THE GROWING POWER OF CHAIN STORES

BY IAN GORDON

One hundred and twenty years ago, Calgary retailer G.C. King & Co. offered products such as crockery, glassware, chamber sets, lamps, groceries and quilts in a store where the "prices... cannot be beaten."[1] G.C. King took out a number of large advertisements in the Calgary Tribune in which the tag line read: "G.C. King & Co., the Mammoth Store." G.C. King & Co. occupied two frame buildings, about 2,300 square feet[2].

George Clift King sold his store in 1885. By 1909, the store's location had become the site of a bank. Few people think of G.C. King & Co. anymore and those who do, might remember the proprietor as Calgary's second mayor.[3]

DEPARTMENT STORES

The disappearance of companies like G.C. King is the story of how chain stores have grown at the expense of independently owned retailers, and how some independents have replaced others. Stores such as G.C. King & Co. were on the wrong end of some major trends. There was a proliferation of retailers as the railway headed west and then larger, well-capitalized stores emerged to offer consumers more choice for less money. The Hudson's Bay Company opened a number of stores across Canada, including their 3,500 square foot Calgary store in 1884. HBC's store was across from another department store of the time, I.G. Baker, that HBC acquired in 1891 and then expanded their original store. G.C. King's sales had been built on the proprietor's reputation and skills as an experienced store manager, but personal relationships counted for less when consumers could select from more merchandise. Stores like HBC provided this additional choice. By 1930, department stores comprised 13% of retail store sales in Canada, and chain stores 18%.

Before HBC built its department store business in Canada, Macy's and other companies proved the concept worked in the U.S. Macy's Brooklyn store opened in 1865 and is 1,157,000 square feet. The Herald Square store opened in 1902 and is 2,168,000 square feet, the world's largest[4]. An old adage in the department store business is to "pile it high and watch them buy" and the sheer scale of stores such as Macy's illustrates the challenge independents faced when trying to compete directly with real mammoths.

Retail Salesmanship[5], published in 1921, notes: "The two reasons why a multiple-shop company (chain) is able to undersell a single-shop trader are: (1) that the company can purchase in greater bulk; and (2) that it can turn over its stock more quickly. Through its large resources, it can... use showier shop fronts and fixtures. Its organization is often more efficient... It not only commands larger capital, but uses its capital more efficiently."

CHAIN STORES

The twentieth century saw a dramatic increase in chain store sales. In 1930, chain stores comprised 18.3% of retail sales in Canada. By 2003, this had increased to 42.1% of retail sales (Chart 1 has detail). At the same time as chain stores increased share of retail sales, retail sales volumes grew substantially. Overall sales volume for all retailers increased 129 times between 1930 and 2003 (to $356.3 billion). Chain store sales were up 298 times in this same period.

Chain stores have been challenging department stores on many fronts. Specialty chains such as The Gap compete with department store anchors in the malls. Chains of warehouse clubs such as Sam's Club and Costco offer high velocity items with standard mark-ups. Off-price chains such as Winners lever well known brands at low prices. Category dominators such as Sleep Country erode the sales volumes of formerly profitable departments within department stores. And more recently, "big box" stores have located with others in so-called "power centres" and have collectively changed the shopping habits of Canadians. Now customers are as likely to buy in the power centres as the local mall, and the impact on independents has been significant. In the Greater Toronto Area, the closure rate for smaller stores located within five kilometers of a big box retailer has been as high as 55%[6].

CONCENTRATION OF RETAILING

Not only is the retail share of the chains increasing when measured for all retail stores, but the concentration of sales within specific retail sub-sectors is also favouring the chains. The four largest chains in Canada in the prescription drugs and food sectors represent over 60% of retail sales, and the four largest general merchandising chains are over 80% of retail sales in this sector.

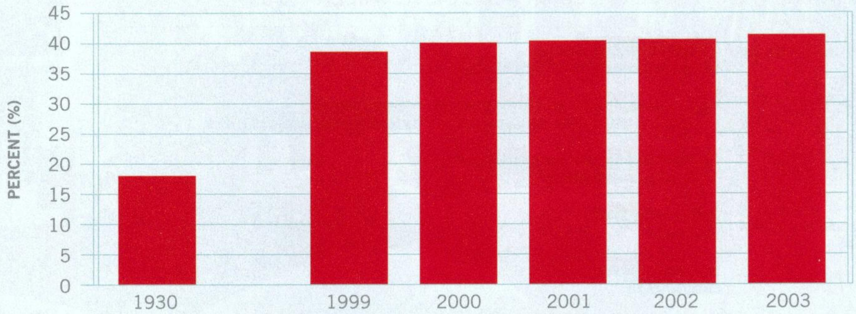
Control of Canadian chain store sales is increasingly foreign. Chains such as Aikenheads, Future Shop and Radio Shack are now owned by U.S. firms – in these cases, by The Home Depot, Best Buy and Circuit City respectively. Between 1985 and 2003, the number of U.S. retail chains in Canada increased from 10 to 185, and 11 of the 20 largest retailers in Canada were owned by U.S. companies in 2003[7].

High levels of concentration are also to be found in many U.S. retail sub-sectors, as shown in Chart 2. For example, the four largest U.S. retail chains comprised 11% of all retail sales in 2002. In the electronics and appliances retail sector, the four largest chains represented 44% of retail sales in this sector. In the building materials and garden equipment retail sector, the four largest chains represented 37% of sales.

Continued on page 4

CHART 1

CHAIN STORES SHARE OF CANADIAN RETAIL SALES (%)



SOURCE: STATISTICS CANADA, CANSIM – SERIES V35-52

1 Advertisement from The Calgary Tribune, October 28, 1885, Page 1.
2 *Alberta: Her Industries and Resources*, March, 1885, Republished 1974, Edited by Burns and Elliott.
3 George Clift King sold his store in 1885 and became Postmaster and Calgary's second mayor (1886-1887). The store site became a Dominion Bank and today is a restaurant.
4 Macy's Fulton Mall. Source: Federated Department Stores *2005 Fact Book* (http://www.fds.com/ir/vote/2005_fact_book.pdf).
5 *Retail Salesmanship*, Thomas Russell, Cassell and Co. Ltd., 1921, p.5.
6 In the period 1993-2002, based on data from CSCA, 2003, as reported in *Consumers and Changing Retail Markets*, Industry Canada (http://strategis.ic.gc.ca/epic/internet/inoca-bc.nsf/en/ca02096e.html#note51)
7 *Consumers and Changing Retail Markets*, Industry Canada. (http://strategis.ic.gc.ca/epic/internet/inoca-bc.nsf/en/ca02096e.html#note51).

Continued from page 3

In the five year period ending 2002, the fastest rate of growth in concentration has occurred in the building materials and garden equipment retail sector, where companies such as The Home Depot and Lowe's Home Improvement are major factors. In this retail sector, the four largest firms increased their share of sector sales by 19.1% in the period 1997-2002. The growth in concentration by retail sector is described in Chart 3.

In the U.S., the 20 largest U.S. home furnishings stores comprised 33.2% of U.S. sales in 2002, up from 23.6% in 1997. The number of U.S. home furnishings stores increased in this period: there were 35,264 home furnishing stores in 1997 and 36,960 in 2002. The number of stores operated by the four largest home furnishing chains increased 73% in this period, to 2,321 stores[8].

WAL-MART

Retailers that emerge to completely dominate their categories are often called "category killers." The most dominant of the category killers is Wal-Mart and the firm's huge success merits separate consideration.

Wal-Mart's product-market boundaries cross the traditional lines of other stores so the category it kills is broader than most. To appreciate the breadth of Wal-Mart's scope, consider that the firm sees its own competitors to include discount, department, drug, variety, specialty stores and supermarkets[9].

It is hard to over-state the scale, speed and importance of Wal-Mart's conquests. Wal-Mart opened its first store in 1962 in Rogers, Arkansas, an unlikely initial location. By 1979, its sales surpassed $1 billion for the first time. In 2005, Wal-Mart's net sales were U.S.$285.2 billion. This made Wal-Mart bigger than companies such as General Motors and General Electric, and even larger than the gross domestic product of many countries, including Sweden, Switzerland, Greece and Portugal. Put another way, Wal-Mart's U.S. and international sales are about the same as the combined retail sales of all Canadian retailers.

In 2005, Wal-Mart operated 663 million square feet in 5,289 stores, 262 of which are in Canada[10]. For perspective, Wal-Mart could put Manhattan inside its stores – and still have room to cover 3,000 football fields.

Wal-Mart's incredible growth has come at the expense of many competing forms of retail, including department stores, independents and chains targeting the mass market, such as the 122 Woolco stores the company acquired to enter Canada in 1994. In 1994, K-Mart had 9.5% of the Canadian market. By 1997, K-Mart Canada was sold – mostly to Zellers, ending a business

CHART 2

RETAIL SALES MADE BY LARGEST COMPANIES IN RETAIL SECTORS – 2002 (U.S.)

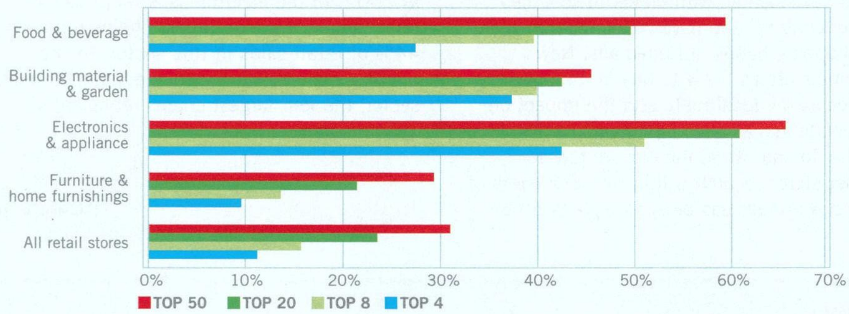
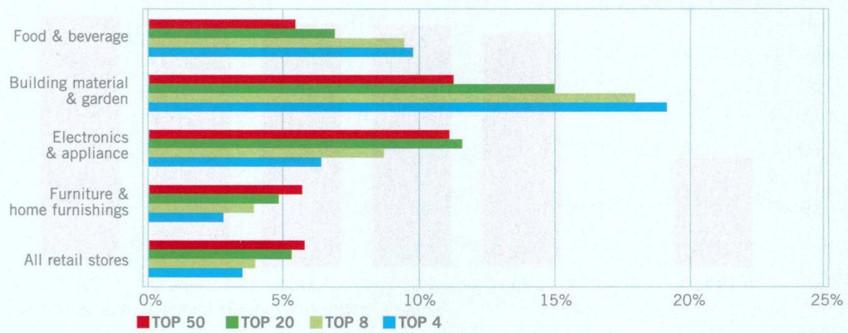


CHART 3

GROWTH IN RETAIL SALES BY SIZE OF RETAILER – 1997 TO 2002 (U.S.)



SOURCE, CHART 2 & 3: U.S. DEPARTMENT OF COMMERCE, BUREAU OF THE CENSUS, 1997 ECONOMIC CENSUS, 2002 ECONOMIC CENSUS

"Wal-Mart's success traces to their initial strategy of opening large stores where competitors were weak, such as in rural areas. Their growth accelerated when consumers benefited significantly from Wal-Mart's scale, everyday low prices, price rollbacks, store operations, customer and product data, significant bargaining power – and voracious appetite."

DOMUS (RIGHT)
Domus, France's first shopping centre dedicated to home, furniture and decoration, is expected to open its doors this March. This home-décor Mecca will offer a vast product range – everything the consumer desires for their home will be on display.

8 These data apply to Home Furnishings – NAICS 4422 (whereas Chart 2 references Furniture and Home Furnishings – NAICS 442). Data source: US Department of Commerce, Bureau of the Census, 1997 Economic Census,2002 Economic Census.

9 According to Wal-Mart's SEC10K filing, January, 2005.

10 Includes Sam's Club (a warehouse club owned by Wal-Mart) and Wal-Mart's international operations. Figures from Wal-Mart's SEC10K filing, January, 2005.

started in 1929. Venerable T. Eaton & Co., founded in 1869, declared bankruptcy in 1999.

By 2002, Wal-Mart's share of the Canadian department store market was 38%.

Among other things, Wal-Mart's success traces to their initial strategy of opening large stores where competitors were weak, such as in rural areas. Their growth accelerated when consumers benefited significantly from Wal-Mart's scale, everyday low prices, price rollbacks, store operations, customer and product data, significant bargaining power – and voracious appetite. Wal-Mart is believed to have more data[11] than the entire Internet. The firm has also benefited from a focus on cost reduction and price competitiveness as articulated in their well-known slogan: "Always Low Prices. Always." Another Wal-Mart success factor: it is China's distribution channel. About 10% of China's exports are through Wal-Mart[12].

THE HOME DEPOT

After Wal-Mart, the next largest category killer is The Home Depot. The Home Depot had sales of U.S.$73.1 billion in fiscal 2004, which is about one-quarter of Wal-Mart's sales.

The Home Depot is the world's largest home improvement retailer, with 1,890 stores, including 117 in Canada. The Home Depot's retail stores sell products that the firm categorizes as building materials, lumber and millwork (24% of 2005 sales), plumbing, electrical and kitchen products (29%), hardware and seasonal products (27%), and paint, flooring and wall coverings (20%). Like Sam Walton at Wal-Mart, the story of The Home Depot's success traces to their founders, Bernie Marcus and Arthur Blank. Both worked for a company from which they were fired on the same day, then they collaborated to found The Home Depot.

Continued on page 6

"The success of The Home Depot has much to do with the willingness consumers had to adopt the do-it-yourself approach to home improvement. The Home Depot now also provides do-it-for-me services and explores new retail formats."

11 Approximately 583 terabytes, *Refining Retail Link*, DSN Retailing Today, Mike Troy, Sept 12, 2005.

12 Wal-Mart bought about U.S.$12billion of Chinese goods in 2002, *The Wal-Mart You Don't Know*, Fast Company, December, 2003.

Continued from page 5

The success of The Home Depot has much to do with the willingness consumers had to adopt the do-it-yourself approach to home improvement. The Home Depot now also provides do-it-for-me services and explores new retail formats, including high-end home improvement items in its Expo Design Center stores, Home Depot Supply for businesses and governments, Home Depot Landscape Supply, and Home Depot Floor Stores.

In Canada, big box stores such as The Home Depot continue to gain market share in the warehouse home centre category. Of sales made by warehouse home centres in 2004, big boxes captured 26.5% (of which The Home Depot is about 70%), Canadian Tire 14.0% and all other hardware stores, building centres and home centres 59.5%[13]. Canadian companies such as RONA are prospering in this environment, too, but independents are facing challenges as the biggest companies compete for market share. And now U.S. giant Lowe's Home Improvement has announced plans to enter the Canadian marketplace, too, starting with the Toronto area.

The four largest hardware and building products retailers and retail chains in Canada, Canadian Tire, Home Depot, RONA and Home Hardware, comprise 57.3% of the market, are seven times larger – and have been growing seven times faster – than the four largest buying groups and co-ops[14].

CONCLUDING COMMENTS

The growing power of chain stores presents a business challenge for independent retailers and their suppliers to plan an effective competitive response. If there is one thing to be learned from chains such as Wal-Mart: they have very few weaknesses, so independent retailers cannot afford to have them, either. In the giftware industry, retailers and suppliers could consider responding to chain stores in ways such as the following:

SHOPPING EXPERIENCE

Can independents cater even more to local customers, offer merchandise assortments and brands not in the chain stores, increase the personal touch and services chains cannot offer, expand customer loyalty initiatives, and make the store's personality decidedly "unchainlike" in nature?

BRANDING

Can independent giftware retailers establish stronger brands for the store as a whole and for product lines? If so, should this be done individually or collectively with other independents?

"If there is one thing to be learned from chains such as Wal-Mart: they have very few weaknesses, so independent retailers cannot afford to have them."

ELLIOTT & COMPANY
Elliott & Company is an example of how an independent retailer can successfully compete with big box stores. Our winner of 2005 Retailer of the Year, it's defined by high-quality design, craftsmanship and perceived value, and is more akin to a home than a store.

13 *Coalitions Out of Chaos*, Hardware Merchandising, July/August 2005.
14 2004 – Figures from Hardware Merchandising, July/August 2005.

FORWARD INTEGRATION

Manufacturers in industries like footwear, furniture, computing and consumer electronics have opened their own retail stores to ensure a stable channel to market for their products. Some giftware suppliers have also done this, too. Do opportunities remain for other giftware manufacturers and suppliers to do the same?

COLLABORATION

Some companies say that supplying the largest chains can be hazardous to their financial health. The reverse is often true, too – independent retailers can be vital to a supplier's profitability. Given this interdependence, how might suppliers protect and assist retailers even more than is now the case?

SALES SKILLS

A statement from a book published in 1921[15] continues to have applicability today: "No amount of ingenuity on the part of the small retailer can enable him to buy as favourably as the multiple shop... but he has certain advantages compared with the multiple shop, of which the most important is salesmanship."

Ian Gordon is a management consultant with over 20 years' experience conducting marketing, research, online surveys, planning and strategy assignments. His clients include retailers, distributors, manufacturers and the public sector.
Email: gordonih@aol.com.

"Some companies say that supplying the largest chains can be hazardous to their financial health. The reverse is often true, too – independent retailers can be vital to a supplier's profitability."

15 *Retail Salesmanship*, Thomas Russell, Cassell and Co. Ltd., 1921.