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Retailing in the 21st Century

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Retail sales are growing, according to government statistics, but many of the UK's biggest retailers are in difficulties. Higher interest rates, changes in consumers' buying habits, and a weaker housing market have all been blamed for this poor showing. Some UK retailers have tried to reduce costs through job cuts, outsourcing or offshoring back-office business functions, and squeezing suppliers. But these tactics have had very little impact on performance. Find out how the retailers who once dominated the UK's high streets could rediscover their winning ways.

Reports of the death of the consumer, prompted by a recent report by the Confederation of British Industry (CBI), appear to have been greatly exaggerated after official figures from the Office for National Statistics (ONS) showed that retail sales grew more strongly than expected in April 2005. While forecasts may have suggested volumes would be flat, retail sales increased by 0.5% in April 2005, more than reversing the 0.3% fall in March 2005. Seasonally adjusted sales for the three months to April 2005 rose by 0.2% (see Figure 1) compared with the previous quarter.

Yet while these figures are not as gloomy as predicted, spending has slowed, despite a background of higher employment, reasonable income growth, high consumer confidence and wealth, and low interest rates. The increase in consumer spending is now running at an annual rate of 2.3% – close to the long-run trend growth rate of the economy – down from 6% in 2004 and is the slowest rate of annual growth in two years.

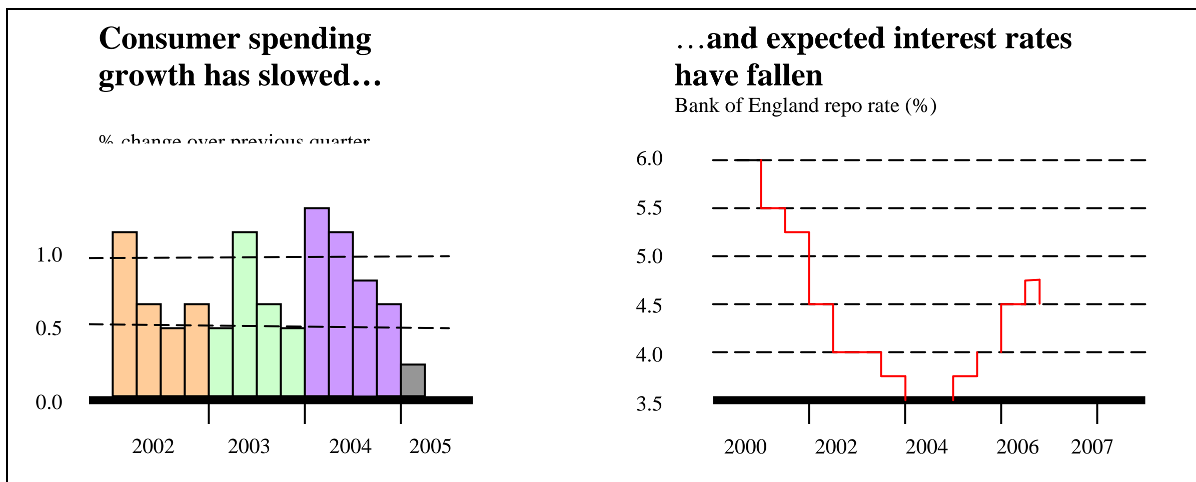

Figure 1: Consumer spending growth and interest rates (Source: Thomson Datastream)

Moreover, although consumer spending is holding up, many of the UK's biggest retailers are in trouble. Sainsbury removed its chairman in April 2004 after a profits warning, Marks & Spencer, stumbling from one trading disappointment to another, faced the humiliation of being taken over by a retail entrepreneur. William Morrison has struggled to digest Safeway. In July 2005, ASDA announced it would be cutting 1400 management jobs after gradually losing market share for some time, dropping to just 16.4% of the grocery market. On the high street, WH Smith has been rocked by falling profits, Boots has had to sacrifice short-term returns to stay competitive and Dixons is all but quitting town-centre locations.

Some commentators have suggested consumers are deserting traditional retailers because they are switching their leisure spending to mobile phones or shopping online. But in an industry with an estimated annual turnover of more than £221 billion, spending on mobile phone services and shopping through remote channels is a drop in the ocean (see Figure 2).

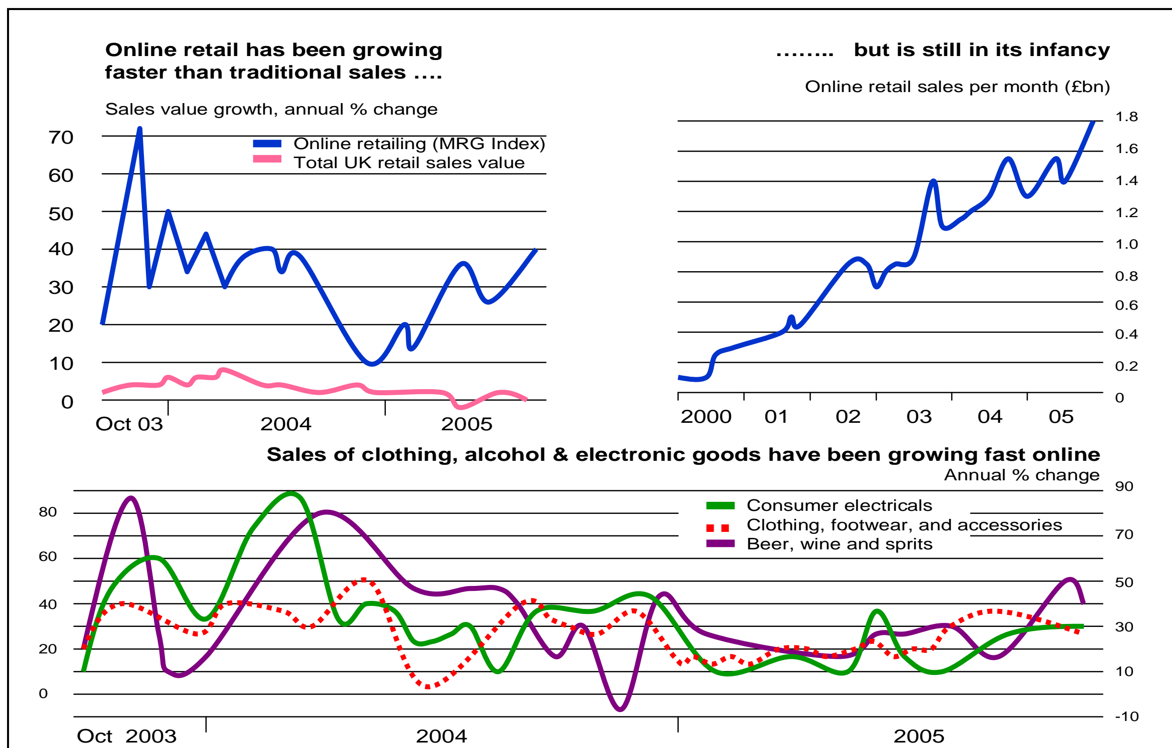

Figure 2: Online retail sales are growing but it is still in its infancy (**Source**: IMRG, ONS, Centrix Analysis)

How the trouble in retailing started

The troubles besetting the high street are not about a change in spending patterns but a failure to adapt. The counterpoint to Darwinist ideas about "survival of the fittest" is that those most fit to survive are those who have been able to adapt best to changing circumstances. Look at Woolworths around the world: a big business in South Africa and Australia, it stopped growing years ago in the UK and went bust in the US. Why? Because Woolworths tried to use the same retailing format in different countries, but it was clear that management teams in some countries knew how to adapt and evolve, while others didn't. Management complacency is the biggest cause of current difficulties for established retail chains. Boots, Marks & Spencer and Sainsbury dominated their sectors ten years ago, but were caught out as new competitors began offering similar products at lower prices. At the same time, senior executives focused too closely on a narrow range of measures of "success", to the overall detriment of the business. Companies such as Sainsbury and Boots sacrificed investment for short-term profit gains that kept the City happy, but customers were aggrieved by the failure to pass on some profit in the form of lower prices or to invest in expanding the range of products on offer (see Figure 3).

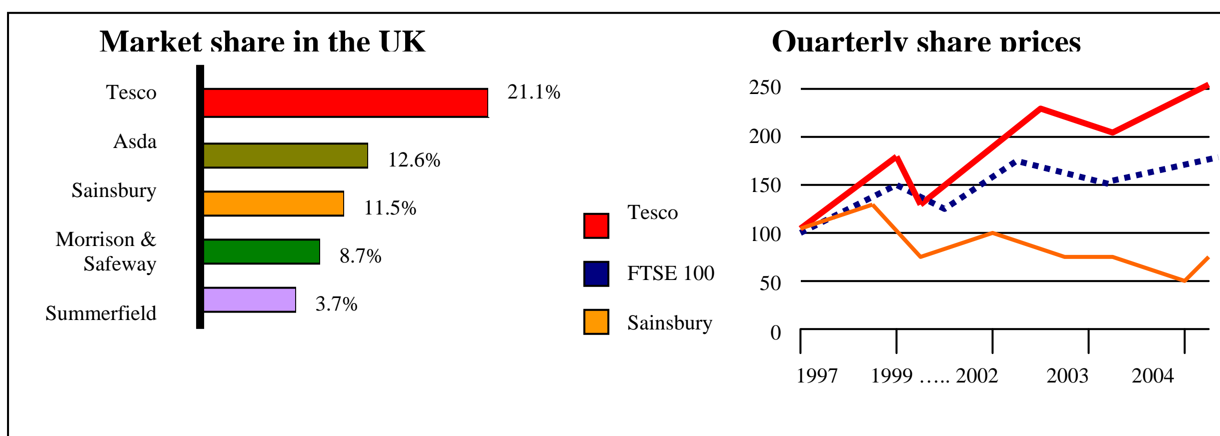

Figure 3: Market share and performance tell the story (**Source**: Taylor Nelson Sofres and Centrix Analysis)

While the new management teams at Boots, Marks & Spencer and Sainsbury are seeking to address these weaknesses, this past complacency has driven customers elsewhere. Supermarkets, with Tesco leading the pack, now take an increasing share of spending on clothing, health and beauty products and newspapers and magazines, while chains such as Next have taken market share from Marks & Spencer. These retailers have been successful because they have been flexible and adaptable.

New operating model for 21st century retailing

It is clear that, in a highly competitive retail industry, consumers will no longer tolerate mediocrity. If retailers' offerings are functional but without anything to differentiate them from competitors, it will be very difficult for them to survive. This basic truth of retailing will not be overcome by notions that retailers will prosper if only they can use technology to communicate better with consumers through e-mail, use the latest version of customer relationship management (CRM) software, or analyse scanner data from tills to tailor specific offers and manage inventory.

In the UK, Sainsbury learnt the hard way that technology is no silver bullet when it outsourced its entire IT function, believing the outsourcer would solve its problems (see *Offshoring: Saviour or Value Destroyer?* by Pitman and Hammond). In contrast, in the US, half of the productivity edge of Wal-Mart, the most successful retailer in the world, stems from managerial innovations that improve the efficiency of stores and have nothing to do with IT: employees who have been cross-trained, for instance, can function effectively in more than one department at a time. Our research has found that simple steps such as better training of cashiers and improved monitoring and management of their utilisation can increase productivity rates at checkout counters by 10% to 20%.

But the UK's formerly successful retailers do have some advantages: scale, buying power, established brands, and infrastructure. What they need now to reverse the recent decline is inspiring management, together with the new operating model. Technology can help any business operate more efficiently, but retailing in 21st century cannot be reduced to the application of software tools and data analysis techniques alone. From our research and work with retail companies, we have found that the successful retailers create value for their customers in six interlocking ways (see Figure 4).

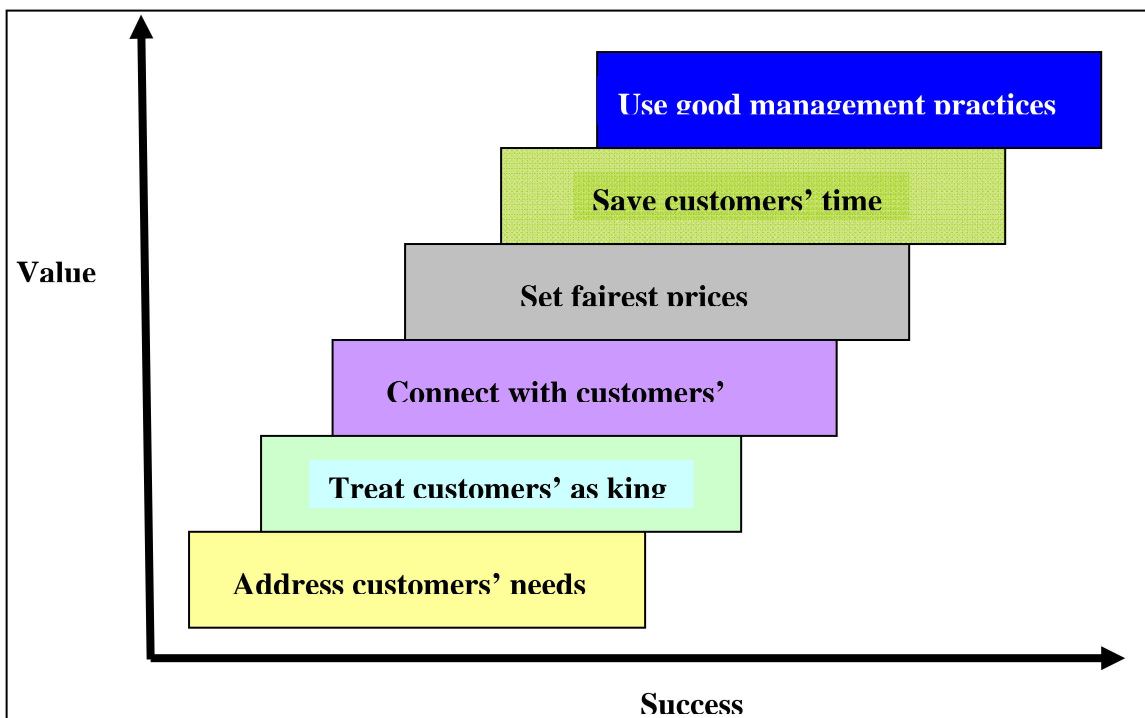

Figure 4: Successful retailing framework

Address customers' needs

In modern retailing, the days of "pile 'em high and sell 'em cheap" are long gone. Today, customers have specific needs and retailers must provide *solutions* that meet those needs. Being focused on solutions means, for instance, not just selling products but employing people who know how to help customers find clothes that fit and flatter, having tailors on staff ready to make alterations while customers wait or do other shopping, and offering home delivery. Every retailer aims to meet its customers' needs but some do it much better than others. Struggling retailers must change their operating practices to focus on solutions. And while that may sound simple and obvious, many retailers seem to have only fuzziest concept about how to sell solutions.

Treat customers as king

Most retail executives would claim that, of course, they treat customers with respect – but our own experiences show it just isn't so. Everyone has stories to tell about complacent retailing. Stories about women trying to buy cars are enough to make one's hair curl. Complacent retailing is pervasive and it is not just about bored, rude, or unmotivated staff. Cluttered, poorly organised stores, lack of signage and confusing prices all show complacency and lack of respect for customers. Successful retailers translate the basic concept of treating the "customers as king" into a set of practices built around people, policies, and place:

- They select, prepare and manage their people to show competence, courtesy and energy when dealing with customers.
- They institute policies that emphasise fair treatment of customers, regardless of age, gender, appearance, or size of purchase. Similarly, their prices, returns policy and advertising are transparent.
- They create a physical space – both inside and outside the store – that is carefully designed to value customers' time.

Connect with customers' feelings

Most retailers understand, in principle, that they need to connect emotionally with customers. However, struggling retailers don't seem to put the principle into practice: instead of taking opportunities to make emotional connections, they put too much focus on price. Low prices undoubtedly appeal to customers' rational judgment, but don't speak to their feelings. Many furniture stores, for example, focus strictly on price appeals, emphasising cost savings, sales and credit terms, rather than highlighting the emotional lift that can come from a new look in the home, and how they can make customers' homes more attractive by delivering furniture in days rather than months. Successful retailers reach beyond the model of the "standard" customer and strive to establish feelings of closeness, affection, and trust. The opportunity to establish such feelings is open to any retailer, regardless of the type of business or the merchandise being sold. Everyone is emotionally connected to certain retailers: from local businesses, such as the butcher's shop and wine merchant, who always remember what their regular customers like, to national retailers like Tesco, who send discount coupons to customers for the items they buy regularly.

Set fairest prices

Prices are about more than the actual pound sterling involved. If customers suspect that the retailer isn't playing fair, prices can also carry a psychological cost. Customers will not feel comfortable making purchases if they suspect that prices might be 20% lower next week, or if they are unsure whether an advertised sale price represents a genuine reduction (for example, one of the biggest retailers was fined £4,600 by the trading standard office on 23 November 2005 after admitting that signs promoting wine deals in stores in Truro and St Austell, in Cornwall, were misleading [1]). Pricing tactics commonly used by retailers which create distrust in consumers include one company's habit of advertising products as "special buys", even though the regular price has not been reduced, while another retailer deliberately misrepresents competitors' prices on price-comparison signs within its stores.

Successful retailers seek to minimise or eliminate the psychological costs associated with manipulative pricing. Firstly, they realise that value is the total customer experience, not just the price of any one item.

Second, they sell most goods at regular but competitive prices and hold legitimate sales promotions. They make it easy to compare their prices with those of competitors and they avoid hidden charges.

Save customers' time

Many customers are poor in at least one respect: they lack time. Retailers often contribute to the problem by wasting customers' time and energy in many ways, from confusing store layouts and inefficient checkout operations to inconvenient hours of business. When shopping is inconvenient, the value of the retailer's offering plummets because the total customer experience is poor. A slow checkout is particularly annoying to busy people. Store managers usually know how much money they are saving by closing a checkout lane, but they may not realise how many customers they have lost in the process. By reducing the amount of time customers spend in their store, successful retailers can actually increase the amount customers put into their tills, as customers choose to use that retailer for more of their shopping.

Use good management practices

Retailing companies in the UK can dramatically improve their performance by embracing best management practices: eliminating unnecessary tasks, aligning all tasks in a process in a continuous flow, recombining workers into cross-functional teams dedicated to that process, and continually striving for improvement (see *Why integrate, when you can aggregate?* by Pitman and Hammond). In this way, companies can procure and distribute products with less human effort, space, time and overall expense.

In the service industries, IT has established itself as a vital strategic tool. But it has yet to deliver the same value in retailing. The implementation of applications such as Enterprise Resource Planning (ERP) has proved time consuming and highly risky. Often the implementation costs of ERP systems have outstripped initial estimates by many times, The only winners are the systems integrators; the projected benefits for the retailer fail to materialise in most cases. As a result, some retailers are managing IT solely on the basis of cost. But retailers can harness IT more effectively to gain competitive advantage, and deliver corporate success, by implementing the framework outlined in Figure 4 to become significantly more flexible and responsive to customers' needs.

Future of UK retailing

Retailers are well-known for being quick to attribute downturns in performance to forces that are beyond their control, with consumer confidence and the state of the housing market being key themes. But the future of UK retailers to a great extent lies in their own hands and can be either promising or poor. In an environment of economic uncertainty, fierce competition from emerging countries with low-cost labour, and squeeze on CAPEX, executives in UK retail companies need new operating models appropriate for today's global market. Tesco is a case of good management adapting to changes when others didn't. In past, Tesco's name was synonymous with cheap - even more so than Asda. But the management realised that tastes were beginning to change and knew that they had to widen and deepen the brand. It was the first supermarket group to understand the future lay in big stores and it was again the first, when new sites proved difficult to find in the late 1990s, to begin opening smaller local stores under the Tesco Metro brand.

Those retailers not hidebound by formulae from the past have the best chance of survival. If there has been a shift in shopping habits, as claimed by some commentators, then it is that consumers have become more demanding, because they have much more choice than twenty years ago. Gourmet ready meals can now be bought at almost every supermarket, not just from Marks & Spencer's food halls. New entrants in the fashion market such as Zara and Mango are delivering catwalk fashion within weeks and changing ranges every four to six weeks, rather than having four annual seasons.

In an age that demands instant solutions, retailers who thoughtfully implement the framework outlined above and make careful and innovative use of technology, will create a solid operation that is capable of delivering superior service to customers and earning their trust and loyalty.

About the authors

Jon Fuller is the Operations Director of Centrix; Steve Pitman is a consultant.

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NOTES

1. "Tesco has twice market share of nearest rival", Elizabeth Rigby, The Financial Times, 24 November 2005.