

Strategies in Retail Sector

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ARTICLE DETAILS

Article History

Published Online: 07 September 2018

Keywords

Strategy, Retail, Objectives, Pricing

ABSTRACT

Strategies in retail sector are an important aspect of retailing, considering the competitive retail environment. The first step in the strategic planning process involves articulating the retailer's objectives and the scope of activities it plans to undertake. These objectives guide the development of the retailer's strategy, and specific performance goals determine whether the retailer's objectives are being achieved.

1.1 Financial Objectives

When assessing financial performance, most people focus on profits: What were the retailer's profits or profit margin (profit as a percentage of sales) last year, and what will they be this year and into the future? But the appropriate financial performance measure is not profits but rather return on investment (ROI). Kelly Bradford set financial objectives of making a profit of at least \$100,000 a year, but she really needs to consider how much she needs to invest to make the \$100,000, the profit she desires from her investment. Think of the decisions you might make when planning how to invest some money you might have. In making this investment, you want to determine the highest percentage return you can – the highest interest rate or greatest percentage increase in stock price- not the absolute amount of the return. You can always get a greater absolute return by investing more money. For example, Kelly Bradford would be delighted if she made \$100,000 and only needed to invest \$500,000 (a 20 percent ROI) in the business but disappointed if she had to invest \$2,000,000 to make \$100,000 profit (a 5 percent ROI). A commonly used measure of the return on investment is **return on assets (ROA)**, or the profit return on all the assets possessed by the firm.

1.2 Societal Objectives

Societal Objectives are related to broader issues about providing benefits to society – making the world a better place to live. For example, retailers might be concerned about providing employment opportunities for people in a particular area or more specifically for minorities or the handicapped. Other societal objectives might include offering people unique merchandise, such as environmentally sensitive products, providing an innovative service to improve personal health, such as weight reduction programs, or sponsoring community events.

For example, McDonald's value diversity among its employees and suppliers. The company ensures diversity among its corporate employees by including it in the business planning process. "As business and corporate departments put together their business plans, diversity is included in them. We have diversity business planning guidelines that we provide to the McDonald's leadership, as that they're incorporated in the

strategic planning process," explains chief diversity officer Pat Harris. McDonald's also values diversity in its supply chain and has been recognized by *Fortune* magazine as the "top purchaser from minority suppliers, spending more than \$3 billion a year, or 27 percent of its total, at minority – owned firms." Performance with respect to societal objectives is more difficult to measure than financial objectives.

1.3 Personal Objectives

Many retailers, particularly owners of small independent business, have important personal objectives, including self-gratification, status, and respect. For example, the owner/operator of a book store may find it rewarding to interact with others who like reading and authors that visit the store for book-signing promotions. By operating a popular store, a retailer might be recognized as a well respected business leader in the community.

Whereas societal and personal objectives are important to some retailers, financial objectives should be the primary focus of managers of publicly held retailers – retailers whose stocks are listed on and bought through a stock market.

2 Strategic Profit Model

The **strategic profit model**, illustrated in Fig 6.1, is a method for summarizing the factors that affect a firm's financial performance as measured by ROA. The model decomposes ROA into two components: (1) net profit margin and (2) asset turnover. The **net profit margin** is simply how much profit (after tax) a firm makes divided by its net sales. Thus, it reflects the profits generated from each of sales. If a retailer's net profit margin is 5 percent, it makes \$.05 for every dollar of merchandise or services it sells. **Asset turnover** is the retailer's net sales divided by its assets. This financial measure assesses the productivity of a firm's investment in its assets and indicates how many sales dollars are generated by each dollar of assets. Thus, if a retailer's asset turnover is 3.0, it generates \$3 in sales for each dollar invested in the firm's assets.

The retailer's ROA is determined by multiplying the two components together:

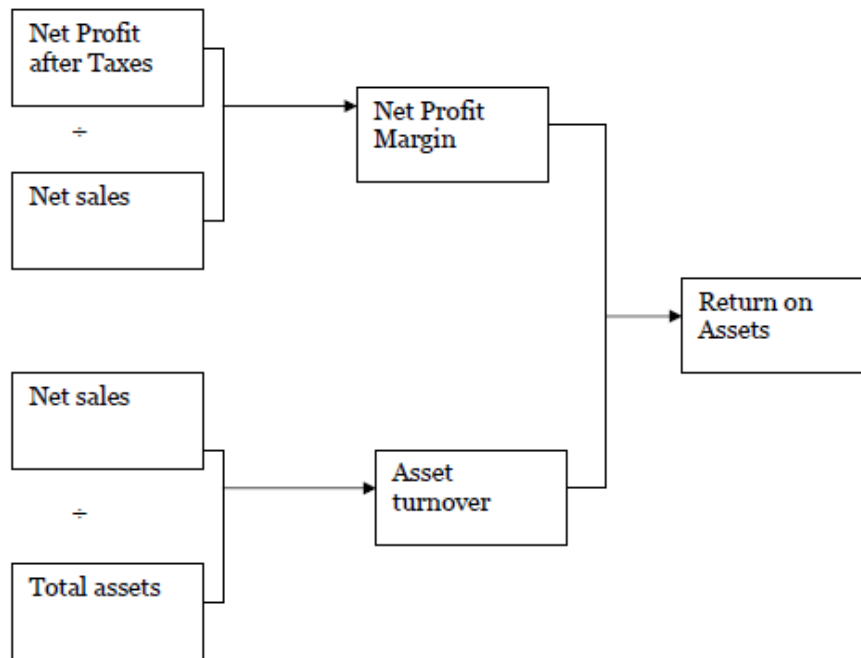


Fig 6.1 Components of the Strategic Profit Model

These two components of the strategic profit model illustrate that ROA is determined by two sets of activities, profit margin management and asset management, and that a high ROA can be achieved by various combinations of net profit margin and asset turnover.

To illustrate the different approaches for achieving a high ROA, consider the financial performance of two very different hypothetical retailers in Table 6.1. La Madeline Bakery has a

net profit margin of only 1 percent and asset turnover of 10, resulting in an ROA of 10 percent. Its profit margin is low due to the highly competitive nature of its business. Consumers can buy baked goods from a wide variety of retailers, as well as from the other bakeries in the area.

However, its asset turnover is relatively high, because the firm has a very low level of inventory assets. It has very little inventory because it sells everything the same day it is baked.

Table 6-1 Different Approaches for Achieving an Acceptable ROA-A Bakery and Jewelry Store

	Net Profit Margin	x	Asset Turnover =	Return on Assets
La Madeline Bakery	1%		10 times	10%
Kalame Jewelry	10%		1 time	10%

On the other hand, Kalame Jewelry Store has a net profit margin of 10 percent-ten times higher than that of the bakery. Even though it has a much higher net profit margin, the jewelry store has the same ROA because it has a very low asset turnover of 1. Kalame's asset turnover is low compared with the bakery's because Kalame has a high level of inventory; it stocks a lot of items that take many months to sell. In addition, the jewelry store offers liberal credit to customers, increasing its assets in accounts receivable.

Thus, La Madeline is achieving its 10 percent ROA by having a relatively high asset turnover-the asset management path. Kalame Jewelry Store, in contra-, achieves its same ROA with a relatively high net profit margin-the profit margin management path.

3 Retail Pricing

Pricing strategies affect both the margins and the positioning of a retailer. Various pricing strategies can be followed by the retailer depending on his business objectives, the influence of other external factors, and the impact of the pricing strategy on other aspects of the marketing mix.

Broadly, retailers adopt one of the three approaches in terms of pricing-discount orientation, at-the-market orientation, and upscale orientation. These approaches may be implemented using various pricing strategies. Discount orientation may take the form of everyday low-pricing strategy or high-low strategy. Upscale orientation is reflected in premium pricing strategies. At times it takes the form of skimming prices for certain product categories to be followed by penetration prices later on. At-the-market orientation is

reflected in strategies that offer average prices for most products. While a store is likely to adopt a long-term approach in terms of pricing, most retailers also adopt short-term tactical pricing tools like coupons, rebates, etc. Hence, while stores like *Lifestyle* and *Arcus* reflect an upscale pricing orientation they do offer rebates and discounts at various intervals. Similarly, many retailers tend to effect price reductions to pre-empt competition or achieve greater penetration. Some stores may adopt lossleader pricing as a tactical move to stimulate additional store traffic while retaining their basic orientation towards at-the-market pricing.

4 Pricing Approaches

There are three retail pricing approaches based on the long-term objectives of the pricing decision. They are discount orientation, upscale orientation, and at – the – market orientation.

4.1 Discount Orientation

Here low prices are used as the major tool for competitive advantage. The store portrays a low status image and offers fewer shopping frills. Profit margins are kept low to target price-based customers. The model works on high inventory turnover and lower operating costs. This is arguably the most common model in India because of the low per capita income and price consciousness. It is not uncommon to see affluent people buying from these low-price shops as Indians largely look for value for money. Frills can be sacrificed for some satisfactory price cuts.

Roadside discount shops thrive in India where everything from clothes to perfumes is sold and the clientele is not necessarily the lower middle class. One such market is the Janpath market in New Delhi. However, with the advent of globalization, Indians are opening up and this seems to be changing.

4.2 Up Scale Orientation

In Up-scale Orientation competitive advantage is derived from the prestigious image of the store. The profit margins per unit are high, coupled with higher operating costs and lower inventory turnover. These stores usually stock distinctive product offerings and provide, high quality service, building up customer loyalty. The products stored generally go with the image of the store. It may be appropriate in situations of

inelastic demand in which an organization decides to keep its prices high. The reason for such strategy might also include a growing super – premium segment of the market, overcrowding at the bottom – end of the market, or the desire to create a prestige image for the product.

4.3 At – The – Market Orientation

A store with at – the – market orientation normally sets average prices. It offers solid service and a nice atmosphere to middle – class shoppers. Margins are average to good and it stocks moderate to above quality products. Since this model caters to the middle class, it has a huge target market. Moreover, as income increases, the price – based customers shift to these stores.

Therefore, some discounts retailers also own such a store to capture customers who would shift to a higher priced store as their income rises.

4.4 Pricing Strategies

Following are the various pricing strategies followed by the retailer to meet his short- and long term objectives. The adoption of these strategies is guided by the basic pricing approach of the retailer.

4.4.1 Every Day Low Pricing (Edlp)

EDLP has been popularized by large retailers like Wal-Mart, Home Depot, and Staples among others. This strategy entails continuity of retail prices below the MRP mentioned on the goods-in other words, at a level somewhere between the regular price at which the goods are sold and the deep discount price offered when a sale is held. So, low does not necessarily mean lowest. The price at a competing store where goods are on sale may be selling at lower prices.

However, in case of EDLP, these low prices are stable and not subject to a one-time sale. In India, many co-operative stores have adopted this strategy. One store that uses ED LP is Big Bazaar.

Here, goods are either sold below their normal prices, or some sales promotion scheme is available. For EDLP to work, volumes are necessary so that the store can negotiate with the manufacturers for bargain prices. The benefits of adopting an EDLP pricing strategy are given in Fig.

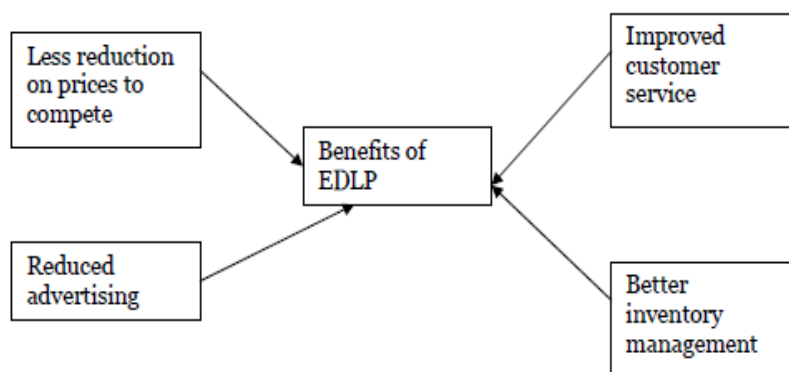


Fig 7.1 Benefits of EDLP

Some retailers have adopted a low-price guarantee policy where they guarantee that they will have the lowest possible price for a product. The guarantee usually promises to match or better any lower price found in the local market. If somebody is selling at a lower price, the retailer would refund the difference.

Benefits of EDLP: The following are the benefits of the EDLP strategy.

- **Less Reliance on Price Reduction to Compete:** In high-low pricing, the goods that were selling for a particular retail price are sold at reduced prices during sale. This makes the customers conditioned to postpone their purchases and they buy only during sale. This is a vicious cycle as fewer items sold at normal prices means more piled up stock, which necessitates a sale to be organized. The sale keeps on getting bigger and better, reducing the average price at which goods are sold, thus hitting the bottom line. Moreover, in high-low pricing the customers can have post-purchase dissonance once they come to know that the product they purchased at 20% discount a week back is being sold at 50% discount in the current week's sale. EDLP provides the customers with the satisfaction that they are paying a fair price for the product, and they tend to buy more frequently instead of waiting for the most beneficial sale to take place.
- **Reduced Advertising:** Since prices are stable in EDLP, the retailer need not advertise frequently.

- In case of sale, which is held for a limited period, the retailer has to necessarily advertise so that more and more people visit the store to take advantage of the temporary low prices. Also, catalogues do not become obsolete since prices do not change so often.
- **Improved Customer Service:** Stable prices also mean stable flow of customers in the store. In high-low pricing, the sales people generally fall short during sale time unless additional workforce is hired. In EDLP, the sales people are sufficient and, hence, are able to attend to customers properly.
- **Better Inventory Management:** EDLP reduces the large fluctuations in demand that one experiences in high-low pricing. So, retailers can manage their inventory with more certainty.

5 Conclusion

It must be noted here that even though EDLP may provide stability in demand and easy forecasting of inventory, it does not make a large difference in many cases of stock-outs. Goods on sale are meant to be cleared as far as possible or reduced to zero. So, essentially, a storeowner 'wants' to achieve the situation of a stock-out. Moreover, as these goods are sold at low profit margins, stock-outs are not of much concern as not much profit is lost. Fluctuations are also experienced in EDLP due to other factors such as festivals. In fact, demand for a majority of products is seasonal in India due to the festive season.

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