Chapter 16

Cofounder Tony Hsieh has ensured that a strong customer-service culture is at the heart of operations at Zappos, the online footwear and accessories retailer.

In This Chapter, We Will Address the Following Questions

1. What major types of marketing intermediaries occupy this sector?
2. What marketing decisions do these marketing intermediaries make?
3. What are the major trends with marketing intermediaries?
4. What does the future hold for private label brands?

Managing Retailing, Wholesaling, and Logistics

In the previous chapter, we examined marketing intermediaries from the viewpoint of manufacturers who wanted to build and manage marketing channels. In this chapter, we view these intermediaries—retailers, wholesalers, and logistical organizations—as requiring and forging their own marketing strategies in a rapidly changing world. Intermediaries also strive for marketing excellence and can reap the benefits like any other type of company.

Online footwear retailer Zappos was co-founded by Tony Hsieh in 1999 with superior customer service and an improved customer experience at the core of its corporate culture. With free shipping and returns, 24/7 customer service, and fast turnaround on a wide selection of 200,000 shoe styles from 1,200 makers, Zappos finds that three-fourths of purchases during any one day are by repeat customers. Unlike many other companies, Zappos has not outsourced its call centers; Hsieh sees that function as too important. In fact, Zappos empowers its customer service reps to solve problems. When a customer called to complain that a pair of boots was leaking after a year of use, the customer service rep sent out a new pair even though the company's policy is that only unworn shoes are returnable. Every employee has a chance each year to contribute a passage to the firm's Culture Book, about life at Zappos, and how each department implements superior customer service from selling to warehousing and delivery, to pricing and billing. Half the interview process for potential new hires is devoted to finding out whether they are sufficiently outgoing, open-minded, and creative to be a good cultural fit for the company. Bought by Amazon.com in 2009 for a reported $850 million but still run separately, the company now also sells clothing, handbags, and accessories. Thanks to its success, it even offers two-day, $4,000 seminars to business executives eager to learn about the secrets behind Zappos's unique corporate culture and approach to customer service.[1]

While innovative retailers such as Zappos, Sweden's H&M, Spain's Zara and Mango, and Britain's Topshop have thrived in recent years, others such as former U.S. stalwarts Gap, Home Depot, and Kmart have struggled. The more successful intermediaries use strategic planning, advanced information systems, and sophisticated marketing tools. They segment their markets, improve their market targeting and positioning, and aggressively pursue market expansion and diversification strategies. In this chapter, we consider marketing excellence in retailing, wholesaling, and logistics.

Retailing

Retailing includes all the activities in selling goods or services directly to final consumers for personal, nonbusiness use. A **retailer** or **retail store** is any business enterprise whose sales volume comes primarily from retailing.

Any organization selling to final consumers—whether it is a manufacturer, wholesaler, or retailer—is doing retailing. It doesn't matter *how* the goods or services are sold (in person, by mail, telephone, vending machine, or on the Internet) or *where* (in a store, on the street, or in the consumer's home).

After reviewing the different types of retailers and the new retail marketing environment, we examine the marketing decisions retailers make. The following are four examples of innovative retail organizations that have experienced market success in recent years.

Innovative Retail Organizations

Panera Bread. The $2.6 billion Panera Bread restaurant chain targets "food people who understand and respond to food or those on the verge of that" by selling fresh "real" food–and lots of warm bread—at full prices that customers are more than willing to pay. An unpretentious atmosphere—no table service, but no time limit—encourages customers to linger. The brand is seen as family-oriented but also sophisticated, offering an appealing combination of fresh, customizable, convenient, and affordable food.

Panera Bread appeals to food lovers of all kinds.

GameStop. Video game and entertainment software retailer GameStop has over 6,000 locations in malls and shopping strips all over the United States, making it highly convenient for customers. Staffed by hard-core gamers who like to connect with customers, GameStop boasts a trade-in policy that gives customers credit for an old game traded in for a new one.

Lumber Liquidators. Lumber Liquidators buys excess wood directly from lumber mills at a discount and stocks almost 350 kinds of hardwood flooring, about the same as Lowe's and Home Depot. It sells at lower prices because it keeps operating costs down by cutting out the middlemen and locating stores in inexpensive locations. Lumber Liquidators also knows a lot about its customers, such as the fact that shoppers who request product samples have a 30 percent likelihood of buying within a month, and that most tend to renovate one room at a time, not the entire home at once.

Net-a-Porter. London-based Net-a-Porter is an online luxury clothing and accessories retailer whose Web site combines the style of a fashion magazine with the thrill of shopping at a chic boutique. Seen by its loyal customers as an authoritative fashion voice, Net-a-Porter stocks over 300 international brands, such as Jimmy Choo, Alexander McQueen, Stella McCartney, Givenchy, Marc Jacobs, and others. The company ships to 170 countries and offers same-day delivery in London and Manhattan; the average order is $250.

Sources: Kate Rockwood, "Rising Dough, *Fast Company*, October 2009, pp. 69–71; Devin Leonard, "GameStop Racks Up the Points," *Fortune*, June 9, 2008, pp. 109–22; Helen Coster, "Hardwood Hero," *Forbes*, November 30, 2009, pp. 60–62; John Brodie, "The Amazon of Fashion," *Fortune*, September 14, 2009, pp. 86–95.

Types of Retailers

Consumers today can shop for goods and services at store retailers, nonstore retailers, and retail organizations.

STORE RETAILERS Perhaps the best-known type of store retailer is the department store. Japanese department stores such as Takashimaya and Mitsukoshi attract millions of shoppers each year and feature art galleries, restaurants, cooking classes, fitness clubs, and children's playgrounds. The most important types of major store retailers are summarized in Table 16.1.

Different formats of store retailers will have different competitive and price dynamics. Discount stores, for example, compete much more intensely with each other than other formats.[2] Retailers also meet widely different consumer preferences for service levels and specific services. Specifically, they position themselves as offering one of four levels of service:

1. ***Self-service***—Self-service is the cornerstone of all discount operations. Many customers are willing to carry out their own "locate-compare-select" process to save money.
2. ***Self-selection***—Customers find their own goods, although they can ask for assistance.
3. ***Limited service***—These retailers carry more shopping goods and services such as credit and merchandise-return privileges. Customers need more information and assistance.
4. ***Full service***—Salespeople are ready to assist in every phase of the "locate-compare-select" process. Customers who like to be waited on prefer this type of store. The high staffing cost, along with the higher proportion of specialty goods and slower-moving items and the many services, result in high-cost retailing.

TABLE 16.1 Major Types of Store Retailers
Specialty store: Narrow product line. The Limited, The Body Shop.
Department store: Several product lines. JCPenney, Bloomingdale's.
Supermarket: Large, low-cost, low-margin, high-volume, self-service store designed to meet total needs for food and household products. Kroger, Safeway.
Convenience store: Small store in residential area, often open 24/7, limited line of high-turnover convenience products plus takeout. 7-Eleven, Circle K.
Drug store: Prescription and pharmacies, health and beauty aids, other personal care, small durable, miscellaneous items. CVS, Walgreens.
Discount store: Standard or specialty merchandise; low-price, low-margin, high-volume stores. Walmart, Kmart.
Extreme value or hard-discount store: A more restricted merchandise mix than discount stores but at even lower prices. Aldi, Lidl, Dollar General, Family Dollar.
Off-price retailer: Leftover goods, overruns, irregular merchandise sold at less than retail. Factory outlets; independent off-price retailers such as TJ Maxx; warehouse clubs such as Costco.
Superstore: Huge selling space, routinely purchased food and household items, plus services (laundry, shoe repair, dry cleaning, check cashing). Category killer (deep assortment in one category) such as Staples; combination store such as Jewel-Osco; hypermarket (huge stores that combine supermarket, discount, and warehouse retailing) such as Carrefour in France and Meijer in the Netherlands.
Catalog showroom: Broad selection of high-markup, fast-moving, brand-name goods sold by catalog at a discount. Customers pick up merchandise at the store. Inside Edge Ski and Bike.

Source: Data from www.privatelabelmag.com.

NONSTORE RETAILING Although the overwhelming bulk of goods and services—97 percent—is sold through stores, *nonstore retailing* has been growing much faster than store retailing. Nonstore retailing falls into four major categories: direct selling, direct marketing (which includes telemarketing and Internet selling), automatic vending, and buying services:

1. ***Direct selling,*** also called *multilevel selling* and *network marketing*, is a multibillion-dollar industry, with hundreds of companies selling door-to-door or at home sales parties. Well-known in one-to-one selling are Avon, Electrolux, and Southwestern Company of Nashville (Bibles). Tupperware and Mary Kay Cosmetics are sold one-to-many: A salesperson goes to the home of a host who has invited friends; the salesperson demonstrates the products and takes orders. Pioneered by Amway, the multilevel (network) marketing sales system works by recruiting independent businesspeople who act as distributors. The distributor's compensation includes a percentage of sales made by those he or she recruits, as well as earnings on direct sales to customers. These direct-selling firms, now finding fewer consumers at home, are developing multidistribution strategies.
2. ***Direct marketing*** has roots in direct-mail and catalog marketing (Lands' End, L.L.Bean); it includes *telemarketing* (1-800-FLOWERS), *television direct-response marketing* (HSN, QVC), and *electronic shopping* (Amazon.com, Autobytel.com). As people become more accustomed to shopping on the Internet, they are ordering a greater variety of goods and services from a wider range of Web sites. In the United States, online sales were estimated to be $210 billion in 2009, with travel being the biggest category ($80 billion).[3]
3. ***Automatic vending*** offers a variety of merchandise, including impulse goods such as soft drinks, coffee, candy, newspapers, magazines, and other products such as hosiery, cosmetics, hot food, and paperbacks. Vending machines are found in factories, offices, large retail stores, gasoline stations, hotels, restaurants, and many other places. They offer 24-hour selling, self-service, and merchandise that is stocked to be fresh. Japan has the most vending machines per person—Coca-Cola has over 1 million machines there and annual vending sales of $50 billion—twice its U.S. figures.
4. ***Buying service*** is a storeless retailer serving a specific clientele—usually employees of large organizations—who are entitled to buy from a list of retailers that have agreed to give discounts in return for membership.

TABLE 16.2	Major Types of Corporate Retail Organizations
Corporate chain store: Two or more outlets owned and controlled, employing central buying and merchandising, and selling similar lines of merchandise. Gap, Pottery Barn.	
Voluntary chain: A wholesaler-sponsored group of independent retailers engaged in bulk buying and common merchandising. Independent Grocers Alliance (IGA).	
Retailer cooperative: Independent retailers using a central buying organization and joint promotion efforts. Associated Grocers, ACE Hardware.	
Consumer cooperative: A retail firm owned by its customers. Members contribute money to open their own store, vote on its policies, elect a group to manage it, and receive dividends. Local cooperative grocery stores can be found in many markets.	
Franchise organization: Contractual association between a franchisor and franchisees, popular in a number of product and service areas. McDonald's, Subway, Pizza Hut, Jiffy Lube, 7-Eleven.	
Merchandising conglomerate: A corporation that combines several diversified retailing lines and forms under central ownership, with some integration of distribution and management. Federated Department Stores renamed itself after one of its best-known retailers, Macy's, but also owns other retailers such as Bloomingdale's.	

CORPORATE RETAILING AND FRANCHISING Although many retail stores are independently owned, an increasing number are part of a **corporate retailing** organization. These organizations achieve economies of scale, greater purchasing power, wider brand recognition, and better-trained employees than independent stores can usually gain alone. The major types of corporate retailing—corporate chain stores, voluntary chains, retailer and consumer cooperatives, franchises, and merchandising conglomerates—are described in Table 16.2.

Franchise businesses such as Subway, Jiffy-Lube, Holiday Inn, Supercuts, and 7-Eleven account for more than $1 trillion of annual U.S. sales and roughly 40 percent of all retail transactions. One of every 12 U.S. retail businesses is a franchise establishment; these firms employ 1 in every 16 workers in the country.[4]

In a franchising system, individual *franchisees* are a tightly knit group of enterprises whose systematic operations are planned, directed, and controlled by the operation's innovator, called a *franchisor*. Franchises are distinguished by three characteristics:

1. The franchisor owns a trade or service mark and licenses it to franchisees in return for royalty payments.
2. The franchisee pays for the right to be part of the system. Start-up costs include rental and lease equipment and fixtures, and usually a regular license fee. McDonald's franchisees may invest as much as $1.6 million in total start-up costs and fees. The franchisee then pays McDonald's a certain percentage of sales plus a monthly rent.
3. The franchisor provides its franchisees with a system for doing business. McDonald's requires franchisees to attend "Hamburger University" in Oak Brook, Illinois, for two weeks to learn how to manage the business. Franchisees must follow certain procedures in buying materials.

Franchising benefits both franchisor and franchisee. Franchisors gain the motivation and hard work of employees who are entrepreneurs rather than "hired hands," the franchisees' familiarity with local communities and conditions, and the enormous purchasing power of being a franchisor. Franchisees benefit from buying into a business with a well-known and accepted brand name. They find it easier to borrow money for their business from financial institutions, and they receive support in areas ranging from marketing and advertising to site selection and staffing.

Franchisees do walk a fine line between independence and loyalty to the franchisor. Some franchisors are giving their franchisees freedom to run their own operations, from personalizing store names to adjusting offerings and price. Beef 'O' Brady's sports pub franchisees are allowed to set prices to reflect their local markets. Great Harvest Bread believes in a "freedom franchise" approach that encourages its franchisee bakers to create new items for their store menus and to share with other franchisees if they are successful.[5]

As part of their franchise agreement, new McDonald's franchisors must attend the company's Hamburger University for two weeks to learn how to properly manage their restaurants.

The New Retail Environment

With the onset of the recession in 2008, many retailers had to fundamentally reassess virtually everything they did. Some adopted a cautious, defensive response, cutting stock levels, slowing expansion, and discounting deeply. Others were more creative about managing inventory, adjusting product lines, and carefully avoiding overpromoting. For example, JCPenney held back 60 percent of inventory for the fall 2009 holiday season, compared to its usual 20 percent, to avoid having empty shelves and stock-outs on one hand and overflowing shelves and heavy discounting on the other hand. Some firms, such as the Container Store and Saks, lowered average prices; others, such as Gilt.com and Neiman Marcus, introduced selective and very short-term deep discounts. Restoration Hardware chose to move its furniture product lines more upscale.[6]

Although many of these short-term adjustments were likely to remain longer-term, a number of other long-term trends are also evident in the retail marketing environment. Here are some that are changing the way consumers buy and manufacturers and retailers compete (see Table 16.3 for a summary).

- ***New Retail Forms and Combinations.*** To better satisfy customers' need for convenience, a variety of new retail forms have emerged. Bookstores feature coffee shops. Gas stations include food stores. Loblaw's Supermarkets have fitness clubs. Shopping malls and bus and train stations have peddlers' carts in their aisles. Retailers are also experimenting with limited-time "pop-up" stores that let them promote brands to seasonal shoppers for a few weeks

TABLE 16.3	Recent Retail Developments
• New Retail Forms and Combinations	
• Growth of Intertype Competition	
• Competition between Store-Based and Nonstore-Based Retailing	
• Growth of Giant Retailers	
• Decline of Middle-Market Retailers	
• Growing Investment in Technology	
• Global Profile of Major Retailers	
• Growth of Shopper Marketing	

in busy areas and create buzz. For the 2009 holiday season, Toys "R" Us set up 350 temporary stores and toy boutiques, in many cases taking over vacant retail space in shopping centers and malls.[7]

- ***Growth of Intertype Competition.*** Department stores can't worry just about other department stores—discount chains such as Walmart and Tesco are expanding into product areas such as clothing, health, beauty, and electrical appliances. Different types of stores—discount stores, catalog showrooms, department stores—all compete for the same consumers by carrying the same type of merchandise.
- ***Competition between Store-Based and Nonstore-Based Retailing.*** Consumers now receive sales offers through direct-mail letters and catalogs, television, cell phones, and the Internet. The nonstore-based retailers making these offers are taking business away from store-based retailers. Store-based retailers have responded by increasing their Web presence and finding different ways to sell online, including through their own Web sites, as well as creating more involving and engaging experiences in their stores. Store-based retailers want their stores to be destinations where consumers enjoy rich experiences that captivate all their senses. Sophisticated lighting, use of appropriate scents, and inviting, intimate designs are all being increasingly employed.[8]
- ***Growth of Giant Retailers.*** Through their superior information systems, logistical systems, and buying power, giant retailers such as Walmart are able to deliver good service and immense volumes of product to masses of consumers at appealing prices. They are crowding out smaller manufacturers that cannot deliver enough quantity and often dictate to the most powerful manufacturers what to make, how to price and promote, when and how to ship, and even how to improve production and management. Manufacturers need these accounts; otherwise they would lose 10 percent to 30 percent of the market. Some giant retailers are *category killers* that concentrate on one product category, such as pet food (PETCO), home improvement (Home Depot), or office supplies (Staples). Others are *supercenters* that combine grocery items with a huge selection of nonfood merchandise (Walmart).
- ***Decline of Middle-Market Retailers.*** We can characterize the retail market today as hourglass or dog-bone shaped: Growth seems to be centered at the top (with luxury offerings from retailers such as Nordstrom and Neiman Marcus) and at the bottom (with discount pricing from retailers such as Target and Walmart). As discount retailers improve their quality and image, consumers have been willing to trade down. Target offers Proenza Schouler designs and Kmart sells an extensive line of Joe Boxer underwear and sleepwear. At the other end of the spectrum, Coach recently converted 40 of its nearly 300 stores to a more upscale format that offers higher-priced bags and concierge services. Opportunities are scarcer in the middle where one-time successful retailers such as Sears, CompUSA, and Montgomery Ward have struggled or even gone out of business.[9]

  Kohl's has found some success going after middle-market consumers by bringing in trendy names such as Lauren Conrad, Vera Wang, Daisy Fuentes, and Tony Hawk. In addition to offering more up-market merchandise, Kohl's also adapted the stores themselves to make the shopping experience more convenient and pleasant.[10] Marks & Spencer in the United Kingdom features in-house brands and has built a strong retail brand image. Although these stores tend to have high operating costs, they command high margins if their in-house brands are both fashionable and popular.[11]
- ***Growing Investment in Technology.*** Almost all retailers now use technology to produce better forecasts, control inventory costs, and order electronically from suppliers. Technology is also affecting what happens inside the store. In-store programming on plasma TVs can run continual demonstrations or promotional messages. After encountering problems measuring store traffic up and down aisles—GPS on shopping carts didn't work because consumers tended to abandon their carts at times during trips and thermal imaging couldn't tell the difference between turkeys and babies during tests—bidirectional infrared sensors sitting on store shelves have been successfully introduced. Electronic shelf labeling allows retailers to change price levels instantaneously at any time of the day or week. Retailers are also introducing features to help customers as they shop. Some supermarkets are employing "smart" shopping carts or mobile phones that help customers locate items in the store, find out about sales and special offers, and pay for items more easily. As exciting as these new technologies are, their cost and unproven effectiveness in many cases can create significant drawbacks.[12]

- ***Global Profile of Major Retailers.*** Retailers with unique formats and strong brand positioning are increasingly appearing in other countries. U.S. retailers such as The Limited and the Gap have become globally prominent. Walmart operates over 3,600 stores abroad where it does 25 percent of its business. Dutch retailer Ahold and Belgian retailer Delhaize earn almost two-thirds and four-fifths of their sales, respectively, in nondomestic markets. Among foreign-based global retailers in the United States are Italy's Benetton, Sweden's IKEA home furnishings stores, and Japan's UNIQLO casual apparel retailer and Yaohan supermarkets.
- ***Growth of Shopper Marketing.*** Buoyed by research suggesting that as much as 70 percent to 80 percent of purchase decisions are made inside the retail store, firms are increasingly recognizing the importance of influencing consumers at the point of purchase.[13] Where and how a product is displayed and sold can have a significant effect on sales.[14] More communication options are available through in-store advertising such as Walmart TV.[15] Some employ goggle-like devices that record what test customers see by projecting an infrared beam onto the wearer's retina. One finding was that many shoppers ignored products at eye level—the optimum location was between waist and chest level.[16]

High-tech shopping carts allow customers to keep track of their total expenditures, search for products, find out what is on sale, and even pay without waiting in line.

Marketing Decisions

With this new retail environment as a backdrop, we will examine retailers' marketing decisions in the areas of target market, channels, product assortment, procurement, prices, services and store atmosphere, store activities and experiences, communications, and location. We discuss the important topic of private labels for retailers in the next section.

TARGET MARKET Until it defines and profiles the target market, the retailer cannot make consistent decisions about product assortment, store decor, advertising messages and media, price, and service levels. Ann Taylor has used a panel of 3,000 customers to provide feedback on its merchandise and even its marketing campaign. The firm also solicits employees' input.[17] Whole Foods has found success by offering a unique shopping experience to a customer base interested in organic and natural foods.

Whole Foods Market

Whole Foods Market

In 284 stores in North America and the United Kingdom, Whole Foods creates celebrations of food. The markets are bright and well staffed, and food displays are bountiful and seductive. Whole Foods is the largest organic and natural foods grocer in the country, offering more than 2,400 items in four lines of private-label products that add up to 11 percent of sales: the premium Whole Foods Market, Whole Kitchen, and Whole Market lines and the low-priced 365 Everyday Value line. Whole Foods also offers lots of information about its food. If you want to know, for instance, whether the chicken in the display case lived a happy, free-roaming life, you can get a 16-page booklet and an invitation to visit the farm in Pennsylvania where it was raised. If you can't find the information you need, you have only to ask a well-trained and knowledgeable employee. Whole Foods' approach is working, especially for consumers who view organic and artisanal food as an affordable luxury. From 1991–2009, sales grew at a 28 percent compounded annual growth rate (CAGR).[18]

Mistakes in choosing or switching target markets can be costly. When historically mass-market jeweler Zales decided to chase upscale customers, it replaced one-third of its merchandise, dropping inexpensive, low-quality diamond jewelry for high-margin, fashionable 14-karat gold and silver pieces and shifting its ad campaign in the process. The move was a disaster. Zales lost many of its traditional customers without winning over the new customers it had hoped to attract.[19]

To better hit their targets, retailers are slicing the market into ever-finer segments and introducing new lines of stores to exploit niche markets with more relevant offerings: Gymboree launched Janie and Jack, selling apparel and gifts for babies and toddlers; Hot Topic introduced Torrid, selling fashions for plus-sized teen girls; and Limited Brand's Tween Brands sells lower-priced fashion to tween girls.

Channels

Based on a target market analysis and other considerations we reviewed in Chapter 15, retailers must decide which channels to employ to reach their customers. Increasingly, the answer is multiple channels. Staples sells through its traditional retail channel, a direct-response Internet site, virtual malls, and thousands of links on affiliated sites.

As Chapter 15 explained, channels should be designed to work together effectively. Century-old department store chain JCPenney has ensured that its Internet, store, and catalog businesses are fully intertwined. It sells a vast variety of goods online; has made Internet access available at its 35,000 checkout registers; and allows online shoppers to pick up and return orders at stores and check which clothes are in stock there. These strategies—as well as the introduction of a.n.a., a stylish line of women's clothing—have helped give JCPenney a younger, more upscale image.[20]

Although some experts predicted otherwise, catalogs have actually grown in an Internet world as more firms use them as branding devices. Victoria's Secret's integrated multichannel approach of retail stores, catalog, and Internet has played a key role in its brand development.

Victoria's Secret Limited Brands founder Leslie Wexner felt U.S. women would relish the opportunity to have a European-style lingerie shopping experience. "Women need underwear, but women want lingerie," he observed. Wexner's assumption proved correct: A little more than a decade after he bought the business in 1982, Victoria's Secret's average customer was buying 8 to 10 bras per year, compared with the national average of two. To enhance its upscale reputation and glamorous appeal, the brand is endorsed by high-profile supermodels in ads and fashion shows. To expand its accessibility and offer privacy, the company began to sell directly to consumers. Victoria's Secret used a comprehensive marketing strategy to connect its retail, catalog, and Web sales. Wexner sought to make it: "stand [out] as an integrated world-class brand. Across all channels—catalogue, stores, Internet—the same products are launched at the same time, in exactly the same way, with the same quality, and same positioning." Since 1985, Victoria's Secret has delivered 25 percent annual sales growth, selling through its 1,000-plus stores, catalogs, and company Web site, posting $5.6 billion in revenues in 2009. Victoria's Secret ships 400 million catalogs a year, or 1.33 for every U.S. citizen, and catalog and online orders account for nearly 28 percent of its overall revenue, growing at double the rate of sales from its stores.[21]

PRODUCT ASSORTMENT The retailer's product assortment must match the target market's shopping expectations in *breadth* and *depth*. A restaurant can offer a narrow and shallow assortment (small lunch counters), a narrow and deep assortment (delicatessen), a broad and shallow assortment (cafeteria), or a broad and deep assortment (large restaurant).

Identifying the right product assortment can be especially challenging in fast-moving industries such as technology or fashion. Urban Outfitters ran into trouble when it strayed from its "hip, but not too hip" formula, moving to embrace new styles too quickly. Sales fell over 25 percent during 2006.[22] On the other hand, active and casual apparel retailer Aéropostale has found success by carefully matching its product assortment to its young teen target market's needs.

Aéropostale Aéropostale has chosen to embrace a key reality of its target market: 11- to 18-year-olds, especially those on the young end, often want to look like other teens. So while Abercrombie and American Eagle might reduce the number of cargo pants on the sales floor, Aéropostale will keep an ample supply on hand at an affordable price. Staying on top of the right trends isn't easy, but Aéropostale is among the most diligent of teen retailers when it comes to consumer research. In addition to running high school focus groups and in-store product tests, the company launched an Internet-based program that seeks online shoppers' input in creating new styles. It targets 10,000 of its best customers and averages 3,500 participants in each of 20 tests a year. Aéropostale has gone from being a lackluster performer with only 100 stores to a powerhouse with 914 total stores in the United States, Puerto Rico, and Canada. Net sales were up 19 percent in 2008 to $1.9 billion, and net sales from e-commerce business increased 85 percent to $79 million.[23]

Aéropostale's "Teens for Jeans" cause marketing campaign encourages its customers to donate used jeans for homeless teens in North America.

The real challenge begins after defining the store's product assortment, and that is to develop a product-differentiation strategy. To better differentiate themselves and generate consumer interest, some luxury retailers are making their stores and merchandise more varied. Chanel has expanded its "ultralux" goods, including $26,000 alligator bags, while ensuring an ample supply of "must-haves" that are consistently strong sellers.[24] Here are some other possibilities:

- ***Feature exclusive national brands that are not available at competing retailers.*** Saks might get exclusive rights to carry the dresses of a well-known international designer.
- ***Feature mostly private-label merchandise.*** Benetton and Gap design most of the clothes carried in their stores. Many supermarket and drug chains carry private-label merchandise.
- ***Feature blockbuster distinctive merchandise events.*** Bloomingdale's ran a month-long celebration for the Barbie doll's 50th anniversary in March 2009.
- ***Feature surprise or ever-changing merchandise.*** Off-price apparel retailer TJ Maxx offers surprise assortments of distress merchandise (goods the owner must sell immediately because it needs cash), overstocks, and closeouts, totaling 10,000 new items each week at prices 20 percent to 60 percent below department and specialty store regular prices.
- ***Feature the latest or newest merchandise first.*** Zara excels in and profits from being first-to-market with appealing new looks and designs.
- ***Offer merchandise-customizing services.*** Harrods of London will make custom-tailored suits, shirts, and ties for customers, in addition to ready-made menswear.
- ***Offer a highly targeted assortment.*** Lane Bryant carries goods for the larger woman. Brookstone offers unusual tools and gadgets for the person who wants to shop in a "toy store for grown-ups."

Merchandise may vary by geographical market. Electronics superstore Best Buy reviewed each of its 25,000 SKUs to adjust its merchandise according to income level and buying habits of shoppers. It also puts different store formats and staffs in different areas—a location with computer sophisticates gets a different store treatment than one with less technically sophisticated shoppers.[25] Macy's and Ross Stores employ *micro-merchandising* and let managers select a significant percentage of store assortments.[26]

PROCUREMENT After deciding on the product-assortment strategy, the retailer must establish merchandise sources, policies, and practices. In the corporate headquarters of a supermarket chain, specialist buyers (sometimes called *merchandise managers*) are responsible for developing brand assortments and listening to salespersons' presentations.

Retailers are rapidly improving their skills in demand forecasting, merchandise selection, stock control, space allocation, and display. They use computers to track inventory, compute economic order quantities, order goods, and analyze dollars spent on vendors and products. Supermarket chains use scanner data to manage their merchandise mix on a store-by-store basis.

Some stores are experimenting with radio frequency identification (RFID) systems made up of "smart" tags—microchips attached to tiny radio antennas—and electronic readers. The smart tags can be embedded on products or stuck on labels, and when the tag is near a reader, it transmits a unique identifying number to its computer database. The use of RFIDs has been steadily increasing. Coca-Cola and Gillette use them to monitor inventory and track goods in real time as they move from factories to supermarkets to shopping baskets.[27]

When retailers do study the economics of buying and selling individual products, they typically find that a third of their square footage is tied up in products that don't make an economic profit for them (profit above the cost of capital). Another third is typically allocated to product categories that break even. The final third of the space creates the vast majority of the economic profit, yet many retailers are unaware which third of their products generate it.[28]

Stores are using **direct product profitability (DPP)** to measure a product's handling costs (receiving, moving to storage, paperwork, selecting, checking, loading, and space cost) from the time it reaches the warehouse until a customer buys it in the retail store. They learn to their surprise that the gross margin on a product often bears little relation to the direct product profit. Some high-volume products may have such high handling costs that they are less profitable and deserve less shelf space than low-volume products.

Trader Joe's has differentiated itself on its innovative procurement strategy.

Trader Joe's

Trader Joe's Los Angeles–based Trader Joe's has carved out a special niche as a "gourmet food outlet discount warehouse hybrid," selling a constantly rotating assortment of upscale specialty food and wine at lower-than-average prices. Roughly 80 percent of what it stocks sells under private labels (compared to only 16 percent at most supermarkets), many with a strong environmentally friendly message. For procurement, Trader Joe's has adopted a "less is more" philosophy. Every store carries about 3,000 products, compared to 55,000 at a conventional supermarket, and only what it can buy and sell at a good price, even if that means changing stock weekly. Its 18 expert buyers go directly to hundreds of suppliers, not to intermediaries, and 20 percent to 25 percent of its suppliers are overseas. With thousands of vendor relationships all around the world, Trader Joe's has a success formula that's difficult to copy. In addition, a product finds a space on the shelf only if it's approved by a tasting panel; there is one on each coast to satisfy regional tastes. The company introduces as many as 20 products a week to replace unpopular items.[29]

PRICES Prices are a key positioning factor and must be set in relationship to the target market, product-and-service assortment mix, and competition.[30] All retailers would like high *turns × earns* (high volumes and high gross margins), but the two don't usually go together. Most retailers fall into the *high-markup, lower-volume* group (fine specialty stores) or the *low-markup, higher-volume* group (mass merchandisers and discount stores). Within each of these groups are further gradations. Bijan on Rodeo Drive in Beverly Hills prices suits starting at $1,000 and shoes at $400. At the other end, Target has skillfully combined a hip image with discount prices to offer customers a strong value proposition.

Target In the mid-1980s, Kmart was the dominant mass retailer, and Walmart was growing rapidly. Sensing a gap in the market for "cheap chic" retail, Target strove to set itself apart from the other big-box retailers by enhancing the design quality of its product selection, focusing on merchandise that was contemporary and unique. The company's team of merchandisers traveled the world looking for the next hot items and trends to bring to the shelves. Target also differentiated its merchandising layout, using low shelves, halogen and track lighting, and wider aisles and avoiding "visual clutter" in stores. With the slogan "Expect More, Pay Less," Target seeks to build an up-market cachet for its brand without losing price-conscious consumers. It introduced a line of products from world-renowned designers such as Michael Graves, Isaac Mizrahi, Mossimo Giannulli, and Liz Lange and has kept innovating with its merchandising model. In 2006, it introduced U.S. consumers to the concept of "fast fashion," already popular in Europe, to help keep the product selection fresh, which in turn led to more frequent shopper visits.[31]

As part of its "cheap chic" retail strategy, Target sells products from famous designers, such as the Harlem Design Series from New York fashion visionary Stephen Burrows.

Most retailers will put low prices on some items to serve as traffic builders or loss leaders or to signal their pricing policies.[32] They will run storewide sales. They will plan markdowns on slower-moving merchandise. Shoe retailers, for example, expect to sell 50 percent of their shoes at the normal markup, 25 percent at a 40 percent markup, and the remaining 25 percent at cost.

As Chapter 14 noted, some retailers such as Walmart have abandoned "sales pricing" in favor of everyday low pricing (EDLP). EDLP can lead to lower advertising costs, greater pricing stability, a stronger image of fairness and reliability, and higher retail profits. Supermarket chains practicing everyday low pricing can be more profitable than those practicing high–low sale pricing, but only in certain circumstances.[33]

SERVICES Retailers must decide on the *services mix* to offer customers:

- ***Prepurchase services*** include accepting telephone and mail orders, advertising, window and interior display, fitting rooms, shopping hours, fashion shows, and trade-ins.
- ***Postpurchase services*** include shipping and delivery, gift wrapping, adjustments and returns, alterations and tailoring, installations, and engraving.
- ***Ancillary services*** include general information, check cashing, parking, restaurants, repairs, interior decorating, credit, rest rooms, and baby-attendant service.

Another differentiator is unerringly reliable customer service, whether face-to-face, across phone lines, or via online chat. Barnes & Noble hires clean-cut people with a passion for customer service and a general love of books; Borders employees are more likely to be tattooed or have multiple body piercings. The company prides itself on the diversity of its employees and hires people who radiate excitement about particular books and music, rather than simply finding a book for a customer.[34]

Whatever retailers do to enhance customer service, they must keep women in mind. Approximately 85 percent of everything sold in the United States is bought or influenced by a woman, and women are fed up with the decline in customer service. They are finding every possible way to get around the system, from ordering online to resisting fake sales to just doing without.[35] And when they do shop, they want well-organized layouts, helpful staff, and speedy checkouts.[36]

STORE ATMOSPHERE *Atmosphere* is another element in the store arsenal. Every store has a look, and a physical layout that makes it hard or easy to move around (see "Marketing Memo: Helping Stores to Sell"). Kohl's floor plan is modeled after a racetrack loop and is designed to convey customers smoothly past all the merchandise in the store. It includes a middle aisle that hurried shoppers can use as a shortcut and yields higher spending levels than many competitors.[37]

Retailers must consider all the senses in shaping the customer's experience. Varying the tempo of music affects average time and dollars spent in the supermarket. Sony Style stores are seasoned with a subtle vanilla and mandarin orange fragrance, and every surface, from countertops to paneling, is designed to be touchable. Bloomingdale's uses different essences in different departments: baby powder in the baby store; suntan lotion in the bathing suit area; lilacs in lingerie; and cinnamon and pine scent during the holiday season.[38]

STORE ACTIVITIES AND EXPERIENCES The growth of e-commerce has forced traditional brick-and-mortar retailers to respond. In addition to their natural advantages, such as products that shoppers can actually see, touch, and test; real-life customer service; and no delivery lag time for most purchases, stores also provide a shopping experience as a strong differentiator.[39]

The store atmosphere should match shoppers' basic motivations — if customers are likely to be in a task-oriented and functional mindset, then a simpler, more restrained in-store environment may be better.[40] On the other hand, some retailers of experiential products are creating in-store entertainment to attract customers who want fun and excitement.[41] REI, seller of outdoor gear and clothing products, allows consumers to test climbing equipment on 25-foot or even 65-foot walls in the store and to try GORE-TEX raincoats under a simulated rain shower. Bass Pro Shops, a retailer of outdoor sports equipment, features giant aquariums, waterfalls, trout ponds, archery and rifle ranges, fly-tying demonstrations and some with an outdoor pond to test equipment, indoor driving range and putting greens, and classes in everything from ice fishing to conservation—all free. Its first and largest showroom in Missouri is the number one tourist destination in the state.

Bass Pro Shops sells its outdoor sports equipment in an experiential retail environment conducive to product demos and tests.

marketing Memo: Helping Stores to Sell

In pursuit of higher sales volume, retailers are studying their store environments for ways to improve the shopper experience. Paco Underhill is managing director of the retail consultant Envirosell, whose clients include McDonald's, Starbucks, Estée Lauder, Blockbuster, Citibank, Gap, Burger King, CVS, and Wells Fargo. Using a combination of in-store video recording and observation, Underhill and his colleagues study 50,000 people each year as they shop. He offers the following advice for fine-tuning retail space:

- *Attract shoppers and keep them in the store.* The amount of time shoppers spend in a store is perhaps the single most important factor in determining how much they buy. To increase shopping time, give shoppers a sense of community; recognize them in some way; give them ways to deal with their accessories, such as chairs in convenient locations for boyfriends, husbands, children, or bags; and make the environment both familiar and fresh each time they come in.
- *Honor the "transition zone."* On entering a store, people need to slow down and sort out the stimuli, which means they will likely be moving too fast to respond positively to signs, merchandise, or sales clerks in the zone they cross before making that transition. Make sure there are clear sight lines. Create a focal point for information within the store. Most right-handed people turn right upon entering a store.
- *Avoid overdesign.* Store fixtures, point-of-sales information, packaging, signage, and flat-screen televisions can combine to create a visual cacophony. Use crisp and clear signage—"Our Best Seller" or "Our Best Student Computer"—where people feel comfortable stopping and facing the right way. Window signs, displays, and mannequins communicate best when angled 10 to 15 degrees to face the direction that people are moving.
- *Don't make them hunt.* Put the most popular products up front to reward busy shoppers and encourage leisurely shoppers to look more. At Staples, ink cartridges are one of the first products shoppers encounter after entering.
- *Make merchandise available to the reach and touch.* It is hard to overemphasize the importance of customers' hands. A store can offer the finest, cheapest, sexiest goods, but if the shopper cannot reach or pick them up, much of their appeal can be lost.
- *Make kids welcome.* If kids feel welcome, parents will follow. Take a three-year-old's perspective and make sure there are engaging sights at eye level. A virtual hopscotch pattern or dinosaur on the floor can turn a boring shopping trip for a child into a friendly experience.
- *Note that men do not ask questions.* Men always move faster than women do through a store's aisles. In many settings, it is hard to get them to look at anything they had not intended to buy. Men also do not like asking where things are. If a man cannot find the section he is looking for, he will wheel about once or twice, then leave the store without ever asking for help.
- *Remember women need space.* A shopper, especially a woman, is far less likely to buy an item if her derriere is brushed, even lightly, by another customer when she is looking at a display. Keeping aisles wide and clear is crucial.
- *Make checkout easy.* Be sure to have the right high-margin goods near cash registers to satisfy impulse shoppers. People love to buy candy when they check out—so satisfy their sweet tooth.

Sources: Paco Underhill, *Call of the Mall: The Geography of Shopping* (New York: Simon & Schuster, 2004); Paco Underhill, *Why We Buy: The Science of Shopping* (New York: Simon & Schuster, 1999). See also, Kenneth Hein, "Shopping Guru Sees Death of Detergent Aisle," *Brandweek*, March 27, 2006, p. 11; Bob Parks, "5 Rules of Great Design," *Business 2.0* (March 2003): 47–49; Russell Boniface, "I Spy a Shopper!" *AIArchitect*, June 2006; Susan Berfield, "Getting the Most Out of Every Shopper, *BusinessWeek*, February 9, 2009, pp. 45–46; www.envirosell.com.

COMMUNICATIONS Retailers use a wide range of communication tools to generate traffic and purchases. They place ads, run special sales, issue money-saving coupons, and run frequent-shopper-reward programs, in-store food sampling, and coupons on shelves or at checkout points. They work with manufacturers to design point-of-sale materials that reflect both their images.[42] Upscale retailers place tasteful, full-page ads in magazines such as *Vogue, Vanity Fair,* or *Esquire* and carefully train salespeople to greet customers, interpret their needs, and handle complaints. Off-price retailers will arrange their merchandise to promote bargains and savings, while conserving on service and sales assistance. Retailers are also using interactive and social media to pass on information and create communities around their brands.[43] Casual dining chain Houlihan's created a social network site, HQ, to gain honest, immediate feedback from 10,500 invitation-only "Houlifan" customers in return for insider information.

LOCATION The three keys to retail success are often said to be "location, location, and location." Department store chains, oil companies, and fast-food franchisers exercise great care in selecting regions of the country in which to open outlets, then particular cities, and then particular sites. Retailers can place their stores in the following locations:

- ***Central business districts.*** The oldest and most heavily trafficked city areas, often known as "downtown"

- ***Regional shopping centers.*** Large suburban malls containing 40 to 200 stores, typically featuring one or two nationally known anchor stores, such as Macy's or Lord & Taylor or a combination of big-box stores such as PETCO, Payless Shoes, Borders, or Bed Bath & Beyond, and a great number of smaller stores, many under franchise operation[44]
- ***Community shopping centers.*** Smaller malls with one anchor store and 20 to 40 smaller stores
- ***Shopping strips.*** A cluster of stores, usually in one long building, serving a neighborhood's needs for groceries, hardware, laundry, shoe repair, and dry cleaning
- ***A location within a larger store.*** Certain well-known retailers—McDonald's, Starbucks, Nathan's, Dunkin' Donuts—locate new, smaller units as concession space within larger stores or operations, such as airports, schools, or department stores.
- ***Stand-alone stores.*** Some retailers such as Kohl's and JCPenney are avoiding malls and shopping centers to locate new stores in free-standing sites on streets, so they are not connected directly to other retail stores.

In view of the relationship between high traffic and high rents, retailers must decide on the most advantageous locations for their outlets, using traffic counts, surveys of consumer shopping habits, and analysis of competitive locations.

Private Labels

A **private label brand** (also called a reseller, store, house, or distributor brand) is a brand that retailers and wholesalers develop. Benetton, The Body Shop, and Marks & Spencer carry mostly own-brand merchandise. In grocery stores in Europe and Canada, store brands account for as much as 40 percent of the items sold. In Britain, the largest food chains, roughly half of what Sainsbury and Tesco sell is store-label goods.

For many manufacturers, retailers are both collaborators and competitors. According to the Private Label Manufacturers' Association, store brands now account for one of every four items sold in U.S. supermarkets, drug chains, and mass merchandisers, up from 19 percent in 1999. In one study, seven of ten shoppers believed the private label products they bought were as good as, if not better than, their national brand. Setting aside beverages, private labels account for roughly 30 percent of all food served in U.S. homes, and virtually every household purchases private label brands from time to time.[45]

Private labels are rapidly gaining ascendance in a way that has many manufacturers of name brands running scared. Some experts believe though that 50 percent is the natural limit for volume of private labels to carry because (1) consumers prefer certain national brands, and (2) many product categories are not feasible or attractive on a private-label basis.[46] Table 16.4 displays the product categories that have the highest private-label sales.

TABLE 16.4 Top 10 Private Label Categories–2009 (billions of dollars)
• Milk ($8.1)
• Bread & Baked Good ($4.2)
• Cheese ($3.5)
• Medications/Remedies/Vitamins ($3.4)
• Paper Products ($2.6)
• Eggs—Fresh ($1.9)
• Fresh Produce ($1.5)
• Packaged Meat ($1.5)
• Pet Food ($1.5)
• Unprepared Meat/Frozen Seafood ($1.4)

Source: Data from www.privatelabelmag.com. December 9, 2010. Used with permission.

Role of Private Labels

Why do intermediaries sponsor their own brands?[47] First, these brands can be more profitable. Intermediaries search for manufacturers with excess capacity that will produce private label goods at low cost. Other costs, such as research and development, advertising, sales promotion, and physical distribution, are also much lower, so private labels can generate a higher profit margin. Retailers also develop exclusive store brands to differentiate themselves from competitors. Many price-sensitive consumers prefer store brands in certain categories. These preferences give retailers increased bargaining power with marketers of national brands.

Private label or store brands should be distinguished from generics. **Generics** are unbranded, plainly packaged, less expensive versions of common products such as spaghetti, paper towels, and canned peaches. They offer standard or lower quality at a price that may be as much as 20 percent to 40 percent lower than nationally advertised brands and 10 percent to 20 percent lower than the retailer's private-label brands. The lower price is made possible by lower-cost labeling and packaging and minimal advertising, and sometimes lower-quality ingredients. Generics can be found in a wide range of different products, even medicines.

Generic Drugs Generic drugs have become big business. Branded drug sales actually declined for the first time in 2009. By making knockoffs faster and in larger quantities, Israel's Teva has become the world's biggest generic drugmaker, with revenue of $14 billion. Pharma giant Novartis is one of the world's top five makers of branded drugs, with such successes as Diovan for high blood pressure and Gleevec for cancer, but it has also become the world's second-largest maker of generic drugs following its acquisition of Sandoz, HEXAL, Eon Labs, and others. Other pharmaceutical companies such as Sanofi-Aventis and GlaxoSmithKline have entered the generic drug market not in the United States but in emerging markets in Eastern Europe, Latin America, and Asia, where some consumers cannot afford expensive brand-name drugs but worry about counterfeit or low-quality drugs. These consumers are willing to pay at least a small premium for a drug backed by a trusted company.[48]

Generic drugs have become big business as a means to lower health care costs.

Private-Label Success Factors

In the confrontation between manufacturers' and private labels, retailers have many advantages and increasing market power.[49] Because shelf space is scarce, many supermarkets charge a *slotting fee* for accepting a new brand, to cover the cost of listing and stocking it. Retailers also charge for special display space and in-store advertising space. They typically give more prominent display to their own brands and make sure they are well stocked.

Retailers are building better quality into their store brands. Supermarket retailers are adding premium store-brand items like organics or creating new products without direct competition, such as three-minute microwaveable snack pizzas. They are also emphasizing attractive, innovative packaging. Some are even advertising aggressively: Safeway ran a $100 million integrated communication program that featured TV and print ads, touting the store brand's quality.[50]

Loblaw Since 1984, when its President's Choice line of foods made its debut, the term *private label* has brought Loblaw instantly to mind. Toronto-based Loblaw's Decadent Chocolate Chip Cookie quickly became a Canadian leader and showed how innovative store brands could compete effectively with national brands by matching or even exceeding their quality. A finely tuned brand strategy for its premium President's Choice line and its no-frills, yellow-labeled No Name line (which the company relaunched with a vengeance during the recent recession) has helped differentiate its stores and built Loblaw into a powerhouse in Canada and the United States. The President's Choice line of products has become so successful that Loblaw is licensing it to noncompetitive retailers in other countries. In 2010, Loblaw introduced a new tier of low-priced store brands, priced slightly above the No Name line, to be made available at its chain of 175 No Frills "hard discount" grocery stores.[51]

Marketing Insight

Manufacturer's Response to the Private Label Threat

To maintain their marketplace power, leading brand marketers are investing significantly in R&D to bring out new brands, line extensions, features, and quality improvements to stay a step ahead of the store brands. They are also investing in strong "pull" advertising programs to maintain high consumer brand recognition and preference and overcome the in-store marketing advantage that private labels can enjoy. Top-brand marketers also are seeking to partner with major mass distributors in a joint search for logistical economies and competitive strategies that produce savings for both sides. Cutting all unnecessary costs allows national brands to command a price premium, although it can't exceed the value perceptions of consumers.

University of North Carolina's Jan-Benedict E. M. Steenkamp and London Business School's Nirmalya Kumar offer four strategic recommendations for manufacturers to compete against or collaborate with private labels.

- *Fight selectively* where manufacturers can win against private labels and add value for consumers, retailers, and shareholders. This is typically where the brand is one or two in the category or occupying a premium niche position. Procter & Gamble rationalized its portfolio, selling off various brands such as Sunny Delight juice drink, Jif peanut butter, and Crisco shortening, in part so it could concentrate on strengthening its 20+ brands with more than $1 billion in sales.
- *Partner effectively* by seeking win-win relationships with retailers through strategies that complement the retailer's private labels. Estée Lauder created four brands (American Beauty, Flirt, Good Skin, and Grassroots) exclusively for Kohl's, to help the retailer generate volume and protect its more prestigious brands in the process. Manufacturers selling through hard discounters such as Lidl and Aldi have increased sales by finding new customers who have not previously bought the brand.
- *Innovate brilliantly* with new products to help beat private labels. Continuously launching incremental new products keeps the manufacturer brands looking fresh, but the firm must also periodically launch radical new products and protect the intellectual property of all brands. Kraft doubled its number of patent lawyers to make sure its innovations were legally protected as much as possible.
- *Create winning value propositions* by imbuing brands with symbolic imagery as well as functional quality that beats private labels. Too many manufacturer brands have let private labels equal and sometimes better them on functional quality. In addition, to have a winning value proposition, marketers need to monitor pricing and ensure that perceived benefits equal the price premium.

Sources: James A. Narus and James C. Anderson, "Contributing as a Distributor to Partnerships with Manufacturers," *Business Horizons* (September–October 1987); Nirmalya Kumar and Jan-Benedict E. M. Steenkamp, *Private Label Strategy: How to Meet the Store-Brand Challenge* (Boston: Harvard Business School Press, 2007); Nirmalya Kumar, "The Right Way to Fight for Shelf Domination," *Advertising Age*, January 22, 2007; Jan-Benedict E. M. Steenkamp and Nirmalya Kumar, "Don't Be Undersold, *Harvard Business Review*, December 2009, p. 91.

Although retailers get credit for the success of private labels, the growing power of store brands has also benefited from the weakening of national brands. Many consumers have become more price sensitive, a trend reinforced by the continuous barrage of coupons and price specials that has trained a generation to buy on price. Competing manufacturers and national retailers copy and duplicate the quality and features of the best brands in a category, reducing physical product differentiation. Moreover, by cutting marketing communication budgets, some firms have made it harder to create any intangible differences in brand image. A steady stream of brand extensions and line extensions has blurred brand identity at times and led to a confusing amount of product proliferation.

Bucking these trends, many manufacturers or national brands are fighting back. "Marketing Insight: Manufacturer's Respond to the Private Label Threat," describes the strategies and tactics being taken to compete more effectively with private labels.

Wholesaling

Wholesaling includes all the activities in selling goods or services to those who buy for resale or business use. It excludes manufacturers and farmers because they are engaged primarily in production, and it excludes retailers. The major types of wholesalers are described in Table 16.5.

Wholesalers (also called *distributors*) differ from retailers in a number of ways. First, wholesalers pay less attention to promotion, atmosphere, and location because they are dealing with business customers rather than final consumers. Second, wholesale transactions are usually larger than retail

TABLE 16.5	Major Wholesaler Types
Merchant wholesalers: Independently owned businesses that take title to the merchandise they handle. They are full-service and limited-service jobbers, distributors, and mill supply houses.	
Full-service wholesalers: Carry stock, maintain a sales force, offer credit, make deliveries, provide management assistance. Wholesale merchants sell primarily to retailers: Some carry several merchandise lines, some carry one or two lines, others carry only part of a line. Industrial distributors sell to manufacturers and also provide services such as credit and delivery.	
Limited-service wholesalers: *Cash and carry wholesalers* sell a limited line of fast-moving goods to small retailers for cash. *Truck wholesalers* sell and deliver a limited line of semiperishable goods to supermarkets, grocery stores, hospitals, restaurants, hotels. *Drop shippers* serve bulk industries such as coal, lumber, and heavy equipment. They assume title and risk from the time an order is accepted to its delivery. *Rack jobbers* serve grocery retailers in nonfood items. Delivery people set up displays, price goods, and keep inventory records; they retain title to goods and bill retailers only for goods sold to the end of the year. *Producers' cooperatives* assemble farm produce to sell in local markets. *Mail-order wholesalers* send catalogs to retail, industrial, and institutional customers; orders are filled and sent by mail, rail, plane, or truck.	
Brokers and agents: Facilitate buying and selling, on commission of 2 percent to 6 percent of the selling price; limited functions; generally specialize by product line or customer type. *Brokers* bring buyers and sellers together and assist in negotiation; they are paid by the party hiring them—food brokers, real estate brokers, insurance brokers. *Agents* represent buyers or sellers on a more permanent basis. Most manufacturers' agents are small businesses with a few skilled salespeople: Selling agents have contractual authority to sell a manufacturer's entire output; purchasing agents make purchases for buyers and often receive, inspect, warehouse, and ship merchandise; commission merchants take physical possession of products and negotiate sales.	
Manufacturers' and retailers' branches and offices: Wholesaling operations conducted by sellers or buyers themselves rather than through independent wholesalers. Separate branches and offices are dedicated to sales or purchasing. Many retailers set up purchasing offices in major market centers.	
Specialized wholesalers: Agricultural assemblers (buy the agricultural output of many farms), petroleum bulk plants and terminals (consolidate the output of many wells), and auction companies (auction cars, equipment, etc., to dealers and other businesses).	

transactions, and wholesalers usually cover a larger trade area than retailers. Third, the government deals with wholesalers and retailers differently in terms of legal regulations and taxes.

Why do manufacturers not sell directly to retailers or final consumers? Why are wholesalers used at all? In general, wholesalers are more efficient in performing one or more of the following functions:

- ***Selling and promoting.*** Wholesalers' sales forces help manufacturers reach many small business customers at a relatively low cost. They have more contacts, and buyers often trust them more than they trust a distant manufacturer.
- ***Buying and assortment building.*** Wholesalers are able to select items and build the assortments their customers need, saving them considerable work.
- ***Bulk breaking.*** Wholesalers achieve savings for their customers by buying large carload lots and breaking the bulk into smaller units.
- ***Warehousing.*** Wholesalers hold inventories, thereby reducing inventory costs and risks to suppliers and customers.
- ***Transportation.*** Wholesalers can often provide quicker delivery to buyers because they are closer to the buyers.
- ***Financing.*** Wholesalers finance customers by granting credit, and finance suppliers by ordering early and paying bills on time.
- ***Risk bearing.*** Wholesalers absorb some risk by taking title and bearing the cost of theft, damage, spoilage, and obsolescence.
- ***Market information.*** Wholesalers supply information to suppliers and customers regarding competitors' activities, new products, price developments, and so on.

- ***Management services and counseling.*** Wholesalers often help retailers improve their operations by training sales clerks, helping with store layouts and displays, and setting up accounting and inventory-control systems. They may help industrial customers by offering training and technical services.

Trends in Wholesaling

Wholesaler-distributors have faced mounting pressures in recent years from new sources of competition, demanding customers, new technologies, and more direct-buying programs by large industrial, institutional, and retail buyers. Manufacturers' major complaints against wholesalers are: They don't aggressively promote the manufacturer's product line and they act more like order takers; they don't carry enough inventory and therefore don't fill customers' orders fast enough; they don't supply the manufacturer with up-to-date market, customer, and competitive information; they don't attract high-caliber managers to bring down their own costs; and they charge too much for their services.

Savvy wholesalers have rallied to the challenge and adapted their services to meet their suppliers' and target customers' changing needs. They recognize that they must add value to the channel.

Arrow Electronics

Arrow Electronics

Arrow Electronics is a global provider of products, services, and solutions to the electronic component and computer product industries. It serves as a supply channel partner for more than 900 suppliers and 125,000 original equipment manufacturers, contract manufacturers, and commercial customers through a global network of 310 locations in 51 countries and territories. With huge contract manufacturers buying more parts directly from suppliers, distributors such as Arrow are being squeezed out. To better compete, Arrow has embraced services, providing financing, on-site inventory management, parts-tracking software, and chip programming. Services helped quadruple Arrow's share price in five years, and the company approached $15 billion in sales in 2009.[52]

Wholesalers have worked to increase asset productivity by managing inventories and receivables better. They're also reducing operating costs by investing in more advanced materials-handling technology, information systems, and the Internet. Finally, they're improving their strategic decisions about target markets, product assortment and services, price, communications, and distribution.

Narus and Anderson interviewed leading industrial distributors and identified four ways they strengthened their relationships with manufacturers:

1. They sought a clear agreement with their manufacturers about their expected functions in the marketing channel.
2. They gained insight into the manufacturers' requirements by visiting their plants and attending manufacturer association conventions and trade shows.
3. They fulfilled their commitments to the manufacturer by meeting the volume targets, paying bills promptly, and feeding back customer information to their manufacturers.
4. They identified and offered value-added services to help their suppliers.[53]

The wholesaling industry remains vulnerable to one of the most enduring trends—fierce resistance to price increases and the winnowing out of suppliers based on cost and quality. The trend toward vertical integration, in which manufacturers try to control or own their intermediaries, is still strong. One firm that succeeds in the wholesaling business is W.W. Grainger.

W.W. Grainger

W.W. Grainger

W.W. Grainger is the leading supplier of facilities maintenance products that help 1.8 million businesses and institutions stay up and running. Sales for 2008 were $6.9 billion. Grainger serves customers through a network of over 600 branches in North America and China, 18 distribution centers, numerous catalogs and direct-mail pieces, and four Web sites to guarantee product availability and quick service. Its 4,000-plus-page catalog features 138,000 products, such as motors, lighting, material handlers, fasteners, tools, and safety supplies, and customers can purchase over 300,000 products at Grainger.com. The distribution centers are linked by satellite network, which has reduced customer-response time and boosted sales. Helped by more than 3,000 suppliers, Grainger offers customers a total of more than 900,000 supplies and repair parts in all.[54]

Market Logistics

Physical distribution starts at the factory. Managers choose a set of warehouses (stocking points) and transportation carriers that will deliver the goods to final destinations in the desired time or at the lowest total cost. Physical distribution has now been expanded into the broader concept of **supply chain management (SCM).** Supply chain management starts before physical distribution and means strategically procuring the right inputs (raw materials, components, and capital equipment), converting them efficiently into finished products, and dispatching them to the final destinations. An even broader perspective looks at how the company's suppliers themselves obtain their inputs.

The supply chain perspective can help a company identify superior suppliers and distributors and help them improve productivity and reduce costs. Consumer goods manufacturers admired for their supply chain management include P&G, Kraft, General Mills, PepsiCo, and Nestlé; noteworthy retailers include Walmart, Target, Publix, Costco, Kroger, and Meijer.[55]

Firms are also striving to improve the environmental impact and sustainability of their supply chain by shrinking their carbon footprint and using recyclable packaging. Johnson & Johnson switched to Forest Stewardship Council (FSC)–certified paperboard for its BAND-AID brand boxes. As one executive noted, "Johnson & Johnson and its operating companies are positioned to make paper and packaging procurement decisions that could help influence responsible forest management."[56]

Market logistics includes planning the infrastructure to meet demand, then implementing and controlling the physical flows of materials and final goods from points of origin to points of use, to meet customer requirements at a profit. Market logistics planning has four steps:[57]

1. Deciding on the company's value proposition to its customers. (What on-time delivery standard should we offer? What levels should we attain in ordering and billing accuracy?)
2. Selecting the best channel design and network strategy for reaching the customers. (Should the company serve customers directly or through intermediaries? What products should we source from which manufacturing facilities? How many warehouses should we maintain and where should we locate them?)
3. Developing operational excellence in sales forecasting, warehouse management, transportation management, and materials management
4. Implementing the solution with the best information systems, equipment, policies, and procedures

Studying market logistics leads managers to find the most efficient way to deliver value. For example, a software company might traditionally produce and package software disks and manuals, ship them to wholesalers, which ship them to retailers, which sell them to customers, who bring them home to download onto their PCs. Market logistics offers two superior delivery systems. The first lets the customer download the software directly onto his or her computer. The second allows the computer manufacturer to download the software onto its products. Both solutions eliminate the need for printing, packaging, shipping, and stocking millions of disks and manuals.

Integrated Logistics Systems

The market logistics task calls for **integrated logistics systems (ILS),** which include materials management, material flow systems, and physical distribution, aided by information technology (IT). Information systems play a critical role in managing market logistics, especially via computers, point-of-sale terminals, uniform product bar codes, satellite tracking, electronic data interchange (EDI), and electronic funds transfer (EFT). These developments have shortened the order-cycle time, reduced clerical labor, reduced errors, and provided improved control of operations. They have enabled companies to promise "the product will be at dock 25 at 10:00 AM tomorrow," and deliver on that promise.

Market logistics encompass several activities. The first is sales forecasting, on the basis of which the company schedules distribution, production, and inventory levels. Production plans indicate the materials the purchasing department must order. These materials arrive through inbound transportation, enter the receiving area, and are stored in raw-material inventory. Raw materials are converted into finished goods. Finished-goods inventory is the link between customer orders and manufacturing activity. Customers' orders draw down the finished-goods inventory level, and manufacturing activity builds it up. Finished goods flow off the assembly line and pass through packaging, in-plant warehousing, shipping-room processing, outbound transportation, field warehousing, and customer delivery and servicing.

Management has become concerned about the total cost of market logistics, which can amount to as much as 30 percent to 40 percent of the product's cost. In the U.S. grocery business, waste or "shrink" affects 8 percent to 10 percent of perishable goods, costing $20 billion annually. To reduce shrink, grocery retailer Stop & Shop looked across its entire fresh-food supply chain and reduced everything from the size of suppliers' boxes to the number of products on display. With these changes, the supermarket chain cut shrink by almost a third, saving over $50 million and eliminating 36,000 pounds of rotten food, improving customer satisfaction at the same time.[58]

Many experts call market logistics "the last frontier for cost economies," and firms are determined to wring every unnecessary cost out of the system: In 1982, logistics represented 14.5 percent of U.S. GDP; by 2007, the share had dropped to about 10 percent.[59] Lower market-logistics costs will permit lower prices, yield higher profit margins, or both. Even though the cost of market logistics can be high, a well-planned program can be a potent tool in competitive marketing.

Many firms are embracing **lean manufacturing,** originally pioneered by Japanese firms such as Toyota, to produce goods with minimal waste of time, materials, and money. CONMED's disposable devices are used by a hospital somewhere in the world every 90 seconds to insert and remove fluid around joints during orthoscopic surgery,

ConMed To streamline production, medical manufacturer ConMed set out to link its operations as closely as possible to the ultimate buyer of its products. Rather than moving manufacturing to China, which might have lowered labor costs but could have also risked long lead times, inventory buildup, and unanticipated delays, the firm put new production processes into place to assemble its disposable products only after hospitals placed orders. Some 80 percent of orders were predictable enough that demand forecasts updated every few months could set hourly production targets. As proof of the firm's new efficiency, the assembly area for fluid-injection devices went from covering 3,300 square feet and stocking $93,000 worth of parts to 650 square feet and $6,000 worth of parts. Output per worker increased 21 percent.[60]

By redesigning its production assembly, medical manufacturer ConMed significantly increased productivity.

Lean manufacturing must be implemented thoughtfully and monitored closely. Toyota's recent crisis in product safety that resulted in extensive product recalls has been attributed in part to the fact that some aspects of the lean manufacturing approach—eliminating overlap by using common parts and designs across multiple product lines, and reducing the number of suppliers to procure parts in greater scale—can backfire when quality-control issues arise.[61]

Market-Logistics Objectives

Many companies state their market-logistics objective as "getting the right goods to the right places at the right time for the least cost." Unfortunately, this objective provides little practical guidance. No system can simultaneously maximize customer service and minimize distribution cost. Maximum customer service implies large inventories, premium transportation, and multiple warehouses, all of which raise market-logistics costs.

Nor can a company achieve market-logistics efficiency by asking each market-logistics manager to minimize his or her own logistics costs. Market-logistics costs interact and are often negatively related. For example:

- The traffic manager favors rail shipment over air shipment because rail costs less. However, because the railroads are slower, rail shipment ties up working capital longer, delays customer payment, and might cause customers to buy from competitors who offer faster service.
- The shipping department uses cheap containers to minimize shipping costs. Cheaper containers lead to a higher rate of damaged goods and customer ill will.
- The inventory manager favors low inventories. This increases stock-outs, back orders, paperwork, special production runs, and high-cost, fast-freight shipments.

Given that market-logistics activities require strong trade-offs, managers must make decisions on a total-system basis. The starting point is to study what customers require and what competitors are offering. Customers are interested in on-time delivery, supplier willingness to meet emergency needs, careful handling of merchandise, and supplier willingness to take back defective goods and resupply them quickly.

The company must then research the relative importance of these service outputs. For example, service-repair time is very important to buyers of copying equipment. Xerox developed a service delivery standard that "can put a disabled machine anywhere in the continental United States back into operation within three hours after receiving the service request." It then designed a service division of personnel, parts, and locations to deliver on this promise.

The company must also consider competitors' service standards. It will normally want to match or exceed the competitors' service level, but the objective is to maximize profits, not sales. Some companies offer less service and charge a lower price; other companies offer more service and charge a premium price.

The company ultimately must establish some promise it makes to the market. Coca-Cola wants to "put Coke within an arm's length of desire." Lands' End, the giant clothing retailer, aims to respond to every phone call within 20 seconds and to ship every order within 24 hours of receipt. Some companies define standards for each service factor. One appliance manufacturer has established the following service standards: to deliver at least 95 percent of the dealer's orders within seven days of order receipt, to fill them with 99 percent accuracy, to answer dealer inquiries on order status within three hours, and to ensure that merchandise damaged in transit does not exceed 1 percent.

Given the market-logistics objectives, the company must design a system that will minimize the cost of achieving these objectives. Each possible market-logistics system will lead to the following cost:

$$M = T + FW + VW + S$$

where M = total market-logistics cost of proposed system

T = total freight cost of proposed system

FW = total fixed warehouse cost of proposed system

VW = total variable warehouse costs (including inventory) of proposed system

S = total cost of lost sales due to average delivery delay under proposed system

Choosing a market-logistics system calls for examining the total cost *(M)* associated with different proposed systems and selecting the system that minimizes it. If it is hard to measure S, the company should aim to minimize $T + FW + VW$ for a target level of customer service.

Market-Logistics Decisions

The firm must make four major decisions about its market logistics: (1) How should we handle orders (order processing)? (2) Where should we locate our stock (warehousing)? (3) How much stock should we hold (inventory)? and (4) How should we ship goods (transportation)?

ORDER PROCESSING Most companies today are trying to shorten the *order-to-payment cycle*—that is, the elapsed time between an order's receipt, delivery, and payment. This cycle has many steps, including order transmission by the salesperson, order entry and customer credit check, inventory and production scheduling, order and invoice shipment, and receipt of payment. The longer this cycle takes, the lower the customer's satisfaction and the lower the company's profits.

WAREHOUSING Every company must store finished goods until they are sold, because production and consumption cycles rarely match. Consumer-packaged-goods companies have been reducing their number of stocking locations from 10 to 15 to about 5 to 7, and pharmaceutical and medical distributors have cut theirs from 90 to about 45. On the one hand, more stocking locations mean goods can be delivered to customers more quickly, but warehousing and inventory costs are higher. To reduce these costs, the company might centralize its inventory in one place and use fast transportation to fill orders.

Some inventory is kept at or near the plant, and the rest in warehouses in other locations. The company might own private warehouses and also rent space in public warehouses. *Storage warehouses* store goods for moderate to long periods of time. *Distribution warehouses* receive goods from various company plants and suppliers and move them out as soon as possible. *Automated warehouses* employ advanced materials-handling systems under the control of a central computer and are increasingly becoming the norm.

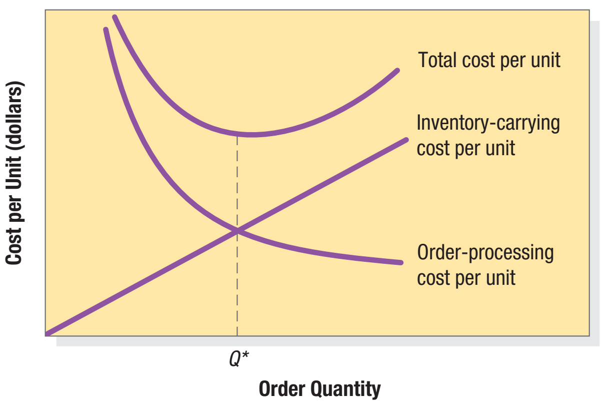
Some warehouses are now taking on activities formerly done in the plant. These include assembly, packaging, and constructing promotional displays. Postponing finalization of the offering to the warehouse can achieve savings in costs and finer matching of offerings to demand.

INVENTORY Salespeople would like their companies to carry enough stock to fill all customer orders immediately. However, this is not cost-effective. *Inventory cost increases at an accelerating rate as the customer-service level approaches 100 percent.* Management needs to know how much sales and profits would increase as a result of carrying larger inventories and promising faster order fulfillment times, and then make a decision.

As inventory draws down, management must know at what stock level to place a new order. This stock level is called the *order* (or *reorder*) *point.* An order point of 20 means reordering when the stock falls to 20 units. The order point should balance the risks of stock-out against the costs of overstock. The other decision is how much to order. The larger the quantity ordered, the less frequently an order needs to be placed. The company needs to balance order-processing costs and inventory-carrying costs. *Order-processing costs* for a manufacturer consist of *setup costs* and *running costs* (operating costs when production is running) for the item. If setup costs are low, the manufacturer can produce the item often, and the average cost per item is stable and equal to the running costs. If setup costs are high, however, the manufacturer can reduce the average cost per unit by producing a long run and carrying more inventory.

Order-processing costs must be compared with *inventory-carrying costs.* The larger the average stock carried, the higher the inventory-carrying costs. These carrying costs include storage charges, cost of capital, taxes and insurance, and depreciation and obsolescence. Carrying costs might run as high as 30 percent of inventory value. This means that marketing managers who want their companies to carry larger inventories need to show that the larger inventories would produce incremental gross profits to exceed incremental carrying costs.

We can determine the optimal order quantity by observing how order-processing costs and inventory-carrying costs sum up at different order levels. △ Figure 16.1 shows that the order-processing



|Fig. 16.1| △

Determining Optimal Order Quantity

cost per unit decreases with the number of units ordered because the order costs are spread over more units. Inventory-carrying charges per unit increase with the number of units ordered, because each unit remains longer in inventory. We sum the two cost curves vertically into a total-cost curve and project the lowest point of the total-cost curve on the horizontal axis to find the optimal order quantity Q^*.[62]

Companies are reducing their inventory costs by treating inventory items differently, positioning them according to risk and opportunity. They distinguish between bottleneck items (high risk, low opportunity), critical items (high risk, high opportunity), commodities (low risk, high opportunity), and nuisance items (low risk, low opportunity).[63] They are also keeping slow-moving items in a central location and carrying fast-moving items in warehouses closer to customers. All these strategies give them more flexibility should anything go wrong, as it often does, be it a dock strike in California, a typhoon in Taiwan, a tsunami in Asia, or a hurricane in New Orleans.[64]

The ultimate answer to carrying *near-zero inventory* is to build for order, not for stock. Sony calls it SOMO, "Sell one, make one." Dell's inventory strategy for years has been to get the customer to order a computer and pay for it in advance. Then Dell uses the customer's money to pay suppliers to ship the necessary components. As long as customers do not need the item immediately, everyone can save money. Some retailers are unloading excess inventory on eBay where, by cutting out the traditional liquidator middleman, they can make 60 to 80 cents on the dollar as opposed to 10 cents.[65] And some suppliers are snapping up excess inventory to create opportunity.

Cameron Hughes "If a winery has an eight-barrel lot, it may only use five barrels for its customers," says Cameron Hughes, a wine "négociant" who buys the excess juice from high-end wineries and wine brokers and combines it to make limited edition, premium blends that taste much more expensive than their price tags. Négociants have been around a long time, first as middlemen who sold or shipped wine as wholesalers, but the profession has expanded as opportunists such as Hughes became more involved in effectively making their own wines. Hughes doesn't own any grapes, bottling machines, or trucks. He outsources the bottling, and he sells directly to retailers such as Costco, Sam's Club, and Safeway, eliminating middlemen and multiple markups. Hughes never knows which or how many excess lots of wine he will have, but he's turned it to his advantage—he creates a new product with every batch. This rapid turnover is part of Costco's appeal for him. The discount store's customers love the idea of finding a rare bargain, and Hughes promotes his wines through in-store wine tastings and insider e-mails that alert Costco customers to upcoming numbered lots. Because lots sell out quickly, fans subscribe to Cameron's e-mail alerts at chwine.com that tell them when a new lot will be sold.[66]

Cameron Hughes has grown a thriving business by using excess lots of wine as input to his limited-edition premium wines.

TRANSPORTATION Transportation choices affect product pricing, on-time delivery performance, and the condition of the goods when they arrive, all of which affect customer satisfaction.

In shipping goods to its warehouses, dealers, and customers, the company can choose rail, air, truck, waterway, or pipeline. Shippers consider such criteria as speed, frequency, dependability, capability, availability, traceability, and cost. For speed, air, rail, and truck are the prime contenders. If the goal is low cost, then the choice is water or pipeline.

Shippers are increasingly combining two or more transportation modes, thanks to containerization. **Containerization** consists of putting the goods in boxes or trailers that are easy to transfer between two transportation modes. *Piggyback* describes the use of rail and trucks; *fishyback,* water and trucks; *trainship,* water and rail; and *airtruck,* air and trucks. Each coordinated mode offers specific advantages. For example, piggyback is cheaper than trucking alone yet provides flexibility and convenience.

Shippers can choose private, contract, or common carriers. If the shipper owns its own truck or air fleet, it becomes a *private carrier.* A *contract carrier* is an independent organization selling transportation services to others on a contract basis. A *common carrier* provides services between predetermined points on a scheduled basis and is available to all shippers at standard rates.

To reduce costly handing at arrival, some firms are putting items into shelf-ready packaging so they don't need to be unpacked from a box and placed on a shelf individually. In Europe, P&G uses a three-tier logistic system to schedule deliveries of fast- and slow-moving goods, bulky items, and small items in the most efficient way.[67] To reduce damage in shipping, the size, weight, and fragility of the item must be reflected in the crating technique used, the density of foam cushioning, etc.[68]

Organizational Lessons

Market-logistics strategies must be derived from business strategies, rather than solely from cost considerations. The logistics system must be information-intensive and establish electronic links among all the significant parties. Finally, the company should set its logistics goals to match or exceed competitors' service standards and should involve members of all relevant teams in the planning process.

Today's stronger demands for logistical support from large customers will increase suppliers' costs. Customers want more frequent deliveries so they don't have to carry as much inventory. They want shorter order-cycle times, which means suppliers must have high in-stock availability. Customers often want direct store delivery rather than shipments to distribution centers. They want mixed pallets rather than separate pallets. They want tighter promised delivery times. They may want custom packaging, price tagging, and display building.

Suppliers can't say "no" to many of these requests, but at least they can set up different logistical programs with different service levels and customer charges. Smart companies will adjust their offerings to each major customer's requirements. The company's trade group will set up *differentiated distribution* by offering different bundled service programs for different customers.

Summary

1. Retailing includes all the activities involved in selling goods or services directly to final consumers for personal, nonbusiness use. Retailers can be understood in terms of store retailing, nonstore retailing, and retail organizations.
2. Like products, retail-store types pass through stages of growth and decline. As existing stores offer more services to remain competitive, costs and prices go up, which opens the door to new retail forms that offer a mix of merchandise and services at lower prices. The major types of retail stores are specialty stores, department stores, supermarkets, convenience stores, discount stores, extreme value or hard-discount store, off-price retailers, superstores, and catalog showrooms.
3. Although most goods and services are sold through stores, nonstore retailing has been growing. The major types of nonstore retailing are direct selling (one-to-one selling, one-to-many party selling, and multilevel network marketing), direct marketing (which includes e-commerce and Internet retailing), automatic vending, and buying services.
4. Although many retail stores are independently owned, an increasing number are falling under some form of corporate retailing. Retail organizations achieve many economies of scale, greater purchasing power, wider brand recognition, and better-trained employees. The major types of corporate retailing are corporate chain stores, voluntary chains, retailer cooperatives, consumer cooperatives, franchise organizations, and merchandising conglomerates.
5. The retail environment has changed considerably in recent years; as new retail forms have emerged, intertype and store-based versus nonstore-based competition has increased, the rise of giant retailers has been matched by the decline of middle-market retailers, investment in technology and global expansion has grown, and shopper marketing inside stores has become a priority.
6. Like all marketers, retailers must prepare marketing plans that include decisions on target markets, channels, product assortment and procurement, prices, services, store atmosphere, store activities and experiences, communications, and location.
7. Wholesaling includes all the activities in selling goods or services to those who buy for resale or business use. Wholesalers can perform functions better and more cost-effectively than the manufacturer can. These functions include selling and promoting, buying and assortment building, bulk breaking, warehousing, transportation, financing, risk bearing, dissemination of market information, and provision of management services and consulting.
8. There are four types of wholesalers: merchant wholesalers; brokers and agents; manufacturers' and retailers' sales branches, sales offices, and purchasing offices; and miscellaneous wholesalers such as agricultural assemblers and auction companies.

9. Like retailers, wholesalers must decide on target markets, product assortment and services, price, promotion, and place. The most successful wholesalers are those who adapt their services to meet suppliers' and target customers' needs.
10. Producers of physical products and services must decide on market logistics—the best way to store and move goods and services to market destinations; to coordinate the activities of suppliers, purchasing agents, manufacturers, marketers, channel members, and customers. Major gains in logistical efficiency have come from advances in information technology.

Applications

Marketing Debate

Should National-Brand Manufacturers Also Supply Private-Label Brands?

Ralston-Purina, Borden, ConAgra, and Heinz have all admitted to supplying products—sometimes lower in quality—to be used for private labels. Other marketers, however, criticize this "if you can't beat them, join them" strategy, maintaining that these actions, if revealed, may create confusion or even reinforce a perception by consumers that all brands in a category are essentially the same.

Take a position: **Manufacturers should feel free to sell private labels as a source of revenue *versus* National manufacturers should never get involved with private labels.**

Marketing Discussion

Retail Customer Loyalty

Think of your favorite stores. What do they do that encourages your loyalty? What do you like about the in-store experience? What further improvements could they make?

Marketing Excellence

>>Zara

Spain's Zara has become Europe's leading apparel retailer, providing consumers with current, high fashion styles at reasonable prices. With over $8.7 billion in sales and more than 1,500 stores, the company's success has come from breaking virtually every traditional rule in the retailing industry.

The first Zara store opened in 1975. By the 1980s, Zara's founder, Amancio Ortega, was working with computer programmers to develop a new distribution model that would revolutionize the clothing industry. This new model takes several strategic steps to reduce the lead time from design to distribution to just two weeks—a significant difference from the industry average of six to nine months. As a result, the company makes approximately 20,000 different items a year, about triple what Gap or H&M make in a year. By reducing lead times to a fraction of its competitors, Zara has been able to provide "fast fashion" for its consumers at affordable prices. The company's success lies within four key strategic elements:

Design and Production. Zara employs hundreds of designers at its headquarters in Spain. Thus, new styles are constantly being created and put into production while others are tweaked with new colors or patterns. The firm enforces the speed at which it puts these designs into production by locating half its production facilities nearby in Spain, Portugal, and Morocco. Zara produces only a small quantity of each collection and is willing to experience occasional shortages to preserve an image of exclusivity. Clothes with a longer shelf life, like T-shirts, are outsourced to lower-cost suppliers in Asia and Turkey. With tight control on its manufacturing process, Zara can move more rapidly than any of its competitors and continues to deliver fresh styles to its stores every week.

Logistics. Zara distributes all its merchandise, regardless of origin, from Spain. Its distribution process is designed so that the time from receipt of an order to delivery in the store averages 24 hours in Europe and 48 hours in the United States and Asia. Having 50 percent of its production facilities nearby is key to the success of this model. All Zara stores receive new shipments twice a week, and the small quantities of each collection not only bring consumers back into Zara stores over and over but also entice them to make purchases more quickly. While an average shopper in Spain visits a high street (or main street) store three times a year, shoppers average 17 trips to Zara stores. Some Zara fans know exactly when new shipments arrive and show up early that day to be the first in line for the latest fashions. These practices keep sales strong throughout the year and help the company sell more products at full price—85 percent of its merchandise versus the industry average of 60 percent.

Customers. Everything revolves around Zara's customers. The retailer reacts to customers' changing needs, trends, and tastes with daily reports from Zara shop managers about which products and styles have sold and which haven't. With up to 70 percent of their salaries coming from commission, managers have a strong incentive to stay on top of things. Zara's designers don't have to predict what fashion trends will be in the future. They react to customer feedback—good and bad—and if something fails, the line is withdrawn immediately. Zara cuts its losses and the impact is minimal due to the low quantities of each style produced.

Stores. Zara has never run an advertising campaign. The stores, 90 percent of which it owns, are the key advertising element and are located in prestigious high-traffic locations around the world. Zara spends significant time and effort regularly changing store windows to help lure customers in. In comparison to other retailers, which spend 3 percent to 4 percent of revenues on big brand-building campaigns, Zara spends just 0.3 percent.

The company's success comes from having complete control over all the parts of its business—design, production, and distribution. Louis Vuitton's fashion director, Daniel Piette, described Zara as "possibly the most innovative and devastating retailer in the world." Now, as Zara continues to expand into new markets and countries, it risks losing some of its speed and will have to work hard to continue providing the same "newness"' all over the world that it does so well in Europe. It is also making a somewhat belated major push online that will need to work within its existing business model.

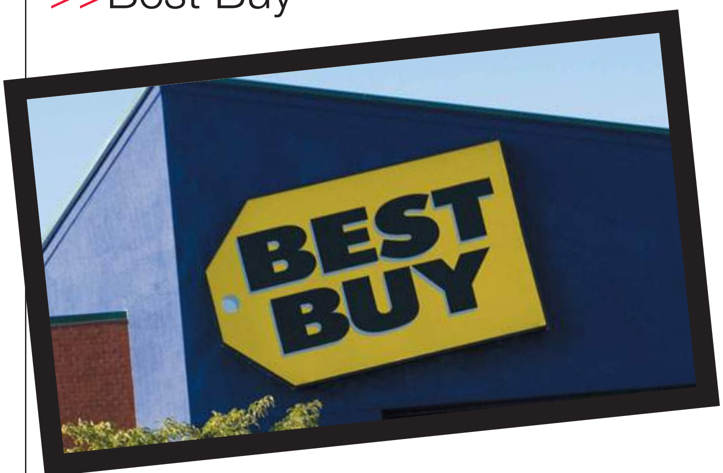
Questions

1. Would Zara's model work for other retailers? Why or why not?
2. How is Zara going to expand successfully all over the world with the same level of speed and instant fashion?

Sources: Rachel Tiplady, "Zara: Taking the Lead in Fast-Fashion." *BusinessWeek,* April 4, 2006; enotes.com, Inditex overview; "Zara: A Spanish Success Story." *CNN*, June 15, 2001; "Fashion Conquistador," *BusinessWeek,* September 4, 2006; Caroline Raux, "The Reign of Spain." *The Guardian,* October 28, 2002; Kerry Capell, "Zara Thrives by Breaking All the Rules," *BusinessWeek*, October 20, 2008, p. 66; Christopher Bjork, "Zara Is to Get Big Online Push," *Wall Street Journal*, September 17, 2009, p. B8.

Marketing Excellence

>>Best Buy



Best Buy is the world's largest consumer electronics retailer, with $34.2 billion in sales in fiscal 2009. Sales boomed in the 1980s as Best Buy expanded nationally and made some risky business decisions, like putting its sales staff on salary instead of commission pay. This decision created a more consumer-friendly, low-pressure shopping atmosphere and resulted in an instant spike in overall revenues. In the 1990s, Best Buy ramped up its computer product offerings and, by 1995, was the biggest seller of home PCs, a powerful position during the Internet boom.

At the turn of the century, Best Buy faced new competitors like Costco and Walmart, which started ramping up their electronics divisions and product offerings. Best Buy believed the best way to differentiate itself was to increase its focus on customer service by selling product warranties and offering personal services like installation and at-home delivery. Its purchase of Geek Squad, a

24-hour computer service company, proved extremely profitable and strategic as home and small office networks became more complex and the need for personal computing attention increased. By 2004, Best Buy had placed a Geek Squad station in each of its stores, providing consumers with personal computing services in the stores, online, on the phone, and at home.

Today, Best Buy has adopted a corporate strategy it calls Customer-Centricity. It has segmented its broad customer base into a handful of specific targets such as the affluent tech geek, the busy suburban mom, the young gadget enthusiast, and the price-conscious family dad. Next, it uses extensive research and analysis to determine which segments are the most abundant and lucrative in each market. Finally, it configures its stores and trains its employees to target those shoppers and encourage them to keep coming back again and again. For example, stores targeting affluent tech geeks have separate home theatre departments with knowledgeable salespeople who can spend time discussing all the different product options. Stores with a high volume of suburban mom shoppers offer personal shopping assistants to help mom get in and out as quickly as possible with the exact items she needs.

Sometimes a store will experience a new type of lucrative shopper. In the coastal town of Baytown, Texas, the local Best Buy observed frequent visits from Eastern European workers coming off cargo ships and oil tankers. These men and women were using their precious free time to race over to Best Buy and search the aisles for Apple's iPods and laptops, which are cheaper in the United States than in Europe. To cater to this unique consumer, the local Best Buy rearranged its store, moved iPods, MacBooks, and their accessories from the back of the store to the front, and added signage in simple English. The result: sales from these European workers increased 67 percent.

This local ingenuity paired with the ability to cater to each market and segment's needs have helped Best Buy survive the electronics storm while competitors like CompUSA and Circuit City have failed. The business is tough, with thin profit margins and continuously evolving products. However, with over 1,300 stores, including locations in Canada, Mexico, China, and Turkey, Best Buy has a 19 percent market share and a trusted, consumer-friendly brand.

Questions

1. What are the keys to Best Buy's success? What are the risks going forward?
2. How else can Best Buy compete against new competitors like Walmart and online companies?