

**SMALL BUSINESS BRIEF**

**SMALL-TOWN MERCHANTS ARE NOT USING THE RECOMMENDED STRATEGIES TO COMPETE AGAINST NATIONAL DISCOUNT CHAINS: A PRESCRIPTIVE VS. DESCRIPTIVE STUDY**

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**ABSTRACT**

*The research question was: do small retailers use the strategies prescribed in the literature for them to compete with the large retail chains? Descriptive survey results of 62 small business owner personal interviews indicate that they do not use three of the four prescribed marketing strategies to compete with the large general merchandise discount store chains. Respondents were asked if they adjusted strategies after the major retailer moved in; 52% did not adjust product, 42% maintained the same price strategy, 21% did increase service strategy, and 50% did not alter promotion strategy. The findings revealed that 34% expanded their product line, with only 10% reducing their product line. Although not recommended, 37% actually dropped prices to compete. However, 77% did place a greater emphasis on service. Assessing the impact of these changes on financial performance, 58% indicated that their sales and profit margins had remained satisfactory over a 5-year period of measurement and a third (32%) had mixed results during the same time period.*

**INTRODUCTION**

There are over 24 million businesses in the United States. Half are part-time businesses and the other half consists of those whose primary occupation is self-employment (NFIB, 2000). One in 15 adults (7%) invest in a start-up business (Zacharakis, Bygrave, & Shepherd, 2000); however, there is a 50% chance that a new business will fail in the first 36 months (Meyer, 2001). Around 1.3 million businesses cease operation each year (Dennis, 1999). Thus, the important role of business suggests that an understanding of why firms fail and succeed is crucial to the economy (Lussier & Pfeifer, 2000).

A discount chain entry into a local community clearly has an impact on existing local retailers (McGee & Peterson, 2000). Although not all small retailers are affected adversely, the overall

impact can be quite negative (Carusome, 1976; Marsh, 1991; Sheets, 1989; Stone 1988). According to McGee and Festervand (1996), on average, local merchants can expect stagnant revenues, if not significant declines both in the short and long term. The "big three" general merchandise discount store chains, Wal-Mart, Kmart, and Target have continued to grow at the expense of smaller retailers (Levy & Weitz, 1998).

As discount chains continue their expansion into small-town communities in America, the survival of local merchants remains in question (McGee, 1995). Thus, the findings that mass-merchandisers contribute to the demise of local independent merchants deserve serious consideration; particularly in small town communities where they are needed the most. Finding the right formula for co-existence between discount chains and small local businesses is crucial to the future of small independent merchants (McGee & Festervand, 1996). This study contributes to the literature by aiding in the explanation of the small business owners strategies used, or the lack of adapting strategies, to compete when a major chain store comes to town.

Also, according to McGee and Peterson (2000) and McGee and Festervand (1996), consultants, business writers, and other "experts" argue that small retailers need to adjust their marketing strategies to survive the big retail competitors. They prescribe strategies to compete. However, there is little empirical research to support these prescribed strategies. There is need for further research. Thus, this study further contributes to the literature by determining if the strategies prescribed in the literature are actually used by small retailers to compete with the major chain stores.

### LITERATURE REVIEW

In a study examining Wal-Mart's effect on small town merchants in five mid-western communities, it was revealed that per capita retail sales and taxes increase faster in towns with a Wal-Mart than those without (McGee & Festervand, 1996). However, it was also noted that while non-competing businesses experienced the greatest benefit, local merchants in direct competition with a Wal-Mart experienced revenue losses ranging from 5% to 50%. McGee and Festervand (1996) examined how local retailers responded to Wal-Mart's arrival. Wal-Mart's arrival disrupts existing retailing patterns and forces merchants to alter their competitive strategies. Small merchants incorrectly placed greater emphasis on lower prices and increased promotional activities as a response to competitive pressure. This current investigation is based more on McGee and Festervand (1996) than any other study; thus, there is much comparison throughout this article. In a follow-up longitudinal study after three years, McGee and Peterson (2000) found that merchants responded to Wal-Mart's arrival by giving noticeable, but modest, levels of increased emphasis to a variety of marketing efforts. The primary discriminator in relative performance among these merchants remained to be the nature of Wal-Mart's original impact on them.

Winninger (1995) investigated, what happens when Wal-Mart comes into a small community, and which of the small guys stay in business...and why? Findings indicated that those that tried to beat or meet Wal-Mart's prices were the ones that failed. Those that succeeded were those that were able to exploit their small size and offer the types of customer service that Wal-Marts around the world are unable or unwilling to give (Winninger, 1995).

Stone (1988) examined 17 rural Iowa towns as the first to focus on a particular discount chain—Wal-Mart and its impact on local merchants. Though per capita sales increased faster in towns with Wal-Mart stores than in comparable towns across the State, the study also reported that Iowa towns within a 20-mile radius felt Wal-Mart's presence. Retail sales in these communities decline by nearly 10% after five years. The outcome was much worse for

Iowa's smallest businesses. A newly opened Wal-Mart store, drained as much as \$200,000 a year from towns with fewer than 1000 people. Some store types most susceptible to severe market losses included clothing, drug, jewelry, auto-parts, variety and hardware stores. All these retailers deal in merchandise varieties typically found in a Wal-Mart store (Stone, 1988).

Carusome (1976) investigated retailers in 10 small Ohio communities as one of the first studies to address how large mass-merchandisers affect local merchants. Results indicated that the number of independent local merchants decreased by approximately 8% during the ten-year study period, while the number of chain store outlets increased by nearly 11% (Carusome, 1976).

### **PURPOSE OF THE STUDY**

The purpose of this study was to determine the strategies used by small retailer to compete with large retailers when they move into their local community. This study examines marketing strategies related to the retail marketing mix of product, pricing, service, and promotion strategies. The descriptive research question was: do small retailers use the strategies prescribed in the literature to compete with the large chains?

Based on the literature, the small retailers need to adjust their marketing strategies to reduce the competitive pressures created by the arrival of Wal-Mart and other large chain retailers. The prescribed strategies include: cutting products and adding new lines of products, increasing service and promotional efforts, and/or diversifying into other lines of business. Conversely, cutting prices to compete with large retailers is discouraged (McGee & Peterson, 2000).

### **METHODS**

#### **Design and Sample**

In this descriptive study, 100 small independent merchant business owners were contacted by telephone to participate in survey. Of this number, 62 owners accepted our request and the rest indicated a lack of time as an excuse to not participate. The survey was conducted through personal interviews. Participant stores were from four small towns within the Southwest Virginia region. These towns are within a half-hour driving distance from each other. One of the towns has a Wal-Mart, Kmart, and Lowe's store chains. These chains attract customers from within a 45-mile radius. All the other towns have supermarkets associated with the major chains.

#### **The Survey Instrument**

The survey instrument was developed based on an extensive review of the retail management literature. It had three sections: a biographical section from which descriptive statistics were gathered, a section dealing with the merchant's retail mix (the questions in this section were open and closed-ended), and a third section dealing with evaluation and performance measures (a mix of open and closed-ended questions). The open-ended questions in section two on the retail mix dealt with three key issues: (1) Has competition from the discount chains affected your retail strategy? (2) What if any changes have you made to each retail mix element (product variety and assortment, price, promotion, and customer service) in response to competition from discount chains? (3) What effect have any of these changes had on your sales and profitability? The survey instrument was improved through a panel of experts and pilot testing to increase its reliability and validity.

### Descriptive Statistics

This study was descriptive, thus only descriptive statistics are reported. Participant merchants were 81% male; about half high school graduates and half had some college; about 25% had 0-4, 5-10, 11-20, and > 20 years in business; 52% had business experience prior to starting their business; and 85% were family owned businesses. The frequencies and percentages are reported for product, price, service, and promotion strategies of small retailers.

### RETAIL MIX RESULTS AND DISCUSSION

#### Product Strategy

A retailer's product strategy is revealed in the variety and assortment of products it chooses to carry out. A discount store chain and a local independent retailer may offer similar merchandise, but the discount store will tend to offer more variety but limited assortment of merchandise. These elements of product variety and assortment form an integral part of the retail market structure, since it is the retail offering that ultimately distinguishes between discounters, department and specialty stores. The question asked of respondents was:

#### *How did competition from major chains affect your product offerings?*

When asked to describe what responsive actions they had instituted to stay competitive, respondents' answers varied as follows:

No change	52%
Expand product line	34%
Decreased product line	10%
Complete new line	3%
Changed retail format	2%

Of the 62 merchants who responded to this question, about a third of them (34%) indicated that they expanded their product line offerings rather than contracting or eliminating some lines. Only 10% (6) indicated that they took this line of action. Half (52%) did nothing to adjust their product offerings. Very few (3%) offered a completely new product line or changed store format as a competitive response (2%).

These results do not support the use of prescribed strategies (McGee & Festervand, 1996; McGee & Peterson, 2000; Winninger, 1995) being used by small retailers as over half of the respondents made no product strategy adjustment despite acknowledging that competition from discount chains had affected their business, and few decreased their product offerings.

#### Pricing Strategy

Today's consumer is more price-sensitive than ever. They want value and to many consumers that means a low price. Others are willing to pay premium prices as long as they believe they are getting a differentiated product/service. Retailers have responded to these market pressures by creating retail formats that emphasize low prices as means of creating a differential advantage. National discount store chains that offer everyday low prices (EDLP) – such as Wal-Mart, Target, and Kmart – dominate many markets in many product categories. A close competitor in this price-driven market is the membership-only warehouse club, such as Sam's Wholesale Club and Price/Costco. Another retail type is the off-price retailer (e.g. Loehmann's, T.J. Maxx, and Marshalls), which purchases closeout and end-of-season merchandise at lower-than-normal prices and passes the savings on to the customer.

In the middle of this price war among national chains are smaller independent retailers. Typically unable to purchase in large quantities to receive lower prices like their larger competitors, "ma-and-pa" retailers have either learned to use other strategies to compete or gone out of business. For instance, to compete with Wal-Mart's low prices, small retailers have developed niche strategies by providing a broader assortment of merchandise within a given product category and better service. Wal-Mart may have the lowest average price on the few athletic shoes and clothing that it carries. A good sporting goods specialty store, however, might have a larger assortment than Wal-Mart and would be willing to special-order merchandise so that its customers could get exactly the shoes they're looking for. It could also give advice on the product itself as well as local sporting information. To determine how local merchants were dealing with intense price competition from the discount chains such as Wal-Mart, Kmart, and Lowe's respondents from the local market area were asked to:

***Describe what pricing actions, if any, you employed to stay competitive.***

Responses were as follows:

No Change in pricing strategy	42%
Lowered price to match discount chains	37%
Did not make major changes in original pricing strategy	16%
Consciously moved away from price competition	3%
Brought in new product lines for price conscious consumers	2%

Over a third of independent retailers (37%) engaged in head-to-head price competition with discount chains by cutting their prices. A respectable number (16%) made only minor changes from time to time and 42% left their pricing strategy unchanged.

Contrary to the prescribed notion that small retailers need to adjust marketing strategies and avoid decreasing prices (McGee & Festervand, 1996; McGee & Peterson, 2000; Winninger, 1995) many respondents made no strategy changes and many did cut prices. Thus, participants are not using the prescribed strategies.

### **Customer Service Strategy**

Customer service is the set of activities and programs undertaken by retailers to make the shopping experience more rewarding for their customers. These activities increase the value customers receive from the merchandise and services they purchase. In a broad sense, all elements of the retailing mix provide services that increase, the value of merchandise. For example, location, in-stock position, and assortments all increase customer convenience.

Small, independent retailers often attempt to develop a strategic advantage over large, national chains by providing customized customer service. Large chains can use their purchasing power to buy merchandise at lower prices than small local stores can. But small retailers can overcome this cost disadvantage by providing better customer service than a large, bureaucratic chain. Local merchants were asked:

***How has your service strategy been affected by competition from discount chains?***

Results were:

Greater emphasis on service	77%
No change	21%
Match competitor's level of service	2%
Less emphasis on service	0%

The majority of the respondents (77%) indicated that they place increased emphasis on services. Just one indicated trying to match the level of service provided by the major chains. No one decreased service as a responsive strategy. Thus, respondents are using the prescribed increased customer service strategy (McGee & Festervand, 1996; McGee & Peterson, 2000; Winninger, 1995).

### Promotion Strategy

A retailer's promotion program informs customers about the store as well as the merchandise and services it offers. In addition, retailers are using promotion programs to build repeat business and store loyalty.

Retailers communicate with customers through five vehicles also referred to as the promotion mix elements: advertising, sales promotion, publicity, store atmosphere and visual merchandising, and personal selling. In large retail firms, the promotion strategy is managed by the firm's marketing or advertising department and the buying organization.

Small independent retailers are often at a disadvantage in the area of promotion because of limited resources. Also, the vehicles or promotion mix they employ differs from those used by large retailers. Most large retailers employ an integrated promotion campaign where they make use of all the promotion mix elements—advertising, personal selling, sales promotion, and public relations. Small independent retailers mostly rely on word-of-mouth, some local events sponsorship, and limited radio/newspaper advertising. Respondents were asked:

#### *Did your promotional activities change after the major chain entered your market?*

Results on how small town retailers accomplish their promotion tasks include:

No change	50%
Increased promotion activities	50%

There is an equal split between those who promote aggressively - using multiple media sources and promotion elements - and those who did not promote at all - preferring to rely on word-of-mouth from satisfied customers. Half of respondents increased their promotional activities, which is consistent with the prescribed strategy to increase promotional efforts (McGee & Festervand, 1996; McGee & Peterson, 2000; Winninger, 1995) aimed at informing the market of the local merchant's unique offerings and service. Local radio, newspapers, billboards, and cable T.V. were the most frequently mentioned media sources.

### Performance Outcomes

Ultimately, the effects of any adjustments to product, pricing, promotion and customer service strategies are revealed in the firm's financial performance. The prevailing assumption has been that small independent merchants who adjust their marketing strategies to reflect a narrower but unique product mix, provide valued services to their customers and put out a focused, yet aggressive and informative promotional campaign, will out perform those that try to mimic the strategies of discount chains like Wal-Mart (Winninger, 1995). Respondents were asked:

#### *What effect have any of these changes had on your sales and profitability?*

Maintained satisfactory profits over the past 5 years	58%
Mixed results over the past 5 years	32%
Mostly losing sales and profits over the past 5 years	10%

Over half of the firms claimed to have maintained satisfactory sales and profit margins over a five year period. A third had a mix of losing years and profitable years. Only 10 percent reported loses in sales and profits during the entire five years or during four out of the five years. Given the fact that these local merchants are most often the surviving candidates in the local market after most of their peers have closed down, it is no surprise that over half reported to be doing well. Also, these were the firms that had adjusted their marketing mix away from the discount chain strategy. Those with mixed results are the marginal firms that have not yet fully adjusted their strategies away from the discount chain format. They have changed certain things and ignored others. As revealed earlier, small independent merchants that are able to exploit their small size and offer the types of customer service and product categories that Wal-Marts around the world are unable or unwilling to offer are the ones for will stay profitable (Winninger, 1995).

### IMPLICATIONS

As researchers have studied this topic, there is a growing consensus that to succeed, the local independent merchant must pursue a focused (niched) differentiation strategy, rather than try to compete against mass merchandisers on the basis of price (Hamilton, Zimmerman, Hill, Dunlap-Hinkler, & Chapman, 2001). Results indicate that a large percentage of small local independent retailers failed to adopt this course of action. Most local merchants expanded rather than contract and focus their product lines. There did not seem to be a conscious attempt to vary the product variety and assortment away from the discount chain's offerings. On pricing, a significant number of respondents lowered their prices to match those of the discount chains. This seems illogical or unrealistic of a move to take. McGee and Festervand (1996) concluded that competing on price may be futile. There is no denying that the small independent retailer must remain price competitive, but success is much more likely if the local merchants are able to satisfy their customers by offering a deeper selection of higher quality products and superior customer service at a premium price. Winninger (1995), suggests that targeting a particular customer type or unsatisfied niche is the better course of action than trying to appeal to the mass market.

An overwhelming number of local merchants indicated that they have expanded their level of customer service in order to keep their customers happy. However, these same merchants revealed that they had lowered their prices to stay competitive. Except for the very best companies, these two strategies may work against each other. Increasing customer service, expanding product offerings, and promoting the store are all spending activities that need to be matched by higher prices to cover such costs. This may explain why many local merchants fail to make a profit or simply go out of business.

Although prescriptive strategies to compete with the giants were concluded in this journal back in 1996 (McGee & Festervand), and others, this study reveals that local merchants still do not have a consistent strategy of competing against discount merchandisers. Instead of trying to compete head-to-head with discount chains, successful small retailers will be those who effectively compete "around" them, most small businesses are not following this advice. Also, there must be an explicit strategy that is based on the external market situation (opportunity & threats) and the internal firm situation (strengths & weaknesses).

In conclusion, this study reveals that many small retailers are still not using the prescribed marketing strategies to successfully compete with the large discount chains. This may be due to the fact that the small retailers are not aware of the prescribed strategies or convinced of the effectiveness of these strategies if implemented. There is a need to educate the small retailers to adopt the prescribe strategies to help decrease the number of small businesses that fail.

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