Retailing in the 21st Century

Current and Future Trends

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Retail Success and Key Drivers

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Retail Success and Key Drivers

The global retail landscape is changing in some dramatic ways. Retail sales are currently improving. At the same time, competitiveness of both the U.S. retail and global marketplace is escalating. Whereas category dominant retailers were once the store of choice for a variety of products, chains like Wal-Mart, Carrefour, METRO Group, Tesco and Target have taken over in most categories ranging from toys to jewelry. As the world's leading retailer, Wal-Mart has a formidable history of providing greater value to consumers than its competitors, in part due to its innovative supply chain management. French-based Carrefour, the world's second largest retailer, operates five different formats in 30 countries (but not in the United States).[1] Based in Germany, METRO Group is ranked fourth in global sales after Wal-Mart, Carrefour, and Tesco, and it operates four different types of retail formats in 32 countries (Table 1).

Costco is the sixth largest retailer in the U.S. and the ninth largest in the world.[2] It has developed a unique retailing strategy that has allowed it to outperform other warehouse club stores such as Sam's Club. A critical component of their strategy is value-based pricing. They generally do not markup merchandise more than 14 %, compared to most supermarkets and department stores who markup products 25 and 50 %, respectively. They also create a lot of excitement by offering limited assortments of prestigious merchandise, such as Waterford Crystal, Polo/Ralph Lauren apparel, and fine diamonds. Their total assortment is about 4,000 stock keeping units (SKU), compared to about 150,000 SKU in a typical Wal-Mart store.

1 "2006 Global Powers of Retailing," *Stores,* January 2006, pg. 16.
2 Fink, Jim. "The Best Blue Chip for 2007: Costco," *The Motley Fool,* November 9, 2006.

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Table 1. Top 10 Global Retailers

Company	**Origin**	**Sales in 2007 in € (billion, net)**	**employees**	**Rank 2007**	**Rank 2005**	**Rank 1996**
Wal-Mart Stores, Inc	US	270.88	2,000,000	1	1	1
Carrefour SA*	France	82.15	490,042	2	2	8
Tesco plc	UK	67.98	440,000	3	5	18
METRO Group	Germany	64.34	280,000	4	4	4
Home Depot, Inc.	US	55.94	300,000	5	3	24
CVS Caremark Corp.	US	55.81	190,000	6	–	–
The Kroger co.	US	50.75	323,000	7	6	13
Schwarz Group	Germany	49.60	260,000	8	10	33
Costco Wholesale Corp.	US	47.78	127,000	9	7	12
Target Corp.	US	45.79	366,000	10	–	–

* *inclusive Joint Venture*

(Source: METRO Group)

This highly edited assortment creates a sense of urgency for their customers – buy it now or it will be gone tomorrow. While a typical grocery store might carry ten brands of ketchup in three different sizes, Costco will carry only one SKU. It has also taken a very proactive orientation towards its employees, and compensates them generously. Although Costco's innovative approach has proved to be successful, they continue to look for new ways to offer exciting products, prices, and retailing experiences.[3]

Significant consolidation by big players such as the acquisition of May Department Stores by Federated Department Stores, expansion of existing retailers into new geographic areas and into new channels, forward integration by manufacturers, and dramatic improvements in productivity are all shaping this increasingly competitive industry. This leads to more over storing – a disproportional increase in the number of retailers in relation to the growth in the population – in more and more markets. In this environment, customer retention is becoming difficult as shoppers become savvier, willing to shop at a wide variety of stores and across a broad range of retailing formats (see, e.g., Weitz, Whitfield, Ott in this book). Indeed, a number of market pressures are forcing retailers to consider how to provide customers with greater perceived value than competitors.

The global business environment has not been kind to retailers since 9/11. The confluence of a number of factors adds to their challenges: deflation, high unemployment, lower consumer confidence, accounting irregularities, terrorism,

[3] Matthew Boyle, "Why Costco is So Addictive," *Fortune*, October 25, 2006.

war in Iraq, ethnic violence in many parts of the world, higher oil prices, and a drop in tourism. Retailers are responding to these challenges in a variety of ways. Some are rising to the challenges and entrepreneurially launching new formats, while others are remaining competitive by driving down costs using sophisticated communication and information systems to manage their businesses. For example, at the 12,105 Seven Eleven stores in Japan, each customer's market basket is scanned. These data are sent via satellite and the Internet to corporate headquarters. Headquarters then aggregates the data by region, product, and time, and make that information available to all stores and suppliers by the following morning. Orders for fast food and fresh food items are placed three times a day, magazines once a day, and processed food items three times a week. Because of the stores' limited size, deliveries are made 10 times a day.[4] Those retailers who do not respond quickly in appropriate ways find themselves floundering and being forced to take a deep hard look at their businesses, at times taking refuge behind bankruptcy protection.

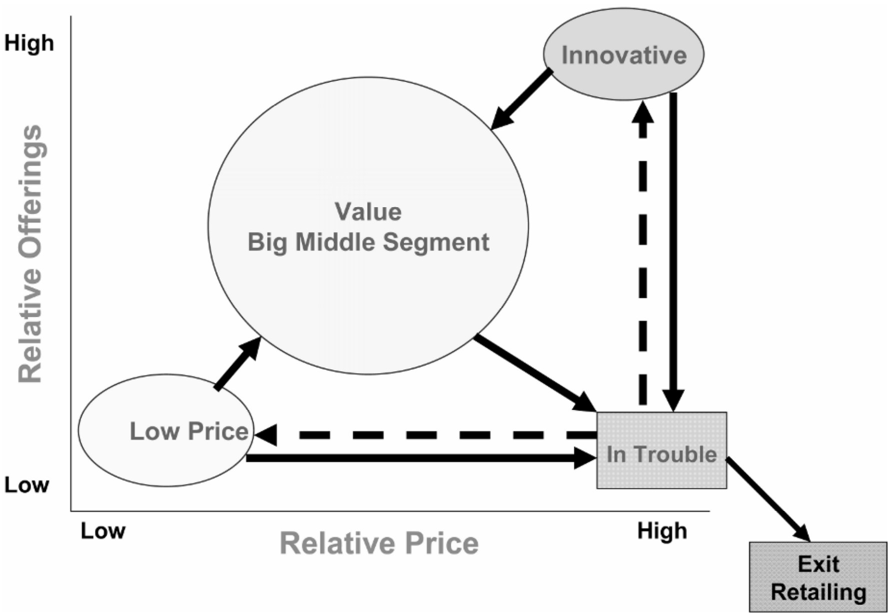

Fig. 1. Retail Landscape

(Source: Levy, Grewal, Peterson and Connolly (2005))

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4 Hau L. Lee and Seungjin Whang, "Demand Chain Excellence: A Tale of Two Retailers," *Supply Chain Management Review,* March 1, 2001, p. 40.

Retailers facing these challenges must understand the key drivers of retail success in order to remain viable. Building on our research and review of the various characteristics of the retail industry, we present an overview of the retail landscape framework and describe strategic levers that retailers must consider as they deliver value to their customers.

Retailing is indeed a dynamic enterprise, and we propose a model to describe some of the more successful retail strategies that have emerged in the last few decades (See Figure 1).[5] This model describes the evolution of retail strategy based on two dimensions: relative price, which is depicted on the horizontal axis, and relative offerings, depicted on the vertical axis. Retailers typically fall in one of four segments: Innovative, Big-Middle, Low-Price and In-Trouble. Retailers occupying the Innovative segment direct their strategies toward quality-conscious markets seeking premium offerings; Low-Price retailers appeal to price-conscious segments; the Big Middle retailers thrive because of their value offerings, and the In-Trouble retailers are those who are unable to deliver high levels of value relative to their competitors. We will now briefly examine each of these.

Innovative Segment

Driven by intense competition and choosy consumers, retailers like Trader Joe's have adopted innovative retail formats to increase the value of the shopping experience. Trader Joe's, the specialty grocery chain, goes beyond offering quality and variety. It carefully manages the customer experience so customers have fun—with a friendly and helpful staff, unique product selection, a sense of discovery from finding something new on the shelf, and tasty samples. Customers who enjoy the experience will inevitably buy something they hadn't originally intended to. The intent is to design a unique shopping experience that integrates the consumer into the process to create a lasting, pleasant memory, and ultimately a loyal customer. Providing consumers with a stimulating experience and a sense of trial before the purchase, and leaving a strong positive impression is the primary goal of these retailers.

Other retailers, such as Neiman Marcus, Nordstrom, Saks Fifth Avenue and many small designer boutiques are also enjoying robust sales. They have a loyal following where customers enjoy the experience of shopping. This also appeals to foreign tourists who are taking advantage of the weak U.S. dollar. High-end stores in particular are the direct beneficiaries of this trend.

[5] This section draws from: Levy, Michael, Dhruv Grewal, Robert A. Peterson and Bob Connolly (2005), "The Concept of the "Big Middle"," *Journal of Retailing, 81 (2), 83-88.*

Low-Price Segment

So called "extreme value" retailers like Dollar General, Family Dollar, and 99 Cents Only Stores are typical examples of retailers in this segment. Extreme value retailers are general merchandise discount stores that are found in either lower-income urban or rural areas and are much smaller than traditional discount stores. They compete by offering good value primarily through their low prices. Whereas the "extreme value" retailers are adding stylish private brand collections and some luxury goods like frozen shrimp to their assortment, low prices remain the centerpiece of their strategy. Double-digit growth of "extreme value" retailers shows that stocking fast-turnaround items in 8,000 to 10,000 square foot stores is a good business model. Moreover, they appeal to today's time-starved consumers because they are easy to shop, being small stores primarily located in easy-access strip shopping centers. Even though the average dollar store transaction is only $9, the average margin of 32 % outpaces convenience stores (29 %), drug stores (27 %) supermarkets (31 %), discounters (24 %) and warehouse clubs (11 %) by keeping prices in check and offering brand and product mixes valued by customers.[6] Lower operating costs contribute to higher dollar store profitability. The double-digit growth of dollar store-type operations has certainly been an eye opener for major players, like Target, Albertsons, and Kroger who are opening dollar aisles in their stores to compete with dollar stores.

Save-A-Lot, a wholly owned subsidiary of the grocery retailer SUPERVALU, is an extreme value retailer that offers food at prices as much as 40 percent lower than those of conventional supermarkets. Although Save-A-Lot, which has increased its selling space by about 10 percent per year, operates more than 1,200 stores across the U.S., analysts believe that number could easily double or triple in just a few more years. Behind Wal-Mart Supercenters, it is the fastest growing retail chain in the United States. Save-A-Lot also is starting to roll out "combo" stores that sell both groceries and fixed-price general merchandise. Save-A-Lot combines the pricing power and efficiency of a Wal-Mart Supercenter with the small-store environment of a convenience store. Save-A-Lot carries about 1,250 items, but only the best selling brands in each category. Its limited assortment strategy allows the company to sell products quickly and avoid getting stuck with excess inventory that eats into its profit margins.

The Big Middle Segment

Wal-Mart, Kohl's, Lowe's, and Best Buy are typical examples of retailers in the Big Middle. Since the Big Middle is the source of the largest potential base of customers, it is where most successful retailers want to compete in the long-term,

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6 "A Concept that Makes Sense," *MMR Annual Report*, MMR, Vol. 21, No. 8, Business and Industry, Gale Group, Inc., May 3, 2004, p. 125.

although it is possible to be successful in the short-term using a different approach. In fact, many of the retailers now in the Big Middle have gotten there by way of initially providing either an innovative offering or low price or both, thus providing superior value to customers. For example, Ann Taylor began by offering innovative products that provided customers with high levels of value through superior benefits, whereas Target had its start by providing customers with high levels of value through low prices for good quality goods by means of its operational excellence. Others, like Lowe's home improvement stores, were innovative in terms of their assortment and category dominant format, while also offering value through its ability to build partnerships with suppliers.

Big Middle retailers have succeeded in leveraging their innovative or low-price position to transform their niche appeal to the mass market. They own an entirely different position in the marketplace by offering innovative merchandise assortments in terms of depth and breadth at reasonable prices. Clearly, they have successfully transformed themselves from being perceived as the innovative leaders or the low-price leaders into a hybrid of the two that appeals to a much larger customer base. They reposition themselves by transforming their image as either offering simply innovative merchandise or low price to being retailers that provide great value in a broader array of merchandise.

Wal-Mart has recently faltered in their expansion strategy. They have, for instance, underestimated the power of labor to influence local municipalities to enact "store size" laws, minimum wage laws, and health care benefits. They are also facing a number of lawsuits. Wal-Mart has responded in part by modifying their assortment, such as offering low price prescription drugs, and expanded banking services. It has also finally realized its "one size fits all" mentality doesn't actually fit all. As a result, they are customizing assortments to cater to urban areas, and geographical and ethnic idiosyncrasies.

Once retailers move into the Big Middle, they cannot expect to rest on their laurels, or they will get "in trouble" and potentially be forced to exit retailing altogether. The Big Middle is a very competitive and profitable space. Other retailers are constantly vying for consumers' attention and a place in the Big Middle. Simply being in the Big Middle is not sufficient for long-term viability. A case in point is conventional department stores. Once the darlings of Wall Street, they are now considered among the dinosaurs of retailing because they have not been able to sustain superior value through innovative offerings and high levels of service for the mass market.

Strategic Levers for Retail Success Through Value

Retailers who successfully compete in The Big Middle provide a compelling value proposition to the customer and are able to quickly respond to market changes. The successful ones maintain a nimble and flexible mindset and constantly monitor changes in the marketing environment. They realize that being flexible and being able to quickly adapt to changes in the marketplace are key to their survival. Examples of companies that position themselves to capitalize on market trends abound.

Consumers have become more attracted to "ethical" products which are those that are not produced by sweatshop labor and the working conditions have met high safety standards. In 2005 for instance, U.K. shoppers spent $50 billion on ethical goods and services, with a concentration on clothing. U.S. demand for ethical products is also high. An interesting derivative of "ethical" products is a program called Product Red Label, in which a group of manufacturers and retailers such as The Gap, Emporio Armani, Motorola, and Apple are producing clothing, cell phones, sunglasses and a variety of other products in sweatshop-free environments. A portion of the profits are donated to The Global Fund to Fight AIDS, Tuberculosis, and Malaria in Africa. [7]

Retailers are adjusting their business models to include philanthropic giving as part of its strategy. Instead of donating to charities separately from its retail business, retailers are now marketing its products for the purpose of giving to a charity. Retailers are realizing that being socially responsible is giving them a competitive advantage and a lifelong positive reputation in the eyes of consumers. Since philanthropic message is tied in to the product, the, retail experience becomes more uplifting and satisfying because the customers believe they are making a difference. These products are generally very successful, which makes it a win-win situation for both the retailer and the consumer.[8]

Retailers who have marketed to Generation Y since they were toddlers now believe they need to continue to follow this market as they mature. Generation Y is characterized by people in their 20s who are now completing college and starting their first jobs. Many retailers are actually abandoning portions of their teenage market to focus on this older Generation Y by opening new and different concepts. Abercrombie & Fitch, for instance started Ruehl No. 925, directed to 20-35 year olds. Not only is the pricing higher than Abercrombie & Fitch, but the retail environment is a "cross between a New York brownstone and a swanky boutique hotel". In 2004, Metropark, the fashion chain opened with a partly club, partly street boutique atmosphere. The twenty-something crowd appreciates the boutique, unique, mature atmosphere combined with the New York City club feel. [9][10]

Astute retailers can reap the benefits of responding to market trends. Demographic changes, emerging lifestyles centered on the home, and lower interest rates have buoyed the sales of home furnishings companies like Ikea, Kohl's and

[7] Stephanie Hanes, "Nice Clothes – But Are They Ethical?" *Christian Science Monitor*, October 15, 2006.

[8] Michael Barbaro, "Candles, Jeans, Lipsticks: Products With Ulterior Motives," *New York Times,* November 13, 2006.

[9] Stephanie Kang, "Chasing Generation Y," *Wall Street Journal*, September 1, 2006.

[10] Stephanie Hanes, "Nice Clothes – But Are They Ethical?" *Christian Science Monitor*, October 15, 2006.

Williams Sonoma. Retailers that traditionally did not sell furniture like Costco, Sam's Club, Wal-Mart, Target and J.C. Penney have recently expanded their furniture offerings in response to these trends. Others have been adept at pursuing underdeveloped market opportunities, for example sales to particular demographic groups. Designed to appeal to women, Lowe's has enjoyed a handsome payoff and a strong competitive position against well-entrenched retailers like Home Depot. In Germany, Generation Market, a supermarket chain, is redesigning its stores and offerings to cater to older consumers. It is predicted that one in three Germans will be 50+ by 2010.[11] The fundamental key to success lies in retailers' abilities to be nimble or flexible in organizing their offerings in response to new opportunities in the market.

Best Buy has experimented in several stores with retailing and customer service that is appealing to women. The stores have lowered its audio volume, made the aisles wider, added play areas for children and most importantly trained its sales people to communicate better with women. Some stores even have full-time personal shopping assistants to help female shoppers navigate the store. Other women who do not have any interest in electronics can recline in a massage chair while a personal shopper gets the merchandise for them.[12]

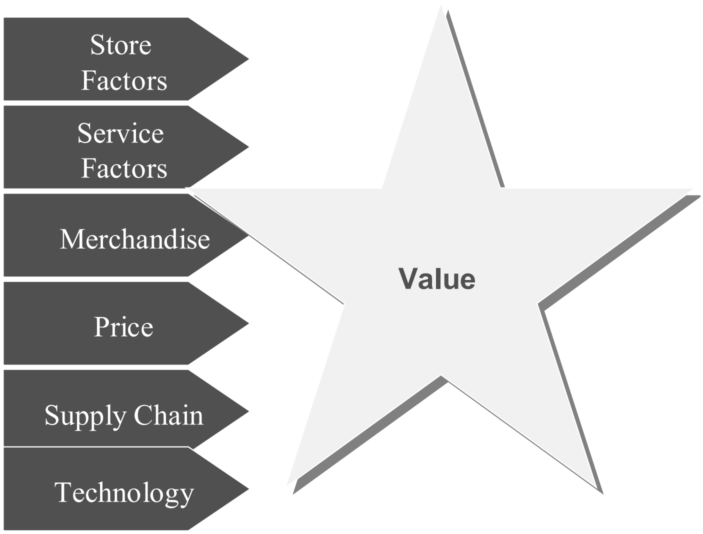

Fig. 2. Strategic Levers Impacting on Retailing Success Through Value

[11] http://abcnews.go.com/WNT/Business/story?id=2883983&page=1 – February 17, 2007-World news)

[12] Chris Serres, "Best Buy Displays a Feminine Side," *Minneapolis Star Tribune,* November 15, 2006.

Central to the ability to capitalize on new opportunities is the importance of managing elements of the offering that influence consumers' perceptions of value. Although there are many factors that affect customers' value perception, six major levers of retail success: store factors, service factors, merchandise, price, supply chain, and technology (See Figure 2), will be discussed. Other potential strategic levers, such as the role of store promotions and customer loyalty management are discussed in other chapters by Gedenk, Neslin, Ailawadi, and reinartz in this book.)

Store Factors

A key strategic value driver at the store level is developing the right combination of format and retail environmental factors. Customers often look beyond the functional benefits of a physical store to the overall experience it offers. Since much of the shopping experience is rather mundane, those retailers who can distinguish themselves with unusual and exciting store atmospherics add value to the shopping experience. Some examples of innovative retailers that are migrating to or are in the Big Middle because they excel at store factors are Crate and Barrel, Starbucks, Japan's Jomo gas stations, Bass Pro Shops Outdoor World, and American Girl.

A variety of factors influence customers' store patronage intentions, some of which are quite subtle. Environmental cues, such as design and ambience, can have a noticeable effect. Consumers' perceptions of value and their subsequent patronage are heavily influenced by their perceptions of the store's "look and feel." Music, color, scent, and crowding can also significantly impact the overall shopping experience.[13] The emotional responses that are induced by the store experience can have a pronounced impact on the amount of time and money spent in the store. Therefore, the extent to which stores offer a more pleasant shopping experience fosters a good mood, resulting in greater spending. Store atmospherics, as they impact perceptions that shopping is a fun and enjoyable experience, are an important strategic tool to manage properly for competitive advantage (see chapters by Uncles, Burke, in this book).

Service Factors

Given the time and effort that is invested by retailers to attract customers into their stores, it is amazing how so many retailers pay little attention to customer service. It is common to visit a retail store and see half-filled shopping carts abandoned by

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[13] Baker, Julie, A. Parasuraman, Dhruv Grewal and Glenn Voss (2002), "The Influence of Multiple Store Environment Cues on Perceived Merchandise Value and Patronage Intentions," *Journal of Marketing*, 66 (April), 120-141. Spangenberg, Eric R., Ayn E. Crowley, and Pamela W. Henderson (1996), "Improving the Store Environment: Do Olfactory Cues Affect Evaluations and Behaviors?" *Journal of Marketing*, 60 (April), 67-80. Hui, Michael K. and John E.G. Bateson (1991), "Perceived Control and the Effects of Crowding and Consumer Choice on the Service Experience," *Journal of Consumer Research*, 18 (September), 174-184.

shoppers who were tired of waiting for their turn at the check-out, or to see shoppers looking for a particular item they wanted to purchase but could not find a service provider to assist them in locating the item or provide the information they need to ensure it is the right item. But those retailers who do provide great customer service distinguish themselves from their competitors, and therefore add significant value to their offering. Innovative retailers that are migrating to or are in the Big Middle because they excel at service factors are American Girl, Build-A-Bear, Trader Joe's, Best Buy, Container Store, and Lowe's.

One of the main drivers of good customer service is the convenience that a particular store provides. Retailers need to ensure that their store service personnel are well trained to provide five sources of convenience: decision convenience, being able to provide customers with appropriate information so they can make informed buying decisions; access convenience, making sure they know where merchandise is and will assist customers in finding it; transaction convenience, training to facilitate transactions such as check-out and returns; benefits convenience, helping customers understand the benefits of the products and services that will result in a more enjoyable experience; and finally post-benefit convenience, providing the training and empowerment to rectify post-purchase problems.[14] Retailers that attend to aspects of customer service can contribute to customer perceptions of value, resulting in a strong competitive position.

Merchandise

Most retailers devote a tremendous amount of time and effort to merchandise management. Retailers who excel in merchandise management do so in one of two ways. First, they can concentrate on finding unique merchandise that appeal to their target customers (for more discussion of consumers' perceptions of retailers merchandise assortment, see chapters by Broniarczyk and Hoyer in this book). Second, they can be certain that enough merchandise is where the customer wants it, when she wants it. Those who can do both, like Spain's Zara or Sweden's H&M, are even more likely to provide superior value for their customers. Innovative retailers that are migrating to or are in the Big Middle because they excel at merchandise management are Wal-Mart, Carrefour, METRO Group, Urban Outfitters, Trader Joe's, Crate and Barrel, Starbucks, American Girl, Build-A-Bear, Target, Dollar General and other "extreme value" retailers.

Generally speaking, greater product variety leads to higher sales levels, however, retailers do not have the luxury of simply adding more inventory in an era where productivity in merchandise management is essential to long-term viability. Innovative merchandise management can be both a challenge and an opportunity especially for multi-channel retailers. Some retailers, such as Staples, have taken

[14] See Berry, Leonard, Kathleen Seiders and Dhruv Grewal (2002), "Understanding Service Convenience," *Journal of Marketing*, 66 (July), 1-17.

slower moving SKUs out of their physical stores, but made them available either through in-store computer kiosks or over the Internet. Such a system brings value to both the retailer and their customers. Customers benefit because they can acquire items that might be unavailable otherwise. Retailers benefit by making the best use of their inventory investment.

Price

Price is a critical factor that consumers consider in ascertaining the overall value of an offering, i.e., whether or not the benefits of the exchange outweigh the sacrifices. Understanding what the customer is being asked to give up in an exchange for what they get is therefore key to the ability of the retailer to deliver superior value. Marketers should carefully determine the price of a good based on the value of what is being offered in the mind of the potential buyer. Retailers that are migrating to or are in the Big Middle because they excel at the pricing factor are Wal-Mart, Target, Carrefour, METRO Group, Trader Joe's, Zara, H&M, Kohl's, Lowe's, Dollar General and other "extreme value" retailers.

Until recently, retailers typically based their initial pricing and subsequent markdown decisions on arbitrary rules that they believed had worked well in the past.[15] Fortunately, a few specialized firms recently have developed software packages to assist retailers in making these important pricing decisions. Some of the largest retailers in the country (e.g., Home Depot, J.C. Penney) have invested millions of dollars in sophisticated pricing optimization software. The Canadian apparel retailer Northern Group Retail Ltd. started using Oracle's price optimization software and, in a test, was able to generate $60,000 of additional gross margin dollars on one stock keeping unit (SKU) by holding its outerwear at full price, though prior experience indicated that it should have reduced the cost by 30 percent.

Similarly, price and promotion optimization software developed by SAP's KhiMetrics has been implemented successfully by top retailers in the grocery, drug, electronics, specialty, and mass merchandising fields. Results from controlled field experiments demonstrated that gross margin increased five to 15 percent, depending on the retailer's margins, and the results were consistent across retail industries.

The monetary price of an offering is the only strategic lever of retail success that generates revenue. It is also one of the most conspicuous sacrifices that consumers make in the value exchange, although the real retail price should be thought of in terms of the monetary cost as well as the time and energy it takes to acquire a product. Retailers can lower the total cost of acquiring a product by either setting a low monetary price or by reducing the time and effort expended by customers.

[15] This section draws from, Levy, Michael, Dhruv Grewal, Praveen Kopalle and James Hess (2004), "Emerging Trends in Pricing Practice: Implications for Research," *Journal of Retailing*, 80 (30), xiii-xxi.

Supply Chain

In times of slow or no sales growth, rising expenses, and increased difficulty finding great locations, a managerial acumen toward supply chain management can generate significant profits straight to the bottom line. This involves efficiently and effectively integrating one's suppliers, manufacturers, warehouses, stores, and transportation intermediaries into a seamless value chain so that merchandise is produced and distributed in the right quantities, to the right locations, and at the right time, in order to minimize system-wide costs, while satisfying the service levels required by its customers. Retailers that are migrating to or are in the Big Middle because they excel at supply chain management are Wal-Mart, METRO Group, 7-Eleven Stores in Japan, H&M and Zara.

To illustrate the power of supply chain management for providing customer value, consider Spain's Zara, which runs about 1,500 fashionable clothing stores in 72 countries (including 41 in the United States). The chain has annual sales of over 6.8 billion Euro, an impressive number for a chain founded just almost 35 years ago. Zara produces the majority of its own clothes, and makes over 40% of its own fabric.

Zara also operates its own worldwide distribution network. Controlling the supply chain gives Zara the flexibility that its competitors can only dream about. It allows Zara to operate with virtually very little inventory build ups because its stores get deliveries twice a week, and newly supplied items rarely remain on the retail shelves for more than a week. In fact, Zara has mastered the art of quick-response (QR) inventory system with a vengeance. Zara takes only four to five weeks to design a new collection and then about a week to manufacture it. Its competitors, by comparison, need an average of six months to design a new collection, and another three weeks to manufacture it.

The company accomplishes this by adding value through an astute use of information and technology. All of its stores are electronically linked to the Company's headquarters in Spain. Store managers together with a fleet of sharp-eyed, design-savvy, trend-spotters in Zara's staff routinely prowl fashion hot-spots such as university campuses and happening night clubs. Their job is to function as company's eyes and ears, to spot the next wave. Using wireless, handheld devices, they send images back to corporate headquarters so that designers can produce blueprints for close-at-hand manufacturers to get stitching and produce garments that will be hanging in Zara stores within weeks.

In effect, Zara's designers have real-time information when deciding with the commercial team on the fabric, cut, and price-points of a new line of garments. This combination of real-time information sharing and internalized production means that Zara can work with almost no stock and still have new designs in the store twice a week. Customers love the results of this high-velocity quick-response operation – they queue up in long lines at Zara's stores on designated delivery days, a phenomenon dubbed "Zaramania" by the press.

Technology

The use of technology goes hand-in-hand with superior supply chain management. It is not surprising therefore, that the same retailers who we believe are migrating to or are in the Big Middle because they excel at supply chain management also utilize superior technology.

These successful retailers use technology throughout their supply chain. Most retailers collect sales data at the point-of-sale. It is what is done with the data after it is collected that separates superior retailers from the rest. As we noted in the Zara example, retailers can use sales data to work closely with their suppliers to plan production and inventory replenishment. Advanced systems like CPFR (collaboration, planning, forecasting, and replenishment) use the data to construct a replenishment forecast that is shared by the retailer and vendor before it is executed (see e.g., chapter by Huchzermeier, Iyer in this book).

Some retailers, notably Wal-Mart and METRO Group, are experimenting with radio-frequency-identification (RFID) technology. Wal-Mart has mandated that by 2006, all shipments to their distribution centers must have their cases and pallets fitted with RFID tags—tiny computer chips that can automatically transmit to a special scanner all of the information about a container's contents or about individual products. The prospect of affordable tags is exciting the supply chain. If every item in a store were tagged, RFID technology could be used to locate mislaid products, to deter theft, and even to offer customers personalized sales pitches through displays mounted in dressing rooms. Ultimately, tags and readers could replace bar codes and checkout labor altogether.

A retailer or consumer goods maker using RFID could cut total warehouse labor costs by nearly 3 percent, chiefly through more efficient receiving, shipping, and exception handling. More promising still are the potential effects of RFID on vendor-managed inventory systems. By exchanging the information gleaned from RFID readers over the Internet, a consumer goods maker could manage its own stock replenishment for key customers more efficiently, saving both parties 20 to 40 percent or more in inventory and out-of-stock costs.

Purchase data is also the basis for advanced CRM (customer relationship management) programs. CRM is a business philosophy and set of strategies, programs, and systems that focuses on identifying and building loyalty with a retailer's most valued customers. Loyal customers are the backbone of any successful retail enterprise because they are the most profitable. CRM programs, or loyalty programs as they are commonly called, can be as simple as a punch-card at a sandwich shop to very complex programs used by airlines and high-end specialty shops and department stores like Neiman Marcus and Harrods (see chapter by Reinartz in this book).

Retailers are experimenting with physical technologies as well. Some stores, like Staples, are utilizing in-store kiosks to help customers and store employees learn about merchandise and order items that the stores to not stock. METRO

Group's store of the Future Initiative includes self-scanning devices and innovative check-out systems enabling the customer to pay without a cashier and resulting in shorter waiting periods at the check-out (described in chapter by Kalyanam, Lal, Wolfram in this book). Customers will also carry small computers that will help them find products and receive important information.

Retailing Challenges and Trends for the Future

A number of enormous challenges face retailers in the 21st century.

Trend 1: Consolidation in the Retailing Industry

Numerous retailers are facing imminent problems since they are unable to deliver high levels of value relative to their more astute competitors. As a consequence, significant consolidation by big retailers is likely to take place, e.g., the acquisition of Sears by Kmart and the merger of May Department Stores with Federated Stores, Inc.

Trend 2: Value Is Key

Successful retailers are developing strategies that offer customers greater value over competitors' and are sustaining them over time. To do so, they are focusing their energies on creating centers of excellence, such as connecting with their customers, being a leader in terms of the merchandise and assortment that they provide, and having excellent operations in place. Although retailers that provide value don't always do so at a low price, extreme value retailers like Dollar General are expected to continue to take share of wallet from the retailers that have traditionally appealed to lower income, treasure hunting, and otherwise value-conscious consumers.

Trend 3: Being Innovative

Retailers are more and more experimenting with their store formats. Additionally, they are effectively designing and managing the various strategic levels to enhance the overall customer shopping experience. The problem with being known as an innovative retailer is that it can only remain innovative as long as its customers believe the innovations are fresh and exciting. Recall, department stores were once thought of as being an innovative retail format. Thus, innovative retailers must continuously implement new ideas or else their customers will begin to view them as being "old hat."

Trend 4: Cost Controls

Successful retailers, particularly those competing in the low price segment and many in The Big Middle, are efficient and effective in integrating their suppliers, manufacturers, warehouses, stores, and transportation intermediaries into a seamless value chain, in order to minimize system-wide costs, while satisfying the service levels required by its customers. They are seeking out and using innovative technology throughout their supply chains, to reduce costs and provide value for their customers.

In the last few years, some of the largest retailers in the U.S. have invested in sophisticated merchandise optimization techniques that help them make decisions about planning assortments, initial pricing, buying, allocation of merchandise to stores, promotion, planning replenishment (rebuys), space management (planograms), and markdown pricing. These techniques enable retailers to better control costs, buy, allocate, and promote the right merchandise, and price and markdown merchandise. By utilizing these techniques, customers get what they want, which translates into loyal customers and in many cases a competitive advantage.

Conclusion

It is important to understand that we are not proposing value-cost trade-off. On the contrary, retailers who pursue simultaneously cost control and value differentiation will succeed in the coming decade. Established retailers must create diversified and innovative retail formats that industry has never offered. Profitability will come from their ability to deliver, efficiently these innovative formats, both from the cost and operational perspective.

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