START AND RUN A RETAIL BUSINESS

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1
THE BASICS OF RETAIL

This part of your job includes:

- Buying an item at wholesale and selling it for more than you paid for it
- Understanding the ways that the many variables affect your net-profit line
- Preparing a pro forma profit and loss statement for your new business
- Adding value to the products you sell by adopting a best-service strategy
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your job description

where you want to go

Understanding the Six Rights of Retail

The basic premise of the retail business is simple — you buy an item at wholesale and sell it for more than you paid for it. Unfortunately, the things in life that seem simple are often very challenging. And in this case, selling an item involves getting *six* things right. We call these the "six rights of retail":

> To be successful, you need to have the right item, in the right place, at the right time, in the right quantity, at the right price, with the right service.

We do not take credit for inventing the six rights of retail. They have challenged retailers for years, defining the business and demonstrating just how much more there is to retail than selling an item for more than you paid for it. For a start, you need to sell it with enough gross profit to pay all of your expenses and leave a net profit.

Your Profit and Loss Statement

The following is a retail income statement in its most basic form. It could describe your business as it will look three years from now:

	Net sales	$ 800,000
–	Cost of goods sold	440,000
	Gross profit (also called "maintained margin")	360,000
–	Expenses (also called "SG&A")	340,000
	Net profit	$ 20,000

The top line shows net sales, the total amount that you received from customers. You subtract from that the *cost of goods sold*, the total amount you paid to buy the merchandise that customers bought from you, including any freight costs. This gives your gross profit, also called your *maintained margin*.

From that gross profit figure, you subtract all of your expenses, known in retail as *selling, general, and administration* (SG&A), and you are left with your net profit, the total amount remaining at the end of the year. Hopefully, this is a positive number.

By separating the expenses into various standard categories and calculating the percentage of net sales that each category represents, you produce a *profit and loss statement* that tells you more about the operation of your business. Sample 1 shows a typical profit and loss statement. (We have included a blank version of this as an Excel spreadsheet on the CD-ROM.)

If you are not familiar with the retail business, the net profit figure in this sample may come as a surprise. Like many people, you may have had a vague notion that retailers simply double the wholesale price of an item and pocket the difference.

In reality, this sample profit and loss statement is quite typical of the retail business today. For running an $800,000 business, this owner-operated retailer made a net profit of only $20,000, or 2.5 percent of sales.

If you look closely at the figures in Sample 1, you will notice that some expenses are *fixed expenses*. For example, the cost of utilities would not change if the store did $600,000 in sales rather than $800,000, or $1 million rather than $800,000.

Other expenses are not fixed, but neither do they vary by the same percentage in either direction as the sales figures. For example, the cost of supplies would change if sales decreased or increased by 25 percent, but the change would be *less* than 25 percent.

By examining these expenses carefully, you can determine the *breakeven sales figure* for the business. This is the amount of sales needed to cover the expenses incurred in running the business. It does not include the cost of goods sold. After your first full year of operation, this is a number that your accountant will be able to calculate easily. Until then, you will need to use an estimate.

Sample 2 shows three profit and loss scenarios, indicating how expenses can vary with sales. A careful examination of these scenarios should help you understand the ways that expenses can vary with sales.

They also illustrate three very important realities of the retail business. First, you need a certain amount in sales just to cover your expenses and make a profit. We have no idea what the breakeven point will be for your particular business, but we do know that calculating and understanding this figure will be critical to your success.

Second, once you get past the breakeven point, sales increases affect the net profit line at an increasing rate. In Sample 2, a 25 percent increase in sales from $800,000 to $1,000,000 resulted in a 240 percent increase in net profit.

SAMPLE 1
PROFIT AND LOSS STATEMENT

		Amount	Percentage of net sales	
	Net sales	$800,000	100.0%	The total amount that you received from customers. Does not include sales taxes, which are sent directly to the government.
(minus)	**Cost of goods sold**	440,000	55.0%	The total amount you paid to buy the merchandise that customers bought from you, including any freight costs.
(equals)	**Gross profit**	360,000	45.0%	This is the amount of money that you have in order to pay your bills. What is left over will become your net profit.
(minus)	**Expenses**			*The following is a typical SG&A for some kinds of retail businesses, but your categories and percentages may be different.*
	Staffing costs	104,000	13.0%	The total amount paid to you and your staff as wages and benefits.
	Rent	68,000	8.5%	The total amount paid for store rent. This also includes percentage rent, which is additional rent you pay when sales reach a pre-set amount.
	Utilities	12,800	1.6%	The total amount paid for water, electricity, and heating, ventilation, and air-conditioning (HVAC).
	Maintenance	5,600	0.7%	The total amount paid to fix and maintain items such as equipment and carpeting.
	Telephone and Internet	9,600	1.2%	The total amount paid for telephone service, including long distance, and for an Internet connection.
	Insurance	9,600	1.2%	The total amount paid to insure your business against liability, flood, and fire.
	Supplies	18,400	2.3%	The total amount paid for boxes and bags for customer purchases and store supplies such as letterhead and pens.

SAMPLE 1 — Continued

	Expenses (cont'd)			
	Advertising	$ 24,000	3.0%	The total amount paid to advertise your business and attract customers to the store, including newspaper, radio, Yellow Pages, and Internet ads, as well as flyers and a company website.
	Relationship marketing	6,400	0.8%	The total amount paid for one-to-one communication with your current customers.
	Administration	21,600	2.7%	The total amount paid for things such as buying trips and payroll services.
	Legal	4,000	0.5%	The total amount paid to your lawyer.
	Accounting and data processing	16,000	2.0%	The total amount paid to your accountant for crunching all of the numbers, preparing an annual statement, and filing a tax return.
	Technology	16,000	2.0%	The total amount paid for hardware, software, training, and supplies.
	Interest expense and statement	4,000	0.5%	The total amount paid as service charges, transaction fees, and interest.
	Depreciation	16,000	2.0%	The total amount paid for capital improvements such as fixtures and equipment that you are paying back over time or that is depreciating.
	Miscellaneous	4,000	0.5%	The total amount paid for the little things that you could not list anywhere else.
	Total expenses	$340,000	42.5%	
(equals)	**Net profit**	$ 20,000	2.5%	The total amount you are left with at the end of the year.

SAMPLE 2
THREE PROFIT AND LOSS SCENARIOS

		25% less sales		Original sales		25% more sales	
	Net sales	$600,000	100.0%	$800,000	100.0%	$1,000,000	100.0%
(minus)	**Cost of goods sold**	$330,000	55.0%	$440,000	55.0%	$550,000	55.0%
(equals)	**Gross profit**	$270,000	45.0%	$360,000	45.0%	$450,000	45.0%
(minus)	**Expenses**						
	Staffing costs	84,000	14.0	104,000	13.0	124,000	12.4
	Rent	62,000	10.3	68,000	8.5	74,000	7.4
	Utilities	12,800	2.1	12,800	1.6	12,800	1.3
	Maintenance	5,600	0.9	5,600	0.7	5,600	0.6
	Telephone and Internet	8,800	1.5	9,600	1.2	10,400	1.0
	Insurance	9,600	1.6	9,600	1.2	9,600	1.0
	Supplies	16,800	2.8	18,400	2.3	19,200	1.9
	Advertising and promotion	18,000	3.0	24,000	3.0	30,000	3.0
	Relationship marketing	4,800	0.8	6,400	0.8	8,000	0.8
	Administration	18,000	3.0	21,600	2.7	25,200	2.5
	Legal	4,000	0.7	4,000	0.5	4,000	0.4
	Accounting and data processing	14,000	2.3	16,000	2.0	18,000	1.8
	Technology	16,000	2.7	16,000	2.0	16,000	1.6
	Interest and banking expenses	3,600	0.6	4,000	0.5	4,400	0.4
	Depreciation	16,000	2.7	16,000	2.0	16,000	1.6
	Miscellaneous	3,200	0.5	4,000	0.5	4,800	0.5
	Total expenses	$297,200	49.5%	$340,000	42.5%	$382,000	38.3%
(equals)	**Net profit/loss**	($27,200)	(4.5%)	$20,000	2.5%	$68,000	6.7%

Third, the secret to running a profitable retail business lies in controlling your expenses. A significant difference between the retail business today and the retail business 35 years ago is that it was much easier for retailers to increase their gross profits back then. When they received new merchandise, they simply attached a higher price to it and customers paid whatever they asked. When there was little competition, that method worked.

Today, however, there is a lot of competition, and customers are extremely price-sensitive. Approximately one in four people shop based on price alone. A favorite question is, "When is this going on sale?" Customers can now check prices on the Internet using only their cell phones — you just can't increase your prices at random in an attempt to increase your gross profit.

Neither will you be able to significantly reduce your cost of goods sold. As an owner-operated retailer, it is unlikely that you will have the upper hand in negotiations with your suppliers or be able to drive prices down by buying larger quantities.

These modern-day realities of the retail business severely restrict your ability to increase your gross profit, and if you cannot increase your gross profit, the only way you can increase your net profit is by reducing your expenses.

The good news is that every dollar you can save in expenses increases your net profit directly. In comparison, it would take additional sales of $40 to add a full dollar to the bottom line in our $800,000 scenario because net profit is just 2.5 percent of the sales figure.

a word to the wise

By being price-sensitive, customers are saying that retailers need to be more efficient. In running your business, you will not pay someone to clean the windows or vacuum the floors if they take twice as long as you would to do the same tasks. You simply will not pay for it.

Your customers will not pay you to be inefficient either. They will not pay for a buying trip during which you buy all sorts of ugly merchandise nor for your inability to run a business properly.

Preparing a pro forma profit and loss statement

At some point while thinking through your business, you will need to take a deep breath and start to prepare a *pro forma* profit and loss statement. This is a profit and loss statement that you prepare in advance of opening your business to determine whether you have a viable business idea. It will also help you describe and define the shape of your business.

Preparing a pro forma profit and loss statement will take literally hundreds of hours of research and planning, and will require you to make a huge number of estimates. While you should be as realistic as possible about all of your estimates, the most important one will be the very first line: your sales plan, or net sales. We strongly suggest that you be conservative in deciding this number because all of your decisions about expenses will flow from it.

To come up with your sales plan estimate, you may find it helpful to answer these three questions:

- What will be the average sale in your store?
- How many customers will you sell to in a day?

  You can visit similar stores to get an idea of how many customers they serve in a day. You may want to increase or decrease the numbers to adjust for size of store and time of year.
- How many days will your store be open in a year?

  You need to allow for the holidays on which stores typically close in your area.

Now let's look at an example. Assume that the average sale in your store will be $44.50, that you will sell to 50 customers a day, and that your store will be open 360 days a year.

What will be the average sale in your store?	(1)	$44.50
How many customers will you sell to in a day?	(2)	50
What amount of business will you do in a day? *Multiply the average sale in your store (1) by the number of customers you will sell to in a day (2).*	(3)	$2,225.00
How many days will your store be open in a year?	(4)	360
What amount of business will you do in a year? *Multiply the amount of business you will do in a day (3) by the number of days your store will be open in a year (4).*	(5)	$801,000.00

You can see the importance of accurate estimates. If the average price of items in your store turns out to be $38.50 instead of $44.50, your sales plan will be off by $108,000 over the year, yet you will have built all of your expense budgets on the higher number.

do the calculation

What will be the average sale in your store? (1) ______________

How many customers will you sell to in a day? (2) ______________

What amount of business will you do in a day?

Multiply the average sale in your store (1) by the number of customers you will sell to in a day (2). (3) ______________

How many days will your store be open in a year? (4) ______________

What amount of business will you do in a year?

Multiply the amount of business you will do in a day (3) by the number of days your store will be open in a year (4). (5) ______________

(We have also included this "volume calculator" as an Excel spreadsheet on the CD-ROM that came with this book.)

Once you are comfortable with your sales plan, you are ready for the second line on your pro forma profit and loss statement and your second most important estimate: your cost of goods sold. To estimate this number, you will need to do some careful research into how much the items you are planning to sell in your store will cost you.

Under the retail method of accounting (see detailed discussion in Chapter 2), retailers express everything as a percentage of the selling price. For example, if you buy an item from your supplier at $24.48 and sell it to your customer at $44.50, your cost of goods sold is 55 percent.

$$\text{Cost of goods sold} = \frac{\text{Price at which you buy}}{\text{Price at which you sell}} = \frac{\$24.48}{\$44.50} = 55\%$$

You will, of course, have many items from many suppliers at many prices in your store. This means that your cost of goods sold will not be an easy number to estimate. You need to start with something, however, so that you can calculate your gross profit.

Then, over a period of perhaps several months, you will need to do some careful research into each of the expense categories on your pro forma profit and loss statement, and estimate the amount you will pay in each category during your first year of operation. This book is designed to help you with the retail-specific items: staffing costs, rent, advertising and promotion, technology, and relationship marketing.

Although the process will be slow, each estimate you make will bring you one step closer to the net profit line and to knowing if you can start and run a profitable retail business, at least on paper. A blank pro forma profit and loss statement is available as an Excel spreadsheet on the CD-ROM.

a word to the wise

Broadly speaking there are two types of people: the creative and the practical. These two groups view the world from very different perspectives. In the retail world, the creative people are the merchants. They tend to have a gut-level love and appreciation for merchandise and the best ways to present it. The practical people are the bean counters. They tend to have a gut-level love and appreciation of numbers and the unshakable truths these numbers represent.

Neither a merchant nor a bean counter can run a successful retail business alone these days. As an owner-operated retailer, you will need to view the world from both perspectives. If you are a creative person, you will need to become somewhat of a bean counter. If you are a practical person, you will need to become somewhat of a merchant.

Adding Value to the Products You Sell by Adopting a Best-Service Strategy

As you think through your store, you will need to make some decisions about your fundamental strategy. You must decide where your retail business will fit into the broad spectrum of retail options. In other words, you will need to decide what you are trying to achieve.

We can help you with many of these decisions by asking one critical question: “Why should a customer shop in your store?” The question is so deceptively simple that the eventual complexity of your answer may surprise you. In part, this answer will come from the way that you add value to the products that manufacturers create.

To be successful, we believe that every retail business needs to add value to its products by adopting one of three basic strategies: offering the greatest assortment, offering the lowest price, or offering the best service. Although these strategies all add value, each one meets the needs of different customers. The challenge you face in retail is to be competitive in all three areas and to clearly exceed your customers' expectations in one of them. Figure 1 summarizes the characteristics of each strategy.

FIGURE 1
ADDED-VALUE STRATEGIES

	Greatest assortment	Lowest price	Best service
Clearly exceeds customers' expectations by providing the added value of:	• an exceptional range or breadth and novelty of product assortments • a uniquely edited selection of products related to a specific lifestyle • a combination of wide assortments within a lifestyle	• price savings and an efficient shopping experience	• customer intimacy based on personalized relationships and individual responsiveness that saves customers shopping time and anxiety • specialized products to meet the needs of individual customers
Devotion to:	• product differentiation	• operational efficiency • elimination of operational waste and costs	• anticipating and solving customer problems • taking responsibility for results • focusing on only those customers who place a premium on this type of service
Characteristics:	• creative selections • special assortments • leading-edge products	• best price • no-hassle shopping	• customized • responsive • personal relationships
Customers say:	• "Their assortment is awesome. If they don't have it, no other store will."	• "You just can't beat their prices. They are the absolute lowest, every day."	• "After we bought it, the sales associate called to see if it was working to our satisfaction."

The greatest assortment strategy involves dominating a product such as toys, office supplies, or furniture. The lowest price strategy involves economies of scale and driving every possible cost out of the business. To adopt either of these two strategies, a retailer must be among the largest in the country, able to purchase in huge quantities and introduce efficiencies that the vast majority of retailers can only dream about.

In today's retail world, the big-box retailers "own" these two strategies. You would need a megastore of 100,000 square feet and millions of dollars worth of inventory just to play in their league.

With the assortment and price strategies taken, the only option left for you is the best-service strategy. Although this strategy comes to you by default, it can be very successful and profitable. Indeed, we believe that the best-service strategy is the very future of owner-operated retail in North America — if you are prepared to walk the walk and make service the heart and soul of your business.

It is easy to answer the question, "Why should a customer shop in my store?" with great-sounding words, but, as anyone who has ever tried to deliver good service knows, the talk is much easier than the walk. To start, you need to structure your business so that everything you do — every strategy, merchandising, buying, human resources, sales management, technology, customer service, and in-store experience decision you make — is focused clearly on service.

That does not mean you can ignore assortment and price as you start to develop a strategic framework for your business. On the contrary, you cannot provide great service if you do not have what your customers want. Neither can you satisfy your customers if your prices are 30 percent higher than the prices at your competitors' stores.

You will need to think carefully about your range of merchandise. As the buyer for your business, you can, in theory, buy anything you want. In reality, you are simply a selector of merchandise for your customers, which means that you really need to understand who your customers are. Once you do, the assortment of merchandise you need to carry in your store will become clear. It will have a focus that comes from your customers.

You will also need to think carefully about your pricing policies. You cannot ignore the fact that customers know and understand the retail marketplace. The same people who shop in your store will see your competitors' advertisements, visit other stores (even in other cities), browse and shop on the Internet, and have a good sense of how much items should cost.

Most of all, you will need to think carefully about your level of service. Eventually, you will find yourself having to decide how many people to schedule for what could be a slow day. Will you decide based on the cost of staffing your store that day or on the level of service you have promised your customers you will deliver *every* day? In other words, how much of your business promise will be just talk and how much of it will be actual and honest walk?

a word to the wise

As consultants, we often see owner-operated retailers trying to follow a strategy of being good at everything. This approach does not work well today. Too many smart and aggressive retailers are finding success offering customers shopping alternatives that are distinctly superior in one important aspect of the business — assortment, price, or service — while being competitive in the other two.

Adopting a specific marketing and operational strategy gives these stores a competitive advantage that adds value to the products they sell and makes them stand out as superior to the competition.

Focusing or not focusing resources in a single direction is why some stores succeed while others fail. The successful stores know where they are going and how to get there. The others usually lack a viable, strategic plan to achieve their goals and wind up being mediocre at everything. This means that they fail to distinguish themselves in their customers' eyes and fail to meet their customers' needs.

Developing a Strategic Framework

Once you have thought carefully about assortment, price, and service, you need to go one step farther in developing the strategic framework for your business. You need to come up with your *secret weapon*: the one thing that your store can provide that no other store can deliver. This is important regardless of what products you sell. If you do not have a secret weapon, your business will be just the same as every other owner-operated retail business that sells similar products and competes in the service arena. Customers will have no compelling reason to shop in your store.

Developing your secret weapon

You should choose your secret weapon based on the needs of your customers. To do this you need to keep a basic marketing lesson in mind: customers do not need to buy drills, they need to buy holes. In other words, there is always a deeper level or purpose to their apparent needs.

If you ran an eyewear store, your secret weapon might be that you are an artisan who can produce custom-made eyewear. Instead of just talking about glasses, you might talk about "unique, handcrafted frames that complement a unique personality." This statement appeals to both the apparent need, which is glasses, and to a deeper need, which is individuality. Your store could adopt this custom-made aspect as the secret weapon it will seek to deliver effectively.

The big question then is whether there are enough customers who need both glasses and individuality for your eyewear store to be successful. More to the point, are there enough customers who need your product and the sense of individuality your secret weapon can deliver?

Because customers' needs are reflected in their attitudes toward shopping, understanding these attitudes may give you part of the answer. Generally, customers' attitudes can be divided into five categories.

Quality shoppers put quality and fashion before price. They enjoy shopping and prefer a moderate degree of personal service. Moderately loyal to a few stores, they tend not to like mass merchandisers. These customers are typically well educated, hold prestigious jobs, and have high incomes. They make up about 10 percent of the market.

Intensely store loyal, *specialty shoppers* typically shop at specialty stores and traditional department stores. Price is far less important to them than quality, fashion, and in-store service. Mainly older, affluent couples with good jobs and incomes, these customers tend to dislike shopping. They make up about 15 percent of the market.

Sociable shoppers want and expect personal in-store service. They remain loyal to a few stores, especially the traditional department stores, for most personal items and furniture. Many are older or retired, with ample time to shop. These customers avoid mass merchandisers, except for toys and domestics. They make up about 10 percent of the market.

Primarily young and middle-aged families with moderate incomes and two or more children, *price-sensitive nonshoppers* rely on discounters and mass merchandisers except for items such as fashion. They do not especially like shopping around, but are forced into it by their moderate incomes. Price-sensitive nonshoppers often have difficulty finding time to shop and consider in-store service a low priority. They make up about 35 percent of the market.

Price-sensitive shoppers are also price-sensitive, but they like to shop. Requiring little in-store service, they do not adopt new fashions early and they are not especially loyal to stores. Most of them have young families and rely on mass merchandisers for nearly all of the items they buy. With lower levels of education and downscale jobs and incomes, they make up about 30 percent of the market.

Keeping these very different attitudes in mind — and the apparent and deeper needs that each one implies — you need to think carefully about five critical questions as you complete the strategic framework for your business. Your ultimate success or failure could well depend on your finding good answers to these questions:

1. Why should a customer shop in your store?________________________

____

____

2. What is the role of price competitiveness in your store?_____________

____

____

3. What is the level of merchandise assortment in your store? __________

____

____

4. What is the level of service in your store? _________________________

____

____

5. What is your secret weapon? ____________________________________

____

____

(This is available as a worksheet entitled Developing Your Secret Weapon on the CD-ROM.)

a word to the wise

The following is not a complete strategic framework for an owner-operated retail business because it does not include the store's secret weapon, but it is a good start:

"My store will be competitive in price with other stores in the market, but I will not meet discount-store prices. I will shop my competitors regularly and make sure that I am never more than 20 percent higher than the lowest price in the market.

"I will carry an assortment that is important to my customers and never be out of stock on basic items, but I will not dominate any merchandise classification.

"I will earn my margins and truly amaze my customers by providing the best service they can find, service that goes the extra mile. This will include detailed product knowledge, a pleasant atmosphere, after-sale service, free delivery, and a make-it-right returns policy."

Developing a Clear Vision of Your Business

Although you have no real alternative but to build your business around service, you have almost total freedom after that to create any kind of business that you can picture in your mind. Because the business will be a reflection of who you are, this vision must come from you. It is not something that anyone else can provide for you.

This book can, however, help you develop a clear vision. The best way to do this is to pretend that you are your store's first customer on opening day. You are standing outside a retail business that you have never seen before, and you will decide in mere seconds whether or not it is worth entering the store. Through the eyes of your customer, what does that store look like? What is it like once you enter? Use Worksheet 1, Developing a Clear Vision, to jot down what you see. (This is also included on the CD-ROM.)

This exercise of picturing your business in your mind is every bit as important as developing a pro forma profit and loss statement. It will be a process rather than an event — a process in which you literally close your eyes and spend hours seeing, hearing, touching, tasting, and smelling the business you are about to create. Your vision describes the merchant half of

WORKSHEET 1
DEVELOPING A CLEAR VISION

Exterior and exterior sign: ______________________________

____

Window displays: ______________________________

____

New experience or “same old”: ______________________________

____

General atmosphere: ______________________________

____

Overall visual appeal: ______________________________

____

General organization: ______________________________

____

Color and texture: ______________________________

____

Mood set by lighting: ______________________________

____

Everything visible from the front door: ______________________________

____

Spotlights highlight merchandise: ______________________________

____

Front-and-forward displays: ______________________________

____

Displays with props, related merchandise: ______________________________

____

Brand names evident: ______________________________

____

Merchandise in departments: ______________________________

____

Presentation tells a story: ______________________________

____

Printed product information: ______________________________

____

Price tickets and signs: ______________________________

____

Consistency of interior signs: ______________________________

____

Sign holders: ______________________________

____

WORKSHEET 1 — Continued

Number of sales associates:____
____

Staff appearance and identification:____
____

Level of in-store service:____
____

Level of product knowledge:____
____

Type of shopping experience:____
____

Price range:____
____

Price competitiveness:____
____

Value:____
____

Merchandise quality:____
____

Merchandise “romance”:____
____

Special sales:____
____

Speed at checkout:____
____

Payment methods:____
____

Delivery service:____
____

Returns policy:____
____

Music:____
____

Neat and clean:____
____

Other:____
____

Other:____
____

Other:____
____

your business. It will take as much work and effort as describing the bean counter half of your business through your pro forma profit and loss statement.

Identifying and Studying Your Three Most Important Direct Competitors

Without limiting the creative process, you will clearly have to stay in contact with the real world as you develop your vision. To start and run a profitable retail business, you will need to find a niche somewhere in today's competitive retail marketplace. You need to find some aspect of your target customers' needs that your competition is not meeting or identify some subgroup of your target customers who have needs that your competition is not meeting.

You should visit those stores that you perceive to be direct competitors while you are developing your vision. These are stores in the same business and which are serving the same customers as you, which means that you must take business away from them in order to grow profitably.

You can tell if a store is a direct competitor by answering one question: "If customers do not buy a given item from my store, will they be able to buy it from the other store instead?" If the answer is yes, the other store is a direct competitor.

If your store is quite different or even unique, you may not have direct competitors. In this case, you should visit those stores that you perceive as *indirect* competitors. These are stores in a different business but serving the same customers as you, which means that you *may* have to take business away from them in order to grow profitably.

In addition to visiting the stores that you perceive to be direct or indirect competitors, you should also visit those stores that your customers perceive to be alternatives to your business. You may need to speak with some of your target customers to get this information, but it will be worth the effort.

For example, we mentioned earlier that specialty shoppers typically shop at specialty stores and traditional department stores. If your target customers are specialty shoppers, department stores could well be your main competition. It is obviously better to know this when you are designing your business than to discover it when your business is already open and you have fewer ways of making changes.

By visiting what you perceive to be your direct or indirect competitors and examining what your customers perceive to be the alternatives to shopping in your store, you will develop a good understanding of the diversity that exists in the retail marketplace today. You will also come back with a lot of ideas that will help clarify your vision of your business.

After you examine all of the competition in a general way, you should identify your three most important competitors and examine those businesses in more detail. By knowing their strengths and weaknesses, you will be able to design your business in a way that avoids their strengths and either attacks or simply fills in around their weaknesses.

The same categories you used to develop a clear vision for your business will also help you analyze your three most important competitors. Use Worksheet 2, Analyzing Your Competitors. Remember how important it is to look at a store through the eyes of a customer; at the same time, look for things that a customer would only perceive subconsciously.

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that's a good idea

While developing your vision, you may want to take a working holiday and visit some of the best retailers in cities such as Chicago, Los Angeles, Montreal, New York, San Francisco, Seattle, Toronto, and Vancouver. This is the logical next step to take after looking at your three most important competitors, and it is a great investment in your future.

You do not need to know in advance which retailers are considered the best — they will jump out at you as you browse the malls and walk through the shopping districts. The idea is not to copy another retailer but to experience firsthand what makes the best retailers stand out from the rest. Spending one or two hours in each store will open your eyes to specific aspects of the competition that customers see every day. Be sure to take along extra printouts of the Analyzing Your Competitors worksheet to take extensive notes about each store you visit.

After you have fully developed your strategy, you will need to start thinking about how you can convey your strategic message to customers through various kinds of communication. We use the word *communication* as an umbrella term to describe all of the ways that you give customers information about your business through sights, sound, written communication, signals, or behavior. This section covers the three most important forms of communication: store location, store design and layout, and advertising.

WORKSHEET 2
ANALYZING YOUR COMPETITORS

	Competitor:_____ Date visited:_____	Competitor:_____ Date visited:_____	Competitor:_____ Date visited:_____
Exterior and exterior sign			
Window displays			
New experience or “same old”			
General atmosphere			
Overall visual appeal			
General organization			
Color and texture			
Mood set by lighting			
Everything visible from the front door			
Spotlights highlight merchandise			
Front-and-forward displays			
Displays with props, related merchandise			
Brand names evident			
Merchandise in departments			
Presentation tells a story			

WORKSHEET 2 — Continued

	Competitor:____ Date visited:____	Competitor:____ Date visited:____	Competitor:____ Date visited:____
Printed product information			
Price tickets and signs			
Consistency of interior signs			
Sign holders			
Number of sales associates			
Staff appearance and identification			
Level of in-store service			
Level of product knowledge			
Type of shopping experience			
Price range			
Price competitiveness			
Value			
Merchandise quality			
Merchandise “romance”			
Special sales			
Speed at checkout			

WORKSHEET 2 — Continued

	Competitor: ___ Date visited: ___	Competitor: ___ Date visited: ___	Competitor: ___ Date visited: ___
Payment methods			
Delivery service			
Returns policy			
Music			
Neat and clean			
Other: ___			
Other: ___			
Other: ___			

Conveying Your Strategic Message Through Your Store Location

The most important communication you have with customers is your store location. A time-honored cliché says that the three most important factors to consider when opening a retail business are location, location, and location. Figure 2 outlines the strengths and weaknesses of the various location types that you may want to consider for your business.

FIGURE 2
STORE LOCATION CONSIDERATIONS

Location	Strengths	Weaknesses
Downtown	• central • big draw • office market • a lot of service and culture	• parking problems • distance from suburbs • quality of location varies
Regional shopping center	• drawing power • good parking and access • mass market	• distance may be too great for convenience merchandise • high cost base
Community shopping center	• close to market • good parking • good traffic from food stores	• may not specialize • can be hurt by downtown and regional centers
Strip malls or street locations	• convenience • low cost base • can specialize	• local traffic only • small geographic base of shoppers • transit, parking problems
Warehouse or industrial district	• low cost base • budget image	• location not typical for shopping — low traffic • requires heavy promotion

With good reason, many owner-operated retailers are concerned about the seemingly high rent charged in shopping centers. However, to really understand which location is right for your business, you will need to evaluate all the options in terms of *value*. In other words, you should not look just at occupancy costs or arbitrarily decide that any given rent is too high. You will be paying for customer traffic in one way or another. If you pay less in rent, you will have to pay more in advertising and promotion. If you pay more in rent, you will have to pay less in advertising and promotion.

If you locate on a street, you will probably pay less in rent, but you will have relatively fewer stores nearby to help you generate customer traffic. Because of this, you will have to allocate more money to advertising and promotion.

In a shopping center, the synergy created by many stores being together in one facility tends to increase the number of customers who walk by your door, and the center's relatively large advertising budget can increase traffic even more. You will pay for this traffic through the higher rent that shopping centers charge, but you will be able to allocate less money for advertising and promotion.

Sample 3 shows how one retailer compared two different locations. The total costs of location B are more than double the total costs of location A — and yet the cost per shopper is less than half. In terms of value, location B is the better choice. (Use the Location Calculator worksheet to compare two locations on your own. We have included this as an Excel spreadsheet on the CD-ROM.)

Negotiating and signing a retail lease is not something that you should do alone. Negotiating is a complex process, and the actual document you sign contains page after page of terms and conditions that have very precise legal meanings. Because you are a retailer and not a lease negotiator or a lawyer, we strongly suggest that you get professional guidance and advice.

a word to the wise

SAMPLE 3
COMPARING THE VALUE OF LOCATIONS

	Location A $ per square foot	Location B $ per square foot
Occupancy costs		
Fixed rent	$ 80	$200
Overhead	10	40
Common area costs	20	30
Total occupancy costs	$110	$270
Advertising and promotion costs		
Advertising	$20	$40
Display and sales promotion	20	40
Total advertising and promotion costs	$40	$80
Total costs	$150	$350
Customer traffic per week	20,000	100,000
Cost per shopper	$ 0.0075	$ 0.0035

Conveying Your Strategic Message Through Your Store Design and Layout

The second most important communication you have with customers is through your store design and layout. We will look at these from a retailer's perspective here and revisit them when we look at things from a customer's perspective in Chapter 8.

Store design and layout are the first things that customers see as they browse through the mall or walk down the street, so these need to be in complete harmony with your strategic framework. If they are not, you will have wasted much of the time you spent developing a vision of your business.

We recall one owner-operated retailer who sought professional guidance because her sales were not meeting her plan. This retailer was a talented young fashion designer in a medium-size city. She had built a beautiful store with columns on the façade flanking elegant display windows. The look was expensive and top of the line. On the inside, however, her prices were quite reasonable considering the high-quality designer merchandise she carried.

This retailer needed to unscramble the mixed message that she was giving to customers. The solution was to place tasteful price tags on the items in the display windows. Customers who had previously assumed that one of this designer's creations would cost $500, and had not entered the store for that reason, learned to their surprise that the price was only half that amount.

As this retailer's communication became clearer, both customer traffic and sales moved closer to plan.

One of the important factors determining whether customers will return to your store is how enjoyable and efficient they find the shopping experience. This begins with layout. Your store design should make it easy for customers to get in, get around, and get out. For this to happen, you will need to have logical aisle patterns and locations for each merchandise, service, and support area.

The Developing a Clear Vision worksheet discussed earlier touches on some of the most important aspects of store design and layout, but you should pay particular attention to the following factors:

- The exterior should be inviting, with display windows that indicate to customers what your store is all about. These can be formal, with closed backs, or informal, with open backs. The total exterior should be interesting and eye-catching, and should convey the strategic framework of the business.
- You should change your window displays often so customers do not start to view your business as a museum instead of a store. Windows send a clear message to your customers, and that message is every bit as important as any newspaper ad. Because you are a professional retailer and not a professional display artist, you should retain someone for this job on a contract basis.
- Your outside signage is another critical part of what you are saying to your customer. If you are a trendy fashion retailer, you will need to have a trendy sign, and it should look very different from the sign above the nearby pet store.

- The prime real estate in your store is within the 20-foot semicircle just inside the front door. This will clearly be the most productive merchandising area in your store, since all of your customers will walk through it, but don't put anything too important within the first 10 feet because many customers won't even notice it. To welcome customers into this area, your entrance should always be open and inviting.
- In-store displays can really help customers understand your store and its merchandise. They let people see a product without packaging and in context with related items. Sometimes referred to as silent salespeople, good in-store displays can dramatically increase your sales. However, they can also convey a messy image if you do not tidy and reorganize them regularly.
- Your in-store signage is critically important, although sometimes you will wonder if customers actually read it. Handwritten signs reflect poorly on your business and, given the wide availability of instant printing shops and desktop publishing programs, we can see no reason to use them. The design of your signs should be consistent throughout the store and be changed often enough to keep the look of the store fresh.
- Any in-store posters must also fit your message. Although vendor-supplied advertising may be attractive and cheap, it may not be appropriate. You may be better off throwing it away or going back to your vendor to request something that does fit your message.
- Your walls are extremely powerful merchandising areas because you can display products vertically to a greater height than you can in the center of the store. Because sales per square foot are always greatest along the walls, store planners often build central interior walls to give a store additional wall space.
- The width of the aisles in your store should reflect both the scale of the store and your customer traffic, but they should never be less than 4 feet wide and never more than 12 feet wide. Fixtures in the center of the store should not exceed 5 feet in height; 4 feet would be better.
- The ceiling height of a store should generally be somewhere between 14 and 18 feet. Whatever it is, it should be unobtrusive. You will want to draw your customers' eyes to the merchandise, not to the ceiling. Dark colors tend to make a ceiling seem lower, while light colors tend to increase the visual height.

- Fluorescent lights are great for economy but incandescent lights are by far the best for lighting merchandise. Track lighting will let you aim spotlights and floodlights at important display areas. Many stores now use low-voltage lighting systems that are expensive but very effective.
- Floor treatments should be easy to maintain, but they should also respect the needs of sales associates who will be standing all day. Tile is easy to maintain but hard to stand on. Carpet is harder to maintain but easier to stand on. Often, a mix of surfaces can accommodate the needs of both the business and its employees.

a word to the wise

Whether you are starting from scratch or planning to renovate an existing store, you should work with an experienced designer.

To begin the process, you should visit stores you like and ask who did the design. You should then contact those designers, plus one or two others, and outline your vision of your business. You should explain clearly that your basic strategy is service and ask how design can support that strategy.

By the time you speak with a designer, you should have a good understanding of what departments need to go where in your store and the budget that you have to spend.

A good designer will talk to you in terms of sales productivity and not just elegant design. His or her role should be to add ideas, creativity, and experience to your strategy and vision. You should judge the designer's suitability based on the way he or she can support your service strategy, relate to your target market, create a unique image, and effectively display merchandise while supporting the service component of your business.

Conveying Your Strategic Message Through Your Advertising

The third most important communication you have with customers is your advertising. This will be especially important during your first year of operation when you need to spread the word and tell your target customers about your secret weapon — the way that your business alone can meet both their apparent and their deeper needs.

By the end of your first year of operation, you will have served thousands of customers, identified your best customers, and developed a relationship-marketing program — a process we will describe in Chapter 7. At that point, you will want to set aside some of your advertising and promotion budget for relationship marketing. Until then, the full amount should go to advertising.

You can use a wide range of media to advertise your new business. Figure 3 shows the reach, cost, and market for each. In this table —

- *reach* refers to the number of people you are speaking to at once,
- *cost* refers to how expensive it is to advertise using this medium compared to others, and
- *market* refers to the extent to which you can target or focus your message.

FIGURE 3
ADVERTISING OPTIONS

Medium	Reach	Cost	Market
Catalogs	Individual	Moderate/high	Personal/mass
Coupons	Broad	Low	Mass
Direct mail*	Individual	Low	Personal
Display	Local	Low	In-store
Flyers*	Local	Low	Custom
Internet*	Exceptionally broad	Moderate	Mass or special interest
Local cable TV	Broad	Moderate	Mass
Local TV	Broad	High	Mass
Magazines	Broad	Moderate/high	Mass
Newspapers*	Broad	Moderate	Mass
Outdoor	Broad	Moderate	Mass
Radio	Broad	Moderate	Mass
Signage (in-store)	Local	Low	In-store
Word of mouth*	Individual	Low	Personal
Yellow Pages*	Broad	Moderate	Mass

*Most important for owner-operated retailers

As an illustration of how this table works, consider newspaper advertising:

- The reach is broad because many people buy the paper. Depending on the newspaper, you may be able to reach potential customers anywhere in your community, city, region, or country.
- The cost of newspaper advertising is usually moderate, depending on the size of ad you run and the rates charged by the paper.
- The market for newspaper advertising is mass market. You do not know who will read your ad: a multimillionaire flying on a private jet or someone using the paper to shield his or her eyes from the sun while sleeping on a park bench.

Flyers, by comparison, have a local reach. You can often work with a flyer-distribution company or the post office to target a very specific neighborhood or area. For example, you might choose an area in which you have fewer customers than you think you should have. The cost of flyers can be very low if you focus on a particular area.

The Yellow Pages can be a powerful form of advertising for attracting new customers to your store. Many people *do* let their fingers do the walking. The difficulty with Yellow Pages advertising is that you need to book your space far in advance and design an ad that can last a full year. Your Yellow Pages message should be concise and easy to understand because potential customers literally just flip through the pages.

At a time when many individuals have their own website, it seems obvious that businesses should have them, too. After all, customers will be able to find and contact you from anywhere in the world. But ask yourself: Is that really what I hope to achieve? In the final analysis, for most owner-operated retailers, the Internet is just another type of advertising. If you decide to have a website, remember that the advertising you deliver through your website should match the look and feel of all your other advertising, and if you decide to sell products online, your customer service should match the high-quality service you provide in your store.

Truly, the most important advertising medium for any owner-operated retailer is direct mail. The reach is individual, letting you shoot right at the target, the cost is low, and the market is very personal. During your first year of operation, you may want to purchase a commercial mailing list to augment the one you are building.

Word-of-mouth advertising is the most powerful advertising category on the list. Its reach is individual, its cost is incredibly low, and it works at the same personal level as direct mail. We will talk later about the critical importance of providing extra-mile service so that you can create, encourage, and build on the power of word-of-mouth advertising.

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that's a good idea

As you make your plans, you may want to know the percentage of advertising dollars retailers typically spend on each option.

Direct mail 35%

Relationship marketing 15%

Newspapers.. 10%

Website 10%

Radio 10%

Other 9.5%
(Includes catalogs, coupons, flyers, local cable TV, local TV, magazines, outdoor billboards, Yellow Pages)

Display 5.5%

Signage (in-store)................................. 5%

Note that newspaper advertising has been steadily declining for some time now and is being replaced with direct mail, Internet, and relationship marketing.

Your Advertising Plan

All advertising costs money and to manage this expenditure, you will need to develop an advertising plan similar to the one shown in Sample 4. (A blank copy of this form is also included on the CD-ROM.) In developing this plan, we suggest that you follow the slogan: Fish while the fish are biting. By this we mean that the money you spend on advertising in a given period should be directly proportional to the business you expect to do in that period. If your objective is to push sales 10 percent higher, it makes sense to strive for a 10 percent increase in sales during a peak-sales month rather than a slow month.

For example, if December is your peak month, you should put much of your advertising money into late November and early December. We suggest starting in late November because when you are planning promotional advertising (as opposed to clearance advertising), you should always launch the campaign ahead of the selling period.

SAMPLE 4
ADVERTISING PLAN
(FOR YEAR TWO, INCLUDES RELATIONSHIP MARKETING)

	Clearance		Spring			Summer			Fall		Christmas		Total
	Jan.	Feb.	March	April	May	June	July	Aug.	Sept.	Oct.	Nov.	Dec.	
Sales last year	$35,000	$30,000	$60,000	$58,000	$65,000	$62,000	$45,000	$45,000	$62,000	$70,000	$78,000	$150,000	$760,000
Sales plan	$40,000	$32,000	$64,000	$60,000	$68,000	$64,000	$48,000	$48,000	$64,000	$72,000	$80,000	$160,000	$800,000
Catalogs													$0
Coupons													$0
Direct mail			$1,500	$1,000	$1,000	$1,000		$1,000	$2,000	$2,000	$2,000		$11,500
Display			$200	$150	$200	$200		$250	$150	$150	$300	$150	$1,750
Flyers									$1,000		$1,000		$2,000
Internet	$300	$300	$300	$300	$300	$300	$300	$300	$300	$300	$300	$300	$3,600
Local TV													$0
Relationship marketing	$400	$400	$400	$400	$400	$400	$400	$400	$400	$400	$400	$400	$4,800
Magazines													$0
Newspapers	$300		$300		$300	$300		$600		$600	$500	$500	3,400
Outdoor													$0
Radio								$800	$900		$900	$1,000	$3,600
Signage	$250		$200		$250		$200		$250		$250		$1,400
Word of mouth	FREE	FREE	FREE	FREE	FREE	FREE	FREE	FREE	FREE	FREE	FREE	FREE	$0
Yellow Pages	$200	$200	$200	$200	$200	$200	$200	$200	$200	$200	$200	$200	$2,400
Total	$1,450	$900	$3,100	$2,050	$2,650	$2,400	$1,100	$3,550	$5,200	$3,650	$5,850	$2,550	$34,450
% to sales plan	3.63%	2.81%	4.84%	3.42%	3.90%	3.75%	2.29%	7.40%	8.13%	5.07%	7.31%	1.59%	4.31%

The other thing to consider when developing an advertising plan is that you must cover your breakeven expenses each month regardless of the sales volume you achieve. If you allow a certain amount for "maintenance" advertising each month, it can help generate sales to cover these costs.

When planning their advertising, many retailers split the year into five periods. The unique sales pattern of your business may lead you to use fewer time periods than the five we show on our sample plan or give less emphasis to the Christmas selling season.

Developing an advertising plan will help you look at advertising the same way you look at every other expenditure — as a percentage of sales. That is why you start by entering onto your advertising plan your expected sales from your sales plan and then divide it up into months. You then work line by line through the various options, planning this much for newspaper during your January clearance, that much for a flyer to announce your spring season, and so on.

We have no fixed rule for how much you should budget for advertising. However, the absolute maximum for an owner-operated retailer is 5 percent of sales; the absolute minimum is 2 percent of sales. Somewhere in between is probably right for you.

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that's a good idea

You should plan your promotions carefully so that you avoid black holes of inactivity. You can do this by using a combination of weekly and monthly promotional events.

Weekly promotional events are effective because they help you create a sense of urgency for customers to shop *now* for that week's featured specials. Any occasion for gift-giving represents a great opportunity to use a weekly theme to link your store with your customers' need to purchase a gift — for example, a Valentine's Day gift in February or a Father's Day gift in June.

Monthly promotional events are umbrellas that reinforce the overall position of your store during the most important times of the retail year — for example, Christmas or back-to-school. These events take advantage of the longer time period to reinforce the store's advertising as the best place to shop by integrating the whole look of your business, including windows, signage, special bags, and employee name badges.

put it to work

We suggest that you pause here to look back over the topics we have covered in this chapter on the basics of retail. While everything is fresh in your mind, you need to decide how well prepared you are for this part of an owner-operated retailer's job.

You then need to decide what three issues on the basics of retail you can work on immediately, what three pieces of additional information you need, and which three people you should telephone or meet with soon.

How well prepared are you for the basics of retail? (Circle one.)

READINESS		RATING
Need to hire a consultant	✏	1
Need to take some courses	✏	2
Need to read some books	✏	3
Can handle this with effort	✏	4
Can handle this in my sleep	✏	5

What three basics of retail issues can you work on immediately, and what can you do about each of them?

1 ____________________

2 ____________________

3 ____________________

What three pieces of additional information do you need to better understand the basics of retail?

1 ____________________

2 ____________________

3 ____________________

Which three people should you telephone or meet with soon about the basics of the retail part of your job?

1 ____________________

2 ____________________

3 ____________________

Please transfer these answers to the Action Plan in Appendix 1.