When Category Domination Isn't Enough

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Mega-stores such as Staples and Home Depot have taken category domination to its limits. What next? How about dollar stores and compact shops in inner cities. A book excerpt from Category Killers.

by Robert Spector

In their constant quest to find places to add stores, most category killers are taking a two-pronged approach. They are either building larger stores in areas with an abundance of available undeveloped property, or building smaller stores in small-town downtowns or in densely populated urban communities.

Shoppers are spending less time at the mall—an average of 2.9 hours a month in 2003, compared with four hours in 2000, according to consultant Stillerman Jones & Co. Because many shoppers are reacting negatively to dealing with bigsuperstores full of jammed aisles and backed-up checkout lines, they are turning to smaller specialty stores, where they can get in, buy what they're looking for, and get out. In response, category killers are opening small, easier-to-shop, neighborhood stores to attract these time-pressed consumers. Although smaller stores translate to lower costs, the challenge for category killers is to find ways to extract the highest possible number of sales in a limited space.

Home Depot, which has about two-thirds of its stores concentrated in the nation's fifty largest markets, has been opening stores in rural and secondary markets such as Iron Mountain, Michigan (population 8,644), and Barboursville, West Virginia (population 2,742). Those moves are based on company research of areas that are underserved by neighboring Home Depot stores or competitors, but that have a population with above-average household income and a high percentage of home ownership. In the mid-1990s, most Home Depot stores occupied 160,000 square feet;
today, they are each about 115,000 square feet.

Home Depot is also opening smaller urban stores, dubbed "Depot Lite," in inner cities. (In fact, most of Home Depot's newer stores are being built in urban markets.) The first of these units—a two-story, glass-fronted emporium with escalators—opened in 2001 in the upscale Lincoln Park neighborhood of Chicago. In 2004, Home Depot opened two pedestrian-friendly stores in Manhattan, including one on Third Avenue at 59th Street, near Bloomingdale's, and another on 23rd Street between Fifth Avenue and the Avenue of the Americas. In its quest for additional viable retail sites, Home Depot, in spring 2004, announced it was acquiring as many as nineteen Kmart stores (many of them in urban areas) from Kmart Holding Corp., with the intention of converting them into Home Depot stores. The company has also been experimenting with new formats, such as its Landscape Supply stores and its upscale Expo home-design stores, which offer do-it-yourselfers sharper prices on items such as granite countertops and window treatments.

Lowe's, which has just under a thousand stores—compared with Home Depot's 1,700—is expanding aggressively into metropolitan areas long dominated by Home Depot. Some industry observers maintain that if Home Depot and Lowe's keep up this same rate of growth, they soon will saturate the category's capacity for big-box stores. Whether that happens in 2004 or 2010, the two chains will eventually be forced to cannibalize their existing operations—including closing old stores and replacing them with new state-of-the-art venues, which will be influenced by changing market conditions, consumer tastes, lifestyle changes, and other factors. Wal-Mart has been doing that for years by replacing its traditional stores with larger SuperCenters, which combine a massive supermarket component with the usual general merchandise.

In 2002, Best Buy began opening smaller thirty-thousand-square-foot stores in smaller markets (under two hundred thousand residents) such as Wichita Falls, Texas, and Kokomo, Indiana. By way of comparison, the typical Best Buy in urban areas is forty-five thousand square feet. These smaller units are expected to account for about half of the chain's new stores, until Best Buy hits its projected saturation point of about 620 large and mid-size outlets in 2005. The stores have the same warehouse feel as Best Buy's larger outlets, but the aisles are narrower, and there is little room for office furniture or small appliances. Unlike Circuit City, which stopped selling appliances in 2000, Best Buy still offers an extensive line of refrigerators and stoves, as well as computer software, big-screen TVs, camcorders, and digital video disc players.

Circuit City, too, has changed its approach. It has spent more than $100 million in redesigning some stores, relocating others, and expanding into new locations. The stores were converted to self-service operations, and designed to make it easier for customers to take the merchandise off the shelves.

Staples Superstores, generally located in suburban malls, typically carry more than 7,500 office supply items in twenty thousand square feet of space, while Staples.com offers forty-five thousand products and a wide variety of business services. Beginning in 2002, Staples began launching stores that were 17 percent smaller—twenty thousand square feet, down from the original twenty-four thousand—and did not have the old warehouse feel. The traditional high red racks were replaced with low gray shelves, which offered more accessible sight lines, showing the full scope of merchandise. Customers had complained that they had been unable to locate the items that they were looking for, and had difficulty finding help to wait on them. In the smaller stores, with everything in plain view, customers need less help from the staff.

Staples used to have a floor plan that featured aisles plotted out like city streets in a linear-grid pattern. They have since changed the floor plan to the oval racetrack design—initially popularized by Kohl's—that promotes faster movement and time-savings while inviting shoppers to stroll past merchandise displays and
pick up impulse items. Staples also made better use of its space by discontinuing slow-moving, unprofitable consumer items such as Britney Spears backpacks, pens shaped like vegetables, printers for under $100, child-oriented computer games, and educational software.

Even Starbucks is looking to go smaller. The coffee retailer has been adding hundreds of drive-through windows in stores in North America, and is testing a drive-through-only format in several markets. Since 1998, Starbucks has been expanding into inner-city locations in partnership with basketball legend Earvin "Magic" Johnson's Johnson Development Corporation, which also operates theaters, T.G.I. Friday's restaurants, and other retail businesses in urban areas.

Costco has been experimenting with a home furnishings and decor warehouse, called Costco Home, which it opened at the end of 2002 in the Seattle suburb of Kirkland. Selling exclusively to Costco Wholesale members, the store—the company's first warehouse to carry a single merchandise category—offers about three thousand items, including top-grain leather sofas, furniture, bedding, desks, limited-edition artwork, tapestries, carpeting, window fashions, and other products and services for the home. In 2003, Costco toyed with the idea of opening a gourmet shop, to be called Costco Fresh, which was to feature gourmet groceries and include a pharmacy, bakery, olive bar, deli, cafe, garden center, and photo and optical departments. Products would be packaged in smaller quantities, and membership would be required. Although the company opted to put off the project, Costco continues experimenting with fresh-food offerings at its warehouse stores.

Wal-Mart is also adding smaller stores. Since 1998, the company has been operating its Neighborhood Market stores, which average about forty-five thousand square feet larger than many supermarkets, but smaller than the average Wal-Mart—in rural areas deemed too small for SuperCenters. Dubbed "Small-Marts" by retail analysts, the fifty-plus Neighborhood Markets are sprinkled throughout the south and southwest, primarily in Oklahoma, Arkansas, Texas, Mississippi, Tennessee, Florida, and Alabama. Neighborhood markets carry about twenty-four thousand products, compared with a hundred thousand in the SuperCenters. The stores stock the usual supermarket inventory of groceries, over-the-counter drugs, and beauty products, as well as prepared foods, pastries, drive-through pharmacies, and half-hour film processing (thanks to research that discovered that half of all women shoppers are carrying an undeveloped roll of film in their purses). Stores also have self-check-out lanes. Wal-Mart has tried to create an old-fashioned general store touch with its honor-system coffee bar. The jury is still out as to whether the Neighborhood Markets will work for Wal-Mart. Because it is selling food (accounting for 65 percent of sales) just like the competition, the Neighborhood Market doesn't appear to be offering any inherent advantage to shoppers.

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**Dollar stores**

Wal-Mart has also been experimenting with one of the hottest concepts in retail: the dollar store. Small variety stores, conveniently located in neighborhoods all across the country, dollar stores—the anti-big-box—represent the virtual rebirth of the five-and-ten store that Frank Winfield Woolworth created back in 1879. The dollar store concept, as its name suggests, is built around price, and is redefining the category killer model. Customers perceive these stores to have lower prices—comparable to Wal-Mart prices—and to be more convenient because they're smaller. Although they were originally intended to attract families with income under $35,000, dollar stores are now drawing more affluent customers. According to an A.C. Nielsen survey of people who shopped dollar stores at least once a year from 2000 to 2003, the demographic with the highest rate of growth was households with annual income of at least $70,000.6

These efficient stores, which feature a tightly-edited assortment of merchandise, attract a customer who...
doesn't have the time or energy to shop a large retail space or even to hike across the football-field-size parking lot. Although many of these stores started out small—3,500 to 6,000 square feet or so—some of the big chains are now building "superstores," ranging from 9,000 to 12,000 square feet.

Dollar stores generate tens of billions of dollars in sales through more than twenty thousand locations throughout the country. In recent years, these stores have achieved annual double-digit increases in volume and net income, according to industry estimates. Some sixty million households in the United States will shop at dollar stores this year, and 28 percent of American consumers surveyed said that they shop at these variety stores at least once a month, according to A.C. Nielsen. Total industry sales are projected to hit $26 billion in 2007. The stores—many of which do not accept credit cards—have become more and more popular every year. They are simple, no-frills retail spaces selling housewares, candy and food, toys, party goods, cleaning supplies, health and beauty aids, and other items at low prices.

The stores are targeting the same middle-income women who shop at Wal-Mart, Target, and Kmart. In fact, many of the dollar stores are located in low-rent neighborhoods or rural areas near those big-boxdiscounters, and draw the traffic to strip centers, where many of them are located. These retailers draw customers from a very small radius—one to three miles—so, as they expand, they are not afraid of cannibalizing their existing stores. We are also seeing them attract middle- and upper-income shoppers who are interested in saving a dollar or two.

The biggest players in this category include: Dollar General, with annual sales of more than $6.7 billion and 6,700 stores nationally; Family Dollar, based in Charlotte, North Carolina, with sales of $4.1 billion and more than 5,100 locations. Dollar Tree Stores, based in Chesapeake, Virginia, which operates about 2,500 stores, with sales of $3 billion, and also runs stores under the names Dollar Express, Dollar Bills, Only One Dollar, and Only $One.8

Wal-Mart has responded by installing an experimental section in its SuperCenters—called "Pennies-n-Cents"—stocked with goods that cost a dollar or less. Target is doing a similar test in a department it calls "The One Spot," which stocks a variety of items from food to batteries. ExxonMobil is trying out the concept in its gas-station-based convenience stores, as are the Kroger supermarket chain and the Walgreens drugstore chain.

Inner-city retailing
The move of category killers to smaller, more compact inner-citylocations is bringing about a Renaissance in retailing in urban neighborhoods that have been underserved for years, sometimes decades.

Historically, big-box retailers had shied away from locating in urban neighborhoods because of the high real estate and construction costs, the hassle of complicated and lengthy permit processes, and higher-than-average crime rates. But today, in many urban municipalities, we are seeing the flourishing of private-public partnerships to help retailers navigate the minefield of government regulation, and to help them secure tax incentives and other benefits. There are tens of billions of dollars in sales opportunities in inner cities, largely being missed by retailers. Even if the actual number is half that amount, that is still a lot of business left on the table.

In 2003, the South Central section of Los Angeles saw the first meaningful development of a commercial area since the riots it endured in 1992. Developers built this project with $7 million in federal and municipal grants and loans. Dubbed Chesterfield Square, the shopping core is located about a mile from the corner of Florence and Normandie Avenues, where trucker Reginald Denny was beaten during the riots. The 250,000-square-foot retail development, which is anchored by a 132,000-square-foot Home Depot, also includes Starbucks, Food 4 Less, Subway, Radio Shack, McDonald's, International House Of Pancakes,
Vision Beauty, and VIP Music. The developer said he was convinced the project could work when he read a 1999 study of the neighborhood by Pepperdine University, which revealed that the half-million people who lived within a three-mile radius of South Central were spending $900 million a year outside their neighborhood, which had an average annual household income of $37,000. Within a five-mile radius, the population was about 1.2 million.

Wal-Mart has begun in earnest to expand to the inner city, despite having to deal with higher costs for construction, traffic issues, parking, and potential union concerns, all of which have an impact on the thin margins that generate its profitability. Urban Wal-Marts have to be multi-floored because one-floor Wal-Mart-sized sites are rarely available for commercial development. In January 2003, the company took over a department store space that Macy's West had abandoned in 1998 and opened a three-floor, 150,000-square-foot store at the 850,000-square-foot Baldwin Hills Crenshaw Plaza in central Los Angeles. Wal-Mart has run television and print ads that prominently feature the positive impact of this project on a community that was starving for affordable retail.

In order for the multi-level store to work, Wal-Mart had to install a special escalator/conveyor system that accommodates the oversized shopping carts that enable its customers to purchase many items at one time. Looking very much like side-by-side escalators, the escalator and cart-conveyor combination moves shoppers and their carts between floors along parallel tracks. The cart-conveyor system, long popular in Europe, where retailers have long been dealing with space limitations, is now used on a regular basis by Wal-Mart, Target, and other big box retailers. The escalator can move up to eight hundred carts an hour from floor to floor and is set up to electronically prevent carts from being taken away from the site. Many observers believe the system will help revive retail in similar urban centers because the technology allows the big boxes to be built to the right size to generate profits. At the Baldwin Hills Wal-Mart, the heaviest merchandise is displayed closest to the escalators, for the convenience of the customers.

These kinds of accommodations have become de rigueur for big-box retailers, which were loath to deviate from their standard store formats. Even as recently as the late 1990s, they were apt to make non-negotiable demands: single-level store (possibly out of scale with the neighborhood), massive parking lots, etc. These days, because of zoning regulations, pressure from neighborhood groups, and competition for sites among other retailers, big-box stores have been willing to make compromises. Their challenge is to shrink stores without shrinking sales by "editing" the store's merchandise mix and customizing it to local tastes.

What is happening in South Central Los Angeles is being played out in many other parts of the country, where urban areas are being revitalized by category killers and other big-box retailers looking for new places to expand. In Stamford, Connecticut, in 2003, Target broke ground on a 164,000-square-foot store on Broad Street, joining Burlington Coat Factory, Wal-Mart, and Sam's Club, which were helping to fill a 4.2-acre, fifteen-block parcel of land at the corner of Greyrock Place and Tresser Boulevard; the site had stood vacant for two decades, and had been called by locals, "the hole in the ground." When completed, the retail space will be complemented by the construction of 550 apartment units at Stamford Place. Wal-Mart is building a 150,000-square-foot Sam's Club warehouse store in the basement of the building, while the seventh floor will be occupied by a 150,000-squarefoot Wal-Mart SuperCenter.

Not surprisingly, bookstores are sought after by developers because they attract a better-educated, more affluent customer; and the in-store cafes, meeting rooms, and author readings and other events are the ingredients for a physical center for a neighborhood's literary, social, and political interests. Borders Books is helping to revitalize parts of urban neighborhoods in Detroit and Chicago that have been underserved by

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major retailers. In November 2003, Borders opened an eight-thousand-square-foot store in the center of downtown Detroit at the Compuware Corporation's new 1.1-million-square-foot world headquarters building, the first meaningful retail development since the construction of the riverfront Renaissance Center in the 1970s. Borders is the anchor for about sixty thousand square feet of retail space at the corner of Woodward Avenue and Monroe Street, once the center of the city's retail core; in another era the location was anchored by the flagship of the J. L. Hudson Company department store, which, before it was closed in the 1980s and then demolished in the 1990s, filled a square block just north of where the Compuware Building stands now. In Chicago, Borders is the primary retail anchor for a mixed-use retail and residential project on the North Side. The complex, called Uptown Square, is intended to gentrify a run-down part of town. Borders occupies twenty-five thousand square feet of the total forty thousand square feet of retail space. Again, big retailers are faced with a growth imperative. In order to achieve that growth, retailers and developers are becoming as creative as they can. Even as they search for expansion in domestic locations, they also know that they must take advantage of opportunities outside the United States. International growth is a much bigger challenge, but it cannot be avoided. Reprinted by permission of Harvard Business School Press. Excerpted from Category Killers: The Retail Revolution and Its Impact on Consumer Culture by Robert Spector. Copyright 2005 by Robert Spector. All rights reserved.

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