

The changing face of retailing

By Jagdish N. Sheth and Rajendra S. Sisodia

The marketing function depends heavily on the presence of intermediaries between the producer and the consumer. These intermediaries provide convenient access to products for a wide range of customers. As well as serving as product conduits, intermediaries also serve as information conduits. Often, producers have little or no direct contact with end-user customers and must rely almost entirely on intermediaries for information about them. Likewise, intermediaries often carry information for end users from producers.

Retailers are perhaps the most important type of intermediary, situated at the point of direct contact with customers. The retailing function adds value in a number of ways, most of which are difficult for manufacturers to replace. These include: breaking bulk (breaking caseloads into smaller quantities); providing an assortment of products so that customers can go one-stop shopping; creating an inventory buffer between producers and consumers so that products are available when desired; and providing support services such as display, demonstration, credit, delivery, assembly, repair, and return and warranty services.

The retailing sector is huge, representing over \$2,200bn a year in revenues in the US alone (approximately 30 per cent of gross domestic product) and employing about 25m people in that country. Worldwide, it is estimated that retailing accounts for about \$7,000bn in annual revenues.

Over its long history, the retailing function has changed, often reacting to changes in consumption patterns (for example, the rise in the proportion of expenditure allocated to services), demographic shifts (for example, the migration from inner cities to suburbs) and technological forces (for example, the widespread use of credit cards). Today, it is going through another round of changes, the scale and scope of which are likely to exceed those that have come before.

Indications are that the retailing sector in most developed countries is overbuilt. In the US the square footage devoted to retailing rose by 216 per cent between 1966 and 1993 while sales (in real terms) rose by only 50 per cent. At the same time, the amount of time spent shopping has been declining. It has been estimated that the average amount of time spent by a typical American in a shopping mall has declined from seven hours a month to about two and a half hours over the past 15 years.

Time pressure, coupled with the general sameness of much retailing, has led to a change in people's perception of shopping: from something regarded as fun and entertaining to an activity that is now generally considered a tiresome burden to be dealt with as expeditiously as possible. As a result of these factors, the retailing sector is experiencing a shakeout. The number of bankruptcies has been rising, reaching approximately 13,000 a year in the US.

"New-style" retailers

A number of "new-style" retailers (such as Wal-Mart and Carrefour) have emerged in recent years. These account for much of the new wealth creation in the retailing sector, while conventional retailers have been responsible for huge declines in shareholder value.

The new retailers have adopted a business philosophy and operating style that includes the following elements:

High levels of investment in information technology (IT) and the establishment of close electronic links with upstream partners

Rather than monitor the inventory of each item themselves, the new retailers move much of the responsibility for ensuring product availability to suppliers. Suppliers accomplish this by monitoring sales at the point of sale on a real-time basis through computerized links. They then automatically replenish stock when inventory levels run low. Payments are made through automated bank-to-bank transfers to suppliers, eliminating a lot of paperwork.

A more rational approach to pricing and sales promotions, with an emphasis on "everyday fair pricing"

Instead of having large and predictable price variations, the new retailers attempt to provide a "fair" price all the time. The objective is to assure buyers that they need not wait for a sale to get a reasonable price on the products they want to buy.

A reduction in the number of suppliers

As this occurs, the share of business for each remaining supplier increases. Rather than rely on new suppliers to increase variety, retailers encourage existing suppliers to add variety and offer a fuller line of products. This enables them to leverage existing logistical systems more effectively.

Greater market power, arising from retail concentration and intense customer loyalty

Successful retailers have to be treated by manufacturers as customers rather than intermediaries; without their support, the manufacturer is effectively barred from a sizeable portion of the market. Wal-Mart, with over \$120bn a year in annual sales, and Toys R Us, which controls over 25 per cent of toy sales in the US, are gatekeepers to large and loyal markets of consumers that rarely shop elsewhere.

Retailer-supplier partnering

Dramatic gains in distribution and marketing efficiency are realized when manufacturers and retailers work together. Partnering between these two groups is a major departure from their traditionally antagonistic relationship; it recognizes that both are part of a single process – which can be greatly streamlined and simplified – for distributing products to customers. These so-called "channel partnerships" have been adopted in such diverse categories as household goods, personal care products and home furnishings.

Inventory is pulled through the system rather than pushed down, allowing companies to provide greater product availability for customers with lower average levels of inventory. This is reflected in Black & Decker's distribution philosophy of "sell one, ship one, build one."

Partnering thus provides the advantages of vertical integration without the attendant drawbacks. It has its roots in the "quick response" movement in the clothing industry. In the grocery business, it is known as "efficient consumer response" (ECR). A report by Kurt Salmon Associates for the US Food Marketing Institute estimated that ECR had the potential to reduce inventory by 41 per cent and save \$30bn a year in the US grocery industry.

Central to partnering arrangements are the enabling technologies of bar-coded product identification and electronic data interchange (EDI), along with the re-

engineering of business processes both within and across companies in the value chain. These systems improve efficiency and customer service primarily by replacing physical assets with information. They reduce the retailer's inventory while providing a supply of merchandise that closely matches consumers' actual buying patterns. Resources that were formerly tied up in inventory can be directed elsewhere – to increased advertising, or the bottom line, for example.

The result is a win-win-win outcome. Consumers consistently find the merchandise they want (often at lower prices); suppliers increase sales, lower costs and cement ties with retailers; and retailers gain increased sales and inventory turns.

Electronic shopping

Beyond facilitating of channel partnerships, technology is affecting retailing through the substitution of electronic shopping for store-based retailing. For many time-pressed customers, shopping online or via a catalog for next-day delivery provides greater time value than a trip to the mall.

US consumers spend \$3bn a year on items from TV shopping networks, \$10bn a year shopping over the Internet and \$60bn a year on purchases from mail-order companies such as L.L. Bean. While this still represents a very small portion of the retailing sector, recent growth trends indicate that electronic retailing is poised to enter the mainstream.

The World Wide Web, even in its current narrowband mode, shows the vast potential of technology. In 1997, \$6bn worth of cars were sold over the internet in the US, while Dell Computer alone was selling its products at a pace of \$6m a day towards the end of the year. America Online reported sales of \$150m in December 1997 alone, much of that in categories such as clothing that have thus far seen little internet shopping activity. While electronic grocery shopping remains tiny, Anderson Consulting projects an astounding \$85bn a year by 2007.

It is a well-established dictum of retailing that the "total shopping experience" must be considered in order to assess the strengths of different retail formats. Electronic shopping is typically more cost-effective than store-based retailing (according to researchers, it can lower costs by around 25 per cent). However, other factors must also be evaluated; these include the number of alternatives that can be made available, the social and recreational dimensions of shopping, the amount of information that customers need and the amount that can be readily provided, and the type of product.

In an award-winning recent paper in the *Journal of Marketing*, Joseph Alba and his co-authors (see Suggested Further Reading) suggest that successful electronic retailers will seek competitive advantage in one or more of the following areas:

- distribution efficiency
- assortments of complementary merchandise
- collection and use of customer information
- presentation of information through electronic formats
- unique merchandise.

Alba and his colleagues suggest that catalog retailers are the most vulnerable to electronic shopping. While it has some of the same limitations as catalog retailing, such as delivery times, electronic shopping can provide customers with much more information than catalogs.

The authors also suggest that electronic shopping is ideal for retailers with strong reputations for high-quality, unique merchandise but incomplete market coverage (for example, Nieman-Marcus, Harrods, Gump's and Saks). Chains such as Sears, which already have extensive market coverage, have less to gain from electronic retailing.

To prevail, store-based retailers will have to emphasize merchandise that has predominantly experiential attributes (that is, it must be seen directly, touched and so on), promote the non-informational benefits of shopping (such as entertainment and socializing), and treat electronic shopping as a complement to their in-store business.

The Alba paper also outlines the conditions under which manufacturers would have an incentive to disintermediate – that is, to bypass retailers and deal directly with customers. Manufacturers with strong brand names and the ability to produce complementary merchandise – such as Levi Strauss – are most likely to consider this. However, they should carefully consider the impact on their relationships with intermediaries.

In situations where the advantages of electronic shopping are very strong, store-based retailers would be ill-advised to try to counter the trend. Rather, they should devote their efforts to developing strategies to take advantage of the opportunities offered by electronic shopping.

Retailing as entertainment

Retailing, entertainment and recreation are converging. Entertainment companies, such as Walt Disney, Warner Bros, Discovery Communications, Sony and Viacom are moving into retailing in a big way, while retail developers are moving rapidly to add entertainment options to their new and existing developments. Such moves are clearly related to the perceived threat from electronic shopping.

Shopping as entertainment and as a social experience has long been an inherent part of retailing, especially in advanced economies. However, the entertainment and social aspects have not usually been explicitly emphasized. In fact, cinemas and other forms of entertainment in shopping malls have generally been considered a financial drain, taking customers away from stores and leading to lower sales per square foot.

In the rediscovery of the link between shopping and entertainment, there is a much more explicit focus on using entertainment as a way to differentiate the retail experience from conventional and electronic retailing. Some new retail developments incorporate nightclubs, zoos, virtual-reality rides, comedy clubs, target ranges, musical revues and stadium-style cinemas. Retailing is also converging with learning. Customers can develop expertise in new areas and parents can make their limited time with their children more meaningful.

Customers come to such stores not just to buy products or learn skills but to browse, socialise and be with other people. They also spend more than in a traditional mall; in a Los Angeles development called CityWalk, sales are about \$500 per square foot compared with about \$203 for the average mall.

The manufacturer's view

From the perspective of producers, some of the key issues in retailing are: a move towards "hybrid" distribution systems in which a larger number of short channels replace a small number of long channels; the growing prominence of non-

traditional retailers; and the increased pressure producers are bringing to bear on retailers to adopt technologies such as EDI and ECR.

Most producers in the past tended to distribute their products either indirectly (via intermediaries) or directly (selling to end users without using middlemen). Now both types of producer are moving towards the simultaneous use of direct and indirect distribution. The aim is to provide the greatest market coverage in the most cost-effective way.

Companies that previously sold only through indirect channels are now adding direct channels (for example, IBM Direct, Xerox Direct). Airlines are adding direct channel options for end users through their websites. Such moves are being facilitated by the rising power and falling cost of IT.

At the same time, many companies are finding that it is uneconomical for them to service smaller indirect accounts; they are now in the process of "outsourcing" some of their retailer customers. In some cases, smaller retailer customers are being outsourced to larger distributors. One packaged goods company, for example, is asking some of its retailers to become "master distributors" and take on smaller retailers as customers. In moving to such complex hybrid marketing channels, companies face a number of areas of potential conflict with distributors. Preventing and managing such conflict is an important factor in the success of these arrangements.

Owing to greater demographic diversity in most markets as well as rising mobility, producers are finding that traditional retailers do not adequately cover many of the locations where customers wish to shop. Increasingly, shopping occurs in the home and in public places such as airports. Non-traditional retailers are stepping into the breach and producers need to include these in the mix in order to achieve greater market coverage.

Finally, the search for efficiency and productivity is leading manufacturers to press retailers of all sizes to integrate IT into their operations, especially for the sake of vertical information flows.

The future

The mammoth retailing sector will experience major shifts and severe dislocations in coming years. Conventional retailers, especially those that are mid-sized, will be squeezed from all sides: from larger players with better economies of scale; from smaller players with more focused selection or a greater emphasis on convenience; from electronic retailers that have few physical assets but are rich in information; and from entertainment- and education-orientated players that offer a more vibrant consumer experience.

Some of the key trends we see for retailing – in addition to electronic shopping and the melding of retailing with entertainment – include:

More polarization in size

We expect retailers to be very large or very small; relatively few will be mid-sized. As in most industries, retailing will be characterized by a handful of giants and a large number of specialists.

More emphasis on services

In the US the share of revenues at shopping malls from services rose from 48 per cent in 1980 to 60 per cent in 1996; this trend will continue. The services that will grow will be those that cannot be delivered by electronic or other means directly to

the home and those that have a substantial social component (that is, their value enhanced by experiencing them in groups rather than singly).

Greater focus on older customers

With the ageing of populations in most developed countries, most buyers have less need for physical products and more desire for services (including entertainment, education, travel, healthcare and financial services). Few retailers currently focus on mature customers; this will change as the needs of older buyers are better understood.

More outdoor shopping centers located in central urban areas

Many existing enclosed malls are "demalling" and opening up to the outside. Newer developments are mostly clustering in city centers, often with active municipal involvement.

Repurposing of malls

Many malls – especially those linked to hotels – will be converted to convention centers or be occupied by fully fledged universities. Other malls will be converted to office space.

Limited globalization

Rather than full-blown globalization of the retail industry, we expect to see regional internationalization. The primary reason is that the supply function is not sufficiently globalized. Global retailers would therefore have to deal with different suppliers in different parts of the world, erasing much of their scale advantage. Retailers will prefer to try to dominate a particular area (because of shared costs) than to spread out thinly around the globe.

Conclusion

Historically, retailing's primary emphasis was on transactions that resulted in the movement of merchandise. In the future, it will increasingly emphasize services, and transactions will be peripheral to the experiential elements of shopping and consumption (see Figure 1).

Past retailing was based predominantly on a gravitational model, in which store locations were the primary driver of customer shopping behavior. Such a model placed clear time and place constraints upon customers; transactions could only occur at the store during specified hours. In the future, such constraints will be self-defeating. Retailers must gain the ability to allow transactions to occur at any time, in any place.

The trend towards disintermediation is still in its early phases but it will result in massive dislocations. It will also cause major growth in support services for companies that deal directly with larger numbers of customers. For example, growth in small package shipping will be likely to exceed by far that in bulk shipments or the building of warehouse space.

Another important consequence of this trend is likely to be "reintermediation," or the emergence of new types of intermediaries that will capture the value-creating opportunities that will be spawned by the confluence of new modes of consumer-producer interaction. Examples of such intermediaries may include rating services, automated ordering services, services based on consolidating small orders from numerous consumers into more economically viable quantities and so on. Market specialists might emerge who will orchestrate the offerings of numerous

The changing nature of retailing

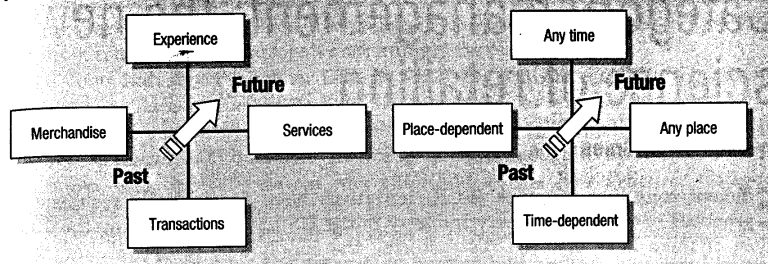


Figure 1

suppliers around the specialized needs of a single customer.

For today's retail intermediaries, the challenge is whether they can adapt to the emerging realities in a way that ensures their continued relevance and thus prosperity. They must identify a value-adding role for themselves in the new landscape of producer-consumer relationships and create a blueprint for moving towards a new business model.

Summary

Retailers play a critical role in the marketing process. Not only do they transfer goods from producers to consumers, they also channel information back from consumers. The importance of retailing is underlined by its immense size; in the US alone it accounts for some 30 per cent of gross domestic product. Yet the sector is currently in the throes of massive change, say **Jagdish Sheth** and **Rajendra Sisodia**. "New-style" retailers, using IT to facilitate close relationships with suppliers, are threatening more traditional formats; online shopping is giving consumers the prospect of more cost-effective shopping; and – partly in response to the online threat – moves are afoot to package retailing as entertainment or even education. The authors predict that mid-sized players have most to fear, as the market will become polarized between retail giants and niche businesses.

Suggested further reading

- Alba, J., Lynch, J., Weitz, B., Janiszewski, C., Lutz, R., Sawyer, A. and Wood, S. (1997) "Interactive home shopping: consumer, retailer, and manufacturer incentives to participate in electronic marketplaces," *Journal Of Marketing*, summer.
- Sheth, J.N. and Sisodia, R.S. (1997) "Consumer behavior in the future," in Peterson, R.A. (ed.) *Electronic Marketing and the Consumer*, Sage, London.