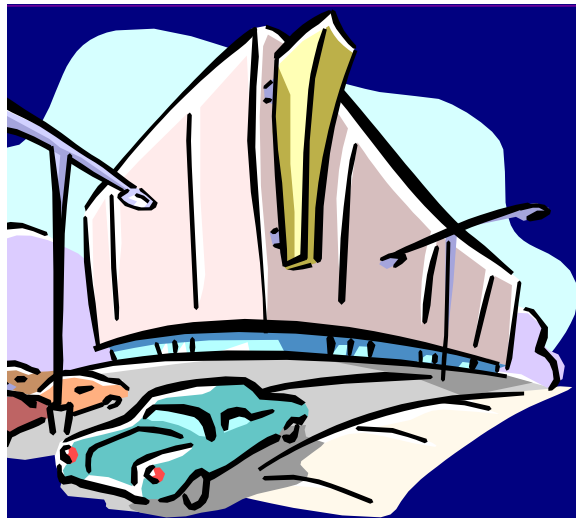


Department of Economics

Competing With The Discount Mass Merchandisers

**An Executive Summary
of a presentation by**

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COMPETING WITH THE DISCOUNT MASS MERCHANDISERS

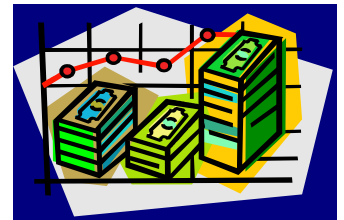
Retailing has changed dramatically in the last 10 to 15 years. There has been a proliferation of discount department stores, such as Wal-Mart, K Mart, Target, an increase in the number of membership warehouse clubs like Sam's, Price-Cosco and B.J.'s and rapid expansion in "category killer" stores such as The Home Depot, Lowes, Toys-R-Us, Office Max, Office Depot, Staples, Circuit City, Best Buy, PetSmart, and Petco. These stores are called "category killer" stores because they have a very large selection within a narrow range of merchandise, along with low

prices, and they "kill" smaller local stores within the same category. We have also seen the development of many new factory outlet malls and the spread of specialty mail order, including Internet sales. The net result of this expansion is the saturation of many retail markets, or what is commonly referred to as the over-storing of America. Many retail markets have more retail stores than can be supported. It would appear that a major shakeout is coming in the not-too-distant future, and it may involve large chains as much or more than local merchants may.

IMPACTS OF DISCOUNT MASS MERCHANDISERS

When a discount mass merchandise store opens in a small-to-medium size town with little population growth, there will be both positive and negative effects. The retail trade area size will expand because of the reduction of out-shopping by local consumers and the capture of more shoppers from the surrounding area. Businesses selling merchandise different from the discounter usually benefit from the increased traffic flow. Businesses selling the same merchandise as the discounter usually lose sales, unless they reposition themselves in the market. Unfortunately, the discounters usually saturate the market with their stores, which causes some towns' trade areas to shrink to a smaller size than before. In an Iowa study it was found that, after 10 years, towns with a Wal-Mart store had trade areas an average of four percent smaller than before the Wal-Mart store opened.

Shopping habits of consumers fundamentally change after the opening of discount mass merchandisers. People purchase a higher percentage of their merchandise from the mass merchandisers and consequently a lower percentage from local merchants. Studies in Iowa found that non Wal-Mart towns (similar in size to the Wal-Mart towns) suffered sales losses for most types of businesses, with the exception of food stores (groceries and supermarkets) after the Wal-Mart stores opened in the state. It appears that residents of non Wal-Mart towns leave their towns frequently to shop at a nearby Wal-Mart town or in a larger city for nearly everything but food. Merchants in outlying smaller towns suffer the greatest reduction in sales after discount mass merchandisers open in nearby larger towns. Most of these smaller towns do not have a critical mass of retail stores necessary to hold residents in town to shop. In Iowa, towns of 500-1,000 population suffered sales reductions of 47 percent in the 10 years following the opening of Wal-Mart stores.



Attitudes and Actions

It is best to take a positive attitude toward the opening of a new mass merchandise store in your area. Consider the following:

- **In a free enterprise economy, all firms are free to compete.** However, local officials should be careful not to offer unduly generous incentives to large firms that could place smaller firms at a disadvantage.
- **Recognize that a discount mass merchandise store will probably enlarge your town's retail trade area size.** Try to figure out ways to capitalize on the increased volume of traffic in your town.
- **It is possible to co-exist and even thrive in this type of environment.**
- **You may need to change your methods of operations**

MERCHANDISE TIPS

- **Try to handle different merchandise.** If you sell the same brand, variety or style of merchandise as the mass merchandisers, you will be compared on price. If you can hold your price within 10 to 15 percent of theirs', you are probably okay. However, if you allow your prices to rise, say 50 percent higher than they do', then you are in trouble as consumers will perceive that everything else you sell is higher priced also. The solution is to handle different brands, varieties, and styles. Many merchants find that private label merchandise works well when available.
- **Try to handle complementary merchandise.** In many areas, the mass merchandisers handle only fast moving items. For example some of the mass merchandise garden centers handle only two or three varieties of hostas. Hosta fans soon learn they will not find selection at these stores. However, if you fill out your lines with new and different hostas, you can gain the reputation of being the hosta center.
- **Look for voids in the mass merchandiser's inventory.** For example, most mass merchandisers do not carry a very good selection of plumbing supplies. It would behoove local hardware owners to carry a complete line of plumbing supplies to fill these voids if it fits their operation and the market.
- **Consider upscale merchandise.** Not all customers desire or demand lower priced merchandise. For example, most mass merchandisers handle low-end apparel. Clothing dealers who serve middle-to-upper income households might want to handle more upscale apparel.
- **Get rid of the "dogs."** Nearly all businesses end up with some merchandise that does not sell and ends up cluttering the sales space. This is bad for at least two reasons— 1) merchandise must turn to generate a profit, and 2) old merchandise tarnishes the image of your store. Merchants should identify the "dogs" and clear them out by whatever means possible.
- **Buy well.** From time to time, nearly all merchants have an opportunity to purchase merchandise at exceptional prices. If the merchandise is something you know you can sell, you should take advantage of the good buys. With good buys you can enhance your pricing image while making better profit margins. Storeowners should also be on the lookout for opportunities to purchase cooperatively with other local merchants or through a larger buying cooperative.



MARKETING TIPS

There are always ways of improving marketing practices. The following tips are offered to merchants regardless of their competition.

- **Know your customers.** It is important to know the demographics of your trade area in order to have the optimal merchandise mix. The breakdown of the population by income, age, occupation, etc. is available from census data, which can be found at most libraries and on the Internet. In addition, several marketing firms can quickly generate a detailed report, tailored to your specific trade area for a nominal fee. You may also want to conduct customer focus groups where diverse groups of customers under the direction of a third party moderator to discuss what they like and dislike about your business. These can be done by community colleges, other colleges and universities and by private consultants.
- **Extended opening hours is a necessity!** Lifestyles have changed dramatically in the last generation and it is now very common for a household to have multiple wage earners working outside the household. Most of these people simply cannot get to local stores to shop if they stay open only from 8:00 a.m. to 5:00 p.m.. By necessity they shop at mass merchandisers and shopping malls where the opening hours are in tune with today's societal needs. Downtown merchants and other independent merchants can not seriously compete in this environment unless they cooperate and offer similar convenient hours.
- **Adopt a "no hassle" returns policy.** Most mass merchandisers have very liberal return policies and they have shaped consumer's expectations. Unfortunately, some independent merchants have more restrictive policies, which frustrate and anger customers. Studies have shown that angry customers typically tell 10 to 20 other people about their bad experience and this can be disastrous for your store. It is essential that independent merchants adopt returns policies similar to those of the mass merchandisers. This policy should be stated on signs at the checkout station, as well as on receipts and shopping bags, so that there is no doubt in the customer's mind about the policy. Signs such as "All sales final!" have little place in today's retail stores.
- **Sharpen your pricing skills.** Most customers judge the pricing structure of your store on the few things they know the price of. Consequently, if you are selling a popular brand of soft-white incandescent light bulbs for 200 percent more than the mass merchandisers, they declare your store to be high priced, when in fact, most of your other products may be competitively priced. The solution is variable markup, where you identify several "price sensitive" items and mark them down to be competitive with the mass merchandisers. Furthermore these price sensitive items should be prominently displayed on end caps and other conspicuous places. Conversely, on unique items or items where you are the sole source, you can take higher markups.
- **Focus your advertising.** Stress your competitive advantage. Every business must have one or more competitive advantages, in the eyes of the customer, in order to succeed. For example Sears established a huge competitive advantage many years ago when it adopted "Satisfaction Guaranteed." With Wal-Mart, "Everyday Low Prices," is a strong competitive advantage. Smart firms incorporate these competitive advantage mottoes into nearly every advertisement. Unfortunately, many smaller merchants do not get their full money's worth from their ads because they often fail to promote their competitive advantages. For example, a nursery that offers free landscape planning or free delivery ought to incorporate these facts into every ad. After a period of repetition, customers will automatically know your competitive advantages and will be more likely patronize your store when the need arises.

SERVICE TIPS

Superior service can become an important competitive advantage for many smaller businesses. Large chain stores usually don't have the flexibility to offer many of these services.



- **Emphasize expert technical advice.** It is difficult to find workers in discount mass merchandise stores who know the merchandise. Many smaller stores build a loyal clientele base because the owner and employees are able to help customers analyze their problems and help them to find the necessary tools, supplies and equipment.
- **Offer deliveries where appropriate.** Many customers, because of schedules or health problems, have a need for deliveries. Others have a need for delivery of certain items that are heavy or bulky. Typically mass merchandisers cannot respond to these needs. Some smaller merchants can carve out a substantial market share by offering delivery service.
- **Offer on-site installation and service of certain items.** Many people have a need for services such as professional tree planting, sod installation, tree pruning, etc. Larger discount stores cannot readily provide this service. Independent merchants can draw a substantial volume of trade by providing these and other services.
- **Develop special order capability.** It is not possible for merchants to carry every conceivable item in inventory. However, they should make arrangements with suppliers or cooperating partner stores to quickly ship out-of-stock merchandise. So rather than let a customer walk out the door when an item is not in stock, it is better to say, "I'm sorry I do not have it in stock, but I can get it for you in two days."
- **Offer other services as appropriate.** Independent merchants can develop many loyal customers by offering "how to do it" classes, rentals of certain items that will boost sales of collateral merchandise, a branch post office, etc.

CUSTOMER RELATIONS TIPS

In past years, small businesses had the reputation of excellent customer relations. Nowadays many consumers perceive that they are treated no better in small firms than in larger ones. Research has shown that poor customer relations is the primary reason that customers quit patronizing with a store. The following suggestions are offered for all businesses.



- **Make sure customers are "greeted."** According to surveys, the primary thing that offends customers is the failure to be greeted or acknowledged when entering a store. This is particularly acute when the customer is in a buying mood. All store personnel should be trained to "greet" customers when they enter a store, determine their needs and assist them in any way possible.
- **Offer customers a smile instead of a frown.** It's a fact that all customers prefer doing business where they are treated in a friendly manner.

CUSTOMER RELATIONS TIPS (continued)

- **Make employees “associates.”** Firms like J.C. Penney, Wal-Mart and The Home Depot call their employees associates and treat them as part of the team. Independent merchants can emulate this. In particular, regular store meetings should be held where everyone is apprised of the latest happenings and plans and where all problems and suggestions can be aired.
- **Solicit complaints.** Many times customers have had a bad experience in a store, but they are reluctant to complain to store personnel for various reasons. Instead, they go around complaining to other people. Good merchants would rather hear of the complaint first so they can find a remedy. They should provide an environment where customers feel comfortable complaining. This can be done by soliciting complaints through ads in the media, through signs at the checkout counter and on shopping bags. You must be prepared however, to solve these problems when complaints are made.
- **Learn how to handle irate customers.** Dealing with irate customers is something that few people enjoy, but it is crucial to the success of the business. The worst thing store representatives can do is to argue with or be rude to an irate customer. The following process with the acronym of LEAR is recommended. (L) Listen. It is easy to become defensive and turn off the customer while you are thinking of your response, but it pays to set everything aside and listen intently. (E) Empathize. Put yourself in the shoes of the customer and think how you would like the situation resolved. (A) Ask. Ask questions to get all the facts on the table. (R) Resolve. Resolve the situation to the satisfaction of the customer. Most merchants have found that by merely asking, “What do you see as a reasonable solution?” they can achieve a win-win solution.
- **Train employees (often).** In the eyes of the customer, the employee **is** the business. Training employees can have one of the highest payoffs of any investment in the business. New employees should be trained on store policies and in the use of any equipment or machines to be used. As they progress in the company, they should receive recurring training on new products or techniques and industry trends. There is an array of training available through educational institutions, parent companies, suppliers and others. In addition employees should be given access to trade journals, videotapes and other educational items.

More information can be obtained by visiting
the Office of Social and Economic Trends Analysis website at:

www.seta.iastate.edu

CONTINUALLY IMPROVE THE EFFICIENCY OF YOUR BUSINESS

Businesses may be doing all the right things as mentioned above, but unless they are efficiently operated, they are probably doomed to failure. Some of the top mass merchandisers such as Wal-Mart and The Home Depot continually strive to improve their operating efficiency. The following are some of the things you can do to improve your efficiency.

- **Adopt modern technology.** Mass merchandisers have improved their efficiency dramatically by adopting new technology. Much of that technology is now available and affordable to the smaller merchant. For example, powerful computers are available at ever decreasing costs. Software packages to handle nearly all store functions are also available. Computers improve accuracy and provide quick analyses of the business' performance. In addition, point of sale (POS) scanner equipment is now available and affordable to all but the smallest businesses. In addition to scanning prices and speeding customers through the checkout line, they can revolutionize inventory control when tied in with the store computer and ultimately with supplier's computers.
- **Become familiar with your financial statements.** Many merchants do not like to deal with the finances of the business. If they can "farm" this operation out to a bookkeeper or accountant, they feel "out-of-sight, out-of-mind." Good merchants must become intimately familiar with the finances and operations of their businesses. They should constantly monitor gross profit margins, operating expenses, net profits and the various ratios important to the business.
- **Relentlessly find ways to reduce operating costs.** One reason that the mass merchandisers can lower prices and still make a profit is that they continually reduce their operating costs. In addition to adopting technology, they find ways to save on utilities, insurance, and transportation. They also find ways to reduce "shrinkage" by reducing shoplifting, pilferage and damage to merchandise. Smaller merchants can adopt similar strategies.

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