



Retail today. Retail tomorrow.

Competing in a Big-Box World:

**HOW RETAILERS CAN
LEVERAGE TECHNOLOGY
TO THRIVE IN TODAY'S
RETAIL ENVIRONMENT**



WHITE PAPER

...To successfully compete in today's environment, mid-sized retailers must carve out a niche based on creative strategies...

In less than two decades, industry consolidation and rapid expansion have enabled big-box retailers to gobble up a tremendous amount of market share at the expense of small and mid-sized rivals. Furthermore, their ability to successfully cut margins to the bone through unmatched efficiency, sheer buying power and masterful execution has made it increasingly difficult for local and regional chains to compete on price alone.

Industry analysts and retail executives now agree that, although competitive prices are a must, “low price” as a leading strategy will no longer lead to long-term business success. To successfully compete in today's environment, mid-sized retailers must carve out a niche based on creative strategies, including better and more localized product assortments, flawless price management and execution, and optimized inventory down to the store level.

This requires access to the same level and quality of information that their big-box rivals have—information that can be made possible only through sophisticated, but affordable, retail-centric systems working in concert through an integrated platform.

This white paper examines some of the most critical business drivers that are forcing mid-sized retailers to, in many cases, rethink how they position themselves. It also addresses four key technology-enabled strategies that can provide the sustained differentiation and market agility needed to succeed in today's big-box retail environment.

CRITICAL BUSINESS DRIVERS

UNPRECEDENTED COMPETITION

The retail landscape has seen drastic changes over the past two decades. Large retail chains have continued to grow unabated, fostering an increasingly commoditized marketplace. Meteoric store growth has led to damaging sales dilution, evidenced by a drop of more than 22 percent in U.S. retail sales per square foot from 1970 to 2001 while U.S. retail space per capita almost tripled during that period.¹

Along with rapid new-store growth, massive consolidation in all verticals—from fashion to hard goods to grocery—has created fewer but larger players. For instance, in 2004, the top three discount store retailers owned 91 percent of their market segment, compared to 61 percent in 1986—and the top three consumer electronic firms claimed 42 percent of their market segment, compared to only 15 percent 18 years earlier.²

Furthermore, competition from foreign-owned companies has dramatically intensified. Retailers such as H&M, Uniqlo and Ikea are aggressively stepping up their U.S. expansion efforts while new players continue to move in. One notable example is British retailing giant Tesco, which is reportedly eyeing 300 potential sites in southern California, Arizona and Nevada to build a series of mid-sized grocery stores.³

THE CHANGING FACE OF THE AMERICAN SHOPPER

Aside from fierce competition, retailers are also grappling with changing consumer expectations. Today's shoppers are smarter and better informed. They're also more demanding, less loyal and tolerant, more fluid in their shopping behavior and growing increasingly cynical and skeptical.

Above everything else, today's time-starved American shoppers value time and convenience. However, they also seek a certain degree of entertainment and variety as well as a more personalized shopping experience. As retailers like Trader Joe's and Williams-Sonoma have proven, delivering high quality, variety, excitement, distinctive style and exclusivity—factors that go far beyond price and convenience—can yield profitable results.

The evolving U.S. demographic makeup is also challenging retailers to rethink their branding and merchandising strategies. For instance, according to the U.S. Census Bureau, the number of Americans aged 55 and older will almost double between 2000 and 2030.⁴ Additionally, Hispanics recently surpassed African-Americans as the nation's largest minority group. And 55 million working women between the ages of 24 to 54 now make 80 percent of all household buying decisions.⁵

ENABLING MID-SIZED RETAILERS TO COMPETE EFFECTIVELY

One fact is clear: to survive and thrive in today's rapidly changing and challenging retail environment—one that is increasingly dominated by large discount chains—mid-sized retailers must differentiate. They must take a closer look at their customers' demographics and buying behaviors and they must carve out a niche based on smarter and more localized product assortments, flawless price management and execution, and optimized inventory down to the store level.

Effective execution of these strategies requires that mid-sized retailers effectively sense, understand and respond to changes in customer demand. This requires that they have access to the same level of information and intelligence their big-box rivals have—information and intelligence enabled by sophisticated yet affordable retail systems working through an integrated retail backbone.

1) DIFFERENTIATE THROUGH CUSTOMER-CENTRIC MERCHANDISING

A recent AMR Research study concluded that, on average, customers make 70 percent or more of their buying decisions only after they are inside the store.⁶ While competitive prices are still important, this figure indicates that the quality of the in-store experience has a tremendous effect on sales and customer loyalty.

One way in which some of the larger chains are differentiating themselves is through new and unique product lines. For instance, retailers such as Target, Kohl's and Wal-Mart have created fashionable and affordable clothing lines—often from celebrities or high-end designers—to lure buyers seeking high quality apparel at lower price points. The results have been nothing short of spectacular. According to Jane Hali, VP and Director of Retail Merchandising at Coleman Research Group, "I don't see the partnerships between designers and retailers ending any time soon. It makes retail stores more exciting places to shop."⁷

In addition to introducing differentiated product lines, many retailers are also working to deploy smarter, more localized product assortments. Consumers have shown a propensity to reward businesses that cater to their individual preferences, making store-specific merchandising a critical success factor. Industry experts now agree that smart, localized assortments not only affect how customers perceive the store, but also communicate what a retailer wants to be famous for.⁸

Recent developments suggest that this strategy is rapidly approaching a tipping point. For instance, Wal-Mart announced last year that it was abandoning its cookie-cutter approach to merchandising in favor of creating more localized and differentiated assortments. As part of a broader effort to boost sluggish sales, the company is beginning to custom-fit its merchandise assortment to reflect one of six clearly defined U.S. demographic groups.⁹ This is a huge shift for a company that became the world's largest retailer on the strength of standardization—and a clear sign that all retailers, regardless of size, must deploy a more focused effort to better adapt to local tastes, needs and expectations.

How can mid-sized retailers do this effectively? Above all, the visibility and responsiveness necessary to support such a strategy requires the establishment of a single, centralized and integrated database environment for all master data, information flow and supply chain operations. Only by having all relevant data in one place—including customer data, point-of-sale data, inventory movement information, DC inventory levels and pricing and promotions data—can retail executives make the fast, educated decisions that enable a profitable localization strategy.

Centralized data also helps retailers establish better control mechanisms. For instance, many retailers have traditionally left the task of localization to their store managers. But as store management turnover has continued to increase over the last decade, making informed and profitable merchandising decisions at the store level is becoming increasingly difficult; it simply isn't a sustainable model. Moreover, companies are now less willing to give local management much latitude on inventory decisions, increasing the need for a centralized data environment that supports localized inventory and merchandising decisions.

2) FOCUS ON FLAWLESS PRICE MANAGEMENT AND EXECUTION

To optimize profitability in a big-box world, mid-sized retailers must also deploy systems that enable them to offer the right price to the right target market while providing the flexibility to adjust prices quickly and accurately when necessary. Understanding the numerous variables that drive demand—such as seasonality, price elasticity, cross-elasticity between items and inventory presentation—is critical to making profitable pricing decisions.

While the SKU explosion of the past two decades has made pricing optimization an increasingly complex process, it is not a process that necessarily requires complex algorithmic calculations. What successful price optimization does demand is greater real-time visibility into customer demand and available inventory. And this requires that all relevant information on customer purchases, product movement, warehouse inventory levels, and pricing and promotions be easily accessible within a single, centralized database.

By centralizing this data, the retailer can better analyze and act on the data in order to promote the right products at the right prices, down to the individual store level. It also enables the retailer to determine the exact minimum relative price gap for each SKU to compete effectively in each store. Furthermore, it provides decision support to help managers accurately predict the revenue and profit-margin impact of price changes for every SKU in any given store.

EFFECTIVE EXECUTION OF PRICING STRATEGIES

Aside from the ability to make optimal pricing decisions, retailers also must be able to effectively execute pricing strategies. This includes communicating price changes to stores, changing point-of-sale pricing information, providing all stores with correct price shelf labels and ensuring that the labels are immediately posted. When these tasks have to be performed manually or through several disparate systems, they can easily overwhelm sales floor staff and lead to increased labor costs, pricing mistakes and poor customer service.

3) WORK TO OPTIMIZE INVENTORY

Out-of-stocks are clearly one of the biggest problems facing retailers today. According to a recent AMR Research report, almost 70 percent of shoppers surveyed said that they would shop for out-of-stock items at a competitor's store or on its website¹⁰ —a clear sign that today's time-starved shoppers have little tolerance for merchants that are, even occasionally, out of stock on the products they want. However, on average, retailers are still experiencing out-of-stock rates between 6 percent and 10 percent for non-promoted products. And, for promoted products, those rates often climb as high as 18 percent to 24 percent.¹¹

At the same time, excess inventory can lead to costly markdowns, storage, obsolescence, product expiration and spoilage of perishable items. Yet this inventory and service-level balancing act will only continue to grow in complexity as the number of SKUs, supply sources, seasons and product characteristics continue to skyrocket every year.

The fact is, improving product availability while minimizing inventory investments requires a better view of real demand. Furthermore, improving real demand visibility means that mid-sized retailers have to effectively leverage an enormous amount of information, including real-time point-of-sale data; bar code and RFID data; movement signals in the distribution center; and external factors like promotions and seasonality.¹²

As the information is captured, an inventory replenishment solution can process the massive data stream by employing complex business rules that yield specific inventory levels for every SKU at every store.

A number of recent surveys show that retailers as a whole are, indeed, quickly moving in this direction. Forty-two percent of retailers in a recent study indicated that they were looking to improve or replace current DC replenishment systems in 2006,¹³ and 80 percent said that they planned to have some software functionality to automate store-level demand replenishment by 2007.¹⁴ Furthermore, nearly 90 percent indicated that they either currently use or planned to use, implement or evaluate an inventory management solution in 2007.¹⁵

A BROADER VIEW OF INVENTORY

When evaluating options, retailers should focus specifically on replenishment systems that take a holistic view of the supply chain to determine at what stage and location inventory is best held. This is critical because overly simplistic, single-echelon systems tend to focus only on the inventory located in a specific location, rather than on the inventory distributed throughout the retailer's entire supply network—and it is precisely this myopic view of inventory that leads to poorly distributed inventory, out-of-stocks, lost sales, decreased customer loyalty and excess stock.

4) GRADUALLY MOVE TO AN INTEGRATED RETAIL SUPPLY CHAIN BACKBONE

These initiatives, while absolutely necessary, can further complicate the already overburdened and disjointed supply chain systems in place in most retail organizations. To survive and thrive in a big-box world, retailers must begin to move away from expensive, risky, outdated and disjointed legacy applications and into an integrated, retail-centric software platform.

Specifically, the ideal retail platform should support business operations end-to-end—from logistics and distribution to replenishment to merchandising and sales—incorporating an integrated set of core retail applications that includes:

- Demand and replenishment optimization
- Merchandise management and optimization
- Store execution
- Supply chain visibility
- Warehouse management and inventory optimization
- Supplier management
- Item and price management; and
- Retail business management and support

However, the platform must also be flexible; it should allow the retailer to methodically deploy it over time through a phased approach in order to help minimize business disruption while also enabling:

- **IMPROVED COMPETITIVENESS**—resulting from greater efficiencies, reduced costs, better-informed decisions and improved responsiveness to continually changing market conditions
- **GREATER OPERATIONAL EFFICIENCY AND VISIBILITY**—enabling regulatory compliance through an integrated transactional backbone that provides a more unified view of inventory, purchasing, promotions, pricing, assets and financials

- **AN IMPROVED SHOPPING EXPERIENCE**—through improved merchandising, reduced out-of-stocks and effective pricing strategies
- **LOWER RISK TO THE BUSINESS AND THE BRAND**—resulting from improved visibility and reporting control, which is necessary to comply with today's demanding regulations

While the prospect of deploying an integrated retail backbone may initially appear out of reach to a mid-sized retailer, it is often a much more affordable undertaking than many realize. Admittedly, large retail companies have spent small fortunes to move in this direction. However, the complexity of stitching together multiple legacy applications over the years—as well as the overwhelming number of complex integration projects brought about by numerous mergers and acquisitions—have made this a costly and painful undertaking even for large organizations.

Fortunately, mid-sized retailers rarely have the complexity and requirements that their larger competitors have to contend with. As a result, most of them can get into a single, integrated retail platform for a fraction of the investment that large companies have had to make, giving them a great advantage—one they can leverage to succeed in today's big-box world.

CONCLUSION

The rapid growth of the large retail chains, the expansion of foreign-owned mass merchants into the U.S. market, and the shifting consumer demographics and expectations have all converged to create the most challenging retail environment in history. To successfully compete, mid-sized retailers must carve out a niche based on better and more localized product assortments, flawless price management and execution, and optimized inventory down to the store level. This requires access to the same level of information and intelligence that their big-box rivals have, enabled by sophisticated systems and an integrated retail backbone that can support sustained differentiation. Mid-sized retailers can now deploy a single, integrated retail platform for a fraction of the investment that their larger rivals have had to make, giving them a much-needed edge in today's big-box-dominated climate.

ABOUT ALDATA SOLUTION, INC.

Aldata helps retailers differentiate and excel. Focused exclusively on retail, Aldata empowers retailers and their suppliers to sharpen the focus on what is essential for success—achieving the optimal balance to effectively and profitably manage and fulfill consumer demand. With a single, integrated solution and data model, Aldata customers realize unparalleled efficiency from headquarters to stores and everywhere in between. Aldata's Core Retail Suite includes merchandising, sales, replenishment, logistics and store operations—providing retailers the visibility, flexibility and responsiveness they need to support the evolving customer, competitive and compliance landscape. For more information, please visit our web site at www.aldata-solution.com/us

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