From market-place to market-space

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From fragmentation to consolidation and from localization to globalization, retailing has undergone a meaningful revolution

Dr Nirmalya Kumar

RETAILING was a very fragmented industry in most countries about quarter of a century ago. Through internal growth as well as mergers and acquisitions, enormous consolidation has taken place in the industry. These mergers and acquisition are, indeed, driven by several factors.

For one thing, strong retailers, because of their cash management system of cash sales to customers while buying on credit from suppliers, are sitting on heaps of cash. Besides, retailers feel that size brings them bargaining power versus suppliers, and, therefore, helps reduce what for many retailers is their biggest expense: COGS, or cost of goods sold.

There are the more traditional economies of scale. If the same products are available through several retailers, then cost control becomes one of the paramount drivers of profitability.

Another reason is that many developed countries have strict restrictions on opening large new stores (Spain, Italy, Germany, for instance), or lack of availability of prime locations of adequate size (Switzerland), leaving mergers and acquisition often the only domestic expansion strategy available.

Trends

Consolidation has several implications for both manufacturers and retailers. It makes it much harder for the independent retailers to succeed as they just cannot buy as efficiently or invest enough in technology to keep their operations competitive. Thus despite the efforts of many governments to protect the small, independent retailer, we will continue to see M&H activity in the industry moving at a hectic pace. For manufacturers this continuing consolidation in points of sale is worrying.

As retailers learn how to integrate their mergers and acquisitions more tightly, especially with respect to sourcing, the pressure on manufacturers will undoubtedly increase.

Perhaps the most dramatic change in retailing has been the increasing globalization of retailers. The early leaders in global retailing were specialty formats and franchise operations. These were mostly privately label formats and it was not clear whether their primary activity was retailing or manufacturing. Furthermore, the economic model and business system of these retailers was such that they could break even in a country with as few as one or two stores. Now one observes true retailers going overseas with their formats carrying manufacturer branded products.

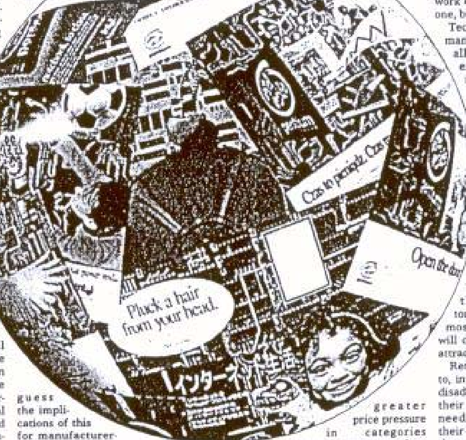
Despite the popularity of globalization in retailing, most retailers are still struggling to develop competencies to succeed in the global markets. To what extent should the 'original' format be adapted is a major issue. Another related question is which activities should be centralized and which should be decentralized. Currently, retailers believe that activities where substantial economies of scale exist, such as merchandising and distribution, should be decentralized. To protect against currency fluctuation, comply with local sourcing requirements and serve local tastes, most 'big' retail formats prefer to rely on local suppliers. However, if 90% of merchandise is locally sourced, then these retailers begin to lose some of their global sourcing leverage against the manufactures and advantage against local competition. Finally, as local partners are often mandated or necessary, who to select and what should be the role of each partner is a crucial question.

Most manufacturers are still in the process of developing a coherent strategy on how to interact effectively with global retailers. To what extent can price differences of 40-60% between markets be sustained in the face of transshipment by retailers? How to keep the traditional retailers who still account for a large majority of the manufacturer's sales in a particular country satisfied while serving the global retailer who undercuts established prices to gain a local market share? How to organize and compensate a dedicated multinational-multifunctional account management team to serve global retailers? These are all as yet unresolved questions.

Retailers were once considered true merchants, making their profits from the spread between their buying and selling prices. Today's most successful retailers are not just excellent merchants, but they are developing a unique and powerful image. This is true both for retailers who carry primarily private label merchandise as well as for the more traditional retailers who carry manufacturer branded products.

While private labels may look very seductive for the retailers, mass retailers have to be careful not to overdo it. For a mass retailer, customer count and traffic are crucial issues. Having too many private labels can turn off many, especially younger, customers.

A strong retailer brand supported by advertising has a positive impact on recruitment of managerial talent and employees. For manufacturers, this means that, unlike in the past, their counterparts in the retail sector are better informed and more analytical while having the same educational and social status. One can guess the implications of this for manufacturer-retailer negotiations.



The past 25 years has seen the emergence and growth of several new retail formats and concepts. Today, we see the supermarket, department store, hypermarket and supercentre, discount store, cash-and-carry warehouse clubs, factory outlets, category killers, convenience stores, specially retailers, as well as the gas station all competing for the same customer.

Undoubtedly, of all the formats, the 'big box' hypermarkets, large discount stores, warehouse clubs, and category killers have had the most revolutionary impact. Their enormous purchasing power that results in lower cost of goods and economies of scale puts severe pressure on the traditional formats.

Clearly, in the future the Internet will revolutionize retailing in the developed world. The Amazon bookstore, which sells books through the Internet only, is a prime example of the revolutionary potential of Internet. A new development is the emergence of the 'intelligent shopping agent', who rapidly searches the Internet for the lowest price on a product. If they become widespread, retailers may face greater price pressure in categories where the customer does not need to feel, see or touch, and where the customer does not desire instantaneous delivery (unless the product can be downloaded). The retailer's competitive focus will shift from the market-place to the market-space.

The traditional formats, especially the supermarket and department store, with their high costs will see more and more customers flee to these new formats in search of better value. To justify their higher cots, supermarkets and department stores have to find ways to increase the value they provide for the customer.

The new formats offer both new opportunities and challenges for manufacturers. Which of these new formats to enter and when? How to develop distinctive offers for each type of format? How to manage intra-brand competition?

Surprisingly, to many, retailing has become a technologically intensive industry. Technology is transforming how retailers configure the supply chain; manage their store operation; and interact with customers. By establishing close links with their suppliers, retailers can utilize ECR (efficient consumer response). ECR allows suppliers to receive daily updates of sales, prices and inventories by item and by store. Thus the entire value chain can work on the principle of 'sell one, ship one, build one.'

Technology also makes it easier to manage thousands of stores spread all over the world and helps the expansion of retailers. Real time information from the stores keeps the headquarters informed of what is happening in each store. Within the store, sophisticated shelf-management programmes aid merchandising to make the shelves easier to shop for the consumer while maximizing profits for the retailer.

Plummeting data processing and storage costs give retailers today the ability to track their customers on an individual basis. Who is buying what, when, and for how much? This allows retailers to cutomize their offers at individual customers. As retailers learn who the most profitable customers are, we will observe more targeted customer attraction strategies.

Retailers who do not, or are unable to, invest in such systems will be at a disadvantage. And manufacturers, in their negotiations with retailers, will need to demonstrate the role that their brand plays in the category for the retailer as well as the profits that it will generate for the retailer. Shelf space according to movement implies that manufacturers must earn the shelf space that is dedicated to them.

Historically, retailers used to be at the mercy of powerful multinational manufacturers. Today, some retailers find themselves much bigger in size than their suppliers, and size brings power. In response to this shift in power, many manufacturers are allocating a larger proportion of their marketing expenditure to trade promotion instead of advertising. This is a self-defeating strategy. While retailers derive their power from size and market access, a manufacturer must derive its power from advertising and product innovation investments in brand equity.

If a retailer does not stock a particular brand and the customer walks out of the store, the manufacturer has the power. On the other hand, if the customer accepts an alternative brand, then the retailer has the power. This is something that even the largest retailer understands. Manufacturers who under-invest in brand equity lose power to retailers, spend more on trade promotion, offer price and service concessions, thereby getting trapped in a vicious circle. Some manufacturers and retailers are starting to see the benefits of developing trust and focusing on the benefits that partnerships can bring to both parties instead of using their power to pummel the other party into submission. Experienced manufacturers now realize that with some retailers, it will always be a power struggle. However, there are other retailers with whom one can develop a partnership that focuses on maximizing joint benefits. Manufacturers increasingly have to develop account management systems that can function differently in different types of relationships, which is difficult.

CONCLUSION: These changes are dramatic for the retailing industry. Retailers have always been more market-driven than manufacturers because they were smaller, more flexible and closer to the markerplace. A retailer who was not market-driven received immediate feedback from customers and had to either adapt or went out of business. Today, however, there are several retailers who are changing the retailing landscape and driving customer's shopping behaviour and habits.

The best retailers today are using available technology and new formats to re-invent the competitive retail market-space. They have a strategy of using technology and systems to lower their gross margins constantly, driving their competition bankrupt. This changes the rules of the game for existing players who are trapped because of their high-cost business systems.

These revolutionary retailers are also reconfiguring the value chain. They are using their power to demand changes from powerful manufacturers and driving the manufacturer's pricing, product, promotion and sales strategies. All this suggests that the term 'market driving' is more descriptive of these retailers than 'market-driven'. ❑

Dr Kumar is a Professor of Marketing and Retailing at the International Institute for Management Development, Switzerland.