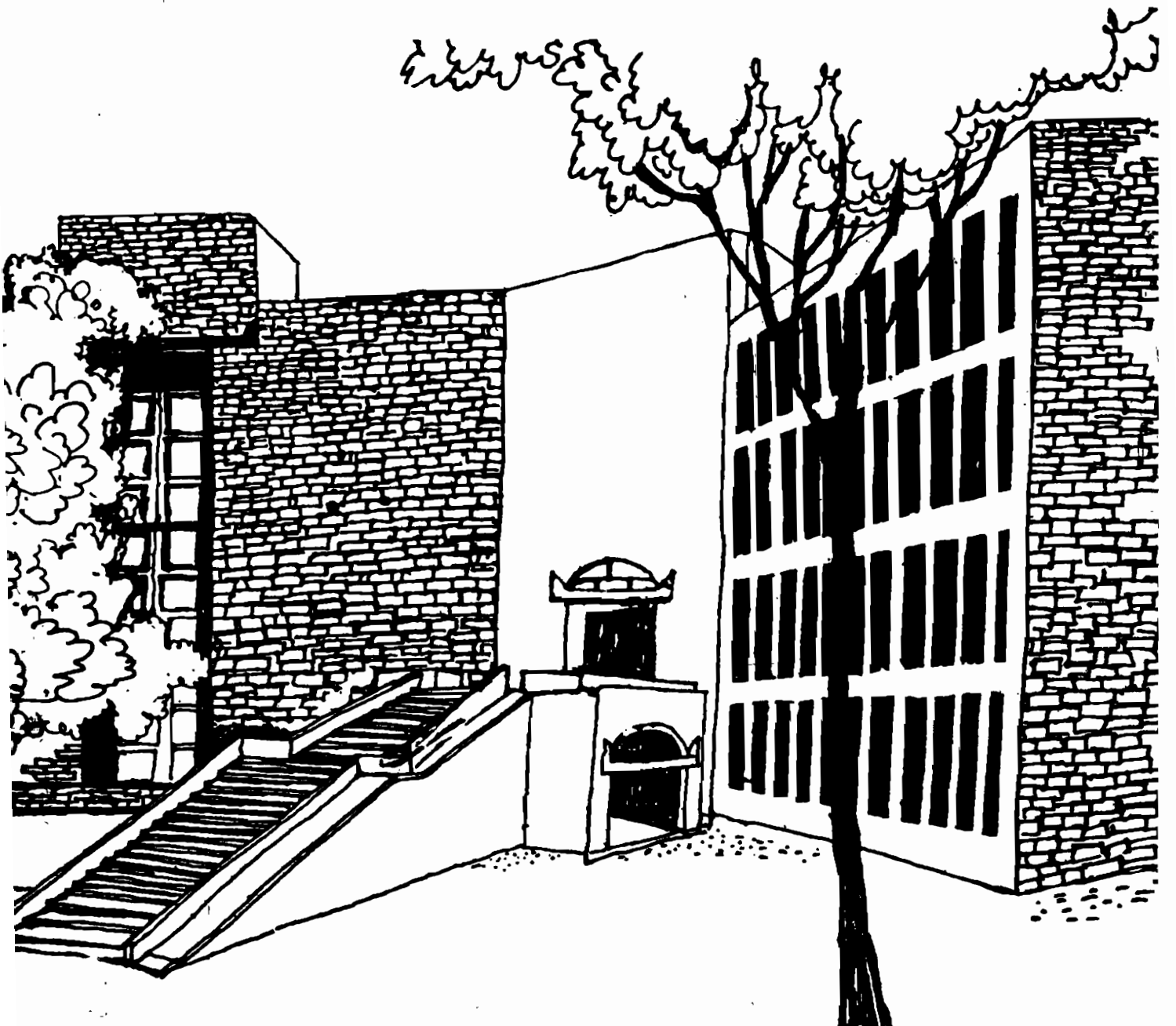




# Working Paper



## Using Transaction Utility Approach for Retail Format Decision

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## Using Transaction Utility Approach for Retail Format Decision:

### **Abstract**

Transaction Utility theory was propounded by Thaler to explain that the value derived by a customer from an exchange consists of two drivers: Acquisition Utilities and Transaction utilities. Acquisition utility represents the economic gain or loss from the transaction. Where as transaction utility is associated with purchase or (sale) and represents the pleasure (or displeasure) of the financial deal per se and is a function of the difference between the selling price and the reference price. Choice of a format has been studied from several dimensions including the cost and effort as well as the non-monetary values. However, the studies that present the complete picture and combine the aspects of the tangible as well as intangible values derived out of the shopping process are limited. Most of the studies, all of them from the developed economies, have focussed on the selection of a store. They represent a scenario where formats have stabilised. However, in Indian scenario formats have been found to be influencing the choice of store as well as orientation of the shoppers. Also, retailers are experimenting with alternate format with differing success rates. The author has also not found a study that has applied this theory. It is felt that the Transactional Utility Theory may provide a suitable approach for making format decisions.

### **Retail Formats**

The retail format is the store 'package' that the retailer presents to the shopper. A format is defined as a type of retail mix, used by a set of retailers<sup>1</sup>. Store Formats are formats based on the physical store where the vendor interacts with the customer<sup>2</sup>. It is the mix of variables that retailers use to develop their business strategies and constitute the mix as assortment, price, transactional convenience and experience<sup>3</sup>.

Therefore each retailer needs to evaluate the enablers and deterrents in the retail marketplace. This primarily involves identifying the key drivers of growth, the shoppers' profile and shopper expectations. It also means evaluating the nature of competition and challenges in the market place. Then the retailer decides the elements of the retail mix to satisfy the target markets' needs more effectively than its competitors. The choice of retail mix elements will enable it to decide the type of format or structure of business.

### **Classification of Formats**

The term retail institution refers to the basic format or structure of a business. Classification for Retail institutions is necessary to enable firms to better understand and enact their own strategies: selecting an organizational mission, choosing an ownership alternative, defining the goods/ service category and setting objectives.

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<sup>1</sup> Levy Michael, Barton A. Weitz, (2002) "Retailing Management", Tata Mcgraw Hill. Fourth edition, p.172

<sup>2</sup> Albrecht Enders and Tawfik Jelassi. (October 2000) "The Converging Business Models of Internet and Bricks-and-Mortar Retailers", European Management Journal, pp. 542-550

<sup>3</sup> Messinger, Paul R and Narasimhan, Chakravarthi (1997), "A Model of Retail Formats Based on Consumers' Economising on Shopping Time". *Marketing Science*, Vol. 16, No. 1, pp. 1 - 23

Figure 1 shows a breakdown of each category<sup>4</sup>. The classification is not mutually exclusive; that is, an institution may be correctly placed in more than one category. For example, a department store unit may be part of a chain, have a store-based strategy, accept mail order sales, and have a Web site. These are commonly used typographies. They are likely to vary between countries. For instance, a *Kirana store* in India or car boot sales in the UK.

### Ownership Based

Retailing is one of the few sectors in our economy where entrepreneurial activity is extensive. Although retailers are primarily small (80% of all stores are operated by firms with one outlet and over one-half of all firms have two or fewer paid employees), there are also very large retailers.

Retail firms may be independently owned, chain owned, franchisee operated, leased departments, owned by manufacturers or wholesalers, consumer owned<sup>5</sup>. From a positioning and operating perspective, each ownership format delivers unique value. Retail executives must work on the strengths and weaknesses inherent in each of these formats to be successful.

### *Independents*

An Independent retailer owns a single retail unit. In the United States, they account for nearly 80 percent of total retail establishments and firms generate just 3 percent of total U.S. store sales. One half of all independents are run entirely by the owners and/or their families and have no paid workers. The high number of independent retailers is associated with the ease of entry into the marketplace, owing to low capital requirement, no or relatively simple, licensing procedures. The ease of entry into retailing is reflected in the low market shares of the leading firms in many goods /service categories as a percentage of total category sales. For example, in the grocery store category where large chains are quite strong, the five largest grocery retailers account for only about 22 percent of sales<sup>6</sup>. A similar large format in India contributed to less than 3% of total retail sales. The Indian retail market has around 12 million outlets and has the largest retail outlet density in the world. However, most of these outlets are basic mom-and-pop stores with very basic offerings, fixed prices, and no ambience. These are highly competitive stores due to cheap land prices and labour. Also, most of the time these stores save tax as they belong to the small industry sector.

Due to relative ease of entry into retailing, there is a great deal of competition resulting in the high rate of retail business failures among new firms. According to Small Business Administration estimates one-third of new U.S. retailers do not

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<sup>4</sup> Berman Barry and Evans Joel R, "Retail Management - A Strategic Approach", Eastern Economy Edition, Eighth Edition - Prentice-Hall India. p.115

<sup>5</sup> *ibid.*4

<sup>6</sup> Caffey Andrew A. (1997), "Opportunity Knocks", Entrepreneur Magazine 's Buyer Guide to Franchisee and Business Opportunities, p. 3

survive their first year and two-thirds do not continue beyond their third year. Most of the failures involve independents.

These stores have a great deal of flexibility in choosing retail formats and locations. They target smaller consumer segments rather than mass markets. Since only one store location is involved, detailed specifications can be set for determining best location, product assortments, prices, store hours, and other factors consistent with their target segment. They have low investments in terms of lease, fixtures, workers and merchandise. Thirdly, independents often act as specialists and acquire skills in a niche for a particular goods/service category. Decision-making in these stores is usually centralised as the owner operator is typically on the premises, who have a strong entrepreneurial drive as they have personal investment in the business, success or failure has huge implications, and there is a lot of ego involvement. They are consistent in their efforts as they generally adopt just one strategy.

There are some disadvantages of independent retailing. They have limited bargaining power with suppliers as they often buy in small quantities. Reordering may also be tough if minimum order requirements are too high for them to qualify. To overcome this problem, a number of independents form buying groups. Due to low economies in buying and maintaining inventory, the transportation, ordering, and handling costs are higher. These stores often have operations that are labour intensive, sometimes with little computerisation. Ordering, taking inventory, marking items, ringing up sales and bookkeeping may be done manually as most independents tend to find investment in technology and training not worthy. Compared to other formats, Independents incur high costs of advertising due to limited access to advertising media and may pay higher fees compared to regular users. There is often disruption when the owner is ill, on vacation, or retires. They also allocate limited amount of time and resources to long term planning. To offset the disadvantage of economies, these retailers offer complementary merchandise and services. Often while all stores in the chain offer the same merchandise, independents can provide merchandise compatible with local market needs.

### *Chains*

A chain retailer operates multiple outlets (store units) under common. In developed economies, they account for nearly a quarter of retail outlets and over 50 percent of retail sales. Retail chains can range from two stores to retailers with over 1,000 stores. Some retail chains are divisions of larger corporations or holding companies. The select large retail chains in India are shown in Annexure-I

Chain Retailers have several advantages. They enjoy strong bargaining power with suppliers due to the volumes of purchases. They generally bypass wholesalers. Many of them buy directly from the manufacturers. Suppliers service the orders from chains promptly and extend a higher level of proper service and selling support. New brands reach these stores faster. Most of these chains sell private. Chains achieve efficiency due to the centralisation of purchasing and warehousing and computerisation. Wider geographic coverage of markets allows chains to utilize all forms of media. Most of the chains invest considerable time and resources in long term planning, monitoring opportunities and threats.

Chain retailers suffer from limited flexibility, as they need to be consistent throughout in terms of prices, promotions, and product assortments. Chain retailers have high investments in multiple leases, fixtures, product assortments and employees. Due to their spread, these retailers have reduced control, lack of communication and time delays. Thus, such retailers focus on managing a specific retail format for a better strategic advantage and increased profitability. Some chain retailers capitalise on their widely known image and adopt flexibility to market changes.

### *Franchising*

Franchising is a contractual agreement between a franchiser and a franchisee that allows the franchisee to operate a retail outlet using a name and format developed and supported by the franchiser. Approximately one-third of all U.S. retail sales are made by franchisees. In a franchise contract the franchisee pays a lump sum plus a royalty on all sales for the right to operate a store in a specific location. The franchisee also agrees to operate the outlet in accordance with procedures prescribed by the franchisers. The franchiser provides<sup>7</sup> assistance in locating and building the store, developing the products and/or services sold, management training and advertising.

There are two types of franchising: product/ trademark and business format. In product/ trademark franchising, franchisees acquire the identities of the franchiser by agreeing to sell the latter's product and/or operate under the latter's names. But they are independent in their operation. They may draw certain operating rules in consultation with the franchiser. In a business format franchising arrangement, the two parties have a synergetic relationship. The franchiser provides assistance in strategic and operation issues besides the right to sell goods and services. The franchisees can take advantage of prototype stores, standardised product lines and cooperative advertising.

Three structural arrangements are found in retail franchising. (a) Manufacturer-Retailer; where a manufacturer licenses the right to sell goods and related services through a licensing agreement as in the case of automotive dealers and petroleum products dealers. (b) Wholesaler-retailer; which may take the form of a voluntary franchise system as in consumer electronic stores or co-operative where a group of retailers set up a franchise system and share the ownership and operations of a wholesaling organisation. (c) Service sponsor retailer, where a service firm licenses individual retailers to let them offer specific service packages to consumers, such as auto rental, hotels and fast food restaurants.

This arrangement has several advantages. Individual franchisees can own retail enterprises with relatively small capital investments. Franchisers gain a national or global presence quickly and with less investment. It improves cash flow as money is obtained when goods are delivered rather than when they are sold. Since franchisees are owners and not employees, they have a greater incentive to work hard. Franchisees may also have to face certain disadvantages. Over saturation could occur adversely affecting the sales and profits of each unit. They may enter into contract provisions that give the franchisers undue advantage. They can exclude franchisees

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<sup>7</sup> Fernie John and Fernie Suzanne I (1997), "The Development of a US Retail Format in Europe", *International Journal of Retail and Distribution Management*, Vol. 25 (11), pp. 342 – 350.

from, or limit their involvement in, the strategic planning process. Franchisers also face a lot of potential problems. Franchisees can harm a firm's overall reputation and/or customer loyalty if they do not adhere to company standards. Intra-franchise competition is not desirable. Ineffective franchised units directly impact franchiser profitability from selling services, materials, or products to the franchisees and from royalty fees. Franchisees, in greater numbers, are seeking independence from franchiser rules and regulations.

### *Leased Department*

A Leased Department is a department in a retail store rented generally by a manufacturer. The lessee is responsible for all aspects of business and pays the store a rent. The store may impose operating restrictions for the leased department to ensure the overall consistency. The leased departments choose to operate in categories that are generally on the fringe of the store's major product lines, such as in-store beauty salons, banks, photographic studios and food courts.

Leased departments help the stores in generating greater traffic and providing one-stop shopping. They benefit from expertise of lessees in personal management, merchandise displays, the recording of items, as store personnel might lack the merchandising ability to handle and sell certain goods and services. This is also a regular source of revenue and reduces costs as leased departments pay for inventory and personal expenses. This may also be a source of conflict with lessees as leased departments may use operating procedures which conflict with those of the stores. The lessees may adversely affect stores' images and customers may blame problems on the host stores rather than on the lessees.

The leased department operators benefit as the main store generates immediate sales for leased departments. This arrangement reduces expenses through economics of scale (like pooled advertising) and shared facilities (like security equipment and display windows). Also lessees' images are aided by their relationships with popular stores. However, there may be inflexibility due to the restrictions imposed by the operations of the main store. There is always the fear that the stores may raise the rent or may not renew leases when they expire even if lessees are successful.

### **Vertical Marketing System**

A Vertical Marketing System consists of all levels of independently owned businesses along a channel of distribution. Goods and services are normally distributed through one of these types of vertical marketing systems: independent, partially integrated, and fully integrated as shown in figure 2.

In an independent firm vertical marketing system, there are levels of independently owned firms: manufacturers, wholesalers and retailers. Such a system is most often used when the manufacturers have to reach a wider market or retailers are small. Also when company resources are low and channel members want to share costs and risks such an arrangement is desirable. Independent retailers capitalise on their targeted customer base and build loyalty by playing the role of a friendly shop-owner and build a good word –of –mouth communication.



With a partially integrated vertical marketing system, two independently owned businesses along a channel perform all production and distribution functions without the aid of the third. The most common form of this system is when a manufacturer and retailer complete transactions and shipping, storing and other distribution functions in the absence of independent wholesalers. A partially integrated system is most appropriate if manufacturers and retailers are large, selective or exclusive distribution is sought, unit sales are moderate, company resources are high, greater channel control is desired, and existing wholesalers are too expensive or unavailable.

Through a fully integrated vertical marketing system, a single Company performs all production and distribution functions by eliminating the other channel members. The advantages to a firm are total control over strategy, direct contact with final consumers, and higher retail mark-ups without raising prices, self-sufficiency, exclusivity over goods and services offered, and retention of profits within the company. In the past, this system was usually employed only by manufacturers, but now retailers have also moved upward in the chain. Some wholesalers have both either way to deliver better value to their customers.

### **Consumer Co-operatives**

A Consumer Cooperative is a retail firm in which a group of consumers invest in the enterprise. The officers are elected. Consumer-members share the profits or savings that accrue. Such retailers are many in number but small in size and are most popular in food retailing. They are started mainly to guard against the malpractice that many retailers indulge in and either charge higher prices or offer inconsistent quality of merchandise. The consumer co-operatives are limited because consumers are usually not expert in buying, handling and selling goods and services and the cost savings and low selling prices have not been as expected in many cases.

### **Store Based Retailer**

Retail institutions may be classified by store based strategy mix and divided into food-oriented and general merchandise. The selected aspects of the strategy of store based retail institutions are described in Figure - 4.

### **Food- Oriented Retailers**

Six major strategic formats are used by food oriented retailers: convenience store, conventional supermarket, food based superstore, combination store, box (limited line store) and warehouse store. These are discussed in the following subsections.

#### *Convenience Stores*

A convenience store is a well-located store. The ease of shopping and personalised services are the major reasons for its patronage, even when it charges average to above average prices, and carries a moderate number of items. It stays open for long hours and provides an average atmosphere and customer services. It is often also called the "mom-and-pop" stores. It is useful for fill-in merchandise and emergency purchases. Many customers shop at least two to three times a week at these stores.

The convenience stores face most competition from supermarkets that have started providing longer hours and better stocks of non-food items.

### Conventional Supermarket

A conventional supermarket is a self-service food store offering groceries, meat, produce with limited sales of non-food items, such as health and beauty aids and general merchandise at low prices. They are large in size and carry 9,000 to 11,000 items. They are chosen due to volume sales, self-service, low prices and easy parking. The self-service nature allows supermarkets to cut costs, as well as increase volume.

The conventional supermarket was once the most common format.<sup>8</sup> Conventional supermarkets have to deal with intense competition from other types of food stores. Convenience stores offer greater customer convenience; food based superstores and combination stores have more product lines and greater variety, as well as better gross margins; and box and warehouse stores have lower operating costs and prices. Membership clubs, with their discount prices, also provide competition – especially now that they have expanded food lines. Discount store chains are able to undercut supermarket prices because their efficient distribution systems focus on reducing inventory investments by selling fast moving items.

### Food-based Superstores:

Superstores are large supermarkets ranging from 20,000 to 50,000 square feet. They cater to consumers grocery needs and offer them the ability to buy fill-in general merchandise. The advantages of food-based superstores are that they are efficient, offer a degree of one-stop shopping, stimulate impulse purchases and feature high profit general merchandise. Other advantages are that it is easier and less costly to redesign and convert supermarkets into food-based superstores than combination stores. Management expertise is better focused in food-based superstores. Many consumers feel more comfortable shopping in true food stores than combination stores. Most of the supermarket chains have also started offering food to compete with these stores.

### Combination Stores/ Supercentres

Combination stores are food-based retailers that unite supermarket and general merchandise sales in one facility with the latter typically accounting for 25 to 40 percent of total sales. They achieve operational efficiencies and cost savings through their large-scale operations. Consumers like one-stop shopping and travel further to visit these stores. Impulse sales are high. A super centre is a combination store blending an economy supermarket with a discount department store. Traditional supermarkets are facing serious new competitive challenges from supercentres at the price-conscious end of the market and from "home meal replacement" providers at the convenience-oriented end. Supercentres with an average size of about 150,000 sq.

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<sup>8</sup> Doris Newton J (1993), "Non-traditional Retailers Challenge the Supermarket Industry", Food Review; Washington; Jan-Apr

ft. devote about 40% of their space to grocery items and the rest to discount general merchandise.

#### Box (Limited-Line) Store:

The Box (Limited-Line) Store is a food based discounter that focuses on a small selection of items, moderate hours of operation (compared to other supermarkets), few additional services, and limited manufacturer brands. There stock usually less items, few or no refrigerated perishables, and few sizes and brands per item. Items are displayed in cut cases. Customers do their own bagging. Box stores depend on low – priced private-label brands. They aim to price merchandise 20 to 30 percent below supermarkets.

#### Warehouse Store:

A warehouse club is a retailer that offers a limited assortment of food and general merchandise, with limited services, at low prices to ultimate consumers and small businesses. It appeals to price-conscious consumers, who must be members to shop there. Its inventory turnover rate is several times that of a department store. Stores are large and located in low-rent areas. They have simple interiors and concrete floors. Aisles are wide to facilitate pick up pallets of merchandise. Specific brands and items differ from time to time as the stores buy merchandise available on special promotions from manufacturers. The clubs pass on these savings to shoppers through lower prices. Most warehouse clubs have two types of members. Wholesale members who are small business people, and individual members who purchase for their own use.

The major retailing challenge faced by membership clubs is the limited size of their final consumer market segment. The main limiting factor is the lack of brand continuity. Since products are usually bought when special deals are available, brands may be temporarily or permanently out of stock. In addition, many consumers do not like shopping in warehouse settings.

### General Merchandise Retailers

#### *Department Store*

A department store is a large retail unit with an extensive assortment (width and depth) of goods and services that are organised into separate departments for purposes of buying, promotion, customer service and control. It has the greatest selection of any general merchandise retailer and often serves as the anchor store in a shopping centre or district. Department Stores are unique in terms of the shopping experience they offer, the services they provide and the atmosphere of the store. They offer a full range of services from altering clothing to home delivery. Over its history, the department store has been responsible for many innovations, including advertising prices, enacting a one-price policy (whereby all shoppers pay the same price for the same good or service.), developing computerised checkouts, offering money back guarantees, adding branch stores and decentralised management

However, during the past few years, industry wide sales growth of traditional department stores has lagged behind the full line discount stores. They no longer have brand exclusivity for a lot of items they sell; manufacturer brands are also available at specialty and discount outlets. Many firms, instead of creating their own brands, have signed exclusive licensing agreements with fashion designers. This perpetuates customer loyalty to the designer and not the store. There are more price conscious consumers than before, and they are attracted to discount retailers. The popularity of shopping malls has aided specialty stores since consumers can accomplish one-stop shopping through several specialty stores in the same mall or shopping centre. Some department stores are too big and have too much unproductive selling space and low turnover of merchandise.

### *Full-line Discount Store*

A full-line discount store targets the middle-class and lower-middle class shoppers who looking for good value. It conveys the image of a high-volume, low cost and fast turnover outlet. It sells a broad merchandise assortment for less than conventional prices. It is likely to carry the range of product lines expected at department stores. Products are normally sold via self-service with minimal assistance in any single department. Centralised checkout service is provided. Buildings, equipment and fixtures are less expensive; and operating costs are lower than for traditional department stores. To respond to category specialists, full-line discount retailers are creating more attractive shopping environments, placing more emphasis on apparel, developing private label merchandise, and increasing store visits by offering easily accessible convenience store merchandise.

### *Speciality Stores*

A traditional specialty store concentrates on a limited number of complementary merchandise categories and provides a high level of service. They are smaller in size.

- **Drugstores**

Drugstores are specialty stores that concentrate on health and personal grooming merchandise. Pharmaceuticals often represent over 50 percent of drugstore sales and an even greater percentage of their profits. Drugstores are facing considerable competition from discount stores and supermarkets adding pharmacies. In response, the major drugstore chains are building larger stand-alone stores offering a wider assortment of merchandise, more frequently purchased consumer products and drive through windows for picking up prescriptions. To build customer loyalty, the chains are also changing the role of their pharmacists from dispensing pills to providing health care assistance and personalised service. For example, Planet Health, Subhiksha.

- **Category Killers**

The category killer concept originated in the U.S. due to abundance of cheap land and the dominant car culture. A category specialist is a discount store that offers a narrow variety but deep assortment of merchandise. These retailers are basically discount

specialty stores. By offering a complete assortment in a category at low prices, category specialists can “kill” a category of merchandise for other retailers. Most category specialists use a self-service approach. They use their buying power to negotiate low prices, excellent terms and assured supply when items are scarce.

The category killers are facing reduced profits as the competition is focusing on prices. They have difficulty differentiating themselves on other elements of retail mix. All competitors in a category provide similar assortments and the same level of service. According to a report in the European Retail Digest, there are some that believe that the category killer format will burn out, leaving only a few hardened experts, as happened with the warehouse club sector. In response to this increasing competitive intensity, the category killers continue to concentrate on reducing costs by increasing operational efficiency, acquiring smaller chains to gain economies of scale and expanding into less competitive international markets. France, Germany, Spain and the UK provide attractive markets for expanding category killers. Interestingly, with the clampdown on out-of-town developments in the UK, homegrown category killers that are typically located in town centres will benefit from legislative changes in this area. Some out of town category killers are choosing to downsize their format to make it fit small towns.<sup>9</sup>

### DIY Stores

A home improvement centre is a category specialist offering equipment and material used by do-it-yourselfers and contractors to make home improvements. It focuses on providing material and information that enables consumers to maintain and improve their homes. While merchandise in these stores is displayed in a warehouse atmosphere, salespeople are available to assist customers in selecting merchandise through demonstrations and workshops. They are not facing the same level of competitive intensity as other category specialists, because the merchandise varies considerably across the country and there are opportunities for differentiation on customer service.

### *Off-Price Stores:*

An off-price chain offers brand-names and designer labels and sells them at a low price in an efficient, limited service environment. An off-price store buys other retailers' cancelled orders, manufacturers' irregulars and overruns and end-of-season items for a fraction of their original wholesale prices. Due to this pattern of opportunistic buying, the same type of merchandise may not be in stock when customers visit the store. Typically, different bargains will be available on each visit. Their inventory turnover is far higher than that of departmental stores. The most crucial aspect of the strategy for off-price chains involves buying merchandise and establishing long-term relationships with suppliers. Three special types of off-price retailers are outlet, closeout, and single-price retail stores.

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<sup>9</sup> “Category Killers in Europe - A Retail Format for the Future”, European Retail Digest, Spring 1996, p. 42.

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Over the past few years, the sales growth of off-price retailers has slowed. The challenge is from an increase in sales and promotion in department stores, consumers being more fashionable, brand name merchandise in department stores at the same discounted prices offered by off-price retailers. Also, more sophisticated inventory management systems have reduced the amount of excess production that can be bought by off-price retailers. Therefore the manufacturers have sought opportunities to apply this successful format in foreign markets, particularly in the UK. By the early 1990s, the UK market appeared to be attractive for the introduction of factory outlet centres for a variety of reasons. First, the growth of retail formats in out of town locations (superstores, retail parks, and regional centres) was conducive to a fourth wave of development. Second, this trend to out of town shopping coincided with the rise of discounting formats, creating a climate suitable for the growth of value retailing. Third, the relaxation of planning guidelines in the 1980s and early 1990s allowed the development of new out of town retail formats.<sup>10</sup>

#### Factory Outlet Stores:

Outlet Stores are off-price retailers owned by manufacturers or by department or specialty store chains and are frequently referred to as factory outlets. A factory outlet is a manufacturer-owned store selling manufacturer closeouts, discontinued merchandise, irregulars, cancelled orders, and sometimes, in season, first quality merchandise. They closely resemble shopping centres, both in terms of size, layout, and in carefully controlled tenant mix, with manufacturers operating separate units on a single co-

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<sup>10</sup> Ibid. 7

coordinated site. Additional amenities include car parking, restaurant and leisure facilities. Factory outlet stores are located out of town, lowering development and operating costs and the distribution channel for certain categories of merchandise is shortened, cutting out the functions and profits of traditional retailers. The manufacturers have various interests in outlet stores.<sup>11</sup> It helps in the disposal of surplus stock due to unreliable accounts, late payers, and cancelled orders. It allows a manufacturer to control where its discounted merchandise is sold. A manufacturer chooses out-of-the-way locations, depressed areas, or areas with low sales penetration of the firm's brands, whereby the factory outlet revenues are unlikely to affect the sales at manufacturers' key specialty and department stores. A manufacturer can decide on store visibility, set promotion policies, remove labels and be sure that discontinued items and irregulars are disposed of properly.

- **Closeout Retailers:**

Closeout Retailers are off-price retailers that sell a broad but consistent assortment of general merchandise as well as apparel and soft home goods.

- **Single Price Retailers:**

Single Price Retailers are closeout stores that sell all their merchandise at a single price.

### *Hypermarkets*

Hypermarkets were created in France after World War II. A hypermarket is a very large retail store offering low prices. It combines a discount store and superstore food retailer in one warehouse like building. Hypermarkets can be up to 300,000 square feet and stock over 50,000 different items. Hypermarkets are unique in terms of store size; low operating margins, low prices and the size of general merchandise assortment. The store sells a broad variety of basic merchandise ranging from food to consumer electronics. All hypermarkets are based on three concepts of: one stop shopping, ample free parking and a discount pricing strategy. The main limitation of hypermarkets is that many consumers find that shopping in stores over 200,000 square feet is too time consuming. It is hard to find merchandise and checkout lines can be very long.

### *Variety Store*

A variety store handles a wide assortment of inexpensive and popularly priced goods and services, such as stationary, gift items, women's accessories, health and beauty aids, light hardware, toys, house ware and confectionery items. They do not carry full product lines, may not be departmentalised and do not deliver products. Transactions are often on a cash basis. There are often displays and few salespeople.

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<sup>11</sup> Fernie Suzanne (1996), "The Future for Factory Outlet Centres in the UK", *International Journal of Retail and Distribution Management*, Vol. 24 (6), pp. 11 – 21.

The challenge for variety stores has come from specialty stores, discount stores and closeout chains often sell similar items to those sold in conventional variety stores, but in plainer surroundings and much lower prices.

### *Flea Market*

A flea market has many retail vendors offering a range of products at discount prices in plain surroundings. It is rooted in the centuries old tradition of street selling - shoppers touch, sample and haggle over the prices of items. Price-conscious consumers who find that other retail formats have upgraded merchandise and customer service or raised prices frequent them. Many flea markets are located in nontraditional sites not normally associated with retailing: racetracks, stadiums and arenas. Others are at sites abandoned by supermarkets and department stores. They may be indoor or outdoor. At a flea market, individual retailers rent space on a daily, weekly or seasonal basis. The newest trend in flea markets involves web-based flea markets such as eBay and Amazon.com with its zShops. Flea markets are believed by some to misrepresent or overstate the quality of merchandise. They can easily avoid taxes and their operating costs are quite low.

### **Non-Store Based Retailers**

Nonstore retailing is a form of retailing in which sales are made to consumers without using physical stores<sup>12</sup>. The non-store retailers are known by medium they use to communicate with their customers, such as direct marketing, direct selling and vending machines or e-tailing. Non store retailing is patronised to time conscious consumers and consumers who can't easily go to stores, or compulsive buyers<sup>13</sup>. Most non-store retailers offer consumers the convenience of buying 24 hours a day seven days a week and delivery at location and time of their choice.

Nonstore sales are now growing at a higher rate than sales in retail stores. The high growth rate is primarily due to the growth of electronic retailing. The growth of catalogue retail sales and sales in other nonstore retailing formats such as TV home shopping, direct selling, and vending machines are slower<sup>14</sup>.

### *Vending Machines*

Vending machine is a retailing format involving the coin or card operated dispensing of goods (such as beverages) and services (such as life insurance sales at airports)<sup>15</sup>. It eliminates the use of sales personnel and allows for round the clock sales. Machines can

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<sup>12</sup> Ibid.1 p.75

<sup>13</sup> Cynthia Crossen and Ellen Graham(1996), "Pressed for Time or Pressed for Money?" The Wall Street Journal , March 8, p. 4; George Milne and Mary Ellen Gordon (1994), "A Segmentation Study Of Consumer's Attitudes toward Direct Mail," Journal Of Direct Marketing, Vol. 8, Spring), pp. 45-52

<sup>14</sup> Ibid.4 p.176

<sup>15</sup> Ibid.4 p.191



be placed wherever they are most convenient to the consumers –inside or outside a store, in a hotel corridor, at a station, airport or a street corner.

Although many attempts have been made to ‘vend’ other products, beverages and food items remain the largest category. Hotels, restaurants and at train stations are highly visible spots for vending but they account for a small proportion of sales. Higher priced items have not sold well in vending machines because too many coins are required for each transaction and many vending machines are not equipped with currency note changers. Many consumers are reluctant to purchase more expensive items - they cannot see them displayed or have them explained and there is the difficulty of returning unsatisfactory merchandise. In evolved markets, vending machine sales have experienced little growth over the past five years largely due to the changes in the workplace. Employment growth has been limited and the largest growth in the work-force is white and pink collar employees rather than the blue –collar workers who buy most heavily from vending machines.

To improve productivity and customer relations, vending machine retailers use microprocessors to track consumer preferences, trace malfunctions and record receipts. The devices transmit data back to the host computer. This data is analysed and communications are sent to route drivers informing them of stock outs and malfunctions. Some machines even have voice synthesisers. Video kiosks enable consumers to assess the merchandise and also use their credit cards to make a purchase. In India vending machines are at a very nascent stage. Almost all of them are operated by an attendant. Even coffee machines are operated with assistance. Companies like Cadbury’s and Malayalam Manorma (newspaper publishing house) have installed them at places that attract a lot of traffic, such as the airport. But the sales from these are limited.

### *Electronic Retailing*

Electronic retailing (also called e-tailing and Internet retailing) is a retail format in which the retailer and customer communicate with each other through an interactive electronic network. After an electronic dialogue between the retailer and customer, the customer can order merchandise directly through the interactive network or by telephone. The merchandise is then delivered to the customer’s address.

The World Wide Web can serve one or more of these roles for a retailer<sup>16</sup>:

- Project a retail presence.
- Generate sales as the major source of revenue for an online retailer or as a complementary source of revenue for a store-based retailer.
- Enhance the retailer’s image.
- Reach geographically dispersed consumers including foreign ones.
- Provide information to consumers about the products carried, store locations, usage information, answers to common questions, customer loyalty programmes and so on.
- Promote new products and fully explain and demonstrate their features.

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<sup>16</sup> Ibid.4 p.193

- Furnish customer service in the form of E-mail, “hot links”, and other communications.
- Be more personal with consumers by letting them point and click on topics they choose.
- Conduct a retail business in a cost efficient manner.
- Obtain customer feedback.
- Give special offers and send coupons to web customers.
- Describe employment opportunities.
- Present information to potential investors, potential franchisees and the media.

The role assigned to the web by a given retailer depends on whether it is predominantly a traditional retailer that wants to have a web presence or a newer firm that wants to derive most or all its revenues from web transactions.

Strong growth of Internet users and electronic retail sales is evident Figure - 4. In addition, Forrester Research has forecast that 13% of U.S. retailing will be conducted via the Internet by 2004.<sup>17</sup> Non U.S. markets account for about 30 percent of the e-commerce industry.<sup>18</sup> In India Non-Store retailing represented by direct selling and e-tailing is estimated at Rs 1,100 crores. Only 19 percent of all retailers have an e-retailing initiative. The number of retailers with plans to e-tail within one year and those with no plans are almost equal. Significantly, 10 percent of the retailers have discontinued their e-retail initiatives. The main reasons for retailers to stay away from e-tailing is predominantly non-viability of business and resource constraints<sup>19</sup>. It is estimated that 5 percent or more of retail sales of goods and services such as apparel, banking, books, computer hardware and software, consumer electronics, gifts, greeting cards, insurance, music, newspapers/magazines, sporting goods, toys, travel and videos will be made online.<sup>20</sup> In the case of products where it is difficult to provide ‘touch and feel’ information electronically, such as clothing, perfumes, flowers and food electronic retailers may not be successful. Branding may help overcome many of the uncertainties in purchasing merchandise without touching and feeling it. For example, if customers purchase a size 30–inch waist / 32-inch inseam pair of jeans, they know they will fit when bought from an electronic retailer.

In some products and services, such as travelling or hotels, electronic retailers might even be able to provide superior information compared to store retailers. The critical issue related to selling successfully for electronic retailers is whether they can provide enough information prior to the purchase and make sure the customers will be satisfied with the merchandise once they get it. There are many buying situations in which electronic retailers can provide sufficient information, even though the merchandise has important ‘touch and feel’ attributes. Figure - 5

<sup>17</sup> Nongkran Lertpittayapoom and Tadisina Suresh, “The Antecedents Of Customer Satisfaction In Electronic Retailing”, Working paper, Department of Management, Southern Illinois University Carbondale,

<sup>18</sup> Byliner: Amazon.Com’s VP on Global Electronic Retailing, (18 May 2000)

<sup>19</sup> Changing Gears: Retailing In India, ET knowledge Series, p. 134

<sup>20</sup> Business Week e.biz (February 7, 2000)

Started on venture capitalist (VC) or initial public offering (IPO) money, by 1999 there was hype around e-tailing. Consumers were thought to be ready to make a deliberate choice of buying from e-tailers rather than retailers. They seemed to fulfil the consumer dream of no queues, no geographic barriers, low prices and unlimited selection - what retail had failed to deliver<sup>21</sup>. But e-tailing ended up disappointing and found that traditional shopping was easier. Ernst & Young statistics for the 1999 Christmas season revealed that US online buyers spent only 26% of their holiday spending (averaging \$1,080 per capita) online, while they devoted 67% of their total holiday expenditure to in-store purchases, the remaining 7% they spent on catalogue products. By the end of the 2000 holiday season more than 90% of e-tailers closed down in the period to January 2001<sup>22</sup>. E-commerce witnessed the collapse of several online grocers, drug stores, auto dealerships, pet supply stores and other budding e-commerce ventures and hundreds of dotcom investors abandoning their dreams of getting rich quick with e-commerce<sup>23</sup>.

However, Retail e-commerce sales grew to \$7.5 billion, up 24.7 percent in the second quarter of 2001 compared with just under \$6 billion in the second quarter of 2000, according to an August report from the U.S. Commerce Department<sup>24</sup>. Leading market researchers suggest that U.S. markets for online retailers will cross \$27 billion by 2005<sup>25</sup>. European Web shoppers are expected to spend more money online for groceries than their American counterparts, according to Forrester Research. The report predicts that Web grocery shopping in Europe will be \$51 million –or five percent of Europe’s total grocery sales by 2005. Seven percent of the United Kingdom’s grocery sales will go online by 2005. The Nordic countries are expected to follow closely with six percent of grocery sales taking place online. France and Germany will account for more than three percent of sales online in 2005<sup>26</sup>. The present players in the market are trying to learn the lessons from the failures and success of extinct and surviving e-commerce pioneers.

#### E-tailing Myths:

The common myths earlier were that online selling required low investment and low cost and hence had no entry barriers and it was easy to succeed. There are four B2C myths that can be misleading while managing e-commerce operations<sup>27</sup>.

1. Stickiness is good: Many sites aspire to keep customers on the site as long as possible by adding features and design navigation. They have too many sequential click through pages and save the best page for the last. On the contrary it is observed that when it comes to e-commerce sites, the customers would rather complete their

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<sup>21</sup> Lindstorm Martin, Peppers Don and Rogers Martha (2001), "Clicks, Bricks and Brands : the Marriage of Online and Offline Business", Kogan Page, London, p. 11

<sup>22</sup> Ibid.21

<sup>23</sup> Mello Adrian (2001), "Four Myths of Online Retailing", November 7

<sup>24</sup> Ibid.21

<sup>25</sup> Ibid.19 p.117

<sup>26</sup> "Electronic Retailing and eMarketing", Newsletter Hermes, Issue No.5-September-October (2000)

<sup>27</sup> Ibid.21

purpose than unnecessarily waste a lot of time on a site when looking for a particular product. Therefore, a site should have an introductory home page, offer speed navigation, vividly describe product benefits, update displays regularly, provide expert information and price competitively.

2. More is better: Some sites try to attract customers with flashy technology by bombarding them with fancy graphics, animation and sound effects. But fancy visual and sound effects slow sites to a crawl. A recent survey from Jupiter Media Metrix found that visitors were twice as likely to return to a site with faster loading pages than they were to sites that provide rich media. The Jupiter survey also found that 59 percent of those surveyed would be more likely to return to a site that offered more product information<sup>28</sup>.
3. Personalisation drives profitability: Personalisation was supposed to be the killer application of B2C. But personalisation is just one of the merchandising techniques that e-commerce sites should consider for incremental sales improvement but per se it does not help to complete sales. This is because customer actions don't always reflect their interests. For example, a customer may have bought a book on baseball as a gift for his brother-in-law, a sports fan. But the customer dislikes sports himself. However, that does not stop the site from continually calling the customer's attention to books on baseball, football, basketball and the like. It is recommended that instead of investing in expensive personalisation technology sites they would be better off devoting their energies to proper merchandising by answering questions and having items logically arranged<sup>29</sup>.
4. You can sell anything on the web: One can sell many products like CDs, books, gifts, online. But certain products aren't a good fit for e-commerce sales, either due to legal restrictions like in the case of alcohol, or the customers need to touch and feel the product or try an expensive piece of apparel to make sure it fits. Sometimes the discounted price shoppers' find on the Web may not offset the hefty shipping charges for large, heavy items such as an oven or jacuzzi. Although, in the case of such products one may not be able to complete the transaction on the Web but it can assist the sale. The web-site can be used to inform customers about these items and direct them to an appropriate sales channel, like its stores or distribution network.
5. Some common myths now are that e-commerce entails high cost and hence is not viable. E-commerce is undoubtedly a high investment business requiring substantial investment to set up the web site, the software for data capture, records and interactive systems for customer dialogue. These are sometimes underestimated and often cause downfalls. But they are investments like any bricks and mortar business; only the heads under which they are made are different.
6. Another myth is that e-commerce cannot make money<sup>30</sup>. But e-commerce can be made profitable by generating volumes to make money and given time to mature and taking up the challenge to change customer behaviour. However, it cannot be a gold mine<sup>31</sup>.

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<sup>28</sup> Ibid. 23

<sup>29</sup> Ibid.23

<sup>30</sup> Sudhakar V.S (2004), "E-Tailing – The Opportunities and the Challenges", Presentation at Indian Institute of Management, Ahmedabad,

<sup>31</sup> Ibid.21 p.98-100

7. According to the Ernst & Young “Global Online Retailing” report, the main reasons that non buyers don’t buy online are: they are uncomfortable sending credit card information, preference for seeing the product before purchasing, no existence of credit card, insufficient information about products to make decisions, lack of confidence with online merchants and limitation of talking to the sale person. In addition, the main concerns of online buyers are overly high shipping costs, need to try for fit in the case of apparel, high prices, inappropriate for large, perishable and luxury items, need to feel and see and concern of privacy<sup>32</sup>. The report also charted that 3 biggest “barriers” consumers feel hinder their online shopping experience are price, security and ease of navigation.
8. The e-tailers have high fulfillment of costs (which can be as high as US\$16 an order for most dotcom e-tailers) and lack of scale makes the business unprofitable.
9. Poor inventory management also causes major losses for many dotcoms. This fact along with inexperienced merchandising teams, brutal price competition, inefficient product return systems, result in poor gross margins for online –only players.
10. High marketing costs: Experienced offline brands spend about 18% less than startups on establishing retail websites. E –tailer-marketing costs are high. Online “rent”, a term for the price of time and space on media channels for on-and offline brand marketing, has inflated hugely over the last decade of the twentieth century. According to Thomas Weitzel Partners (August 1999) where a superstore spends an average of US\$2.50 promoting a product, e-tailers spend US \$17.29 per product.
11. Online customer acquisition costs: Most consumers still need to be persuaded to go online and at the same time almost all e-tailers lose money on every customer. Their customers generate too few orders and too little profit per order to cover the costs of winning them, which can be as high as 65% per order. According to a study by The McKinsey Quarterly in July 2000, for e-tailers to achieve comfortable contributions on each transaction, they would need efficient order fulfilment processes, average orders of at least US\$100 and gross margins of at least 25%.

### **Factors Affecting the Growth of Electronic Retailing<sup>33</sup>:**

Three critical factors affecting the adoption of a new innovation such as shopping electronically are (1) the ease with which customers can try the innovation, (2) the perceived risks in adopting the innovation, and (3) the benefits offered by the innovation compared to the present alternatives.

#### **Trying Out Electronic Shopping:**

In September 2002 about 605.60 million around the world had access to the Internet. Majority of these web surfers were living in Europe, followed by Asia/Pacific, Canada & USA, Latin America, Africa and the Middle East. According to the United Nations

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<sup>32</sup> Ibid.26

<sup>33</sup> Ibid.1 p.81

Conference on Trade and Development (UNCTAD report) Internet usage is seeing an annual rise of about 30-percent which is equivalent to about 2.5 percent of the global population. A growing share of new internet users are in developing countries, which accounted for nearly a third of all new Internet users worldwide in 2001. Already Asia, excluding Japan and the Republic of Korea, added almost 21 million new users to the Internet in 2001, more than North America<sup>34</sup>. With 77 million people under 18 expected to be online globally by 2005, teenagers and children constitute one of the fastest growing Internet populations,. Surfing the net is a highly regarded activity by this age group. However, adults over 50 years old are one of the fastest growing markets on-line. A large number of this age group have home access to the Internet. Studies have revealed that older people are receptive to new technology and have time, money and enthusiasm to surf the web regularly. Apart from staying in touch with far-flung family and friends, the older people tend to purchase merchandise and services online because shopping in stores can be difficult for them<sup>35</sup>.

### Perceived Risks in Electronic Shopping

Technological developments are reducing the risk of electronic shopping by enabling secure transactions and increasing the amount and quality of information available to electronic shopper. However, security of the credit card transactions remains one of the major concerns, especially in developing economies.

### Entertainment and Social Experience:

All non-store retail formats are limited in the degree to which they can satisfy these entertainment and social needs. In-store retail formats score high on this account. They provide more benefits to consumers in terms of entertainment and social experience than simply having merchandise readily available and helping them to buy it. Even the most attractive and inventive web pages and video clips will not be as exciting as the displays and activities in a Disney or Toys R Us store due to their interactivity.

### Ordering and Receiving Merchandise:

In the case of store-based retail formats the delivery time of getting merchandise is immediate. But in the case of non-store retail formats consumers usually have to wait several days to get merchandise, especially when the goods are of a perishable nature and bought prior to an occasion.

### Number of alternatives:

The biggest benefit of electronic retailing compared to other retail formats is the vast number of alternatives that become available to consumers. For example, a person living in India can shop electronically at Harrod's in London in less time than it takes to visit

<sup>34</sup> [http://www.metimes.com/2K2/issue2002-47/net/655\\_million\\_internet.htm](http://www.metimes.com/2K2/issue2002-47/net/655_million_internet.htm)

<sup>35</sup> Cleaver Joanne (1999), "Surfing for Seniors," *Marketing News*, July 19, pp.1-7; and Gapper Justina (1998), "The Rise of the New Media Greys," *New Media Age*, January 29, p.p.10-12

the local supermarket. However, it does have limitations. Shoppers may visit all the sites selling the product. This may be a time consuming exercise unless the consumer is focussed and finds a few items that they might like to study in detail.

A more significant potential benefit of electronic retailing is the ability to have an electronic agent to select a small set for the customer to look at in detail. Service-oriented retailers score higher on this account as their salespeople know what their preferred customers want and help indecision making by limiting the choice.

#### Cost of Merchandise:

Since electronic retailers do not have to spend money building and operating stores at convenient locations, they have much lower costs, as much as 25 percent lower than in-store retailers. But the electronic retailers or the customers will have higher costs to get the merchandise to homes, deal with the high level of returns and attract customers to their website. It is quite costly to deliver merchandise in small quantities to customers' homes. Customers presently incur these costs when they spend their time and money going to stores to pick out and take home merchandise and then going back to the stores to return the merchandise they don't want. A comparison of various formats in terms of their economies and the cost of operation for format in food stores are given in Figure - 5<sup>36</sup>. The comparison reveals that online retailing scores over all newer formats in terms of benefits to retailers. It scores over even hypermarkets with respect to the benefits to the customers. It is also observed that its operation costs are also similar to other formats. Therefore it is necessary that an e-tailer should try to achieve large volumes as soon as possible.

#### E-TAILING CHALLENGES<sup>37</sup>

##### 1. Zero error operations<sup>38</sup>:

A study by Boston Consulting Group in the United States and Canada in 1999 showed that 57% of Internet users have shopped online and 51% actually purchased goods or services online. The typical online purchaser completed ten transactions and spent \$460 online over the previous twelve months. Yet 28% of all attempted online purchases failed, and four out of five consumers who made purchases online experienced at least one failed attempt over the same period. These failures resulted from technical problems consumers encountered with the sites, difficulties in finding products and logistical and delivery problems after the sale. Twenty eight percent of consumers who suffered a failed purchase attempt stopped shopping online and 23 % stopped purchasing at the site in question.

However, the study also showed that consumers who enjoyed a satisfying first purchase experience online were likely to spend more time and money on the Net. The satisfied

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<sup>36</sup> Ibid.30

<sup>37</sup> Ibid.30

<sup>38</sup> Ibid.21 p.39

first-time purchaser typically engaged in twelve online transactions and spent \$500 during the previous twelve months. The dissatisfied first time purchaser spent only \$140 on four online transactions. About 5% of users who had bad online shopping experiences also stopped patronizing the retailer's physical store. There are a number of things in the e-business environment that can impact the consumer's shopping experience negatively. Primarily the e-tailers need to think about providing support for customers on two subjects: problems with the website usage and questions or problems with the product. Appropriate use of technology and people solutions will have to be defined in order to support e-business initiatives by understanding, tracking and monitoring the online behaviour of customers<sup>39</sup>. Normally, people have to spend a lot of time describing the problem. The customer support team can see where the customer was at the time of reporting the problem or what task was abandoned. Based on which they can efficiently resolve this issue. This type of service will not only enhance a customer's experience on the e-tailers website but also provide the organisation with an opportunity to reduce costs. E-tailers have several customer service options ranging from real-time consumer interactions to self-service options:

*Frequently Asked Questions (FAQs):* This is a self-service option that relies on information stored in a database to assist customer transactions and provide answers to common questions that are asked by customers. This database is continually built over time and new customers and answers are added, based on knowledge gathered from earlier customer interactions.

*Call Us Buttons:* Call-us buttons appear on the website pages, allowing the customer to call the customer support representative on a regular phone via the web. PCs that are equipped with speakers and a microphone may take advantage of voice-activated websites that send voice over Internet using VoIP technology. Another variation to the same option is 'call-me' buttons, where the customer can request the customer representative to call back, though this may force the customer to go offline.

*Text Chat:* Text chat over the net allows a client to send a question and receive a real-time written response. This allows almost instantaneous communication with more than one customer at a time or in a group. Depending on how it is implemented, it may appear to be slow to some users.

*Collaboration/Co-browsing:* Web collaboration technology allows a customer support representative and the customer to share the same screen so that the representative can see exactly what the customer is doing. This type of interaction will help the support representative solve a problem if the customer is stuck at a certain place on the website. On the other hand co-browsing offers the capability where more than one person can browse a site together, with one of the users doing the 'driving' while the other has secondary control. This type of interaction will provide the representative with capability to handle a customer who seems lost on the website.

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<sup>39</sup> Nanda Rajeev, "How to Map out a Viable e-Strategy", e-verything.com, p.196-198



*E-Mail Management:* email systems should be fully automated using artificial intelligence (AI) or other new technologies that help the e-tailer to deliver an instant automatic reply based on key words or FAQs. E-mail systems can automatically route e-mails to a call centre, where a customer support representative can review the suggested computer-generated response or can prepare a new response before it is sent to the customer.

*Call Centres:* Plain old call centres should be enhanced to support calls from online customers as well as catalogue shoppers. Earlier, the call centres had to be confined to a geographic area or country to provide the best support, with the Internet, the call centres can be spread across multiple countries to provide the same, or better, quality of support and reduce the cost of providing the support.

E-businesses are realizing that it is imperative to communicate with their customers through a range of media options and that these technologies must work together seamlessly for the customer. This places huge pressure on the customer service divisions of the company. The online e-tailer will use multiple forms of customer service including live interaction by telephone and chat, asynchronous communications using e-mail and fax and computerised service using natural language-based help systems<sup>40</sup>.

## 2. Increased Gross Margin:

Every retailer ideally wants to have high value, high margin and fast moving products. But that is often not possible. The products that fetch the most money may not be the products that the customer wants to buy. Therefore retailing is ultimately about being able to find a balance<sup>41</sup>. E-tailers need to pay attention to gross margin return on investment. For example, if a 25 percent margin category sells six times a year and a 15 percent one sells 12 times a year, it is better to go with the latter<sup>42</sup>. Therefore getting the right product mix is critical to retailing. An e-tailer should also try to cut down the direct costs by achieving distribution efficiencies. There are many factors like the product's retail price, the physical requirements of the product to be shipped and delivery speed required for the product category that would influence the e-tailers distribution considerations. Price point is a crucial determinant in distribution and business viability decisions<sup>43</sup>. The fulfilment costs associated with FMCG products are so high that merchandise with low price points fail to achieve break even. For almost all products, packaging and/or shipment and same day fulfilment can be vital. In these cases the best distribution centre is the retail outlet closest to the consumer, making personal collection or speedy individual delivery possible. E-tailers should be, wherever possible, to adopt

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<sup>40</sup> Ibid 21

<sup>41</sup> "Retailing", A&M, February 28, 2001 p.39

<sup>42</sup> Ibid.41p.40

<sup>43</sup> Ibid.28 p.15

the vendor shipping option that would enable it to cut down direct costs and hence increase the realisable gross margin<sup>44</sup>.

### 3. Customer Acquisition:

Gaining information about customers and potential customers and converting such needs into demand is more feasible in electronic commerce than any other marketing channel<sup>45</sup>. The Internet allows e-tailers to gather huge amounts of information about their customers easily. They can use this information for personal pricing and customer specific targeted promotions. It might also be used to directly offer customers related products, either in real time during the on-line shopping process or by e-mailing them with special offers. This possibility offers benefits for customers. It is a convenient opportunity to get to know new products they would like to buy without having to look for information in many places.

One way e-merchants attempt to lure new customers is through online coupons especially in the case of grocery shoppers<sup>46</sup>. Other categories such as toys, books and music are also popular in terms of redemption of e-coupons. Majority of grocery shoppers use online coupons and nearly half as many redeem online coupons. Toy e-coupons witness the highest online redemption rate at 87% followed by books at 83%. While the potential for e-tailing seems boundless, challenges do exist to altering customers' expectations and behaviour. Changing customer behaviour is the most complex task<sup>47</sup>. The e-tailer can change customer behaviour and increase their clientele by managing four key elements<sup>48</sup>:

*Educate:* As a rule, the more potential customers know about the product or services the e-tailer is selling, the more they're likely to buy. Education does not only have to be about the product but also of the e-tailers' business, quality assurance and processes.

*Guarantee:* Any purchase represents a risk to the buyer. The risk may be of paying much more than what it's worth or the item may not look as good at home as it does on the web site. The e-tailer should not only eliminate the risk but also reduce the customer's perception of risk by having risk-free return or exchange policies.

*Manage Expectations:* The e-tailer will need to manage customers' expectations so that they are not disappointed or frustrated by the shopping experience. The expectations may be as simple as those about availability of the item or shipping time or the total cost.

*Satisfaction:* The e-tailer, after having educated its customers, hedged their risk and set their expectations, needs to follow through with online customer service. A study in found that U.S. businesses lost more than \$6.1 billion in potential

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<sup>44</sup> Ibid.22

<sup>45</sup> Efraim Turban, Jae Leel, David King H and Michael Ching (2000), "Electronic Commerce: A Managerial Perspective", Prentice Hall, p.86,

<sup>46</sup> Ibid.26

<sup>47</sup> Ibid.30

<sup>48</sup> Ibid.26 p.202

Internet sales in 1999 because of poor online customer service and estimated that an industry wide failure to resolve the problem could lead to at least \$ 173 billion in lost revenues through 2004. Additionally, 7.8 percent of online transactions initiated by customers are abandoned because of poor customer service<sup>49</sup>. Thus, customer service must integrate seamlessly not only with the company's existing Web site, but the company's entire operations, online and offline.

#### 4. Generating customer traffic:

E-tailers adopt one of two approaches to generate traffic: Impulse Driven and Serious Shopper Approach. Impulse purchases are defined as purchases that signify with high emotional activation, low cognitive control and largely reactive behaviour<sup>50</sup>. This occurs when consumers experience a sudden and often powerful and persistent urge to buy something immediately even though they she had no prior intention of doing so. Under this approach the e-tailer generates high traffic<sup>51</sup>. The more often a customer visits a site, the more likely they are to spend an increasing amount of money and thus generate profits for the e-tailer. For instance, in apparel, the average repeat customer spends 67% more overall in the third year of shopping relationship with an online vendor than in the first six months. And over three years, customers referred by online grocery shoppers spent an extra 75% above what the original shopper spent<sup>52</sup>. Products that are generally bought on impulse purchases usually have several of the following characteristics:

- Their price is considered average or acceptably low enough by the consumers;
- They are low involvement goods;
- They are related to entertainment activities and hobbies;
- They are used as gifts to friends and relatives;
- They are considered "trendy" or popular items;
- They are personalised versions of common products;
- They are related to holidays or important festivals or occasions

In order to take advantage of such shopping online retailers should offer products that can be bought on impulse. They also need to emphasis product presentation and placement to reinforce the emotions that motivate consumer purchase decisions. They could choose some of the following to generate higher traffic:

*Ease of access:* Impulse purchases can be made without requiring the customer to leave their home in order to see the product on display.

*Low touch:* Most products likely to be bought on an impulse do not require "touching" or "tying on" which makes them appropriate for on-line retailing.

*Dynamic displays:* customers can be presented with such products while navigating through the online shop; different items can be shown on each page to maximize the

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<sup>49</sup> Ibid.26

<sup>50</sup> England Debra, Retailing on the Internet Aparoop, Kozyrakis Christoforos, Singh Ena and Wemhoener Nils (1999), "Retailing on the Internet: Beyond Commoditization", Strategic Computing and Communication Technology. Spring

<sup>51</sup> Ibid.21

<sup>52</sup> Ibid.30

likelihood of purchase; items which are related or complimentary to those in the section of the catalogue currently viewed can be displayed.

*Personalised displays:* on line technology allows personalising the items advertised to the customer during navigation which can be done based on the customer preferences or demographic information (if membership is an option) or purchase history.

*Personalised reminders:* members or previous customers can be sent or presented reminders about coming holidays or popular items (best sellers) in categories they have expressed interest or made purchases in, in the past.

*Personalisation opportunities:* customers can easily be presented with opportunities to personalise common products (e.g. print a name on a cup) that can initiate impulse purchases.

*Advanced visualisation techniques:* graphics technology (animation, sound / image effects) gives many opportunities to present a product in a way that will impress the consumer and motivate them to buy it.

*Purchase expediting:* on line retailing allows on-click purchasing (for registered customers or members) which leaves virtually no time for second thoughts or reasoning about the purchase of product.

In case of the Serious Shopper Approach, the e-tailer builds a relationship based on service levels and quality of products. The e-tailers have to proactively anticipate and handle consumer expectations and ensure that what's being delivered is better than what users expect<sup>53</sup>. So retailers constantly need to analyse their product/service category's relationship with consumers and ensure that their own business isn't becoming disconnected from general expectations<sup>54</sup>.

## 5. Customer Retention

E-business is redefining the way the e-tailers manage customer relationships and place new demands for customer support throughout the sales cycle and thereafter. This task has been made more complex by individualisation of customers. The e-tailers cannot afford to ignore even an individual customer because word -of- mouth spreads very fast on the Internet. User groups, communities, web chat and e-mail each have enough individual power to drain away revenues or create bad publicity. Only personalised support and sophisticated customer interaction can help the e-tailer convert more 'browsers' into buyers, resulting in higher revenues per customer<sup>55</sup>. Also, it costs about five to eight times more to acquire a new customer than to keep an existing one. Therefore, it is essential for the e-tailers to build loyalty, aim to achieve zero error operation, to create continuing excitement at the stores and have a mix of impulse and need based products to induce customers to visit the site often<sup>56</sup>. Some notable consumer-driven e-commerce site content already in use<sup>57</sup>:

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<sup>53</sup> Ibid.26

<sup>54</sup> Ibid.21 p.67

<sup>55</sup> Ibid.26 p.194

<sup>56</sup> Ibid.30

<sup>57</sup> Ibid.23

- i. Testimonial pages: Testimonials are a powerful tool to establish credibility, which is especially important for a website in the early stages of existence and/or in the early stages of developing any individual consumer relationship. A web site can also request feedback for testimonials from happy customers and opinion leaders.
- ii. Awards: This is another credibility tool as well as a tactic to increase traffic.
- iii. Extensive and useful links or resource pages.
- iv. Contests, sweepstakes, sign-ups to get visitors to voluntarily opt for future marketing efforts targeting their specific consumer interests.
- v. Information: according to an MSN Sidewalk survey, 74% of Internet users seek information
- vi. Reviews/ Opinions, especially product related.
- vii. Learning networks/communities: through forums, chats, interactive software mailing lists and newsletters. This is particularly relevant to complex and/or non-commoditised products.
- viii. A niche network of related sites: reciprocal links, banner ads, sponsorships. New releases and articles can be sent to publications focused on various products or product-user niches.

## 6. Earning Customer E-loyalty

Customer loyalty is a key driver of profitability for on line companies. Consumers are motivated to buy more goods online when security features were enhanced and personal information kept private. Increased loyalty can bring cost savings to a company in many ways: lower marketing costs, lower transaction costs (such as contract negotiation and order processing), customer turnover expenses and lower failure costs such as warranty claims and so on. During the past decade, customer loyalty in general has been decreasing. The introduction of electronic commerce accelerated this trend because customers' ability to shop, compare and switch is extremely fast and inexpensive, given the aid of search engines, mall directories and intelligent agents<sup>58</sup>. A study found that 75% of online customers who participated in loyalty programmes say that it is not the loyalty factor that motivates them to make online purchases. Instead, e-commerce providers should fill functionality gaps or face losing customers to competitors. Only 22% of 1,200 online consumers said loyalty programmes served as an incentive to buy online. The survey highlighted that loyalty programmes must go beyond giving out points and should reward loyalty with improved service such as priority service, personalised offers and e-mail updates. 72% of the respondents said that customer service is a critical factor in shopping satisfaction and only 41% indicated they were satisfied with the service they had experienced as evident from Figure – 5.<sup>59</sup> Managing privacy is an important issue in building loyalty. It is becoming a major concern as technology gets better and companies collect large customer data and start trading it in the market. As a business, e-tailers would need to clearly communicate their privacy policies to build trust with customers<sup>60</sup>.

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<sup>58</sup> Ibid.21 p.50

<sup>59</sup> Ibid.21p.40

<sup>60</sup> Ibid.33

## 7. Managing Technology

In e-tailing business, size is no longer a determining factor for success. The critical metric is the speed of decision-making, customer service, response time, etc which are all shortening, owing to the technological revolution<sup>61</sup>. Up-to-date, intelligent and user-friendly technology also communicates professionalism, a vital quality in building trust<sup>62</sup>. Indian retailers are gradually but steadily upgrading their IT infrastructure. Companies are willing to increase their IT spending from 1 percent of sales at present to 5 percent and expect clear benefits in vital areas like inventory management and customer interfaces<sup>63</sup>. In India, Shoppers Stop has one of the most advanced IT systems in place. In a recent Economic Times survey the company was recognised as among the most IT-savvy companies in India. It has already pumped in over 10 crores in to IT systems - merchandise management systems, inventory management, CRM package etc, and has futuristic plans to continue its spate of investments. The main aim of the company is to see that the time spent by their merchandisers on mundane functions is minimised and they can spend more time on strategy related issues<sup>64</sup>. However, e-tailers should not fall prey to becoming a slave to technology. In the aftermath of the dotcom blowout and the downturn in the economy e-tailers are reviewing strategies, processes and questioning IT spending as they strive to improve performance and boost profits in a difficult economic climate<sup>65</sup>. It is more critical to have a robust, reliable and scalable software platform than have bells and whistles<sup>66</sup>. Therefore e-tailers should not try to attract customers with flashy technology with fancy graphics, animations and sound effects but should offer more product information<sup>67</sup>. A recent survey found that visitors were twice as likely to return to a site with faster loading pages than they were to sites that provided rich media. It also found that 59 percent of those surveyed would be more likely to return to a site that offered more product information<sup>68</sup>.

### **New Retailing Formats**

The practice of retailing is continuously evolving. New formats are born and old ones die. Incessant pressure to improve efficiency and effectiveness and a continual effort to serve the customer better forces the retailers to find new ways of doing business. This has also resulted in a shortened lifecycle for retail formats. For example, in the late 1980s most retail experts agreed that hypermarkets would be retailing's success story of the 1990s. However, despite their overwhelming success in Europe and their limited success in the United States, these mega stores were retailing's biggest failure in the 1990s. The customers were unnerved by the sheer size of these stores. In addition, category killers offered greater selection and wholesale clubs offered better prices, while supermarkets and discounters offered more convenient locations. Another retail format that didn't

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<sup>61</sup> Ibid.30

<sup>62</sup> Ibid.21p.92

<sup>63</sup> Ibid.19 p.9

<sup>64</sup> Ibid.19 p71-72

<sup>65</sup> Friedman Tom. "The Future of Retail IT: Keys to the Technological Payoff ",

<sup>66</sup> Ibid.30

<sup>67</sup> Ibid.23

<sup>68</sup> Ibid.23

achieve the success predicted was the off-price retailer because the regular merchants, including discounters, became more price-competitive on the brands the off-pricer was currently selling. Although these retailing formats have not lived up to expectations, many other new formats are emerging.

#### Supercentres:

Supercentres, which is a one-stop combination of supermarket and discount department store that carries from 80,000 to more than 100,000 products (ranging from televisions to peanut butter to fax machines), are new the format for the mass merchants<sup>69</sup>. These stores offer the customer the convenience of one-stop shopping without sacrificing service and variety. They are capable of drawing customers from a 60 to 80 mile radius in some rural areas. Hence they seem to be a perfect answer to today's time-pressed consumer needs. The supercentre concept has even branched out in to the automobile market. The supermarkets are implementing strategies to counteract the supercentres. They are joining the discounters in letting the customers' purchasing habits determine their purchasing and inventory decisions. By using "just-in-time"(JIT) methods grocers are now reordering only when and what their computer, which is connected to their in-store bar-code scanners, deems necessary. This way supermarkets try to reduce costs and meet the discounters' prices head on.

#### Recycled Merchandise Retailers:

Recycled merchandise retailers are a product of great depression, which sell cast-off clothes; furniture, sporting goods and computers. They include pawnshops, thrift shops, consignment shops and even flea markets. Due to their very small numbers just a decade ago, recycled merchandisers have experienced the fastest growth of any retail format over the past five years. Even as a record number of retailers were seeking bankruptcy protection in the mid-1990s, these recycled merchandise retailers were growing at 10 percent a year. Recycling is not just an American phenomenon; it is also big in Europe and Latin America. However, it is growing fastest in Japan where this retail format is expanding at nearly a 20 percent annual rate. Japanese companies from kimono stores to catalogue retailers have jumped on the second-hand bandwagon. One of the most popular stores in Japan is called "Per Gram Market", which sells items at eight cents a gram. Thus, a second-hand T-shirt would cost around \$ 8.50, but a silk scarf would sell for \$2.80<sup>70</sup>. Recyclers have developed to serve specific markets, such as pregnant women, large sizes or children, or even specific merchandise such as toys, sporting goods (including camping and backpacking equipment), outwear, CDs, tools or jewellery. The apparel group accounting for the lowest resale and thrift store sales is men's clothing. The reason being that men hang onto their clothes longer than women and children do, leaving much less available for resale.

#### Liquidators

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<sup>69</sup> Dunne Patrick M., Lusch Robert F, Griffith David A. "Retailing - Future Changes in Retail Competition"

<sup>70</sup> "Used Products Are Hot as Japanese discover the joy of Buying Second -Hand", Wall Street Journal, June 22, 2000, A1

Liquidators are a retail format that comes in and liquidates leftover merchandise when an established retailer shuts down or downsizes. They make their money by seldom paying more than 30 cents on the wholesaler price for the closeout retailers. They are often called retailing's undertakers or vultures. Retailers utilise the services of liquidators because running closeouts requires some special retailing skills. Liquidators have a talent for pricing merchandise and estimating the expense of everything from ad budgets and payrolls to utility bills. Liquidators also have to develop special incentive plans to make it more profitable for store personnel to stay and work rather than quit or walk off with merchandise<sup>71</sup>.

### Video Kiosks

The video kiosk is a freestanding, interactive, electronic computer terminal that displays products and related information on a video screen. It often uses a touch screen for consumers to make selections. Video kiosks can be situated anywhere (from a store aisle to the lobby of a college dormitory to a hotel lobby). They require enable consumers to place orders, complete transactions (typically with a credit card) and arrange for products to be shipped. Kiosks can be linked to retailers' computer networks or tied in to the web. Many shopping centres and individual store-based retailers are setting up video kiosks in open hallways.

At the beginning of 1999, there were about 250,000 video kiosks, in use through out the United States. It is estimated that there will be 1.7 million U.S. kiosks by the end of 2003. It is also forecast that video kiosk sales will rise from \$830 million in 1999 to \$3 billion in 2003. Worldwide, nearly 80 percent of kiosks are involved with retail related transactions. North America accounts for 59 percent of kiosk sales, the Pacific Rim for 20 percent, Europe for 16 percent and the rest of the world for 5 percent<sup>72</sup>.

### Car Boot Sales

Car boot sales are becoming increasingly popular, where often a vehicle is modified for the sale of a variety of merchandise like books, magazines, clothes, music cassettes, export surplus and/or rejects, fast food items. The boot sale boom has given software pirates, for example, "an ideal outlet and quick getaway". It also provides opportunities for small traders who may lack the capital for permanent premises. They are often situated near the university campus and commercial areas. Its target audience is lower middle and middle class customers looking for "value for money products."

Mobile Vans are modified vehicles usually poultry and meat products, library books, etc. They move from location to location, for fixed periods of time, thus providing convenience by coming closer to customers.

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<sup>71</sup> "Everything Must Go-To The Liquidators," Business Week, January 15, 1996, 52

<sup>72</sup> Frost & Sullivan (1999), "Interactive Kiosk Markets", San Francisco



## **A Value Based Model of Format Choice**

It is evident that each of the formats offers some unique benefit that helps in attracting shoppers. What is also interesting is that even with the proliferation of formats, each one of them is surviving. Shoppers have spread their purchases across formats. In some cases, different merchandise is bought through specific channels. So, while books and music are being bought in large volumes through the Internet, grocery and high value purchases are being bought through store-based formats. Some shoppers are also buying similar merchandise through separate formats. Due to the choices available to shoppers, there is an effort to optimise the value derived and hence split purchases between formats. However, it is also noticed that shoppers tend to make one of the formats their primary choices and make most of their purchases from that format. It is, therefore, imperative that a retailer should select the value and then choose the format that delivers the value to the fullest. A format is defined as the system for delivering the value promised to the shoppers so as to create a sustainable competitive advantage as described in Figure - 6.

- **Define Value Proposition:**

The first step in deciding the format is to identify and select the value proposition that the store would like to offer to shoppers. Shoppers have several reasons for choosing their stores<sup>73</sup>. A study conducted in India indicated that proximity and merchandise were the primary reasons. More than 70% of respondents indicated these as their strongest reason for choice. The third reason was ambience (8%) and patronised store (8%). Only 40% could provide as many as three reasons. Seventy percent had at least two reasons. This indicates that shoppers generally have just one good reason, and at most two reasons for visiting a particular store. A store would thus build a value proposition based on its target customers, competition and company objectives. Each retailer would need to vary its offering by different combinations of the elements of value mix, called Retail Value Proposition.<sup>74</sup>

- **Identify enablers and Deterrents:**

Each of the formats would yield optimum results only when certain conditions are fulfilled. A store needs to identify these conditions and the variables causing them. These variables then need to be classified as enablers or deterrents. Enablers are factors that could be utilised to manage the format successfully. Deterrents consist of variables that would impede the successful working and growth of the format. Toys R Us found that in entering Japan their biggest challenge was finding space for large size stores. The largest stores in Japan were about 1/3 of the existing stores of TRS. TRS is a category killer. It drives the value from focusing on one category and offering price and depth. The store needs to conduct a thorough analysis of the macro and microenvironment that is impinging on its business.

- **Find out what its take to Deliver the Values**

Based on the value identified and the environmental factors, retailers develop a mix by using the following five elements:

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<sup>73</sup> Sinha, Piyush Kumar; Banerjee, Arindam and Uniyal Dwarika Prasad (2002), "Deciding Where to Buy: Store Choice Behaviour of Indian Shoppers", *Vikalpa*, Vol 27, No 2, pp. 13-28.

<sup>74</sup> Stevenson, Lawrence N; Schlesinger Joseph C and Pearce Michael R (1999), *Power Retail*, Canada: McGraw-Hill, pp. 58 – 84.

- a) **Variety and assortment of merchandise:** Variety is the number of different merchandise categories a retailer offers. Assortment is the number of different items in a merchandise category. Each different kind of merchandise is called an SKU (stock keeping unit). For example, department stores, discount stores and toy stores all sell toys. However, department stores sell many other categories of merchandise in addition to toys. (They have greater variety). The toy stores stock more types of toys (more SKUs). For each type of toy, such as dolls, the specialty toy retailer will offer more assortment (more models, sizes, brands and deeper assortments) than general merchants such as department or discount stores. Elements like product quality, uniqueness and reliability can also be clubbed with this factor of the retail mix<sup>75</sup>.
- b) **Customer Service and Facility:** Services provided by retailers to facilitate the shopping process for customers are called customer services. It includes easy access to product and price information, employing in-store sales people, parking, accepting modes of payment suitable to customers, express checkouts, home delivery, gift wrapping, rest and refreshment facility, child care facility etc.
- c) **Store design, Display and Ambience:** Ambience can be described as non-visual, background condition in the store environment including elements like temperature, lighting, music, noise levels, air quality, and scent<sup>76</sup>. Display and design factors are the environmental elements that are more visible in nature than ambient factors. These include layout, width of aisles, equipment, furnishing, cleanliness etc. Kotler<sup>77</sup> has proposed atmospherics as an important part of retail marketing strategy. Shoppers also determine the value of the merchandise based on monetary as well as non-monetary costs<sup>78</sup>. The shopping experience, as created by the store environment plays an important role in building store patronage. Along with the merchandise, it triggers affective reaction among shoppers<sup>79</sup> and contributes to creating store patronage intentions<sup>80</sup>.
- d) **Pricing:** It is one of the strategic decisions and plays a vital role in store selection. Pricing decisions like Premium Pricing, Everyday Low Pricing (EDLP), Hi-Low (HILO) pricing, Discount Pricing are some of the pricing considerations offered to the customer. The shopper may also evaluate each of the situations in the light of the cost incurred and the utilities derived out of shopping. These costs can be classified as fixed and variable costs of shopping<sup>81</sup>. The variable cost is related to the basket size or the list and hence is likely to change with every trip. The fixed costs, such as location of the store or the price format, would remain unchanged over list size. It is suggested that these costs can be converted into utilities for each of the shoppers by the store. In a study of the two price formats, EDLP and HILO, it was found that the store could influence the choice of shoppers by enhancing the

<sup>75</sup> Ibid .1

<sup>76</sup> Spenberg, E.R; Crowley, A.E and Henderson, P.W (1996), "Improving the store environment: Do olfactory cues affect evaluation and behaviours", *Journal of Marketing*, Vol. 60, No. 2, pp. 67 – 80.

<sup>77</sup> Kotler Philip (1973), "Atmospherics as a Marketing Tool", *Journal of Retailing*, Vol. 49 Winter, pp. 48 – 64.

<sup>78</sup> Zeithaml V (1988), "Consumer Perception of Price, Quality and Value: A Means-End Model and Synthesis of Evidence", *Journal of Marketing*, Vol. 52 (July), pp. 2 – 22.

<sup>79</sup> Baker J, Grewal D and Levy (1992), "An Experimental Approach to Making Retail Store Environmental Decisions", *Journal of Retailing*, Vol. 68, Winter, pp. 445 – 60.

<sup>80</sup> Baker J, Grewal D, Parasuraman A and Glenn B (2002), "The Influence of Multi-Store Environmental Clues on Perceived Merchandise Value and Patronage Intentions", *Journal of Marketing*, Vol. 66, April, pp. 120 – 41

<sup>81</sup> Bell, David R; Ho, Teck-Hua and Tang, Christopher S (1998), "Determining Where to Shop: Fixed and Variable Costs of Shopping," *Journal of Marketing Research*, Vol. XXXV, August, pp 352-369

perceived utilities<sup>82</sup>. It is also argued that the shopper may evaluate a shopping situation in the light of cost incurred and utilities derived out of shopping<sup>83</sup>.

- e) Accessibility: It is the convenience component of the retail mix. Store location, travelling time, parking facility, service hours are considered as important elements. The first decision is the store - location choice problem. The second is the shopping trip incidence problem relating to the timing of shopping trips. The two decision processes are correlated. It is found that, on an overall basis, shoppers give prominence to proximity of the store, merchandise and service provided by the store<sup>84</sup>.

- Decide on Brick or Click or Brick and click

Offline retailers have taken cognisance of the online model's ability to drive an expansion in customer base that would never have been possible in a pure offline-retailing model and with much lesser investment to boot. The Click model also enables retailers to offer a lot of value added services to their customers, which perhaps will be the only differentiation, factor in the emerging global market place<sup>85</sup>. For the pure play online retailers such alliances offer a chance to leverage the extensive distribution infrastructure, credibility and stability of the established offline players. It also helps in customer acquisition because experience has shown that shoppers are more comfortable in making online purchase if their familiar offline retailers have an online presence.

Many offline retailers realised that it is not always viable to venture alone into the online market place. This has given rise to several alliances. Offline retailers can include their web addresses in their communication. Moreover, they can also tie their store loyalty cards and catalogue circulation lists to their mailing lists in order to increase awareness and usage of the online channel. They can find out new shoppers to their site and their conversion. Traditional retailers can leverage their "physical" assets to build strong "bricks and clicks" organisations that are able to deliver seamless offerings across multiple channels to build and strengthen customer loyalty.

However, integrating offline and online store operations is a complex process. Initially there were concerns for the pure plays about mergers between offline and online retailers because pure plays were concerned about erosion in their valuations due to merger with the conservative offline ventures. On the other hand offline retailers were concerned about the potential cannibalisation of the sales from their traditional offline outlets. But the advantages outweigh the disadvantages.

In integrating click and brick retail models the executives need to decide on integrating or keeping them separate. Integrating them offers the benefits of cross promotions, shared

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<sup>82</sup> Tang, Christopher S; Bell, David R; Ho, Teck-Hua (2001), "Store Choice and Shopping Behaviour: How Price Format Works," *California Management Review*, Vol. 43, No. 2, Winter, pp. 56 – 74.

<sup>83</sup> Messinger, Paul R and Narasimhan, Chakravarthi (1997), "A Model of Retail Formats Based on Consumers' Economising on Shopping Time", *Marketing Science*, Vol. 16, No. 1, pp. 1 – 23; Sinha, Piyush Kumar, Banerjee, Arindam and Uniyal Dwarika Prasad (2002), "Deciding Where to Buy: Store Choice Behaviour of Indian Shoppers", *Vikalpa*, Vol 27, No 2, pp. 13-28; Leszczyc, Peter Popkowski, T L; Sinha, Ashish and Timmermans, Harry J P (2000), "Consumer Store Choice Dynamics: An Analysis of Competitive Market Structure for Grocery Stores," *Journal Of Retailing*, Vol. 59, No.2, Summer, pp. 75-105; Van Kenhove, Patrick; De Wulf, Kristof; Van Waterschoot, Walter (1999), The Impact of task Definition on Store Attribute Salience and Store Choice *Journal of Retailing*, Spring, Vol. 75, pp. 125 – 135.

<sup>84</sup> *ibid.* 7

<sup>85</sup> Meyer Harvey (2000), "Building a Click and Mortar World". *Journal of Business Strategy*, Mar/Apr, Vol. 21 (2), pp. 20 - 25

information and purchasing leverage and distribution economies. Figure 7 highlights some points that a retailer needs to keep in mind while deciding on this issue. The primary concern in integration is the cultural fit. The two types of retailer represent different business and retailing environment. The shoppers behave differently, the technology is different and so are the processes.

### Meaning Of Utility

Utility is a concept used to denote the subjective pleasure, usefulness or satisfaction derived from consuming goods. It is an analytical construct used to explain how consumers divide their limited income among goods that provide them satisfaction or utility. When economists describe about utility, they also proclaimed the law of diminishing marginal utility, which states that total utility increases with increase in consumption. However, as consumption increases, total utility grows at a slower and slower rate. A consumer with a fixed income and facing given market prices of goods can come to a point (or equilibrium) of maximum satisfaction or utility only by acting in the following manner. Each product is demanded up to the point where the marginal utility for every unit of money spent on it is exactly the same as the marginal utility of the spent on any other good. This fundamental condition of consumer equilibrium can be written in terms of Marginal Utilities (MU) and Prices (P) of the different goods in the following compact way.

$$\frac{\text{MU Good1}}{P1} = \frac{\text{MU Good 2}}{P2} = \frac{\text{MU Good3}}{P3} = \text{Common MU per unit of income.}$$

In Victorian days, philosophers and economists talked blithely of “utility” as an indicator of a person’s overall well being<sup>86</sup>. Utility was thought of as a numeric measure of a person’s happiness. Given this idea, it was natural to think of consumer’ making choices so as to maximize their utility, that is, to make themselves as happy as possible. The trouble with this definition was that classical economists never described how to measure utility or quantify the “amount” of utility associated with different choices. Is one person’s utility the same as another’s? What would it mean to say that an extra candy bar would give me twice as much utility as an extra carrot? Does the concept of utility have any independent meaning other than its being what people maximize? Because of these conceptual problems, economists have abandoned the old fashioned view of utility as being a measure of happiness. Instead the theory of consumer behaviour has been reformulated entirely in terms of consumer preferences and utility is seen only as a way to describe preferences.

Economists gradually came to recognize that all that mattered about utility as far as choice behaviour was concerned was whether one bundle has a higher utility than another – how much higher didn’t matter. Originally preferences were defined in terms of utility, to say a bundle  $(x_1, x_2)$  was preferred to a bundle  $(y_1, y_2)$  meant that the x-bundle had a higher utility than the y bundle. A utility function is a way of assigning a number to every possible consumption bundle such that more preferred bundles get assigned larger numbers than less preferred bundles. That is bundle  $(x_1, x_2)$  is preferred to a bundle  $(y_1, y_2)$  if and only if the utility of  $(x_1, x_2)$  is larger than the utility of  $(y_1, y_2)$ . The only property of a utility assignment that is important is how it orders the bundle of goods. The magnitude of the utility function is only important in so far as it ranks the different consumption bundles. The size of the utility difference between any two consumption

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<sup>86</sup> Varian Hal R. “Intermediate Microeconomics - A Modern Approach”, 3<sup>rd</sup> Edition, affiliated East West Press, New Delhi.

bundles doesn't matter. Because of this emphasis on ordering of bundles of goods, this kind of utility is referred to as ordinal utility.

In studying the Consumer Behaviour Model the value or worth of a good or service, its utility is the prime determinant of individual demand<sup>87</sup>. Utility is a number that represents the level of satisfaction that the consumer derives from a particular market basket<sup>88</sup>. Individuals are viewed as attempting to maximize the total utility or satisfaction provided by the goods and services they acquire and consume. This optimisation process requires that consumers consider the marginal utility of acquiring additional units of a given product and of acquiring one product as opposed to another. Product characteristics, individual preferences (tastes) and resources are important determinants of direct demand. Utility is maximized when products are purchased at levels such that relative prices equal the relative marginal utility derived from consumption. Therefore utility concept works as a measure of satisfaction or well-being derived from consumption. The utility functions are shaped both by the tastes and preferences of consumers and the quantity and quality of available products. The utility derived from consumption is intangible. However, the consumers reveal their preferences through purchase decisions and thus provide tangible evidence of the utility they derive from various products. The utility function of a consumer is simply a function from the commodity space to a real line, which preserves the ordering of the indifference curves in the commodity space<sup>89</sup>. The consumer's preferences among commodity bundles can also be represented by an index, showing the degree of his satisfaction associated with each commodity bundle. Such an index, called the utility index function or simply the utility function, assigns a real number say  $u(x)$  for each point  $x$  of the commodity plane so that, for commodity bundles  $x'$  and  $x''$  whenever  $x' \succ x''$ .

$$U(x') \geq U(x'')$$

That is the utility function need only preserve the ranking by the consumer's preferences. In this sense the utility function is ordinal and defined by the preference relation on the commodity plane.

Utility can be defined as an individual's perception of his or her satisfaction from consuming any specific bundle of goods and services<sup>90</sup>. We can write a utility function in the form of

$$U = f(X_1, X_2, X_3, \dots, X_n)$$

Where  $X_i$  is the amount of the  $i$ -th good or service to be consumed. If  $U$  is some index, the value of this index depends upon the quantities of goods one through  $n$  consumed. For example, let's assume that the consumer chooses among bundles consisting of only among goods (or services)  $X$  and  $Y$ . The utility function can be written as

$$U = f(X, Y)$$

Where  $X$  and  $Y$  are respectively the levels of consumption of the two commodities.

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<sup>87</sup> Pappas James L, and Hirshey Mark, "Fundamentals of Managerial Economic", Third Edition, Dryden Press, Chicago

<sup>88</sup> Mansfield Edwin, "Essential Microeconomics", W W Norton & Co, New York, London

<sup>89</sup> Kogiku K.C (1971), "Micro Economic Models", Harper International Edition, Harper & Row Publishers, New York

<sup>90</sup> Meuve Charles S, Smithson Charles W(1985). "Managerial Economics", 2<sup>nd</sup> Edition, Irwin Publication, Homewood Illinois

A utility function is a mathematical representation of individual's tastes, preferences and morals<sup>91</sup>. An individual utility function takes the form  $U = U(x_1, x_2, \dots, x_n)$ , the amount of utility that a person has is some function of the level of goods  $x_1, \dots, x_n$  consumed. The more  $x_1$  or  $x_2$  there is, the higher the utility indicator. The utility numbers are meaningless, unless the scale is known. The level of the numbers does not indicate quantitative amounts of happiness. Instead it only compares two states and indicates whether one is better than the other. It is impossible to say that a person enjoys one thing a lot more than something else. All we can say is that a person prefers one bundle or situation to another. The higher the utility indicator, the happier is the customer. It is important, however to remember that this formulation of consumer preferences does not allow for interpersonal utility comparisons nor does it permit cardinal quantification.

### Maximizing Utility

Economic theory assumes the consumers' objective is to maximize utility. People want to be as happy as possible. However the limited income restricts the ability to achieve maximum happiness or satiation. In other words income constrains the choice of goods. As a mathematical problem, the consumer maximizes a utility function,  $U(x_1, x_2, \dots, x_n)$  subject to the constraint that total expenditures on goods do not exceed the amount of income or money available,  $M$ . If the expenditures for a particular is expresses as  $E_1 = P_1 \cdot x_1$ , then

$$M = \sum_{i=1}^n x_i p_i$$

So the Utility Function can be written as

$$\text{Maximize } U = U(x_1, x_2, \dots, x_n)$$

Subject to

$$M = \sum_{i=1}^n x_i p_i$$

This is a mathematical problem that can be solved using a technique called LaGrange Multipliers. Solving this problem is equivalent to finding the appropriate levels of each  $x_i$  to maximize happiness given the prices of the goods and the amount of money available. In simple terms, the consumer has a fixed amount of money to allocate among many different products in a way that gets the greatest level of happiness from the expenditure. The mathematical conditions necessary to maximize  $U$ , subject to the budget constraint  $M$  are

$$U_i / U_j = P_i / P_j \text{ for all } i \text{ and } j$$

Where  $U_i$  is  $\partial U / \partial x_i$ , the marginal utility of all the  $i$ th good. The marginal utility of every good divided by the marginal utility of each other good is equal to the relative price ratio of the goods. Alternatively,  $U_i / P_i = U_j / P_j$  By dividing both sides by  $P_i$  and multiplying both sides by  $U_j$ . The second expression is analytically equivalent to the first but the interpretation is slightly different; the extra happiness a consumer gets from every unit of money spent must be the same for all goods. Regardless of the equation, to maximise utility subject to a budget constraint, the

<sup>91</sup> McCormick Robert E (1993), "Managerial Economics", Prentice Hall , Englewood Cliffs

consumer purchases an amount of each good such that the ratio of the marginal utilities is equal to the ratio of their prices. The ratio of the marginal utilities of the two products is the consumers' personal evaluation of one product versus the other, the consumers' own feelings about the merits of one good compared to the other. The price of the first product  $p_1$  divided by the price of the second  $p_2$ , is the price of the first good in the market place in terms of the second good. It represents the *sellers'* relative evaluation of one good versus the other. Since the consumer can choose the quantities to buy, equilibrium is only achieved when the consumer chooses goods in proportion that makes the consumer's evaluation equal to the seller's posted evaluation. The ratio of the marginal utilities of the two goods must equal the ratio of the prices. In essence, to maximise utility the consumer must select goods from a limited budget in such a way that the personal evaluation of the products is the same as the market evaluation. Otherwise there is a profit opportunity, a chance for the buyer to increase happiness. The ratio of the marginal utilities of any two goods is called marginal rate of substitution. Utility maximisation requires that the consumer arrange expenditures so the marginal rate of substitution is equal to the ratio of prices for all goods.

### Transaction Utility Theory

The basic tenet of the theory is that a consumer's notion of value depends not only on the value of goods and services available relative to the respective prices, but also on the perception of the quality of the financial deal.<sup>92</sup> This theory was developed based on the Prospect Theory as explained by Khanmen and Tversky.<sup>93</sup> Later the concept of Transaction Utility was modelled depending on the difference between the selling price and reference price.<sup>94</sup> To explain this he postulated reference price, which is the amount of money that a customer expects to pay for a good or service. It is suggested that any purchase occasion is associated with two utilities: acquisition utility and transaction utility. Acquisition utility represents the economic gain or loss from the transaction. Where as transaction utility is associated with purchase or (sale) and represents the pleasure (or displeasure) of the financial deal per se and is function of the difference between the selling price ( $p$ ) and the reference price ( $q$ ). The situation where  $p > q$ , the transaction utility is negative (rip-off situation); conversely when  $p < q$ , the transaction utility is positive (bargain situation). The total utility of a purchase is just sum of acquisition utility and transaction utility. The implication is that an individual may not buy a product if acquisition utility is offset by loss in transaction utility when the price is sufficiently larger than reference price.

This theory has found uses in several contexts. One of the studies investigated the determinants of consumers' purchase probabilities towards recycled products. It concluded that the psychological benefits derived out of purchase might be more significant than the product itself.<sup>95</sup> Transaction Utility Theory, in the context of social exchange, explored the concept of fair price on relationship and perspective between buyer and seller as well as legitimacy of profits.<sup>96</sup> This

<sup>92</sup> Thaler, Richard (1983), "Transaction Utility Theory", *Advances in Consumer Research*, Vol. 10, pp. 229 – 232.

<sup>93</sup> Khanmen, Daniel and Tversky, Amos (1979), "Prospect Theory: An Analysis of Decision Under Risk", *Econometrica*, Vol. 47, March, pp. 263 – 291.

<sup>94</sup> Thaler, Richard (1985), "Mental Accounting and Consumer Choice", *Marketing Science*, Vol. 4, No.3, pp 199-214.

<sup>95</sup> Bei, Lien Ti; Simpson, Ethil M (1995), "The Determinants of Consumers' Purchase Decision for Recycled Products: An Application of Acquisition – Transaction Utility Theory", *Advances in Consumer Research*, Vol. 25, pp. 257-261.

<sup>96</sup> Boza, M. E; Diamond, W (1998), "The Social Context of Exchange: Transaction Utility, Relationship and Legitimacy", *Advances in Consumer Research*, Vol.25, 557 – 562.

theory has also been used to understand the difference between coupon proneness and value consciousness of customers.<sup>97</sup>

However, even though this theory exemplifies a purchase situation, it has not been applied in a retailing perspective. Given the basic tenet, it is felt that acquisition utility and transaction utility can be used to explain the shoppers' choice of a format. The theory may require modifications. Acquisition utility can be extended to include not only the price of the merchandise but also other costs associated with shopping such as, cost of product search, cost of information, size of purchase, and cost of access to the store. Shopping, being essentially a process that occurs in a context of a store, may have a close association with the transaction utility. The perceived value delivered through the transaction could include all non-monetary aspects of the 'deal' that may include ambience and service at the retail point for explaining the transactional utility of the format. The theory also suggests that the two utilities are not mutually exclusive. It is imperative that any format decision would have to take a holistic view and incorporate both sets of utilities.

### Research Agenda

A framework of store choice developed in Indian context (Figure - 8) suggests that customers use three broad dimensions in choosing a store that could be utilised to classify the formats as (a) formats that reduce the risk of purchase, (b) formats that enhance the choice and (c) formats that enhance shopping experience.<sup>98</sup> Based on this the utility of a format could be expressed as

$$U_{Fi} = U_{Pi} + U_{Di} \quad \text{----- (1)}$$

Where,

$U_{Fi}$  = Utility of Format i

$U_{Pi}$  = Utility of Price at format i

$U_{Di}$  = Utility of Deal at format i

$U_{Di}$  could take the form of Risk Reduction ( $rr_i$ ), Choice Enhancing ( $ce_i$ ) and Experience Enhancing ( $ee_i$ ). While a store would consist of all the three dimensions, generally one of them is chosen to develop the value proposition. Therefore, for three formats that plan to deliver different utilities, Equation 1 can be written for primary utility drivers as

$$U_{Fi} = U_{Pi} + U_{rr_i} \quad \text{----- (2a)}$$

**OR**

$$U_{rr} = U_{Pr} + U_{(proximity + merchandise\ quality + personal\ relationship)} \quad \text{----- (2a')}$$

In equation 2a, the reference for determining the deal and the price, for formats that position based on Risk Reduction, would be determined by proximity of the store, its quality of the merchandise and the personal relationship developed with the customers.

<sup>97</sup> Lichtenstein, Donald R, Netemeyer Richard G and Burton Scot (1999), "Distinguishing Coupon Proneness from Value Consciousness: An Acquisition-Transaction Utility Theory Perspective", Journal of Marketing. Vol. 54, July, 54 – 67.

<sup>98</sup> Sinha P K and Banerjee A (2004), "Sore Choice in an Evolving Market", International Journal of Retail and Distribution Management (Forthcoming)



Similarly, the reference for determining the deal and the price for the formats that deliver the Choice Enhancing value more than others would be determined by convenience in terms of timings, deliveries and payments, and width and depth of the merchandise.

$$U_{F2} = U_{P2} + U_{ce2} \quad \text{----- (2b)}$$

$$U_{ce} = U_{P\pi} + U_{(timing - home\ delivery - payment\ terms + merchandise\ width + merchandise\ depth)} \quad \text{----- (2b')}$$

The reference for determining the deal and the price for the formats that deliver the Experience Enhancing value more than others would be determined by ambience, customer service and entertainment provided at the store.

$$U_{F3} = U_{P3} + U_{EE3} \quad \text{----- (2c)}$$

$$U_{ce} = U_{P\pi} + U_{(ambience + service + entertainment)} \quad \text{----- (2c')}$$

Inferring from the above expressions, several hypotheses could be generated for the research. It is assumed in each case, in line with the Transactional Utility Theory, that customers would trade-off between price and deal and patronise store where  $U_{P_i} < U_{D_i}$ . It is not desirable to compare the utilities of different formats and, by themselves, they are different. Also the total utilities of each of the formats are a function of their own primary value drivers. However, if it is assumed that the price of a merchandise remain same across formats, the deal utilities can be the main drivers of value. Such situations exist in cases where products are subject to MRP restrictions.

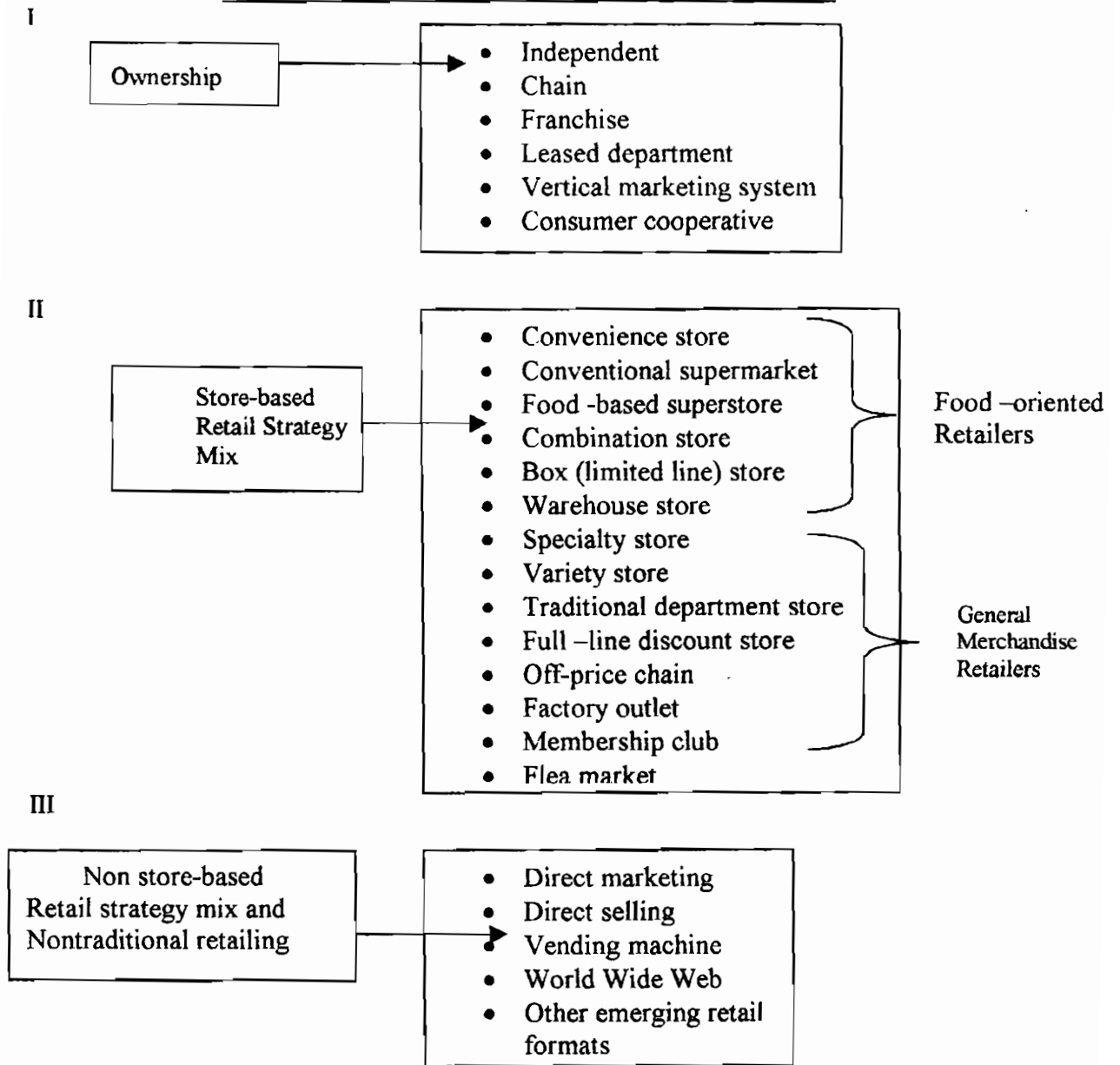
The role of the price of the merchandise in selecting a format is interesting. It is likely that its importance in customers' decision making for each of the formats would be different and would reduce in a manner such that  $U_{P1} > U_{P3} > U_{P3}$ . In the same manner, the deal factors can also be expressed in an orderly fashion as given in Figure - 9.

## Summary

The retail canvass is dotted with several formats. These are broadly classified into store and non-store formats and on the basis of their ownership. Each format has a specific driver that makes it succeed. This is called the Retail Value Proposition. This proposition is a combination of the variables of the retail mix that consists of merchandise, display, pricing, accessibility and service. A retailer needs to identify one aspect that would provide sustainable competitive advantage. The selection is dependent on the target customers, competition and the objectives of the retailers.

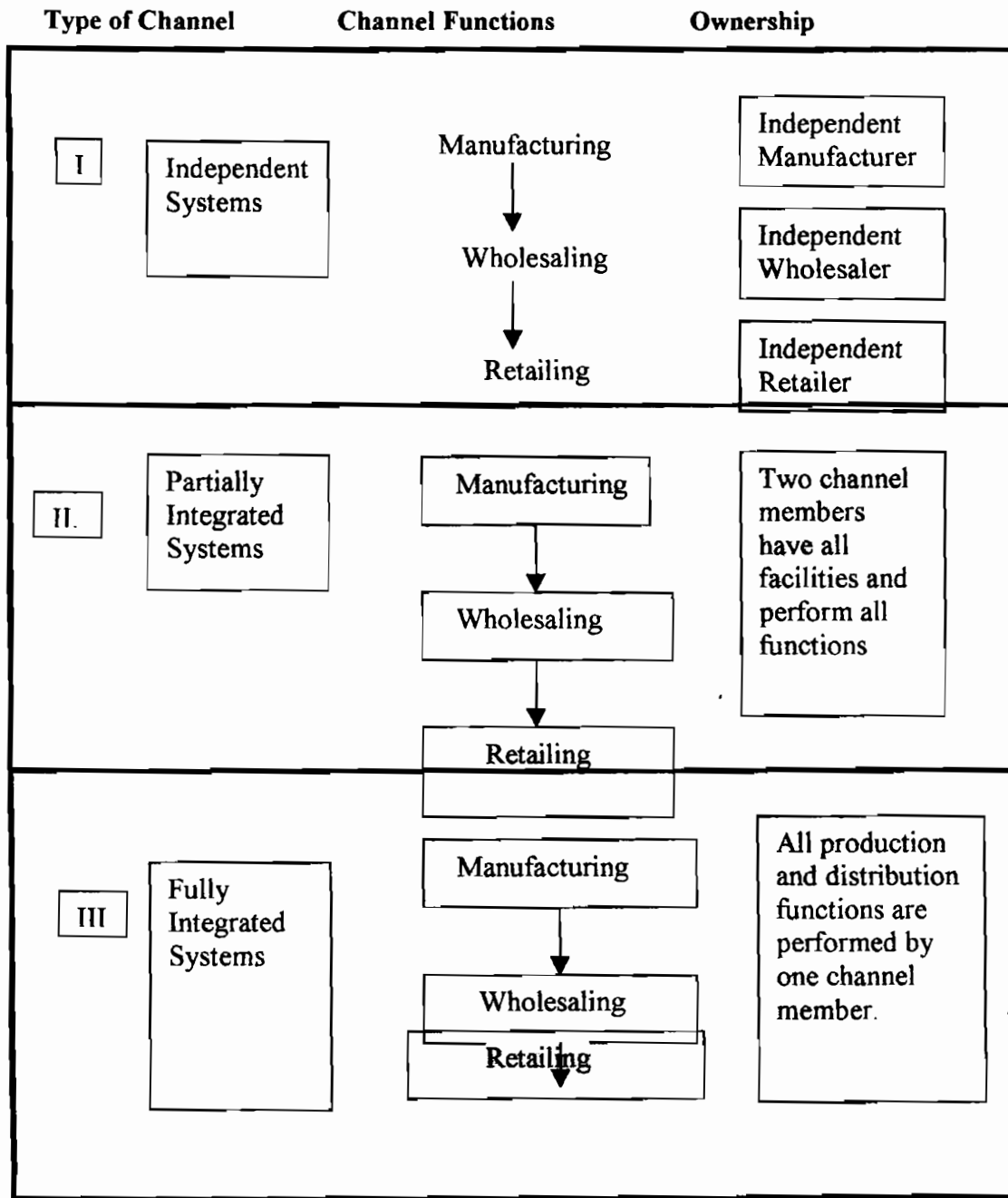
Based on the market the retailer wishes to target, the mix could be decided using the Transaction Utility Theory as proposed by Thaler. The elements of mix could be divided into price and non-price factors. An approach for the same is described in this paper. The study could use either Conjoint or structural equation based models to understand format choice behaviour of the customers.

**Figure 1: A Classification Method for Retail Institutions**



Source: Berman Barry and Evans Joel R, "Retail Management - A Strategic Approach", Prentice Hall India, Eighth Edition

**Figure – 2: Vertical Marketing Systems: Functions and Ownership**



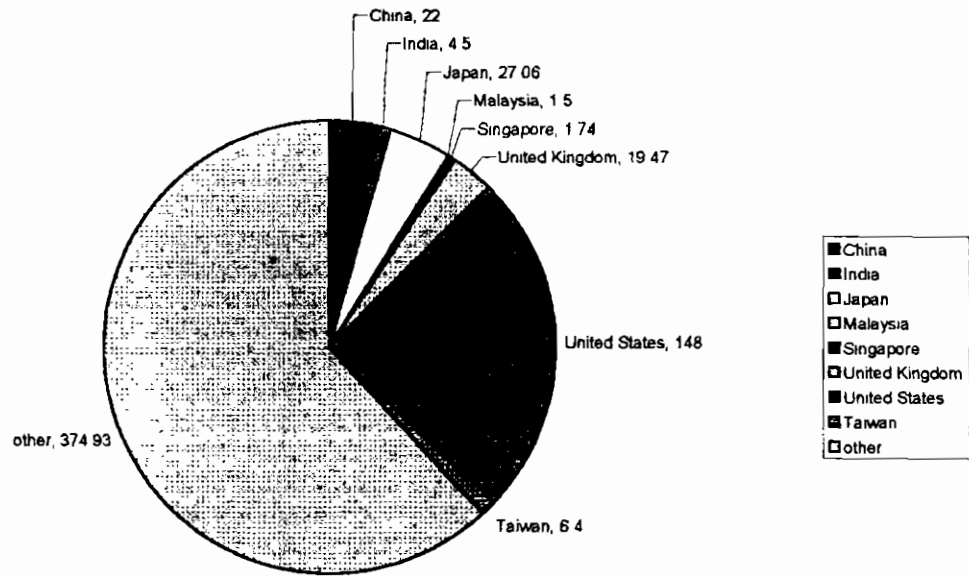
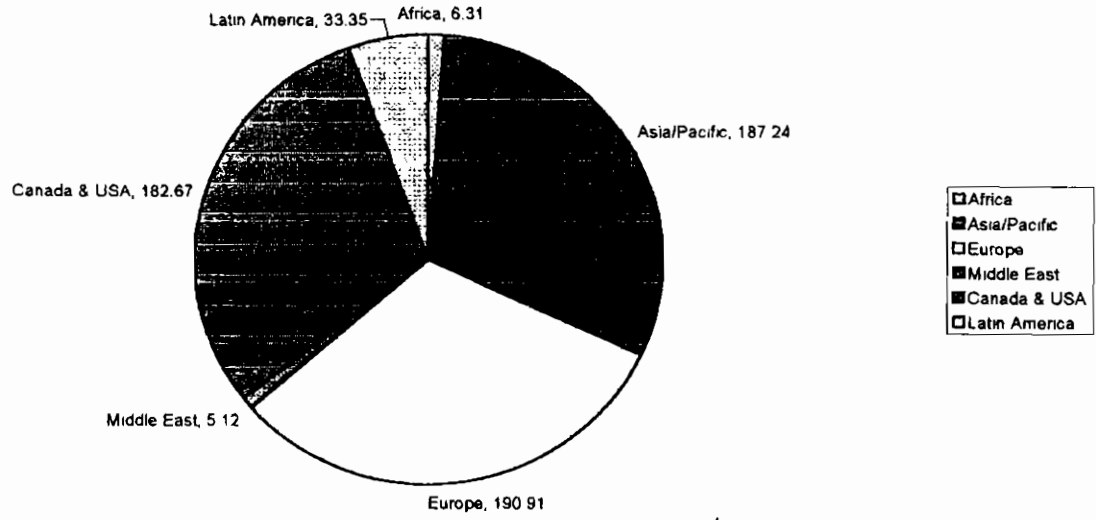
Source: Berman Barry and Evans Joel R, "Retail Management - A Strategic Approach", Prentice Hall India, Eighth Edition

**Figure – 3: Store Based Retailers**

<b>TYPE</b>	<b>LOCATION</b>	<b>ASSORTMENT</b>	<b>SERVICES</b>	<b>PRICES AND PROMOTIONS</b>
Traditional department Store	Business district shopping centre Or isolated store	Extensive width and depth of assortment; average to good quality	Good to excellent	Average to high Prices Heavy ad and catalogue use, direct mail; personal selling
Full –line discount store	Business district shopping centre Or isolated store power strip centres	Extensive width and depth of assortment; average to good quality	Slightly below average-to-average	Low Prices; Heavy use of newspapers, price oriented, moderate sales force
Speciality store	Business district Or shopping centre Regional malls	Very narrow width of assortments; extensive depth of Assortments; average to good quality	Average to high excellent	High Prices, Heavy use of displays; extensive sales force
Hypermarkets	Stand-alone	Average	Low	Low
Variety Store	Business district shopping centre Or isolated store	Good width and depth of assortment; below average to average quality	Below Average	Heavy use of newspapers, self service
Off-price Chain	Business district, suburban shopping strip or isolated store.	Moderate width, but poor depth of assortment; average to good quality, low continuity	Below Average	Use of newspapers, brands not advertised; limited sales force
Factory Outlet	Out-of –the –way site or discount mall	Moderate width but poor depth of assortment; some irregular merchandise; low continuity	Very low	Little; self-service
Membership Club	Isolated store or Secondary site	Moderate width but poor depth of assortment; low continuity	Very low	Little; some direct mail; limited sales force
Flea market	Isolated site, race track Or arena	Extensive width, but poor depth of assortment; variable quality; low continuity	Very low	Limited ; self service
Drugstore	Stand alone, strip centres	Very deep	Average	Average to high
Home improvement Centres	Stand-alone, power strip centres	Very deep	Low to high	Low

**Figure - 4: Internet Users**

**World wide Internet users  
in million in September 2002  
source Nua Internet Surveys**



**Figure 5: A Comparison of E-tailing and Other Formats**

**MODEL COMPARISON FOR GROCERY**

	Hypermarket	Supermarket	Kirana	Online	Call-in
<b>BENEFITS TO THE RETAILER</b>					
Breakeven volumes	High	Medium	Low	Medium	Medium
Scalability	High	High	Low	High	Medium
Up front investment	High	Medium	Low	Medium	Medium
GM based on volumes	High	High	Low	Medium	Medium
End customer experience	Medium	High	Low	Medium	Medium
<b>BENEFITS TO CUSTOMERS</b>					
Pricing	Low	High	High	High	High
Services	Low	High	Low	High	High
Atmosphere	Medium	High	Low	Medium	Medium
Convenience	Low	Medium	High	High	High
Range	High	Medium	Low	High	Low
End customer experience	Medium	High	Low	Medium	Medium

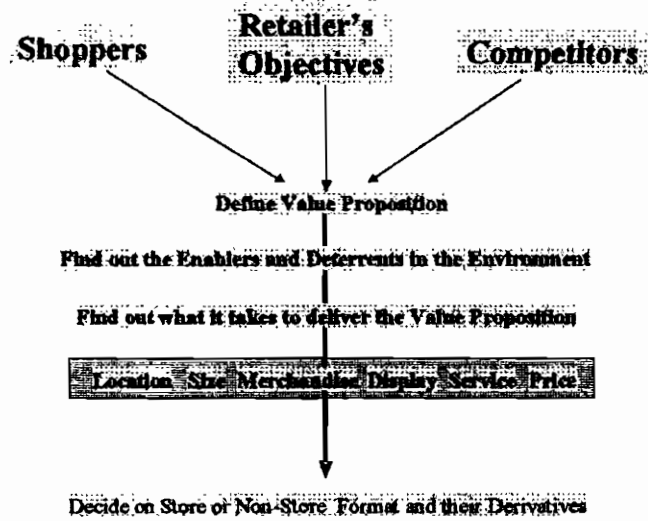
**Comparison of Cost of Operation**

Sales/Sq.ft	Rs. 500	Rs. 750	Rs. 1000	Rs. 1250
Hypermkt	13.33%	10.23%	8.68%	7.75%
Supermkt	19.96%	14.52%	11.81%	10.18%
Kirana	7.60%	5.57%	4.55%	3.94%
SuperKirana	16.85%	11.68%	9.10%	7.55%
<b>Sales/Location</b>	<b>Rs. 14 Lac</b>	<b>Rs. 18 Lac</b>	<b>Rs. 26 Lac</b>	<b>Rs. 38 Lac</b>
Online*	13.29%	9.62%	8.03%	7.16%

**Notes:**

1. Online cost does not include Marketing and Technology costs.
2. Location is treated as mainly a large city when the store's service centre is located.
3. Lac = 1,00,000

**Figure - 6: Process of Format Selection**

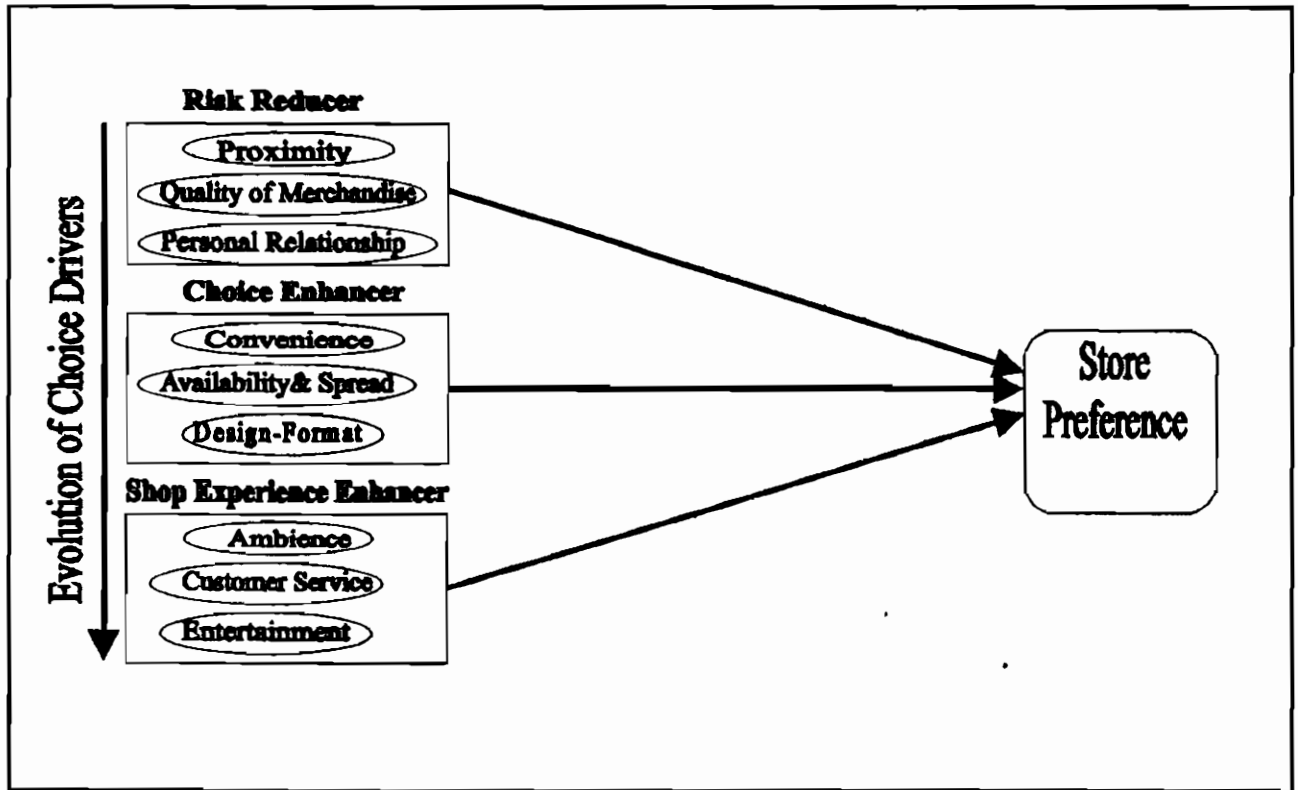


**Figure 7: Click, Click and Brick and Brick and Mortar**

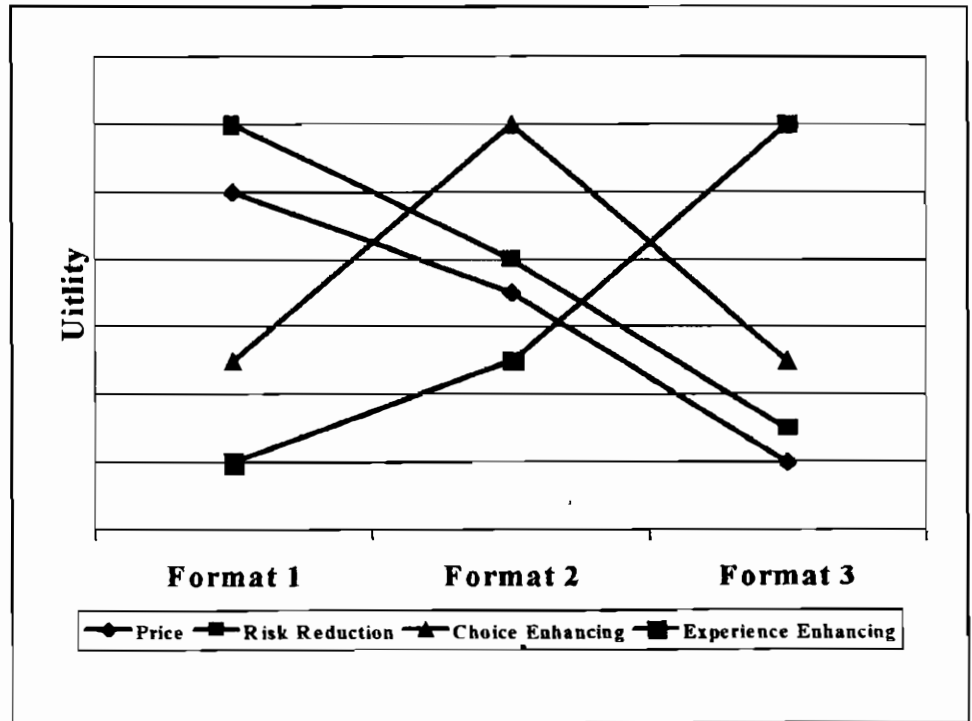
<b>Factors</b>	<b>Pure Play</b>	<b>Click and Brick</b>	<b>Brick &amp; Mortar</b>
Ease of Distribution	Low	High	High
Scalability	High	Moderate	Low
Market Valuation	High	Moderate	Low
Inventory Costs	Low	High	High
Infrastructure Cost	Low	High	High
Security of Payment	Low	Mixed	High
Variable Costs	High	Low	Low
Consumer Tracking	Easy	Easy	Difficult
Channel Conflict	Low	High	Low
Brand Equity	Low	High	High
Customer Acquisition Cost	High	Moderate	Low



**Figure - 8: Store Choice Model for Evolving Markets**



**Figure - 9: Assumed Utilities of Formats**



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