip)

Telephone: _________________________ Email Address: ____________________________________

Are you 18 years of age or older? ____ Yes _____ No

If hired, can you provide written evidence that you are authorized to work in India _____ Yes ____ No

**EDUCATION**

| Type | Name/Location | Course of Study | # Years Completed | Degree/Diploma |
|---|---|---|---|---|
| Elementary & Jr. High | | | | |
| High School | | | | |
| College | | | | |
| Technical or Other | | | | |

**EMPLOYMENT RECORD**

| Company Name and Address | Kind of Work | Date: Started/Left | Rate of Pay | Reason for Leaving |
|---|---|---|---|---|
| 1. | | | | |
| 2. | | | | |
| 3. | | | | |

**<u>REFERENCES (Do Not Include Relatives)</u>**

Name/Occupation/Years/Known Address

1. ________________ 2. ____________________ 3. ______________________

**EMPLOYMENT**

Type of Work Desired _________________________________________ Salary Desired ___________

How Were You Referred To Our Organization? _____________________________________________

Do You Have Any Relatives Who Are Employed By This Organization? ____ Yes ____ No

**<u>APPLICANT'S STATEMENT</u>**

I understand that the employer follows an "employment at will" policy, in that I or the employer may terminate my employment at any time, or for any reason consistent with applicable state or federal law; this "employment at will" policy cannot be changed verbally or in writing, unless the change is specifically authorized in writing by the chief operating officer of this organization. I understand that this application is not a contract of employment. I understand that federal law prohibits the employment of unauthorized aliens; all persons hired must submit satisfactory proof of employment authorization and identity; failure to submit such proof will result in denial of employment.

I understand this application will be active for a period of one year; after that time, if I wish to be considered for employment, I must submit a new application.

I understand that the employer will thoroughly investigate my work and personal history and verify all data given on this application, on related papers, and in interviews. I authorize all individuals, schools, and firms named therein, except my current employer if so noted, to provide any information requested about me, and I release them from all liability for damage in providing this information.

I certify that all the statements herein are true and understand that any falsification or willful omission shall be sufficient cause for dismissal or refusal of employment.

Your Signature: ______________________________________ Date: _______________________

### Application forms

Application forms/blanks enable the employer to know about the applicants' history relating to his education, work experience, reasons for leaving the previous job(s), hobbies etc. Normally, an application form includes the personal data of the applicant along with his employment history and experience, educational qualification, his personal tastes and preferences.

The applicant is tested at the interview on the basis of the data collected through the application form. Apart from this, the past experience of the applicant plays a crucial role in revealing the nature of the applicant, whether he is a frequent job changer or not. Exhibit 13.4 depicts an application blank used to collect data from the applicants.

### Reference check

After the initial screening of the prospective employee applications is complete, unqualified applicants are eliminated. The next step in the selection process is to verify the applicant’s information with the references he has provided. This helps the retail store manager to understand the nature of the prospective employee better. The reference check can be made through a telephone or through mail.

### Personal interview

The next step of the selection process is the personal interview. Conducting a personal interview helps the retail store manager to check the knowledge and skills of the applicant by questioning and observing him personally.

Personal interview is also known as an in-depth interview, one-on-one interview or executive interview. As the interview is one-to-one, the applicant is not influenced by the reactions of others. Personal interview can either be formal and structured or informal and unstructured. In a structured and formal interview, both the applicant and the interviewer formally stick to their assumed roles (of interview) and the communication is highly structured. In an unstructured and informal interview, there is no set pattern that is followed and communication is very informal. The applicant is relaxed and therefore talks more freely to the interviewer.

The number of interview rounds is based on the position for which the applicant is being interviewed. For example, if the retail organization is conducting an interview for salesmen (functional level), the number of rounds of interview will be less i.e., one or two rounds. And if the interview is for the top-level managers, there will be more rounds of interviews. These interviews are conducted to analyze the applicants’ knowledge in various store functions like planning, merchandising, pricing, selling, etc.

Personal interviews play a crucial role in hiring the right candidate as they help the retail store manager to assess the applicant’s attitude, personality, motives and interest in the job he is applying for.

Technological developments have simplified the recruitment and selection process. For instance, initial screening through computers makes the job of the retail manager much easier, and at the same time, reduces the embarrassment of the interviewee. Exhibit 13.5 explains how Nike, the world’s leading athletic shoe manufacturer and marketer, uses information technology to make the recruitment and selection easier.

**Exhibit 13.5**

**Technological development**

Technological development has changed the selection and recruitment procedure of many retail organizations. Automated hiring technology has helped reduced the hiring time of retail organizations about 90%, and anticipate the skills required before they are articulated and call up information about a potential hire on their computer screens. For example Interactive Voice Response (IVR) technology enables the organization to capture all information regarding the potential store personnel, thereby making the recruitment process move fast and flexible.

By using computers for interviewing store personnel Nike has reduced employee turnover by 21% in two years. For the appointment of 250 store personnel's in Las Vegas, around 6,000 applications were received. Nike used IVR technology for screening the candidates in the first round. Among the 6,000 applicants, around 3,500 applicants were rejected in the first round itself as they are not available when needed or didn't have retail experience. The remaining applicants had a computer-assisted interview followed by the personal interview. The computer interview identified those candidates who had been in customer service environments, had a passion for sports and would make good Nike customer service representatives. Interviews were conducted in batches. The computer interview (which includes a video showing three scenarios for helping a customer and asks the applicant to choose the best one) was given every 45 minutes to a group of applicants. As applicants completed the interview a printer in the next room printed their responses. Areas that needed to be probed further were flagged, along with the areas that indicated their particular strengths. While the applicant completed an application form online, the interviewer used the printout to prepare for the applicant's personnel interview.

The computer not only helped interviewers screen for people who lost their temper in work situations or who demonstrated other undesirable behaviors, but it also helped the interviewers to determine what to ask in order to reconcile inconsistencies in the computer interview or to probe an applicant's strengths in desired areas. As Nike uses behavioral-based interviewing, applicants must document their areas of strength with examples from their work. Some applicants were offered jobs on the spot. Others were called back for second interviews.

*Source: www.shrm.org*

### Testing instruments

While hiring an employee, a retailer uses various tests. Tests try to forecast the future performance of the applicant by measuring his intellectual capabilities and his past experience in handling the job. Most of these tests require the prospective employee to provide his responses in a written form and demonstrates his abilities for performing a particular job. These tests are of two kinds- psychological tests and achievement tests.

*Psychological tests*

Psychological tests help the retail store manager analyze whether the applicant's psychological state suits the job or not. This allows the manager to judge the prospective employee's personality, aptitude, interests, and supervisory skills.

*Achievement tests*

These tests are developed to judge the applicant's job related skills like computing skills, typing skills, analytical skills, book keeping skills and other skills required to perform the job he applied for.

Often, retailers prefer achievement tests as it is easy to conduct and it is also easier to judge the applicants on the basis of the results of these tests. Moreover, the past experience of many retailers may suggest that the applicants who score well in achievement tests are more likely to be successful on the job. However, some retailers are also apprehensive about the effectiveness of these tests in judging the future performance of the applicant.

### Physical examination

When an applicant fits the job requirement, some organizations request him to undergo a physical examination. Normally, a physical examination is mandatory for individuals who aspire to take up a job in food and drug stores. Now a days, some organizations ask the applicants to undergo a physical examination to check their fitness, as many retailers now provide health and disability insurance.

### Final selection

Final selection of the applicant is vital in retail store management. Along with subjective and objective evaluation, the retail manager should also use his intuition while selecting the retail personnel.

## Socializing and Training new Store Employees

When a retailer hires a new employee, he would expect him to contribute to the success of the organization. At the same time, the new employee would be eager to learn about the organization and his job responsibilities. To serve the mutual interests of the firm and the employee, retail organizations use the socialization process. *Socialization* is a process that focuses on molding the new employee into a productive and committed individual. Retailers design various orientation programs for familiarizing the new employees with other employees, superiors, the work culture etc.

*Orientation programs*

A new employee in a retail store usually faces difficulty in adjusting to the new work environment. This can be avoided to a great extent by conducting orientation programs. The duration of orientation program may vary from one store to another. It can last for a few hours or a few days.

In the employee orientation program, employees are provided with an Employee Handbook, which gives a detailed explanation about the functioning of the retail store along with its reporting relationships and structure, the number of employees working presently and the rules and regulations followed in the retail store. In some retail organizations, a trainer conducts the orientation program. Thus, the orientation program familiarizes the new employee with the rules and regulations and various other operational aspects of the retail store.

However, as employees come from different backgrounds and have varied experience, the management should ensure that all information about the retail store, goods and services provided through the store, and the operations of the store is provided to them.

*Functional training*

Retail stores arrange functional training for their employees to sharpen their basic skills and knowledge and perform their tasks successfully. The functional training program includes sessions on selling techniques, customer service procedures and inventory control. This type of training increases the employee’s knowledge about the product lines in a retail store. This helps him serve the customers better.

## Training

Training programs are conducted by retailers to teach the new employees to perform their jobs efficiently. Training in retailing takes many different forms like class-room presentations, videos, interaction with manufacturer’s representatives, one-on-one encounters, role playing, staff meetings, outside seminars and reading material.

The main aim of training is to sharpen the basic skills possessed by the employees and increase the productivity and the efficiency of the store. Training programs also concentrate on improving teamwork, leadership qualities, motivation levels and customer service orientation. Training also helps develop confidence within the store personnel and encourages them to challenge the status quo, to question complacency, and to develop improved methods of operation.

Training should be a continuous process. Training in a retail store is generally conducted when new people are appointed, and when new procedures or instruments are introduced. The trainer has to use his intellectual, technical as well as conceptual skills to excel in training. Exhibit 13.6 explains how McDonald's provides training for its store personnel.

**Exhibit 13.6**

**McDonald's Training Program**

McDonalds has an extensive employee training program - both on-the-job in the restaurants as well as at the Hamburger University training facility in the US and Singapore. It gives training to its employees at all levels. The entry level employees are given the basic training through its Crew training system. At every stage of progress from the crew level, McDonald's provides intensive training to its employees in order to sharpen their skills.

Training starts as soon as a person is employed in McDonald's. Each McDonald's centre is provided with a video player and a training room. Training on the entire operation is provided in a step-by-step manner. The Crew trainers take each and every new employee through the workstations, and explain the various operations till he/she masters the skills required. The trainer uses a series of station observation checklists to follow the level of competency and the activities of trainees. Each crew person is expected to follow a 3/30 plan, that is in the first 30 days, a crew person learns 3 stations, and so on until all the stations are mastered.

Once the crew trainee is promoted to swing manager, he has to undergo the Management Development Program to equip him with technical and functional management skills. All fundamental restaurant operations are covered under the Basic Operation Course and the Basic Management Course that cover topics such as leadership, time planning, and crew recognition. The Intermediate Operation Course provides training on crew recruitment and retention, store leadership and decision-making.

When a front line crewmember becomes the assistant manager, he or she becomes eligible for attending the Hamburger University, the company's worldwide training center for management personnel. Here he/she is trained in Advanced Operation Courses, which cover business management topics such as Equipment, Operations, and Accounting, while the majority of time is devoted to teaching interpersonal and communication skills. Other than this, McDonalds provides various courses like Area Supervisor's Development Program, Field Consultant's Class, Operations Manager Class, Training Consultant's Class, and Presentation Skills.

*Source: www.mcdonalds.com*

Training can be of two types:

- Off the job training
- On the job training.

### Off the job training

Off the job training is conducted in centralized training classrooms away from the employees' work environment. This type of training program is also known as a structured training program. It can be in the form of lectures, audio- visual presentations, slides and charts, written materials and group exercises. The duration of such training programs is comparatively lesser than other training programs. Video presentations communicate a consistent message to all employees of the firms' support for training, and enhance the quality of training programs.

## On the job training

On-the-job training allows the new employee to learn through observation and imitation, along with a regular feedback from the store supervisior about his performance. Under the supervision of a retail store manager, new employees are assigned their work. Each activity of the employee is monitored by the supervisior. When an employee commits an error, the supervisor tries to correct him by explaining how to overcome the difficulty he experiences. This helps the new employee to sharpen his basic skills required for performing his job in the store through trial and error. The supervisor spends time with the new employee explaining the improvements required. This also boosts the self confidence of the employee.

Failures are common for new employees. It is the responsibility of the store manager to allow the new employees to learn from their mistakes and create an atmosphere where they can try new approaches for providing better customer service.

It is the responsibility of the store manager or the supervisor to spend time with the new employees and explain to them the reasons for the failure of a particular approach and motivate them to adopt a new approach.

## How to train

Employee training increases employee satisfaction, facilitates the updating of skills, leads to increased sense of belonging, increases employee commitment to the organization and strengthens the organization's competitive position. Training can be provided by using any of the following methods:

- Individual training method
- Sponsor training method
- Group training method
- Executive training method

*Individual training method*

Under this training method, an individual trains himself ("on your own" approach) to meet the needs of the retail organization. Here, the employee is directly put on the job without any formal training. The employee learns through observation, trial and error method.

Although such training involves no initial cost for the retailer, the retailer's total cost increases in the long run on account of low employee productivity, increase in the number errors committed by the employees and reduced customer satisfaction.

To eliminate the shortcomings of individual training, retailers use an alternative method called 'programmed learning'. In this kind of training, the new employee is provided with study material describing how a particular task should be performed. Within a given period of time, the employee has to respond to a given set of questions. Immediate feedback is given to the employee as a response to his/her questions. These procedures continue till the employee develops a satisfactory level of understanding about the ways of performing a particular task. When the employee performs satisfactorily he is given more material to upgrade his skills further. Thus training becomes a continuous process.

*Sponsor method of training*

Under the sponsorship method, an experienced employee (sponsor) takes the responsibility of training the new store employee. Here, the sponsor is entrusted the duty of introducing the new employee to his colleagues and getting him acquainted with the various activities of the store like buying, selling, promotion etc. Apart from this, the sponsor is responsible for evaluating the trainees' performance and addressing his problems on a regular basis. This type of training program would be successful when experienced employees volunteer to take up the role of a sponsor and such acts are rewarded by the organization.

*Group training method*

Under the group training method, a group of new store personnel are trained together through lecturers, demonstrations, case studies, role playing activities, computer simulation and interactive videos. Specialized personnel conduct these training classes. This training method is used by large retail organizations with multiple stores. The per employee cost of training is minimal as this method achieves the objective of training a large group within a specific time. The duration of these training sessions may vary depending on its training objectives. For example, a brush up course for updating the knowledge of the present employees on a new policy may end within an hour, whereas group training for a batch of new recruits may run for a week.

Once an employee's training is over, he has to work under the supervisor/manager to achieve the desired goal of the organization. The supervisor/manager directs, co-ordinates and inspects the efforts of the store employee and helps him achieve his individual as well as the store objectives. An effective manager should be able to satisfy the retailer's requirements (performance, loyalty and profit) as well as the employees' needs.

## Motivating

Motivation is more important in the retail industry than in any other industry and plays a significant role in increasing the productivity of the store personnel. This is because the very nature of work in retail stores is physically demanding. For example, in a textile store, the store personnel need to keep standing for a long time. They have to do their routine work like re-stocking racks, replacing and re-arranging clothes and other merchandise tried on by customers. These activities can drain out the store personnel quickly. The store manager can play an important role by boosting the employee morale and explaining the positive aspects of their job. Thus, in a retail store, motivation of employees includes cultivating leadership qualities in the store personnel, setting targets and maintaining their morale.

Motivation techniques can vary from one retail organization to another (Refer Exhibit 13.7 for the motivation strategies used by some Indian retailers). Some motivational factors can be a good working environment, performance based rewards, use of suggestion boxes etc.

Under certain situations like job cuts, layoffs, downsizing and restructuring, the morale of the store personnel falls. An effective store manager should understand that his responsibility is not only limited to decision-making but that he is also responsible for motivating the human capital for the long-term growth of the retail organization.

The retail store manager can maintain the store morale by taking a few things under consideration:

- Before opening a new branch or introducing new merchandise, the store manager can call for a meeting, and provide all information about the new branch, merchandise and promotional programs. He should also ask employees to give their opinions and suggestions.
- Educate the store personnel about the store's goals and financial matters. The store manager can also give incentives when they meet set targets.
- Share the total amount that the retailer wishes to spend on charity equally among all the employees and then taking individual suggestions on how to spend their portion of that fund.
- Print the company's goal at the other side of the visiting cards that the company provides to its employees.

**Exhibit 13.7**

**Motivation- Indian Retail Industry**

Retail stores employ different strategies to keep their store personnel motivated. These strategies differ from one store to another. Let us analyze the motivational tools used by three retail stores in India – Shopper's Stop, Globus and Crossroads.

Shopper's Stop: Shoppers Stop does not consider salary as the only motivating factor. This retail store believes that the work environment plays a major role in motivating the employees of an organization. It believes that a challenging environment would motivate the employees and give them a sense of responsibility and achievement. Hence, the store personnel are provided challenges like sales targets, improving the sales performance etc. Customer satisfaction is the main objective of Shopper's Stop and it remains as a major challenge to the store personnel. Shopper's Stop provides a hygienic atmosphere for its customers as well as its store personnel. Shoppers Stop thus tries to motivate its employees by caring for their well being.

Globus: Globus tries to motivate its employees by providing them an opportunity to actively participate in the day-to-day activities of the store. The store has a scheme to solicit suggestions from its store personnel, where the best suggestion is rewarded. The problems with the working environment are discussed with the store personnel and solved regularly by the store manager or the management. Other factors for motivating the employees include a monthly motivating scheme, the best sales associate scheme, the best cashier scheme, and the best team scheme. Here various departments work as a team and the overall performance of the store personnel is appraised.

Globus follows a unique appraisal format. It selects four members from the store personnel. These personnel then appraise their co-workers and decide the best team, employee etc. Here the focus is only on bringing out the best and creating a congenial atmosphere in the store.

Crossroads: Crossroads believes in unity and teamwork. Crossroads provides 20 to 30 percent higher salaries to its store personnel as compared to other retail stores. Other than the salaries, Crossroads motivates its employees by providing them discounts for families, canteen and lunch facilities and free lockers. Every morning employees gather together and sing the Crossroads song. This helps create a feeling of unity among the employees in the store.

*Adapted from The ET Knowledge Series – Retail 2000-01*

## Evaluating Store Employees

Performance evaluation is the systematic assessment of how well employees are performing their jobs in relation to established standards and communicating the same to the employees.

Retail firms evaluate the performance of their employees at every level of the organization in order to determine their compensation, suitability for promotion or continuation in the organization. If carried out properly, evaluation can fetch the retailer valuable information on the basis of which he can motivate the employees by designing appropriate compensation and employee development programs. The success of an evaluation program depends on the evaluator, frequency of evaluation, the performance variable selected for evaluation and the methods used for evaluation.

### Who should evaluate

Evaluation of employees is generally coordinated by the human resource department of a retail store. For accurate evaluation, the employee should be evaluated by his immediate superior or the manager who oversees his activities. For example, a salesperson can be better evaluated by his department head or manager as they observe him on a daily basis.

### Frequency of evaluation

Evaluation of the retail personnel is done annually or semi-annually. A periodic evaluation will be advantageous for both the employees and the retail store. From the employee's point, periodic and constructive feedback allows the employee to improve his performance and meet the retail organization's goals and objectives. On the other hand, it allows the organization to provide training and development, compensation and promotions for its employees.

### Evaluation criteria

The accuracy of evaluation depends on the factors selected for evaluation and how well they are communicated to the employees. Generally, retailers use various performance characteristics and personal attributes as a basis for evaluation. Performance characteristics include job knowledge, work quality, speed of work, ability to perform under pressure, degree of supervision required, relationship with colleagues, customer relationship etc. Personal attributes include leadership qualities, enthusiasm to do work, dependability, willingness to take initiative, creativity, integrity, etc.

### Evaluation method

The method selected for evaluating the employees depends on the degree of objectivity and formality desired by the retailer. Most of these evaluation methods are based on quantifiable performance criteria or the subjective judgment of the evaluator. Evaluation can be done in four ways:

- Formal objective evaluation
- Formal subjective evaluation
- Informal objective evaluation
- Informal subjective evaluation

A *formal objective employee evaluation* can be done by evaluating the performance record or by using a method called management by objectives. The performance record gives a quantitative measure of an employees' performance. The performance record includes performance related figures like:

i. Total sales in rupees
ii. Total number of sales transactions
iii. Number of customer complaints
iv. Number of merchandise returns and their value
v. Number of times the employee is absent or late for the work
vi. Net sales per working hour or per hourly wage.

The employee is rated after comparing his performance with a pre-determined set of store averages. In this evaluation process, performance objectives are set based on each employee's job description. His performance is then measured to check how successful he had been in achieving the pre-set objectives. When a retail store uses the management by objectives method for job evaluation, employees are requested to prepare a set of objectives for a given time, the methods to accomplish them, the time required to accomplish them, and the measures for evaluation.

*Formal subjective evaluation* methods are based on rating scales and checklists. Here the evaluator has to prepare a list of criteria on which an employee has to be evaluated and then give weightage to each of the criteria. As more subjective factors are included in this evaluation method, retailers prefer to have the evaluation done by different supervisors. After taking the rating of the employee from different supervisors, the retailer can take the average score of the employee to evaluate his performance.

In *informal objective employee evaluation*, retailers hire the services of professional evaluators, who pose as shoppers and evaluate the performance of the store personnel. Since this method fails to give a holistic picture of an employee's performance, a retailer should use the results of this method to complement other evaluation methods.

*Informal subjective evaluation* has no structure and is completely based on the supervisor's intuition. Most employees complain against this evaluation method as it has ambiguous criteria and is prone to be affected by the prejudices of the evaluator (supervisor).

### Evaluation Errors

It is very common to commit mistakes while evaluating store personnel. This can be due to various factors like:

- Inadequately defined standards of performance
- Overemphasis on recent performance
- Reliance on gut feeling
- Miscomprehension of performance standards by employee
- Insufficient or unclear performance documentation
- Inadequate time allotment for discussion
- Too much talking by manager/supervisor
- Lack of a follow-up plan

The evaluator should neither be too strict nor too lenient while evaluating store personnel. If the evaluator is too strict, he may evaluate the performance of the employee as lower than it actually is. On the other hand, if the evaluator is too lenient, he may evaluate the performance of the employee as better than it actually is. Errors can also occur if the evaluator's opinion about the employee is biased. Sometimes, the evaluator takes into consideration the recent performance of the employee. If an employee has performed poorly during appraisal time, the evaluator considers only his recent performance and rates the employee poorly. In order to evaluate an employee correctly, the evaluator should also consider the environment in which the employee is performing the particular task.

## Compensating

Retailers use compensation as a tool to reward a store personnel's contribution to the organization and to motivate him to perform better in future. Compensation can be defined as the total value of returns given to employees in exchange for their membership in the organization and for performing the tasks, duties and responsibilities associated with their jobs.

Compensation is an important factor in attracting talented employees to a retail store. The quality of the employees attracted towards a retail organization depends on the compensation and rewards offered. Compensation does not reflect what they are paid but it reflects how much they are valued in a particular retail organization.

In a retail organization, rewards are given on the basis of the evaluation done by the store manager. Rewards can be classified as extrinsic rewards and intrinsic rewards.

*Extrinsic rewards* include compensation, promotion and recognition. To motivate the store personnel, store managers can use any of the above rewards. Though extrinsic rewards motivate the store personnel, the level of motivation they provide varies from one store employee to another. Therefore, the store manager should identify the motivating factor for each store employee and try to provide him the particular extrinsic reward that will motivate him the most. Recognition and appreciation work as positive extrinsic rewards for motivating a store employee. Publicized recognition (in store magazines, notice boards, etc.) can also motivate employees.

*Intrinsic rewards* refer to offering jobs which individuals find interesting to perform. These rewards are inbuilt into the job and come from carrying out an activity rather than being a result of an activity. For example, the intrinsic reward for a salesperson may be the sense of accomplishment and achievement he experiences while selling the merchandise.

## Compensation program

Retail managers sometimes find it difficult to motivate their experienced employees with monetary rewards. These employees reach a saturation point, where the monetary benefits or the prospects for promotion do not appeal to them. Managers should find ways of enriching their jobs and entrusting some additional responsibilities like handling a merchandise category; designing a training program etc., for such employees.

In a retail organization, a salesperson’s compensation can consist of a straight salary plan, a straight commission plan, a salary plus commission plan, or a salary plus bonus plan, and fringe benefits.

### Straight salary plan

Under this compensation program, store personnel are paid a specified salary for a given period of time without any incentives. This compensation program was common among small retailers where they also used salespeople for non-selling activities like stock arranging, merchandise display etc. Since the salary is fixed there would be less resistance from the employee to move from a sales job to a back-end job.

One of the major disadvantages of a straight salary plan is that employees lack incentives to increase the productivity of the store. As the employees receive the same salary, there will be no incentive to work hard. As the salary is fixed, the store has to bear the fixed cost whether sales are generated or not.

### Straight commission plan

Under the straight commission plan, employees are compensated on the basis of their productivity. They are paid a commission, which is generally a portion of the sales they generate. They are not paid a fixed amount as salaries. Thus, their earnings depend on how much they sell. For example, Amway (a US based multilevel marketing company) employees receive compensation on the basis of the volume of products and services they sell.

Though a straight commission plan generates sales, it has some disadvantages:

- A retailer generally needs to involve salespersons in non-selling activities. But under a straight commission plan, the salesperson will be reluctant to undertake non-selling activities, as they do not generate any additional income for him.
- Under the straight commission plan, commissions vary depending on the merchandise. The salesperson will be interested only in selling expensive and fast moving merchandise, as the commission in this case is high. There is a tendency to neglect other merchandise offered by the store.
- A salesperson, who is compensated under a straight commission plan, may ignore customer service as he will be more interested in generating sales and earning more commission.
- This type of compensation plan ignores the employee-customer relationship. Rather than trying to build up customer loyalty, the employee tries to increase sales.

### Salary plus commission plan

In this compensation plan, employees earn a monthly fixed salary and a commission in the basis of the sales they generate. Here, the retailer offers lower salaries as compared to straight salary plan. But the commission structure allows the salesperson to earn more than the salary of an employee in the straight salary plan. Under the salary plus commission plan, the salespersons are encouraged to undertake non-selling tasks and concentrate on sales as well, because they get a fixed income in the form of salary as well as incentives or bonus for generating the sales.

### Salary plus bonus plan

In the salary plus bonus plan, the store personnel receive a monthly salary, along with a bonus (semiannually or annually) on the basis of their performance. Retailers use this method to compensate the middle and top level store managers. The bonus amount depends on measures such as the annual sale of the store, decrease in the total operating cost of the store, return on equity, or the return on investment in the store.

### Fringe benefits

Fringe benefits include all benefits offered to the employees other than salaries, bonuses, and commissions for the services rendered to the retail organization. For example, a retail store manager can get fringe benefits like paid vacations, paid medical insurance and sick leave. Some retail stores give merchandise discount (varying from 20% to 40%) for its employees. Retirement and health packages offered by the retail store also form a part of the fringe benefits.

## LEGAL AND ETHICAL ISSUES IN MANAGING STORE PERSONNEL

The store manager of a retail organization must abide by the country, state and local laws of the place where the organization functions. The major areas covered under these laws are concerned with hiring of employees in the organization, selection, compensation, their promotion, health, and safety.

### Hiring

In the US, Title VII of the Civil Rights Act prohibits the discrimination of employees on the basis of race, national origin, gender, or religion. Discrimination was prohibited in areas like recruitment, hiring, discharges, layoffs, discipline, promotion, compensation and access to training. Equal Employment Opportunity Commission (EEOC) was setup to monitor the employer’s compliance to the Civil Rights Act. If any employer violates this law, he can be sued. The Age Discrimination and Employment Act make it illegal to discriminate against individuals while hiring and terminating in the age group of 40 to 70. The Americans with Disabilities Act (ADA) allows employment opportunities for the disabled and requires employees to provide an accommodating work environment for the disabled.

### Selection

Using lie detector tests and HIV confirmation tests while hiring is considered illegal in the US. But, testing prospective employees for drug abuse is permitted because hiring a drug addict may result in increased medical bills and productivity loss to the retailer.

### Compensation

In the United States, the Fair Labor Standards Act of 1938, set minimum wages, maximum working hours, child labor standards and overtime pay provisions. This prevents the employers from hiring laborers for low-wages and using child labor in their organization.

### Labor relations

In the United States, the National Labor Relations Act legalized labor organizations, and prohibited employers from engaging in unfair labor practices. A National Labor Relations Board (NLRB) was also established. It was responsible for conducting union elections and resolving cases related to unfair practices.

# COST CONTROL

Technological development and globalization have played a major role in changing the retail strategies of an organization. Globalization and technological progress increased competition among retail organizations. Moreover, the new store formats like hypermarkets and discount stores are adopting novel pricing strategies. To survive and retain customers in this competitive environment, the retailer has to reduce the prices either by reducing his profit margin or by reducing the operating cost.

Globalization has made it possible to produce a product at one place, using resources from another place, and sell it elsewhere. At the same time, customers have become selective and more knowledgeable, thus becoming more demanding. So retail organizations should sell products of superior quality and provide services of world standard. They should also try to create unique store brands and capture new markets through increased employee productivity and proper technology utilization.

In a retail organization the major operating costs emerge from labor, store maintenance and energy management.

## Labor Scheduling

Labor cost constitutes a major part of the operating expenses of a retail organization. The success of retailers also depends on how efficiently they use their services to generate sales. Labor scheduling is the process of determining the optimal number of employees to be assigned to each area of the store at a particular time, in order to serve the customers effectively. Labor scheduling becomes difficult in a retail store as the retailer requires to schedule labor over extended business hours (usually 12 hours, which means more than one shift). Irregular customer traffic flow at different hours of the day and different days of the year make the retail store manager's job more difficult. As the customer traffic in a retail store varies and cannot be predicted, scheduling of labor should be done in such a way that the employees are available 12 hours a day, 7 days a week and 365 days of the year.

As the traffic flow of a retail store depends mainly on the attitude and behavior of the store personnel, it is important for the store to manage them effectively and efficiently.

The major operating cost of retail stores is in the form of salaries paid to store personnel. If the store manager wants to reduce the operating cost of the store, he has to schedule labor in such a way that customer service is not affected at any point of time. Scheduling can be made easier with the application of computer software which can reduce the operating cost of scheduling by 2 to 5 percent.

## Store Maintenance

Store maintenance includes the activities of managing the exterior and interior physical facilities associated with the stores. The exterior physical facilities include the parking place, the entrance of the stores and the signs outside the stores. The interior facilities include the walls, floorings, ceiling and displays and signs.

A well-maintained retail store attracts more traffic and generates more revenue. Maintaining the store is quite expensive and therefore, it should be done properly and regularly. If the store is not maintained properly, it shortens the lifespan of fixtures, floors and air conditioners.

## Energy Management

Energy is a major operating expense for the retail organization. More and more retailers are relying on technology to reduce the cost of energy. Energy management is crucial for food retail stores, which use high power consuming storage equipment.

## Reducing Inventory Shrinkage

Shrinkage is the term used for the reduction in the physical count of the inventory as compared to its accounted value. Shrinkage has become a serious problem for many retailers the world over. It even threatens the very existence of some retailers as these losses eat into their already dwindling profit margins. Inventory shrinkage may be a result of various factors like:

- Employee theft
- Shoplifting
- Mistakes and inaccurate records
- Vendor errors.

Exhibit 13.8 gives the magnitude of losses incurred by retailers all over the world, on account of inventory shrinkage.

Employee theft accounts for approximately 43 percent of the losses due to inventory shrinkage in a retail store. Generally, employees resort to theft as they feel that they are underpaid or they deserve a part of the retailer’s profits. The items that are prone to employee theft include cash at the POS, merchandise and supplies like paper etc. Shoplifting by customers accounts for 34 percent of the inventory shrinkage losses. Apart from theft by employees and customers, losses due to administrative errors and vendor fraud account for 23 percent of shrinkages. Examples of this type of shrinkage are unrecorded markdowns, transfers, allowances, damaged goods, mis-recording sales and/or receipt invoices and similar inaccuracies in book-keeping. Administrative errors may include unrecorded inventory, price fluctuations and other book-keeping errors.

### Calculating shrinkage

Shrinkage is the difference between the recorded value of inventory based on the merchandise bought and received, and the value of the actual inventory in stores and distribution centers divided by retail sales during a particular period. Retailers usually use retail prices while calculating the value of shrinkage.

To maintain the retail method of accounting system for calculating shrinkage, one should carefully record all retail inventory transactions: purchases, sales, price changes, transfers (among stores), returns to vendors, and employee discounts to calculate book value (at retail) of the inventory. The calculation of book inventory value would be as follows:

Book Inventory (at retail) = Total Merchandise - Net Sales - Markdowns (retail) - Employee Discounts - Returns to Vendors (retail) - Transfers Out (retail) Where, Total Merchandise = Opening Inventory (at retail) + Purchase (at retail) + Markup Additions + Sales Returns (from customers) + Transfers in

**Exhibit 13.8**

**Retail Inventory Shrinkage**

Inventory shrinkage is one of the fastest growing expenses in the retailing today — and no retailer is immune to it. The main cause of retail shrinkage is pilferage by employees and customers. The following were the results of research carried out in international markets on shrinkage of retail inventory:

***In US***

- In 1998, losses due to employee theft and shoplifting amounted to 1.72 percent (about $24.9 billion) of total sales.
- Inventory shrinkage varied from 0.5% to 6% of the gross margin (depending on the retail format). The average shrinkage was 1.75%.
- Items generally stolen were CDs, medicines sold over-the-counter, and health and beauty products.
- In many cases of shoplifting, there was collusion between employees and customers (in some retail segments).
- While most of shoplifters were adults, youngsters constituted 25% of the shoplifters.
- The average amount of theft in each shoplifting case was $60.74.
- The number of male shoplifters was more than female shoplifters.

***In Asia***

- Shrinkage varied from 1.5% to 5%. The average was 2.5%.
- The loss (in dollar terms) due to internal theft was 10 times more than loss due to external theft. Maximum employee theft occurred in sales/service areas, followed by the cash counter. On an average, there were 51 cases of employee theft in any store in a year.
- Employees caught stealing were dismissed by most retailers
- In terms of US dollar value, employee theft in a year varied from $49 to $173 per store.
- On average, each store reported 114 cases of shoplifting per year.
- Liquor was the most commonly stolen merchandise. It was followed by staple foods and health and beauty products. Other items commonly stolen were cigarettes, clothing, merchandise and other food items.

*Adapted from The ET Knowledge Series – Retail 2000-01*

Once the book inventory value is ready, the actual value of inventory is calculated by counting the physical inventory. The difference between the book value and the actual value of inventory counted will give the value of shrinkage. A retailer can get the shrinkage percentage (on sales) by dividing the shrinkage value by retail sales generated in the period.

For example, if the accounts show the book inventory value at Rs 1,00,000 and the actual count of inventory shows 92,000, and sales were 4,00,000, the shrinkage would be;

(1,00,000 – 92,000) ÷ 4,00,000 = 1/50 or 2 percent

## Detecting and Preventing Shop lifting

As mentioned earlier, inventory shrinkage in a retail organization can take place due to various reasons like error or fraud by the vendor, administrative error, loss in transit, and shoplifting by employees or customers. It can take place at any point of time and at any place i.e., on the shop floor, or out of the store at the warehouse or distribution center, or even in transit. Among all the reasons for inventory shrinkage in a retail organization, shoplifting is considered as the main form of inventory shrinkage. The loss due to shoplifting can be reduced by improved store design, employee training and special security measures.

### Store design

While designing a store, it is essential for retailers to give due consideration to security. The store should be designed in such a way that the exit doors and the trial rooms are visible to the shop floor employees. In addition, adequate care should be taken to ensure that no small-high value merchandise is allocated display space near the exit doors or the trial rooms. Some stores have incorporated security measures in the basic store design itself. For example, a retail store can have a multi-floored building design without pillars on any floor. Each floor may be an open space, with no structures in the middle and no dark spot in any of the corners. Such a design of the basic structure itself can reduce the operation cost of the store on security measures. The number of security personnel and closed circuit television (CCTV) used in such a store would be comparatively less.

For financial security purposes, retailers may specify the amount of money that employees can carry and provided separate lockers for the store employees. In some retail stores there are separate doors for entry and exit. Employees are not allowed to enter or exit through the main gates. A staff room is provided to the employees, where they have to keep their belongings before they enter into the shop floor.

### Employee training

If trained properly, employees can act as the retailers' best guards for preventing shoplifting. Retailers should therefore train their employees to identify shoplifters and situations that foster theft. It helps the employees to know the various kinds of shoplifters so that they can deal with them accordingly. Exhibit 13.9 gives the types of shoplifters.

### Security measures

Technological developments have helped prevent inventory shrinkage. Sophisticated and advanced equipment like Closed Circuit Televisions (CCTV), Electronic Artificial Surveillance (EAS), and Source Tagging have brought about drastic changes in the way security is maintained.

#### *Closed Circuit Television*

Closed Circuit Television (CCTV) is a television transmission system in which live or pre-recorded signals are sent over a closed loop to a finite and pre-determined group of receivers, through coaxial cables or as scrambled radio waves that are unscrambled at the point of reception. Retail stores often install CCTV cameras to safeguard against theft and robbery. Television screens are linked to cameras installed on the shop floor. The monitoring screen could be in a control room or at the cash counters. With the help of this, a single person can observe and manage the entire store.

CCTVs can also help the retailer monitor customer behavior, maintenance personnel, store cleanliness, vendor deliveries and the progress of renovations. They can also be used to check whether or not the SKUs are stocked, displays are set up, and customers are efficiently served at the checkout counters. In addition, CCTVs can be used to pass instructions to the shop floor employees for achieving better coordination.

**Exhibit 13.9**

**Types of Shoplifters**

In general, six types of shoplifters are found in retail stores: addictive shoplifters (50% of total shoplifters), professionals (15% of total shoplifters), impoverished (10% of total shoplifters), thrill-seekers (10% of total shoplifters), drug addicts (10% of total shoplifters) and kleptomaniacs (5% of total shoplifters). This classification is based on the characteristics of shoplifters and their behavior when caught.

***Addictive Shoplifters:*** These are compulsive shoplifters, who usually have other compulsive addictions like overeating, gambling or drug use. Addictive shoplifters have in them suppressed anger and typically do not care much about themselves. They steal inexpensive items and present them to others. They show guilt, shame, or remorse when caught, and may even break down and cry.

***Professionals:*** Such shoplifters steal numerous expensive items. They carry tools to help them steal these items. If confronted, professional shoplifters resist and try to flee. When caught, they stay cool and show no remorse.

***Impoverished:*** Impoverished shoplifters are economically deprived people. They steal necessities like food, toiletries and children's clothing. Though they show remorse when caught, they express their hostility towards society and its inequalities.

***Thrill Seekers:*** Such shoplifters steal for excitement or in response to a challenge. Thrill seekers are often teenagers who come in groups and steal on a dare.

***Drug Addicts:*** They steal to pay for the drugs they are addicted to. These shoplifters steal a number of high end items. They can be identified by their appearance and the drugs they carry. They are not as careful as addictive shoplifters while stealing. They flee the store if confronted.

***Kleptomaniacs:*** These shoplifters steal for no specific reason. They steal items on impulse. Generally, they do not need or cannot use the items they steal. They are careless and do not show much shame when caught. If caught, they admit that they are kleptomaniacs.

*Source: http://www.shopliftersanonymous.com/Differing.htm*

### *EAS Tagging*

Electronic Artificial Surveillance systems are designed to help retailers increase their sales and profits by reducing shoplifting and increasing open merchandising opportunities. It includes detection systems or STRATA lines at the checkout or exit of a store. The system works with small electronic tags or labels that are affixed on the merchandise. These tags or labels are either “turned-off” or removed at the billing counter. If merchandise is removed from the store with an active label or tag still attached, an alarm will sound, alerting the sales personnel.

EAS tag functions on three different technologies:

- Radio frequency identification
- Acoustic magnetic
- Electromagnetic

*Radio Frequency Identification (RFID)* refers to wireless electromagnetic energy that is transmitted in the form of waves that increase and decrease in amplitude or size. This technology is best suited for identification, tracking and control of valuable assets.

*Acoustic Magnetic*: These are magnetic waves used to detect any shoplifting. These are also called Tell Tags. A Tell Tag is an intelligent "talking" tag with an embedded computer chip that activates an audio alarm in the tag that is amplified by an acoustic tone detector in the store ceiling. The tag will beep until a salesperson removes it from the merchandise. If the merchandise is taken beyond the store perimeter, the tag will beep loudly, enabling store personnel to identify the shoplifters in a crowd.

*Electromagnetic tags* use electromagnetic waves for the same function.

#### *Source tagging*

Source tagging is the process of applying anti-theft RFID labels to products or packages during the manufacturing process.

### Reducing employee theft

Employee theft is one of the most common problems faced by retailers to reduce employee theft and shoplifting, retailers should repose trust in their employees and provide a supportive work environment. Employees should feel that they are respected and are a part of the organization. This feeling will increase their productivity as well as reduce the tendency to steal.

Some of the activities undertaken by retailers to reduce the employee theft in a retail store are screening prospective employees, using security personnel and establishing security policies and control systems.

#### *Screening Prospective Employees*

Employee theft can be prevented to an extent by screening prospective employees. To screen out potentially dishonest employees, retailers use paper and pencil honesty tests and reference checks. In the same way, to avoid recruiting drug addicts, retailers can ask the prospective employees to submit a drug test certificate as a condition for employment.

#### *Using Security Personnel*

Retailers usually outsource the security functions to various agencies. These agencies allocate security guards based on the value of merchandise and the size of the store.

Other than security personnel, retailers use undercover shoppers to identify and detect employee theft. Undercover shoppers act as shoppers and check whether the salesperson is reporting transactions accurately or not.

#### *Establishing Security Policies and Control Systems*

Many retailers draft policies to govern some activities that may lead to theft. For example, retailers can check the POS activity using computer software. Retailers can keep a watch on the POS terminals that record above average number of returns, as this may be due to some handy work of employees.

## SUMMARY

Store personnel play a major role in attracting and retaining customers in a retail store. Without productive labor, no merchandise and operational plans can be successful. Store personnel are the most productive assets in a retail store, who can increase or decrease the store's profit.

This chapter discussed the various processes of recruitment and selection to build an effective team of store personnel. Once an applicant is selected for a retail position, he has to undergo various training programs wherein his basic skills can be sharpened according to the requirements of the retail store.

Store personnel can easily get tired and depressed as their work is monotonous and they have to deal with different types of customers daily. The store manager should boost the morale of the store personnel to retain them in the store.

The store manager also needs to conduct a periodic review regarding the performance of its store personnel, and reward them accordingly. The chapter concludes with a discussion on the various legal and ethical issues involved in managing a retail store.

# Chapter 14

# Store Layout, Design and Visual Merchandising

**In this chapter we will discuss:**

- Store Exteriors - Store Layout
- Store Interiors - Managing Space, Merchandise Presentation Techniques, and Atmospherics
- Store Security

# INTRODUCTION

Successful retailers strive to provide an enduring shopping experience to the customers through their store design and visual merchandising initiatives. While planning and developing the store environment, retailers should consider the impact of various physical and psychological factors on customer behavior and store functions including employee performance. The store operations and customer behavior patterns will improve if the interior and exterior of the store are well planned and well designed. The physical environment of a store constitute tangible elements like land, building, equipment and fixtures, put together creatively for the convenience of customers. The psychological environment of a store is as important as its physical environment. It is an imaginary atmosphere created by the retailer, that is, an image of the store in the customer's mind. The effectiveness and distinctness of a retailer lies in its ability to plan, develop and control the physical and psychological environment of the store. The image and the buying environment of a store determine the psychological impact that a store has on its customers.

This chapter analyses the various factors that should be considered by a retailer while setting up a new store or renovating an existing one. Designing the exterior and interior of a store are the key aspects of the store design process. Designing the exterior of a store refers to the overall architectural aspects of what a customer sees before entering the store, that is, what makes the customer enter the store. These aspects include the colors and materials used, signage, windows, security and the main entrance. Interior designing of a store deals with managing the layout, determining the value of space, managing the flow of customer traffic and the merchandise and complementary merchandise placements. Interior designing takes care of the various store elements - displays, fixtures, floors, colors, lighting, ceiling and the security.

Though exterior and interior designing form a major part of the store layout designing process, there are other important elements like insurance, computerization, credit management and crisis management that a retailer has to take into account. In this chapter we will discuss store exteriors, store interiors, store security, insurance, credit management, computerization and crisis management. Before examining the various elements of store design, it is appropriate to discuss the need for creating a store image and a buying environment.

## Creating a Store Image

Creating an image of the store in the customer's mind is one of the primary concerns of a retailer. Building the store image is one of the most powerful tools for drawing customers towards the store, and satisfying them. Because an image is a mental impression formed in the human mind because of various stimuli, creating an image is an extremely difficult task. The various stimuli consist of the retailer's physical facilities, its location, the merchandise offered and services provided, the pricing policies, and the promotional activities. The image of a store comprises how the consumer feels about the store. Therefore, retailers must be sure about how they want their store to be perceived by the customers. Though there are a number of factors that determine a store image, it is the integration of all these factors that creates the overall store image. The following are the factors that contribute to the overall store image:

- The quality of the merchandise offered, prices and the merchandise assortment
- Advertising, external attractiveness, salesmanship and fashionability

- Convenience of location, products offered, shopping experience, ease in transaction, strength of the image, and clarity of message
- Cleanliness of the premises, credit facilities, keeping in line with the level of customer sophistication, friendly sales personnel, free space inside and outside the store
- Operational efficiency, and physical and technological factors
- Design, ambiance and social factors

The exterior and the interior design of a store are some of the key determinants of a retailer's image. There are many factors concerning the exterior of a store that represent its image: store's location, its architectural design, its facade, the positioning of the signs, the entrance, and the display windows. The image of the store's interiors can be created partly through the layout of the departments, traffic aisles, and store displays and partly by careful selection of fixtures and other equipment.

### Creating a Buying Environment

To create a friendly buying environment, the retailer or the store should create an atmosphere that would boost the customers' buying spirit. Of late, an increasing number of consumers are attracted towards a safe, attractive and comfortable shopping environment. The atmosphere of the store should be comforting for the consumers as well as the retailer. Retailers always try to create store environment that would have positive effect on the buying behavior of the consumers. A buying atmosphere can be effective only if it can appeal to the five senses of the consumer – sight, audibility, smell, touch and taste.

## STORE EXTERIORS

Generally, the first impression of a customer about a store is formed by its exteriors. The exterior of a store plays a vital role in attracting new customers and retaining the existing customers. Therefore, the retailers should plan the exterior of their stores carefully. The store exterior has a powerful impact on the store image. The exterior of a store includes its signboard, its entrance(s), windows, lighting, and the color of the building. The exterior of a retail store can convey various types of store images - conservative, trendy, rich, discount and so on - to its target customers. Therefore, the retailer should not overlook the fact that the exterior of a store determines the image of the store, especially in the case of new customers. Retailers, while planning their store exterior, may consider any of the following options:

- Modular Structure: A single piece of rectangular or a square structure that is attached to many other stores.
- Prefabricated Structure: An external frame that is built in a factory and assembled at a store.
- Prototype Structure: The exterior of all the stores of a retailer are the same, as the retailer may seek consistency in its store exteriors and interiors. These type of structures are adopted by most of the retail chains.
- Recessed Structure: A store in which the customers have to walk in a small distance to see the exteriors.
- Distinct Structure: A unique structure of the building, for instance circular, oval or semi-circular.

There are several other ways in which a retailer can enhance the store image. Creating fountains, lawns, benches and plants can enhance the exterior image of a store.

## Marquee

Of the various elements that make up a store's exterior, the marquee is the most significant, as it displays the store name. A marquee typically carries the store name, along with its trademark and other relevant information like captions. It is usually a painted signboard, or a neon light or a glow signboard. In order to be effective, a marquee should be unique and should be able to catch the attention of the target customers. It may be a strong image determinant, as it can be subdued and subtle, or flashy and gaudy. Such features of a marquee contribute largely to the building up of the store image. For instance, McDonald's Golden Arches is the most popular marquee in the world.

## Entrances

Store entrances make another significant element to be considered carefully while planning the store exterior. The retailers should first determine the number of entrances. Small retailers usually have a single entrance, while large retailers can have three or more entrances. Ideally, a store should have two entrances, so as to draw both the pedestrian (by the front entrance) and vehicular traffic (by the rear or side entrance). Both these entrances must be designed differently, as they serve different purposes. However, increasing the number of entrances has a drawback; it runs the risk of pilferage. Some retailers even close the additional entrances because of security reasons.

## Door Types

Selecting the type of door is another factor worth considering while planning a store's exterior. There are many types of doors that a retailer can select - regular, revolving, electric, self-opening, push-pull or climate controlled. A climate-controlled door is actually an open entrance with an air curtain, whose temperature is set at the same level as inside the store. This type of door eases traffic congestion at the entrance and allows the customers to see the interior of the store. Once the type of door is selected, the retailer has to select appropriate flooring for the entrance - cement, tiles or a carpet.

## Walkways

Walkways play a very important role in building up a store's exterior image. A wide and rich walkway makes a very unique feature of a store's image, when compared to narrow and constrained walkway. While constructing a store, the retailer should ensure that ample space is available for a walkway.

## Display Windows

Display windows play a major role in projecting a strong image of the store. These help the customers identify the store and the merchandise offered, and motivates the customers to enter the store. Display windows provide a lot of information to customers about the store. They carry the following benefits:

- Creating a particular mood by displaying the merchandise being offered
- Conveying the store's 'contemporariness' by displaying seasonal merchandise or merchandise that is currently in fashion.

- Attracting the price sensitive customers by displaying merchandise that is on ‘sale’.
- Catching the attention of pedestrians by displaying eye-catching goods that are not linked directly with the merchandise being offered.
- Show its concern towards the society by displaying messages that are for the common good of the public.

Creating good display windows requires considerable amount of planning. Most of the retailers seek the services of specialists for this job. There are a number of factors that retailers, as well as these specialists, have to consider while creating a display window. These factors include the number, size, shape, color, theme and the frequency of changes in a year. However, retailers in shopping malls usually do not have display windows facing the parking area, as they feel that vehicular traffic is generally not attracted by the display windows.

## Size of the Building

The size of a building also has an impact on the store atmosphere. The height of a building may either be disguised or non-disguised. The height of a building is said to be disguised if a portion of the building is below the ground level. Retailers in these types of buildings can attract the customers who are intimidated by large, impersonal buildings. The height of a building is said to be non-disguised if all the floors or the whole building is visible to pedestrians from the ground level. Retailers in these types of buildings should study the perceptions of the target customers visiting them. It is important to select right sized building for various types of merchandise. A retailer cannot create a fashion boutique in a huge building and a departmental store image in a small building.

As the final goal of a retailer is to make its store a unique one, its visibility can be enhanced by combining various elements of the store’s exterior. The unique look of a store can attract consumers’ attention. A store can be made to look unique by combining the following:

- Unique store design
- Elaborate marquee
- Recessed open air entrance
- Decorated window displays
- Distinct size of the building

While planning the exterior of a store, a retailer should thoroughly examine the surrounding areas including the stores located there, because these would have a significant impact on the retailer’s store. An upmarket premium store will not fit in an area dominated by low price discount stores. The ‘surrounding area’ comprises demographics and the lifestyles of people living near the store. And since people tend to have a general perception about a particular area, the overall image of an area has a significant impact on the image of each store in that area. Thus, a store’s exterior should be distinct, and it should complement the overall image of the area (and not affect it negatively).

Parking facilities also have a significant effect on the store’s image. Providing abundant and free parking space creates a positive image of the store, when compared to insufficient parking space and paid parking facility to its customers. Some potential customers might not visit a store because of the parking problem. Congestion of space is another factor that may turn potential customers away.

## Colors and Materials

At the very first sight, the colors and materials used for the store's exterior do create an impression in the customer's mind. Generally, this impression leaves a long lasting image of the store in a consumer's mind. The exterior of a store should appeal to the target customers. The colors and materials used should convey the image of the store. An increasing number of retailers are using various types of textures, building materials like brick, matte-finished acrylics etc., at the entrance to create a soothing effect. Steel exteriors tend to project an image of strength, while extensive use of glass creates a unique impression - of contemporariness. Concrete structures create an impression of a low cost and value-based store, whereas use of brick creates a rather upscale image.

Very often, it is the color that creates a first impression on the mind of anyone looking at an object. Color has the ability to attract customers' attention, retain it and encourage them to purchase. This psychological impact of color on the customer's mind depends upon its properties, hue, value and intensity. Hue is the name of the color, like Blue, Green, Red and so on. Value is the lightness or darkness of the hue. Dark values are known as shades. Intensity is the brightness/dullness of the hue. Hues are basically classified as warm colors and cool colors. While warm colors are those that create a more comfortable and informal atmosphere, cool colors create a more formal, lonely and chilled atmosphere. Red, yellow and orange are generally considered warm colors and blue, green and violet are considered cool colors. It is necessary for a retailer to understand the psychological impact of color on the customer's mind, because it not only helps the retailer sell its merchandise, but also helps create a conducive environment for selling it. Thus, the retailers should use an appropriate color scheme that would appeal to their target customers.

## Theft Prevention

Theft prevention is another significant factor that a retailer should keep in mind while designing the exterior of a retail outlet. Theft prevention involves controlling employee and customer pilferage. The retailer, while planning the store exterior, should carefully observe the flow of the customers into and out of the store, and find ways to monitor them through electronic theft prevention systems installed at the entrances, exits, inventory receiving doors and at the trash disposal corridors. Whatever be the system adopted for theft prevention, the final objective should be to minimize the chances of unauthorized entry and exit into and from the store.

# STORE INTERIORS

The principal objective of any retailer is to maximize its sales and customer satisfaction, and to minimize the operational costs. Therefore, the interior of a store should be designed in such a way that it serves this purpose. The store interiors should be attractive, comfortable and convenient for customers. Retailers should use the store's internal space in an efficient and effective manner. The interior of a store determines the merchandise storing patterns and the way in which it is offered for sale. The interior should be so planned that the customers should have easy access to the merchandise offered. Customers' access to the merchandise can be improved through right layout. The image projected by the store's interior should complement the image conveyed by its exterior, promotional activities, prices and the quality of the merchandise offered. The interior of a retail store should provide comfort to its customers and should motivate their buying behavior.

## Exhibit 14.1

## Using Technology and Planograms in Allocating Space

Managing space, like managing merchandise, is both an art and a science. Retailers generally assign the task of space allocation to planogrammers. They analyze the data collected from the point-of-sale systems and integrate it with the information on the target customers, to allocate space to a particular department and develop a shelf design that motivates the customers to buy their goods. Traditionally, managing space has been considered an art because of factors like incomplete data on the shopping behavior of target customers and the lack of proper coordination with other functional areas of the store. But with the evolution of advanced space management systems, the effectiveness of scientific store assortments and displays is increasing.

Retailers these days are able to provide their planogramming staff with advanced technology and more relevant data on the shopping behavior of target customers. This helps the planogramming staff to micro-merchandise their stores and to customize the assortments according to the demand patterns of each individual store. This technique helps in increasing the in-stock sales, while reducing the inventories. Space management facilitates an appealing presentation of general goods along with impulse goods that customers will be attracted to buy, apart from the goods they actually intend to purchase. Planogramming is a technique that presents a stocking plan in a manner in which the merchandise fits on the shelves and in the fixtures when it is brought into the store. Space management can be referred to as intelligent planogramming. However, developing such a technique requires direct integration of merchandise and sales data with technology so as to minimize the inventory required to achieve high levels of in-stock sales. This technique helps increase sales, improve the inventory turn-over rate, and increase gross margin return on investment (GMROI).

Initially, retailers used to develop a single planogram for all their stores. But of late, with the changing market conditions, the need for developing individual planograms for each store has been felt. This illustrates each store's unique demand patterns, demographics, and different layouts and fixtures. Further, integration of data on sales, gross-margins, inventory turnover, category management roles, etc., with technology is becoming increasingly crucial. This leads to improved efficiency and productivity. The ability of the latest technology to utilize tools for integrating with other operating systems helps the staff at the store and in the headquarters to use the same database and make decisions based on accurate and updated information. For instance, the buying staff would have the same data as that of merchandising staff.

However, these techniques have their own drawbacks. There are a number of hurdles that inhibit micro-marketing and micro-merchandising using space management technology. Firstly, there are some basic organizational and cultural issues that need to be grappled with. Implementation of advanced space management techniques generally changes the roles of the individuals within the company, and makes them adopt new thought patterns and processes. Also, it is natural for people to oppose such changes.

The retailers can also optimize their space by integrating with other existing systems without considering the relational databases and ERP systems. This can be a last level for retailers who would like to take a snapshot of the business activity, update different types of data and optimize them. And the technology barrier at this stage is not capital. All that is required is a personal computer and access to some of the retailer’s POS data, which can be accessed from another system. Each of these approaches has different technology costs and will deliver varying results. The return on investment of space management technology being used to micro-merchandise retail locations is typically measured in terms of months, not in terms of years. Retailers benefit from the immediate reduction in the cost of merchandising, and the substantial improvement in the buying process. Like other technologies, space management is in its phase of transition to the Internet. The advantage is that retailers can use the same technology for both the brick-and-mortar as well as for online stores without duplication of efforts in developing content. However, as the physical stores are not changing as quickly, there is still some room for improving the space management applications.

But, in the short-to-mid term, space management can be an important aspect of merchandise planning. Though it could be the best of breed or a pure ERP, integrating with broader systems and the interdependencies of those systems is probably the most significant improvement to take place in the short term.

## Managing Space

Retailers can make the most out of the store space and get optimum results from the available space through proper layout management. There are two major factors that make a store look unique - store layout and the visual merchandising. The following are the factors that a retailer should consider while taking any decision regarding the store layout:

- the value of space
- space utilization and allocation

Apart from the above mentioned factors, a retailer should also consider the flow of customer traffic, types of merchandise offered, proximity of the complementary merchandise and the desired store image while deciding on the store layout.

Planning a store layout is not a one-time event for a retailer. Though an overall layout plan is developed while opening a new store or renovating an existing one, checking for the optimization of returns and making the necessary changes is an ongoing task. Exhibit 14.1 illustrates the usage of technology and planograms for the allocation of space to various departments. Exhibit 14.2 illustrates the space management techniques adopted by Indian retailers like Shopper's Stop and Globus.

### Value of Space

Retailers generally represent the value of space in terms of sales per square foot of floor space, sales per linear foot of shelf space, sales per square foot of exposure space, and sales per cubic foot of shelf space. The fact that store space varies in value is the most significant factor that has to be considered by a retailer while planning a store layout. Stores, departments or free standing displays use the sales-per-square-foot measure. The shelf space for merchandise like grocery and cosmetics is measured in terms of sales per linear foot. Though the shelf space value for grocery and cosmetics is also measured in terms of sales per square foot of exposure space, it is an emerging technique. The height value of space is calculated as length multiplied with height of the vertical space. The value of space for merchandise stocked in freezers and refrigerators is measured in terms of sales per cubic foot. It is generally found that particularly some parts of the store are visited by a larger number of people. The merchandise displayed in those areas is most likely to receive customer's attention, and thus, the sales of these merchandise categories are likely to be high. This implies that the value of the space along the high traffic routes is also high. Thus, the space near the store entrance is the most valuable; the space value starts decreasing gradually as we move towards the end of the store. Variations also take place in the sales and profit volumes of merchandise displayed on floors of the store. The difficulty in attracting the customers is directly proportional with the number of floors of the store or the height of the building from the ground level. For instance, the value of the space in the basement or the floors above the ground floor is less when compared to the value of the space on the ground floor. Thus, the uniform distribution of customers across all parts of the store is difficult to achieve. However, retailers should allocate space to every department in such a way that it optimizes the sales per square foot of space in the store.

### Utilizing and Allocating Space

Analyzing the available store space and allocating it to various departments is the first step in determining the store layout. Allocating the store space is usually based on various mathematical calculations on the returns from the various merchandise categories. But, before starting the process of allocating store space to various departments, the retailers should have a clear understanding of the different types of space required.

**Exhibit 14.2**

**Managing Space – The Shopper's Stop and Globus Way**

Organized retailing is an evolving industry in India, and so is the concept of space management. Since space is expensive, and the process of optimization of returns per square foot is not known to many retailers, they try to stuff as much of merchandise as possible in a given store space. Thus, not much of care is taken to create sufficient space for convenience in going around the store, rest rooms, trial rooms, customer service desks and so on.

However, some retailers like Shopper's Stop and Globus follow specific guidelines on return on per square foot of selling space and other performance measurement factors. At Shopper's Stop and Globus, the merchandise allocation and display process begins right from the stage of the store plan. Once the store's basic architecture is ready, the visual merchandisers work in association with the project team (architects). Developing planograms that indicate the store's visual displays depicting the exact merchandise locations on the floor is the most important task at this stage. Separate documents are then prepared for each merchandise category. These documents describe the suggested fixtures and the number of stock keeping units allowed by each fixture. The planograms also indicate the areas for visual merchandising and the areas to be used as display aids, such as the walls.

At Globus, the entire process was aimed at maximizing the display area within the store. The project team of the retailer prepared the layout for different services like elevators, escalators, trial rooms, customer service desks, food courts, rest rooms for the staff and the customers and back rooms. Generally, one-third to one-fourth of the store space is allocated for these service areas. Then the planograms for the remaining area are prepared. Planograms also define and demarcate the division of the walls into various sections. Then the blueprints for each section are prepared. Globus standardized its fixtures, shelves, pegs, side hangings and front hangings. Once the planograms are completed, it is time for the merchandiser to plan for various products to be displayed in each department or section. The details of each section or department are then documented for future reference. Documenting helps the merchandiser determine how many stock keeping units are on display at any specific point of time. The total merchandise display area is divided into two feet modules, which can be modified easily according to requirements.

At Shopper's Stop, planograms form a vital part of the store's total business plan. Shopper's Stop is the only Indian member of the Intercontinental Group of Departmental Stores (IGDS), Switzerland. IGDS holds annual meetings in Switzerland, at which valuable information on various types of store layout, display techniques and fixtures are exchanged. Some of those exchanges are reflected in many Shoppers' Stop stores. The store also has a standard set of suppliers, architects and designers.

*Adapted from Retail ET Knowledge Series, 2000-2001, p.85*

Basically, a retailer needs five types of space in its store - the back room, the office and other functional spaces, the aisles, service areas, and other non-selling areas of the sales floor, wall space and the floor space. Because space is the most expensive and scarce resource for a retailer, it becomes very difficult to strike a balance between the need to present a greater variety of merchandise with store functionality and to enable customers to shop comfortably in the store. Thus, most of the retailers' compromise on some or the other parameters by prioritizing their goals. While analyzing each of its space needs, a retailer should ensure that maximum space is available for displaying the merchandise, and it should make the store an attractive place for the consumers. Exhibit 14.3 illustrates the way NANZ, a retailer based in New Delhi, India, allocates space to its various departments. The different types of space required by a retailer are described below:

**Exhibit 14.3**

**Allocation of Space at NANZ**

NANZ, a Delhi–based chain of super markets tied up with a North American local supermarket chain, Marsh. NANZ has 12 stores in New Delhi, India, of which eight are managed by the company itself, while the remaining four are operated through franchisees. The stores run by the company operate under two formats – large and small. The area for large stores ranges between 8000 and 10000 square feet, while that of the small stores ranges between 2500 and 3500 square feet. The number of stock keeping units in a store varies according to the size of the store. The larger stores usually have 4000 to 5000 stock keeping units, while the smaller ones have 3500 stock keeping units.

Allocation of space to various departments or merchandise categories at NANZ is done according to the GMROI (Gross Margin Return on Inventory). But, there is a trade-off between the GMROI and destination category. The company generally allocates more space to the destination category products as it has been found that these products are the key drivers for sales, though the margins on these products are lower.

Allocation of space also depends on factors like the positioning strategy adopted by the management, and cluster marketing. Regular and convenience goods are sometimes located towards the end of the store, so as to make the customer move through the entire store before making his intended final purchase. While the customer goes through the entire store, he may do some impulse shopping too. The space allocated for branded products generally reflects the market share of that particular product. Typically, products with higher market shares are assigned with more space or shelf space. However, it is the sales of a product in any merchandise category that determine the space that is to be apportioned to it.

*Adapted from RETAIL ET Knowledge Series, 2000-2001.*

***Back Room:*** This consists of space for receiving inventories, a store room for processing these and stocking the surplus inventories. The back room is the most essential space required for any retail store to operate. The percentage of space allocated to the back room varies from retailer to retailer, depending on the type of merchandise that the retailer offers. The retailer's continuous efforts to maximize the sales per square foot of the store space, the use of the latest distribution techniques like just-in-time inventory management, quick response delivery system and efficient consumer response lead to a significant decrease in the space allocated for the back room. Some of the modern retail formats like wholesale clubs allocate space only for receiving inventory, but not for store room. Wholesale clubs are found to take advantage of the height of the building by stocking the excess inventory above the display racks itself. This helps retailers reduce the rental expenses, which the retailers would otherwise have to pay for in terms of the square feet of space required. This type of inventory stocking generates a low-cost image for the store, which attracts a higher number of value-conscious customers.

***Office and other functional spaces:*** These usually consist of a rest room for the sales personnel, a training room, cabins for the store managers and assistant managers, a cash office, bathrooms for the shoppers and the staff and other functional spaces. Every retail store must allocate some space for its office and other utilities like rest rooms. Spaces of this type are usually located in the areas that are least noticed or those that are too small to be back rooms.

***Aisles, service areas and other non selling areas:*** These include spaces that are allocated for customers to move around. Retail stores usually have two types of aisles - the primary aisles through which customers can go around the store and secondary aisles through which customers can reach a particular merchandise category on display. Other non-selling areas include service facilities like space for stacking shopping trolleys and baskets, trial rooms and service desks. Though retailers generally attempt to reduce the space allocated to non-selling areas, these form an important part of customer service, and can sometimes make the store look unique.

***Floor space:*** This is also referred to as floor merchandise space. It consists of various kinds of fixtures that are used to display the merchandise.

***Wall space:*** This is one of the most important part of a retail store, as it acts as a fixture for carrying significant amount of merchandise. In addition to this, walls act as an excellent visual backdrop for the merchandise displayed on the shop floor.

There are different methods that retailers use to allocate space to various departments. The following are some of the commonly used methods:

- Allocation based on historical sales
- Allocation based on gross margins
- Allocations based on industry averages
- Allocations based on strategic objectives

All these methods are used by retailers whose stores are already established. The retailer who plans to set up a new store should devise a new strategy for allocating space to the various departments.

***Allocation based on historical sales:*** The amount of space allocated to a specific department can sometimes be based on the sales that the products in that department have been generating. But, practicing this continuously for a long time can lead to under-allocation or over-allocation of space. Though this allocation method is simple and relevant**,** it has been severely criticized, as it may end up allocating little space for highly profitable merchandise and more space for merchandise that makes relatively less contribution to profits.

***Allocation based on gross margin:*** This method of space allocation is quite similar to the above method. The only difference is that in this case, the space is allocated on the basis of the proportion of the margins. For instance, the luggage department of a departmental store contributes to 15 percent of the sales and 11 percent to the gross margin. Therefore, only 11 percent of space is allocated to this department. Big retailers are now using software that helps allocate space on the basis of various financial factors. These tools help the retailers determine the space required for each merchandise category in a manner that maximizes profits.

***Allocation based on industry averages:*** Space allocation is sometimes done on the basis of the pressure from competitors. Retailers tend to allocate the same amount of space to a particular department, as their competitors. In such cases, the relevant information is usually provided to the concerned retailer(s) by the trade associations. Though this method of allocation does not weaken the retailer's merchandise category, it creates a ‘me too’ atmosphere devoid of uniqueness.

***Allocation based on strategic objectives:*** In order to increase the sales of a specific merchandise category, retailers allocate more space for products in that particular category, than what is justified by its historical sales data. This allocation method is used as a short-term promotional strategy to build up the sales of a newly launched product line. Hence, this allocation method is sometimes referred to as the build-up method.

As all the above mentioned space allocation methods are based on historical data, the retailers cannot use any of these methods for allocating space for various departments in a new store. In such a situation, retailers usually assign space according to the industry standards and prior experience with similar store formats.

Once a specific amount of space is allocated for a particular merchandise category, the retailer should devise a technique for presenting the merchandise in the most attractive manner. Hence the need for understanding various merchandise presentation techniques.

## Merchandise Presentation Techniques – Store Layout

Preparing a store prototype is the first step in determining a store layout. Store prototype is a model prepared by integrating various elements of a store. These elements include decor, lighting, music, scent, color, fixtures, and so on. While designing an effective store layout, retailers should strike a trade-off between many conflicting objectives. Firstly, the store layout should enable and incite the customers to move around the store to purchase more products than they have actually planned for. The layout should tempt customers to walk along the inexpensive merchandise display sections for impulse buying and then move on to expensive merchandise. There is another way of making customers navigate the store – by adding variety to the display style and by offering a wide variety of products. Retailers should create small secluded places in the store instead of huge straight spaces. Instead of placing racks and shelves in long rows, he should add multilevel shelves and racks, and ramps, or slightly vary the heights of the displays. In order to do this, modern retailers adopt any of three design types – grid layout, race track layout, and free form layout.

### Grid layout

A grid layout is generally found in grocery stores. It consists of numerous long gondolas and aisles. This marks the most cost-effective and efficient utilization of retail space. This layout is found to be most effective in supermarkets, where customers come to buy similar products (Ex: groceries) very often. But this layout does not work effectively in departmental stores and specialty stores.

### Race track layout

A race track layout is a store layout which has a major aisle running inside the store. The customers can access various departments in the store through the aisles. The flooring and colors of these aisles is typically different from those of the individual departments. A majority of the departmental stores prefer this layout. The customers are exposed to only one type of merchandise in each section or department of the store. This layout helps each department draw the complete attention of the customers. Each department is independent, with natural or virtual breaks that separate one product from the other. Also, there are some primary and secondary aisles in every section that lead to individual product sections. The lighting and flooring of the aisles is different from that of the merchandising section.

### Free-form Layout

A free-form layout, also referred to as 'boutique layout', has the aisles and fixtures arranged in an asymmetrical fashion. This layout is most effective in small specialty stores or in the individual departments of large stores. This is an inexpensive layout, and has been adopted by many international fashion boutiques. In such a layout, the store usually resembles a luxurious living room in which the merchandise is arranged on a single floor at different levels. This creates on the customers' mind an impression that a wide range of merchandise is being offered. The merchandise is arranged in sections depending on the adjacent section or group. In this layout, no attempt is made to create a break within a department. For instance, men's formal wear, casual wear and sportswear can be all displayed in one section of the store. The customers will have ample space to move around, and pick and choose from the merchandise at ease.

Retailers generally adopt free-form layout for their accessories and novelty departments. But this layout is expensive for individual departments because of the high cost of the display aids. However, there are some key factors that a retailer should take into account, while developing a layout prototype. The following are the optimizing factors:

***Increasing sales:*** The store layout should encourage the customers to go around the store and buy more merchandise than they have actually planned for. Typically, retailers achieve this by providing several entry and exit points. This makes the customers see a majority of the merchandise prior to coming out of the store. Circulation plan is the most significant aspect of devising a plan to increase sales. A circulation plan aims at providing indirect guidance to the customers in going around the store, so that they look at all the merchandise on display and maximize their purchases. For instance, supermarkets typically place the merchandise customers intend to buy towards the end of the rack so as to make the customer walk through the aisle and look at all the other merchandise before reaching their target merchandise. This makes customers purchase some impulse goods as well. There should be no provision for dead ends in the circulation plan of a store.

***Maximizing returns per square foot:*** An effective layout should strike a trade-off between providing customers' ample space to shop and utilizing the often expensive and scarce resources efficiently. In order to achieve this, a retailer should make qualitative decisions about the various types of design, space allocation to selling areas (both feature and bulk of merchandise) and optimum utilization of wall and window spaces. An effective store layout has the potential to increase the amount of time and money spent by the customers in the store.

***Coordinating the merchandise with the store format:*** Retailers should design the store with its target customers' in mind. A store meant for teenagers should not have a formally designed interior and exterior. For instance, music retailers – majority of whose customers are youth – usually have a store layout that is clogged with merchandise, heavy fixtures with flashy lights, bright colors, interactive displays and lively music playing in the background. On the other hand, there are stores that use a minimum number of fixtures, like upmarket jewelry stores, fashion boutiques and home furnishing stores. Typically, the interior of these stores is colored white, the lighting is good, and the store is unclogged, and has a serene atmosphere, with little merchandise on display. All the merchandise categories are treated equally. However, there are stores that take a middle position between these two extremes. Stores that adopt this type of layout generally use a contemporary design.

***Allowing flexibility in store design:*** The store should be highly flexible and adaptable to the changing needs of the customers and the type of merchandise. The retailer should be able to adapt to these changes with minimum effort and maximum efficacy. Hence, all the furniture and fixtures in the store should be movable, so that the interior of the store can be modified when needed.

***Recognizing the needs of the disabled/ women/ kids and the safety of the customers:*** In most western countries, legal guidelines are issued for the retailers to provide proper facilities to physically challenged and disabled customers. But in many developing countries no such guidelines exist. However, with the increase in the number of organized retailers in such countries,, this scenario is fast changing. Today, retailers usually provide wheelchairs and assistants to physically challenged customers. Many of them have created separate rooms for mothers with babies and rest rooms for pregnant women and senior citizens. They also provide some playing bins where kids can play while the adults shop. Also, retailers should take enough care about the safety of its customers. It must be ensured that the furniture in the store does not have sharp or protruding edges, and that the floor or the staircase is not slippery.

Though retailers can adopt many combinations of the various methods of store designs and presentation techniques, they should keep in mind the following four points that will help them develop appropriate presentation techniques:

First, the merchandise presentation techniques should be consistent with the image of the store. Second, the nature of the merchandise being displayed should be taken into account while developing a merchandise presentation technique. For example, blazers and suits should be left hanging, while shirts and trousers can be stacked. Third, packing is an important aspect of the presentation of merchandise. For example supermarkets sell packed grocery, which is slightly costlier than what is sold at general or ordinary stores. Finally, the profit potential of the merchandise is a major determinant in the display decisions. For instance, high turnover – low profit merchandise does not require expensive displays, unlike high profit – low turnover merchandise.

## Visual Merchandising

Visual merchandising can be regarded as a retail function that helps the retailer create a visually appealing or pleasing shopping environment, which will, in turn, increase the sales. This is also referred to as point-of-purchase (POP) display. The POP display has three main roles to play – informing the customers about the products, adding value to the atmosphere of the store, and acting as a significant promotional tool. There are various techniques that a retailer should consider while developing a visual merchandising technique for its store:

**Idea-oriented presentation:** This involves presenting the merchandise depending on a specific idea or the store's image. The merchandise is presented in a manner that helps the customer visualize the use of that particular product in their homes, when they buy it. This motivates the customers to purchase complementary products too.

**Style or item oriented presentation:** This is the most commonly used presentation technique. Retailers who generally adopt this technique include discount stores, grocery stores, hardware stores and pharmaceutical stores. Most of the apparel retailers are also found to use this technique. Customers looking for a specific product in a merchandise category would like to find all the products in that category at one place. Organizing merchandise on the basis of size is the most common style-based presentation. For example, apparel retailers may arrange shirts at one place on the basis of their sizes - small to extra large. Such an arrangement makes it easy for the customer to identify the shirt of his size.

**Color Presentation:** This involves presenting the merchandise using appropriate color combinations. Apparel retailers generally use colors (for their interior) that are appropriate for the season.

**Price Lining:** In this case, the merchandise is arranged according to the various price points. This type of presentation technique helps customers find the merchandise in the price range that they are looking for.

**Vertical Merchandising:** This is the most popular technique of merchandise presentation. It involves displaying the merchandise on the walls and high gondolas. While purchasing products in stores using a vertical merchandising technique, customers follow a set buying pattern, i.e. from left to right through each column and from top to bottom of each SKU. Retailers, especially grocery stores, tend to get maximum advantage of this buying pattern, by displaying national brands at eye level and store brands at a lower level, since customers usually scan down the racks. Also, retailers display merchandise of same color and kind in a vertical sequence.

**Tonnage Merchandising:** This is a presentation technique in which a huge quantity of merchandise is displayed at a time. Customers usually regard this type of presentation as something that has value and is offered at a lower price. Retailers adopt this technique to promote the store on the basis of price.

**Frontal Presentation:** Typically, it is not possible for the retailers to create effective display areas and display all the merchandise. Displaying as much merchandise as possible is as important as creating effective display areas. Frontal presentation is an answer to this problem. It is a merchandise display technique that helps the retailer exhibit as much portion of a product, as would be required to draw the customers' attention.

Once the retailers are aware of all the visual merchandising techniques, they should know about the various types of display areas. There are three types of display areas - feature areas, bulk of stock and the walls.

*Feature areas* are created to attract the customer's attention. These consist of end caps, promotional areas, freestanding fixtures and mannequins (all these act as an introduction to the soft goods sections), windows and the point-of-purchase sections. End caps are a relatively smaller number of shelves that are situated at the end of the aisles and are generally used to stack or display special promotional merchandise like sealed fruit juices, chips, chocolates, etc. as their visibility rate is high. Promotional areas are the spaces used in the same manner as an end cap. Freestanding fixtures and mannequins are generally placed on the aisles to draw the customers into the store and then into the departments. Typically, these fixtures carry the latest merchandise in the store or a department. Point-of-purchase areas are considered to be the most important and valuable places in the store, because the customers are highly attracted towards this place. These are the points where impulse goods like magazines, batteries, chocolates, candies, etc., are displayed.

*The bulk of stock area* carries the entire range of merchandise. The merchandise in the bulk of stock area is usually displayed on gondolas or on freestanding fixtures (depending on the store format and design).

*Walls* are one of the most significant feature areas for storing extra merchandise. For instance, sportswear companies like Nike, and Adidas, and the footwear major Bata typically display their merchandise on the walls. This adds to the customers' comfort, as the store is not crowded by racks and shelves.

## Fixtures

The basic purpose of a fixture is to carry and display merchandise effectively. In addition to this, fixtures should help in defining various departments and increase the flow of customers. Apart from this, the fixtures should fit well with the interior of the store and its image. In other words, fixtures should not convey any message that goes against the store image. Though there are a wide variety of styles, colors, materials and sizes of fixtures, only a few types are used by a majority of retailers. Gondolas are the most popularly used fixtures, especially in grocery stores and supermarkets. Other retailers like apparel stores use fixtures like straight racks, rounders, and four-way fixtures.

A straight rack has a long pipe supported by two suspenders, with their bases fixed on the floor or on the wall. Though straight racks can carry a lot of merchandise, it is difficult to display certain colors and styles. Customers can only see a sleeve or a leg in such a display. Hence these types of fixtures are generally found in discount stores.

A rounder is a circular fixture that stands on a pedestal. Because of their ability to revolve around their axes and to carry a lot of merchandise, rounders are used by most of the apparel stores. But, like straight racks, rounders provide only a side view of the merchandise.

A four-way fixture stands on a pedestal with two cross tubes that are perpendicular to each other. These fixtures can carry large amounts of merchandise, and customers can see the whole garment. However, these fixtures are relatively difficult to maintain, when compared to straight racks and rounders. Retailers must ensure that a specific arm of the fixture should carry garments of similar style and color, or else customers may be confused. Because of their superior display properties, these fixtures are generally found in fashion-based retail stores.

A gondola consists of a series of self-service counters having shelves or bins, in the form of an island. Because of their versatility, gondolas are used extensively in grocery stores, discount stores, and departmental stores. Retailers can display a wide variety of merchandise through gondolas. Though folded apparel can also be displayed in gondolas, it is much more difficult for the customers to view the merchandise here than on straight racks.

Fixtures can also be categorized as closed sell and open sell, depending on the customers' access to the merchandise. In a closed sell fixture, the customers are not allowed to access the merchandise. The salesperson helps the customer. In an open sell arrangement, customers are allowed to access the merchandise physically.

Also, manufacturers or vendors provide fixtures to the retailers for displaying their merchandise exclusively. This way, their brand stands out and improves the consistency in displaying their merchandise across all the stores that sell it. Because most of the fixtures used in a store look the same, it is the way the merchandise is displayed that makes it unique. This phenomenon is referred to as visual merchandising. For instance, vendors like Coca-Cola, Pepsi, Cadbury's, and Gillette use their own fixtures for displaying their products. Apart from using fixtures to display the merchandise, visual merchandising involves displaying the merchandise on walls, windows, and mannequins. It is closely linked with the retailer's overall marketing strategy and its marketing theme in a particular season. But the retailer must ensure that the visual merchandising tools it uses are in congruence with the overall image of the store.

## Atmospherics

Atmospherics can be described as an environment that stimulates the perceptual and emotional responses of the customers through

- visual communications
- lighting
- colors
- music and
- fragrance

**Visual communications** involve communicating with the customers through graphics, signs and certain theatrical effects inside the store and through the windows. Visual communications help increase the sales by providing information to customers about the merchandise offered, the best buys and so on. Apart from this, customers find it easy to locate the departments or sections they are looking for in the store with the help of signs and graphics. Moreover, graphics enhance the beauty of the store. But enhancing the beauty of a store is no easy task. There are many key issues that a retailer should take into account while developing a visual communication strategy. The following are some of those issues:

**Coordination between the signs and graphics and the image of the store:** The signs and graphics used in a store should ideally establish a link between the merchandise offered and the target customers. The color and tone of the signs and graphics should go well with the merchandise offered and the corporate logo. It must be ensured that the colors used create a pleasant feeling, or else they may spoil image of the store. The color should be blended in such a manner that it appeals to its target customers. Posters or danglers, if used, should show the merchandise being used by the right target customers. For instance, posters of women wearing jewelry should be put-up in a jewelry store.

***Providing information to the customers:*** Signs and graphics that provide information about the merchandise can make it more desirable. For instance, in many hypermarkets, product information, including its price are printed on small cards. Large photo panels depicting the actual application of the merchandise help the customers imagine what exactly its use is. This is necessary because when customers are buying a product, they are actually buying a solution to a problem.

***Using signs and graphics as supporting material:*** Using signs and graphics as supporting material can be a unique manner of blending the theme and the merchandise appealingly. For instance, an apparel retailer can put up the pictures of beaches all over its store to project the 'cool' image of its summer clothing.

***Updating signs and graphics:*** Signs and graphics used in the store should be congruent with the merchandise offered, and they should be updated along with the merchandise, that is, when the merchandise changes, the signs and graphics should be changed accordingly.

***Avoiding excessive use of text in the signs:*** As the primary objective of a sign is to keep the customers informed about the merchandise and various offers at the store, the text on it contributes significantly to its success. However, using too much text may be detrimental to its purpose, as customers generally do not like to read too much of text. The text should be presented in such a manner that the customers can obtain product information as they move around in the store.

***Using appropriate fonts on the signs:*** The font style used for the text is a critical factor for their effectiveness. Different fonts can convey different meanings and moods.

***Creating theatrical effects:*** Creating a theatrical effect in a store will enhance the excitement (of the customers) in the store along with its image. This may be brought about through an elaborate display of functional elements like excessive use of colored fabrics blended well with the colors used in the store, or by hanging large laminations from the walls or the ceiling (for decorating, providing information or for covering up less attractive areas like ceilings and beams).

## Lighting

Lighting can be used intelligently to highlight the merchandise and attract customers to specific departments in the store. Retailers often overlook and underestimate the impact of proper lighting on the store image and the sales. Though it has been proved that appropriate lighting can increase the sales of the store by 20 percent, many retailers often ignore its importance. Proper lighting does more than just illuminating the store. It highlights the products displayed, moulds the space, captures the customers' mood and enhances the store image. Excellent lighting also masks the less attractive areas of the store that cannot be modified otherwise. Some of the main objectives of lighting are the following:

- Highlighting the displayed products. A proper lighting system, apart from creating a sense of excitement for the customers in the store, should present the products on display in their original colors. For instance, a dark blue shirt should look the same inside and outside the store. Further, the store lighting should match the customer requirements. For instance, the automobile showrooms require brighter and more expensive lighting, when compared to small grocery stores or supermarkets. Also, proper lighting helps highlight the strategic merchandise locations that help attract the customers to specific areas of the store.

- Capturing customer's mood. The lighting systems should be so effective as to capture the customer's mood in all the departments of a store. They should also be able to change the customers' mood according to the merchandise displayed.
- Ability to mask the unattractive features or places of the store. Proper lighting can mask the outdated designs.

**Colors:** These are the most important and most strategic visual promotional tools that help build a retailers image by creating a positive effect on the customers' psychology. Though warm colors tend to create excitement by attracting the customers and capturing their attention, these can be distracting and unpleasant at times. Cool and bright colors like blue or green are suitable for retailers offering expensive products. As different colors convey different moods and meanings, retailers should ensure that the colors they use must complement the message conveyed by the merchandise being sold and the store itself.

**Music:** Like color and lighting, music may complement or contradict the atmospherics of a retail store. However, unlike the other elements of atmospherics, music can be changed as and when needed. Music can be used effectively to influence the buying behavior of many customers. Music has the ability to control the traffic in the store, to develop a store image, to capture as well as divert customer's attention. As music preoccupies the consumers' brain, it inhibits their ability to evaluate the merchandise. In addition, some customers may not like music, and leave the store without purchasing any thing, while others may purchase more than what they have had originally planned, as their resistance to attractively presented merchandise comes down.

**Fragrance:** Most of the purchasing decisions of the consumers are emotional and of all the different human senses, smell has the most significant impact on human emotions. The retailers should use fragrances in the various departments of the store according to the preferences of their target customers and the merchandise displayed. There are many factors that a retailer should take into account while deciding on which perfume to use. Factors like the gender, age and ethnic background of the target customers determine the intensity of the perfume to be used. With so many variations in the customer profiles, it is certainly not an easy job for a retailer to decide on a perfume that would appeal to all its target customers.

## STORE SECURITY

Retailers should protect their stores from many types of merchandise losses, especially from those caused by customers, employees, burglars and robbers. While developing security systems for their stores, retailers should bear in mind their customers and employees, in addition to the store image and the merchandise offered. Exhibit 14.4 illustrates the role of technology in the prevention of merchandise shrinkage. Retailers usually spend up to five percent of their total retail expenditure on covering merchandise losses or on establishing security systems to prevent such losses. But it has been found over the years that a majority of these losses are caused by theft and shoplifting committed by employees.

### Customer Theft

This means theft of the merchandise on display in a store, committed by entrants into the store. This is also referred to as shoplifting. This petty pilferage usually leads to 30 to 40 percent of the overall inventory losses of a retailer. And in order to cover these losses, retailers are forced to price their merchandise on the higher side. Shoplifting is done in three basic ways:

**Exhibit 14.4**

**Electronic Artificial Surveillance**

Many retailers usually train their internal staff and adopt innovative measures to prevent losses due to shoplifting. However, the role of technology in preventing such losses is remarkable. Electronic Artificial Surveillance (EAS) is one such technology-driven product. It helps the retailer increase its profits by reducing losses due to shoplifting. EAS consists of detection systems installed at the exit of the store. In this system, small electronic tags are attached to the merchandise. These tags are disabled or deactivated at the billing counter after a purchase is made. If one attempts to take the merchandise out of the store with out deactivating the tag, an alarm rings, thus alerting the sales personnel or the security staff. The EAS system can be split into three parts - the electronic tags that are attached to the merchandise, the deactivators at the point-of-sale counters, and the detection systems installed at the exit of the store. Retailers use three types of EAS tags - radio frequency, acoustic-magnetic and electro magnetic tags.

The radio frequency - based EAS tags run on wireless electromagnetic energy, which is transmitted in the form of waves, the amplitude of which increases and decreases. These tags are the best for identifying, monitoring and controlling valuable assets. These tags transmit and receive data with the help of a battery. These can be hidden in the merchandise, for, they can transmit and receive data even from the closed boxes. A smart EAS system can track up to 40 tags per second. Once the data is transmitted, the system can be tuned in such a manner that it ignores the subsequent transmissions of the same product, for a certain period of time.

Acoustic-magnetic EAS tags use magnetic waves. These tags are sometimes referred to as tell tags. These tags are embedded with a computer chip that switches on an audio alarm fitted in the tag, and this alarm is amplified with the help of acoustic tone detectors located in the store's ceiling. The tag continues to beep until it is detached from the merchandise. If an attempt is made to take the merchandise out of the store's permissible limits, the tag beeps loudly, thus enabling the security personnel to trace the shoplifter even in a crowd. Electromagnetic wave-based EAS tags perform the same function, the only difference being that they use electromagnetic waves, instead of acoustic magnetic waves.

*Adapted from RETAIL ET Knowledge Series, 2000-2001.*

- Direct theft of the products on display
- Tampering with the retailer’s price tag to show a lower price
- Replacing the original price tag with a lower priced tag

There are broadly two types of shoplifters - those who commit the theft to derive a physical or psychological satisfaction, and those who do it for a living. The former type of shoplifters are called amateur shoplifters, and the latter type of shoplifters are referred to as professional shoplifters. There are a number of techniques that these shoplifters might adopt to conceal both their act of theft and the stolen merchandise. Depending on the techniques adopted by shoplifters they are categorized as boosters, diverters, blockers, sweepers, walkers, wearers, carriers, wrappers, and price changers. Exhibit 14.5 provides descriptions of all these categories.

The security system of the retailer should have effective techniques for detection and prevention of shoplifting. The most common detection technique is observation, wherein the sales staff are trained thoroughly to observe the entrants into the store. This technique, apart from increasing the chances of detection of shoplifting, potentially prevents it. The use of electronic gadgets like closed circuit televisions, electronic barcodes, smart tags, and so on, is very effective in detection of shoplifting.

**Exhibit 14.5**

**Different Types of Shoplifters**

Shoplifters adopt a number of methods for pilfering the merchandise. According to the techniques they adopt, they are classified as follows:

A booster is a shoplifter who hides the merchandise in the concealed portions of the bags, parcels or his clothing.

A diverter is one among a group shoplifters who diverts the attention of the sales personnel while the other, accompanying member(s) lifts the merchandise.

A blocker is a shoplifter whose primary technique is to obstruct the vision of the sales personnel while he himself or his partner(s) shoplifts.

A sweeper is a shoplifter who sweeps the merchandise off the shelves into a bag or any other container.

A wearer is a shoplifter who tries the merchandise, and walks out of the store, still wearing it.

A carrier is a shoplifter who replaces the tag of a large piece of merchandise with a fake sales slip and carries it out of the store.

A self-wrapper is a shoplifter who uses his own packing material to wrap the merchandise before taking it out of the store.

A price-changer is a shoplifter who pays a fake price for the merchandise by replacing its original price tag with a fake one.

*Source: Essentials of Retailing, Dale M. Lewison Merrill Publishing Company 235*

## Employee Theft

Pilferage done by employees has been a major reason for inventory losses for most retailers. The retailers' strong trust on their employees is perhaps the major cause of these losses. The first step in the process of detecting and preventing such pilferage is to identify the existence of the problem, and then understand the reason for it and subsequently understand the mechanism of the act. Theft of merchandise and theft of money are the two most common types of employee pilferage. Opportunity and need are the most prominent factors that cause employee theft. When some employees continuously find opportunities to pilfer, they take advantage of the situation. At times, employees steal in order to satisfy their financial needs. This problem will be solved (at least to a certain extent) if the retailer pays a wage to the employees which would satisfy their needs to a considerable extent (if not wholly). But the retailer should understand that this is not a permanent solution to the problem.

Employees, depending on the means which they adopt for pilfering money or merchandise, have been categorized into eaters, smugglers, discounters, dippers, embezzlers, partners and stashers. (Refer Exhibit 14.6).

## Supplier Pilferage

In order to control employee pilferage, retailers should create a store environment in which the slightest dishonesty is severely punished and integrity and honesty are rewarded. Retailers should develop effective security systems to bring down the chances of employee pilferage. The retailer can develop a personal relationship with the employees by showing their concern towards their problems and needs. This will encourage their honesty and integrity. Retailers should employ security guards in uniforms, undercover shoppers and silent witness programs to detect and prevent employee pilferage.

**Exhibit 14.6**

**Types of Employee Pilferers**

Like shoplifters, employee pilferers are also classified into many categories depending on their operational techniques.

An eater is an employee pilferer, who tastes the food and beverages of a retailer.

A smuggler is an employee who sends the merchandise out of the store through dustbins, coats, lunchboxes, wallets, purses, and so on.

A discounter is an employee who offers unauthorized discounts to his friends and relatives.

A dipper is an employee who steals money from the cash counter or misutilizes the office money.

An embezzler is an employee who diverts the retailer's funds either permanently or temporarily, by taking advantage of the high trust the retailer has on him or her.

A partner is one who does not steal merchandise and money, but leaks vital information about the store, such as security aspects, that increase the probability of theft.

A stasher conceals the merchandise in a safe area in a store, and buys it at a lower price during a discount period.

*Source: Essentials of Retailing, Dale M. Lewison Merrill Publishing Company 236*

While developing a security system for their store, retailers should also consider the security problems faced by its vendors. The pilfering activities of the vendor representatives are of two types – short counts (where fewer number of items are delivered than are listed on the purchase order and are signed for on the invoice) and merchandise removal (where the merchandise is stolen from the points of receiving, checking, stocking and selling). The following are some procedures through which the retailer can reduce and eliminate pilferage by the supplier’s representatives:

- Establish a separate receiving point in the rear of the store for accepting all the incoming inventory
- Monitor all the deliveries that are made directly to the sales floor and the store room
- Minimize the number of entrances to the receiving point and lock them properly
- Thoroughly monitor and control the entry and exit into the receiving point
- Randomly inspect the delivery staff and their equipment within the stores' premises
- Check all the incoming shipments
- Properly document all the incoming shipments in all respects – their contents, weight, size and condition of receipt.

## Credit Management

Of late, almost all retailers have started to accept credit cards or credit purchases. Petrol filling stations, restaurants, electronic goods stores, grocery stores, supermarkets, departmental stores - all of them accept credit cards. Some retailers even accept personal cheques with proper identification marks. Selling merchandise on credit has become necessary for retailers because of the increase in number of customers using credit cards (like Visa, Master Card and American Express) across the world. Apart from this, computerization and the Internet have eased the process of credit and increased the efficiency of the credit management process. However, retailers should be very cautious while handling credit or credit cards, as many of these can be stolen or fictitious cards. To reduce such losses, retailers should take enough care while accepting credit cards. Some of the precautionary measures are the following:

- Tallying the signature of the cardholder on the credit slip with that on the credit card.
- Checking the authenticity of the individual carrying the card (Some credit cards carry the photograph and signature of the cardholder).
- Seeking approval from the finance provider if the sale through credit card is over a certain amount.
- Sending all the credit card sale documents for immediate processing.

## SUMMARY

Store layout and visual merchandising are factors that contribute to the uniqueness of a store. The exterior and interior of a store convey several messages about the store to the consumers. The building that houses retail store, (whether new or old) and the exterior design of the store are important aspects of the design of the store. Marquees, walkways, entrances, doors, display windows, the height and size of the building, colors and materials used, and theft prevention are some of the key factors to be kept in mind while developing a store’s exterior.

Managing space is the first and foremost concern of almost every retailer, when it comes to designing the store’s interior. Space is always an expensive and scarce resource. Retailers always try to maximize the return on sales per square foot. Planning a layout for the store’s interior is the first step in designing the store's interior. There are three kinds of layouts - grid layout, race track layout and freeform layout.

Allocating space to various merchandise categories in a store is very important. Allocation of space can be based on many factors, like historical sales, gross margins, industry averages and strategic objectives. Apart from allocating space to various merchandise categories, space has to be allocated for carrying out some essential functions. Such space includes the back room for receiving the inventories and sorting them out, office and other functional spaces, aisles and customer service desks, floor space and wall space. The interior of a store influences the purchasing behavior of the customers to a great extent. Designing the interior of a store in such a way as to influence customer behavior is referred to as visual merchandising. It includes optimum and appropriate use of fixtures, displays, color, lighting, music, scent, ceilings and floor, and designing all of these properly. Merchandise presentation is the most significant aspect of store design, because it helps attract customers' attention. A retailer can resort to many forms of presentation such as idea-oriented presentation, item-oriented presentation, price lining, color presentation, vertical merchandising, tonnage merchandising and frontal presentation.

Prevention of losses due to merchandise pilferage is a major cause of concern for all retailers. This issue should be addressed at the initial stage of store design. The retailer can use many electronic security systems like CCTV and EAS for the prevention of such losses. Thus, by appropriately integrating the various elements of store design (both exterior and interior), a retailer can create an excellent image of itself in the target customer's mind.

# Chapter 15

# Customer Service

**In this chapter we will discuss:**

- Gaining Strategic Advantage through Customer Service
- Types of  Customer Services
- Customer Evaluation of Service Quality
- Gaps Model for Improving the Quality of Service
- Service Recovery

## INTRODUCTION

With increased competition in the marketplace, the importance of customer service has been growing rapidly. Customer service is now becoming a key differentiation strategy for retailers.

In a retailing environment, customer service can be referred to as a set of activities and programs taken up by a retail organization to offer its customers a rewarding shopping experience. Customer service involves all activities that determine – i) the ease of shopping for potential customers or information provided about the store's offerings, ii) the ease of completing a transaction and iii) the satisfaction of customers after the shopping. These activities comprise the different stages of customer service – pre-transaction, transaction, and post-transaction. According to a research conducted by Cap Gemini Ernst & Young in the UK, consumers no longer expect best quality products at the lowest prices, but they certainly expect a deal that is fair and suits their respect and dignity. Such activities and programs taken up by the retailer add great value to the goods and services bought by the customers. Some of the most common services offered by the retailers are: accepting credit cards, making alterations, assembling products, offering credit facilities, providing home delivery, making product demonstrations, providing trial rooms, dressing rooms, extending business hours, elaborate signages to help customers locate merchandise and gift wrapping, parking facilities, etc.

This chapter examines the significance of customer services from various perspectives, especially from the strategic and customer perspectives.

## GAINING STRATEGIC ADVANTAGE THROUGH CUSTOMER SERVICE

In order to gain a differential competitive advantage, retailers should develop their customer service programs after considering the pre-transaction, transaction and post-transaction activities of sale. Because of mass distribution of the merchandise, it becomes highly difficult for the retailer to differentiate itself from its competitors solely on the basis of the merchandise offered. Though the same rule applies to location and design of the stores, innovative customer service programs can certainly provide retailers with a high level of differential advantage. The most successful retailers in the US attribute their success to their excellent customer service programs. Excellent customer service leads to improved customer loyalty and protects retailers from competition on various factors, like price, merchandise, location and store design. A loyal customer is less vulnerable to the temporary price discounts offered by competitors. The experience of shopping at a retail store is much more than moving into the store, selecting and purchasing the merchandise. It begins much before the customer has entered the store and ends much after he has left the store. Thus, it is necessary to emphasize on customer service during pre transaction, transaction and post transaction stages of a sale, to attract new customers and strengthen the loyalty of existing customers. While providing excellent customer service during the pre-transaction and post-transaction stages, it is essential to ensure that the transaction actually takes place. Good customer service in the post-transaction stage is essential to build customer loyalty and retain them. Transient customers are those who are dissatisfied by the customer service of a store or those who find that the product they are looking for is not in stock. There are a considerable number of transient customers for any retail business or store. These customers continuously try to find a store that offers customer service that matches their expectations. Stores which provide excellent customer service programs have the opportunity to convert these transient ncustomers into their loyal customers. Thus, superior customer service can play a vital role in building sales volume for the retailers. Globally, retailers like Sears, Nordstorm, and L.L.Bean have differentiated themselves on the basis of merchandise they offer and their superior customer service. Excellent service makes the customers repeat their purchases at the same store and helps generate a positive word-of-mouth by which new customers can be attracted. Exhibit 15.1 illustrates the way by which Sears has become the number one retailer in Canada.

**Exhibit 15.1**

**Customer Service – The Sears Way**

Superior customer service played a major role in the success of Sears in Canada. Their excellent customer service programs have placed them far ahead of their competitors. The following are some of the key elements of customer service, delivered by Sears:

**1. Ease the purchase process**

The customer need not go to a Sears outlet to buy Sears' products. The customers can shop online if they prefer to do so, 24 hours a day. Telephone shopping facilities are made available on any day of the week. Moreover, being the best catalog retailer, it provides many options for the customers.

**2. Establish clear return and refund policies**

Providing the customers with clear return and exchange policies will help increase customer satisfaction. All the customers' shopping at Sears are aware that they can return the merchandise they have bought and no question would be asked for a full refund. If the merchandise ordered by a customer is stocked out, the customer receives the merchandise of the same or better quality. These policies led to an increase in the number of new customers and converted many of the existing customers into loyal customers.

**3. Develop a dependable supply chain and/or delivery system.**

The speed of delivering goods is another important aspect of Sears' customer service that makes it the number one retailer in Canada. Their delivery system and infrastructure are so efficient that they can deliver goods to their customers almost anywhere in Canada within three days.

*Source: http://sbinfocanada.about.com/library/weekly/aa660602b.htm*

## Nature of Customer Service

The service and merchandise offered by retailers differ on two factors, intangibility and inconsistency. Many of the services provided to customers do not have a physical form and are intangible. Customers can see/touch a trouser but cannot feel (see or touch) the service provided by the assisting salesperson. These factors make it difficult for both the retailer and the customer to measure and evaluate the services offered. Customers, while evaluating the merchandise, can use many physical cues like color, size, weight, fit, etc. But, while evaluating services, customers do not have any such physical cues. This makes it even more difficult for the retailer to offer and maintain the kind of high quality service that customers expect. Retailers too cannot measure or evaluate their service before delivering it to their customers. However, the quality of service provided by retailers can vary considerably from store to store, customer to customer and even within a store. This is because services are delivered by people and it is difficult to check the performance of its personnel at all times. The same salesperson can provide good service to some customers and poor service to others. Since it is difficult to provide a superior customer service consistently, a retailer who succeeds in doing so gains sustainable competitive advantage. Though large retailers can have a price advantage, small retailers generally try to gain a strategic advantage through customized customer service.

## Customer Service Strategies

Retailers, in order to develop an enduring competitive advantage, usually follow two approaches, customization and standardization.

### Customization

Customization involves tailoring the goods and services as per the individual needs of customers. Such an approach motivates the service providers to customize their services according to the personal needs of their customers. Typically, customization helps retailers provide superior customer service. However, the service provided might not be consistent, as its delivery is based on the judgment and capability of the service provider. Further, customizing the services can be expensive because it requires a number of well-trained service providers.

### Standardization

Standardization refers to the process of conforming to standards (a set of rules and procedures) while providing service to customers. Standardization helps minimize various inconsistencies in customer service. The global fast food major McDonald's serves its customers with the same food and service in all its 30,000 stores in 121 countries across the globe. McDonald's has standardized its customer service initiatives by strictly enforcing the QSCV (Quality, Service, Cleanliness, Value) policy across all its restaurants. QSCV ensures superior quality food and excellent service. Store design and layout are also considered to be a part of the standardization process. Very often, it has been observed that customers do not like to avail the services provided by the sales personnel of a store and prefer to locate the merchandise themselves. Retailers can therefore, offer good service to its customers by designing the layout of the store in such a manner that the customers can locate the merchandise easily and quickly.

Some self service retailers place computer kiosks throughout the store to assist the customers in locating and selecting the merchandise.

# TYPES OF CUSTOMER SERVICES

As discussed earlier, services in a retail store are usually delivered at three levels, pre-transaction, transaction and post-transaction.

## Pre-Transaction Services

These help the potential customers to find out the store's merchandise offering easily. Convenient store hours are the most basic and most important service that any retailer can offer to its customers. Convenient store hours make it easier for the customers to visit the store. Retailers must determine what their customers are expecting from their stores and then measure the cost of fulfilling those expectations against the additional income that would be generated once the expectations are met. The retailers should extend their business hours if it suits the convenience of its target customers. However, they should do so only if operating for extended hours is profitable for the store. Some retailers like petrol stations and restaurants may offer round-the-clock service. Competition is a major factor that determines the operating hours of a store. It will not be wise to shut the store by 7pm when every other retailer in the vicinity operates till 10pm until and unless there is a legal compulsion to do so.

These days, a majority of retailers provide their customers with many informational tools that facilitate wise decision making while purchasing goods and services. Many of the large retailers provide their target customers with all the information pertaining to exchange policies, credit policies, merchandise offered and also the prices of merchandise, through various sources like online catalogs. Most large retailers today have their own websites. Retailers often give demonstrations on the usage, operation and maintenance of products. Most customers are averse to buying products without having proper knowledge of their application. If the store demonstrates the usage of the product, customers will certainly be less reluctant to try and buy new products. Some retailers even provide users guides that provide useful information about a product or service.

## Transaction Services

Transaction services are those services that are delivered to customers while they are shopping in the store and carrying out business transactions. The most commonly offered transaction services include providing credit facilities, gift-wrapping and packing, personal shopping and personal selling. These services help customers to make a business transaction conveniently and quickly.

Providing credit facilities is one of the most popular transaction services offered by a retailer. Retailers help customers purchase the goods without the need to carry cash. Apart from this, it provides a 'buy now pay later' facility. Offering credit services helps retailers increase their sales as it encourages the impulsive buying behavior of customers and makes the purchase of expensive goods much easier. However, offering in-house credit facility with easy credit policies can sometimes have a negative effect on the profits.

Retailers can serve their customers better by offering excellent packaging. The packing service of a retailer should be well coordinated with the overall image of the store and the type of merchandise it sells. Though a nominal fee is generally charged for merchandise wrapping, some large retailers offer this service for free as a goodwill gesture.

Merchandise availability is a type of transaction service that helps customers locate the merchandise they wish to buy. There can be many reasons due to which the customers might not find the merchandise they are looking for. However, the most common ones are: merchandise might not be available due to a stock–out situation, merchandise might not have been displayed in the place where customers expect it to be, or the customer might not know what he wants to buy. Though stock-outs cannot be avoided completely, the retailer can minimize stock-out situations through effective merchandise management practices. By having a well-designed layout along with various point of purchase displays and helpful sales personnel, retailers can make it relatively easier for customers to locate the merchandise they are looking for. Retailers should not overlook the importance of merchandise availability because, if the customers fail to find the merchandise they require, irrespective of the reasons, it can lead to negative word-of-mouth communication.

Having strong, customer-friendly sales personnel is the most important transaction service that a retailer can provide. Personal selling can have a significant effect on customer satisfaction by providing a good shopping experience to the customer.

Customers usually evaluate a sales transaction by the time taken to check out of the store after the merchandise has been selected, the friendly nature of employees at the billing counter, and honoring credit cards. The final sales transaction services offered by a retailer should ensure that customers do not leave the store with any bad experiences.

## Post-Transaction Services

Post-transaction services are those services that are provided by the retailer to the customers after the merchandise or the services have been purchased. Retaining a customer is the most complex task for a retailer because of the increasing competition. Hence, most of the large retailers are now developing customer loyalty programs. Exhibit 15.2 illustrates the nature of a loyalty program and the various forms in which loyalty programs can be delivered. Complaint handling, merchandise exchange handling, repairing, free service and delivery are some of the most common post transaction services offered by retailers.

**Exhibit 15.2**

**Loyalty Programs**

**Typically, a loyalty program must:**

- Require customers to enroll
- Provide rewards, discounts, or services based on the purchasing patterns of customers
- Communicate the benefits received by customers from specific purchasing patterns

**Types of Loyalty Programs**

i. Frequent-shopper card: Shoppers scan the card at the time of purchase to get real-time discounts. This type of card usually comes without credit linkage. This card can also be used for cashing cheques, especially at grocery stores.

ii. Store credit card with tiered membership benefits: Rewards and incentives generally motivate or reward high spending customers. Benefits usually include "cardholder only" sales. Promotions are based on the spending habits of customers.

iii. Co-branded credit cards: These cards allow customers to accumulate reward points which can be redeemed for gifts and other benefits, depending on the spending patterns. These cards generally provide differentiated discounts to consumers based on purchases in store versus elsewhere (For example, 5 percent cash back for apparel purchases, 1 percent cash back for all other purchases).

*Source: Icfai Center for Management Research*

Handling customer complaints effectively can have a very positive impact even on the most dissatisfied customers. While dealing with dissatisfied customers, there is a greater probability of misunderstanding. Such misunderstandings between the employees and customers can tarnish the retailer's image. There are several ways in which a retailer can handle and resolve the problems of its customers. Some large retailers may have a centralized customer grievances cell, which handles all the grievances of customers and makes attempts to resolve them. The employees of this cell are specialized in handling and resolving the customer problems. Some retailers assign the job of handling complaints and resolving problems to a single individual who is friendly and sympathetic by nature. However, an individual salesperson might not always have the complete authority to resolve the problem. There are three fundamental rules that the retailers should follow, irrespective of the complaint handling mechanism they adopt. Customers expect and deserve respectful treatment, fair problem solving and proper attention. The retailer should ensure that the customer should not be lost even if the sale is lost.

Handling merchandise returns and exchanges is the most important post transaction service. It can sometimes be a differential between profit and loss. A moderate exchange policy can build customer goodwill effectively. Because of the return and exchange facility, retailers' money would be locked up for that period. Further, the item would be stocked out. In order to control these losses, retailers usually set the validity of their return policy. For example, the goods should be exchanged or returned within seven days from the purchase date. "Goods once sold will not be taken back or exchanged", "Merchandise sold is exchanged during week days from 1pm to 3 pm, subject to the condition of the merchandise" are a few of the most commonly found tag lines given in fine print on the invoice of any merchandise purchased. Some of the exchange policies of Shopper's Stop (an Indian retailer) are given in Exhibit 15.3.

**Exhibit 15.3**
**SHOPPERS' STOP**

Feel the experience. While you shop.

**STORE POLICY ON EXCHANGES**

We will accept exchanges with in 10 days from the date of purchase on PROVIDING PROOF OF PURCHASE (Cash Memo), if the merchandise is returned undamaged and in saleable condition except items made to order or items like cosmetics, jewellery, watches, lingerie, hosiery which cannot be exchanged for hygiene reasons.

**TERMS & CONDITIONS**

1. We are responsible what we sell.
2. No Refund/Exchange on discount items.
3. Please follow care instructions.
4. For reference retain Cash Memo.
5. Subject to Hyderabad Jurisdiction
6. Timings: 10.30 a. m. to 8.30 p. m.

**SHOPPER'S STOP**

1-11-251/1, BEGUMPET, HYDERABAD (INDIA) -500016.

TEL: (040) 7761080, 7761084

FAX: (040) 7761108

CST: PJT/03/1/2569 w.e.f 1-14-98 CST: PJT/03/1/2569 w.e.f 1-14-98

Offering service and repair facilities for the merchandise being purchased can be a key factor for attracting new customers. Many customers are cautious to find out about these services while purchasing goods, especially electronic goods. The quality of repair and service facilities can also generate repeat purchases. Most of the car dealers these days are offering round-the-clock breakdown service at any place.

Home delivery, though an expensive post-transaction service is being offered by an increasing number of retailers to increase customer satisfaction.

## CUSTOMER EVALUATION OF SERVICE QUALITY

While evaluating the services provided by retailers, customers compare the services they receive with the services expected by them. When the services received, meet or exceed the services that are expected, customers are satisfied. However, they are dissatisfied when the services received by them do not match their service expectations. Expectations are based on the knowledge and experience of customers. Expectations can vary from customer to customer and from retailer to retailer. A customer who may be satisfied with a low level of service at a retail outlet may not be satisfied with high service levels of another retailer. For example, though the actual service offered by Wal-Mart is lower than the service expected from a typical departmental store, the customers are satisfied by the services provided by Wal-Mart. This is because of some of the unusual service practices adopted by Wal-Mart. For example, at every store, one of its employees stands at the entrance to greet the customers and answer their queries.

The evaluation of the service offered by a store usually depends on perceptions of customers. Though perceptions are influenced by the services actually provided, accurate evaluation of a service is difficult as it is intangible. Sales personnel are the major determinants of the customer's perception of service provided by the retailer. The satisfaction or dissatisfaction of a customer arises from the gap between the perceived service and the actual service provided. As there is always a gap between the customer's expected service and the actual service offered to the customer, retailers should understand the need to provide their customers with superior quality services.

## GAPS MODEL FOR IMPROVING THE QUALITY OF SERVICE

The Gaps Model for improving the quality of service was given by Valerie Zenthaml and the Center for Retailing studies at the Texas A&M University. The model gives insights into the various obstacles that may hinder a retailer's ability to close or otherwise minimize the gap between the customers' expectations and the perceived service (the customer's perception of the actual service received). For example, the level of service expectations from a fast-food outlet will certainly be different from that of a restaurant at a star hotel. There are many factors that influence the customers' expectations. They include advertising and sales promotions, personal needs, word-of-mouth publicity and competitive offerings. The success of a retailer in developing superior services lies in understanding the wants and needs of customers and how customers evaluate the merchandise and services received. There are four key potential gaps that a retailer should understand in order to evaluate the service satisfaction:

Gap 1: Lack of knowledge regarding customer expectations or the knowledge gap

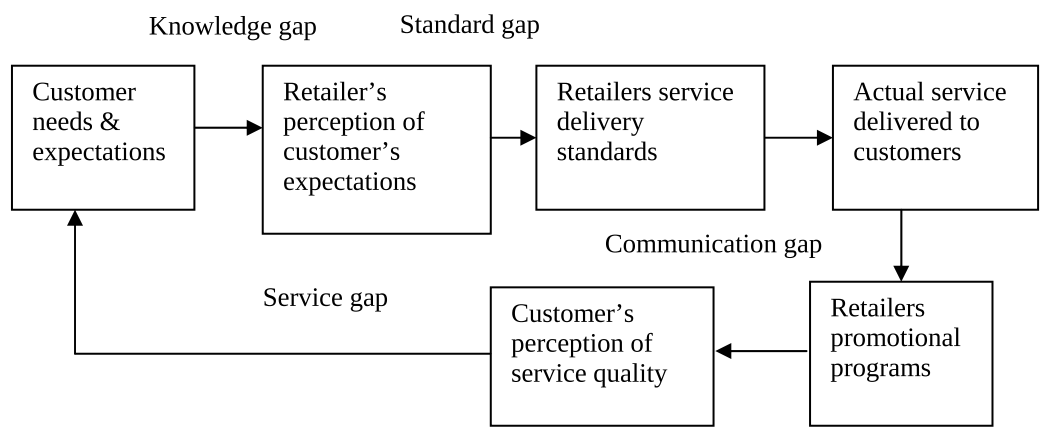
Gap 2: Lack of appropriate service standards or the standard gap

Gap 3: Failure to deliver the promised service standards or the delivery gap

Gap 4: Failure to deliver the performance as per the promises made or the communications gap

Figure 15.1 depicts the GAPS model for improving the quality of customer service. These four potential gaps together form the service gap. The objective of a retailer is to reduce the service gap by minimizing each of these four gaps. Thus, the key to improve the quality of service is to

**Figure 15.1: The GAPS Model for Improving Quality of Customer Service**




*Adapted from Parasuraman, Zeithaml and Berry, "A conceptual model of service quality and its implications for future research", Journal of marketing, fall 1985, pp: 41-50*

i. understand the customer expectations on the level of service quality (the knowledge gap)

ii. develop standards for delivering customer services (standards gap)

iii. execute programs that deliver services that match the standards set (delivery gap) and

iv. develop communication programs that convey information on various services offered by the retailer (communication gap).

## Knowledge Gap

Retailers should have complete knowledge of customer expectations from a store. Acquiring this knowledge can be as simple as interacting with customers on a regular basis or it can be as complex as conducting thorough research on customers (including focus group studies, satisfaction surveys and brainstorming sessions). Some retailers develop programs for analyzing the service expectations and perceptions of their customers. These programs usually involve getting questionnaires filled up by customers visiting the store and then analyzing them. Retailing major JC Penney conducts these types of studies annually as a part of its regular quality improvement process. Some retailers survey customers immediately after closing the transaction. This type of survey helps the retailer get up-to-date information about the service expectations and perceptions of customers. Such surveys make the customer notice the retailer's concern for providing better service. The ability of the survey to collect feedback related to a specific encounter helps managers reward employees delivering good service and improve those who deliver average or poor service. In some stores, managers interact with a panel of selected customers who share their experiences at the store while shopping and give suggestions for improving the service. Complaints form another important source of information about the quality of service at a retail outlet. Through complaints, retailers can interact with customers and can get detailed information about their quality of service and merchandise. Sales personnel and other staff members, who interact with customers on a regular basis usually know a lot about the service expectations and perceptions of customers. This information can be accessed only if there is an open channel of communication across the retail organization.

## Standards Gap

Apart from understanding customer needs, retailers should also set some service standards. Clearly defined service quality standards help employees understand how the company and its customers define a quality job. In order to close the standards gap, retailers should focus on

i. providing high service quality;

ii. providing innovative solutions to various service related issues;

iii. defining and describing the role of people delivering the service;

iv. establishing service objectives; and

v. measuring the performance of the service.

The commitment of the top management is necessary to attain high levels of service quality. The top management should be prepared to deal with any temporary problems and costs that arise when improving service quality. Management's concern for service quality should be clearly demonstrated to the service providers. Though the top management develops the quality standards, it is the store managers who meet and maintain these standards. Store managers should ensure that service providers' attempts to deliver superior service are recognized and rewarded. Rewarding service providers on the basis of the quality of service they provide can encourage the sales personnel to make service their key personal goal. Generally, retailers do not set high service standards, as they perceive them to be too expensive for them or too difficult for current employees to achieve. Such a perception shows the lack of a positive approach to an issue.

Retailers can improve customer service by exploring new ways of dealing with various service issues. Technology can help retailers simplify and improve the quality of customer service. Retailers can implement an automated system to handle routine tasks so that the employees are free to deal with the more demanding queries and problems of customers. Though managers can ask service providers to deliver superior service, the service providers cannot do so until a clear definition of superior service is established. In order to deliver excellent service, retailers should establish goals that guide employees. These service goals should be developed on the basis of the needs and expectations of customers. Employees are motivated to accomplish service goals when the goals are specific and measurable, and when employees are involved in goal setting. The quality of the service should be evaluated on a regular basis to ensure the achievability of the service goals. Most retailers use timely customer surveys to measure the quality of the service.

## Delivery Gap

In order to minimize or close the delivery gap and deliver services that exceed the set standards, retailers should provide employees with the necessary knowledge and skills, material and emotional support, and empower them to act in the best interests of customers and the organization as a whole. The interpersonal skills of service providers should be improved and they should be trained in various customer-handling techniques. The employees should be provided with the appropriate systems and equipment for delivering efficient service. Service providers should also receive sufficient emotional support from their supervisors and co-workers. Providing service providers with guidelines and policy of service with a clear description of the rationale behind them can minimize potential conflicts in the organization. The quality of service can be improved by empowering the staff at the operational level of the organization to take important decisions. It has also been found that the quality of service improves significantly when incentives are based on the quality of service delivered.

### Communication Gap

Retailers generally raise the expectations of their target customers through advertising and other forms of communication. If any of their communication channels raise customer expectations to unrealistic levels, the actual experience at the store will disappoint customers. Retailers can minimize the communication gap by making realistic commitments and managing customer expectations.

There should be a clear line of communication between the marketing department and the operations department since the marketing department develops the advertisements while the operations department delivers the services. Any miscommunication between these two departments would lead to a mismatch between the promises made through the advertisements and the services actually delivered.

Thus, to provide excellent service quality, retailers should pay attention to minute details, measure the perceptions and expectations of customers, and develop systems for addressing customer service. The management of a retail store along with its service providers must clearly establish service goals and obtain the necessary resources for delivering the promised services.

## SERVICE RECOVERY

Customer complaints are an excellent source of information to judge the quality of merchandise and services being provided. Retailers can modify their service programs on the basis of information received through complaints, thus improving customer satisfaction. They can strengthen their relationship with customers by responding to complaints and addressing various service related issues. Most retailers develop their own policies for handling complaints and customer problems. Retailers, on identifying a correctable problem, try to solve it instantly and apologize for the trouble caused. However, in most situations, it is not possible to identify the cause of the problem. The problem could have been caused by the salesman's rude behavior or the poor law and order situation that forced the store to close early. In such situations, it is very difficult to rectify the mistakes. In all cases, the following steps should be taken for service recovery:

- Listening to customers
- Providing a fair solution
- Resolving the problem quickly

### Listening to the Customer

Generally, customers get very emotional when they have a problem with a retailer; and such emotions can be controlled by letting customers freely express their feelings, without interruption. It is not easy to pacify such customers. In such situations, customers expect a sympathetic response from the store personnel. Therefore, the service providers should show their eagerness to solve customer problems. They should approach the problem with an open mind, should listen to customers with utmost attention, and try to understand what type of solution is expected. The service providers should never indicate that they are already aware of the customer's problem.

## Providing a Fair Solution

When solving a customer problem, service providers should think of ways to retain the customer. Handling customers' problems in a fair manner can create a favorable impression of the store. Customers generally evaluate the way their problem was resolved by comparing the treatment provided to them with the treatment provided to others facing a similar problem. These evaluations of customers are based on distributive and procedural fairness.

Distributive fairness refers to the customer's perception of the value received in comparison with the price paid for it, the problems faced, or the loss (if any). They would like to get the most out of what they paid for. But the need of the customer (for a product being purchased) has a significant influence on his value and cost perceptions. Generally, customers expect a tangible solution for their problem rather than an intangible one. If the retailer is not able to provide a tangible solution to a customer's problem, then it is better to assure the customer that his or her complaint will be taken care of in the future. This can be done by putting up a note to the manager about the problem in the presence of the customer, or by informing the customer about the actions taken to avoid such problems in the future.

Procedural fairness refers to the customer's perception of the fairness of the process of solving the customer's problems. When assessing the fairness of a process used for resolving a problem, customers ask three questions:

- Did the service provider gather all the required information about the problem or the complaint?
- Did the service provider use the information gathered to solve the problem?
- Was the solution of the problem influenced by the customer?

Generally, customers feel that their problem has been addressed fairly when the service providers follow the company guidelines strictly. Guidelines reduce inconsistencies in problem solving, thus making customers feel that they were treated fairly and equally like everyone else. However, following guidelines strictly has its drawbacks. Therefore, the service providers are allowed some flexibility when handling complaints and resolving problems. This flexibility makes customers feel that they have influenced the problem resolution process.

## Resolving Problems Quickly

The time taken to resolve a particular problem has a significant effect on the level of customer satisfaction. The longer the time taken for a problem to be resolved, the more dissatisfied the customer will be with the service and the overall experience at the store. The time taken for resolving a problem can be minimized by:

- bringing down the number of contacts
- providing clear instructions on the store policies
- speaking from the customer's angle

Though customer satisfaction increases when customer problems are resolved quickly, solving problems without proper care can lead to customer dissatisfaction. Hence, retailers should strike a balance between solving a problem quickly and taking time to listen to the customer.

## SUMMARY

Providing superior service has always been a complex and challenging job for retailers. This is because of the intangible and inconsistent nature of services. Retailers generally use customization and standardization to deliver customer services. While customization motivates the service providers to customize services according to the needs of individual customers, standardization ensures that they follow established guidelines when delivering service.

The various services provided by retailers to customers can be grouped under three categories; pre transaction, transaction and post transaction services. Convenient store hours and information availability are the most common pre-transaction services offered to customers. Pre transaction services help target customers gather information about a store's merchandise and methods for purchasing it easily. Transaction services are delivered to customers while they are shopping at a store. Post transaction services are provided by retailers after the merchandise or the services have been purchased.

Customers evaluate the quality of a service by comparing the actual service delivered at the store with the service expected. The gap between the perceived quality of service and the expected quality of service has led to the identification of four types of gaps in service quality being delivered: Knowledge gap, Standards gap, Delivery gap and the Communication gap. These four gaps together form the Service gap. In order to improve the quality of service, retailers have to minimize, if not close the service gap between the delivered and the expected service. Retailers can close the gap by finding out customer expectations, establishing standards for delivering the expected service to customers, providing instrumental and emotional support to service providers, and communicating the merchandise and the service offerings to customers in a realistic manner.

The failure to provide services according to the set standards leaves the retailer with little opportunity to build and strengthen relationships with his customers. Though recovering a service failure is very difficult, retailers can re-establish and strengthen their bonds with customers by following a three step procedure; listening to customers, providing a fair solution, and resolving the problem quickly.

Customer service has become the major determinant of retailing success. Retailers can earn maximum profits only by developing integrated customer service programs.

# Chapter 16

# Retail Selling

**In this chapter we will discuss:**

- Role of a Retail Salesperson
- Role of Personnel Selling in Retail Promotion Mix
- Requirements of Effective Selling
- Retail Selling Process
- Evaluation of a Salesperson

## INTRODUCTION

The retail industry is becoming increasingly competitive. To gain advantage over their competitors, retailers are adopting new store formats. The existing store formats like department stores, specialty stores, discount stores and warehouse stores are competing with each other by differentiating themselves on the basis of price and the customer service they provide. Thus, the importance of salespeople in the retailing industry is growing tremendously. A salesperson serves the consumer and tries to make his shopping experience pleasant. In addition, the salesperson also provides the consumer with information that will help him satisfy his needs.

All retail stores have the same systems, processes and more or less the same type of products. Thus, the key differentiator in a retail store is its employees.

In this chapter, we examine the role of the salesperson in promoting retail selling and the significance of the salesperson in personal selling. We also analyze the various steps involved in the retail selling process and the requirements of an effective salesperson.

## ROLE OF A RETAIL SALESPERSON

A retail salesperson acts as an interface between the retailer and the customer. A retail salesperson communicates with the customer to help him evaluate the merchandise and encourage him to buy the product.

A retailer uses advertisements and promotional activities to create awareness among the customers and builds a strong brand image for the store. But the above activities only help the retailer to inform/educate the customer and bring him to the store. Once the customer enters the retail store, it is the salesperson who provides more information about the product and ensures that the customer buys the product.

The salesperson can tailor his communication according to the requirement of individual customers, making him the most effective communication vehicle for the customer.

In a retail store selling merchandise like shoes, consumer durables or automobiles, a salesperson assists customers to locate the merchandise they are looking for. If a person seems to be a potential customer, the salesperson creates interest in him/her to buy the merchandise. To generate interest, a salesperson describes the product's features, demonstrates its use, and shows various models and colors available in the retail store. If the salesperson is working in a retail consumer durable store, he has to explain the features of the merchandise, the availability of models in the retail store, warranty information, the manufacturers' specifications regarding the product, the options available as well as ways to finance the product.

Customers form an opinion on the store by evaluating its salespeople. By providing efficient service and being courteous, a salesperson helps the retailer gain good reputation and remain competitive in the market. For example, if a customer wants a product that is not available on the sales floor, the salesperson can check the stockroom, place a special order, or call another store to locate the item, thereby enabling the customer to satisfy his needs. Such behavior from the retail salesperson will encourage the customer to come back to the store.

The role of the salesperson varies from one retail store to another. The nature of the job depends on the retail store the salesperson is working for. A salesperson working in a department store or an apparel store has the responsibility to prepare sales cheques; receive cash, check, and charge payments; and give out change and receipts. Moreover, he would have to take up different responsibilities based on the time of the day that he works. Occasionally, he may have to open or close cash registers, check the cash, separate charge slips, coupons, exchange vouchers and make deposits at the cash office.

Salespersons in a retail store are also responsible for handling returns and exchange of merchandise, gift wrapping and maintaining the cleanliness of the store. They have to help stock shelves or racks, arrange for mailing or delivery of purchases, mark price tags, receive inventory, and prepare displays.

The work of a salesperson during special sales and promotional activities becomes highly demanding. At such times, salespersons should take care of the security risks and thefts and take adequate measures to prevent such situations.

In a retail store, customers demand personal attention and service. They require the suggestions of the salespeople and want to see demonstrations of the products they plan to buy. A well-trained salesperson not only sells products desired by the customer but also promotes the sale of complementary goods (suggestive selling).

Product knowledge is one of the criteria for successful retail selling. Understanding the features of the merchandise and its characteristics helps the salesperson meet the customers' demands in a better way.

## ROLE OF PERSONAL SELLING IN RETAIL PROMOTION MIX

Personal selling is the process of convincing the customer about the product through personal communication. The salesperson is flexible enough to provide the information according to the need and behavior of the individual customer. Personal selling takes place at two levels;

- Retail level (Retail selling)
- Field level (Field Selling)

Retail selling takes places when a potential customer approaches a retail store. Here, the role of the salesperson is to satisfy the need of the customer with the available merchandise in the retail store.

In field selling, the salesperson approaches the customer with prior appointment and tries to make the customer a potential buyer by convincing him/her about the benefits of the product. This form of selling is also known as door-to-door selling.

Personal selling helps the salesperson build a strong relationship with the customer and learn about the requirements of prospective buyers. It also helps the salesperson to:

- Promote the merchandise of his store by explaining the benefits of the product and encouraging the customers to place an order
- Maintain a cordial relationship with the existing customers by providing information about the company's new products and services, thereby trying to make them prospective buyers

Personal selling acts as a direct tool for communication between the organization and the target customers.

## REQUIREMENT FOR EFFECTIVE SELLING

In these competitive times, effective selling is becoming a challenge for the retail salesperson. He has to meet the requirements and expectations of both retailers and customers. Retailers expect a continuous increase in sales, while customers expect good customer service and value for money. Customers expect the salesperson to understand their needs and requirements and update them on the market trends. The increasing sophistication in technology and a wide variety on products has made the job of a salesperson more difficult. To become a successful salesperson, one should find time to cultivate strong relationships with customers and develop a comprehensive understanding of various industries, markets and customers.

The salesperson should have a clear understanding of the store's policies and procedures because while making the buying decision, the customer may require this information. The salesperson should be able to provide them information about safety measures, the product guarantee and the after-sales service etc. If the salesperson does not have adequate knowledge on the subject, he should refer the customer's query to another person in the store who could answer the query satisfactorily and clear the confusion.

There are certain fundamental requirements for a salesperson:

- Listening
- Questioning
- Interpreting and Non-verbal communication
- Flexibility and Adaptive selling

### Listening

A salesperson who is not experienced may think that he can attract the customer's attention by being a good orator. However, to gain customer attention, a salesperson should be an attentive and good listener as well.

The salesperson should allow the customer to talk and should carefully listen to his requirements. Listening is more than just hearing. A salesperson may hear many things, but need not register everything in his mind. The technique of active listening includes repeating or rephrasing information, summarizing conversations and remaining silent at times.

By listening carefully, the salesperson can understand the nature and requirement of the customer more correctly and predict what the customer is looking for. An effective salesperson is one who listens carefully and can even change the decision of a prospective customer to make him a customer.

### Questioning

By asking questions, the salesperson can actively involve the customer in the sales process. This helps the salesperson know customers more clearly, understand their needs and thus, provide the merchandise that they need. It also helps salesperson to make complementary sales.

For questioning to be effective a retail sales person should:

*Seek long responses:* The questions asked by the salesperson should not be answerable in simple 'Yes' or 'No'. The questions of the salespersons should evoke a long response from the customer. This would help the salesperson understand the customer better, find out what the customer is looking for and provide a more efficient service.

*Space out the questions:* If a customer is bombarded with a series of questions, there is a possibility that he may feel uncomfortable and stop responding to them. Hence, a salesperson should space out the questions to the customer at various stages of the discussion.

*Keep the questions short and simple:* The salesperson should ask short and simple questions that would make the customer comfortable and feel at ease. If a salesperson asks lengthy questions, the customer may get bored and lose interest in the conversation.

### Interpreting and using Nonverbal Communication

It is not enough for a salesperson to be a good listener. He must know how to interpret the body language of the customers and understand other forms of non-verbal communication as well. Awareness of the prospect’s personal space, a firm and confident handshake, and accurate interpretation of body language can be of tremendous help to a salesperson. Salespeople must listen closely to what customers have to say, analyze their spoken words, and be attentive to their non-verbal communication. The eyes, gestures, vocal intonations, and overall appearance of customers reveal much about their thoughts. Salespeople must carefully note their impressions of these verbal and non-verbal expressions and structure their sales communication such that the critical product features presented meet the customers’ desires and he decides to buy the product.

### Flexibility and Adaptive Selling

A salesperson should tailor his selling techniques according to the requirements of the customer. The customers in a retail store vary in their tastes and preferences. A salesperson should be able to understand this and should provide the merchandise and service according to the requirement of customers. They should be flexible enough to change their sales presentation depending on the customer they are serving.

The main job of a retail salesperson is to attract customer’s interest to the product by describing its benefits, demonstrating its use; offering them a wider choice by showing different models, sizes, colors, etc. A retail salesperson should be flexible and adaptive enough to cater to the customers' needs quickly and politely.

## RETAIL SELLING PROCESS

Retail salesmen adopt various approaches to sell their merchandise. Irrespective of the selling approach (see Exhibit 16.1) adopted by them, there would be certain basic steps that a retail salesperson follows, which together constitute the retail selling process. But the time a salesperson devotes to each of these processes may vary depending on the merchandise type, the customer and the situation. Therefore, the process of retail selling involves all activities that a salesperson undertakes to facilitate the customer make his purchase decision.

The selling process starts with the salesperson approaching the customer and trying to understand his needs. Customers with unsatisfied needs are always looking for information about products or services, which can satisfy their needs. A salesperson helps customers gather information on various products and helps them select the merchandise that they are looking for. To help customers evaluate the various alternatives available, the salesperson demonstrates the products, explains the features and benefits of the product and persuades them to buy the product. Once the sale is made, the salesperson provides follow-up services to build a long lasting relationship with the customer. Even though a retail selling process generally comprises these activities, it is not necessary that a sales person should undertake all the above activities at all times.

**Exhibit 16.1**

**Approaches to Selling**

Salespeople usually use three approaches while selling merchandise. They are:

- Stimulus-response Approach
- Selling Formula Approach
- Problem-solving-need-satisfaction Approach

**Stimulus-response Approach:** This approach suggests that a particular response can be generated for specific stimuli. If the salesperson does and says the series of things that he is supposed to, his action would act as a stimuli for the customer who favorably responds by buying. But customers differ, and all customers may not respond in the same way for specific stimuli.

**Selling Formula Approach:** This approach rests on the assumption that all the customers receive and respond to the sales presentations in the same manner. The selling formula approach involves preparing and making a sales presentation that touches on all the elements or stages involved in the purchase process. For instance, AIDA i.e., attract *attention,* arouse *interest,* create *desire* and obtain *action* is an often used formula in the sales presentations. The drawback of this approach is that it does not take into account the fact that needs and preferences differ from customer to customer.

**Problem-solving-need-satisfaction Approach:** This approach addresses the drawbacks of the above two approaches by acknowledging and considering the individual consumer's needs rather than trying to persuade them all with a generalized sales presentation. In this individual oriented approach, the salespersons try to identify and understand the customers' needs and requirements by careful questioning. The salespersons then do their sales talk incorporating those features of products that cater to the needs of the customer. The salespersons thus appeal to the customers by making the product features appear as benefits to them by tailoring the presentation according to individual needs.

The salespersons adopting the problem-solving-need-satisfaction approach should have an absolute knowledge of the products, their usage, service, retailer's merchandise policies and promotional offers. They must also be good listeners with a knack to embody the individual preferences into the presentation in specific terms.

*Adapted from Ronhasty and James Reardon, Retail Management (McGraw Hill, 1997) pg, 538*

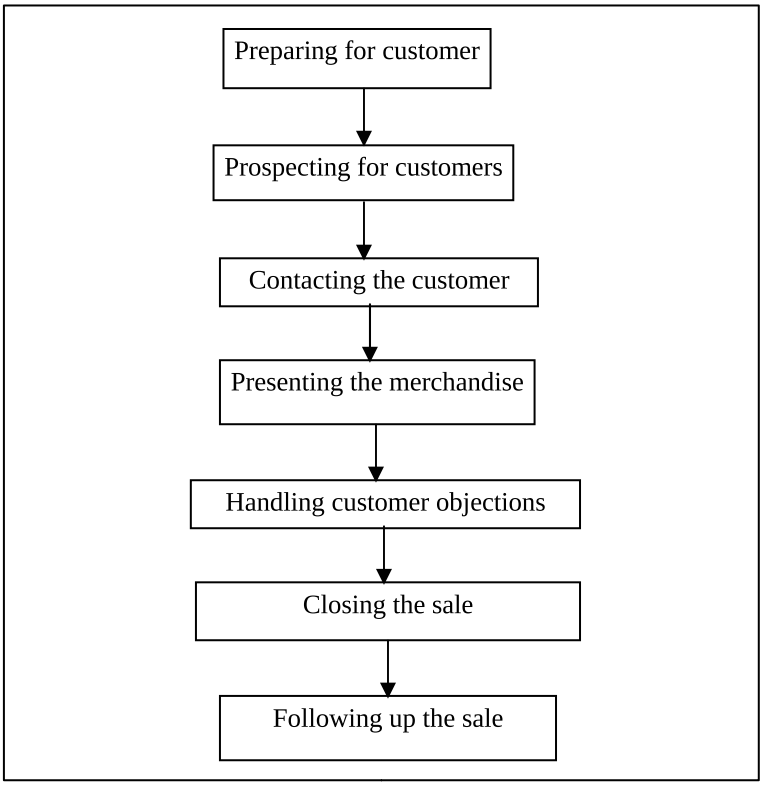
Though the selling process largely depends on the goods being sold, it can be broadly divided into seven steps:

- Preparing for the Customer
- Prospecting the Customer
- Contacting the Customer
- Presenting the Merchandise
- Handling Objections
- Closing the Sale

- Following up

Figure 16.1 illustrates the steps in a retail selling process

**Figure 16.1 Steps in a Retail Selling Process**




## Preparing for the Customer

For effective selling, a salesperson should have a thorough knowledge of the merchandise being offered by the store, the various activities undertaken by the store and the policies and procedures followed by the store. A salesperson's preparation stages can be of two types:

- Long run preparation
- Short run preparation

*Long run preparation* involves gathering information on the policies and procedures (exchange and return policies, operating procedures, use, demonstrations, etc.), and merchandise of the store.

In *short run preparation,* a salesperson tries to acquire knowledge about the day-to-day activities of the store like the existing stock volume for sale, and recent changes in policies and procedures. He would also need to keep track of the changes in style, fashion, models of the merchandise etc.

## Prospecting the Customer

Prospecting is the process of identifying customers who would not only be interested in the merchandise but would also have the ability to pay for the same. Prospecting becomes all the more important when customer traffic is high.

On the basis of the buying behavior of customers, a salesperson can classify them as good prospects or poor prospects. Good prospects are customers who show genuine interest in the merchandise, while poor prospects are those who only glance through the merchandise and are not interested in buying it.

During the peak hours of sales, if the salesperson identifies a good prospective customer, he can concentrate more on the needs of the good prospect rather than wasting time with a poor prospective customer. But at other times, the salesperson should pay equal attention to good prospects as well as poor prospects. By doing so, he can convert the poor prospects into good prospects for future.

## Contacting the Customer

It is essential for a salesperson to first generate interest so that the customer gets involved. The approach of a salesperson influences the buying decision of the customer. A customer builds an image of the store based on the nature and behavior of its salespersons. For example, consider an apparel retail store, where the consumers' buying decision is completely based on the approach of the salespersons. If a salesperson does not behave according to the customers' expectation, the customer may not buy the apparel from that particular retail store.

Customers expect a cordial welcome from the salesperson and good service. While purchasing a product from a retail store, customers expect a salesperson to provide them with a complete description of the product, its features along with usage and maintenance suggestions. He is also expected to caution them about any dangers that may arise out of the misuse of the product. Good communication skills of a salesperson can sometimes induce customers to buy products, which they may not otherwise have been interested in.

## Presenting the Merchandise

Once the customer has entered the retail store, the salesperson should collect some basic information from him with regard to the merchandise he is looking for, his tastes and preferences. For example, in an apparel retail store, a salesperson can ask questions like: What kind of apparel are you looking for? Are you looking for formal wear or casual wear? What is your price range?

Preferences vary from one customer to another. Basic questions about the preferences of a customer help the salesperson to offer merchandise, which suits his/her needs and preferences.

While presenting the merchandise, a salesperson should follow certain basic guidelines:

- Understand the customer's needs and wants
- Reduce the customer's perceived risk
- Demonstrate the product
- Actively involve the customer
- Sell product benefits
- Make the message simple

### Understand the customer's needs and wants

A salesperson should understand the needs and wants of the customer by asking them certain basic questions and listening attentively to the answers they provide. He should then try to cater to the requirements of the customer by showing him/her the appropriate merchandise. He should carefully observe the response and reaction of the customer while displaying merchandise. The reactions and responses provide valuable cues about the customer's level of interest in the merchandise. When a customer shows interest in a particular merchandise or category a salesperson can try 'trading-up' (where in he tries to sell higher quality and higher priced merchandise by explaining the features, quality and durability of the merchandise as compared to other low-priced products).

### Reduce the customer's perceived risk

Consumers assess the risk attached to a product they intend to buy by trying to find answers to questions like: Is the product durable or not? Will I get value for money? Is the product of good quality?

These perceived risks are high for buying high-priced merchandise like refrigerators, cars, furniture, jewelry etc. Therefore, salespersons should take adequate care to decrease the risk perception of the customer by providing information about the warranty given by the manufacturers, after-sales service centers, after sales service conditions, success of the brand in other markets etc.

### Demonstrate the product

The demonstration of a product involves the display and explanation of the product's features and functions, benefits and possible hazards to a prospective buyer. It helps a customer understand the working of the product, thus reducing his perceived risk. Demonstrations are most effective when the product features appeal to the senses. Demonstrations can be conducted in a common place for all or separately for specific individuals. Some retail showrooms employ experts to demonstrate specialized merchandise like cars, fitness equipment, etc. Such demonstrations help generate more interest among customers.

### Actively involve the customer

Once the demonstration of the product is over, the salesperson should encourage the customer to use it. This creates more interest and attracts their attraction. For example, some automobile showrooms allow customers to take a test drive. The salesperson also accompanies the customer and explains the features to the customer, while he is driving.

Once the customer experiences the merchandise, the chances of him buying the merchandise increase. Moreover, when a customer has used the product personally, he is less apprehensive about the product.

### Sell product benefits

A salesperson should realize that a customer does not pay for the product but for the service/utility that it offers. Therefore, he should concentrate on selling the benefits of the product rather than trying hard to sell a product.

Before purchasing a product, the customer analyzes the product, by asking himself - Why am I buying this product?

When he approaches a salesperson in a retail store, the salesperson should provide a suitable answer to this question by explaining the benefits or the use of the particular product. When introducing a product to a customer the salesperson should first highlight the benefits of the product. By doing so, the salesperson can clear the doubts that arises in a customer's mind and give him greater satisfaction.

### Make the message simple

While explaining the benefits and features of a product to each one of the customers, the salesperson should understand the level of understanding of the individual customer and communicate to him accordingly. For example, if the salesperson uses technical terms while explaining the features of a product to a layman, the customer may not understand and there are chances of him losing the deal. On the other hand, if the salesperson uses simple words while dealing with a technically educated person, he may feel bored. There are chances of customer getting irritated and annoyed, and the salesperson losing the deal. Hence, the salesperson should analyze the product knowledge of every customer before he starts talking about the product.

## Handling Objections

Sometimes, a customer may raise various objections regarding the price, place (stores image), product quality, time and the behavior and appearance of the salesperson. A salesperson should know how to handle such objections.

In certain instances, though a customer likes a product he is not sure whether to purchase the product or not and he starts giving some vague reasons (like the size is too big or small, the product is heavy or light, complex or too simple, etc.). In such situations, the salesperson should be quick and creative to convince the customer about the benefits of the product, its previous record, guarantee and the warranty given by the manufacturer and the after sales service provided by the retail store.

Sometimes, the customer suspects the rationale behind the price of the product and may find it high. In such situations, the retail salesperson should explain the product's value as well as the comparative price of competing products. In certain situations, the customer may like the product but he may not have enough cash in hand to purchase the product immediately. In such situations, the retail salesperson should provide information about the credit facilities offered by the store.

Sometimes, even before making a purchase, the customer may have formed a perception of the store through advertisements and displays. And when he comes to the store for the purchase, he may find that his perception of the store is different from what he actually sees and experiences. In such a case, the retail salesperson should assure the customers with regard to integrity of the store, its management and merchandise.

In yet another situation, the customer may put off the purchase mentioning time as a constraint. They may not be in a situation to tell why they don’t want to buy, but they may just want to postpone the purchase. This is one of the most difficult situations for a salesperson. However, the salesperson can try to create interest in the customer by informing him about the special offers (if any), or caution him about the high prices in the peak season and convince him to buy the product.

Sometimes, customers postpone the purchase because of the salesperson. They may not like the appearance of the salesperson, or the behavior, following which they postpone the purchase. At such times, the salespersons can emphasize more on the product, its benefits and advantages to the customer.

## Closing the Sale

Once the customer’s doubts with regard to the merchandise are cleared, the salesman should look for cues, which help him understand whether the customer is interested in buying the product or not. The decision - making process of a customer depends on his/her individual nature. Some customers are quick in decision-making, others are slow, while some others require the assistance of a third person in making decisions.

A skilled salesperson will understand the preferences of customers and display the merchandise according to the customer's preferences (by removing the less preferred items). Skilled salespersons in the apparel section can even suggest the kind of apparel and color that would suit the customer.

Before closing the sale, the salesperson can suggest complementary items that go well with that particular merchandise that the customer intends to buy. This technique of promoting sales is called *suggestive selling*. For example, if a customer is buying a shirt, the salesperson can show a trouser or tie that goes well with the shirt. Though the customer actually intends to buy only a shirt, if the salesperson shows him the complementary product that goes very well with the shirt, the customer may buy it too. Suggestive selling also increases the satisfaction of the customer with regard to the service provided by store. If the customer buys the complementary merchandise, both the customer as well as the salesperson stands to gain. While the customer derives greater satisfaction (better appearance), the salesperson achieves greater sales.

Once the customer finalizes the merchandise, the salesperson would need to inform the cashier, check the accuracy of the address, validate authenticity of the cheque that the customer has presented or verify the customer's credit card and pack the merchandise.

### Following up the Sales

Once a customer has bought a product, he may seek the opinion of his friends, relatives and others to know whether or not he derived value for money through this purchase. Some times the customer may regret the purchase and this might prevent him from making future purchases from the retail store. This generally happens for highly priced products such as furniture, car, jewelry etc.

In such situations, the salesperson needs to reassure the customer that he had got a good deal by emphasizing more on the quality and benefits of the product. He can do this using any of the following:

- Writing letters to the customer
- Telephoning the customer
- Making personal visits to the customer

Although many sales processes include all the above-mentioned steps (prospecting through closing), the sales approach adopted by the salesperson may vary depending on the type of customer. Exhibit 16.2 gives the list of customer types and the recommended selling techniques the retail salesperson should adopt.

## EVALUATION OF A SALESPERSON

Evaluation of salespersons plays a crucial role in a retail store as it determines the compensation to be paid, promotions, transfers, terminations and reinforcements of sales personnel. (Exhibit 16.3 shows a typical rating form for evaluating sales personnel). The main criteria for evaluating the performance of a salesperson are the following:

- Conversion rate
- Sale per hour
- Use of time

### Conversion Rate

The conversion rate refers to the percentage of shoppers who are convinced to make a purchase. In a retail store, all the people entering the store may not end up buying the goods/services. Some customers see the product, inquire about the merchandise in detail and leave the store. Hence, the success of a store depends on how effectively the salespeople can convince these window shoppers to make a purchase. The revenue/profits of a store are directly proportional to the conversion rate.

**Exhibit 16. 2**
**Types of Customers**

| Basic Types | Customer | Recommendations |
|---|---|---|
| **Defensive** | Doesn't trust any salesperson. Resists communication as he has a dislike of others. Generally, uncooperative and will explode at the slightest provocation. | Avoid mistaking their silence for openness to your ideas. Stick to basic facts. Tactfully inject the product's advantages and disadvantages. |
| **Interrupter** | Intense, impatient personality. Often interrupts salespersons and has a perpetually "strained" expression. Often driven and successful people who want results fast. | Don't waste time, move quickly and firmly from one sales point to another. Avoid overkill since they know what they want. |
| **Decisive** | Confident in their ability to make decisions and stay with them. Open to new ideas but prefer brevity. Highly motivated by self-pride. | No canned presentations. The key is to assist. Don't argue or point out errors in their judgment. |
| **Indecisive** | They worry about making the wrong decision, therefore, they tend to postpone all decisions. Want salesperson to make decision for them. | Avoid becoming frustrated. Determine the need as early as possible, and concentrate on that. Avoid presenting too many alternatives. Start with making decisions on minor points. |
| **Sociable** | Friendly, talkative types who are enjoyable. Many have excess time on their hands (e.g., retirees). They usually resist the close. | You may have to spend time with these customers. Listen for points in conversation where you can interject the merits of the product. Do not pressure for the close. Subtle friendly close is needed. |
| **Impulsive** | Quick to make decision. Impatient, just as likely to walk out as they were to walk in. | Close as rapidly as possible. Avoid any useless interaction. Avoid any oversell. Highlight the merits of the product. |

*Source: Patrick Dunne and Robert F. Lusch, Retailing, Third Edition, Harcourt Brace College. Publications, 1999, Pg:445*

The conversion rate varies from one retail store to another. A retail store selling jewelry or appliances will have a lower conversion rate than a grocery store. On the other hand, a mall will have more walk-in traffic but its actual conversion rate will be lower than a free-standing "destination" store.

The rate of conversion reflects the performance of the entire sales force of a retail store. A low conversion rate can be due to various reasons like non-availability of clerks at the point of sale, inefficiency of the clerks to handle the traffic, arguments with the customers, insufficient information provided to customers, poor demonstration of the product, unfriendly attitude of the salesperson etc.

## Sales per Hour

This is one of the commonly used measures to evaluate the performance of a retail salesperson in a store. Sales per hour is computed by dividing the value of total sales of the retail store at a given period of time by the total hours of work. Sales per hour can be used to evaluate the performance of a salesperson, a group of people or the entire sales-force in a retail store. But the sales per hour differs depending on the nature of the retail store. A salesperson's sale per hour in a department store is different from the sales per hour of a jewelry salesperson.

**Exhibit 16.3**

**Sample Evaluation Form for Sales Personnel**

Employee Name_____________ Department _______________ Period Covered_______________

Evaluated by _____________ Date Completed _________ Date Reviewed with Employee_______

| | **Weight** Total must equal 100% | **Rating** Use 1 through 5 | **Score** Weight x Rating |
|---|---|---|---|
| **Sales**<br>Assists in establishing sales goals<br>Assists in developing and promoting a marketing plan<br>Makes proper recommendations and applications of products sold<br>Knows prices of products and services<br>Maintains current market share<br>Assists in developing competitive marketing strategies<br>Comments: | | | |
| **Service**<br>Provides and promotes exceptional service<br>Comments: | | | |
| **Inventory**<br>Effectively manages inventory levels<br>Comments: | | | |
| **Maintenance:**<br>Maintains property, facilities and equipment<br>Comments: | | | |
| **Job Knowledge:**<br>Understands the requirements of the job<br>Comments: | | | |
| **Quality of Work**<br>Work is accurate and neat<br>Comments: | | | |

| | | | |
|---|---|---|---|
| **Quantity of Work**<br>Consistently performs an adequate amount of satisfactory work<br>Comments: | | | |
| **Cooperation**<br>Works well and effectively with co-workers and supervisors<br>Supports company policies and goals<br>Comments: | | | |
| **Initiative**<br>Begins assignments without direction and recognizes the best way of accomplishing tasks<br>Comments. | | | |
| **Attendance and Dependability**<br>Can be relied upon to report to work and stay on the job<br>Comments: | | | |
| **Problem Solving**<br>Handles on the job problems<br>Comments: | | | |
| **Other Duties**<br>Upholds cooperative policies<br>Perform other duties as assigned by management<br>Enforces and upholds the cooperative's credit policy<br>Comments: | | | |
| **Total Score** | | | |
| Overall Merit Rating<br>451-500-Outstanding<br>351-450-Exceeds Standards<br>251-350-Meets Standards<br>151-250-Below standards<br>100-150-Unacceptable<br>Signature of Manger/Supervisor __________________ Date_________<br>Signature of Employee __________________________ Date _______________<br>Rating System: 5 – Outstanding 4.5 to 4 – Above standards 3.5 to 3 – Meets standards 2.5 to 2 – Below standards 1 – Unacceptable | | | |

*Source: www.mbrservices.com/coopknowledge/jobdescription*

## Use of Time Standards

Salespersons in a retail store are evaluated on the basis of the time they spend in the store. A salesperson can spend his time in the retail store in four different ways:

- Time spent on selling
- Time spent while not selling
- Idle time
- Absent time

The selling time includes the time a salesperson spends with a customer, time spent while demonstrating the product, writing sales receipts or assisting the customer in other potentially revenue-generating activities.

The time spent by a salesperson on marking merchandise or straightening up the store are included in non-selling time.

When a salesperson spends his time on the sales floor but is not involved in productive work, it is referred to as idle time.

When a salesperson is not available on the sales floor, it is recorded as absent time. This includes the time he spent for lunch, rest etc.

Based on this division, the retailer calculates the time spent by the salesperson on each activity. This reveals how efficiently and effectively a retail salesperson has spent his time in the retail store.

## SUMMARY

A retail salesperson plays a crucial role in the retail selling process. The salesperson acts as an interface between the retail store and the customer. In this chapter, we have analyzed the retail selling process wherein the salesperson identifies the potential customers and tries to sell them the merchandise. We have discussed the various stages of the selling process and ways of handling and providing information to the customer to increase the sales of a retail store.

A good salesperson can convert a prospective customer to a potential customer with his effective communication and people skills. The chapter also analyzed the evaluation process for a salesperson which is based on certain factors like conversion rate, sales per hour and use of time.

# Chapter 17

# Information Systems and Logistics

**In this chapter we will discuss:**

- Retailing: The Role of Information
- Information Sources
- Retail Information Systems
- Information Systems in Retail Logistics
- Strategic Advantages of Information Systems in Logistics
- Quick Response Delivery Systems
- Data Mining
- Data Warehousing
- Data Warehousing and Business Intelligence

## INTRODUCTION

Organized retailing involves many operations that require dealing with large amounts of data. Retail managers are required to take decisions every day of the year on the basis of the previous day's learnings. Information systems are enablers that provide the data necessary for taking decisions in the retail business.

In this chapter, we will discuss the role and importance of information in retailing and the sources of information. We will then examine retail information systems and their impact on the logistics function. We will also understand the new technologies of value added network, data mining, data warehousing and business intelligence.

## RETAILING: THE ROLE OF INFORMATION

Information is referred to as 'processed data'. Such data is presented in a format that is easy to understand. Information is essential for decision-making in any kind of organization and in any sector of the industry.

Information plays a very important role in organized retailing. Strategic, tactical and operational decisions in this sector depend heavily on the sales and merchandise data collated each day. The industry requires not just information but 'timely' information.

Information systems make it possible for retailers to get hold of such timely information. These systems store data and process it as per the need of the information-seeker.

Timely information on fast moving items helps retailers determine the number of items they need to store to avoid stock outs. In the same way, information on non-moving items helps retailers avoid an inventory pile-up.

Good performance can be achieved by having access to timely information. Daily monitoring of information helps retailers keep an eye on customer trends and preferences. Daily information reports developed on the basis of data provided by Point-of-Sales (POS) terminals enables retailers to take proactive decisions and stay competitive in the marketplace. The anticipated benefits of implementing POS at Quix Food Stores in Australia are presented in Exhibit 17.1.

The information provided by retail information systems is both general and specific. They can give information on the performance of the entire supply chain as well as specific information on the best selling merchandise line in the best performing department of the best performing store of the best performing region.

### Information Flow

Retailers are aware of the vital role of information in their businesses. To capture the information needed, retailers should understand the information flow in their retail stores. Information was traditionally considered to flow from customers to retail stores to distribution centers to vendors. But now-a-days information is not viewed as a one-way flow moving in a sequential manner. Instead, the flow of information is regarded as a dynamic one, moving not only from customer to retailer to vendor, but also from vendor to retailer to customer.

Each purchase at the sales counter stimulates a cycle of information interchange throughout the supply chain. Advances in technology have made it possible to link a computer terminal at the cash counter with the vendor's terminals and the retailer's warehouse terminals. Thus, at the press of a key, as the invoice is generated, information regarding the sale is transferred to all the channels involved in bringing the merchandise to the store. Similarly, information on exchanged or returned products and purchase orders is transferred to the vendor’s system. Such a system also permits the vendor to send information on the inventory status in his plant, probable price changes, and date of shipment (ASN or Advance Shipping Notice).

**Exhibit 17.1**

**POS Technology at Quix**

The Australia-based convenience retailer, Quix Food Stores, has decided to implement state-of-the-art POS Technology from Radiant Systems Inc. in many of its stores. Through the installation of POS systems, Quix is equipping itself with highly reliable technology and also creating a common technology platform that improves POS reliability. The POS system would lower service and maintenance costs for Quix and also ensure consistent systems up-time so that Quix can deliver good customer service.

The POS system, which is touch-screen based, has an intuitive user interface. It performs many retail specific functions on a system-wide basis through continuous monitoring of the retail operations at the retail site.

The implementation would also reduce the costs, improve customer service, and increase the speed and ease of use. The POS solution can integrate POS with card readers and fuel pumps, thus streamlining the processing of electronic payments, and providing quicker, more convenient payment options for customers.

*Source:http:// www.retailsystems.com/index.cfm*

## INFORMATION SOURCES

Internal and external sources constitute the two major sources of information for retailers. Information from both these sources have to be collated properly to develop a comprehensive information system for policy decision making.

### Internal Information

Internal information refers to information generated from sources internal to the organization like purchasing invoices, warehouse records, payment statements, employee records and financial accounts. The information thus generated forms the major chunk of the databases of retailers. Most of the tactical and operational decisions made by retailers are based on this information. In addition, certain statistical and analytical procedures help retailers process this information to make need-based decisions.

Electronic equipment (like bar code detectors) makes it easy for retailers to capture internal data. Also, an automatic inventory replacement system can be developed (in collaboration with vendors) to share sales data from POS terminals almost immediately (online) with vendors so that the inventory can be replaced as per the selling trends observed that day. Even the delivery status can be tracked online, inventory levels checked, and re-order points can be set accordingly.

This online sharing of information with vendors is achieved through EDI (Electronic Data Interchange). EDI makes it possible to electronically share data with vendors by establishing computer connectivity between the vendor’s systems and retailer’s systems. Information now passes to vendors directly from retail stores. Information about transportation routings and changes in purchase orders can also be transferred through EDI.

EDI has proved to be very advantageous for retailers. Since EDI makes sales data available to vendors online, retailers are in a position to order in small quantities. Improved inventory turnover means reduced inventory carrying and storing costs. Quick movement of goods in inventory means early replenishments and ready availability of merchandise demanded by consumers.

The enforcement of bar code standards for vendors by EAN.UCC (European Article Numbering, Uniform Code Council) has made things easy for the retailer as it eliminates the cost and efforts of relabeling. (More about EAN.UCC is given in Exhibit 17.2.) In addition, the use of bar code detectors does away with the need for a skilled worker at the billing counter. Bar codes can also be profitably used by retailers for stock management, automated stock ordering and tracking of products.

**Exhibit 17.2**

**Bar Code Standards - EAN.UCC**

Bar codes, to put it simply, are a series of bars and spaces printed / labeled on a product / package which enable the automatic capture of information used for identifying it. For the last 25 years, the EAN.UCC system has been the de-facto standard world wide for barcoding retail products. The European Article Numbering's (EAN)'s partner organization in the US and Canada is the Uniform Code Council, Inc. (UCC)

EAN.UCC standards help reduce costs, improve the efficiency of operations, and drastically reduce errors. Over 850,000 companies worldwide from over 24 industry sectors are members of EAN. According to some estimates, over 5 billion transactions based on the EAN.UCC system are executed automatically daily.

EAN International and UCC and various EAN member organizations around the world are working on a GLI (Global Logistics Initiative) Master project, the objectives of which are:

- To develop global models, schemes and application guides of the EAN.UCC system for use in multi-model transport.
- Produce an application guideline for returnable asset management (pallets, containers etc.)
- Develop logistics implementation guidelines for dispatch and receipt operations in the delivery process.
- Develop standards for transport processes in XML and EANCOM (subset of UN/EDIFACT) by collaborating with appropriate international initiatives like Trans-core, Bolero, ITIG & Rossettanet.

*Source: http://www.eanindia.com*

## External Information

External information is procured from sources outside the retail organization, like firms or agencies that undertake research on subjects that would be of interest to corporates and sell their results commercially. Government departments engaged in the analysis of economic and other related issues are also good sources of external information. Other external information sources include published statistics, standardized retailing information services, research reports and the Internet.

### Published statistics

Retailers use statistical reports generated by public (primarily the government) and private agencies. Such agencies generate a considerable amount of statistical data.

### Standardized retailing information services

Studies and research activities that monitor the consumer behavior and market trends are undertaken by many research agencies. Their reports are purchased by retailers to sense the pulse of their customers and formulate new strategies. The Nielson Retail Index tracks data concerning various brands, their market shares and promotions every two months from 1600 supermarkets, 750 drugstores and 150 mass merchandisers in the US. Further, the retail store audits carried out by ORG-MARG across various categories of products can be the source for data of customer goods. Retailers can use such data for various purposes such as identifying market opportunities, analyzing portfolios, pricing trends, etc.

### Research reports

Business magazines, trade journals and newspapers usually publish some research reports. Some newspapers also release yearly publications covering a particular sector or industry.

### Internet

The Internet is used by many retailers for accessing external information. Some retail management websites, like www.retailsystems.com and www.retailyatra.com have started a paid subscription based access for acquiring key information and articles. Other websites, like www.retailwire.com provide information free of cost, but require the user to register.

## RETAIL INFORMATION SYSTEMS

Retailers can enhance their performance if they have a better understanding of market dynamics than their competitors. To increase their knowledge of the markets, retailers should build systems that feed them information related to the firm's internal activities and external environment. A Retail Information System can provide retailers the kind of knowledge they need to succeed in the marketplace and gain a differential competitive advantage.

Retail Information System (RIS) is a tool that enables retailers to collect, aggregate and analyze data from retailing activities. An RIS anticipates the informational needs of the retailer; collects, organizes and stores relevant data on a continuous basis; and directs the flow of information to suitable decision makers (i.e., to the store managers, merchandise buyers, category managers, etc.).

An RIS is of great help to retailers when profit margins are decreasing and a sustainable competitive advantage is difficult to achieve. Such a system helps retailers explore ways in which they can beat their competitors by efficiently performing various store functions with the use of minimum resources.

Unlike other retail initiatives relating to pricing, merchandise and location, RIS provides a definite edge in the market to the first-adopter. This is because an RIS initiative cannot be easily imitated. After all, RIS is not like a readymade software package that gives the same results to everyone; instead, it has to be built carefully to meet the needs of an organization.

To put it simply, RIS is a tool for analyzing the satisfaction levels of customers and the performance of the stores. RIS can also track products through automatic identification programs, scan performance areas, analyze vendor reports, and monitor changes in behavioral and environmental trends.

To be successful, retailers need data that is timely, accurate and reliable. Data, in itself, holds no value until it is organized and used properly. Data can be effectively used if it is as detailed as possible.

## Data Features of RIS

An RIS is a comprehensive system that helps in the systematic collection of relevant data that influences the performance of the retailer. It also analyzes and reports the data collected. The following are the data features of RIS:

- Data collection by RIS can be continuous or periodic, depending on the kind of data being collected. Data is continuously collected for activities that require close monitoring and thorough scrutiny (such as financial performance). Periodic collection of data is done for non-recurring problems.
- Data is collected in a systematic and orderly fashion. Only relevant data is collected.
- Analysis and reporting of data form a vital part of RIS. Huge volumes of data are of no use until they are analyzed and reported in an understandable format.
- Past, present and future data is provided by RIS. The system acquires present data from POS terminals and past data from records stored in the database of the previous system. In addition, future data (the projections of the government and economists) is fed into the system so that it can be accessed by the retailers.

## Subsystems in RIS

An RIS helps the strategist at various stages of the retail planning process. For instance, it helps planners by providing relevant information for formulating a retail marketing strategy and developing solutions for problems that may crop up when implementing this strategy. Depending on the information needs that RIS caters to, it can be classified into two subsystems:

i. Problem identification subsystem

ii. Problem solving subsystem

The problem identification subsystem monitors a retailer’s behavioral, environmental and operating atmosphere to identify factors that may lead to problems for the retailer. A problem solving subsystem provides information that would help the retailer develop solutions for the problems that have been identified.

### Problem identification subsystem

A problem identification subsystem helps retailers identify existing problems or potential problems in the firm. The subsystem does so by monitoring and making available information on behavioral trends, environmental trends and operating performance trends continually.

Such a subsystem helps retailers design effective strategies by providing information on changing trends that affect the retailer's situational analysis (discussed in chapter 4) and overall strategy.

*Behavioral trends*

Monitoring the behavioral trends of all parties in the supply chain (i.e., the marketing channel and the customers) as well as those of competitors enables retailers to understand and be prepared for any contingencies that may arise. By observing early warning signals, retailers can take appropriate corrective action in a timely manner.

*Monitoring customers:* Different retailers adopt different means for monitoring customers’ buying patterns. Some retailers scan customer trends through secondary data sources like trade journals and the Internet. Some study local economic forecasts to identify trends in customer behavior. Small retailers often gather information through informal conversations with their customers. Although retailers can better understand their customer interests by adopting more formal methods of customer monitoring, many don't employ such methods because of the high expenses involved. Wal-Mart used to survey future customer trends by the method of MBWA (Management by Walking Around).

Large organized retailers generally use systematic, formal methods like analysis of purchases, trailing of customer complaints, and customer panels for studying and monitoring buyer behavior. Since large retailers do not have direct contact with their customers, they have to use such impersonal methods for collecting information. Such retailers must gather data on:

i. Purchase probabilities

ii. Consumer attitudes

iii. Consumer satisfaction

*Purchase Probability* refers to the probability of a customer purchasing a particular item within a specific period of time. If the retailer gets a clue regarding the purchase probabilities of its customers (i.e., what the customer may buy or may not buy in the next three months or six months), the retailer can plan to stock those items. Such information thus helps the retailer select merchandise to be stocked and promoted for the next few months.

Retailers collect information about purchase probabilities from a variety of sources like newspaper surveys, universities' research departments, and probability models proposed by retail consultants. These models help retailers relate consumer spending on one product with the relative spending on another product. For example, if a customer buys a pair of jeans in the price range, Rs.999-Rs.1499, he would also purchase a T-shirt in the Rs.299-Rs.499 range in the next few days. Purchase information thus helps retailers anticipate customer needs and make available items that have a high purchase probability.

Sometimes, strange patterns can be found from the study of sales data. Though such patterns do not appear logical, they are often repeated. For example, Wal-Mart found that customers who purchase Huggies (the brand name of a disposable baby diaper marketed by Kimberly-Clark Corporation of the US) on Thursdays make more purchases than customers who buy Huggies on other days. Hence, it announced a price discount on Huggies on Thursdays.

*Consumer attitude* towards the operations and practices of retail stores has a significant impact on the retail business. Retailers should be aware of changing customer attitudes because their patronage is necessary for the survival of the business. To track attitudinal changes in customers, retailers should identify certain attributes (friendly personnel, quality of stock, etc.) of their stores that are of value to customers and assess the customer attitude in terms of their perception of each one of those attributes. On the basis of such studies, retailers can take corrective action. For example, if the store is not performing well on an attribute that is of high importance to customers, the retailer can take suitable corrective measures.

*Customer satisfaction* is essential for the very existence of retail stores. Satisfying and retaining current customers costs less than attracting new customers. Customer satisfaction is measured in two areas: satisfaction with regard to the merchandise sold and satisfaction with the service offered in the stores. Only customers who are satisfied with their purchase(s) and the atmosphere of the store come back for a second purchase. Therefore, understanding customer expectations and meeting their needs forms a vital part of the retail business. Monitoring customer satisfaction helps a retailer identify areas that require improvement.

Customers leave stores and take their business elsewhere because of the discrepancies between:

- The customers’ expectations (regarding service and merchandise) and the retailer's understanding of customer expectations and needs.
- Retailer’s perception of customer wants and what the retailer actually provides.
- Retailer’s promises in promotions and the actual delivery in the stores.

To avoid the discrepancy between customer expectations and the retailer's understanding of customer needs, retail managers should interact frequently with customers. Even though top management cannot come to the floor to meet customers, they should meet customer contact personnel to determine if their perception of customer needs is correct.

Discrepancy between perception of customer needs and what the retailer actually provides reflects a lack of commitment on the part of top management towards customers. A management that gives undue importance to profits, margins, market share and costs indirectly informs employees that the customer is of secondary importance to the company. As a result, employees tend to pay attention to customers expectations only as long as they don't interfere with management-reflected-importance-factors. As a result of this change in priorities, both the customers and the organization suffer.

Discrepancy between what the retailer promises and the actual delivery in stores occurs as a result of extravagant claims made by the retailer in publicity campaigns and advertisements. Retailers’ advertisements, by raising expectations too high, often lead to customer dissatisfaction. Therefore, retailers should try to stick to the facts when advertising their products or service. They should also tell their salespeople not to exaggerate the quality of the products to increase sales.

Customer satisfaction does not necessarily ensure a loyal customer base, but it does ensure that a customer will not be lost unless he receives an exceptional satisfaction elsewhere. To identify customer satisfaction levels and address customer problems, some retailers encourage customers to call a toll free number to lodge their complaints. This provides a cost-effective method for tracking the satisfaction levels of customers and identifying areas that require corrective actions.

*Monitoring the marketing channel:* No retailer exists in isolation. He is surrounded by channel partners, who together make the marketing channel system. In this inter-related environment, it is important for the retailer to monitor the behavior of his marketing channel partners.

Retailers should also keep an open eye for other channel partners, like alternative merchandise suppliers, alternative facilitating agencies, etc. If they do not do so, they may lose some good deals.

However good the present channel partners may be, it is not desirable to become over-dependent on them or be complacent with the present partners. Retailers should always try to obtain information about evolving vendor practices and new players in the industry.

Too much dependence on a single supply source (even if the retailer is provided the best quality merchandise at the lowest market price) decreases the bargaining power of retailers and puts them at the mercy of the supplier.

Retailers usually keep track of the bargains offered by all suppliers in the market so as to have the best price and pass it on to their customers. Information regarding price should be collected on an ongoing basis if a retailer wants an edge in the marketplace. If the retailer constantly studies market dynamics and gathers up-to-date information on all his marketing channel partners, the channel partners will be more cooperative.

The use of a Retail Information System helps not only retailers but also the vendors. Through this system, a retailer's sales data is shared with its vendors, thus allowing them to be prepared for extra production if sales are doing extremely well. If, according to the sales data, a product is not moving, the vendor can stop production. Sharing such data helps both the vendor and the retailer reduce inventory costs.

Retailers should also have access to information about the financial performance of channel partners and channel conflicts at all links. If a vendor is in any kind of trouble, financial or non-financial, he will pass it on to the retailer. The vendor may cut the credit terms, raise prices, increase the minimum order quantity or resort to other such practices to stabilize his firm financially. It would be difficult and expensive for the retailer to cope with the new terms and conditions set by the vendor. So, to avoid such problems, the retailer should collect information on the turnover, sales growth, profit margins, credit policy, cash flows, and union-management relations of channel partners. Such information would give the retailer time to anticipate the moves of any channel partner.

Many retailers partner with facilitating agencies like banks, brokers, insurance firms and ad agencies. Information about facilitating agencies like financial performance and alternative facilitating agencies should also be gathered by retailers. Such information will help retailers identify new and good agencies that can serve them better.

Retailers should also keep themselves informed of channel conflicts. A conflict may arise between any of the partners in the channel. To avoid conflict, the probable sources of conflict should be identified and monitored. The common sources of conflict are incompatible goals between partners, undue control by one partner over another, differences in perceiving the significant events in external environment (legal, political, economic, social) and lack of mutual trust between the various channel partners.

*Monitoring competitors:* Understanding competitors forms the key to business success in any sector. Monitoring competition is as important as monitoring customers and channel partners. The conditions of the market play a role in determining the power of competition. If a marketplace is over-stored (more than a proportionate number of stores for the population in that area), then the profit potential would be much lower than in a market area that is under-stored (fewer number of stores for that area's consumers). Hence competitors would be contending for a limited profit potential. By monitoring competitors, retailers can understand their operations and anticipate their moves.

Retailers employ different methods for monitoring competitors. Small retailers do so simply by reading competitors' ads or promotional schemes and visiting their stores to inspect their commodities, prices and display. Large retailers monitor competitors by collecting and analyzing data on product lines, prices, promotions, market share and sales strategies.

The retailer should contemplate a product segment that it wishes to be most competitive in, in terms of price. Then the retailer should construct a price index comparing the price of each of the items in his selected segment with the major competitors' prices for those items. This index gives a visible and comprehensive indication to the retailer about whether or not he is managing his preferred position in the market place. These indices should be constructed and reviewed on a weekly or fortnightly basis.

Competitive comparison of the merchandise mix, quality of products sold, product availability, and general price differentials would help the retailer maintain his competitive position in the marketplace. The comparison with key competitors about the assortment of products should be done on an ongoing basis, for the analysis to be authentic. To collect the needed data, the retailer should require its personnel to frequently visit the competitors' stores.

While monitoring competitor behavior, information systems can be used to find out i) the relative spending on promotions and ii) the relative quality of promotions. Both of these involve cost and time. The retailers should analyze the data on competitors' publicity efforts, sales promotions, advertising and personal selling. To limit the expenses involved in collecting such data regularly, most retailers limit their data collection to data on competitors' advertising and sales promotions. Retailers in some segments maintain a record of all the paper ads released by the competitor during the whole month. At the end of the month, they analyze the intensity of advertising and the quality of the ads. This is then compared with the analysis of a retailer's own advertising efforts to identify any significant deterioration in its advertising.

Market share is another important indicator of the performance of retailers. Comparing market shares of competitors gives insight into the future profitability problems that may arise. Market share data of particular merchandise lines and specific product-departments would be very useful to retailers. But acquiring that would involve a sophisticated and extremely expensive process, which may not prove to be worthwhile. Moreover, such specialized data is often impossible to collect.

The geographical area to which a retailer caters to is called its 'trade area'. The size of a retailer's trade area is determined by the power and influence of competition. Hence, retailers should analyze their trading area as a part of competitor monitoring. The factors that influence the size of the trade area are competitive pricing, competitive product assortments and promotions. Retailer's business is also affected by the shrinkage or expansion in its trade area. The trade area shrinks when the area is over stored. An expanding trade area is a good sign for a retailer.

Information on a trade area is relatively easier to gather. A retailer can construct a 'trade area map' by using the addresses of the customers in its database (this data is collected through weekly contests and monthly draws). By comparing one month's trade map with that of the previous month, the retailer can easily trace any changes in its trade area.

### *Environmental trends*

Changes in socioeconomic, legal and technological environments have a major impact on the functioning of a retail store. Although a retailer cannot control the changing trends in these environments, he can be better equipped to deal with these changes if he closely monitors them on a regular basis.

*Monitoring the socioeconomic environment:* Monitoring of socioeconomic environment provides vital insights into consumer behavior. The socioeconomic environment can be categorized into demographic, psychographic and economic trends.

Demographic trends that should be monitored by retailers are age, occupation, education levels, ethnic background and number of earning members in the family. The psychographic trends that influence the retailer include changing interests, lifestyles, changes in habits, opinions, cultural values and free-time activities. Economic trends that retailers should monitor are changes in disposable income, and changes in spending.

Although national data on the socioeconomic environment is available for retailers, it provides little information on trade areas. It would be very expensive for the retailer to obtain information on demographic, psychographic and economic trends using his own meager, private resources. Hence, the retailer must gather data from secondary services and surveys conducted by large newspapers in big cities. These surveys cover a large number of demographic, psychographic and economic attributes.

*Monitoring the legal environment:* Retailers must follow the changes in legal requirements and understand the legal issues concerning retailing, to perform optimally in the marketplace. To avoid costly legal battles, retailers should constantly incorporate legal changes into their RIS. As retailers grow in size, so does the importance of monitoring the legal environment.

Though the retailer cannot be aware of all the changes in legal environment in all the countries of its operation, retail journals play a helping role in publishing the retail implications of pending legislation.

Tax laws are one area that has immense practical implications to the retail firms. Major retail decisions are often drawn after thinking about the tax-implications. For instance, a retailer can decide for store expansion after a favorable change in investment tax rules. Some retailers change the method used for inventory valuation if a tax change shows it beneficial to do so. Further, the components of compensation are also designed based on the tax laws.

Retail companies that are public should also maintain the accounting standards prescribed by the relevant authority. They should also follow certain guidelines while reporting to the shareholders.

*Monitoring technological environment:* Technology has changed the basic way of functioning for many firms throughout the industry and is all set to do the same for retail firms. Management techniques, merchandising methods, equipment and construction can be improved through technology. The technological environment should be constantly monitored by retailers in two stages: basic science stage and applied science stage.

At the basic science stage, the retailer starts reading about technological advancements in the area in which he wants to make improvements. This sources of information are usually trade journals (which publish evolving retail practices), discussion forums, and case studies on developing technological areas. Topics covered in journals generally take a long time to enter the applied science stage because many unforeseen problems surface during the implementation of new technology. Write-ups on future technology and discussions published in academic journals give only a vague idea of the new technologies. The retailer cannot decide to implement them at this stage.

That is why it is more useful for the retailer to survey technologies at the applied science stage. The importance of understanding technology is discussed in Exhibit 17.3. To learn about technologies at the applied science stage, retailers need to read business publications and attend trade fairs organized by different relevant agencies.

### *Operating performance trends*

Operating performance trends can be identified by monitoring information on the financial aspects of a firm. The information gathered by the problem identification subsystem on the assets, revenues and expenses of the firm will help the retailer detect any deterioration in the firm's performance.

*Monitoring assets:* The financial performance of a retail firm can be assessed easily if the accounting system is incorporated into the RIS. The RIS should be designed with the capability of monitoring assets in the retail firm constantly. The magnitude and composition of assets can be monitored by designing the RIS in such a way that it constructs a balance sheet at the end of every operating period (typically a month or half month). Changes in the composition of assets and growth in the asset base can be tracked by comparing any two consecutive balance sheets. Careful study of the balance sheet gives the retailer advance warning of problems that may arise later.

**Exhibit 17.3**

**Understanding Technology**

Retail technology is facing a lot of criticism these days because of heavy investments by many retailers in technology and their unrealistic expectations from it. Management gave technology heads a free hand in purchasing and implementing systems, expecting the development of wonderful new marketing channels, accelerated sales, automated vendor management, and growth in customer loyalty. Though many retailers achieved a measurable ROI by implementing systems for marketing, sales, vendor management, and customer loyalty, they expected much more from new technology. So retailers became reluctant to implement new advancements in technology and viewed all new proposals from IT managers with suspicion. Systems managers, therefore, should learn to clearly communicate what the new technology they propose to implement will achieve.

And top management should have a realistic view of what exactly technology is and what it can really do, instead of regarding it as a magic box.

**Technology is NOT:**

- Technology is not an instant cure for the daily turbulence in the retail sphere. It is an enabler of strategic business practices and goals.
- Technology helps existing employees perform better, but cannot take their place. For instance, POS systems make more data readily available for the marketing team to design their promotions, but the system doesn't increase sales on its own.
- Systems are not capable of thinking independently. The sophisticated data analysis solutions available in the market deliver the 'intelligence' promised by the vendors only if they are fed the correct information.
- Technology does not make the retailer realize profits and receive huge benefits overnight. The increase in operational efficiencies and reduction in costs happen over a period of time.
- Systems and technology do not magically transform a retailer's firm. Retailers should not have unrealistic expectations of technology.

**Technology is:**

- Technology is a measure. Analytical systems enable retailers to measure their operational performance and the profitability of their business models.
- Technology solves problems in an objective manner. Since automated processes are not hampered by emotions, information sharing between departments is not affected by personal feelings.
- Detecting hidden issues and negative trends is easier with processes such as exception-based reporting. Loss of merchandise through theft has been reduced in many retail firms through loss prevention solutions.
- Errors by operators due to fatigue and boredom caused by doing routine operations can be eliminated completely by having such tasks done by automated systems. By doing so, these tasks will be carried out efficiently and the operators will have the opportunity to be assigned to more interesting jobs.
- Systems provide unbiased analysis since they use mathematical equations and predictive rules. However, human judgment is still irreplaceable.

*Source: http://www.retailsystems.com/index.cfm?PageName=PublicationsTONArticle&ArticleId=2855*

*Monitoring revenues and expenses:* The early monitoring of the revenues and expenses helps retailers identify deviations from the budget and gives them time to take corrective actions. Some retailers monitor their sales and labor costs every day to check for any fall in performance and take remedial action immediately.

A detailed income statement can be regularly generated through RIS to provide all the revenue and expense data that may be required by retailers for information or analysis.

Income statements should, preferably, include percentile figures along with the usual rupee amounts because the measure of rupees keeps changing from time to time. Moreover, percentile equivalents (equating sales to 100%) make it easy to compare income statements over different operating periods. Thus, considerable drop or rise in any of the figures in the income statements (purchase costs or advertising or salaries as compared to sales) can be immediately identified, analyzed and rectified.

A standard income statement can also be developed where each component of the statement is expressed as a percentile of sales. This statement reflects the planned performance of the retail firm. The periodic income statement generated by the retailer's RIS can then be compared with this standard income statement to check for any undesirable percentile changes of any of the components of the standard statement.

To develop the standard statement mentioned above, retailers can use data from the annual study of operating results conducted by retail trade associations of all the retail firms that are members of these associations. Using this data as a base, and keeping in view its objectives, the retailer can develop its standard income statement.

The frequency of generation of income statements is extremely important for the retailer. Income statements should be generated at a frequency that gives the retailer early indication of problems in the firm, thus allowing the retailer to take corrective action in a timely manner. Yearly income statements would not suffice, because identifying an increase in expenses or decrease in revenues at the end of the year doesn't give the manager any time to look into the matter and put things right. Bi-monthly or monthly income statement generation is considered ideal by most retailers.

## Problem solving subsystem

A problem solving subsystem supplies the retailer with extensive information on the problem areas identified by the problem identification subsystem. In a retail firm, problems generally arise in the areas of operations management or administrative management. The problem solving subsystem thus helps the retailer use its resources properly and manage its operations well.

### *Operations management problems*

Operations problems are everyday problems encountered by the retailer. These problems occur in the activities of buying and handling merchandise, pricing, advertising and promotion, customer services and selling. Operations problems are generally solved by the concerned managers, who have the knack and experience for dealing with them. To solve some tough problems, retail managers require specialized information.

Operations problems can be broadly classified into those related to assets and those related to revenues and expenses. Everyday problems related to assets can be theft of inventory from stockroom or shelves, delay in credit payments by customers, breakdown of generator or air conditioning system, damage to store, etc. Operating problems concerning revenues and expenses could be an alarming rise in overtime of employees, a significant drop in sales of a previously fast moving item, a drop in gross margins, etc.

An RIS helps the retail manager solve problems related to the management of assets by providing the necessary information that is not readily available to the retailer. The system can help a manager by providing information necessary for taking a decision. For instance, if a generator in a retail stores breaks down, the manager needs information to decide whether he should repair it or replace it. If he decides to replace it, the system can give him information that helps him do so.

For dealing with the operating problems regarding revenues and expenses, the retail manager must carefully study all the factors to find out the cause of the problem. Without sufficient information, the retail manager can only make some suppositions, which may or may not be true. Relevant and detailed information helps the retail manager deal with problems and devise solutions or formulate new strategies.

As explained in the section on operating performance trends, the problem identification subsystem helps retailers by identifying operating problems related to revenues and expenses. The problem solution subsystem does not provide a solution to these problems. Instead, it provides detailed information to help retailers solve the problems that have been identified.

### Administrative management problems

Administrative management problems are problems related to the resources of retail firms, chiefly, financial, human and locational resources.

The retailer can use the problem solving subsystem to solve any financial problems identified. For instance, a retailer who purchases merchandise from different places of the world has to keep itself updated of the exchange rates and the predicted rise or fall in exchange rates so that it would not make a bad purchase. Added to that, the retailers need to have a check on inter-state tax systems so that they can avail any tax provisions that would be of advantage to them. The problem identification subsystem monitors all these changes for the retailer.  At the same time, the problem solving subsystem gives the retailer the internal information about what purchases are to be made from which country and which state, so that the retailer can schedule the purchases according to the predicted changes in exchange rates or taxes.

The human resource problems identified by the problem identification subsystem can be solved by collecting more information with the help of a problem solving subsystem. Information concerning employee satisfaction, attitude towards the company and customers, motivation levels, productivity, loyalty, turnover, etc. helps the retail manager take proper steps to resolve the problems and restore employee morale.

To solve human resource problems, retailers often rely on external consultants as they offer unbiased analysis, judgment and suggestions. Retail managers find it difficult to deal with such problems because they know the individuals concerned are often too close to the situation to analyze it objectively. So, information seeking and analysis should be done with the use of the retailer's RIS. The RIS will provide the external consultant the authentic information he needs.

Retailers also encounter problems relating to their location, whether physical or online. Locational problems generally arise when retailers move from their existing trade area to a new trade area. A problem solving subsystem helps retailers solve locational problems by equipping them with information on the alternatives like closing stores, building a new store image, adding/changing merchandise, re-changing the location etc.

## Advantages of Retail Databases of RIS

Let us now examine the advantages of the huge databases stored in the RIS. (Difficulties regarding the creation and use of large databases are discussed in Exhibit 17.4.)

**Exhibit 17.4**

**Difficulties with Databases**

The creation and use of large databases is not an easy task. Some of the difficulties of developing and using database are discussed below:

- Collecting, storing and analyzing databases is expensive and time consuming. Collecting data on the hundreds of different items that a store stocks and on thousands of customers is no easy task. The storage costs of such huge data are very high.
- The successful implementation of databases creates customer expectations regarding rewards for their loyalty. For example, the customers of a particular retail store may receive “membership” status when they purchase a certain amount of items. These customers expect fresh seasonal offers with every change in season because they have been offered such privileges or discounts in the past.
- The collection and storage of data can affect people’s privacy. The National Retail Federation (US) and the European Community are imposing restrictions on companies maintaining databases about the use and passing-on of data.

*Source: Icfai Center for Management Research*

### Build and manage dialogues

Traditionally, the retailer purchases and showcases merchandise that he thinks would interest customers visiting his stores. But the purchases made anticipating customer interests may not always yield a positive response from customers. Now-a-days, instead of guessing at customer needs, the retailer can use the sophisticated databases of RIS to build a dialogue and initiate a long-term relationship with each customer.

The information available to the retailer is no longer restricted to the purchase and the customer who made the purchase. Instead, the retailer can now access information on a customer’s interests and preferences, his previous purchases, his household details, etc. This information availability helps the retailer analyze its customer’s purchase interests and define its target group clearly. Retailers can thus attract their target groups. Reaching such a customer group would also be easier with targeted advertising and customized promotional offers that would persuade both customers and potential customers to make a purchase. Some retailers even give specialized coupons along with the bill. For example, when a customer purchases a trial pack of a shampoo, he receives a coupon for a large pack of the same item.

Remke Markets in Cincinnati, US developed a CRM program using its integrated POS and store system software. The software identifies the top 2000 customers every winter and the CEO personally hand delivers promotional gifts to them. Frequent shoppers are identified through the system's database and demographically targeted store circulars are posted with coupons for customers with specific tastes. The system also helps Remke markets track how much money was spent in their stores, how often shoppers come back, how many customers were retained over time, and what was the direct-mail campaign’s return on investment.

Such a database can be used by retailers to lure back customers who no longer shop at their stores. Using the information stored in the database, retailers can send birthday discounts or anniversary gifts to attract customers who used to come to their stores.

### Value of customer

Though all retailers agree that the customer is their most important asset, the value of the customer is intangible. By maintaining a customer database, it is possible to compute the discounted lifetime value of a customer. And by finding out the value of a customer, the customer's response to marketing campaigns can be anticipated and the campaigns designed accordingly.

### Integrate marketing campaigns

The data stored in RIS can be used to integrate various marketing campaigns to increase their effectiveness. For example, when launching a new version of software, the retailer can not only design TV ads, he can also send customized promos to all customers who purchased the software earlier (identified from the RIS database). This would improve customer response and increase the effectiveness of the launch.

### Improve marketing productivity

Earlier, it was very difficult to measure the effectiveness of marketing decisions. But now, with the use of RIS, the retailer can correctly measure the effect of its marketing efforts on sales. The link between expenditures and results can be analyzed by the use of retail database. The retailer can also study each customer's response to a generic promotional scheme. In addition, the retailer can find out if a particular customer responded to the customized offer communicated to him/her.

Marketing productivity can be improved further by using the database to identify niche markets. The niche markets identified (like customers who buy pet food for their cats) can be catered to by designing special schemes to attract the target groups or by making available the products that these groups wish to purchase.

### Improve inventory management

Better inventory management is the most cited advantage of adopting a retail information system. An RIS helps businesses avoid inventory pile-up. (The inventory assortment tips followed by Dell are shown in the Exhibit 17.5.) The system allows retailers to make inventory forecasts in a more effective way. The purchase information of each day, in fact the very purchased minute, is made available by an RIS to help retailers make decisions. Large retailers dealing in readymade clothing maintain huge databases of sizes commonly purchased by customers so that they can know which sizes sell in which of the stores, and stock them accordingly.

Stock outs can be completely avoided by sharing sales information online with the retailer's own warehouse and the retailer's vendor. Sharing of sales data with the supplier also reduces inventory holding in warehouses and, in turn, inventory carrying costs. RIS also makes it easy to identify the stock of non-moving items so that something can be done to move that stock (like putting those items for sale).

## INFORMATION SYSTEMS IN RETAIL LOGISTICS

With the intensifying competition among retail enterprises, retailers are trying to improve the efficiency of their logistics functions. For this, retail enterprises require flexible, adaptable and integrated information systems that support their business processes.

**Exhibit 17.5**

**Dell's Inventory Assortment Tips**

In the recent Retail Systems 2002 Conference & Exhibition/VICS Collaborative Commerce, Randy Mott, SVP/CIO of Dell Computer Corporation, spoke on the topic "Inventory Stifles Innovation." His address discussed the importance of product assortments and inventory management.

Contrary to the thinking that greater inventory implies the increased availability of merchandise, greater inventory actually reduces the assortment. This is because, as the increase in inventory causes financial concern to management, they tend to eliminate the stocks of non-selling items (making them completely unavailable).

A good assortment should be broad, dynamic, and responsive. Assortments have become broader in the past 15 years as a result of developments in inventory management techniques. Broad assortments should not just mean more products on the shelf, as it would only make the selection of items time consuming for the customer. By including new product forms and product enhancements, assortments should be made dynamic. If the frequency of inventory turns decreases, assortments will be neither broad nor dynamic.

The selection of products (or merchandise assortments) by retailer should be customer-driven. Assortments need to be responsive to changing seasons, lifestyles, and events. Being responsive means giving customers a choice and offering merchandise that reflects their individual needs. Manufacturers must also customize their offerings for individual retail customers.

Infrequent inventory turns has a negative affect on merchandise assortments. Electronic Inventory data interchange between retailers and suppliers would solve many inventory problems. Dell's real-time information sharing with its suppliers provided it the advantage of inventory flexibility. This flexibility allows Dell, which stores no finished inventory, to combine different components each day in a way that has never been done before.

*Source: http://www.retailsystems.com/SiteSearchDetail.cfm?ArticleId=2550*

Information is essential to run retail channels smoothly and retail businesses profitably. Complex logistics challenges can be handled successfully by implementing the right kind of software in retail operations. The logistics information module of the Retail Information System covers a wide range of areas like warehouse management, materials handling, transaction processing and product slotting. Some RIS's also include in-cab communications, traffic information systems and vehicle routing packages.

Detailed information about order picking and warehouse stock, as well as order tracking within the system, will help retailers shorten production and delivery times and reduce inventory. Further, the entire distribution process can be improved by maintaining a balance between manual and automatic processes. Doing so will also save logistics costs.

The objectives of retail logistics have always been reduced inventory levels, improved on time delivery, and the reduction of distribution costs. Due to insufficient information sharing in the past, inventory reductions were sought through increase in delivery frequency and reliability, and reduction in order lead times. But now, the use of information technology allows for inventory reductions through information sharing and visibility. The information visibility and sharing through logistics information system brings about quick replenishment of products at the store or warehouse level. Some retailers are further implementing software applications that enable continuous replenishment. Exhibit 17.6 shows the continuous replenishment program of Tesco.

**Exhibit 17.6**

**Continuous Replenishment**

Tesco, the largest grocery chain retailer in the UK, is now being recognized as the hypermarket leader in Thailand, Hungary, Poland, the Czech Republic, the Slovak Republic, and Ireland. Though such a success brings in profits for any retailer, after a while, the retailers begin to record a stagnation in market share and need to look for ways to increase revenues.

As achieving growth in market share was a costly method for increasing profits, Tesco tried to raise its profits in the saturated market by shifting its focus to the supply chain. The firm evaluated ways of increasing sales to existing customers instead of going in for the more expensive proposition of attracting new customers. It has decided to do so by ensuring the availability of products that customers look for.

Tesco developed a continuous replenishment (CR) application in-house to improve product availability at its present locations to increase sales. This application enables Tesco to deliver ready-to-stock, locally tailored shipments to stores by providing real-time data on the whole supply chain. The efficient delivery of goods led to reduced inventory in distribution centers and storerooms, quickly filled shelves, and improved in-stock position.

The running information flow resulted in daily multiple store deliveries. CR solution's constant data updates helped Tesco’s managers cross-analyze Web and brick-and-mortar customer behavior patterns, revealing previously unrecognized sales trends.

*Source: http://www.retailsystems.com/index.cfm*

Let us understand the impact of information systems on retail logistics in a better way by first defining retail logistics and then examining the logistics processes carried out or outsourced by the distribution center.

## Logistics

Logistics is that part of the supply chain process that plans, implements, and controls the efficient, effective flow and storage of goods, services, and related information from point of consumption in order to meet the consumers’ requirements.

## The Distribution Center

The typical activities carried out by a distribution center are managing inbound transportation; receiving and checking products; storing and cross-docking merchandise; ticketing and marking products; filling orders; and managing outbound transportation.

### Managing inbound transportation

Terms between vendors and retailers regarding the product assortments being shipped, the pricing, packaging, delivery times, purchase and payment of goods would usually be agreed on when the partnership is finalized. Once the vendors have been selected and the orders placed, the retailer only has to synchronize the delivery times of different vendors to ensure that all the merchandise is received by the distribution center at the specified time to be transported to the stores. Transportation expenses are traditionally borne by the manufacturer. If, for any unforeseen reasons, the shipment does not arrive at the distribution center in time, the retailer fines the vendor heavily for the delay and then reassigns the delivery slot. In order to reduce merchandise cost and better manage inbound transportation, the retailer can also rope in truck companies to consolidate shipments from various vendors.

### Receiving and checking

Registering the products received and recording the time of arrival of the goods into the distribution center comes under the *receiving* function. *Checking* refers to examining the received merchandise to ensure that the goods received are of the promised quantity and quality.

Voice recognition technology enables the receiving clerks to process key data by directly speaking into a headset. The purchase order information (consisting of words and numbers) spoken by the clerks is converted into printed bar code labels. The labels are then pasted on cartons and the cartons forwarded for further distribution center processes before being dispatched to stores. Healds (Day & Nite) in UK was the first grocery and convenience retailer to introduce 'voice only' activated distribution center operator terminals.

### Storing and cross-docking

A distribution center enables the temporary storing of merchandise till it is required by the concerned stores. In the past, the function of re-packing of merchandise according to the transportation and usage requirements of stores was done at the distribution center itself.

Modern retailers are minimizing the handling and storage of inventory by going in for ***cross docking***. Cross docking refers to the packing of merchandise by the vendor in the quantity required by the store, thus eliminating the need for re-packing by the distributor. As a result, the merchandise received by the distribution centers from various vendors can be combined and immediately shipped to the stores. As the stock is delivered by the vendor when the replenishment order is placed, the inventory stocking period is minimum. A look at Exhibit 17.7 will give a better understanding of cross docking.

**Exhibit 17.7**

**Cross-docking at Sears**

Cross-docking seems to be a valuable solution for bringing down inventory costs. The return on investment on cross-docking comes pretty quickly. The payback is also quick and the benefits are far-reaching. Earlier, cash was tied up in unwanted inventory while rents needed to be paid and carrying costs borne. Through cross-docking and centralization of distribution, retailers can save millions of dollars.

The retail giant, Sears, is implementing cross docking at all of its seven distribution centers. That means more than 135 million cartons, or 45% of its shipments. Though the return on investment for Sears through cross docking is not known, we do know that Sears did not have to expand its distribution centers in the last 10 years even though its product volume increased by almost 50%.

Sears has also extended technology-incorporated process improvements to its vendors too. Its vendors (7,500 vendors for its consumer goods) have to submit Advance Shipping Notices (ASNs) and bar codes of each carton via EDI. Sears assists small vendors who may lack the technical resources to implement ASNs by partnering with SPS Commerce. (SPS Commerce is an organization that helps firms build electronic integration with channel partners.)

Shipments from vendors are unloaded at the receiving dock and the boxes are loaded on a high-speed conveyor which passes through a series of barcode scanners that read the carton's bar code. The carton's destination and contents, which have already been sent to the warehouse through ASN, are cross checked with the license plate identifier. The details are added to the financial inventory of the receiving store and also the store's replenishment inventory. The computer on which the data is processed directs another system in Sears' distribution center to convey each carton to the appropriate loading dock. The entire process that used to take two days now takes only 15 minutes!

*Source: http://www.spscommerce.com/news/art/1999/risnews-0999.shtml*

Many ERP and warehouse systems packages in the market have cross-docking modules. Retail firms need to have a warehouse management system (WMS) to integrate bar-code technology and EDI-originated ASNs from vendors. Retailers need to integrate ordering and inventory information into the cross-docking system. Some cross-docking systems use automated materials-handling equipment to mix and match hundreds of boxes at a time.

Cross docking saves time to the retailers as the merchandise gets directly into the store shelf, where it's going to sell. It also saves overall labor costs by reducing the handling in distribution centers.

Cross docking reduces inventory levels and lowers the direct cost associated with excess inventory by eliminating the unnecessary handling and storage of products. Reduction in inventory levels results in less use of space and equipment required for handling and storing products. It also results in reduced product damage and product obsolescence. The distribution centers of today are much smaller than those in the past because of cross docking. Now-a-days, distribution centers are only used for storing merchandise that has not been delivered according to the planned/scheduled delivery date and time.

Cross docking would benefit high-volume, large-store retailers with many stock keeping units. Such stores do not wish to carry huge inventories, but need to get the required products in time on the store shelves.

### Ticketing and marking

Ticketing and marking refers to the process of classifying products and attaching identification labels and price tags to them. This process was once carried out in the store itself. However, retailers soon realized that engaging salespersons in pricing and pasting would hinder sales activities. Hence, they shifted the ticketing and marking (labeling) activities to the distribution center.

Also, since there was considerable variation in the way vendors labeled the goods, retailers had to re-label the merchandise. Today, retailers are in a position to do away with the tedious and time consuming process of relabeling as every vendor follows Universal Product Code norms when labeling the merchandise. This kind of labeling also makes it easy for operators on the shop floor to bill the items purchased because these codes can be directly scanned into POS terminals.

### Filling orders

The procedure for filling orders has become quite smooth and convenient with the advent of information systems. The process follows an orderly pattern: POS terminals record every sale and transfer information regarding purchases to the staff, who convey the replenishment requirements to the distribution center personnel through an inter-connected computer system. The computer at the distribution center generates a ***pick ticket*** (information about the quantity of items in each storage area, along with the distribution center location). Then, the computer prints the pick ticket after checking for the availability of merchandise being ordered. The order-filler collects all the merchandise ordered, consolidates it and ships it to the stores.

There are two ways to make this process smoother. A ‘Quick response delivery system’ can be used to share POS data with the vendor directly so that all the activities carried out at the distribution center can be done by the vendor (this system will be discussed later in detail). Or else, a cross-docking distribution center can be set up where the merchandise can be shifted from the vendor's inbound shipment to the retailer’s outbound shipment directly, without requiring consolidation.

### Managing outbound transportation

Whenever a shipment is dispatched from the vendor to the retailer, any number of things could go wrong, from flat tires to lost shipments. The management of outbound transportation is a sophisticated activity, especially for large retailers who make considerable use of distribution centers. The distribution centers of big retailers like Sears run as many as 100 routes in one day. Retailers are most likely to adopt those technical innovations that improve vehicle utilization and minimize the impact of traffic congestion. (Technology adoption at Sears is discussed in Exhibit 17.8.)

**Exhibit 17.8**

**Sears Mobile System**

Sears Logistics Services Inc., a subsidiary of Sears Roebuck & Co., had installed a mobile wireless system in the mid-90s. The system eliminated its manual, paper-based method of managing tons of deliveries, shipments and inventories and also made necessary operational improvements. But the DOS based system was slow and not as reliable as expected. Moreover, it was very difficult to connect this system to the host.

So, recently, in fall 2001, Sears replaced the old DOS based system with a new Windows CE based wireless mobile system, which promised more speed, reliability, accuracy and flexibility. The new system was installed in the seven Retail Replenishment Centers (RRC) that supply all the merchandise for Sears' 870 shopping malls across the U.S. On a daily basis, the distribution centers handle more than 25,000 pallets per day, while most merchandise on average is stored for only 24 or 48 hours. At the seven RRCs, merchandise is constantly moving in and out, round the clock, throughout the week.

Since the applications of the new system were built specifically for the RRCs, the system was able to provide efficient network connection, more memory, and more hard drive space and speed. Application development was done quickly and the installation took only few days because the applications were very intuitive and required little employee training.

RRCs handle huge trailer loads of merchandise (about 250,000 in 2001). Warehouse workers (slotters) at Sears receive the merchandise/pallets delivered by vendors' trucks and place it in bins (that provide damage protection) before moving it to a location in the warehouse to make it easier for workers to locate the merchandise for shipments (the process is called slotting). After installing the new system, the productivity of slotters almost doubled. The average pallets moved per slotter increased to 300-400 pallets from the earlier 220-230. The new system was able to achieve this increase through the wireless application advantage of providing real time data regarding the available bins and their locations in the warehouse. Such data availability eliminated human error. The new system, sometimes, does not generate a single error in two weeks, while the old system generated some 30 to 40 errors a day in an 8-hour shift.

The new system has reduced labor costs since workers who had to work overtime earlier to complete a shipment now get their shipments filled in regular shifts. Moreover, distribution centers do not need to hire additional labor for deliveries and shipments during peak times.

As a result of the implementation of the new system, inventory information became more reliable and retail replenishment managers (who restock products at Sears stores), received more accurate information on the availability of merchandise at the distribution centers. The investment paid off in eight months and Sears realized a productivity improvement of 30%.

Sears' is now considering a mobile device that can hold large amounts of data so that even if the connection to the server is lost, employees can keep on working because the information would be retained in the handheld device. Once the connection is re-established, the user can file the data to the server. Since mobile devices can hold large amounts of information, they do not need continuous connection with the server. This increases the speed of mobile devices and facilitates employee productivity. And by only using the wireless connection to the server when necessary, the battery life of the handhelds increases. Sears also wants to incorporate voice command recognition functions in its system to increase the accuracy further.

*Source: http://www.mobileinfo.com/News_2002/Issue41/Sears_logistics.htm*

Vehicle utilization can be improved by a combination of new software and hardware. These include the use of 'dynamic scheduling' and real time vehicle routing packages that identify the best route for the transportation of merchandise after considering road conditions, transportation operating constraints, and customer service levels.

The problem of traffic congestion can be dealt with by increased out-of-hours delivery, transfer of freight traffic to rail and improved vehicle tracking and communication. All these areas can benefit from advances in technology. Advances in vehicle handling and tracking technology are opening up new avenues for rationalizing the movement of freight in urban areas. There is also considerable scope for improving the fuel efficiency of delivery vehicles.

Outbound transportation also includes the inter-store transfer of merchandise. In many cases, the customer asks for a size or color of clothing that may not be in stock in one store but may be available in many other stores. So, instead of losing the customer, the retailer can acquire the required merchandise from the other store and make the sale. Such transfer of merchandise should be done quickly. Inter-store transfer of merchandise can be an advantage to the retailer if the retailer can manage inter-store transportation efficiently.

When the merchandise has to be returned to the vendor, either because it is damaged or because return of unsold merchandise was a pre-condition of purchase, the retailer incurs an extra outbound transportation expense. Large retailers even incur inter-store transportation expenses as they have to collect such unsold or damaged merchandise from all their stores.

## Outsourcing

Outsourcing is the process of getting a function (that has been done in-house in the past) done by some other firm outside the retailer's purview. Retailers outsource the logistics function to third party logistics companies when they find that doing so would either improve their performance or reduce expenses. Outsourcing results in better use of manpower in the core functions and the streamlining of retail operations.

Sometimes, some of the functions like checking, packing and attaching price tags are passed on to the vendors (like in case of floor-ready merchandise). In some cases, functions like source tagging, which were a part of the vendor's responsibilities in the past, are being outsourced.

### Floor-ready merchandise

The once tedious process of manual checking and counting of incoming merchandise, unpacking and repacking into convenient cartons, attaching price labels, security devices, bar codes to shipping labels, placing hangers (if required) is now almost extinct giving way to 'floor-ready merchandise', now the most common form in which merchandise is shipped by vendors. Floor-ready merchandise refers to merchandise shipped by vendors to retailers with the necessary tags, prices, security devices, etc. already attached so that the merchandise can be cross-docked rapidly through the retailer's distribution centers and sent directly to stores.

Floor-ready merchandise makes the functions of receiving and checking easy for the retailer. The clerks at the distribution center are only required to scan the inbound cartons that are already marked with unique identifying bar codes. The contents of the cartons are electronically recorded, and the clerks at the distribution center need to open them and check the merchandise only if they find the carton to be damaged.

The products inside the cartons are already marked with the retailer's sales price, identifying information and UPC barcode so that they can be electronically scanned at the POS terminals. All the items also have a source tag, a tiny electronic device attached to the products as protection against shoplifting and as an indicator of product movement inside the store.

Since the cost of marking the merchandise is passed on to the vendor, floor-ready merchandise also provides a cost advantage to the retailer. Small vendors cannot afford to provide such service to their customers (retailers). Large vendors, however, have developed systems to supply their customers with floor-ready merchandise in the manner demanded by them.

### Source tagging

Source tagging has many benefits for retailers. Though it was initially done by vendors (as a part of floor-ready merchandising), it evolved into a specialized function that is outsourced to other parties. The source tags used now-a-days are wafer-thin and less than two inches long, making them extremely usable and completely non-obstructive, unlike the traditional hard tags. The source tag attached to a product can remain on it even after the product has been sold and taken out of the shop. This tag need not be taken off even while billing.

Source tags are much more efficient than traditional theft-prevention measures. These tiny and compact electronic tags can easily be attached to any theft-prone item, even if it is ‘small and expensive’ or ‘large but sensitive’. After the tag is attached to the products, even jewelry and expensive metal items can be made accessible to customers. Source tags can also replace hard, uncomfortable tags on clothes so that they don't hurt customers trying on new outfits.

In future, microchips inserted into the source tag could carry information about the product, the date of purchase, the owner, and the warranty. Such microchips would be permanently sealed into the fabric. This would make it easy to identify false claims and stolen items.

### Third party logistics companies

Third party logistics companies (or TPLs) are firms that take outsourcing contracts from retailers or manufacturers to manage the flow of merchandise from manufacturers to retailers. The functions that come under such contracts typically include management of inbound transportation, warehousing and packaging. Other functions like customs provisions, order realization and documentation are also carried out by TPLs.

Some TPLs provide services that facilitate electronic data interchange through Value Added Networks (VANs) that are vital for quick response delivery systems. Since the computer systems of retailers and their vendors may not be compatible, TPLs provide a Value Added Network to integrate retailers’ computer systems with that of their vendors; VANs weave a network with both retailers and vendors by establishing communication links with each one of them separately (through EDI), converting the data into a format that is compatible with that of the other and transferring the data.

TPLs carry out one of the following functions: transportation, warehousing or packaging. But some TPLs carry out all three functions in an integrated manner. Both types of TPLs are discussed below:

#### *Transportation*

TPLs provide transportation services using their own fleet or a partner's fleet to create an optimal network. Retailers should take care while choosing a TPL for transportation because the efficiency of the selected firm determines the retailer's lead time. Employing TPLs is beneficial to retailers, as TPLs adopt new technologies to provide the best service possible to their customers. The E-procurement initiative by a leading TPL, Ryder, is described in exhibit 17.9.

Shipment management systems (SMS) allow TPLs to effectively plan load management, routing, and equipment and driver management, and carry out network freight analysis. Further, warehouse management software can be integrated with SMS to provide integrated logistics solutions.

**Exhibit 17.9**

**Ryder rides technology**

Outsourcing is rapidly becoming popular among retailers. An increasing number of companies are showing interest in outsourcing transportation management to a TPL instead of handling it in-house. The third-party logistics company, Ryder System Inc., is one of the world's leading supply chain and transportation management solutions vendor. In a move to enhance its global transportation procurement process and maximize customer savings and service, Ryder implemented the OptiBid application (of logistics.com).

This E-procurement tool will allow Ryder to conduct rapid and seamless procurement of merchandise. E-procurement solutions reduce paper-based processes between buyers and suppliers, which often result in significant costs and longer business cycles. OptiBid would also establish optimal transportation contracts for Ryder's transportation business. Ryder plans to further expand across other modes, including air, ocean, and less-than-truckload (LTL).

The OptiBid solution has a transportation focus, unlike other e-procurement tools. It also allows for basic 'What If' scenario management in an online environment. The solution has the ability to achieve freight capacity quickly, easily and intelligently, thus enhancing customer service. OptiBid has helped make Ryder's supply chain solutions more efficient and responsive to the market needs. As a result, Ryder has improved its competitive position and increased sales.

*Source: http://www.retailsystems.com*

Many TPLs are trying to reduce costs and avoid delays by mixing different modes of transportation. Some TPLs promise 'less than truckload' to serve their customers better. Other TPLs use multi vendor consolidation to reduce overall costs. They combine merchandise from different vendors going to the same destination to achieve full truckload economies.

### *Warehousing*

In order to provide customers the best service possible, vendors set up distribution centers near their retailers' stores. This proximity allows them to meet retailers' demands for floor ready merchandise deliveries. Now-a-days, however, vendors are outsourcing distribution to TPLs that own and manage distribution centers either specially for the vendor or common warehouses.

Automatic scanning and bar code labeling are also done by TPLs to track the movement of goods. Using Warehouse Management Systems, real time, periodic and accurate information can be provided to vendors and retailers. Services like advance shipment notifications add to the value retailers and vendors derive from outsourcing.

### *Packaging*

Packaging is another service that is being offered by TPLs. TPLs set up facilities for final packaging in their warehouse itself, thus reducing the time taken for packaging for retailers. This results in reduced product handling, reduced cycle time and reduced costs.

TPLs also offer a variety of packaging services like custom pallets, display shippers, inserts and coupons, labeling and printing, repackaging-conversion, and wrapping and bundling.

*Integrated third-party logistics services*

Some TPLs provide only one of three logistics services: transportation, warehousing or packaging. However, other TPLs provide all three services. Such integrated services are proving more useful for retailers.

## Store Vs Distribution Center Delivery

The use of information systems is making stores delivery as convenient as distribution center delivery. But the feasibility of either delivery system - store or distribution center – can be judged only on a retailer-to-retailer basis. There is no “ideal” or “correct” choice. Depending on the retailer's size, requirements, strategies and systems, the most suitable system must be selected.

Some large retailers have to re-distribute the merchandise among their own stores in a complex manner. Such retailers prefer to have their merchandise delivered to a central distribution center because they have to maintain a sophisticated logistics system to handle all inter-store merchandise distribution.

The retailer must do a cost-benefit analysis when deciding between an in-store delivery system and a distribution center delivery system.

The advantages of using a distribution center could be:

i. Sales forecasts would be more accurate if they are developed for all stores instead of individual stores. Developing separate forecasts for each store would increase the proportion of error because forecasting involves an element of approximation. However, if the sales forecasts are based on inventory levels in the central distribution center, the proportion of error would be reduced.

ii. Maintaining a central distribution center would reduce the total inventory held in the stores, and thus the investment in the form of inventory. If there is a central distribution center, the individual stores will not have to hold extra items in the form of buffer/safety stock, because the distribution center would store that back-up merchandise.

iii. There would be less chance of stock-outs in any particular store as replenishments can be ordered from the distribution center.

iv. Distribution centers are developed for storing merchandise. Storing merchandise in the retail store would not only be inconvenient, it would also be wasteful because the retailer has to pay a considerable amount of money for renting retail space.

Retailers who find distribution center delivery beneficial are: i)retailers with stores that do not experience a constant demand for certain items, as sales forecasts can be more accurate when demand is aggregated at the distribution center, ii) retailers whose stores are not geographically concentrated but are spread out, can have a central distribution center within 150-200 miles from most of the stores iii) stores that would have frequent need for some items can replenish the stocks in store from their distribution center iv) stores that order products in small quantities (half-truck) can save transportation costs by ordering larger quantities and storing in distribution center.

In-store delivery has its own set of benefits:

i. It may be more affordable for a small retailer with few stores.

ii. Merchandise can be delivered more quickly if delivered directly to stores instead of through an intermediary (distribution center).

iii. If the retailer has many stores in the same area, the merchandise can be consolidated and delivered, thus bringing down costs.

iv. If the vendor can deliver floor-ready merchandise, then the total merchandise cost for the retailer would be less than the cost of merchandise routed through a distribution center.

### Pull Vs Push Logistics Strategies

With the advent and use of information technology and the increasing complexity of retail operations, the traditionally followed and much practiced push logistics strategy is being replaced by the pull logistics strategy.

The push logistics strategy requires the distribution of merchandise by the vendor according to historical demand, inventory position and the stores' needs. In the pull strategy, orders for merchandise are generated by the stores or, in sophisticated cases, by POS terminals that are connected to the vendors' computers.

The pull strategy enables store personnel to order stocks on the basis of daily demand and customer needs. Adopting such a strategy would almost eliminate the chances of over-stocking or stock-outs because the inventory levels are based on daily customer preferences and changing demands. Balancing inventories by undertaking inter-store distribution of merchandise would also not be required.

But this strategy cannot be used by all retailers. Retailers who do not have the advanced information systems that are necessary for projecting sales of individual stores, should continue with the push logistics strategy. Retailers who hold merchandise that isn’t purchased on a regular basis should also adopt the push strategy.

## STRATEGIC ADVANTAGES OF INFORMATION SYSTEMS IN LOGISTICS

Retailers cannot increase their net profit in a sustained manner only through an increase in sales. They should also manage their logistics effectively. Retailers who have realized the profit potential of maintaining efficient logistics have invested heavily in information systems. These retailers experienced an increase in their bottom line. The strategic advantages of adopting a logistics information system are:

- Improved product availability
- Improved assortment
- Improved return on investment

### Improved Product Availability

Product availability makes a lasting impression on customers. The knowledge that a product is always available in a store would encourage customers to return to the store. No retailer likes to lose a sale due to lack of product availability. And no retailer would like to be in a situation in which the product was available in the warehouse, but couldn’t be transported to the shop floor in time.

### Improved Assortment

To keep pace with changing customer tastes, retailers are maintaining more stock keeping units (SKUs). Earlier, maintaining a few SKUs for fast moving colors and sizes was sufficient but now retailers have to maintain SKUs for almost as many sizes and colors as are available. This change in practice will naturally lead to an increase in inventory levels. If this large inventory is not efficiently managed and distributed, the cost of maintaining so many SKUs would outweigh the benefits of holding them.

## Improved Return on Investment

Return on Investment (ROI) is a measure of the performance of a retail firm. One of the ROI measures commonly used is return on assets, which is the result of net profit divided by total assets:

Return on assets = Net profit / Total assets

The total assets can be reduced by the efficient use of information systems in logistics. The use of information systems can also increase net profit (either by raising the gross margin or lowering expenses).

Information system networks between vendors and retailers allow the retailer to take advantage of special prices and reduce the purchase costs, thereby improving the gross margin. Operating expenses of the retailer can be lowered by reducing the transportation costs through coordinated deliveries. The retail information system streamlines all the processes so well that, at the distribution center, the merchandise can be received, checked, labeled, stored and shipped to stores with minimum handling. The retailer would need to carry little back-up inventory because his inventory management system would be directly connected to the vendor’s system. This reduces the inventory investment and, in turn, the inventory carrying cost. The problem of stock-outs can be avoided as the customer database of the retailer holds the details of specific customers, their purchase preferences, color choices and sizes.

The desirable outcomes of using a retail information system are many, but the net effect would be higher returns through a considerable improvement in performance and distribution.

# QUICK RESPONSE DELIVERY SYSTEMS

A Quick Response (QR) Delivery System is a combination of a logistics system and an information system. It is designed to reduce inventory investment, bring down logistics expenses, and increase customer service levels by reducing the lead-time for receiving merchandise from vendors.

Let us see how a quick response delivery system works for both the retailer and the vendor. Consider a large retailer and a vendor of merchandise that is stocked in the retailer’s stores. One of the vendor’s items, say a sweater, is purchased at one of the retail stores. Information regarding all purchases of the vendor's item (the sweater) is downloaded by the vendor's computer system every day. So all the sales information by SKU and by store is transferred to the vendor the very same day the sale is made. Information regarding warehouse movement and forecast analysis is also transferred. The vendor can generate the past 100 weeks’ sales history for the product with the help of a Decision Support System (DSS) and assess the product's overall performance and region-wise performance.

After receiving the information, the vendor starts with the order fulfillment by affixing the retailer’s price label, UPC code and source tag. He then ships the cross-docked order to the retailer’s distribution center the very next day of the purchase in retailer's store. Since the merchandise is cross-docked, the operators at the warehouse only need to unload the inbound merchandise and re-ship it to the stores that require it. The merchandise is again ready for sale in the retailer's stores within three days (while the process earlier took one month).

The detailed purchase information available to the vendor (even SKU wise) helps him plan his production accurately and avoid holding excess inventory. He can also customize the assortments region-wise and climate-wise. For instance, if the sales of denim shirts in early winter are found to be high, the vendor can manage stocks accordingly. The sales data can also be analyzed further to identify the sizes that are moving fast and the colors that are being preferred.

## Benefits of Quick Response System

QR delivery systems have the following advantages:

- Reduced lead-time
- Increased product availability and lowered inventory investment
- Reduced logistics expenses

### Reduced lead-time

Lead time is the time difference between the identification of the need for replenishment and the time when the replenishment is actually done. QR System reduces the lead time by completely eliminating paper transactions (through EDI). Safeway, a UK based retailer, realized a reduction in lead time by adopting fully paperless intake systems for its warehouse operations.

This system also reduces manual errors as the electronic transfer of data to the vendor's system eliminates the need for an operator at the other end to feed in the data. EDI in the QR system thus reduces the lead time by a week or more. As the lead time comes down, demand forecasting becomes easier and inventory holding decreases.

### Increased product availability and lowered inventory investment

Increased product availability generally requires the maintenance of high inventory levels, and this in turn leads to an increase in inventory investment. The use of QR system eliminates the need for holding huge inventories. Since purchase orders can be made according to daily sales fluctuations and accurate forecasts can be made, the retailer need not hold huge, unnecessary inventories. Also, as the vendor works with the retailer as an extended partner in transporting the merchandise, the retailer can decrease inventories and increase the number of shipments.

Further, aligning deliveries with sales assures shorter lead-times for critical items. For instance, if an item’s sales increased during a particular week and the item is about to go out of stock, the QR system ensures that it is replenished faster than usual.

### Reduced logistics expenses

A QR system helps bring down logistics expenses by reducing the amount of warehouse space, or, in some cases, even eliminating warehouses by adopting cross-docking, or, better still, delivering floor ready merchandise to retailer' stores. The costs involved in the processes of receiving, checking, consolidating multiple-vendor merchandise, unpacking and repacking, then labeling and shipping to stores can be avoided by using a QR system. In addition, retail space need not be used and personnel time need not be wasted (in labeling store-delivered merchandise) as the merchandise is floor-ready.

## Costs of Quick Response System

The QR system that provides retailers with so many advantages creates many problems too. The costs of maintaining a QR system include the increased transportation cost of frequent deliveries and the cost (for both the vendor and the retailer) of acquiring the necessary hardware and software. The retailer often tries to pass on these costs to the vendor. A QR System also leads to problems regarding the coordination and transportation of deliveries.

## DATA MINING

Data mining is used by customer-focussed companies like retail firms to mine useful information from the huge volumes of data generated over time and stored in databases. Regarded by many as the most revolutionary development in technology, data mining is being used by retailers to improve customer acquisition and retention rates.

Data mining helps retailers extract useful information that will help them compete more effectively and respond more quickly to consumers' changing lifestyles and demands. This information will help them classify customers according to demographics, preferences, purchase habits and apparel sizes. They can then design personalized promotions to attract target customer groups.

Retailers are trying to extend their customer base by properly utilizing data mining tools to reach the right prospects instead of trying to woo anyone who comes to their stores.

With the help of data mining technology, retailers can reach customers in a personalized manner through customized marketing. Now-a-days, retailers compete over providing the best personalized shopping experience to customers. Some retailers use data mining to offer old customers individually targeted discounts when they visit their stores (see Exhibit 17.10.)

Since databases provide many benefits, there is an increased emphasis on data collection. Storing the data collected has become a problem for retailers. Hence, there is increasing interest in data management tools.

**Exhibit 17.10**

**Maintaining Loyalty-'ThanQ'**

Quality Farm & Country (QFC) is an agricultural specialty retailer in the US with 350 stores in 30 states. Traditionally, farmers were its primary customers, but in the last ten years, many farm families moved out of farming to non-farm jobs. However, QFC is still able to maintain a highly loyal customer base. The company manages its loyalty program with Archer software, a campaign management and transaction analysis toolset.

QFC has established a ThanQ program at all its stores (yet to be extended to online customers). In this program, a customer who fills in his personal data along with farm data like crops, livestock, pets, etc. gets a ThanQ card. ThanQ card members receive annual rebates of 1-3%, a newsletter on products and services of QFC, and other special offers and promotions.

Data from POS terminals is added to the existing database to observe the purchasing patterns of more than 700,000 customers who have signed up for the ThanQ program. These patterns are analyzed with the help of the software application.

QFC not only studies product sales, it also identifies and meets customer needs. For instance, if the customer indicates that he owns horses, the customer loyalty manager checks if his purchases include horse feed and health products. If not, the manager provides the customer with product information and promotional offers to encourage him to make the purchase.

QFC also sends targeted direct-mails to its customers. It also advertises on television, over the radio and in newspapers. ThanQ members are offered promotions on the basis of the identified needs of that geographic area. Archer software helps managers accurately analyze the response to its promotions. The results are then weighed against a control group, a random selection of customers, to evaluate the effect of promotions in terms of returns. This kind of analysis has helped QFC stay competitive in a market niche that has changed a lot in recent years.

*Source: http://www.risnews.com//issue/cover_story.htm*

## DATA WAREHOUSING

A data warehouse is a repository of integrated information, available for queries and analysis. Data and information are extracted from heterogeneous sources as they are generated. This makes it much easier and more efficient to run queries over data that originally came from different sources.

Data warehousing technology equips retailers with a data repository that can be used to suit their needs. Till recently, retailers did not have access to much data because it was too costly to retrieve, store and analyze data manually. The POS system is very powerful data repository, which gives important insights into a retailer's business and its consumers. That's why a large number of data warehouses are built on point-of-sale (POS) data. Large retailers also build data warehouses on information regarding purchase orders, receiving, inventory flow, promotions and advertising. Some of the largest data warehouses in the world are used by retailers like Wal-Mart, Sears, K-Mart and Target.

Since the use of a data warehouse leads to better decision-making, it helps retailers improve bottom-line results. The ROI from a data warehouse is realized by reducing the amount of obsolete stock or increasing sales through target and affinity marketing. With the use of its large data warehouse (approaching 300 Terabytes), Wal-Mart has discovered that it can build some stores in well-heeled neighborhoods and target the rich.

Many retailers are developing data warehouses as a fad rather than to meet a business need. In order to justify investments and bring quantifiable results, a data warehouse must be driven by specific business requirements. Just building information storehouses will not lead to magical results overnight. Data warehouses only facilitate retail decision processes. For instance, by studying historical data from a data warehouse, a model of customer behavior can be built to predict how consumers will respond to new products. The retailer can then decide whether or not to introduce new products into the present merchandise line.

Retailers should not simply build a data warehouse in every suitable area. Instead, they should consolidate sales, inventory, and customer information into a single, enterprise-wide data warehouse. For a data warehouse to be successful, its initial investment should be justified economically, its implementation should be driven by business needs, and management should be committed to exploit its benefits. In addition, a data warehouse should be aligned with the overall corporate strategies of the organization.

The issues to be considered by retailers when implementing a data warehouse include:

- What data to capture and how much history to keep (this may require re-structuring existing systems)
- Reviewing of vendors' data models
- Designing important queries and reports
- Defining methodologies for such projects as developing specific assortments
- Identifying the Return on Investment (ROI)
- Analyzing business requirements
- Designing business and IT strategies for successful implementation
- Selecting the most suitable software
- Training retail executives in the use of the data
- Developing an analytical approach to decision making using the data warehouse

## DATA WAREHOUSING AND BUSINESS INTELLIGENCE

Business intelligence refers to the advanced analysis of data, collected from various sources to develop intelligent, fact-based business decisions and strategies. This helps the retail firm achieve a business advantage. For such advanced analysis, business intelligence systems use the comprehensive data provided by data warehouses. This combination of business intelligence systems and data warehouses has proved to be the most significant breakthrough in retail information technology since the introduction of POS scanning.

Many retail companies across the globe have integrated their data warehouses with business intelligence systems to enhance their profitability and gain a competitive advantage, along with a rapid pay-back on investment.

The integrated enterprise-wide data that data warehouses hold can be analyzed using business intelligence as data mining tool. The analyzed data can be presented to managers and senior executives who make vital business decisions. Such integration will ensure that the right kind of information reaches the right people in a timely manner, enabling them to take the right decisions. The integration of business intelligence with data warehouse(s) has benefitted many retailers. It has increased their margins and stock turns and improved their customer service.

## SUMMARY

The value of information systems is being realized and appreciated by retailers throughout the world. Many large retailers have benefitted from the use of information systems. The systems approach has helped them perform efficiently, reduce costs, improve service levels, expand the customer base and manage their functional areas better.

Information systems have helped retailers meet customer demands concerning better product availability and better product assortments. Huge databases and sophisticated data mining systems are enabling retailers to reach many customers in a personalized way.

The use of information systems has led to major changes in merchandise distribution. Distribution centers are now being used for cross-docking instead of storage. The quick response delivery system has enabled the delivery of floor ready merchandise. The availability of timely and accurate information on daily customer demands has led to the development of new pull logistics strategies. In addition, the online sharing of information has strengthened vendor-retailer relationships. Retail information systems have enabled retailers to compete successfully in a complex and challenging environment.

# Part V
# Contemporary Issues in Retailing

# Chapter 18

# Ethical and Legal Issues in Retailing

**In this chapter we will discuss:**

- Focus on the Customer
- Dealing with Ethical Issues
- Social Responsibility
- Environmental Orientation
- Legal Framework

## INTRODUCTION

Like quality, customer focus and responsiveness, in these times of tough market situations and cut-throat competition, business ethics has become another source of competitive advantage that retailers aspire for, in order to improve the company's image and to attract new customers.

Apart from abiding by the mandatory rules and obligations of a legal framework, retailers feel responsible for the society they are operating in. Legal laws can only be imposed on firms for protecting the interests of the society by curbing bad practices. But the challenge of retailers in earning the goodwill of customers lies in being more sensible and projecting a truthful and caring attitude through ethical practices, community development programs and other forms of voluntary service.

The presence of an ethical sense may not necessarily attract customers, but the absence of it certainly puts off several customers and turns them away. Ethical issues are not only an object of concern for people across the supply chain — vendors, suppliers, distributors and customers — but also important for the shareholders and community at large. Ethical reputation acts as a differentiating factor among various retailers. In this chapter, we shall learn the ethical and legal issues that retailers confront.

## FOCUS ON THE CUSTOMER

The changing marketplace dynamics and intensifying competition are leading to an increasing emphasis on the customer. The customer is the one who ultimately benefits from competition among firms, because this competition results in better bargains for customers as to both the choice of products and the price. Retailers' dealings with suppliers, competitors, employees and customers are governed by the various rules and regulations specified by the government.

To build an organization and maintain its reputation and goodwill, retailers need to address issues of wider interest than merely abiding by the law. Retailers in the new era have added responsibilities — ethical, social and environmental responsibilities. The negative publicity received by some retailers when faced with such situations like trash disposal have brought these concerns into the limelight. The importance that the green revolution has gained in the recent years is also a reason for retailers' newly developed concern for the environment, which has resulted in waste reduction processes.

Retailers also have to keep checking the effect of their existence and practices on the environment and the localities around them. As environmental concerns among customers have increased, the need for retailers to establish themselves in the customers' minds as environmentally-friendly firms has also increased. Almost all firms now understand these changing dynamics, and hence, being socially responsible is fast becoming a norm rather than a distinguishing factor.

## DEALING WITH ETHICAL ISSUES

Legal ethics aim at guiding companies against the unreasonable actions. In most countries, employing children is not only unethical but is also a punishable offense in the eyes of law. But still there are many retailers who employ children for odd jobs like packaging and cleaning, though they are not directly on the company rolls.

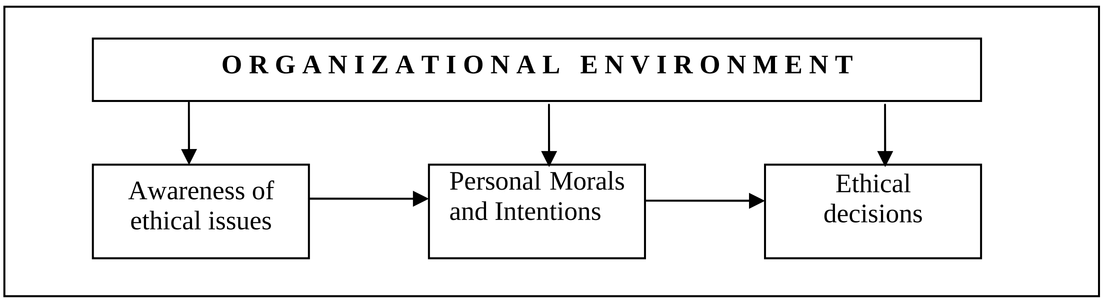
Very often, organizational practices get influenced by ethical dilemmas and financial pressures. Some retailers have a written code of ethics, which guide their employees. Such a code of ethics generally deals with the retailers' relations with suppliers and customers. But many retailers do not have such a written code of ethics, because the ethical situations are not predictable. Instilling ethical thinking in employees is a challenging task in the retail sector, like in any other sector. One way to deal with this challenge seems to be recruiting persons with a moral stand and good attitude. But, in practice, such a precaution alone will not ensure the perfect ethical functioning of employees.

Moreover, employees tend to face dilemmas for which there is no perfect solution, like the dilemma of sympathy vs. written rules, the dilemma about whether or not to accept a friendly gift from business partners and so on. There are no set standards to help an employee judge whether or not a decision is ethical. Each person who is confronted with a particular situation will have a different view.

There are other instances in which unethical behavior is clearly visible and directly countable as improper and inappropriate. For instance, a retailer using a 'to-be-sold' unsealed perfume as a tester and selling the same bottle to another customer as a new one is clearly an unethical practice.

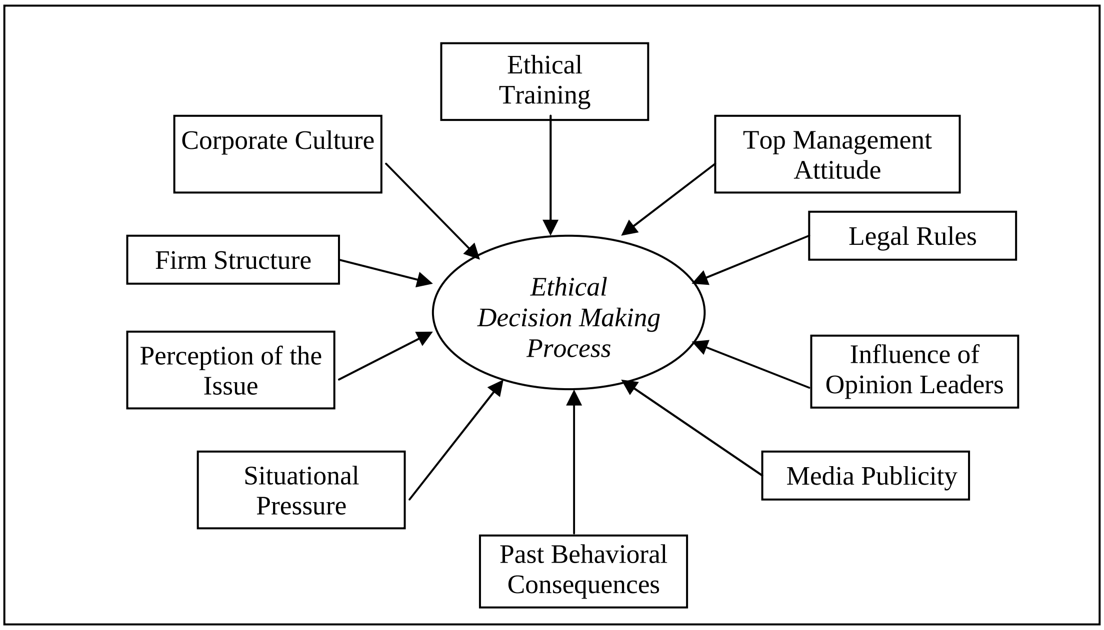
Ethical decisions are based on various individualistic and environmental factors like personal beliefs and thinking, media publicity, opinion leaders, organizational orientation, top management's attitude and beliefs. Figure 18.1 indicates the ethical decision making process. Figure 18.2 depicts the various factors influencing the ethical decision making process.

**Figure 18.1: Ethical Decision Making Process**




*Source: Icfai Center for Management Research.*

**Figure 18.2: Factors Influencing Ethical Decision Making Process**




*Source: Icfai Center for Management Research.*

The awareness that a decision involves an ethical issue, that is, the way an individual perceives the issue, is the primary step in the whole decision making process. Then the personal morals of the employee play an important role. Equally influential at every step of the decision-making process are the organizational factors like corporate culture, the attitude of the top management, the firm's structure and ethical training. Certain ethical issues that come under the legal framework also guide the decision-making process. Again, the behavioral consequences of the past and current behavior, like demotion, fine or punishment will influence the future decision making processes.

## Awareness of Ethical Issues

Awareness of ethical issues forms the basis for taking ethical decisions. The employee should first realize that there is an ethical side for every decision he takes, otherwise he may intuitively settle upon what strikes him first, without considering its long-term implications on the company and associated parties. This may lead to undesirable consequences for the individual or to the company in the long run. Hence, it is very important for a retailer to inform its employees about its policies regarding ethical behavior.

A test for ethical concerns while taking a decision could be to think of the decision in terms of acceptance by others in the company, in the industry and in the media. If the decision seems acceptable to all the groups, then the retailer can go ahead with that decision. Then, there will be little or no chance of any ethical fallout, that is, chances of negative consequences of the decision, in the long run. Ethical fallout for individuals could be in the form of suspension, probation, loss of job or even imprisonment. Ethical fallout for the retailer could be in the form of fine imposed, spoilt image, reduction in customer base and profits, and in worst cases, government investigation and regulations, and public disapproval of the industry as a whole.

## Moral Philosophy, Intentions and Behavior

The employee's attitude and his moral philosophy come into action when he becomes aware of the ethical issues attached to a decision. The moral philosophy of an individual is the character traits that are integral to his nature — his basic thinking, beliefs and concerns, his perception of 'right' and 'wrong' — that play a role in taking any kind of decision. Action follows thinking and beliefs and, hence, whether the decision-maker is only concerned with the result or the means of achieving that result as well, depends on the morality of the individual.

Retailers can be classified into three groups on the basis of their philosophical perspectives in solving day-to-day retail management problems — teleologists, deontologists and relativists.

***Teleologists*** are those individuals, for whom any action is ethical so long as it produces the desired results. Some teleologists are egoists who always look for what they are going to gain personally by doing something. If by selling the customer database, they get a huge amount of money, they consider it a good sale. The other group of teleologists are utilitarians who think of the benefit of people at large, and consider an action ethical if it produces useful outcomes for the majority of people. Retailers in this group may stop purchasing a brand if it is known that the producers do not adopt proper waste disposal measures.

***Deontologists*** are those people for whom the result is not of as much value as the means. The effect of their action on the people involved in the action is their concern. For example, installing surveillance cameras inside trial rooms to detect theft is not an acceptable practice for deontologists.

For ***relativists***, the practice that is being followed by the majority of people is the standard ethical behavior. What most stores (other than theirs) do is an acceptable practice for them.

An employee intends to behave in a certain way on the basis of his moral philosophy and his understanding of an associated ethical issue. His behavior is guided by whether or not the intended behavior is considered ethical by other people in the organization. Individual intentions may not always take shape as behavior because there are other's intentions that may affect these intentions either in a good or a bad way. For example, a salesperson with good intentions may intend to tell the customer about the cost-benefit of a product over the one that the customer wants to purchase, but may not actually do so because of the fear of inviting the wrath of his supervisor.

## The Organizational Environment

The environment prevailing in a retail organization has a major impact on the decisions made by its employees. There are two theories that define the organizational role in the employees' ethical decisions --- Bad Apple Theory that holds unethical individuals responsible for unethical decisions, and the Bad Barrel Theory that throws the blame for an unethical decision on the whole organization. In practice, however, the organization does have an impact on the ethical decisions that its employees make. Over time, the employees also exert an influence on the organization through the consequences of their ethical decisions and behavioral outcomes of the same.

The culture of an organization has some characteristics embedded in itself, which influence the decisions of an employee. The stand taken by the organization in the past about suspending an employee performing exceptionally well for bad conduct, or whether or not the firm succumbed to the temptation to buy goods from the gray market offering products of the same quality for a price much lower than the suppliers', would all pass on to the employees through the grapevine, however hard the management may try to suppress them. And such stories would be the guiding blocks for the employees, irrespective of the written code of ethics or the ethical image of the company projected by the management.

Ethical philosophy should be reflected by an organization in its working. Retail firms should display a stern attitude in dealing with unethical practices. They have to set an example for their employees. Even in tough market situations and at times when a small unethical step may bring in big benefits, the firms have to stick to their moral stand. Such actions would spread an ethical sense across the organization and create an impression on the employees like no code would.

Even a retailer's organizational structure affects the ethical thinking of the firm. In case of a decentralized organization, though flexibility is an advantage, a certain cost is involved in keeping control on the employees. As the authority to handle situational problems is given to those who are in the field, putting a check on employees' activities become difficult, and deviations from the accepted ethical practices generally do occur. At such times, the retail organization can only hope for a consistent moral philosophy in its employees. Another problem with a decentralized structure is that the supervisors transfer the blame of any inefficiency to their subordinates.

In centralized organizations, free flow of information to the top management is ensured. However, if there are more levels of management, information may be lost or distorted before reaching the top management. So both structures have their pros and cons in taking ethical decisions and showing ethical behavior, and neither of them ensures a perfect ethical atmosphere.

The instances of 'passing blame' and 'refuting allegations' should be taken seriously and resolved immediately through a thorough investigation. Serious action should be taken against anyone who is found guilty, irrespective of his position, status or cadre. Practicing discrimination in the action taken against unethical behavior keeping in mind a person's position (for example, an employee who is closely related to the CEO) would create a negative impression about the management's commitment to maintaining the ethical standards that they preach.

There are certain things that a retail employer must keep in mind while hiring employees, like not rejecting an applicant because of race or color.

### Employer ethics

Factors like gender and ethnic background should never be the criteria for rejecting an applicant. Many retail firms in America encourage and take pride in the workplace diversity. In addition, the hiring, promotion and compensation policies should be equitable and transparent, if the retailer wants to develop an environment of healthy competition in the firm.

### Employee ethics

Just as an employer is expected to be fair and unprejudiced with his employees, employees, too, have a responsibility towards their employer. There is nothing more an employer would desire than the employees developing a sense of belonging to the company, and acting accordingly. But it is frequently found that retail employees resort to several unethical practices like theft, which cause a loss to the company.

Here again, there is no set of written rules to decide or judge an employee's action as unethical. For example, one employee may find it unethical to take home even a pen that belongs to the company, but for another employee, only an action that would cause a countable loss for the company may be unethical. Though it is personal ethics that come to play in such situations, one common practice that is considered unethical by everyone alike is stealing — a practice that is most prevalent in the retail industry. Theft has become a major problem for many retailers across the globe. The big size of retail stores, the large number of salespersons, and huge variety of products make it very difficult to keep a regular check on the products and closely monitor the salespersons' activities.

Job switching is another area where individual consciousness and personal judgment come to play. An employee shifts jobs for numerous reasons like increased pay, challenging work, growth prospects, location, company repute, etc. But when moving to a different company, which most probably is another retail firm, an employee should never disclose the confidential information of the previous company to which he had access.

### Company Ethics Programs

It is required that the retail firms have policies for thorough checks and controls, especially for those categories of employees who are faced with ethical issues more often than others due to the very nature of their job. There should also be a well-designed, easily understood and confidential reporting and complaint mechanism, so that any unethical practice would come to the notice of the management. Many of the Fortune 1000 firms (almost one third) have set up ethics committees to carry out appropriate procedures when ethical dilemmas arise in the organization.

The importance of ethics programs lies in their ability to minimize unethical behavior. Developing a framework of ethical behavior expected from employees would be a proactive action on the retailer's part. A code of ethics reflects a retailer's effort to maintain an ethical retail environment. The code of ethics acts as a guide for employees in dealing with ethical issues that may arise while performing their jobs. Such a code should be provided to all the employees. And they should read, understand and sign this code of ethics, thus showing their consent to abide by it.

The next important step in an ethics program is its enforcement. Any violation of the code of ethics should be strictly dealt with. Transparency and consistency should be maintained while dealing with various cases of code violation. Managers may even need to resort to dismissals or suspensions if the need arises. The management should also keep itself well-informed about what is going on within the firm. It should encourage employees to report any breach, and keep the identity of those individuals confidential.

## SOCIAL RESPONSIBILITY

Sometime after its inception, every retailer feels an obligation towards the society in which it is operating. Though not mandatory, caring for the community and country becomes a retailer's felt responsibility while doing business in the society.

Retailers make societal contributions for several reasons, and not always in anticipation of some kind of benefit for the organization. They are sometimes driven by the urge to serve, sometimes as a form of appreciation for the credible work done by charities, sometimes by the wish to help people struck by a calamity, sometimes by the desire to sponsor events in the performing arts, sometimes by the urge to give donations to government programs, and sometimes by the desire to build a positive image in the society and the corporate world. Still, the fact remains that most of the time retailers are motivated to take up these activities to earn the good-will of customers as a store associated with a worthy cause, rather than just the mind-share as a good store. Over time, social activities create goodwill for retailers among the customers and the society.

Moreover, such charitable activities bring in the advantage of tax rebates for retailers. In cases of excess inventory, retailers donate the excess goods to charitable institutions and avail a tax rebate, thus helping both those organizations and themselves. Some of the social activities undertaken by retailers are discussed below:

## Cost-free Activities

Out of the various ways in which retailers show care for the society, same like the employers' and employees' participation in communal activities are totally cost-free, while others like cash donations for charity are expensive.

## Legally Mandated Activities

Some kinds of social responsibilities, like paying taxes to the government and paying them on time, and disposing of wastes in a careful manner, are legally supervised and are mandatory. For instance, wheelchair accessibility to the store premises is a legal mandate in US.

## Policy Influenced Activities

Embedded in the company's policies are some societal obligations like hiring handicapped people and those belonging to minorities, cooperating with school and college students with regard to information for their studies, treating all customers equitably, and ensuring that the customer finally benefits from competition.

## Group Imposed Activities

There are certain restrictions that some groups impose upon themselves, like uniform work hours and cooperative security forces, which are followed by retailers, though not mandatory legally.

## Interest-groups Coerced Activities

Special interest groups play an important role in forcing certain actions on retailers. Under this category come boycotting certain products or brand manufacturers for the bad advertising of products or for the manufacturer's unethical behavior — things that these special interest groups find offensive. Retailers try to solve such problems by mediation — a process in which a neutral third party enters the scene, listens to and understands the arguments from both sides, and tries to resolve the conflict by suggesting a mutually agreeable solution.

## Free-will Activities

The various kinds of activities carried out by retailers as a part of their social responsibility are the following:

- Projecting an 'environment-friendly' image by using paper bags instead of polyethylene bags, using recycled paper, and promoting bio-degradable products and products that have not been tested on animals.
- Retailers' representatives helping in traffic control during high-peak traffic hours.
- Collecting donations on behalf of charitable organizations by placing a donation box at the cash counter.
- Participation of company associates in events that make a difference to the community.
- Facilitating social mobilization by setting up counters where the public can donate.

- Giving cash or product donations to the needy.
- Using greeting cards made by mentally challenged children or societies/organizations working for handicapped people, for festive occasions.
- Hosting social events.
- Donating a part of the sales for a definite purpose or to a particular organization
- Sponsoring cultural functions for the disabled and old age homes.
- Offering merit scholarships to poor students.
- Employees providing honorary service for community development activities.
- Providing discount coupons for shows organized by charity organizations.

## ENVIRONMENTAL ORIENTATION

Retail firms are growing increasingly responsible for preserving the environment and the society. Almost all firms have written statements mentioning what they strive to do for the society at large. For instance, the value statement of Shopper's Stop (an Indian retailer) can be seen in Exhibit 18.1. The planning and budget allocation at the start of the financial year includes budget allocation for such activities.

**Exhibit 18.1**

**Shopper's Stop Values**

The following are the values that help us in achieving our mission and vision:

- We shall not take what is not ours.
- The Obligation to Dissent (against a viewpoint that is not acceptable)
- We shall have an environment conducive to openness.
- We shall believe in innovation.
- We shall have an environment conducive to development.
- We shall have the willingness to apologize and/or forgive.
- We shall respect our customer's rights.
- The value of trust.
- We shall be fair.

*Source: www.shoppersstop.com*

Along with the usual celebrations on occasions like the anniversary of the stores, retailers are found to be inclined towards environment-related activities like planting trees and organizing painting contests for children. In addition, some retailers take the responsibility for maintaining gardens created by the government or trees planted on the road dividers.

## Waste Reduction

Just like vision and mission statements, many retailers now have a policy statement on waste management to guide employees' actions. The Body Shop International plc. initiated a waste reduction policy in 1976, and continues to follow it till now. A brief is given in Exhibit 18.2. Some retailers also encourage suggestions from employees on this front by rewarding the employee who comes up with the best suggestion on waste reduction.

**Exhibit 18.2**

**Waste Reduction Inc.**

The Body Shop International plc. (Body Shop) is a leading skin and body care retailer operating in 50 countries with over 1900 outlets. Body Shop has the tradition of introducing a wide range of best selling products and in 1999, 'The Body Shop' brand was voted the second most trusted brand in the UK by the Consumer's Association.

Body Shop initiated a waste reduction practice as early as 1976, when the store was in its inception stage. The customers were encouraged to bring back emptied bottles of their products for refilling because the owner could not afford to supply new bottles every time. This policy is continuing even today, though it is no more due to affordability.

For those customers who do not opt for reusing bottles, Body Shop offers its products in recyclable bottle made of HDPE plastic. In fact, all the bottles used for Body Shop products are made with this material as HDPE plastic is commonly collected in US for recycling. Body Shop also has a collection counter for such recyclable plastic to help those customers who do not have recycling services in their areas. The bottles thus collected are sent to processing plants where they are processed into products like combs and soap-boxes. The cycle is completed when these products are again merchandised in Body Shop.

This noteworthy procedure ensure waste reduction and encourage recycling is being continuously being implemented in the stores of Body Shop across the world and has had a very positive impact on the environment. Such practices mark the praiseworthy environmental responsibility of the management of the Body Shop and set an example for the corporate world.

*Source: http://www.co.washtenaw.mi.us/depts/eis/retlfs.htm*

## Recycling

Recycling has caught the attention of almost all retailers worldwide. Waste materials such as cardboard and paper that are commonly generated in the retail industry can be easily recovered for recycling. Incorporating recycling in retail operations, in fact, sends a positive message to customers about the retailer's environmental concern and cost-consciousness.

A large portion of any retail store's waste consists of packaging material (particularly corrugated cardboard), much of which is generated outside the retail establishment. Efforts to reduce such waste must be made in cooperation with vendors. For example, to avoid unnecessary packaging for the products being shipped into the stores, the retailers can plan along with vendors how to reduce packaging and what materials they can use for packaging, and which of them can be recycled or reused. The process of retail recycling (in simple steps) is shown in Exhibit 18.3.

Right from retailers themselves using recycled paper for paperwork within the organization, to reusing the incoming bags and boxes as packaging for customers, to promoting trash recycling among customers by organizing contests for awareness and setting up collection counters for used aluminum cans, plastic covers, paper bags, the efforts seem wide in this area.

**Exhibit 18.3**

**Process of Retail Recycling**

- Identify waste producing practices
- Switch to alternatives wherever possible
- Identify recyclable materials
- Provide training on recycling to new employees
- Orient the ground staff about trash separating procedures.
- Arrange recycling containers at common areas
- Put up visible signs instructing consumers to recycle products

*Source: Icfai Center for Management Research*

To reduce the amount of plastic waste, many retailers have joined hands with manufacturers for retrieval and safe processing of plastic waste. Retail chains in US have gone a step further by offering marginal financial rewards to customers who return the plastic tins and bags for reuse.

Creating awareness about recycling by way of organizing poster and essay contests for schoolchildren and putting them up inside the store is something retailers can comfortably afford.

Not only are retailers promoting recycling programs, but are also taking measures to reduce the use of plastics by using more paper bags in place of plastic ones, by avoiding the use of plastic wrappers for gift wrapping, etc. Today's environmentally conscious customer would naturally appreciate such moves.

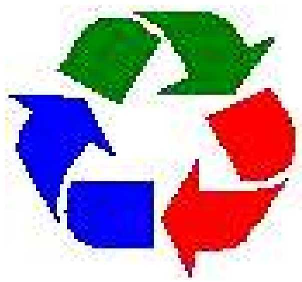
## Packaging

The consumer is becoming more and more environmentally conscious and widely aware of ways to lessen the burden on Earth. Customers now are willing to buy products with little or no packaging, or packaging materials that are reusable. People are growing more conscious about the well-being of the environment ('Green Movement') and this has led to an increase in the responsibility of the retailers not just to stock and sell whatever is bought from the suppliers, but to check for the quality of the products and the effects those products may have on the customers and the environment before they agree to add a product to their shelves. The advent of this concept, often addressed as 'green marketing' has generated concern among retailers about the suppliers' manufacturing processes, their ethical beliefs and environment-friendly practices.

With the standard norms for labels firmly in place, a look at the packaging of a product gives insights into the environmental friendliness of the brand. Whether any animal fat has been used in a product, even as a scanty ingredient, whether it is tested on animals, whether or not it is bio-degradable, whether the package is made of recyclable paper — these are all clearly evident just from a glance at the package. Shown in Exhibit 18.4 (Symbols indicating the environmental friendliness of products) are the various uniformly accepted and internationally recognized symbols.

In fact, the retailer can pass on favorable messages to the customers by displaying the signs of environment-friendliness at visible spots in the store.

**Exhibit 18.4**
**Indicators**



RECYCLABLE


BIO-DEGRADABLE


NOT TESTED ON ANIMALS

In spite of all these, the basic questions — whether the customers would be willing to bear the extra cost involved in such careful investigations, whether they would accept a product slightly inferior to other products in terms of quality, though much better from the ‘green movement’ perspective — remain unanswered.

## LEGAL FRAMEWORK

In order to protect the consumers from being cheated by deceptive claims and monopolistic practices of the retailers, we see an increase in legal enforcement these days. Legal issues governing the retail environment should be constantly studied in order to understand the legal regulations constraining the retailers’ operational flexibility.

Retailers cannot afford to be unaware of the laws or to stay ignorant of the kind of effects those laws may have on the way they do businesses. Such ignorance would certainly cost them dear. Moreover, retailers operating in more than one country (or state) should abide by the rules of each country (or state) they are operating in.

Large retailers keep themselves aware of the changing policies and guiding structures of the government by maintaining legal departments, which sometimes even influence the government regulations. While small retailers cannot afford to maintain such departments, in many countries, there are retailers’ associations that keep retailers informed about the proposed changes in laws.

Unless retailers understand the trade regulations like central laws, state laws and local laws that affect them, they cannot make any business decisions relating to products, pricing, promotions, credits, consumers, competitors, employees or society, freely and confidently.

Such laws cover a wide range of issues like the location of a store, the building structure, its business practices, mergers and acquisitions, pricing, product and promotional activities, trademark infringements, and so on. Let us study the impact of the law on:

- Supplier Relations
- Competitor Relations
- Consumer Relations
- Employee Relations

## Supplier Relations

Retailers have to take special care about not contravening the regulations set by the legal framework, not only in their operations, but also in the supplier's operations. There are legal regulations concerning the relationship between retailers and suppliers in the areas of pricing, product promotion and channel constraints.

### Pricing

Retailers are not at complete freedom to fix the price to buy or sell the products of their stores. Most of the laws framed by the government are aimed at restricting vertical price fixing and discriminative supplier pricing.

#### *Vertical price fixing*

Vertical price fixing - sometimes referred to as “resale price maintenance” - occurs when a business at one level of distribution (e.g. a manufacturer) dictates the price or terms under which a business at a different level of distribution (e.g. an independent distributor) may resell the goods or services. This type of price fixing was aimed at preventing large retailers from selling goods below the suggested retail prices and negatively affecting the business of small retailers. But later, this practice was considered illegal as it restricted the consumers to obtain goods and services at the best possible price.

Now a manufacturer can suggest a price for the product being sold, but cannot impose that price on the retailer. Neither the manufacturer nor the wholesaler can threaten to cut off the supply of goods if the retailer does not agree to sell the item at the price suggested by the retailer.

#### *Discriminatory pricing*

Price discrimination occurs when a vendor sells the same merchandise at different prices to two or more retailers. But under certain circumstances, price discrimination is legal. Different prices can be charged to different retailers when there is a difference in the manufacturing, sale and delivery costs due to differences in the order volume. Retailers cannot be charged with price discrimination - a) if the cost of selling to a particular retailer is less; b) if a change in market conditions affects the marketability of a particular merchandise, and; iii) if they have to match the local competition.

Price discrimination by manufacturers usually is in the form of offering different discounts to different customers (wholesalers and retailers), depending on the order quantity. Manufacturers offer trade discounts on bulk purchases because their per unit cost of transportation and delivery charges decrease as the order quantity increases.

For the same reason, manufacturers offer merchandise at different prices to wholesale and individual retail customers. Functional discounts or trade discounts are different prices or percentages off the suggested retail price, granted to customers in different lines of trade. Wholesalers are given higher functional discounts than individual customers as they perform a range of functions like storing, distributing, merchandise, servicing retailers' orders etc., which are not performed by individual customers. Both these forms of price-discrimination are exempt from legal action as they are based on the costs associated with servicing customers' orders.

Manufacturers are also allowed to charge different prices to different customers if changing market conditions require a price change to sell that particular merchandise. If a manufacturer's sales volume declines because a local player is offering similar merchandise at substantially lower prices, the manufacturer can offer that merchandise at a lower price to the retailers in that particular area. This type of price discrimination is acceptable because the price discount is aimed at matching the competitor's price.

Retailers should not demand/accept any price differentials from vendors when buying merchandise in other than the above mentioned circumstances. But, in reality, large/chain retailers demand and receive more price benefits than individual, small retailers, even when the order quantities are the same. Such price discrimination is considered illegal in the US, as it puts the survival of small/individual retailers at stake and reduces competition in the market.

Discriminatory pricing with regard to the purchase or sale of goods or services is illegal (abuse of dominant position) if such pricing is for reasons other than meeting the competition. Some countries like US, have specific acts like the Robinson-Patman Act, which address the legality of supplier-retailer relations.

### Product

Counterfeiting has become a serious problem in many countries, especially in the unorganized retail sector, where for every successful product there are at least two or three duplicates being released into the market with almost the same kind of packaging. It is illegal for the retailer to sell such merchandise.

### Purchasing

Firms in the retailing business face more ethical dilemmas while buying merchandise. These include issues related to product quality checking, sourcing, slotting fees, charge-backs and bribery.

#### *Merchandise quality check*

Whether or not to check the quality of the products brought into the stores is a dilemma unique to retail firms, because in other firms it is almost mandatory to check the quality of goods bought from the suppliers. Retailing involves buying merchandise of company brands as well as private brands and even unbranded ones (garments, footwear, fancy items, gift articles, etc.). The customers buy branded labels on the basis of the reputation and faith in the manufacturer's label, while they buy products sold with the store's label on the basis of their faith in the retailer. But the private labeled ones are items which raise ethical questions. It so happens that customers of a retailer buy the private labeled merchandise with the goodwill they have for the store and their trust in the retailers' judgment. Here, the question arises whether it is proper to sell private labels without checking their quality. Some retailers have started employing their own testing methods for verifying the quality of the private labeled products before deciding to sell them in their stores.

#### *Sourcing*

Verifying the source of the merchandise is a major problem as it not only involves cost and time, but also may create an irresolvable ethical confusion. The vendor from whom a retailer purchases merchandise may have used child labor in manufacturing it; he may have underpaid his workers; he may have violated social norms. Moreover, such a thing may have happened at any link in the value chain. So, deciding on the extent of ethical responsibility of a retailer is tough. Sometimes, the merchandise that a retailer sells may be the work of political prisoners or child laborers, but the retailer may have been unaware of the source.

To assure consumers that the source of merchandise is not unethical, some big retailers employ private investigators to check into the sourcing details. Some other retailers employ independent observers for the task of inspecting the sources of the merchandise they buy.

But some retail firms, probably to bring down the buying costs and in turn give customers the best price bargains, are deliberately sourcing merchandise by adopting unethical practices.

#### *Slotting fees*

Slotting fees is the money paid by a vendor to a retailer for stocking a new product on retailer's shelves and in its inventory, and for adding its UPC (Universal Product Code) number in the retailer's computer system. A UPC entry gives a permit for individual stores to stock the item. From the retailers' point of view, this fee helps them in coping with the added expenses in the form of storing an additional item in the warehouse, inventory carrying cost, reshuffling the shelves and replacing the existing items. The slotting fees also acts as a form of minimum guarantee for the retailer to accept a new product into the store.

#### *Charge-backs*

Retailers punish vendors by issuing charge-backs. Charge-backs are the amounts deducted from the invoices of the vendors for breaching any of the agreed upon conditions. Such conditions include early or delayed shipment of goods, use of improper packing materials, and incorrect shipping labels. Sometimes, retailers also collect an allowance for damages during transit. Though some vendors protest such charge-backs by showing evidence that errors occur for reasons beyond their control, many vendors silently suffer this practice due to the power of the retailer.

#### *Bribery*

One of the most prevalent forms of bribery is the inducements accepted by the retailer while buying the vendor's products. Such a practice is traditionally overlooked in many firms and is even considered legal in some countries. Many retailers don't have a formal written code or rule pertaining to bribery but some retailers condemn such practices by their employees. Few retailers are so particular about it that they do not allow their employees to accept even a cup of tea from the suppliers. The ethical dimensions of some retailers extend to their vendors and require that they, too, maintain integrity in business practices.

### Channel Constraints

There are many laws that govern the retailers' relations with other members in the distribution channel. These laws are concerned with practices like territorial restrictions, dual distribution, exclusive dealing and tying agreements.

#### *Territorial restrictions*

These are restrictions imposed on the retailer by the manufacturer with regard to the geographic area where the retailer is allowed to sell products bought from the manufacturer. Within an acceptable purview of matters, for as long as these restrictions are not agreements formed in consensus with a single retailer, and so long as such acts do not restrict the trade by limiting the sale of a manufacturer's products by a particular retailer, the law (in US) does not forbid territorial restrictive practices. In case of franchisor-franchisee businesses, territorial restrictions such as those restricting the opening of a new franchisee within some decided distance, help in protecting the franchisee's business to a certain extent.

### *Dual distribution*

It is the process whereby the manufacturer sells the products produced by him through self-operated retail stores as well as private retail stores. It is a case of dual distribution when the same product is supplied through two distribution channels. For example, Kodak cameras are sold at Kodak's own retail stores and other organized and unorganized retailers as well.

There are two possible effects of such a practice:

i. It may foster competition.

ii. It may damage competition.

In the former case, the manufacturer sells his products through private retail stores in areas where he cannot afford to have his own stores, and sells the products through his self-operated stores where he finds it necessary to do so to remain competitive and gain enough market share. Thus it fosters competition.

In the latter case, the private retailer and the company-operated stores may compete with each other if both have a presence in the same area, and the manufacturer may win the game by attracting customers through lower prices or increased expenditure on advertising. Thus an atmosphere of unhealthy competition is created.

The way the regulations affect the manufacturer clearly depend on which of the above effects is the outcome of adopting the practice of dual distribution. In the US, while the first outcome is considered favorable by the law, the second outcome is treated as an offense, if such an effect is proved by strong evidence.

### *Exclusive dealing*

There are two kinds of exclusive dealing arrangements prevalent in the markets today. One arrangement is the one-way exclusive dealing wherein the supplier or manufacturer enters into an agreement with a retailer to distribute his products exclusively through this particular retailer in an area, without expecting any kind of favor in return. While such a practice results in a one-sided benefit for the retailer, it is not an illegal practice.

Generally, two kinds of vendors enter into such dealings with retailers with maximum customer visits — a new player in the market who is trying to establish his brand by increasing the awareness of his product through the shelf space of the leading retailer, or a weak manufacturer who is trying to reach the customer through price bargains.

The other arrangement in exclusive dealing is two-way exclusive dealing, where both the parties enter into this kind of arrangement to gain mutual benefits. Such benefits offered by the retailer could be agreeing to share the sales information or promising not to carry a competing brand or a similar product. This kind of arrangement would be considered illegal if it leads to monopoly.

### *Tying agreements*

Tying agreements are those whereby the manufacturer or franchisor demands that the retailer stock a new brand or non-selling product as a condition to supply the retailer/franchisee with well-established, 'much-in-demand' product(s). For example, a leading manufacturer with many popular products may force a retailer to handle the entire product line offered by the manufacturer as a pre-condition to selling him the popular merchandise. Such an act is termed as 'full-line policy'. These kinds of agreements are usually considered to be in violation of the law (in many countries across the world) if they affect the retailers' business substantially.

## Competitor Relations

The survival and success of retailers depend on the level of competition, but competitive practices are very often determined and constrained by rules and regulations. These rules and regulations try to maintain healthy competition and protect customers from deceptive business claims. The laws relating to competition pertain to pricing, promotion and trademarks.

### Pricing

Horizontal price-fixing occurs when two or more retail competitors agree to sell their products for the same price, or according to some set formula. Such a practice is considered unlawful in the US because of its potential impact on the consumers' bargaining power. It is illegal for competitors to enter into agreements for raising, stabilizing or otherwise affecting prices. Even an informal understanding concerning prices between competitors is illegal. In fact any agreement affecting price levels in any way is illegal. Even exchanging price information with competitors violates antitrust laws, if it affects prices.

### Promotion

Deceitful diversion of patronage is an offense in the eyes of law. A retailer trying to harm competitors by attracting customers through false claims, either verbally or symbolically, can be said to be violating the law.

'Palming off' is another kind of offense through which a retailer tries to deceitfully divert patronage. Palming off is the practice in which the retailer labels the goods of a manufacturer as someone else's. For example, the retailer purchasing clothes in lots from some place and selling them in his stores with the label of a known brand or a designer's name is a punishable act, even if the manufacturer's or designer's label is not trademarked.

### Trademarks

Retailers can register their store names, logos and private labels through trademark registration laws. But it is the responsibility of the retailer to keep an eye on the market to check whether its trademarks are being used by anyone else. Though the law does take action if such infringements are brought to notice, there are no agencies to check for infringement of trademarks. New retailers use trademark search teams to check whether the brand name or logo that they plan to use already exists. This way, they eliminate the probability of being sued for trademark infringement, and consequently losing huge amounts of money.

## Consumer Relations

Consumers today, more than ever before, are wary of tantalizing offers from retailers. They are intelligent enough to differentiate between genuine offers and fake sales tactics. Moreover, the law is actively making rules to safeguard the interests of the consumers. These rules are discussed under pricing, promotion, product and consumerism. Ethics in selling is also discussed.

### Pricing

Pricing rules are concerned with a retailer's deceptive and predatory pricing practices:

#### *Deceptive pricing*

Advertising incorrect prices to attract customers into the store, and later adding on some hidden charges to the price advertised for the product, or terming the product as unavailable, come under deceptive pricing. This unfair practice is also often termed as 'bait-and-switch pricing'. Such tactics not only cheat the customer, but also harm the competing retailers.

### *Predatory pricing*

Predatory pricing occurs when a dominant firm sells products below cost for a long period of time to drive away competitors from the market. Firms who have market power in more than one market may set prices below cost for a period of time to drive out rivals and restrict the entry of new players. Large retailers who give massive discounts are also using the predatory pricing strategy to destroy independent, small retailers, which can't compete on price. After the small retailers have been forced out of the market, the large ones generally increase prices to a level that is higher than that which had been earlier set by the small businesses. This can be considered to be an anti-competitive practice.

This pricing practice of the retail chains offering the same products at different prices in various geographical locations to eliminate competition is specifically stated unlawful by the laws of some countries. Selling goods at unreasonably low prices to win over competitors is also a forbidden practice.

## Promotion

Unlawful promotional activities constitute deceptive advertising and deceptive sales practices:

### *Deceptive advertising*

It is most difficult for the law to prove a retailer guilty on the basis of deceptive advertising. This is because there is a very subtle difference between misleading claims and puffery promotions.

If an advertisement is found misleading in nature, that is, if it is found to be making false claims about the look or the taste or the ingredients, or the uses and benefits of buying it, the retailer can be easily held responsible for such material claims. At the other end, subtle claims can always be dismissed by the retailer either by attaching a different sense to the claim or by quoting it as the personal opinion of the spokesperson in the advertisement.

In bait and switch advertising, 'bait' is the benefit or claim that the retailer makes to attract the customer into the stores, while 'switch' is the alternate or the 'real motive' that the retailer tries to promote once the customer comes into the store. Here, a retailer lures a customer by advertising goods and services at exceptionally low prices; then, when the customer contacts the retailer, a salesperson informs him that the good/service of interest is out of stock or of inferior quality. The salesperson tries to convince the customer to purchase a better, more expensive substitute that is available. The retailer has no intention of selling the advertised item. The primary aim of a bait advertisement is to obtain leads i.e., the persons interested in buying merchandise advertised. The store using this type of pricing never intends to sell the advertised product. The only idea is to kill the customer's desire to buy what is advertised and then try to convince the customer to buy a more expensive item.

This type of advertising is considered to be unfair and deceptive when the retailer:

- compares the "Sale" price with the "Regular" price of a product while he has not sold that product at the "regular" price being quoted for at least 50 percent of the time in the recent, regular course of business.
- compares the "Sale" price with a higher price being charged by other retailers for the same or similar merchandise, when in reality, the merchandise has not been sold in that trade area at the higher price being quoted.
- claims that a customer can get a savings off the list price, while in reality those products are not regularly sold at the higher price (list price) by retail outlets in that trade area.

### *Deceptive sales practices*

There are some kinds of sales practices that are considered illegal. Omitting key facts in advertisements or in promotions by the salespersons is an unlawful practice for which the retailer is held responsible because it is the retailer's firm that the salesman represents. Hence the retailer should take care to select the right salesperson and provide all the salespersons with the right kind of training, both in terms of products and company policies.

Using deceptive credit contracts is another illegal practice, whereby the customer is not provided with the right information to make purchase decisions. In these cases, the retailer generally hides facts/information or confuses the customer on the credit terms.

Superficial discounting is another deceptive sales practice that retailers use to lure customers into buying products, which they otherwise would not. In this case, retailers present a product as remarkably valuable just by showing reductions from an exceptionally high price, which actually never existed. In US, as per the guidelines of FTC in 1964, a sale is not deceptive if the product has been sold at the original price for a reasonable time, if the sale is for a specified period, and if the product assumes its previous price once the sale period is over.

## Product

A retailer selling any kind of merchandise in his stores must provide information to the customers about its safety and capability to serve their needs. Laws pertaining to the products sold by the retailers focus on product safety, liability and warranties.

### *Product safety*

The retailer cannot be held responsible for the hazards that any of his merchandise may cause to the customers who use it. However, the fact is that though the retailer is not a manufacturer and does not really know the intricacies of the product(s) he is selling, he can be held responsible for hazards caused by the use of these products. This is because the law (in US) requires the retailer to take the responsibility of checking the products he is selling for safety, and if he notices the chances of any product hazard, he must report to the safety commissions.

Because all this involves substantial cost for the retailers, they opt for reputed brands so that they are assured of the company’s guarantee about the safety of the product. Thus the safety of the ready-to-sell products and durables is ensured either by monitoring the products or by relying on manufacturers of well-established brands, who cannot afford to put their reputation at stake by selling products which are unsafe.

In addition to these precautions, retailers selling eatables should be extremely careful. For example, if a retailer is careful about the instructions written on the to-be-cooked items, like the cooking time, the amounts of ingredients to be added, and so on, no harm would be caused due to improper cooking. Furthermore, thorough checks should be carried out on the expiry dates of all kinds of items stored and sold in the stores.

### *Product liability*

The law in some countries holds that it is the responsibility of the retailers to warn the customer in advance about the probable hazards of using a particular product. The retailer should do so by foreseeing the various ways in which the products might be misused. For example, a drug store is expected to caution the customer about the danger of an overdose while selling sleeping pills.

### *Warranties*

The retailer also has the responsibility of ensuring the performance and safety of the product as promised in the warranties given by the manufacturers. The laws in some countries give the customer the right to sue both the manufacturer and retailer in the same legal suit with regard to the products, the warranties of which have failed.

In practice, the retailer holds two kinds of warranties — Expressed Warranty and Implied Warranty. An expressed warranty is an expression about some or all aspects of a product, like product quality, its physical nature, workability and durability. Expressed warranties are guaranteed by the retailer or his salespersons, either in writing or orally, and not necessarily using terms like 'warranty' or 'guarantee'. For example, a salesman often assures the customers with related examples that a grinder of a branded manufacturer would function flawlessly for three years though the company does not hold such warranty. So the three years of functioning guarantee is an expressed warranty of the retailer.

Implied warranty is the implied expectation of the buyer with regard to the product itself or the product's usability for a purpose. Implied warranties are of two types-implied warranty of merchantability and implied warranty of fitness.

Implied warranty of merchantability is the implicit understanding that the product the retailer is selling satisfies the apparent purpose for which the product is manufactured. Such implied warranty holds true for all kinds of products that a retailer sells unless particularly disclaimed by the retailer that the obvious purpose that a product is supposed to satisfy would not or may not be satisfied. For example, if a retailer, in a sale of old products, sells a room freshener to a customer and after going home, the buyer finds that the sprayer of the bottle is not functioning, the retailer may be held liable.

When an ignorant customer buys a product from the retailer, making it evident that he/she is relying completely on the understanding and judgment of the retailer with regard to the nature, quality and usability of the product, and the retailer makes a sale to such buyer, there is an implied warranty from the retailer about the product satisfying the purpose of the buy. For example, a customer enters an electrical shop and asks for a stabilizer for his refrigerator, and if the retailer gives the customer a stabilizer which cannot support a refrigerator, then the customer can hold the retailer liable for violating the implied warranty of fitness for a particular purpose.

## Selling

The ethical questions in selling merchandise to customers are related to products that are being showcased and sold in the retail stores as well as the selling practices adopted by the salespersons in the store.

### *Products*

In some cases, the very nature of the product being sold would pose an ethical question to the retailer. For example, selling cigarettes in a retail shop may be legal. But it is for a retailer to decide whether or not to sell such a product in a shop near a school.

### *Selling practices*

In the world of retailing, many ethical issues are related to the selling practices adopted by the store, or the store personnel. Generally, stores pay their personnel a commission in proportion to the merchandise that they sell. This practice motivates the sales personnel to push the ‘wrong’ products to the customer, even if they do not meet the customer’s needs. In doing so, even though the salespersons may not be giving any ‘false’ information to customers, they are ‘concealing’ some information. Retailing giants like McDonald’s were believed to have indulged in such practices (see Exhibit 18.5*)*.

**Exhibit 18.5**

**‘Beef Fries’ Controversy**

The notorious French fries controversy began in 2000, when an Indian software engineer, Shah (working in the US) happened to read a news article, which mentioned that French fries at McDonald’s contained beef. Shah sent an e-mail to the customer service department of McDonald’s, asking whether the French fries contained beef or not, and if they did, why this was not mentioned in the ingredient list. Shah soon received a reply stating that McDonald’s French fry suppliers use a miniscule amount of beef flavoring as an ingredient in the raw product for flavor enhancement. The reason for which beef was not listed as an ingredient, as stated, was that McDonald’s voluntarily (restaurants are not required to list ingredients) follows the ‘Code of Federal Regulations’ (required for packaged goods) for labeling its products and that the ingredients in ‘natural flavors’ are not broken down.

In May 2001, Harish Bharti (Bharti), a US-based Indian attorney, filed the class action lawsuit against McDonald’s. McDonald’s immediately released a statement saying it never claimed that the fries sold in the US were vegetarian, and added that it was up to the customer to ask about the flavor and its source. This enraged the vegetarian customers further. Experts commented that the issue was not of adding beef extract to a supposedly vegetarian food item; it had more to do with the moral and ethical responsibility of a company to be honest about the products and services it offered.

Moreover, McDonald’s statement that it never claimed its French fries were vegetarian was proved completely wrong after Bharti found a letter dated 1993 sent by the company’s corporate headquarters to a consumer in response to an inquiry about vegetarian menu items. The letter clearly bundled the fries along with garden salads, whole grain cereals and English muffins labeling it as a completely vegetarian item. Also, it was reported that many of McDonald’s employees repeatedly told customers that there was absolutely no meat product in the fries.

Meanwhile, in June 2001, another class-action lawsuit was filed in Austin, Texas, alleging that Hindu moral and religious principles had been violated by their unintentional consumption of French fries that were flavored with beef. The ‘beef fries’ controversy attained greater dimensions in India as 85% of the country’s population was vegetarian. Even non-vegetarian Hindus do not consume beef, as cows are considered to be holy and sacred. Eating beef is thus viewed as a sacrilege.

As public outrage intensified, McDonald’s released a conditional apology on its website, admitting that the recipe for the fries used a ‘a miniscule trace of beef flavoring, not tallow’. Unsatisfied by the apology, Bharti continued the legal battle for 11 months when McDonald’s announced that it would issue a new apology and pay $10 million to vegetarian people and religious groups in a proposed settlement of all the lawsuits in March 2002. Around 60% of this payment went to vegetarian organizations and the rest to various groups of children’s nutrition and assistance and kosher dietary practices.

The company also decided to pay $4,000 each to the 12 plaintiffs in the five lawsuits, and to post a new and more detailed apology on the company website and in various other publications. McDonald’s also decided to convene an advisory board to advise on vegetarian matters.

Though $10 million was definitely a pittance for the $24 billion McDonald’s, what remained to be seen was whether the case would set an example and make corporates across the world more aware and responsible towards their customers.

*Adapted from “Mc Donald’s Beef Fries Contraversy” case by A.Mukund, Faculty Member, Icfai Center for Management Research*

The ethical questions that confront retailers while selling are the following: Should the sales strategies be aimed only at maximizing sales? Or should a retailer be also concerned about providing all the facts and necessary information about each product he is selling, that is, should the retailer take the responsibility in enabling the customer decide better?

*Consumerism*

The efforts made by the government and business organizations to protect the basic rights of the consumer is referred to as ‘consumerism’. In doing so, they take the help of the existing laws to give shape to their aspirations for a consumer-oriented business atmosphere. Some of the basic consumer rights are listed in the Exhibit 18.6.

**Exhibit 18.6**

**Basic Consumer Rights**

**The right to satisfaction of basic needs:** To have access to basic, essential goods and services such as food, clothing, shelter, health care, education and sanitation.

**The right to safety:** To be protected against products, production processes and services which are hazardous to health or life.

**The right to be informed:** To be given the facts needed to make an informed choice, and to be protected against dishonest or misleading advertising and labeling.

**The right to choose:** To be able to select from a range of products and services offered at competitive prices with an assurance of satisfactory quality.

**The right to be heard:** To have consumer interests represented in the making and execution of government policy, and in the development of products and services.

**The right to redress:** To receive a fair settlement of just claims, including compensation for misrepresentation, shoddy goods or unsatisfactory services.

**The right to consumer education:** To acquire knowledge and skills needed to make informed, confident choices about goods and services, while being aware of basic consumer rights and responsibilities and how to act on them.

**The right to a healthy environment:** To live and work in an environment which is non- threatening to the well-being of present and future generations.

*Source:http://www.rediff.com/money/perfin/2000/jun/23con1.htm (as per Consumer Guidance Society of India)*

The highly informed consumers of this century patronize those firms that give utmost importance to them and their interests. The buyer seeks products that are unique, and that match his style and attitude. Many retailers do meet the demands of the consumers with novel and innovative practices and a consumer- oriented attitude. Retail firms are competing with one another to provide the best bargain to consumers.

Retail consumers no more yearn for just a better bargain in terms of price-quality mapping. They look for a lot more — convenience in shopping, customer service and the environmental concern of the retail firms, to name just a few. Hence, it is no more an easy affair to attract consumers only by offering better price deals or superior quality. Retailers cannot afford to be complacent anymore. They need to constantly change themselves according to the changing customer preferences if they want to maintain a lead position in the retail market.

## Employee Relations

The way retail employers treat their employees is governed by certain laws. Laws related to minimum wages of workers, laws related to health and safety of workers, child labor legislations, legislations related to the employment of physically and mentally challenged employees, etc., are some of the legislations that are applicable to retail establishments in almost any part of the world. Apart from these, each country have some specific legislations that are applicable to the retail industry of that specific country only. Retailers' operating in that country are required to abide by these regulations.

## SUMMARY

Retailers have realized the advantages of reflecting an ethical sense in business operations. The organizational environment plays a major role in the kind of ethical sense the employees possess. Retailers are trying to ensure that their employees behave ethically. Though there are many laws influencing the business environment of the retailer, there are many more aspects that come under the purview of ethics. These aspects concern the merchandise buying and selling practices in the firm. Retailers also need to be socially responsible and environmentally concerned. They often undertake activities that are beneficial to the society. Retailers are also taking measures for waste reduction, trying to recycle the materials used and are switching over to environment friendly packaging materials.

Legislation governs the retail firm's operations and relations with its channel partners. Its relations with suppliers, competitors, consumers and employees are governed by appropriate laws. Legal restrictions are imposed on practices concerning pricing, product, promotion, distribution, trademarks and HR policies.

# Chapter 19

# Careers in Retailing

**In this chapter we will discuss:**

- Getting into the Retail Industry
- Personality Traits of Retailers
- Employment Aspects of a Retailing Career
- Employment Opportunities
- Careers in Retailing
- Ownership Opportunities

## INTRODUCTION

The retail sector is one of the largest contributors to a country's GDP. The quantum of employment generated by the retail industry is high in developed nations like the US and the UK. The retail industry employs more than 23.5 million people in the US, according to industry employment details released by the Department of Labor for the year 2001. This figure is bound to go up as the rate of employment in the retail industry is expected to grow at 22%.

Clearly the retail industry plays a major role in generating employment in the US. Even in developing countries, the retail sector is generating plenty of employment opportunities. The stability, growth prospects, compensation and good working conditions offered by the retail industry have attracted many people to careers in retailing.

This chapter explores the various career options available in the retail industry and the skills required to pursue these careers.

## GETTING INTO THE RETAIL INDUSTRY

There are two ways in which one can become a part of the retail industry. One, by starting one's own retail business; or by working for a retail organization. Retailing jobs are more exciting than other jobs. But they can be frustrating too. To do well in the retail arena, one has to have some special characteristics.

## PERSONALITY TRAITS OF RETAILERS

To succeed in a retailing job, one should have certain types of personality. Some of the personality types that will succeed in the retail arena are:

- The People Pleaser
- The Risk Taker
- The Problem Solver
- The Decision Maker
- The Retail Entrepreneur

### The People Pleaser

The retailing business calls for building relationships with people. Retailers must therefore have the ability to interact with different types of customers and understand their needs and wants. Only retailers who like people and make a genuine effort to understand them and cater to their needs and demands can be successful. People pleasers have a knack for reading their customers' mind and anticipating their likes and dislikes. They communicate well with customers. They appreciate their customers, empathize with them, identify their motives and develop a great rapport with them.

### The Risk Taker

A certain amount of risk is involved in every business, including retailing. The risks in retailing include supply risks, retail price risks, operational risks, technological risks, and business cycle risks. A retailer takes risks when he decides on a number of issues like:

- The markets to be served
- The width and depth of the product line
- The services to be provided

An element of risk is present in every decision a retailer makes. The risk taker will be the type of retailer who willingly takes risks and also has the ability to differentiate productive merchandising risks from unproductive merchandising risks.

## The Problem Solver

A retailer who not only understands the inherent problems of retailing but also derives pride/pleasure from solving them is called a problem solver. Retailing involves providing appropriate goods/services that can satisfy customer needs or solve a particular problem. Retailers not only have to deal with problems regarding the procurement and display of merchandise, they also have to handle the problem created by dissatisfied and vocal customers. These problems, whether of a routine or unusual nature, must be solved as soon as they arise.

## The Decision Maker

A retailer has to make numerous decisions in the course of his operations. Decision-making becomes difficult when the retailer has too many options to choose from. Sometimes the retailer has to take decisions under pressure and with limited knowledge of the marketplace. The retailer who likes to take decisions under pressure in a rapidly changing marketplace is likely to succeed in the retail industry.

## The Retail Entrepreneur

A retail entrepreneur is a person who has the ability to organize, manage and take on the responsibility of running a retail business. Entrepreneurial skills are found in varying degrees in different people. A retail entrepreneur should have certain attributes to create a healthy organizational culture and to conduct the business successfully. Some of these attributes are discussed below:

i. The entrepreneur should be able to take calculated risks that will help in organizational growth.

ii. The entrepreneur should identify opportunities for growth and focus on satisfying customer needs.

iii. The entrepreneur should try to improve all aspects of the retailing business constantly. This will enhance profitability and customer satisfaction.

iv. The entrepreneur should try to develop good rapport with employees at all levels by meeting them personally and encouraging an open door policy.

v. The entrepreneur should try to inculcate a spirit of passion among employees by making them understand the corporate vision. This will give a strategic direction to their work and help them provide better service to their customers.

vi. The entrepreneur should encourage change and identify areas for improving service.

# EMPLOYMENT ASPECTS OF A RETAILING CAREER

In this section we will discuss five key aspects of employment that one should consider before taking up a job at a retail outlet. These five key aspects are:

- Employment Security
- Employee Compensation
- Working Conditions
- Career Advancement
- Job Satisfaction

## Employment Security

The retail sector offers a high degree of employment security even during times of recession. There are many reasons for this. Firstly, consumers will continue to purchase even during a recession. This means that the retailing industry will not perish until people stop buying. Secondly, there is greater job mobility in the retailing business, which translates into greater job security. Finally, retailing skills are easily transferable. This means that retail employees can move from one department to another without major hiccups at times of restructuring. This can reduce the number of layoffs during restructuring, thereby leads to higher job security.

## Employee Compensation

Salaries in the retail sector vary considerably, depending on the position of the incumbent in the organizational hierarchy. Top managers are paid competitive salaries while lower level retailing personnel are paid according to the minimum wages prevalent in the country. Though the initial salaries for people may not be very high, salaries increase as one goes up the corporate ladder.

## Working Conditions

Working conditions in the retail industry have their upside and downside. On the positive side, a retail environment offers a great degree of job variety. People who do not like monotonous jobs should work in a retail store to experience the excitement of doing a variety of tasks. Retailing tasks offer variety because of

- changing economic conditions, changes in merchandising seasons and the ever increasing influx of old and new customers;
- opportunity to train in a number of areas like merchandising, operations management, sales promotion, personnel management and logistics.

Retailers try to create a dynamic, glamorous and stimulating environment in which customers feel comfortable. This approach makes retailing tasks exciting and creates a lively and challenging work environment.

On the negative side, most retail jobs call for long and arduous hours of work. Sometimes employees are expected to work even on holidays and weekends. Apart from this, the close supervision and control found in retail stores can affect employee morale. Hence, working in a retail environment can often be very taxing.

## Career Advancement

Retailing careers offer ample scope for advancement, mainly due to the presence of many levels in the organizational hierarchy, the diversity of retailing positions, and the vast number of retail outlets. Retailing is a great career for people who are ambitious, talented and hardworking. They can expect to go up the corporate ladder within a short period of time. The number of managerial jobs available offers many opportunities for advancement. For example, a chain of department stores may have assistant department managers, department managers, promotions managers, assistant store managers, and store managers at the district, regional and national levels. So many jobs at the managerial levels mean greater scope for career advancement. Exhibit 19.1 provides details about entry-level jobs in retailing. Retailing can be a great career for women since most retailers believe that women executives have greater understanding of the shopping needs of women shoppers. These retailers feel that women executives can boost sales tremendously.

**Exhibit 19.1**

**Entry-level Jobs**

Due to the high turnover of retail employees and the opening up of new stores at various locations, there is constant need for recruitment and selection in retail firms. The turnover is caused by the promotions and re-locations of the present employees. Though employers prefer experienced people, they also offer fresh graduates/undergraduates entry-level careers as salespersons, customer service representatives, cashiers and Management Trainees in stores. Openings are also available in the departments of finance, logistics, and information systems, generally in assistant positions, like buyer's assistant in the purchase department.

These jobs do not require expertise or prior experience. For instance, sales associates help customers in all sections find what they want to buy and entice them to buy. They show models, patterns, colors, sizes of the items, describe their features and benefits and sometimes demonstrate the use. They may have to make bills, open/close cash registers, and take payments. Sales associates also look into gift vouchers or discount coupons and make the necessary adjustments when collecting payments and deposit them at the cash office. Their job includes handling returns and exchanges of merchandise, stocking the merchandising racks, arranging for the delivery of purchases, and preparing displays.

While recruiting for such positions, the employer looks at the applicant's personality traits rather than the qualifications or work experience. For instance, the position of sales associates requires that the candidate have patience and stamina, be courteous, and tactful, have good communication skills, be able to provide efficient service, possess high energy levels, and have the ability and willingness to work for long hours.

An entry-level career in the retail sector promises opportunities for advancement as the employee gains experience. The employee can even look for advancement opportunities outside the retail sector as sales executive, insurance agent, customer service representative, etc.

*Source: Icfai Center for Management Research*

### Job Satisfaction

As discussed earlier, there are a number of benefits to working in a retail environment: varied job tasks, rapid advancement, decent compensation, opportunity to interact with people, quick recognition of one's efforts, greater flexibility and freedom to take decisions. Apart from these, daily performance feedback, the opportunity to demonstrate one's talents and recognition for one's efforts translate into greater job satisfaction for employees working in the retail industry.

## EMPLOYMENT OPPORTUNITIES

The employment decision is one of the most important decisions a person makes. This decision can have a profound impact on the professional and personal life of an individual. While taking the decision, an individual may be confronted with a number of employment choices, of which retailing could be one. Hence, it is important that he/she conduct a personal assessment of life and career goals before taking such an important decision.

## Making a Personal Assessment

A personal assessment can be conducted in two stages. The first stage involves conducting a life audit and the second stage is concerned with conducting a career audit.

### Life audit

The main aim of conducting a life audit is to help one understand one's own feelings, aspirations and abilities. It is very rare to see individuals who are very clear about what they want to do. Most of us are confused and do not have direction in our life. A life audit is a type of self analysis that helps us understand ourselves better. It involves answering a set of questions pertaining to family issues, personal beliefs, values, goals and objectives to gain insights into personal interests, abilities and aspirations.

### Career audit

The next stage in personal assessment is to conduct a career audit. A career audit is performed to develop a career plan. A career plan is a written statement that indicates the necessary strategies and tactics an individual needs to adopt for career growth. A career audit requires the use of a questionnaire. Answering the questionnaire will help an individual discover oneself and one's career aspirations. Once life and career audits are completed, one should make a note of the career goals and objectives derived through these audits.

## Securing a Retail Position

After completing the personal assessment, an individual must decide the area in which he would like to work. If the chosen area is retailing, then the next step for him would be to start an employment search process. In the following paragraphs, we will discuss various steps involved in the employment search process.

The employment search process consists of four basic steps;

- Identification of prospective employer
- Obtaining a personal interview
- Preparing for an interview
- Participating in an interview

### Identification of prospective employers

This is a four-step process that helps individuals organize job opportunities.

i. Listing employment criteria

ii. Ranking employment criteria

iii. Scaling employment preferences

iv. Matching job preferences with prospective employers

#### *Listing employment criteria*

In this step, an individual decides on the criteria or preconditions for selecting a particular job. Some of the employment preconditions could be location preferences, organizational preferences and the type of position one is looking for.

#### *Ranking employment Criteria*

Once the employment criteria are determined, an individual must try to rank each criterion on the basis of its importance. The criteria that rank fairly high on the list are the ones that an individual should not compromise on.

### *Scaling employment preferences*

This is the third stage of the prospective employer identification process. In this step, the individual identifies and ranks the types of jobs he is looking for.

### *Matching job preferences with prospective employers*

Once the listing, ranking and scaling processes are over, the individual must match his job preferences with prospective offers from employers. During the matching process, a list of available jobs is compiled and compared with the list of prospective employers. In order to compile the job list, an individual can source details of available jobs from various sources like university campuses, employment sections of newspapers, professional journals, magazines, commercial employment agencies etc. Apart from this, one can get job leads by directly applying to firms in the retail business. Some of the best job leads can be received from friends, professors, relatives and other personal contacts.

## Obtaining a personal interview

A personal interview is a face-to-face meeting between the retailer and the prospective employee. During the personal interview, applicants are questioned and their behavior is closely watched. For managerial positions, personal interviews are conducted in a number of stages by various managers from different departments. Getting the initial interview is not easy. For getting an initial interview, candidates adopt several methods like:

- Scheduling an interview through the university placement office
- Contacting the manager of a retail store and scheduling an interview
- Taking help from personal contacts for fixing interviews
- Writing job application letters and making telephone calls and personal visits to retail stores.

Successive interviews usually take place depending on the performance of the candidate in the previous interview.

## Preparing for a personal interview

Inadequate preparation for an interview decreases the chances of success. To prepare for a personal interview, an individual should do some research on the firm applied to. He should have sufficient knowledge of the firm’s activities and businesses. Interviewers prefer people who have done their homework. Some of the areas in which an individual should collect information include the firm’s organizational structure, financial position, market position, and future prospects. This information can be collected from the firms’ annual report, trade magazines, business digests and reference books. Such preparation will help the individual in asking meaningful questions during the interview. The individual should also prepare a resume that includes

- Personal details like name, address, phone number, marital status etc.
- Educational details like type of degree, field of specialization, date of graduation, rank in the class, awards and honors etc.
- Details of work experience, including list of previous employers and duration of employment, job profile, responsibilities etc.
- Details of other activities like hobbies, interests, skills.
- Name, address and telephone numbers of two referees who are in a position to comment on the professional skills of the individual.

The resume should look professional and be concise and factual.

### Taking a personal interview

Interviews can be conducted in a formal or an informal manner, depending on the personal preferences of the interviewer. Formal interviews are highly structured and may take the shape of a question and answer session. Informal interviews do not follow a structure. Irrespective of whether the interview is formal or informal, interviewees must assess the situation and act accordingly. Most interviews consist of four parts. The first part is a rapport building session, during which the interviewer asks some personal questions to gather information on the interviewee’s background. The second part is a question and answer session, during which the interviewer tries to test the knowledge and depth of understanding of retailing of the interviewee. The third session is the selling session, during which the interviewee tries to sell his ideas and tries to explain how he can bring about a positive change in the organization. The last and final stage is interview closing, during which the interviewer and interviewee end the interview. If the interviewer is impressed, he will end the interview on a positive note.

### Guidelines for facing an interview

There are certain guidelines, which, if followed, can make a positive impact on the interviewer. Some of these guidelines are presented below:

- The interviewee's dress can have a strong impact on the interviewer. It is necessary to dress appropriately and neatly to make a positive impact on the interviewer.
- The interviewee should be prepared for open questions like “why do you want to work for our firm?” These type of questions are tricky and one has to be careful when answering them.
- The interviewee should try to remain relaxed and be as open and frank with the interviewer as possible.
- The interviewee should listen carefully to the interviewer and should not try to dominate the interview (at least not in the initial stages).
- The interviewee should be inquisitive and should ask intelligent questions about the firm. This will reflect on the interviewee’s interest in joining the firm.
- The interviewee should be informative. He/she should try to answer questions completely and fully. One-word answers like ‘Yes’ or ‘No’ should be avoided.
- A little bit of aggression during interviews always helps. Interviewers prefer people who are a little aggressive rather than people who are passive.
- Honesty is the best policy. The interviewee should be truthful and should admit his/her weaknesses, if any.

## CAREERS IN RETAILING

Of late, retailers have realized that to build customer loyalty, they have to differentiate themselves from their competitors by providing value added services to customers. These value added services determine which store the customer would purchase goods from. A retailer can differentiate himself from his competitors by providing excellent customer service. To provide such service, a retailer should have trained and skilled manpower in the field of sales, store management and merchandising. A number of institutes provide special education and training facilities to help retailers develop a trained retail sales force. Some major retailers have developed their own in-house training programs to suit their store needs. Some common retailing positions found in a retail store are:

- Sales Executive or Marketing Executive
- Store Manager
- Sales and Merchandising Representative (SMR)

## Sales Executive or Marketing Executive

A sales executive's main job is to attend to customers and help them during their purchases. Some of the other responsibilities of a sales executive are:

- Explaining to all walk-in customers about the products and providing any additional information that would help customers to make the right product choice.
- Taking part in the entire selling process from prospecting to closing the sale.
- Achieving the personal sales targets set by the store manager.
- Managing in-store inventory and cash counter (in some cases).
- Conducting product demonstrations when necessary.

## Store Manager

The store manager is the overall in-charge of all the activities at a retail store. He has a team of sales executives who help him handle all major retailing activities like merchandising, space management, inventory management, sales management and customer support. Some of the responsibilities of a store manager are:

- Achieving predetermined monthly and annual sales targets.
- Leading and motivating a team of in-store sales executives.
- Preparing pre-sales reports like potential client lists and sales progress charts.
- Preparing post-sales reports like daily and weekly sales reports.
- Coordinating with logistics to ensure timely deliveries to customers and to maintain optimum inventory levels in the branch.
- Developing human resources at the branch level.
- Preparing business plans for the financial quarter.
- Supervising the overall merchandising of the store and designing the look of the store.
- Designing and carrying out promotional schemes within the store.

Desired Skill-set required for Sales Executive/Store Manager

- Good communication skills (ability to persuade customer).
- Patience to deal with all kinds of customers.
- Good product knowledge (in terms of features).
- Knowledge of competitor's products.
- Good knowledge of store dynamics in terms of hot selling goods, high traffic spots (in the store) and merchandising requirements.

### Sales and Merchandising Representative

This is an emerging career in retailing. Recognizing the role of retail stores in selling and building the image of their products, manufacturers have started employing Sales and Merchandising Representatives (SMR) to communicate information to retailers. An SMR is responsible for

- earning the mind-share and shelf-space of the retailer
- educating sales teams in stores about the nature and working of the product
- motivating retailer's salespersons to promote the manufacturer's products
- collecting information on new products and buying patterns of retail customers.

## OWNERSHIP OPPORTUNITIES

As mentioned earlier, some people enter the retail industry by setting up their own business. People who have high entrepreneurial skills prefer to start something on their own instead of getting employed. They believe that the only way they can surge ahead of others is by making others work for them. These individuals do not believe in a 'paycheck to paycheck' existence. Rather, they like to take the risk of starting their own business.

When such individuals have a good and marketable idea, they waste little time in starting their own business.

In retailing, an entrepreneur can choose to set up a new business, buy an existing business, or a franchise. Before starting a retail business, the entrepreneur must evaluate all the available options.

## SUMMARY

The retailing industry is becoming a major driver of world economies. Its rapid growth has opened up many career opportunities for people with all types of experience and qualifications. This chapter examined the various attributes that a person aspiring for a career in the retail industry should possess. The employment opportunities in the retail industry were also explained.

# Part VI
# Annexure

# ANNEXURE

# The Future of Retailing

Retailing is an extremely important part of any economy. The largest contributor to the US GDP is the retailing sector. Hence, the future performance of the retailing industry determines the overall performance of the economy.

There are numerous ways in which retailing can be carried out. The most common form of retailing is the brick-and-mortar operation. This category consists of a physical store to which customers can go, to make purchases from a range of merchandise. The advent of the Internet and the development of e-commerce are expected to change the retailing landscape. It is estimated that by 2005, 90 percent of businesses around the world will be wired. Around 25 percent to 30 percent of global consumers will visit websites to seek information and to buy products from retailers. Due to the impact of the Internet on retailing, a completely new business model has emerged: e-tailing.

## EMERGENCE OF E-TAILING

Doing retail business over the Internet is called e-tailing. In an e-tailing model, competition is intense as the closest competitor is only a mouse click away.

The retail store on the Net is a virtual store that never closes. It provides service to customers irrespective of time and place. Retailers must carefully study all aspects of e-tailing, from start-up to profitability, before adopting the e-tailing model, because click & click ventures have a very high failure rate (Exhibit A1 shows how traditional retailers are using e-tailing.) In their quest for adopting the e-tailing model, companies will pass through three stages. The first stage is called ramp-up. During this stage, the company tries to develop a presence in the online marketplace. The second stage is hyper-growth during which the company focuses on penetrating the market. The third and final stage is managed growth, during which the company tries to stabilize its earnings. In order to do well during these stages, a company has to pay attention to eight key aspects of e-tailing. They are eStrategy, eMerchandising, eArchitecture, eSupplyChain, eConnections, eBackOffice, eProperty, and eCapital. Each of these aspects is important, depending on stage of growth the company is in. Exhibit A2 gives some tips on making e-tailing work.

### Increased Consumer Control

In the days to come, markets will be controlled by consumers instead of marketers. Over the years, marketers pushed their sales using mass marketing techniques, but these techniques will not hold good in the near future. In the near future, individuals will be the primary marketing target and the home will emerge as the new marketing channel. For example, in future most consumers will have their own websites on which they will have data pertaining to their purchases, correspondence, personal research etc. Consumers will use specialized software agents that not only integrate all the data pertaining to their purchases but also surf the web for products matching their individual

**Exhibit A1**

**Catching up with E-tailing**

Large retailers have witnessed their online sales increase by 200-500% during the holiday shopping season. According to a report by Goldman Sachs & Co. and Nielsen//NetRatings, the most preferred e-tailing purchases of customers in 2002 were books, music, videos and DVDs. These purchases amounted to 17.8% of total holiday shopping, which accounted for nearly US$1.9 billion. The second choice was apparel. Travel-related purchases, which usually form almost a quarter of the online retail market, accounted for just 14.7 % of holiday spending. Third-quarter results by the U.S. Census Bureau indicate a rise in online sales of 34.3% over the last year's third quarter.

E-tailing holiday spending in 2002 represented a gain over the previous year. Percentage increases were recorded in apparel, consumer electronics, books, music products and toys segments. The largest amount was spent in the apparel and consumer electronics categories, which recorded gains of 10 % and 47 % respectively. Spending on books, music and video/DVD products increased 23 % since last year's holiday season, while that on toys increased 57 % since the same time period. These five categories together cover nearly two-thirds of all consumer spending online. Those e-tailers who focussed on these categories have benefitted from this purchase pattern.

Traditional retailers like Gap, Sears, Macy’s, Kmart and Toys ‘R’ Us have foreseen the power of e-tailing and adopted it. They have integrated the in-store experience with the Internet. For example, Gap allows its customers to order out-of-stock items through its websites from computers at its stores itself. E-tailing is more advantageous for multi-channel merchants.

The key drivers that pull customers to e-tailing are the comfort of shopping from home, the ability to compare prices with a few mouse clicks and the absence of crowds. Customizable sizing technologies, including the use of virtual models, are the drivers that attract apparel shoppers online. Avoiding traffic on the way to stores and avoiding waiting in long queues was the main reason 39% of customers shifted to e-tailing, especially during the holiday season. The study revealed that 26% of customers shopped online to avoid crowds at retail stores. For 33% of those surveyed, better online bargains was the major reason for shift. 21% stated a lack of sales tax as a reason for shopping online.

The reason for increased online shopping during the holidays season is said to be the pace with which they can shop online compared to in-store shopping.

*Adapted from www.nielsen-netratings.com*

preferences and budgets. These software agents will help establish a relationship between individual consumers and manufacturers or distributors. When consumer preferences match the description and price of a product, the software agent will place an order for the same.

## Impact of Customization

In the future, customization will become a part and parcel of retailing. This can already be seen in the computer hardware industry, where people can purchase built-to-order PCs. After a period of time, customization will be possible for all products. People won't just buy products; they will buy products that are tailor-made for them.

### Exhibit A2

### Making E-tailing Work

Retailers should ensure the following to attain success in e-tailing:

**1. Display the total charges**

Online retailers should avoid adding hidden charges to the amount quoted for the product in the website. Retailers can earn customers' confidence by giving them a clear picture of all the add ons like shipping charges, handling charges and taxes.

**2. List the cart contents**

The shopping carts in websites should not only list out the items selected, but should also display the total purchase value so that the shoppers can keep track of their spending.

**3. Let the shoppers change orders**

Providing online shoppers the flexibility to remove and replace the items and quantities even after billing may increase the purchases. The customers then would add items they wish to buy as well as those that they need because they have the choice of deferring the purchase even minutes before paying the bill.

**4. Save cart contents**

When shoppers select some items and leave the site without purchasing, such cart contents should be saved for some period of time (especially expensive items). This is because online shoppers are often found to return to the site to buy the selected items.

**5. Make shoppers aware of special promotions**

The special offers associated with the purchases should be highlighted so that the customers know about them. This can be done by placing special links on the home page

**6. Keep the order status traceable**

Once the shoppers have selected the items and made the payments, they should be able to trace the status of delivery. Websites should enable the shoppers to check the site to track whether the items are held up due to some problem or whether they are on the way. The order status should also be e-mailed when the delivery is being delayed.

**7. Provide multiple destination deliveries**

The shoppers may sometimes want a part of their purchases (in case of gifts) to be delivered to one place and the remaining to another place. The site should enable the customers to do so with ease. Some sites even offer a choice in gift wrapping services along with an option to add personalized messages.

**8. Ask for minimum information**

The registration process should be kept simple by requesting shoppers to provide only relevant information needed to process the order. Moreover, in case customers may have to go back to the registration form to fill in some missed out information or to correct some details, the details filled earlier should not be cleared.

*Source: http://www.business2.com/articles/mag/0,1640,8786,00.html*

## Complex Supply Chains and Channel Conflicts

The main reason for the success of huge retail stores like Wal-Mart is the effective management of their supply chains. Wal-Mart has grown geographically but it still is the market leader because of its smooth supply chain management. In order to remain competitive, retailers will have to streamline their supply chain systems. Now-a-days, retailer-supplier conflicts are common because manufacturers have entered the retail space with products traditionally distributed by retailers. To prevent such conflicts, supply chain managers will have to employ real-time location and tracking systems that will help them monitor their orders from inception to delivery. By linking an order to its execution, a company achieves greater control over delivery and costs.

Such conflicts can be avoided by establishing long-term relationships with partners and taking on new roles in the supply chain. Another method for avoiding conflicts is establishing vertically integrated relationship that will reinforce and reinvigorate the agreements between the parties.

### Integrated Multichannel Retailing

Most retailers nowadays operate in a multichannel environment. In a multichannel environment, customers can buy and return the products offered by the retailer through more than one channel. For example, at Wal-Mart, an item purchased from one channel can be returned through any other (for any reason.) Wal-Mart Online even includes a postage-paid return label with every order so that consumers don't have to pay return shipping charges. For retailers, managing the sales of products through multiple channels is a challenging task. In order to manage the challenges posed by multichannel retailing, retail executives should take the following steps:

- They should try to understand the needs and wants of their customers.
- They should understand how and why a customer chooses a particular channel.
- They should adopt emerging technologies that will enable them to provide better service to their customers.
- They should be able to anticipate future challenges and build their capabilities to tackle them.

### Future of Integrated Multichannel Retailing

Internet has become a great source of information for people. Consumers use the Internet to get information about products, services and retailers. But traditional brick-and-mortar stores remain the channel of choice for consumers because such stores enable consumers to touch and examine products, obtain advice from salespersons and satisfy themselves before purchasing the product. A recent study conducted by shop.org in the US, an industry trade association, showed that 78 percent of online shoppers also buy through a merchant's physical stores, and 45 percent of them also buy through the catalog channel (that is, using phone, mail or fax). Similarly, 23 percent of catalog shoppers also make purchases on the company's website. These facts demonstrate complementary nature of retailing channels.

### PET Framework for Assessing Multichannel Readiness

As multichannel retailing is still in its infancy, retailers should assess the need for and benefits of multichannel retailing before investing in this area. A retailer can adopt the PET framework to assess readiness and move from a single channel to a multichannel retailing system. PET stands for protect, evolve and transform, the three main stages of this framework.

### Protect

This is the first stage of integrated multichannel retailing. In this stage the retailer ventures into multi-channels to keep up with the competition or to gain a competitive edge. To do so, the retailer identifies gaps in the consumer's shopping experience and chooses channels accordingly.

### Evolve

During this stage, the retailer achieves significant incremental revenue and improves efficiency in operations. His business becomes more customer-centric. The central challenge in this stage is to obtain a cross-channel view of customer needs and patterns and to respond to them in a coordinated fashion along all customer contact points.

### Transform

Ultimately, a retailer can harness the benefits of integrated multichannel retailing only when he gains insights into the needs of the marketplace and the preferences of current and potential customers.

# Glossary

**Absent time** When a salesperson is not available on the sales floor, it is recorded as absent time. This includes the time he spent for lunch, lounge etc.

**Achievement tests** They are developed to judge the applicant's job related skills like computing skills, typing skills, analytical skills, book keeping skills and other skills required to perform the job he applied for.

**Additional markup cancellation** The amount by which the retail price is lowered after an additional markup.

**Additional markup** An additional markup refers to an increase in the retail price after the initial markup percentage has been applied, but before the merchandise is placed on the selling floor.

**Administrative management problems** The problems related to the resources retail firms, chiefly, financial, human and locational resources.

**Advertising effectiveness** The degree to which the advertisements have produced the desired results or helped the retailer accomplish its advertising goals.

**Allowances** The additional discounts and price reductions that are given to customers by the retailer.

**Analog model** It is used to estimate the potential sales of a new store on the basis of the revenues of existing stores in identical areas, the competition at a prospective location, the expected market share of the new store at the proposed location, and the size and density of the primary trade area of the location.

**Balance sheet** It is a snap shot of the financial position of the retailer at that moment of time. The balance sheet consists of three components Assets, Liabilities and Owner's equity (net worth). The balance sheet is based on a simple concept, i.e., in order to acquire assets, a firm (retailer) must pay for them with either debt (liabilities) or with the owners' capital (shareholders' equity).

**Beginning of the month inventory** It is the amount of inventory planned for the beginning of the month.

**Bottom-up planning** In the bottom-up planning approach, lower level managers propose the objectives. These estimates are passed onto higher level. They flow up to the top management. Based on these estimates the overall objectives are set by the top management

**Box store** A food-based discount store that concentrates on a small selection of goods.

**Career plan** A written statement that indicates the necessary strategies and tactics an individual needs to adopt for career growth.

**Catalog marketing** Marketing of goods and services using catalogs mailed to a select list of customers.

**Catalog showrooms** Discount operations that offer merchandise through a catalog or a showroom.

**Centralization** The degree to which authority for taking retailing decisions is delegated to corporate managers rather than to geographically dispersed regional, district, and store managers.

**Chain stores** Stores that have two or more retail outlets that are commonly owned and controlled. These stores have a centralized buying, and merchandising system and sell similar lines of merchandise.

**Charge-backs** The amounts deducted from the invoices of the vendors for breaching any of the agreed upon conditions.

**Checking** Examining the received merchandise to ensure that the goods received are of the promised quantity and quality.

**Closed circuit television (CCTV)** A television transmission system in which live or pre-recorded signals are sent over a closed loop to a finite and pre-determined group of receivers, through coaxial cables or as scrambled radio waves that are unscrambled at the point of reception.

**Combination store** A blend of a super market and a general merchandise store, where the general merchandise contributes more than 40 percent of the sales.

**Community shopping center** A medium sized planned shopping center consisting of the branch of a department store, a variety store, a category killer store, and many small stores.

**Comparative price advertising** It is used to communicate price reductions or savings on merchandise by comparing the current price of a product with the prices charged by other retailers for the same or similar merchandise; or with the price changed by a manufacturers list price or the suggested retail price.

**Compensation** The total value of returns given to employees in exchange for their membership in the organization and for performing the tasks, duties and responsibilities associated with their jobs.

**Consumer cooperative** A group of customers invest in the retail operations in return for stock certificates, which entitle them to a share in the profits of the retail store.

**Consumer markets** Consumer markets consist of the individuals or the households, which are the ultimate users of goods and services.

**Consumerism** The efforts made by the government and business organizations to protect the basic rights of the consumers.

**Consumer's buying behavior** The response and reaction of the ultimate consumer to various situations involved in purchasing and using various goods and services

**Convenience goods** Products that customers buy frequently, such as fruits, vegetables, groceries

**Convenience stores** Small stores that are located near residential areas. It cater to customers who prefer 'convenience of buying or shopping' to the price of the product

**Conventional supermarkets** Stores that focus on food and household maintenance products. These stores earn very limited revenues from the sale of non-food or general merchandise goods.

**Conversion rate** The percentage of shoppers who are convinced to make a purchase.

**Corporate buyers** The companies that either buy the merchandise offered by the retailer for corporate use, or promote sales for the retailer by giving coupons to their employees.

**Cost of goods sold** The direct cost associated with manufacturing/procuring the merchandise for the store.

**Cost per thousand method** A technique used to measure the effectiveness of advertisements in various media, depending on their cost and reach.

**Counterfeit merchandise** Products that are manufactured and sold without the permission of the owner of the trademark, copyright or patent which is legally protected in its country of operation.

**Coupons** The documents that entitle the holder to a reduced price, or a percentage price reduction from the actual purchase price of a product or service.

**Cross docking** Cross-docking is the movement of materials from the receiving docks directly to the shipping docks. Goods do not need to be placed in storage, creating a significant cost savings in inventory and material handling. It involves packing of merchandise by the vendor in the quantity required by the store, thus eliminating the need for re-packing by the distributor.

**Customer service** A set of activities and programs taken up by a retail organization to offer their customers a rewarding shopping experience

**Customer theft** Theft of the merchandise on display in a store, committed by entrants into the store. This is also referred to as shoplifting.

**Customization** The production of individually customized merchandise at the cost of a mass produced product.

**Deontologists** People for whom the result is not of as much value as the means. The effect of their action on the people involved in the action is their concern

**Department stores** Large retail units that offer wide variety and a deep assortment of goods and services.

**Destination store** Store that has larger trading area than a competitor with a less unique appeal. It offers a better product assortment, have heavy promotions, and a stronger image.

**Discriminatory pricing** Offering different prices to different players operating in the same market for a similar product

**Distributive fairness** The customer's perception of the value received in comparison with the price paid for it, the problems faced, or the loss (if any).

**Dual distribution** It is the process whereby the manufacturer sells the products produced by him through its self-operated retail stores as well as private retail stores

**Electronic artificial surveillance systems** Electronic Systems designed to help retailers increase their sales and profits by reducing shoplifting and increasing open merchandising opportunities.

**Employee discounts** The special discounts provided to the employees on purchase of merchandise from the store.

**Equal-store approach** In the equal store approach, all the managerial functions are centralized and controlled by headquarters.

**Everyday low pricing (EDLP)** A version of customary pricing, whereby a retailer strives to sell its goods and services at consistently low prices throughout the selling season.

**Exclusive dealing agreements** Agreements between manufacturers or vendors and retailers that restrict retailers to sell only their merchandise and not that of competitors or competing vendors.

**Expressed warranty** An expression about some or all aspects of a product, like product quality, its physical nature, workability and durability.

**Field selling** The salesperson approaches the customer with prior appointment and tries to make the customer a potential buyer by convincing him/her about the benefits of the product.

**Financial leverage** The financial ratio which measures the extent to which a retailer is using the outside finances (debt) in its capital. It indicates total asset value in relation to the value of owner's equity.

**Flea market** An outdoor or indoor facility that rents out space to vendors who offer merchandise, services and other goods that satisfy the legitimate needs of customers.

**Floor-ready merchandise** The merchandise shipped by vendors to retailers with the necessary tags, prices, security devices, etc. already attached so that the merchandise can be cross-docked rapidly through the retailer's distribution centers and sent directly to stores.

**Franchise store** A store based on a contractual arrangement between a franchiser (manufacture) and a retail franchisee, which allows the franchisee to conduct a given form of business under an established name and according to a given pattern of business.

**Fringe benefits** All benefits offered to the employees other than salaries, bonuses, and commissions for the services rendered to the retail organization.

**Fringe trade area** It includes the customers not found in primary trade area and secondary trade areas. These customers are the most widely dispersed.

**Fully integrated vertical marketing system** A marketing system wherein only one player manages all the activities (production and distribution), without any help from other channel members.

**Gray market merchandise** Products that carry a valid trademark, but are manufactured in a foreign country and imported into another without the permission of the owner of the trademark.

**Gross margins** The difference between net sales and the cost of goods sold. It is also expressed as a percentage of net sales.

**Group training method** Under the group training method, a group of new store personnel are trained together through lecturers, demonstrations, case studies, role playing activities, computer simulation and interactive videos. Specialized personnel conduct these training classes.

**Horizontal cooperative advertising** Horizontal cooperative advertising, the advertising costs are shared by a group of retailers.

**Horizontal price fixing** The process wherein various competing retailers come together to decide on a fixed price for a certain branded product to be sold in all the stores in a particular area. Horizontal price-fixing occurs when two or more retail competitors agree to sell their products for the same price, or according to some set formula. It is illegal for competitors to enter into agreements for raising stabilizing or otherwise affecting prices.

**Huffs law of shopper attraction** Huff's model provides a series of probabilities of consumers choosing to visit one center as opposed to another in terms of the attractiveness of each center (measured by floor space) and a deterrence factor (measured by traveling time to the center).

**Hypermarket** A large retail store that offers products at a low price. It is a combination of a discount store and a food based supermarket.

**Idle time** The time a salesperson spends on the sales floor without being involved in productive work.

**Implied warranty of merchantability** The implicit understanding that the product the retailer is selling satisfies the apparent purpose for which the product is manufactured.

**Implied warranty** The implied expectation of the buyer with regard to the product itself or the product's usability for a purpose.

**Income statement** It summarizes the financial performance of a company for a given accounting period (usually one year). The statement shows how much revenue the company earned through its operations, and the expenses associated with bringing in that revenue.

**Independent store** A store which is owned by a single retailer. The entry barriers for setting up an independent store are low: licensing procedures are simple and the initial investment is low

**Independent vertical marketing system** An independent vertical marketing system consists of independent businesses like manufacturers, wholesalers and retailers.

**Index of retail saturation (IRS)** It measures the level of demand in a particular market on the basis of the population, consumer expenditure, competing retail space and a particular product or product area.

**Individual training method** Individual training method an individual trains himself ("on your own" approach) to meet the needs of the retail organization.

**Initial markup** The initial retail selling price based on the merchandise less the cost of merchandise sold.

**Input measures** Input measures identify the amount of resources needed to provide a product or service.

**Inter store competition** Inter store competition refers to competition among the retailers selling dissimilar merchandise

**Interest expenses** The interest payments that have to be paid periodically for financing provided by lenders like banks.

**Interest expenses** Interest payments that have to be paid periodically for financing provided by lenders like banks.

**Intra-store competition** The competition between two retailers selling similar merchandise

**Intrinsic rewards** The reward that are inbuilt into the jobs and come from carrying out an activity rather than being a result of an activity.

**Inventory turnover** The ratio of net sales to average inventory.

**Inventory turnover** The number of times (on an average) inventory is sold in a year.

**Isolated store** A freestanding retail outlet situated either on a street or a highway. Stores of this kind do not have any retailers in their vicinity with whom they have to share consumers.

**Job analysis** The systematic analysis of an existing or proposed position or group of positions within an organization.

**Job description** A clearly written statement that explains the duties, responsibilities, qualifications and performance expectations of a particular retail employee.

**Job specification** An official document, which describes the duties, skills and abilities, and minimum qualifications, knowledge required to perform a job

**Labor scheduling** The process of determining the optimal number of employees to be assigned to each area of the store at a particular time, in order to serve the customers effectively.

**Lead-time** The time difference between the identification of the need for replenishment and the time when the replenishment is actually done.

**Leased department** A department in a retail store that is rented to an outside party.

**Licensed brands** are another form of manufacturers' brands. In this type of brands, the owner (the licenser) of a popular brand name establishes a contract with another party (referred to as the licensee) to manufacture and sell the licenser's branded products.

**Life audit** A type of self analysis that helps us understand ourselves better.

**Logistics** A supply chain process that plans, implements, and controls the efficient, effective flow and storage of goods, services, and related information from point of consumption in order to meet the consumers' requirements.

**Main store approach** Main store approach in this approach, the main store or the parent organization control the operation of the branches.

**Maintained markup** The actual price received for merchandise sold less merchandise cost.

**Markdown cancellation** The amount by which the retail price is raised after a markdown has taken.

**Markdown** A reduction from the original retail price of an item to match the lower price offered by competing retailers, to adapt to inventory overstocking, to clear out shopworn merchandise, to reduce assortments of odds and ends, and increase customer traffic.

**Market area analysis** Analyzing regional and local markets to determine the area that seems to offer the highest market potential. Such an assessment is called market area analysis.

**Market positioning** The kind of image the retailer wants to establish among its target group and the group of firms with which it wishes to compete and coexist.

**Market segment** A group of customers whose needs will be satisfied by the same retail offering because they have similar needs and go through similar buying processes.

**Market share objectives** aim to increase and maintain market share of the retailer.

**Markup pricing** The difference between the cost of the merchandise and the retail-selling price is known as the markup.

**Marquee** It is usually a painted signboard, or a neon light or a glow signboard that carries the store name, along with its trademark and other relevant information like caption.

**Merchandise controlling** A process for evaluating revenues, profits, turnover, shortage of inventory, seasonal fluctuations and costs for each product in the merchandise category being offered by the retailer

**Merchandise handling** The physical handling of the merchandise by the retailer

**Merchandise mix** The total range of products that a store offers to its customers.

**Moral philosophy** The moral philosophy of an individual is the character traits that are integral to his nature — his basic thinking, beliefs and concerns, his perception of 'right' and 'wrong' — that play a role in taking any kind of decision.

**Multiple-unit pricing** Multiple-unit pricing occurs when the price of each unit in a multiple-unit package is less than the price of each unit if it were sold individually.

**Neighborhood business district (NBD)** An unplanned shopping center that caters to the convenience shopping and service needs of a particular residential area. An NBD typically consists of a small grocery store, stationery store, a bakery, a restaurant, a vegetable store etc.

**Neighborhood shopping center** A planned shopping center, which aims at providing convenience products that meet the daily needs of customers in a particular neighborhood.

**Non-selling time** The time spent by a salesperson on marking merchandise or straightening up the store.

**Odd pricing** The practice of setting retail prices that end in an odd number or just under an even rupee value.

**Off- price retailers** Retailers who offer an inconsistent assortment of branded fashion-oriented soft goods at low prices.

**Off-the- job training** Training conducted in centralized training classrooms away from the employees' work environment. it can be in the form of lectures', audio- visual presentations, slides and charts, written materials and group exercises

**On-the-job training** On-the-job training allows the new employee to learn through observation and imitation, along with a regular feedback from the store supervisior about his performance.

**Operating cycle** Cash invested in retail business (inventory) takes various current asset forms (inventory, accounts receivables) before it is converted into liquid cash (which includes profits). This cycle of cash-inventory-sales-accounts receivables-cash is known as the operating cycle or the current asset cycle

**Organizational market** An organizational market is comprised of corporates and resellers who represent intermediate consumers of merchandise.

**Outsourcing** The process of getting a function (that has been done in-house in the past) done by some other firm outside the retailer's purview.

**Over stored market area** An area which has so many stores selling a specific good or service that some retailers unable to make enough profits.

**Parasite store** A retail outlet that do not have a trading area of its own and even do not have its own traffic. It is dependent on customers who are pulled towards the area for some other reasons.

**Partially integrated vertical marketing system** In a partially integrated vertical marketing system, only two independent business units in a distribution channel work together.

**Partnership** When two or more persons come together to start a business, without incorporating it, the business is called a partnership

**People pleasers** People pleasers have a knack for reading their customer's mind and anticipating their likes and dislikes.

**Percentage markups** The percentage of the merchandise cost added to the unit merchandise cost.

**Performance evaluation** A systematic assessment of how well employees are performing their jobs in relation to established standards and communicating the same to the employees.

**Personal selling** A form of paid personal communication, wherein the sales personnel satisfy the customers' needs, by exchanging information through personal interactions.

**Positioning** The process of developing and implementing a retail communication program that creates an image of the retailer in the mind of the consumers, against the backdrop of the images of its competitors.

**Post transaction services** Post transaction services are those services that are provided by the retailer to the customers after the merchandise or the services have been purchased.

**Predatory pricing** occurs when a dominant firm sells below cost for a long period of time to drive away the competitor from the market.

**Prepaid expenses** Expenses paid in cash and recorded as assets before they are used or consumed.

**Price discrimination** occurs when a vendor sells the same merchandise at different prices to two or more retailers.

**Primary trade area** The trade area that consists of fifty to eighty percent of the store's customers. This area is nearest to the store, has a highest density of customers to population, and contributes the highest per-capita sales.

**Private label brand** Private label brands, also referred to as in-store brands, are products that are produced and marketed by retailers.

**Problem solver** A retailer who not only understands the inherent problems of retailing but also derives pride/pleasure from solving them is called a problem solver.

**Procedural fairness** Procedural fairness refers to the customer's perception of the fairness of the process used to provide a solution to the customer's problems.

**Prospecting the customer** The process of identifying customers who would not only be interested in the merchandise but would also have the ability to pay for the same.

**Public relations** A form of unpaid impersonal communication. It is the process of reaching the target customers through an unpaid and impersonal channel, such as an article about the store or its products in a leading newspaper.

**Purchase probability** The probability of a customer purchasing a particular item within some specific period of time.

**Quantity discount** A discount that is offered to retailers by vendors upon the purchase of a specific quantity of merchandise.

**Quick response delivery system** A combination of a logistics system and an information system. It is designed to reduce inventory investment, bring down logistics expenses, and increase customer service levels by reducing the lead-time for receiving merchandise from vendors.

**Radio frequency identification (RFID)** A wireless electromagnetic energy that is transmitted in the form of waves that increase and decrease in amplitude or size.

**Rebate** In rebates, a portion of the purchase price is returned to the buyer. After making a purchase, the customer has to send the proof of purchase to the manufacturer. Upon receipt of the proof of purchase, the manufacturer mails the rebate to the customer.

**Recruitment** The process, whereby an organization induces suitable people to apply for employment vacancies by making them aware that such vacancies exist.

**Regional shopping center** A planned shopping center catering to a geographically dispersed market. It consists of at least one big department store and 50 or more small retailer

**Regression model** This model develops a series of mathematical equations representing the relationship between the potential sales of the store and the various independent factors of each location

**Reilly's law of retail gravitation** The law is used to determine the position of an intermediate area where trade becomes split between two competing centers.

**Reorder quantity** The quantity that is to be ordered when the existing inventory goes below the order point.

**Resellers** Retailers who buy merchandise in large quantities at discounted prices from the retailers, and sell them at normal prices in their shops.

**Retail entrepreneur** A person who has the ability to organize, manage and take on the responsibility of running a retail business.

**Retail information system (RIS)** A tool that enables retailers to collect, aggregate and analyze data from retailing activities.

**Retail market strategy** A written statement, which defines the orientation of the firm, in terms of the target market that it wishes to cater to, the retail format that it proposes to build, and the retail mix variables that it chooses to gain decisive competitive advantage and sustain its position in the retail market.

**Retail market** A group of customers who have common or similar needs which can be collectively addressed by a retailer who chose to cater to the same group or customer segment.

**Retail promotion** Any communication (initiated by the retailer) between the retailer and his target customers that informs, persuades, and/or reminds the latter about anything related to the store.

**Retail selling** Retail selling takes places when a potential customer approaches a retail store. Here, the role of the salesperson is to satisfy the need of the customer with the available merchandise in the retail store.

**Retailer** The last entity in the distribution channel. It includes all businesses and individuals who actively participate in the transfer of ownership of goods and services to their end users.

**Retailing -** A set of business activities that adds value to the products and services sold to the final consumers for their personal, family or household use.

**Return on net worth** Net profit after taxes divided by owner's equity (net worth).

**Rupee markups** A rupee value is added to the cost of the merchandise to cover all the selling expenses and provide a profit.

**Sales area index (SAI)** A measure of an area's per capita retail sales in relation to the per capita sales for the entire country.

**Sales per hour** Sales per hour is computed by dividing the value of total sales of the retail store at a given period of time by the total hours of work.

**Sales promotion** The technique of offering short-term incentives to customers, so that they are motivated to purchase the retailer's products or services.

**Saturated market area** In a *saturated market area*, customers are offered a good range of goods and services and allow the retailers to make good profits.

**Seasonal discount** A discount that is offered to retailers for ordering or receiving the merchandise prior to the starting of the normal selling period

**Secondary business district (SBD)** An unplanned shopping center in a city, which is generally bounded by the junction of two major streets. SBD contain at least a mini department store, a variety store, and some big specialty stores apart from many small stores.

**Secondary trade area** The trade area that provides another 15 to 25 percent of the store's customers. This trade area is situated beyond the primary trade area and the customers in the area are dispersed more widely than in primary trade area.

**Selling time** The time a salesperson spends with a customer time spent while demonstrating the product, writing sales receipts or assisting the customer in other potentially revenue -generating activities

**Sell-through analysis** A sell-through analysis helps determine the requirement of early markdowns or the requirement of more merchandise to fulfill the demand by comparing the actual sales with the planned sales.

**Separate store approach** In this approach, each branch is treated as an independent operation within the organizational structure.

**Service quality standards** they help employees understand how the company and its customers define a quality job.

**Shopping goods** Shopping goods are bought less frequently than convenience goods. These goods include clothing, and electronic goods etc.

**Shopping products** Items for which buyers are willing to make more efforts to plan for and purchase

**Shrinkage** Reduction in the physical count of the inventory as compared to its accounted value. Shrinkage is the difference between the recorded value of inventory based on the merchandise bought and received, and the value of the actual inventory in stores and distribution centers divided by retail sales during a particular period.

**Site selection process** The retailer must select the most suitable site within the preferred trade area, i.e, the one that satisfies the firm's objectives and meets customer needs. The process of choosing the best site is known as the *site selection process.*

**Slotting allowances** Slotting allowances, also referred to as slotting fees, can be defined as the fees paid by a vendor for securing space in a retail outlet for its products, usually for displaying its merchandise.

**Slotting fees** The money paid by a vendor to a retailer for stocking a new product on retailer's shelves and in its inventory, and for adding its UPC (Universal Product Code) number in the retailer's computer system.

**Socialization** A process that focuses on molding the new employee into a productive and committed individual.

**Sole proprietorship** Sole proprietorship is a common and a simple ownership. In this type of ownership, the store is completely owned by a single person.

**Source tagging** The process of applying anti-theft RFID labels to products or packages during the manufacturing process.

**Specialty products** Those products, while purchasing, which, the consumer is least concerned about the time, effort or expense involved.

**Specialty store** A specialty store is a type of general merchandise store that sells limited lines of closely related products or services to a select group of customers

**Sponsorship method** Under the sponsorship method, an experienced employee(sponsor) takes the responsibility of training the new store employee.

**Standardization** The consistency of the merchandising and operating procedures practiced by geographically dispersed retail stores. (or) The process of conforming to standards (a set of rules and procedures) while providing service to customers.

**Store image** Image of a store comprises how the consumer feels about the store. Therefore, retailers must be sure about how they want their store to be perceived by the customers.

**Strategic profit model (SPM)** A financial tool for planning and evaluating the financial performance of retailers.

**Strategic profit model (SPM)** A financial tool for planning and evaluating the financial performance of retailers. It combines information from the income statement and balance sheet into a single, comprehensive framework. The strategic profit model establishes a mathematical relationship among net profit margin, asset turnover, and financial leverage. By doing so it arrives at two important performance measures for return on investment- return on assets and return on net worth. This model regards return on net worth as important indicator of the performance of a firm.

**Strategy implementation** The implementation process involves developing action plans and assigning the ownership, establishing critical paths and linking the action plans to operating plans. The main objective of all these strategies is to create value for customers.

**String** An unplanned shopping center, consisting of a group of retail outlets, generally offering similar or related products, situated along a street. Car accessory stores and jewellery stores are often found in a string.

**Suggestive selling** This technique of promoting sales is called suggestive selling Before closing the sale, the salesperson can suggest complementary items that go well with that particular merchandise that the customer intends to buy.

**Teleologists** Individuals, for whom any action is ethical so long as it produces the desired results.

**Tell tag** Tell tag is an intelligent “talking" tag with an embedded computer chip that activates an audio alarm in the tag that is amplified by an acoustic tone detector in the store ceiling.

**Territorial restrictions** The restrictions imposed on the retailer by the manufacturer with regard to the geographic area where the retailer is allowed to sell products bought from the manufacturer are territorial restrictions.

**The central business district** A central business district (CBD) is the traditional center for retailing in a city. A CBD contains at least one major department store and a group of specialty and convenience stores.

**The planned shopping center** A planned shopping center consists of a set of architecturally similar commercial establishments constructed on a site which is owned and managed centrally, operated and designed as a single unit, has a balanced tenancy, and has access to good parking facilities.

**Ticketing and marking** Ticketing and marking refers to the process of classifying products and attaching identification labels and price tags to them.

**Top-down planning** It involves setting of overall goals by top management and these goals are then narrowed down to store levels.

**Trade area analysis** Trade areas refer to the places from which most of the customers are drawn. The process of selecting trade areas is known as *trade area analysis*.

**Trade area** A geographical area containing the customers of a particular firm or group of firms for specific goods or services.

**Trade discounts** A price discount that is available only to some classes of purchasers, like wholesalers or big retailers.

**Transaction services** The services that are delivered to a customer while they are shopping in the store and carrying out business transactions.

**Tying agreements** Tying agreements are those whereby the manufacturer or franchiser demands that the retailer stocks its new brand or non-selling product as a condition to supply the retailer/franchisee with well-established, 'much-in-demand' product(s) of its make

**Tying contract** A contract between a vendor and a retailer. In such a contract, the retailer accepts a product that is not essentially required, so as to be able to purchase a product that is actually required.

**Under stored market area** A market area that has very few stores, which offer goods or services that satisfy the needs of the population.

**Unplanned business district** Retail locations in which two or more stores are either situated together or closely in a manner that the total arrangement in that particular district was not planned in the initial long range planning.

**Value gaps** The gaps in consumer's expectation of value from the retailer. These gaps are generally referred to as 'value gaps.' determining the value gaps in consumers' value expectations from a retailer is not a simple task.

**Variety stores** A store that offer a large assortment of inexpensive and popular goods like stationery, gift items, women's accessories, house wares etc

**Vertical cooperative advertising** Advertising whose costs are shared by the retailer and the manufacturer or the wholesaler.

**Vertical marketing system** A distribution system in which the producers, wholesalers, and retailers act in a unified manner to facilitate the smooth flow of goods and services from producer to end-user.

**Vertical price fixing** A pricing practice wherein the manufacturer or the wholesaler collaborates with the retailer to sell a product at a agreed-upon price.

**Vertical price-fixing** -- sometimes referred to as “resale price maintenance” -- occurs when a business at one level of distribution (e.g. a manufacturer) dictates the price or terms under which a business at a different level of distribution (e.g. an independent distributor) may resell the goods or services.

**Visual communications** involve communicating with the customers through graphics, signs and certain theatrical effects inside the store and in the windows.

**Warehouse club** is a general merchandise retailer who offers a limited merchandise assortment with limited service at low prices to consumers as well as small businesses.

**Warehouse stores** are discount food retailers with a size of 100,000 square feet. They cater to customers who look for low price deals.

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