Three's A Crowd — The Latest Merger Wave Signals A Change In Retail Dynamics

The recent merger of Staples and Office Depot illustrates the continuing changes taking place in retail dynamics. Specifically, it demonstrates two major strategic changes within the retail business:

- **Consolidation on a grand scale.** *Unusual because of its size (the number one and two companies combining), it also sends a powerful signal that three (or more) category killers will not be able to profitably compete in the same marketplace. Most mergers involve a large company swallowing up a considerably smaller one or acquiring a company that was destined for trouble. In this case, both companies were healthy and growing.*

- **Shortening of the retail lifecycle.** *It is also part of an ongoing confirmation that retail lifecycles are shortening. The office products superstore concept, pioneered by Staples a mere 10 years ago, is already experiencing its consolidation phase and is heading towards maturity. Where retail development once enjoyed a 20- to 30-year period from inception to maturity, the timeline has been drastically altered thanks to mass communications, venture capital and the vast resources available from public markets.*

The retail marketplace has experienced a rude awakening during the past several years. Growth for growth's sake no longer works. There is currently too much retail space per capita and not enough demand to support all the growth planned for by retailers. Something has to give, whether it be less profitable companies, more Chapter 11s, or, in the most recent case, more mergers that provide synergy.

The office products category is a case in point. With all three major companies (OfficeMax, Office Depot and Staples) growing at an explosive rate (unit growth of over 70 per chain planned, with bigger-sized stores in the works), it was only a matter of time until all the major players landed in the same market.

Usually in such situations there is an obviously weaker player who would lose the battle. In this instance, all three companies are financially strong, exceptionally well run and certainly not distinct enough in the customer's mind to determine a real victor. The only outcome would have been a long, drawn-out battle with all companies losing on the profit side. Hence, a merger makes a lot of sense, despite its magnitude.

It is fairly easy to point to other retail segments and predict much of the same. Best Buy and Circuit City in consumer electronics, CompUSA and Computer City in computers, Barnes & Noble and Borders in books, Home Depot and Lowe's in home improvement, etc. The drug store industry is looking at a boat full of potential acquisitions. Can other industries (discount stores, sporting goods, home stores, etc.) be far behind?

Given consumer time poverty, there is no longer room for the player with the third- or fourth-best market share in a category. They fall off the map in terms of share of mind and will find difficulty competing for an essentially stable market as the big players continue to get bigger. While this is not news in itself, there is news in the strategic way to approach the problem. As the business matures, we expect to see more examples of mega-mergers like Staples and Office Depot.

While you mull that scenario over, consider the following: Can these niches even support two players? As the categories chosen to kill get smaller, can we even support two major players in the same market? PETsMART is standing alone in the pet supply business in many markets and Toys "R" Us pushed out its big box competitors. But, even without direct competition, these companies have plenty of competitors to worry about that attack them in a different way. Nature abhors a vacuum, and so does retail.

Late breaking news: Toys "R" Us' acquisition of Baby Superstore hits upon this last point squarely. Remember, you read about Babies "R" Us here last month.

RETAIL WATCH

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