

## CHAPTER 2

### TYPES OF RETAILERS

ANNOTATED OUTLINE	INSTRUCTOR NOTES
<p><b>I. Retailer Characteristics</b></p> <ul style="list-style-type: none"> <li>The 1.1 million U.S. store-based retailers range from street vendors selling hot dogs to Internet retailers like <a href="http://Amazon.com">Amazon.com</a> to omnichannel retailers like Best Buy that have both a physical store presence and an active Internet site.</li> <li>The retail industry is always evolving. As consumer needs and competition within the industry change, new retail formats are created to respond to those changes.</li> <li>The most basic characteristic of a retailer is its retail mix – the elements used to satisfy its customers’ needs.</li> <li>Four elements of the retail mix that are particularly useful for classifying retailers are: (1) the type of merchandise sold, (2) the variety and assortment of merchandise and/or services sold, (3) the level of customer service, and (4) the price of the merchandise.</li> </ul>	<p><i>Ask students to compare the four elements of the retail mix -- the type of merchandise sold, the variety and assortment of merchandise and/or services sold, the level of service provided to customers, and price -- of two women's specialty stores in a local mall. Now compare the retail mixes of one of the specialty stores and the local discount store (e.g., Wal-Mart). Use this comparison to illustrate how the competition between the two specialty stores is stronger than the competition between the specialty store and the discount store.</i></p> <p><i>PPT 2-5 illustrates classification of retailers by merchandise offering and by variety and assortment.</i></p>
<p><b>A. Variety and Assortment.</b></p> <ul style="list-style-type: none"> <li><b>Variety</b> is the number of merchandise categories a retailer offers. <b>Assortment</b> is the number of different items in a merchandise category. Each different item of merchandise is called a <b>SKU (stock keeping unit)</b>.</li> <li>Variety is often referred to as the <b>breadth of merchandise</b> and assortment is referred to as the <b>depth of merchandise</b>.</li> </ul>	<p><i>See PPT 2-7</i></p> <p><i>Ask students to give examples of local retailers with low variety and high assortment, with high variety and low assortment.</i></p> <p><i>What benefits does high variety offer to customers? What is the benefit of high assortment?</i></p> <p><i>Ask student to give an example of an SKU.</i></p>
<p><b>B. Services Offered</b></p> <ul style="list-style-type: none"> <li>Retailers also differ in the services they offer customers. Customers expect</li> </ul>	<p><i>See PPT 2-9</i></p> <p><i>Discuss the different customer service policies</i></p>

<p>retailers to provide some services-- accepting personal checks, displaying merchandise, providing parking, and being open long and convenient hours.</p> <ul style="list-style-type: none"> <li>• Some retailers charge customers for other services, such as home delivery and gift wrapping, although upscale retailers offer customers these services at no charge.</li> </ul>	<p><i>of a specialty store like Apple and a local department store or an Internet retailer.</i></p> <p><i>Discuss how customers' expectations differ at each type of store.</i></p>
<p><b>C. Prices and the Cost of Offering Breadth and Depth of Merchandise and Services</b></p> <ul style="list-style-type: none"> <li>• Stocking a deep and broad assortment is appealing to customers but costly for retailers. When a retailer offers many SKUs, inventory investment increases because the retailer must have back-up stock for each SKU.</li> <li>• Similarly, services attract customers to the retailer, but they are also costly.</li> <li>• To make a profit, retailers that offer broader and deeper assortments and services need to charge higher prices.</li> <li>• A critical retail decision involves the trade-off between costs and benefits of maintaining additional inventory or providing additional services.</li> </ul>	<p><i>See example in PPT 2-10 for illustration</i></p> <p><i>Customers like wide variety, deep assortments, and a lot of service, though some customers appreciate having the retailer edit the assortment for them. Ask students why all retailers don't have this type of offering? Retailers have constraints of money, size of store, and limited number of employees.</i></p> <p><i>Why don't discount stores offer more services? (They appeal to a target segment that does not want to pay the cost for more service options.)</i></p> <p><i>PPT 2-12 shows a comparison of sales and growth rates in various retail sectors</i></p>
<p><b>II. Food Retailers</b></p> <ul style="list-style-type: none"> <li>• Twenty years ago, consumers purchased food primarily at conventional supermarkets. Now conventional supermarkets account for only 60 percent of food sales.</li> <li>• Supercenters, warehouse clubs, convenience stores and extreme value food retailers are significantly changing consumers' food purchasing patterns because they too sell food. At the same time, traditional food retailers carry many nonfood items.</li> <li>• The world's largest food retailer is Wal-</li> </ul>	<p><i>See PPT 2-13</i></p> <p><i>Where do students make the majority of their off-campus food purchases? What are the pros and cons of these different food retailer formats?</i></p> <p><i>Ask students where they see the direction of food retailers going in the next 20 years.</i></p>

<p>Mart with supermarket-type sales of more than \$134 billion.</p>	
<p><b>A. Supermarkets</b></p> <ul style="list-style-type: none"> <li>• A <b>conventional supermarket</b> is a self-service food store offering groceries, meat, produce, and limited non-food items.</li> <li>• A <b>limited assortment supermarket</b> (also called an <b>extreme value food retailer</b>) only stocks about 2,000 SKUs. The two largest US examples of these stores are Save-A-Lot and ALDI.</li> <li>• Limited assortment supermarkets are designed to maximize efficiency and reduce costs through limited assortment and service offerings. These cost savings and efficiencies allow the stores to charge significantly lower (40-60% lower) prices than conventional supermarkets.</li> </ul>	<p><i>See PPT 2-14</i></p> <p><i>Ask students to consider the retail mixes of the major supermarkets in the area surrounding campus. Which compete on price? On merchandise? On service? A combination?</i></p> <p><i>Do students have concerns about the quality of items at conventional supermarkets versus limited assortment supermarkets?</i></p>
<p><b>1. Trends in Supermarket Retailing</b></p> <ul style="list-style-type: none"> <li>• Today, conventional supermarkets are under substantial competitive pressure. Supercenters are attracting customers with their broader assortments and general merchandise at attractive prices. Full-line discount chains and extreme value retailers are increasing the amount of shelf space they devote to consumables.</li> <li>• Competitive pressure also comes from convenience stores who are selling more fresh merchandise.</li> <li>• Low cost competitors are especially challenging for conventional supermarkets because of their superior operating efficiencies.</li> <li>• To compete successfully with intrusions by other types of retailers, conventional supermarkets have taken steps to differentiate their offerings, such as emphasizing their “<b>power perimeters</b>” (areas around the outside walls with fresh perishables such as dairy, produce, florist,</li> </ul>	<p><i>See PPT 2-17</i></p> <p><i>Ask students about why they would continue to shop at conventional supermarkets. Alternatively, why would they shop for food at supercenters, warehouse clubs or convenience stores? What types of needs are fulfilled by conventional supermarkets that can't be filled through other food retailing formats? Based on these discussions, will conventional supermarkets be driven out of business by competing formats?</i></p>

<p>deli and bakery departments), targeting health conscious and ethnic consumers, providing a better in-store experience, and offering more private-label brands.</p> <ul style="list-style-type: none"> <li>• Conventional supermarkets are also offering more natural, organic, and fair trade foods for their increasingly health and environmentally conscious consumers. <b>Fair trade</b> means purchasing from factories that pay workers a living wage, well more than the prevailing minimum wage, and offer other benefits like onsite medical treatment.</li> <li>• Through adjustments to the traditional merchandise mix, conventional supermarkets are also targeting more ethnic shoppers.</li> <li>• Conventional supermarkets chains are leveraging their quality reputations to offer more private-label merchandise. Private-label brands benefit both customers and retailers.</li> <li>• The online grocery market also represents a growing category.</li> <li>• Creating an enjoyable shopping experience through wider variety, better store ambiance, and customer service is another approach supermarket chains may use to differentiate themselves from low-cost, low-service competitors. Some have begun to integrate “food as theater” concepts, such as cooking and nutrition classes and food tastings.</li> </ul>	
<p><b>B. Supercenters</b></p> <ul style="list-style-type: none"> <li>• <b>Supercenters</b> are the fastest growing retail category. At 150,000 to 220,000 square foot these stores offer a wide variety of food and non-food merchandise. The largest supercenters are Wal-Mart supercenters, Meijer, Kmart, Fred Meyer (a division of Kroger), and Target.</li> <li>• By offering broad assortments of grocery</li> </ul>	<p><i>See PPT 2-18 for an illustration of the characteristics of supercenters and warehouse clubs.</i></p> <p><i>The supercenter is one of the fastest growing retail formats. Why is the supercenter more attractive than a hypermarket in the U.S., but not in Europe? What are benefits to consumers shopping in supercenters versus conventional</i></p>

<p>and general merchandise under one roof, supercenters provide a one-stop shopping experience.</p> <ul style="list-style-type: none"> <li>• General merchandise items are often purchased at supercenters. These items have higher margins, which allows supercenters to offer food items at a more aggressive price.</li> <li>• However, since supercenters are very large, some customers find them inconvenient because it can take a long time to find the items they want.</li> <li>• <b>Hypermarkets</b> are also large (100,000 to 300,000 square feet) combination food and general merchandise retailers. They typically stock fewer SKUs than supercenters.</li> <li>• Popular in both Europe and South America, hypermarkets are not common in the United States. Located in large, warehouse-type structures with large parking facilities, hypermarkets typically carry a larger selection of food items than supercenters with a focus on perishables.</li> <li>• Supercenters place greater emphasis on general merchandise and dry grocery items such as breakfast cereals and canned goods.</li> <li>• Although supercenters and hypermarkets are the fastest growing categories in global retailing today, these retailers do face challenges in finding and acquiring appropriate land for building (particularly in Europe and Japan), along with backlash against these supersize stores, particularly in the U.S.</li> </ul>	<p><i>supermarkets? What are the disadvantages?</i></p> <p><i>Ask students if they prefer the supercenter model to a traditional supermarket? How do students feel about the growth of Walmart? Do students prefer Walmart's format over Target? Why?</i></p>
<p><b>C. Warehouse Club</b></p> <ul style="list-style-type: none"> <li>• A <b>warehouse club</b> is a retailer that offers a limited and irregular assortment of food and general merchandise with little service at low prices to ultimate consumers and</li> </ul>	<p><i>See PPT 2-18 for an illustration of the characteristics of supercenters and warehouse clubs.</i></p> <p><i>Ask students to give local examples of warehouse clubs. What is the target market for</i></p>

<p>small businesses.</p> <ul style="list-style-type: none"> <li>• Stores are large (at least 100,000 to 150,000 square feet) and located in low rent districts.</li> <li>• Warehouse clubs reduce prices by using low-cost locations and inexpensive store designs, and offering little customer service. They reduce inventory holding costs by carrying a limited assortment of fast-selling items and buying merchandise opportunistically.</li> <li>• Most warehouse clubs have two types of members: wholesale members who own small-businesses and individual members who purchase for their own use. Typically members must pay an annual fee.</li> </ul>	<p><i>warehouse clubs? (Consumers with larger families and small businesses.)</i></p> <p><i>Are warehouse clubs wholesalers or retailers? (When they sell to small businesses they are wholesalers. When they sell to individual members for personal or household use, they are retailers.)</i></p> <p><i>Ask students if they are members of a warehouse club? Do they prefer warehouse clubs to supercenters?</i></p>
<p><b>D. Convenience Stores</b></p> <ul style="list-style-type: none"> <li>• <b>Convenience stores</b> provide a limited variety and assortment of merchandise at a convenient location in a 3,000-to-5,000-square-foot store with a speedy checkout, with higher prices than supermarkets. They are a modern version of the neighborhood mom-and-pop grocery/general store.</li> <li>• Convenience stores enable consumers to make purchases quickly without having to search through a large store and wait in long checkout lines.</li> <li>• Convenience stores generally charge a higher price than supermarkets for staple items like milk, eggs, and bread?</li> <li>• Convenience stores are facing increasing competition from other retail formats, especially from supercenters and supermarket chains who have added gasoline to their merchandise offerings, offering tying gasoline sales to their frequent shopper programs.</li> <li>• In response to these competitive threats, convenience stores are taking steps to decrease their dependency on gasoline</li> </ul>	<p><i>See PPT 2-19 for an overview of the characteristics of convenience stores</i></p> <p><i>Ask students to give examples of local convenience stores.</i></p> <p><i>Which products do they tend to buy most often at convenience stores?</i></p> <p><i>What do they like/dislike about them? In general, what is so "convenient" about convenience stores?</i></p> <p><i>What services do students believe would make a convenience store more "convenient"?</i></p>

<p>sales by tailoring their merchandise assortments to local markets, making their stores even more convenient to shop, and adding new services.</p> <ul style="list-style-type: none"> <li>To increase convenience, some convenience stores are opening smaller stores close to where consumers shop and work. Others are exploring the use of technology to increase shopping convenience such as self-service kiosks.</li> </ul>	
<p><b>III. General Merchandise Retailers</b></p> <ul style="list-style-type: none"> <li>The major types of general merchandise retailers are department stores, full-line discount stores, specialty stores, category specialists, home improvement centers, off-price retailers, and extreme value retailers.</li> </ul>	<p><i>See PPT 2-20</i></p> <p><i>PPT 2-20 compares the various types of general merchandise retailers along several characteristics.</i></p>
<p><b>A. Department Stores</b></p> <ul style="list-style-type: none"> <li><b>Department stores</b> are retailers that carry a broad variety and deep assortment, offer some customer services, and are organized into separate departments for displaying merchandise.</li> <li>The largest department store chains in the U.S. are Macy's, Sears, JCPenney, and Kohl's, Nordstrom, Dillard's and Saks Fifth Avenue.</li> <li>Today, most department stores focus almost exclusively on soft goods. The major departments are women's, men's, and children's clothing and accessories; home furnishings; cosmetics; and kitchenware and small appliances.</li> <li>Each department within the store has a specific selling space allocated to it as well as salespeople to assist customers, often resembling a collection of specialty shops.</li> <li>Department store chains can be categorized into three tiers: (1) upscale, high fashion chains with exclusive designer merchandise and excellent customer</li> </ul>	<p><i>See PPT 2-21, 2-22, 2-23</i></p> <p><i>Ask students to give examples of local department stores. Why do customers go to department stores? What do they like/dislike about them?</i></p> <p><i>Ask students to give local examples of specialty stores. What are the differences between specialty stores, department stores, and discount stores? Where do students buy business suits, dresses, jeans, computers, electronics? Why do they go to that type of store?</i></p> <p><i>Which department stores do students prefer? Which tier do they shop most often? Discuss differences in these responses.</i></p>

<p>service (Neiman Marcus, Nordstrom); (2) traditional chains with more moderately priced merchandise and less customer service (Macy's and Dillard's); and (2) value-oriented chains catering to price-conscious consumers (Kohl's and JCPenney).</p> <ul style="list-style-type: none"> <li>• Today many customers question the benefits of shopping at department stores due to: (1) lack of convenient locations, (2) decreases in customer service and (3) relatively high prices.</li> </ul>	
<p><b>B. Full-Line Discount Stores</b></p> <ul style="list-style-type: none"> <li>• A <b>full-line discount store</b> is a retailer that offers a broad variety of merchandise, limited service, and low prices. They offer both private and national brands.</li> <li>• The big three full-line discount store chains are Wal-Mart, Target and Kmart.</li> <li>• A significant trend in this sector is Wal-Mart's conversion of discount stores to supercenters as a result of increased competition faced by the full-line discount stores, as well as the significant operating efficiencies realized by supercenters.</li> <li>• Target is becoming one of the most successful retailers in terms of sales growth and profitability, succeeding because its stores offer fashionable merchandise at low prices in a pleasant shopping environment.</li> </ul>	<p><i>See PPT 2-24</i></p> <p><i>Discuss the target markets of the three largest full-line discount store chains (Wal-Mart, Target and Kmart). How will the category specialists (Toys R Us, Staples, and Home Depot) affect the retail strategy of full-line discount store chains? What about Internet only retailers? Are discount stores going to succeed in the "clicks" environment?</i></p> <p><i>In general, what are the factors that contribute to the success of discount stores despite increasing competition from other formats?</i></p>
<p><b>C. Category Specialist</b></p> <ul style="list-style-type: none"> <li>• A <b>category specialist</b> is a big box discount store that offers a narrow variety but deep assortment of merchandise. These retailers predominantly use a self-service approach, but they offer assistance to customers in some areas of the store.</li> <li>• By offering a complete assortment in a category at low prices, category specialists can "kill" a category of merchandise for</li> </ul>	<p><i>See PPT 2-25</i></p> <p><i>Ask students to give local examples of category specialists. How are they similar to specialty stores? Discuss the differences and similarities with discount stores.</i></p>



<p>other retailers and thus are frequently called <b>category killers</b>.</p> <ul style="list-style-type: none"> <li>• Because category specialists dominate a category of merchandise, they can use their buying power to negotiate low prices, and assured supply when items are scarce.</li> <li>• One of the largest and most successful types of category specialist is the home improvement center. A <b>home improvement center</b> is a category specialist offering equipment and material used by do-it-yourselfers and contractors to make home improvements.</li> <li>• While merchandise in home-improvement centers is displayed in a warehouse atmosphere, salespeople are available to assist customers in selecting merchandise and to tell them how to use it.</li> <li>• Competition between specialists in each category is very intense (Staples vs. Office Depot; Home Depot vs. Lowe's) as firms expand into the regions originally dominated by another firm. Direct competition focuses on price, resulting in reduced profits because the competitors have difficulty differentiating themselves on other elements of the retail mix.</li> <li>• In response to this increasing competitive intensity, the category killers continue to concentrate on reducing costs by increasing operating efficiency and acquiring smaller chains to gain scale economies, although some category killers, like Home Depot and Lowe's are attempting to differentiate themselves with service through licensed contractors.</li> </ul>	<p><i>Ask students to describe an experience at a home improvement center such as Home Depot or Lowe's in terms of merchandise, atmosphere and salesperson service.</i></p>
<p><b>D. Specialty Stores</b></p> <ul style="list-style-type: none"> <li>• A <b>specialty store</b> concentrates on a limited number of complementary merchandise categories and provides a high level of service in a relatively small store.</li> </ul>	<p><i>See PPT 2-26</i></p> <p><i>Why do customers go to specialty stores? What do they like/dislike about them?</i></p>

<ul style="list-style-type: none"> <li>• Specialty stores tailor their retail strategy toward very specific market segments by offering deep but narrow assortments and sales associate expertise.</li> <li>• Today, competitors from other countries also are making some of the most successful specialty stores in the U.S. rethink how they satisfy their customers' needs. For instance, Zara and H&amp;M have introduced "fast fashion" to the U.S. market. Fast fashion is cheap and chic offering new, fresh merchandise 2-3 times per week.</li> </ul>	<p><i>Manufacturers are also opening their own specialty stores (Levi's, Godiva, Cole Haan, Coach, etc). What are the implications for other retailers like department stores who also sell these brands?</i></p> <p><i>Discuss the "fast fashion" specialty store model with students. Which of these stores have they visited? What do they like/dislike about the concept?</i></p>
<p><b>E. Drugstores</b></p> <ul style="list-style-type: none"> <li>• <b>Drugstores</b> are specialty stores that concentrate on health and personal grooming merchandise. Pharmaceuticals often represent 50 percent of drugstore sales and an even greater percentage of their profits.</li> <li>• Drug stores, particularly the national chains, are experiencing sustained sales growth because the aging population requires more prescription drugs. Prescription pharmaceutical margins are shrinking due to governmental health care policies and HMOs.</li> <li>• Drugstores are also being squeezed by competition from pharmacies in discount stores and supermarkets, as well as prescription mail-order retailers.</li> <li>• In response, drug store chains are building larger stand-alone stores offering a wider assortment of merchandise, more frequently purchased food items, and drive-through windows for picking up prescriptions. Also, drugstore retailers are encouraging pharmacists to take the time to provide personalized service.</li> </ul>	<p><i>See PPT 2-27</i></p> <p><i>Ask students if they have shopped online for drugstore products. What has been their experience? Do they think the Internet is a viable channel for drugstore merchandise?</i></p>

<p><b>F. Extreme Value Retailers</b></p> <ul style="list-style-type: none"> <li>• <b>Extreme value retailers</b>, such as Family Dollar Stores and Dollar General, <b>are</b> small, full-line discount stores that offer a limited merchandise assortment at very low prices.</li> <li>• By offering limited assortments and operating in low-rent locations, extreme value retailers are able to reduce costs and maintain very low prices.</li> <li>• Despite some of these chains' names, few just sell merchandise for \$1. Rather, the names imply a good value but do not limit prices to the arbitrary dollar price point.</li> <li>• The growing popularity of extreme value retailers has led some vendors to agree to create special, smaller packages just for them.</li> <li>• Once considered low-status retailers catering to low-income consumers, extreme value retailers have broadened their appeal to higher-income consumers by offering exciting bargains and unique merchandise.</li> </ul>	<p><i>See PPT 2-28 for a summary of issues facing extreme value retailers.</i></p> <p><i>Ask students to name the extreme value retailers in the local marketplace. How many have shopped at one of them? For what types of merchandise? What is the primary appeal of these retailers?</i></p>
<p><b>G. Off-Price Retailers</b></p> <ul style="list-style-type: none"> <li>* <b>Off-price retailers</b>, also known as <b>close-out retailers</b>, offer an inconsistent assortment of brand name merchandise at low prices.</li> <li>* Off price retailers can sell brand name and even designer-label merchandise at low prices due to their unique buying and merchandising practices. Most merchandise is bought opportunistically from manufacturers or other retailers with excess inventory at the end of the season.</li> <li>* End of season merchandise that will not be used in following seasons is called <b>close-outs</b>. The merchandise may be in odd sizes or unpopular colors or styles, or it may be <b>irregulars</b>, merchandise that has minor</li> </ul>	<p><i>Ask students to give examples of local off-price retailers. What do consumers like about off-price retailers? What don't they like?</i></p> <p><i>See PPT 2-29 for a summary of the issues facing off-price retailers</i></p>

<p>mistakes in construction.</p> <ul style="list-style-type: none"> <li>* Typically, merchandise is purchased at one-fifth to one-fourth of the original wholesale price. Off-price retailers can buy at low prices because they don't ask suppliers for advertising allowances, return privileges, markdown adjustments, or delayed payments.</li> <li>* Due to this pattern of opportunistic buying, customers can't be confident that the same type of merchandise will be in stock each time they visit the store.</li> <li>* <b>Outlet stores</b> are off-price retailers owned by manufacturers, or by department or specialty store chains.</li> <li>* Outlet stores owned by manufacturers are frequently referred to as <b>factory outlets</b>.</li> <li>* Manufacturers view outlet stores as an opportunity to improve their revenues from irregulars, production overruns, and merchandise returned by retailers. Outlet stores also allow manufacturers some control over where their branded merchandise is sold at discount prices.</li> </ul>	<p><i>Ask students which type of off-price retailer offers consumers truly the best value? Why?</i></p>
<p><b>IV Differences between Services and Merchandise Retailers</b></p> <ul style="list-style-type: none"> <li>* Four important differences in the nature of the offering provided by services and merchandise retailers are: (1) intangibility, (2) simultaneous production and consumption, (3) perishability, and (4) inconsistency of the offering to customers.</li> </ul>	<p><i>PPT 2-30</i></p>
<p><b>1. Intangibility</b></p> <ul style="list-style-type: none"> <li>* Services are generally intangible -- customers cannot see, touch, or feel them. Services are performances or actions rather than objects.</li> <li>* Intangibility introduces a number of challenges for services retailers. It is difficult for customers to evaluate services</li> </ul>	<p><i>Ask students how customers can evaluate the quality of an intangible service offering. What problems does intangibility cause for the services retailer?</i></p>

<p>before they buy them, or even after they buy and consume them. Services retailers often use tangible symbols to inform customers about the quality of their services.</p> <ul style="list-style-type: none"> <li>* Services retailers also have difficulty in evaluating the quality of services they are providing. To evaluate the quality of their offering, services retailers place emphasis on soliciting customer evaluations and complaints.</li> </ul>	
<p><b>2. Simultaneous Production and Consumption</b></p> <ul style="list-style-type: none"> <li>* Service providers create and deliver the service as the customer is consuming it. The simultaneity of production and consumption creates some special problems for services retailers.</li> <li>* First, the customers are present when the service is produced, may have an opportunity to see it produced, and in some cases, may be part of the production process.</li> <li>* Other customers consuming the service at the same time can affect the quality of the service provided.</li> <li>* Finally, the services retailer often does not get a second chance to satisfy the needs of their customers. While customers can return damaged merchandise to a store, customers that are dissatisfied with services have limited recourse. Thus it is critical for services retailers to get it right the first time.</li> <li>* Because services are produced and consumed at the same time, it is difficult to reduce costs through mass production.</li> </ul>	<p><i>What problems does simultaneous production cause for the services retailer?</i></p>
<p><b>3. Perishability</b></p> <ul style="list-style-type: none"> <li>* Because the creation and consumption of services is inseparable, services are perishable. They can't be saved, stored, or</li> </ul>	<p><i>Give examples of retailers for which perishability is a real problem? [movie theaters, airlines, cruise lines, public golf courses] What do these retailers do to</i></p>

<p>resold. This is in contrast to merchandise, which can be held in inventory until a customer is ready to buy it.</p> <ul style="list-style-type: none"> <li>* In addition, the demand for a service varies considerably over time. Thus, services retailers often have times when their services are underutilized and other times when they have to turn customers away because they cannot accommodate them.</li> <li>* Services retailers use a variety of programs to match demand and supply. They also attempt to make customer waiting time more enjoyable.</li> </ul>	<p><i>minimize the problem?</i></p> <p><i>What actions have students seen services retailer take to make waiting time more enjoyable for customers?</i></p>
<p><b>4. Inconsistency</b></p> <ul style="list-style-type: none"> <li>* Merchandise is often produced by machines with very tight quality control. Because services are performed by people, no two services will be identical.</li> <li>* Thus, an important challenge for service retailers is providing consistently high-quality services.</li> </ul>	<p><i>What problems does inconsistency cause for the services retailer? Are there services retailers whose inconsistency is acceptable? (Custom designers, hair “artists”)</i></p>
<p><b>V. Types of Ownership</b></p> <ul style="list-style-type: none"> <li>* Another way to classify retailers is by their ownership. The major classifications of retail ownership are: (1) independent, single-store establishments, (2) corporate chains, and (3) franchises.</li> </ul>	<p><i>See PPT 2-34</i></p>
<p><b>A. Independent, Single-Store Establishments</b></p> <ul style="list-style-type: none"> <li>* Retailing is one of the few sectors in our economy in which entrepreneurial activity is extensive. Many of these retail start-ups are owner managed which means management has direct contact with their customers and can respond quickly to those customers’ needs.</li> <li>* While single-store retailers can tailor their offering to their customers' needs, corporate chains can more effectively negotiate lower prices for merchandise and</li> </ul>	<p><i>Ask students to give examples of local independent, single-store retailers. Do they shop at independents? Why or why not?</i></p> <p><i>Do students believe national chains will drive all independents out of business?</i></p>

<p>advertising due to their larger size.</p> <ul style="list-style-type: none"> <li>* To better compete against corporate chains, some independent retailers join a wholesale-sponsored voluntary chain. A <b>wholesale-sponsored voluntary cooperative group</b> is an organization operated by a wholesaler offering a merchandising program to small, independent retailers on a voluntary basis.</li> </ul>	
<p><b>B. Corporate Retail Chains</b></p> <ul style="list-style-type: none"> <li>* A <b>retail chain</b> is a company operating multiple retail units under common ownership and usually having some centralization of decision making in defining and implementing its strategy.</li> </ul>	<p><i>Wal-Mart has pursued a strategy of opening stores on the outskirts of small rural towns with populations between 25,000 and 50,000. These stores offer broader selection of merchandise at much lower prices than previously available from local retailers. Discuss the pros and cons of this strategy in class. What ramifications may result? (Monopolizing market, demise of small stores, potential to become major employer in rural area).</i></p>
<p><b>C. Franchising</b></p> <ul style="list-style-type: none"> <li>* <b>Franchising</b> is a contractual agreement between a franchisor and a franchisee that allows the franchisee to operate a retail outlet using a name and format developed and supported by the franchisor. Approximately 40% of all US retail sales are made by franchisees.</li> <li>* In a franchise contract, the franchisee pays a lump sum plus a royalty on all sales for the right to operate a store in a specific location. The franchisee also agrees to operate the outlet as per the procedures prescribed by the franchisor. The franchisor provides assistance in locating and building the store, developing the products and/or services sold, management training, and advertising.</li> <li>* The franchise ownership format attempts to combine the advantages of owner-managed businesses with efficiencies of centralized decision-making in chain store operations.</li> </ul>	<p><i>Ask students to give examples of local franchises. If they wanted to own a retail business, would they want a franchise or their own store? Why? What are the advantages of being a franchisee?</i></p> <p><i>PPT 2-35 provides a brief introduction to the Franchising form of retail ownership.</i></p>

<p><b>VIII. Summary</b></p> <ul style="list-style-type: none"> <li>Over the past 30 years, U.S. retail markets have been characterized by the emergence of many new retail institutions. Traditional institutions have been joined by category specialists, hypermarkets and superstores, extreme value retailers, and nonstore retailers among others.</li> </ul>	
<p><b>IX. Appendix 2A: Comparison Shopping</b></p> <ul style="list-style-type: none"> <li>All retailers learn about their competitors through comparison shopping. It might be as informal as walking through a competitor's store and looking around. However, a structured analysis is more helpful in developing a retail offering that will attract consumers from a competitor's store.</li> <li>The first step is to define the scope of the comparison; the comparison might be between two retail chains, two specific stores, two departments, or two categories of merchandise, depending on responsibilities of the person undertaking the comparison.</li> <li>Comparisons might also focus on chains' financial resources, inventory levels, number of stores and employees, store locations, merchandise sold, employee compensation programs, and return policies.</li> </ul>	<p><i>For an exercise on comparison shopping see Ancillary Exercise 2-2. Breaking the class into groups and having each group do a comparison shopping exercise is a good way to get students to understand the difference between retailers and the types of decisions retail manager make. Have each group compare different institutions selling the same merchandise category. For example, men's suits in a department store and men's specialty store, athletic shoes in a discount store and specialty shoe store, CD's in a discount store and a specialty music store.</i></p>

**ANSWERS TO SELECTED “GET OUT AND DO ITS”**

**2. GO SHOPPING** Go to an athletic footwear specialty store such as Foot Locker, a sporting goods category specialist, a department store, and a discount store. Analyze their variety and assortment of athletic footwear by creating a table similar to that in Exhibit 2–2.

Students should be able to fill in this type of table and explain their findings.

	Variety of Athletic Footwear Breath of Merchandise	Assortment of Athletic Footwear Depth of Merchandise
Footlocker		



Specialty Store		
Sporting Goods Category Specialist		
Department store		
Discount Store		

**3. GO SHOPPING** Keep a diary of where you shop, what you buy, and how much you spend for two weeks. How did each retailer meet your shopping needs? Get your parents to do the same thing. Tabulate your results by type of retailer. Are your shopping habits significantly different or are they similar to those of your parents? Do you and your parents' shopping habits coincide with the trends discussed in this chapter? Why or why not?

Students should keep a list of places shopped. Results can be compared to a parent or another classmate. This assignment should give student insight to their own consumer buying behavior and how they select merchandise and retail formats. Ask students to discuss the managerial implications of their findings. How should retailers with differing target markets communicate with the different audiences based on the differences in buying behaviors, as discovered by this assignment.

**4. GO SHOPPING** Describe how the supermarket where you shop is implementing organic, locally grown, ethnic and private label merchandise. If any of these categories of merchandise are missing, explain how this could be a potential opportunity for growth for this supermarket. Then describe any strategies or activities that you believe are providing any a better shopping experience than its competition. If you believe that competing stores are providing a better shopping experience than your store, explain what they are doing, and evaluate whether or not these activities would benefit from your supermarket.

Responses here will vary. Some stores have big commitment to organic, locally grown, ethnic and private label merchandise. Students should consider the demographics of the store's customers to evaluate the potential demand for these categories.

**5. INTERNET EXERCISE** Data on U.S. retail sales are available at the U.S. Bureau of the Census Internet site at [www.census.gov/retail](http://www.census.gov/retail). Look at the unadjusted monthly sales by NAICS (found in the Monthly Retail Trade Report Section). Which categories of retailers have the largest percentage of sales in November and December? Do your findings make sense to you?

Students will notice that many retail categories generate their largest percentage of sales in the fourth quarter. Some are:

- (443) Electronics and Appliance Stores
- (44312) Computer and Software Stores

- (4453) Beer, Wine and Liquor Stores
- (44812) Women's Clothing Stores
- (45111) Sporting Goods Stores
- (454) Nonstore Retailers

The higher level of sales in the last quarter of the year are likely due to holiday sales. Do these categories make sense to students? Are there other categories students would expect to see similar sales?

**6. INTERNET EXERCISE** Three large associations of retailers are the National Retail Federation ([www.nrf.com](http://www.nrf.com)), the Food Marketing Institute ([www.fmi.org](http://www.fmi.org)) and the National Association of Convenience and Petroleum Stores ([www.nacsonline.com](http://www.nacsonline.com)). Visit these sites and report on the latest retail developments and issues confronting the industry.

Information on these sites will change daily. The National Retail Federation will likely have information on trends in retailing like showrooming and omnishopping. Similarly, the NRF will also report on federal regulations, like taxes and swipe fees, that impact retailing. The Food Marketing Institute will provide information on trends in food retailing and manufacturing as well as legal and economic concerns. For example, the FMI may report on information about changes in regulations on what constitutes organic. The NACS will report on regulations as well, such as debit card swipe fees, as well as information on oil prices and petroleum.

**7. INTERNET EXERCISE** Go to *Entrepreneur Magazine's* Franchise Zone web page at <http://www.entrepreneur.com/franchise> and view the top 500 franchises for the past year. How many of these retailers in the Top Ten have you patronized as a customer? Did you know that they were operated as a franchise? Look at the list for previous years to see changes in the rankings. Click on the link, About the Franchise 500, and describe what factors were used to develop the list. Finally, what is the nature of the business that seems to lend itself to franchising?

The Top 10 Franchises for 2013 include many familiar names. Students will likely report having visited a Subway, McDonald's, or 7-Eleven. Students should uncover some notable changes in the Top 10. Perhaps most significant, Subway has been moved into the number 2 spot after many years at number 1. For 2013, Hampton Hotels is number 1. Why is Hampton Hotels rated higher than Subway? An interesting point for discussion of competitive strategy is the reintroduction of fast food retailers like McDonald's and KFC to the top 10. What do students believe are behind the reinvigoration of these fast food franchise retailers? Will they be able to maintain these positions in the face of changing trends in consumer lifestyles and food retailing?

The web site notes that the list of the Top 500 franchises is based on quantifiable measures such as financial strength and stability, growth rate, size of the system, and number of years in business. Students will likely notice that service-based retailers tend to lend themselves best to the franchise system, particularly those services that allow for standardization of business practices and retail operating formats.

8 Bed Bath & Beyond is the number one superstore domestics retailer in the US with about 1,000 stores throughout the US and Ontario, Canada. This retailer sells domestics (bed linens, bathroom and kitchen items) and home furnishings (cookware and cutlery, small household appliances, picture frames, and organizing supplies). What are the SIC and NAICS codes used by this retailer? What other retailers compete against Bed Bath & Beyond and which store format is implemented by each competitor?

Primary SIC Code                      5023: Home furnishings

Primary NAICS Code                    442299: All Other Home Furnishings Stores

Other SIC Codes

2273 Carpets and rugs	535 Household vacuum cleaners
2391 Curtains and draperies	539 Household appliances, nec
2392 House furnishings, nec	561 Telephone and telegraph apparatus
2519 Household furniture, nec	521 Furniture
2844 Toilet preparations	541 Children's and infants' wear stores
3631 Household cooking equipment	519 Misc. home furnishings stores
3633 Household laundry equipment	522 Household appliance stores
3634 Electric housewares and fans	547 Gift, novelty, and souvenir shops

Key Competitors

<a href="#">Macy's</a>	Department store
<a href="#">Target</a>	Discount Store
<a href="#">Wal-Mart</a>	Discount store

Other Competitors

<a href="#">Anna's Linens</a>	<a href="#">J. C. Penney</a>
<a href="#">Art.com</a>	<a href="#">Kmart</a> <a href="#">Macy's</a>
<a href="#">Babies "R" Us</a>	<a href="#">Pier 1 Imports</a>
<a href="#">Burlington Coat Factory</a>	<a href="#">Ross Stores</a>
<a href="#">The Children's Place</a>	<a href="#">Saks</a>
<a href="#">Container Store</a>	<a href="#">Sears</a>
<a href="#">Cost Plus</a>	<a href="#">Sensational Beginnings</a>
<a href="#">Dillard's</a>	<a href="#">Target</a>
<a href="#">Euromarket Designs</a>	<a href="#">TJX Companies</a>
<a href="#">Garden Ridge</a>	<a href="#">Tuesday Morning Corporation</a>
<a href="#">Gymboree</a>	<a href="#">Wal-Mart</a>
<a href="#">IKEA</a>	<a href="#">Williams-Sonoma</a>

**ANSWERS TO DISCUSSION QUESTIONS AND PROBLEMS**

**1. Distinguish between variety and assortment. Why are these important elements of retail market structure?**

The main difference between variety and assortment is that variety refers to the number of different merchandise categories a retailer sells, whereas assortment is the number of different items or SKUs in a merchandise category. In addition, variety is often referred to as the breadth of merchandise carried by the retailer, and assortment is referred to as the depth of merchandise. These elements form an integral part of the retail market structure, since it is the retail offering that ultimately distinguishes one retailer from another.

**2. What sorts of competitive pressures are confronting traditional grocery stores? What options do these stores have to ease these pressures?**

Supermarkets are under competitive pressures from supercenters, warehouse clubs, extreme-value retailers, convenience stores, and even drug stores. These retailers have increased the amount of space that they provide for consumables. In addition, these competing retailers offer food merchandise to build the traffic in their stores and increase the sales of more profitable nonfood merchandise. To compete against these stores, supermarkets are offering more fresh merchandise, green merchandise, ethnic merchandise and private label merchandise. In addition, supermarkets are also working on ways to enhance the store ambience and customer service to provide a more enjoyable shopping experience.

**3. What do off-price retailers need to do to compete against other formats in the future?**

The main competitive weapon for the off-price retailers is their low price. While they may not directly compete with higher service formats, such as department and specialty stores, they do face increasing competition from discount stores. Here, the off-price stores may be at a relative disadvantage since their merchandise is based upon opportunistic buying, while discount stores offer a relatively stable mix of merchandise at stable prices (everyday low pricing).

Since the option of improving service may increase costs and weaken their only source of competitive advantage, low price, off-price retailers should focus on strategies to keep their costs and prices low and explore low cost methods of attracting and retaining customers. In terms of keeping operational costs low, they can locate in lower cost urban and rural areas (note that outlet stores are more clustered within outlet malls located farther from the city but near major highways). They can also implement more efficient inventory and merchandise management systems (note that for a discount store, such as Wal-Mart, operational efficiency and costs reductions are crucial to offering lower prices to customers). Also, they can expand their sourcing to include imports from low cost international markets.

Another threat for off-price retailers may be from Internet stores. Often several stores publicize their low prices and also attempt to match consumer price preferences through reverse bidding and auctions (sites such as Priceline and eBay). Off-price retailers can explore the possibility of using the Internet for relatively low cost advertising about current merchandises (since their merchandise stocks fluctuate more rapidly due to opportunistic buying). Factory outlet stores, on the other hand, can compete more directly over the Internet.

**4. Compare and contrast the retail mixes of convenience stores, traditional supermarkets, superstores, and warehouse stores. Can all of these food retail institutions survive over the long run? How? Why?**

<b>Element of Retail Mix</b>	<b>Convenience Store</b>	<b>Traditional Supermarket</b>	<b>Superstore</b>	<b>Warehouse Store</b>
Location	Typically freestanding, easily accessible sites	Typically in strip shopping centers	Typically in strip shopping centers	Typically in strip shopping centers
Merchandise Assortment	Limited variety and assortment	Average variety and assortment	Greater variety with deeper assortment than supermarket	Greater variety with about the same assortment as supermarket. Primary difference is that merchandise assortment varies because of opportunistic buying.
Pricing	Higher pricing than supermarkets	Average pricing. Some chains have constant (every day) pricing and others have special sale (high-low) pricing.	Lower pricing than supermarkets. Typical every day pricing.	Lower pricing than supermarkets. Pricing depends on cost of merchandise bought on special buys.
Advertising and Promotion	Limited advertising, frequent shopper programs tied to gasoline sales.	High-low pricing chains advertise weekly specials.	Limited advertising since most have everyday pricing.	Minimal promotion since all merchandise is basically on sale.
Personal selling	Minimal	Minimal	Minimal	Minimal
Store design and display	Designed for quick and easy merchandise selection and checkout	Typically use a grid-iron with cross-hatch aisles, extensive signs.	Same as supermarket.	Same as supermarket. A bit more disorganized to give the customers the feel of searching for a bargain.
Service	Minimal	Some services for produce, bakery, meat and fish categories.	Some services for produce, bakery, meat and fish areas.	Minimal

All four types will persist because they appeal to different customer needs. The warehouse stores typically have larger pack sizes that are very attractive to customers with large families and to small business owners like local restaurants. In addition, due to the varying assortments, customers who are brand loyal might not want to shop in these stores.

Convenience stores are located and designed to offer customers a snack, quick meal or minimal grocery/general merchandise purchase along with their gasoline. These retailers offer easy in and out access and speedy transactions. In response to competitive pressures from other food retailers, as well as dependency on gasoline sales, many convenience stores are now offering consumers fresh food and healthy fast food choices to reduce dependency on fuel sales while maintaining on-the-go ease and convenience.

The superstores are low in price but more inconvenient to shop in because of the large size. Thus they appeal to customers who are very price conscious and are willing to drive a longer distance and spend more time shopping in a larger store.

Conventional supermarkets are the most convenient. In major metro areas, there is a conventional supermarket two to three miles from everyone's home. They also provide more services for customers such as cutting meat to order. Conventional supermarkets appeal to customers who value service and convenience and are not as price conscious.

Note that the same consumer may shop at all four types of food retailers depending on the nature of the shopping trip. For example, a consumer might stock up on basic such as toilet paper, soft drinks, and can goods at a warehouse or superstore and then go to a supermarket to buy meat, produce, and gourmet food.

**5. Why is Walmart, the largest retailer in the world, facing slower growth than in the past? What can it do to accelerate its growth?**

Full line discount stores, like Walmart, face challenges from category specialists that dominate specific product categories. In response to this pressure, Walmart has converted many of its stores into supercenters that are more efficient and generate higher traffic. In addition, Walmart is expanding to more urban locations using smaller storefronts.

**6. Why are retailers in the limited assortment supermarket and extreme value discount store sectors growing so rapidly? From which retailers are they getting these additional sales.**

Both limited assortment supermarkets and extreme value discount stores focus on relatively limited merchandise offerings at highly appealing (low!) prices. The retail formats are able to offer their extremely low prices through maximizing efficiency. By reducing extras and service offerings, as well as managing a relatively low merchandise assortment, these retailers are able to provide consumers with the "thrill of the hunt" for amazing deals. Extreme value retailers are attracting customers away from supermarkets and supercenters.

**7. The same brand and model of tablet is sold by specialty computer stores, discount stores, category specialists, online retailers and warehouse stores. Why would a customer choose one retail format over the others?**

Each type of retail store provides a unique combination of price and services tailored to the needs of different types of customers. The specialty store typically will have higher prices, but will offer more services. It will have salespeople with technical expertise available to provide information to customers and answer questions. This service is particularly valuable to customers who do not know much about computers.

On the other hand, discount stores, category specialists, and warehouse stores have lower prices and do not offer much personalized service. These stores are more attractive to customers who have more expertise and do not need personalized service.

Due to the greater assortment in category specialists, customers are able to compare the prices and features of different brands in one store visit. Warehouse and discount stores have limited assortments and thus customers can only see a limited set of brands and models. But they can also buy merchandise in different product categories at the same time they are buying a computer.

Some customers will prefer the convenience and selection offered online. The Internet may also be used to collect information and compare features and prices prior to shopping in a store location.

- 8. Choose a product category that both you and your parents purchase (e.g., business clothing, casual clothing, music, electronic equipment, shampoo). In which type of store do you typically purchase this merchandise? What about your parents? Explain why there is (and is not) a difference in your store choices.**

Students may emphasize specialty stores such as The Gap, Old Navy, Abercrombie and Fitch, Express, and Best Buy etc. for their purchases for clothing, or electronic equipment, while mentioning that their parents favor traditional department stores such as Macy's or Sears for the purchase of such product categories. If price is a major factor, there may be some similarities between the students and their parents; both may shop at discount stores.

The merchandise, service and prices for the various retail formats stocking different product categories are different. In general, stores deliberately targeting a younger population will be favored by students since these stores would better match their expectations of merchandise (such as fashion clothing), prices and services (students may consider themselves savvy customers for certain products, such as music and electronic equipment, and may not need the type of service demanded by their parents for instance in purchasing business clothing).

- 9. At many optical stores you can get your eyes checked and purchase glasses or contact lenses. How is the shopping experience different for the service as compared to the product? Design a strategy designed to get customers to purchase both the service and the product. In so doing, delineate specific actions that should be taken to acquire and retain optical customers.**

Optical stores present an interesting mix of service and related merchandise. On one hand, the eye examination is usually done by a trained and licensed eye doctor and here the service experience is often very professional and similar to a visit to any physician or hospital. On the other hand, the glasses or contact lenses are displayed in a retail store setting with the service being mostly oriented towards helping the customer try out various options. The contrasts between the service and retail environments may be unnerving for some customers.



One strategy to reduce the gap is to ensure that the retail setting is very professional and courteous. Since the problem has been detected and identified by the eye doctor, the sales staff in the retail setting could engage and interact more directly with the customer with more of a problem-solving approach. This would involve educating consumers on various issues, including the merits/demerits of using glasses or contact lenses, the types of lenses and coatings, proper care of glasses and contact lenses, etc.

It must also be recognized that most customers who are prescribed glasses for the first time are likely to continue wearing glasses or contact lenses for the rest of their lives. Thus, it is important to start building consumer trust and confidence through professional service and expertise. One strategy would be to encourage customers to return for an eye examination every year and also have their current prescription for the glasses or lenses checked. Another is to provide free repair service for the frames.

**10. There are services and products involved when buying or renting a car, and in both cases, the customer drives away in a car. But buying a car focuses more on the product, whereas renting involves the service. Explain four ways in which marketing for a rental car company differs from marketing for an automobile dealership.**

The differences in offerings provided by service retailers include (1) intangibility, (2) simultaneous production and consumption, (3) perishability, and (4) inconsistency of the offering to customers. Although the automobile at the rental car company is tangible, the experience of renting is an intangible offering. The services surrounding the accessibility of the car rental or what is most important to the customer. Similarly, the service is consumed at the same time it is being produced. This differs from the experience of purchasing a car. The rental car service is also perishable. If a day goes by and an car is not rented, the revenue from renting the car for that day is gone forever, making the rental car service perishable. Finally, the experience with the rental car company may be inconsistent. As personalities and training programs might differ by location, the experience the consumer has with a rental car provider at different locations may vary significantly.

## **ANCILLARY LECTURES**

### **LECTURE # 2-1: FRANCHISING**

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Instructor's Note: Franchising is one of the most popular and successful ways for individuals to start their own business. The growth in franchising as a retail format will probably continue in the near future. Many students who take a retailing course have intentions of someday starting their own business and this lecture may provide them with an interesting possibility to consider. Instructors might want to use this lecture as a stimulus to a class discussion on the topic. PowerPoint slides 2-59 to 2-67 can be used with this lecture.

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#### **Introduction**

Franchising is the licensing of an ENTIRE business format by a parent company (FRANCHISOR) to a number of outlets (FRANCHISEES) to market a product or service and engage in a business developed by the FRANCHISOR using the FRANCHISOR'S trade names, trademarks, know-how, and methods of doing business.

In 1985, sales of goods and services by all franchising companies exceeded \$529 billion, approximately 33 percent of all U.S. retail sales flow.

There are roughly half a million establishments in franchise-related businesses.

#### **The growth of franchising**

Franchising has had a steady stream of growth. Some of the reasons include

1. Technological advances,
2. Profitable utilization of capital resources,
3. Attainment of the American dream,
4. Demographic expansion, and
5. Product/service consistency.

#### **Technological advances**

Equipment and systems--reduce product variability and more efficient marketing and distribution systems.

For example: Electronic Data interchange.

#### **Profitable utilization of capital resources**

Can tap savings and credit capacity of individuals to realize national product/service saturation

#### **Attainment of the American dream**

Owning your own business.

#### **Demographic expansion**

**Urban “sprawl” creates need for more small retail establishments.**

No-longer just downtown locations.

**Product/service consistency**

Due to geographic mobility, franchises have provided a level of homogeneous (boring) quality in its product or service.

For example: A Big Mac tastes the same everywhere.

**Types of franchise systems**

There are various types of franchise systems including

1. Territorial,
2. Operating,
3. Mobile,
4. Distributorship,
5. Co-ownership,
6. Co-management,
7. Leasing/Licensing,
8. Manufacturing, and
9. Service.

**Territorial franchise**

The franchise granted encompasses several counties or states.

The holder of the franchise assumes the responsibility for setting up and training individual franchisees within his territory and obtains an ‘override’ on all sales in his territory.

For example: McDonalds and Burger King Regional franchises.

**Operating franchise**

The individual independent franchisee that runs his own franchise.

He deals either directly with the parent organization or with the territorial franchise holder.

For example: McDonalds and Burger King individual locations.

**Mobile franchise**

A franchise that dispenses its product from a moving vehicle, which is either owned by the franchisee or leased from the franchisor.

For example: Country Store on Wheels and Snap-On Tools.

**Distributorship**

The franchisee takes title to various goods and further distributes them to sub-franchisees.

The distributor has exclusive coverage of a wide geographical area and acts as a supply house for the franchisee that carries the product.

For example: Texaco gasoline supply centers.

### **Co-ownership**

The franchisor and franchisee share the investment and profits.

For Example: Denny's Restaurant.

### **Co-management**

The franchisor controls the major part of the investment.

The partner-manager shares profits proportionately.

For example: Travelodge and Holiday Inn.

### **Leasing/Licensing**

The franchisor leases/licenses the franchisee to use his trademarks and business techniques.

The franchisor either supplies the product or provides franchisees with a list of approved suppliers.

For example: Sheraton Hotels.

### **Manufacturing**

The franchisor grants a franchise to manufacture its product through the use of specified materials and techniques.

The franchisee distributes the product, utilizing the franchisor's techniques.

This method enables a national manufacturer to distribute regionally when distribution costs from central manufacturing facilities are prohibitive.

For example: Sealy.

### **Service**

The franchisor describes patterns by which a franchisee supplies a professional service, as exemplified by employment agencies.

For example: Personnel One.

### **Why franchises fail**

Individuals who are interested in franchising need to recognize that there is risk despite the high potential for success.

Franchises can fail for several reasons including

1. Inept management,
2. Fraudulent activities, and
3. Market saturation.

**Inept management**

Poor finances, product/service mix rejected, grew too quickly.

**Fraudulent activities**

The selling of unsound or unproven franchises to ignorant buyers, unfair contracts, etc.

**Market saturation**

Too many franchises of same type, e.g., chicken fast-food.

**Franchisors and the marketing channel**

A franchisor may occupy any position in the marketing channel.

**Manufacturer-retailer franchise**

Automobile dealers and service stations.

**Manufacturer-wholesaler franchise**

Coca-Cola, Pepsi, Seven-Up, etc. sell syrup they manufacture to franchised wholesalers who bottle and distribute to retailers.

**Wholesalers-retailer franchise**

Rexall Drugs and Sentry Drugs.

**Service Sponsor--Retailer franchise**

Avis, Hertz, and National, McDonald's, Chicken Delight, KFC, Howard Johnson's and Holiday Inn, Midas and AMCO, Kelly Girl and Manpower

**Franchisor benefits**

Franchisees (the store) provide benefits for the franchisor (the parent company).

**Continuous market**

Insured through consistent quantity and quality and strong promotion.

**Market information**

Information such as sales, local advertising, employee turnover, profits, etc. is usually provided.

**Money**

Principal sources of franchise company revenue.

**Royalty fees**

Royalties provide continuous income although often the rate may decrease as sales volume increase.

Sometimes a flat rate is established regardless of level of sales.

### **Sales of products**

Often the franchisor supplies raw materials and finished products to the franchisee at a profit.

For example, Coke supplies syrup, Holiday Inn supplies furniture and carpeting.

### **Rental and lease fees**

The franchisor may lease buildings, equipment, and fixtures.

### **License fees**

There may be special fees that allow the franchisee to use and display the franchisor's trademark.

### **Management fees**

Franchisor can charge for consultant fees, management reports, training, etc.

### **Franchisee benefits**

Franchisors provide benefits for the franchisee through initial and continuous services. .

### **Initial services**

There are a number of initial services that franchisors provide for franchisees including

1. Market survey and site selection,
2. Facility design and layout,
3. Lease negotiation advice,
4. Financing advice,
5. Operating manuals,
6. Management training programs, and
7. Employee training.

### **Continuous Services**

There are also a number of continuous services that franchisors offer to franchisees including

1. Field supervision,
2. Merchandising and promotional materials,
3. Management and employee retraining,
4. Quality inspection,
5. National advertising,
6. Centralized purchasing,
7. Market data and guidance,
8. Auditing and record keeping,
9. Management reports, and

10. Group insurance plans.

### **Franchisor advantages/disadvantages**

Depending upon which viewpoint one takes (the franchisor or franchisee) there are many advantages and disadvantages of franchising.

From the perspective of the franchisor, the advantages include

1. Rapid expansion,
2. Highly motivated franchisees do a good job, and
3. Additional profits by selling franchisees products and services.

The disadvantages include

1. Company-owned units may be more profitable,
2. Less control than independent retailers over advertising, pricing, personnel practices, etc. (e.g., can't fire franchisee).

### **Franchisee advantages/disadvantages**

From the viewpoint of the franchisee the advantages include

1. Established/proven product/service,
2. Business and technical assistance, and
3. Reduction in risk.

The disadvantages include

1. Loss of control -- are really only semi-independent business people,
2. Many franchisors own a number of their outlets which may compete with those owned by franchisees, and
3. High royalties, fees, costs of equipment, supplies, merchandise, rental or lease rates and mandatory participation in promo and support services.

### **Franchising trends for the New Millennium**

Most of the growth of franchising occurred in the 1980s in the retailing of goods and services. However, there two basic types of franchising that merit consideration.

The first, product and trade franchising, a common form of retailing in the automobile and petroleum industry, focuses on what is sold.

Examples include brands like Ford, Honda, and Texaco.

The second, business format franchising, sells the right to operate the same business in different geographic locations.

The emphasis here is on how the business is run.

Examples include Kentucky Fried Chicken, McDonald's and Burger King.

The major franchising trends perceived for New Millennium are

1. Sustained growth,
2. Enduring plus unimagined applications,
3. International expansion,
4. Increased tensions, and
5. Greater emphasis on financial returns.

### **Sustained Growth**

It is perceived that franchising will continue to grow steadily, a trend begun in the 1980s.

One of the possible explanations for this growth is that franchising offers franchisors rapid expansion as well as highly motivated owner-managers.

Also, annual growth in franchised sales volume will exceed the inflation rate by several percentage points.

### **Enduring plus unimagined applications**

Today, such things like video yearbooks, house-sitting services, and house calls by doctors may be owned by franchises.

With the applications such as these, the possibilities are certainly diverse.

For example, in the future, franchisees will come from three main sources, which include middle managers, women, and independent small-business owners.

### **International expansion**

Franchisors are currently exploring foreign markets.

In fact, in 1988 one-sixth of all business-format franchisors had businesses outside the United States.

In addition, this trend has also been reciprocated by foreign franchisors as well.

However, non-U.S. franchisors have had a more difficult time in the U. S. due to stiff competition.

### **Increasing tensions**

Despite the overwhelming of franchisors on the whole, there is still a major source of contention.

That is, franchisor-franchisee relations have witnessed a rise in class-action suits and arbitration hearings.

In 1989, over 400 franchisee-related hearings were held.

Dissatisfaction among franchisees could originate from various sources.

First, perceived inequity among this group regarding mandated or proposed changes may be a major source of conflict.

Also unsatisfactory financial performance may be another cause of discord.



### **Greater emphasis on financial returns**

The main sources of financial returns include: dual operations in which a franchisee may be permitted to run two or more franchises from a common or adjacent area; reduced costs due to downsizing; and incentives for ownership.

*[Source: This lecture was adapted from Gerald Pintel and Jay Diamond, Retailing, 4th ed. (Englewood Cliffs, NJ.: Prentice-Hall, 1987), pp. 73-76. in El-Ansary and Stern's book, Marketing Channels, Prentice-Hall, 3rd. ed. , 1988, p. 333); Bruce J. Walker, "Retail Franchising in the 1990s," Retailing Issues Letter, Published by Arthur Andersen & co, in conjunction with the Center for Retailing Studies, Texas A&M University, Vol.; 3, No.1, January 1991, pp. 1-.]*