

Big Impact in a Small Format

by Thomas Ripsam, Alonso Martinez, and Carlos Navarro

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Large retailers are beginning to see the beauty of a tinier world.

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J.B. Beaumont, a convenience store operator in the U.K.'s East Midlands, saw less-than-stellar sales in its six stores — and recognized an opportunity. Changing demographics in the region, such as smaller families and more single-head households, were creating a valuable segment for a retailer that could provide a broad array of products in a format suited to these groups.

To cater to their needs, Beaumont began offering both takeout meals and meals that a family can prepare at home with minimum effort. It added cold beverages that can be consumed immediately; traditional grocery items, such as condiments, in smaller packages; and single-serving sundries such as aspirin. In short, it moved into the middle ground between, say, a fish-and-chips shop that can provide a meal but not much else and a grocery store that can meet all of a shopper's needs but might also eat up an hour of her time. Beaumont's new format did so well that it attracted the attention of giant J. Sainsbury PLC, which acquired the smaller retailer in November 2004.

The popularity of small format retail stores isn't limited to Europe's mature and affluent markets. The same trend is gaining traction in Latin America, where convenience store retailer Oxxo, for instance, has established around 4,000 stores in Mexico and is adding 300

to 400 stores there per year. The stores operate as franchises, usually owned by locals who are familiar with the micromarket in which the store is located and can customize service to the neighborhood's needs. Stores in neighborhoods where residents return home late at night remain open 24 hours; other stores deliver to nearby areas with high numbers of elderly or affluent residents. Oxxo is building on the region's traditional changarros, or mom-and-pop stores, by personalizing its service for its customers.

After years of hype about "big box" retailing, we see an increasing number of small format success stories, ranging from convenience stores, such as Beaumont in the U.K. and Oxxo in Mexico, to discounters, such as Germany's Aldi and EKI Descuento in Argentina, which sell basic staples and key grocery items in a cost-effective neighborhood format. The interest in small formats may soon extend to the United States, as well, where big retailers including Wal-Mart and Publix already are experimenting with the idea.

However, the trend isn't limited to purveyors of food items. Regardless of whether the smaller stores are selling groceries, electronics, clothing, or home goods, there are three major reasons that retailers should consider how small formats could work in their markets. One is that the consumer experience in massive retail

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establishments is becoming increasingly unattractive. The amount of time it takes to negotiate the seemingly endless aisles is a drawback to harried shoppers — and it's made worse when they hit the checkout and run into dozens of other people in a hurry. The size of the store also takes away from personalized service and doesn't allow for a product assortment tailored to a particular demographic niche.

Lower-income shoppers, in particular, find that they are not comfortable in large stores because service is less personal and the broad assortment of products drives home how little they can afford. Furthermore, getting to large stores, which are often located far from city centers, is difficult for this group of shoppers, who have to spend money to get there and may even lose hourly wages if it's truly out of the way. Going farther to a bigger store is only a good value, in terms of the total cost of purchase, if the big store offers substantially lower prices — and even then, the resulting savings are usually not enough to offset the cost of public transportation.

Essentially, consumers will still patronize those large establishments, but many of them want to complement that shopping with frequent stops at more conveniently located establishments.

A second reason for rising interest in small formats is that economics and technology have shifted the value proposition. Smaller stores are no longer necessarily saddled with higher prices or lesser quality. Savvy operators of chains of smaller stores are able to achieve efficiencies of scale in procuring their merchandise and are then able to distribute those goods to specific stores through distribution channels that have been much improved by computerization and supply chain logistics.

Last, small formats offer retailers a more intimate

relationship with customers and employees and therefore allow for genuine innovation in store design and even business model design. At Oxxo, for example, store operators are not just employees; as franchisees, they receive a share of the store's profits. However, Oxxo frequently makes all of the necessary capital investments to ensure consistency across the chain, such as purchasing standard shelving, microwaves, and refrigerated displays. Oxxo's store displays, layouts, and product assortment — with modern fixtures, lighting, and high standards of cleanliness — are much more appealing than those of traditional Mexican mom-and-pop stores. Oxxo's parent company also drives intensive promotional and bundled offerings by, for example, offering Marlboro cigarettes with a free lighter or a bottle of Coke bundled with a discounted Powerade. The business model is novel — and effective.

Interestingly, the small format trend is widening in both Europe and Latin America, which have entirely different demographics and income levels. In Europe's affluent economies, consumers are looking for convenience items, including meals, to suit the busy lifestyles of single heads of households. Retailing in Latin America, by contrast, is focused much more on low-income and larger families. Part of the explanation for why smaller formats are working in Latin America is that items such as dry pasta, cooking oils, milk, bath soap, and laundry detergent can be acquired in precisely the right quantities for daily use. The stores are, in effect, the customers' pantries.

The big question is whether the U.S. market is ready for a shift toward smaller formats. In grocery, for instance, industry analyst Planet Retail and Booz Allen Hamilton have found that large format stores capture

80 percent of retail sales in the United States, a number significantly higher than in the vast majority of other markets in the developed world.

European retailers, such as U.K.-based grocer Tesco Corporation and German discounter Aldi, may be the first to test the U.S. market for its receptivity to smaller formats. Tesco, for example, plans to enter the U.S. market with 100 convenience-type stores of roughly 10,000 square feet under the Fresh & Easy Neighborhood Market brand. Those stores are slated to be opened in 2007 in Arizona, Nevada, and California.

We believe that for U.S. retailers like Wal-Mart, Home Depot, and Lowe's to catch up with their international competitors, find the next spurt of growth, and escape the market saturation they are now suffering, they will also have to consider smaller formats as key channels in their overall retailing models. Wal-Mart is considering stores as small as 20,000 square feet, about one-tenth the size of its Supercenters, and other large retailers are rumored to be doing the same.

All the big box retailers need a more balanced approach to reach their customers and will benefit in important ways from what they learn about shopper preferences in smaller format contexts. Manufacturers of consumer packaged goods (CPG), too, can cash in on this opportunity, by working with their retail partners to mine the personalized data available and creating new products accordingly. The major players in the CPG industry are already reasonably sophisticated in how they adapt their product mixes from one geography to another and from one demographic mix to others, but using small stores to get close to their customers could foster a new wave of innovation in retail formats and in the products and business systems on which they rely. +

Resources

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