

TABLE OF CONTENTS

1. Strategic Planning and Management in Retailing Program Runs for 50th Time in North America
2. The Evolution and Resurgence of Value Retailing

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PROGRAM SUMMARY

Strategic Planning and Management in Retailing Program Runs for 50th Time in North America.

The open enrollment version of the Strategic Planning and Management in Retailing Program ran for the 50th time in North America in May 2009. The program was conducted at Williamsburg, Virginia, at the Mason School of Business of The College of William and Mary. In addition, the program was offered for the 24th time in Australia later in May at the Cape Schanck Resort outside of Melbourne and sponsored by the Australian Centre for Retail Studies of Monash University. This program currently is offered twice in North America (at Babson and at William and Mary) and once in Australia.

The program is next scheduled to be offered September 12–18, 2009 at Babson College. Those interested are encouraged to apply early. To register, contact Susan Hartshorn at shartshorn@babson.edu, or at 781-239-2923.

The programs were kicked off with “The Eight Ways to Win in Retailing,” and, with slight differences from program to program, featured cases on Target Stores, Best Buy and Best Buy in 2005, Starbucks, Home Depot, Zara and Zara in 2007, and Meijer. In addition, the faculty delivered lectures and exercises on financial and productivity analysis, strategic thinking and planning, category scorecards, customer relationship management, customer and associate satisfaction, and supply chain management, including a simulation.

On Wednesday afternoon at the Williamsburg program, the group participated in a store tour with visits to Wal-Mart Supercenter, Target Greatlands, Costco, Lowe’s, World Market, Ukrop’s, Best Buy, PETSMART, Toys “R” Us, T.J. Maxx, and others. In addition, they were given a guided tour of Colonial Williamsburg, followed by dinner at Christiana Campbell’s Tavern in the restored colonial area.

Australia program participants enjoyed the Cape Schanck's spectacular coastal environment and views of the Southern Ocean, also called the Antarctic Ocean, and Port Phillip Bay. The Cape Schanck Resort is ideally located between the traditional resort areas and the burgeoning wine, food, and golf district of the Mornington Peninsula.

Participants in the programs represented eight countries: the United States, Australia, Canada, Netherlands, New Zealand, Poland, South Africa, and Sweden. The group included companies in the drug, food, apparel, baby, fabric, home improvement, consumer electronics, music, pet supplies, convenience, automotive, accounting, and consulting sectors. The class was composed of senior executives from buying and merchandising, marketing, store operations, strategic planning, human resources, logistics, finance and control, and business development. Channel management executives represented several manufacturers.

Professors Larry Ring and John Strong were the primary program faculty for each of the programs. Professors Ron Hess and Ram Ganeshan also participated in the U.S. program.

The Evolution and Resurgence of Value Retailing

By John S. Strong, CSX Professor of Finance, and Lawrence J. Ring, Chancellor Professor and EMBA Alumni Professor of Business'

The extremely difficult retail environment of 2008–2009 has resulted in stunning drops in sales, profits, and returns for traditional retailers. A recession was declared in the United States in December 2008 and it apparently actually began in December 2007. The manifest signs of this downturn have been all around us for some time. The stock market has declined dramatically; unemployment has risen to nearly double its pre-recession levels; the credit crisis has led to bank bailouts and home foreclosures reaching record levels; housing prices have declined precipitously; consumer spending has crumpled; retail sales have turned negative; credit card default rates are at record levels, exceeding 10 percent for the largest issuers; and retail bankruptcies (especially liquidations) have ballooned. Restructurings and bankruptcies in other major industries also are creating major retail fallout, especially in the regions dominated by the auto industry.

In the past year, in general, the only retail companies able to post gains were those in the value or extreme value sector. Tables 1, 2, and 3 show the comparable store sales for all of 2008 and for the first quarter of 2009 for department stores, apparel retailers, and mass merchandisers. For the most part, only those chains operating at the value end of the spectrum showed improved "comps," while most others had significantly declining "comps."

Table 1
Comparable Store Sales for Department Stores

Store Name	2008	Q1 2009
Kohl's	-6.9%	-4.2%
JCPenney	-8.5%	-7.5%
Macy's	-4.6%	-9.0%
Sears	-9.5%	-11.7%
Dillard's	-7.0%	-13.0%
Nordstrom	-9.0%	-13.2%
Neiman Marcus	1.7%	-22.8%
Saks	-6.1%	-27.6%

Source: Retail Forward

Table 2
Comparable Store Sales for Apparel Retailers

Store Name	2008	Q1 2009
Buckle	20.6%	17.7%
Aeropostale	8.0%	11.0%
TJX	1.0%	2.0%
Chico's	-15.1%	-3.2%
Limited Brands	-9.0%	-7.0%
Gap	-12.0%	-8.0%
American Eagle Outfitters	-10.0%	-10.0%
Abercrombie & Fitch	-13.0%	-30.0%
Ann Taylor	-14.8%	-30.7%

Source: Retail Forward

Table 3
Comparable Store Sales for Mass Retailers

Store Name	2008	Q1 2009
Dollar General	9.0%	13.3%
Dollar Tree	4.1%	9.2%
Family Dollar	1.2%	6.4%
Wal-Mart Stores	3.5%	2.9%
BJ's Wholesale	9.4%	-1.5%
Kmart	-6.1%	-2.1%
Target Corporation	-2.9%	-3.7%
Costco	8.0%	-7.0%

Source: Retail Forward

The Roots of Value Retailing

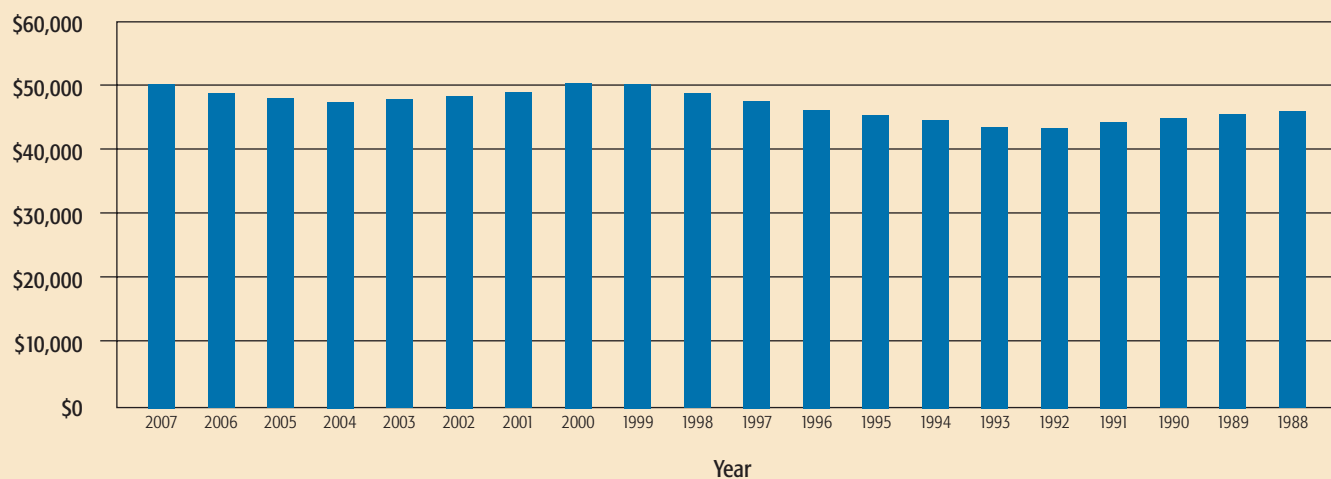
The relatively strong economy from the late 1990s through mid-2007 raised questions about whether the growth in value retailing was a function of economic conditions. Many analysts have heralded the return of value retailing as a response to these difficult times. They point to outstanding performances by Wal-Mart and MacDonald's, along with extreme value retailers such as Aldi and Sav-a-Lot.

The truth, however, is that value retailing never went away. Value retailing has been the primary growth vehicle of the U.S. retailing industry for the past three decades. What is the evidence for this assertion? Let's take a look at which retailers have been the winners during this time and which ones have been losers. Among the winners are Wal-Mart, of course, and Target (discount department stores). In addition, warehouse clubs Costco, Sam's, and BJ's also are on the winners list. Others include "off-pricers" such as T.J. Maxx and dollar stores such as Dollar General, Family Dollar, and Dollar Tree. The most successful of the category killers also have been big winners during this time period, including Home Depot and Lowe's, Bed Bath & Beyond, Best Buy, Staples, and AutoZone.

In the losers' column are the department stores, most conventional supermarkets, lots of specialty stores, mom and pop, and other more traditional outlets. In the last two years, retail bankruptcies have accelerated and include the likes of well-known retailers Circuit City Stores, Linens 'n Things, Steve & Barry's, Sharper Image, Bombay Company, Levitz, and CompUSA.

So, what is driving the long-term value trend? First, we need to look at the macroeconomic and financial context. Income statistics are a good place to start, since retail sales are most closely linked to household disposable incomes. Figure 1 shows U.S. median family income from 1988 to 2007 (actually ending March 2008). These data

FIGURE 1 MEDIAN HOUSEHOLD INCOME 2007



Source: U.S. Census Bureau

conjure up several observations. First, income growth during the past 20 years has been relatively stagnant, rising in 2007 constant dollars from \$45,852 in 1988 to \$50,233 in 2007. This represents a growth of less than one-half of 1 percent per year. Second, the low interest rate environment of the last 15 years helped fuel an unprecedented boom in retail space and capacity. Retail space per capita grew from 19 square feet in 1990 to 38 square feet in 2005.²

Third, the rise of the Internet helped shape the new retail environment, providing increased price visibility and the increased availability of product information to consumers. While less than 10 percent of nonautomotive retail sales in the United States are consummated through the Internet, this channel clearly has a greater than 10 percent influence on shopping.

The Evolution of Value Retailing

What makes a value retailer and who should be considered in the value retailing segment is open to debate. In a 2003 article,³ McKinsey concluded that almost all retail sectors had “gone to value,” with value retailers

almost doubling their share of sales in the 1991–2001 period. However, the McKinsey study defined value retailers as mass merchandisers, warehouse, dollar, and big box stores. We believe this definition is too broad (not all big box retailers are value players) in some ways, and too narrow in others (it excludes extreme value grocers such as Aldi and Sav-A-Lot, for example). In fact, as we write in 2009, almost every retailer claims to provide “value.” We think that value retailing has undergone considerable evolution in the last 30 years. Some value players of the 1980s and 1990s are probably not in that category today, while others have moved from traditional to more value-based strategies.

Basic Principles of Value Retailing

In this section, we refer often to our basic conceptual framework for building competitive advantage in retailing, “The Pentagon and the Triangle” or “the Eight Ways to Win.”⁴ The pentagon defines “how you’re going to win.” It’s the five key points of a retail offer that a customer can see—place, product, value, people, and communication, and each of those “pentagon corners” has several sub points. Inside the pentagon is the triangle which encompasses the

systems, logistics, and suppliers the retailer employs to deliver success. Triangle activities both lower costs and support the customer facing activities of the pentagon. Graphically, the model is depicted in Figure 2.

In our view, there are several basic principles that tend to define value retailing. They include the following:

- **Every Day Low(est) Prices.** Pricing strategy that promises consumers the lowest available price without coupon clipping, waiting for discount promotions, or comparison shopping; also called value pricing. EDLP saves retailers the time and expense of periodic price markdowns, saves manufacturers the cost of distributing and processing coupons, and is believed to generate shopper loyalty.⁵
- **Cost focused.** Cost-focused retailers work hard on the triangle. Often it's in their DNA. A lower cost structure than competition allows the EDLP strategy to work. Cost-focused retailers are what we might call "triangle

driven." This is not simply a goal of minimizing operating costs, but rather seeking efficiencies so that costs that are incurred help to generate additional sales and gross margin dollars.

- **Productivity loop.** This begins with an investment in the Triangle, whether it is systems, logistics, or supply chain, for the purposes of supporting the pentagon and lowering operating expenses.⁶ The benefits of value and selling-oriented retailing are captured in the concept of the productivity loop, as shown in Figure 3. First is an income statement component that focuses on passing on some part of lower operating costs or gross margin reductions to generate higher net sales or market share. The balance sheet loop emphasizes reducing the relative amount of capital employed as sales grow, especially through better inventory productivity. This increases the return on invested capital. A third aspect is translating these operating returns to higher total stockholder returns through dividends and share price appreciation.

FIGURE 2 THE EIGHT WAYS TO WIN IN RETAILING

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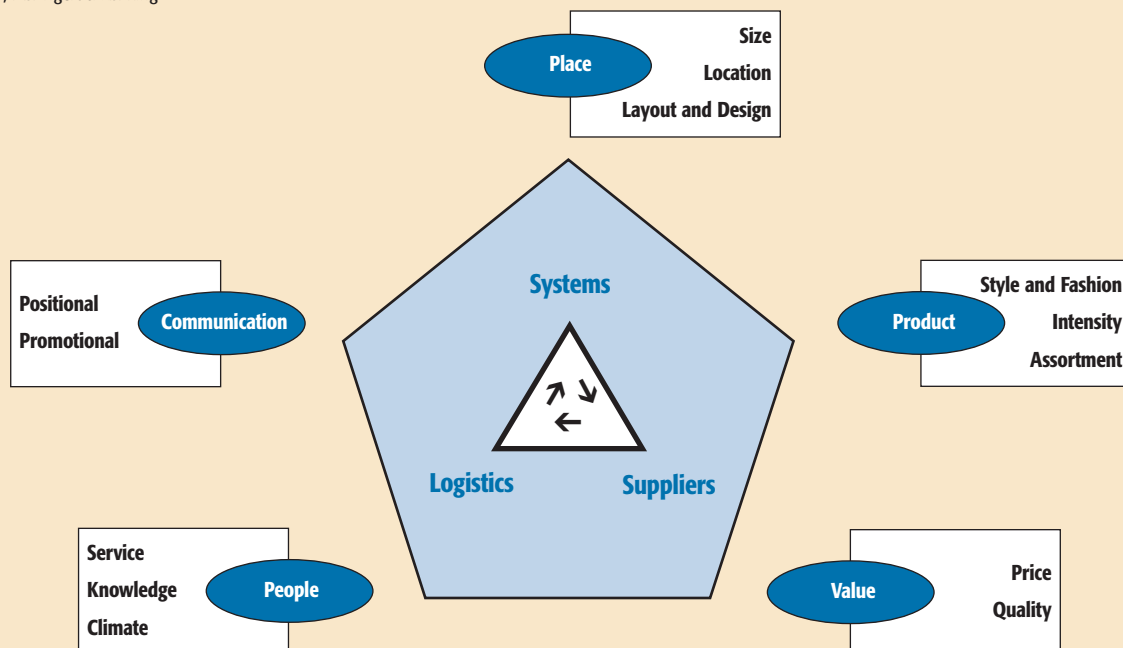
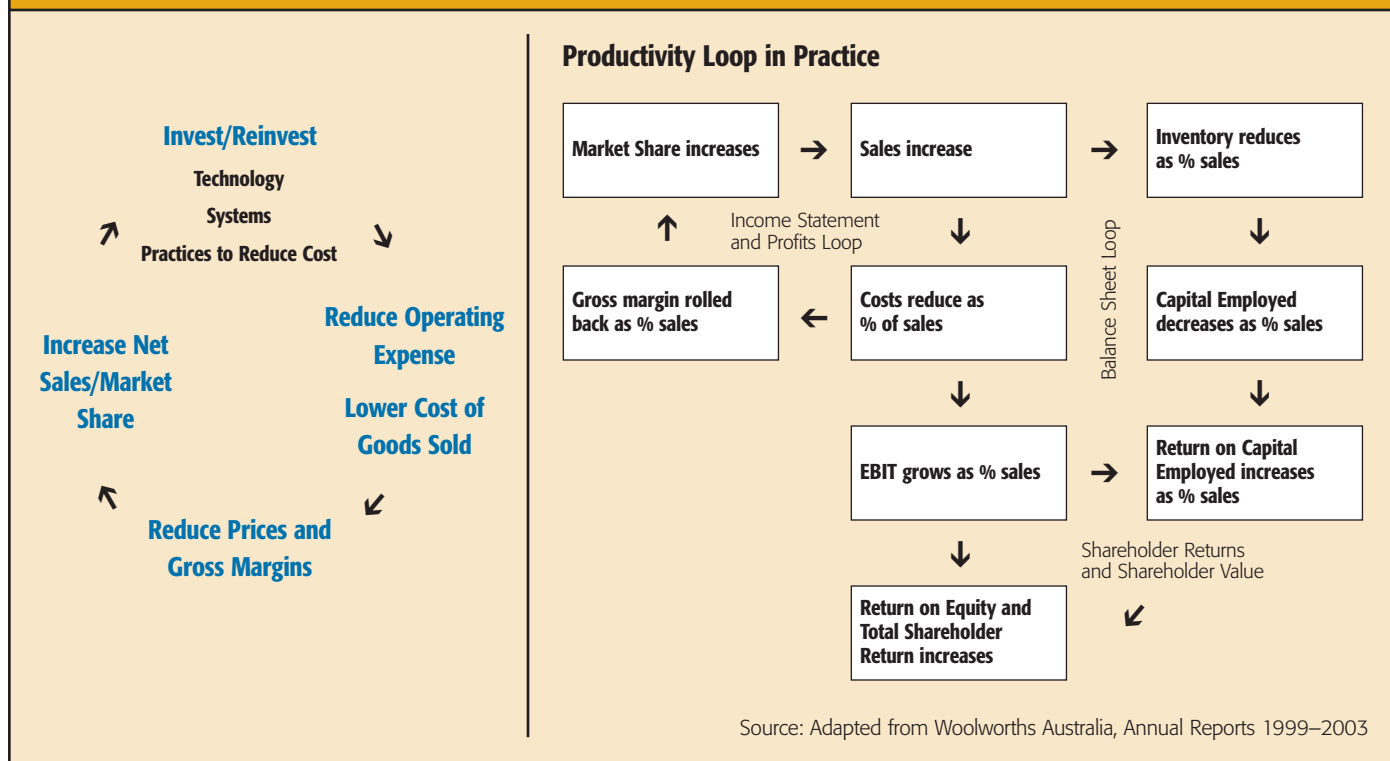


FIGURE 3 THE PRODUCTIVITY LOOP



(This third component has been harder to achieve in the current economic environment, although the share performance of value retailers has held up better in relative terms compared to general retail.)

- **Customer, not supplier focused.** Unlike high/low promotional retailers, value retailers place much less emphasis on merchandising discounts, allowances, rebates, and “financial income” with a greater emphasis on obtaining the lowest possible cost of goods, which then can be passed on (at least in part) to customers. The fundamental perspective is to be a buying agent for customers, rather than a selling agent for suppliers.

The Early Stages of Value Retailing: The Wal-Mart Explosion and the Growth of Big Box Category Killers and Warehouse Clubs

Perhaps no other chain represents the growth of value retailing better than Wal-Mart. Founded in 1962 by the legendary Sam Walton with the idea of bringing discount

retailing to small communities, the company grew modestly to 1980, when it passed \$1 billion in sales. Shortly thereafter, the company began moving to suburbs of big cities such as Atlanta and growth became explosive as it delivered its everyday lowest prices to consumers. By 1990, company sales passed \$30 billion and exploded to \$93 billion in 1995. Sales for 2008 (January 31, 2009) were \$402 billion, making the company, by far, the largest retailer in the world.

Among big box “category killer” retailers, several examples stand out as great success stories at delivering value for money and broad assortments simultaneously. Home Depot was founded in 1978 and reached sales of \$30 billion, \$40 billion, \$50 billion, \$60 billion, and \$70 billion faster than any retailer in the world. In 2006, Home Depot passed \$90 billion in sales before dropping back after the sale of its Home Depot supply business. As early as 1984, marketing research indicated that Home Depot had achieved a dominant position on “lowest overall prices” as

well as “value for the money.”⁷ Today, Home Depot is the second-largest retailer in the United States and the fifth-largest in the world.

Best Buy was founded in 1966 as the Sound of Music and changed its name to Best Buy in 1982 (called Concept I). But the company really accelerated its growth with Best Buy Concept II in 1989. This concept transformed the company to a low-cost player and allowed the introduction of guaranteed everyday low prices to the market. From then on, there was no looking back. Best Buy grew revenues from about \$500 million in 1990 to \$5 billion by 1995, \$12 billion by 2000, and \$45 billion today.

Staples was Thomas Stemberg’s solution to the lack of availability of office supplies on the weekends and their high prices. His idea was to build a supermarket of office supplies and the first store was opened in 1986. Building on a low-cost/low-price foundation, Staples grew rapidly and reached \$3 billion in sales by 1996. Sales topped \$10 billion in 2000, \$16 billion in 2005, and stand at \$27 billion in early 2009.

The first warehouse club was Price Club, founded by Sol Price in San Diego in 1976. The company later (1993) merged with Costco (founded in 1983) and became PriceCostco. Costco itself became the first company to grow from zero to \$3 billion in sales in less than six years. In 1997, PriceCostco changed its name to Costco. Just after the merger, the company had \$16 billion in sales and more than 200 locations. By 2004, Costco sales exceeded \$40 billion and at the end of 2008 were at \$71 billion, making Costco the largest warehouse membership club in the world and the fourth-largest retailer in the United States.

The Dynamics of Value Retailing: Intramural Competition Among Value Retailers

The early years of value retailing saw the rapid expansion and extension of Wal-Mart from discount department

stores into supercenters, with persistent declines or failures of regional discount department stores and steadily declining market shares for traditional department stores.

It also was a period of the birth and rapid growth of big box value retailers in many categories. At first, these new category killers could co-exist, because each typically had their roots in a particular region (for example Staples in the Northeast, Office Depot in Florida, and OfficeMax in the Midwest; or Home Depot in metro markets and Lowe’s in secondary markets in the Southeast). Rapid expansion facilitated large gains from applying the productivity loop, spurring consolidation and concentration in what previously had been fragmented categories and markets. By the mid-1990s, much of this consolidation had been achieved, with the most successful category killers now faced with competing with companies that looked much like themselves. In short, the category killers began to try to kill each other.

A good example of this category killer competition was in sporting goods. By the mid-1990s a healthy group of regional sporting goods category killers effectively saturated their home turfs and began to invade each other’s territories. In short order, these battles resulted in significant profitability pressures and the consolidation of Sports Authority (East Coast roots), SportMart (Chicago and West

VALUE RETAILING IS NOW A MUCH MORE DIVERSE COLLECTION OF RETAILERS THAN EVER BEFORE. THERE IS MUCH GREATER COMPETITION ACROSS MORE CATEGORIES AND PRODUCTS THAN EVER BEFORE; CONSUMER DISTINCTIONS ACROSS RETAIL SEGMENTS ARE QUITE BLURRED.

Coast roots), Oshman's (Texas roots), Dick's (Midwest roots), Sports and Rec (Southeast roots), Galyan's (Midwest roots), and Gart (Mountain states roots) into two survivors—Dick's and Sports Authority.

It was much harder to grow in this new environment; the battle had become more about taking share from competitors that had similar strategies and operating models. As this new stage of competition evolved, some of the big box retailers sought to differentiate themselves and moved away from their value roots. Some, such as Best Buy and the office companies, moved toward promotional and high/low strategies for at least part of their range. Others began to talk less about "Everyday LowEST prices" and more about "Everyday LOW Prices"—and in some cases even shifted to "Everyday FAIR Prices." At the same time, the rapid growth trajectories of the big box retailers began to slow, although pressures for growth companies share returns persisted. This growth orientation also spurred substantial acquisitions and share repurchases, frequently funded by taking on additional debt. In short, many of the big box retailers began to focus more heavily on exploiting their market position and size—and ironically, created new opportunities for a value players in other sectors (especially Wal-Mart and Costco) to launch major attacks on big box categories such as consumer electronics and lawn and garden. At the same time, traditional retailers were developing more effective strategies to compete with value players, while new extreme value formats (dollar stores and hard discounters) were rapidly growing in the U.S. market. For example, the leading dollar store, Dollar General, grew from around 1,000 stores in 1984 to 6,700 by 2004 and was at nearly 8,500 by 2009, with revenues of more than \$9 billion. Meanwhile, Aldi recently opened its 1,000th store in the U.S. and continues to trumpet its slogan "Incredible Value Every Day. Sav-a-Lot has 1,200 stores and refers to itself as the nation's leading extreme value chain. Both chains plan significant expansion in 2009.

The Current Landscape of Value Retailing

Value retailing is now a much more diverse collection of retailers than ever before. There is much greater competition across more categories and products than ever before; consumer distinctions across retail segments are quite blurred. However, the principal value players are now segmented into a few distinct formats and strategies:

- Wal-Mart, with renewed emphasis on lowest pricing and aggressive expansion into specific categories.
- Extreme value retailers such as Aldi and Sav-a-Lot, with a very low-cost operating model, and extremely low prices on a limited range of 2,500–3,000 stock keeping units, often dominated by private label own brands.
- Dollar stores, focused on pack sizes at low price points to appeal to income-constrained households.
- Warehouse clubs, offering a large number of categories but with limited range of both brands and own label in each category; with low prices and margins made possible by membership fees and extremely high inventory productivity but mixed range.
- Off-pricers, such as Kohl's and T.J. Maxx, selling heavily discounted general merchandise bought at extremely low cost through opportunistic buying.
- Online retailers, such as Overstock or Sierra Trading Post, offering deeply discounted or closeout products.
- Online services, enabling shoppers to search for the lowest prices on products or to identify special deals or promotions.
- Revitalized big box category killers, selling a deeper assortment of products in selected categories, while putting greater emphasis on returning to everyday low pricing.

This new stage and structure of value retailing means that we will see lots of competition between value retailers themselves. This emerging array of value strategies also poses new challenges for traditional retailers and conventional retail formats. While a variety of competitive responses are being attempted, efforts to differentiate product and customer experience too often drive up costs and complexity. The need is to develop new models of differentiation through better infrastructure and lower costs. One example is the major efforts by drugstores to retain their core business by supporting it with an extensive array of convenience grocery items, in effect becoming more like large convenience stores with a core pharmacy and health and beauty offer. Another example is the efforts by convenience stores to become more like fast food restaurants and gas stations, using these categories to improve margins and/or drive traffic to support traditional categories.

There also are a number of new initiatives being tried by traditional retailers, whose success is uncertain at this point. First, there are hybrid strategies, by offering everyday low prices on “key value items” while retaining high/low promotional activity elsewhere. However, many retailers are finding it difficult to sustain or limit the range of key value items. A second approach is offering lower prices through loyalty program memberships, but this creates new challenges with supplier relationships and product costs and realized margins. A third initiative is more extensive private label or house brands being rolled out by traditional retailers. However, “own” brands have the potential to create more conflict with national or global brands; this is especially a challenge for promotional department stores and supermarkets. In addition, private label strategies also are readily imitated by value competitors—in fact, the lower cost structures and typically higher sales productivity of value retailers make private label even more attractive in some segments. A fourth initiative involves extreme localization, attempting to tailor each

store to its local market or trade area. While this has some appeal in providing better connections with customers, its success may be constrained by the degree to which core ranges are common across stores or regions. Moreover, such localization might be copied; in fact, the systems and infrastructure may make it easier and cheaper for value retailers to tailor stores and merchandise to local preferences.

Overall, the value retailing landscape has become both pervasive and differentiated. The recent economic downturn has forced many households to seek more ways to save, to be more focused on price as part of value, and to trade down in both product offers and in the retail stores that are patronized. But this is not just about chasing low prices. Many value retailers have transformed themselves by refurbishing stores, adding categories, and improving convenience and customer service. Many shoppers are discovering (or rediscovering) that the value retailers not only have low prices, but are offering shopping, customer, transactional, and service experiences that are much better and, in many cases, on par with those of more traditional retailers who claim to provide a better service and shopping experience. We expect that many, if not most, of the market share gains by value retailers will be held, even as the economy improves. In the longer run, we expect that value retailing will be the core of the economy, surrounded by specialty niches (some of which might be quite big) ... but if the niche is big and profitable enough, the value retailers will be lurking.

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PROGRAM DATES

- William and Mary, May 1–7, 2010
- Monash, May 23–28, 2010

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