
EST Retailing: How To Stay Out Of The Black Hole

By Norman H. McMillan

Why do some stores win big, while others, which appear to be dead ringers down to the last detail, fall flat on their faces? Another way to say it, “How do you tell the winners from all the look-alike losers?”

Here is the real question, “How do customers pick and choose, how do they go about the business of picking one store over another and making it a winner, leaving behind the lesser stores and thus making them losers?” These are the key questions retail management asks anxiously as it pours cash into new prototypes. It is the key question investors, and all those who finance retailers, ask as well.

These simple questions have been around a long time, but they obviously still beg for better answers, or fewer retail companies would be stumbling so noticeably in the development of new store prototypes.

There is a way to get an answer, of course. You build a test store, correct and improve, then follow up with a few more stores, then you add more, and wait for the customers to storm the doors, and the cash to roll in. The trouble is, it costs so much if the management is wrong, and they ARE wrong a great deal of the time. (We think the five-year success rate for new stores is less than 25 percent.)

What is needed is a better system for predicting success prior to spending the big dollars. We are proposing here a theory based on history: witnessing and learning from the failures, and

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also from some notable successes with new stores over the past 20 years.

EST Theory

The search for answers began about five years ago as we attempted to understand and rationalize the operating results of supermarket chains. We had noted that only a few chains achieved pre-tax operating profits in the five percent neighborhood. And, we wanted to know what made them so exceptional. In our attempts to figure out the key to the extraordinary results of these chains, we were disappointed to learn there was no single key to the puzzle. There were many ways to win with customers and then go on to win on the profit line. And a lot of ways to lose, too.

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Supermarket companies have long divided their industry into two segments: upscale stores, and the much larger segment, stores that attracted customers with low prices. But this simple division of the market did not begin to explain the success of the supermarket chains we found in the group of five percent profit producers.

The search for insights that began with supermarkets quickly broadened to encompass other kinds of retailing. So, what we are reporting on here is a theory based on observable customer behavior that we believe applies in all kinds of retailing.

We now believe there are at least four ways to win with customers, and here they are:

- You can win if your store offers the cheapest prices. No surprises here. This is the weapon all retailers understand. Some readers will want to reject the use of the word “cheap,” but we urge you not to do so. “Cheap” is the word consumers use, so you should get comfortable with it.
- You can win if your store offers the biggest assortment. “Biggest” does not refer to the store’s footprint as measured in square feet; it refers to assortment size — the number of items you carry in a specific category compared to other stores customers visit.
- You can win if your store is easiest to shop. Here we are looking squarely at the urgent need customers express to get in, get what they need, and get out fast. Anything you can do to help that process along is moving in the direction of EASY-EST. This means every aspect of what is labeled “convenience.”
- You can win if your store is HOT-EST; that is, has the most wanted merchandise, the most fashionable items. HOT-EST applies to every single merchandise category, including hardware and food. It does not apply just to apparel.

“EST” derives from the word “best,” and there are four ways to be best, four ways to win with customers.

And here it is pictorially:

Figure 1

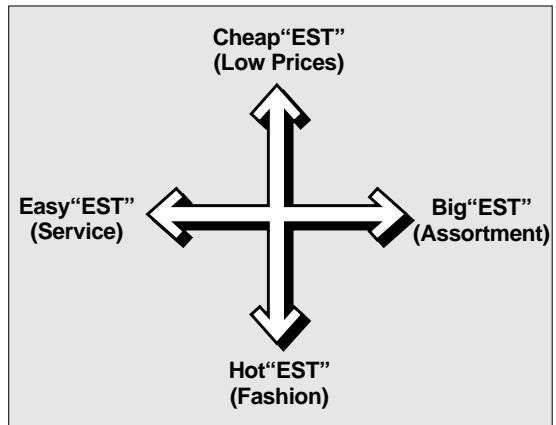
- | | |
|---------------|----------------|
| • Cheap “EST” | (price) |
| • Big “EST” | (selection) |
| • Easy “EST” | (easy to shop) |
| • Hot “EST” | (fashion) |

Rules of Thumb

Contained here are the first two important rules of thumb:

- **FIRST** — Profit success begins with customers. You can’t get there if you do not place solving customers’ problems at the top of the list. This is probably the rule that is most abused in the process of developing new stores. Retailers who are developing new prototypes or formats are generally trying to solve a problem **THEY** have. It doesn’t work. To solve your problems, you have to solve a problem for customers first. That is the beginning rule: figure out customers’

Figure 2: The EST Quadrants



needs, THEN figure out how you can address them better than anyone else.

- **SECOND** — You can’t make it to the top of the profit list unless you are seen as clearly and obviously **THE BEST** at something. In a market that contains many shopping alternatives (the universal case in all merchandise categories, everywhere in the country), if you are seen by customers as being only “pretty good,” your long-term future is murky and doubtful. You have to be best at something to be secure. Better yet is being best at a couple of “somethings.”

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When we read the research of retail companies and when we talk to customers directly, we notice that customers focus on different subjects than managers. Customers talk about merchandise; they talk about price; they talk about products they can’t find; they talk about hot items (fashion); and they talk about the difficulties, or about how easy it is to shop particular stores. In sharp contrast, retailers think about and talk about square footage, fixtures, and formats. And that leads to the third rule of thumb:

- **THIRD** — When developing a new store, about 75 percent of your planning time and energy should be aimed at the things customers are concerned with — the merchandise, the price, being in-stock, fashion, and the whole shopping experience. **THEIR** needs, **THEIR** problems, not yours. If you spend more than 25 percent of your planning time on the company’s problems,

you've got it backwards, and maybe now you have discovered a problem you did not know you had!

In Figure 3, we have drawn a big circle that represents the arena where most stores operate. As customers view them, most are undifferentiated in any meaningful way. They are good enough and competent enough to have survived, but they are not good enough to get their heads up and out of the pack. Most supermarkets are in this circle, as are most department stores, most discount stores, and most mass merchandisers. Most stores, period.

“They are good enough and competent enough to have survived, but they are not good enough to get their heads up and out of the pack.”

The little arrows that stick out of the circle are the stores that customers regard as great, the best in some important way. These are the “EST” retailers.

“Pretty Good”: Words To Dread

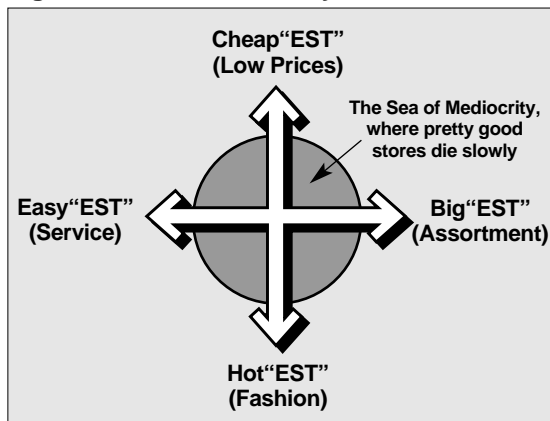
Now, if you are not an “EST” retailer, then what are you? How do customers rate you? Most customers use the words “pretty good” to describe unexceptional stores. These are the words we have learned to dread. They sound vaguely reassuring, but carry with them a whole different, and negative, meaning.

“The word ‘mediocrity’ also applies. We interpret that to mean you are in the process of dying. Dying slowly, but dying. You need to start the process of renewal.”

We are saying in this diagram that if your store is rated as only “pretty good” on all characteristics, that means customers have better choices and will sooner or later find them. From the customers’ perspective, you are in the great sea of “mediumness.” The word “mediocrity” also applies. We interpret that to mean you are in the process of dying. Dying slowly, but dying. You need to start the process of renewal. Your customers are telling you that small adjustments to the current strategy probably won’t get you where you need to be.

Marginal improvements will still leave you in the sea of mediocrity, unless you can figure out how to win on at least one of the “EST” directions.

Figure 3: Sea of Mediocrity



First Step Toward “EST”

The process of becoming an “EST” retailer is an arduous one:

- Recognition of where you really are is where you must start — in the arena with a lot of competitors whose stores are not noticeably different from your own, as viewed by customers. This is why most of our projects begin with what we call a “strategic audit.” We want to start the planning process on the bedrock of reality.
- Then you must understand what your company is good at, and bad at, too. This means studying your own core competencies. A company with high break evens, for example, should not pursue being the CHEAP-EST. It probably isn’t in the cards.
- You must then choose one of the “EST” directions where you intend to excel, where you are going to become the best. This is going to become the key plank in your company’s strategy, the strength customers are going to recognize you for and talk about to other customers.
- You then commit to a plan of many actions, which, if you stick to it and are disciplined enough, is going to get you out of the arena occupied by all of the other “pretty good” stores.

It isn’t easy. It starts with a total commitment to excellence, as the consumer defines excellence, and ends with your company being a top profit

producer. In between is an enormous amount of hard and smart work.

Don't Try To Be Four-EST

Now, the fourth rule of "EST" retailing:

- FOURTH — You cannot be the best on all four directions. Some of the directions are in serious conflict. Occasionally we have had retail chieftains respond by declaring, "We're going to be the best at all..." Don't even think about it. By definition, if you head off in all four directions you will wind up in the middle, the BLACK HOLE, the place where mediocre stores eventually die and disappear. So, pick one direction. You will win. Guaranteed. Pick one more, where you intend to be damn good.

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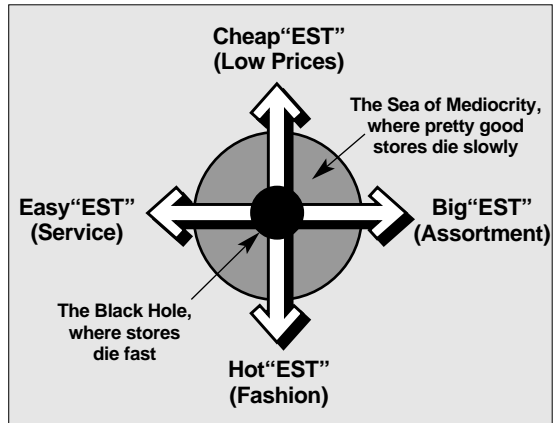
A little more on the matter of going off in too many directions. We can think of only one retailer who we believe has "EST" status on three directions, and that is Nordstrom. We can think of only a handful who win on two: Harry's in Atlanta, Larry's in Seattle, Home Depot, and Toys "R" Us.

Beware The Black Hole

In Figure 4, which follows, we have plugged in the final and concluding step, THE BLACK HOLE. This is where chains of stores, even multi-billion dollar chains, go because they don't get it right with customers in some significant way. They are not the best at anything; they are not particularly hated, nor are they loved by their customers. Mostly they are just ignored. The one way they sometimes get a favorable mention is on location. These are the stores that show up in research data as "convenient" when customers are asked why they shop there. A more brutal way to say that is, these are the stores customers shop when they lack the energy to go to a store they really prefer!

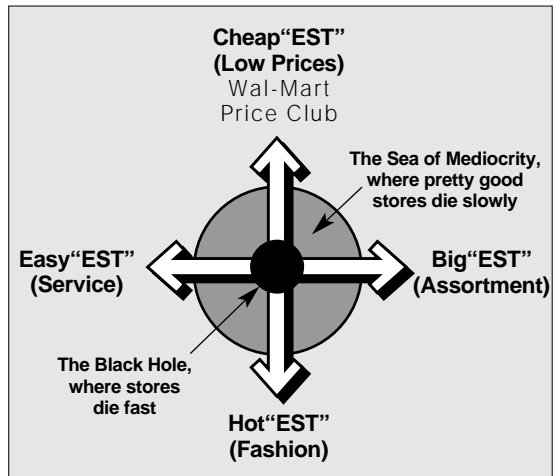
Locational convenience is a very fragile base on which to build your company's future, or to bet the stockholders' investment. The Black Hole is where chains meet their maker. Sometimes they come back, but not often. Don't count on it.

Figure 4: The Black Hole



With the "EST" theory explained and behind us, we will now take a look at a few examples of retailers who illustrate the idea that you can win with customers by being the best, pursuing any one of the four directions. In this first illustration, we are looking at CHEAP-EST.

Figure 5: CHEAP-EST



Wal-Mart and Price Club are excellent examples of chains who have positioned themselves as having cheap prices. They are the places to go for low prices.

- Wal-Mart is now the largest retailer in the world, and is continuing to grow at a rate of 20 to 25 percent per year. They will have a sales increase in 1993 that is bigger than most retail companies' total sales. While there are many things Wal-Mart does well, they clearly win by having the lowest prices for customers, day in and day out. They achieve this by having the lowest costs, utilizing superior technology, and keeping a tight lid on expenses.

- Price Club (now merged with Costco) is the pioneer of the membership warehouse club industry, which has been a phenomenon in U.S. retailing. It is now a \$30 billion plus industry.
 - The clubs are true warehouses, operating on extremely low margins. They appeal to small business users and heavy-duty consumers, charging a membership fee to get in.
 - The Price Club has average store sales over \$100 million and operates with a gross margin of under 10 percent!
 - It offers best sellers, and carries very small assortments.
 - It also has lots of surprises, selling everything from fur coats to juke boxes to Yamaha pianos.

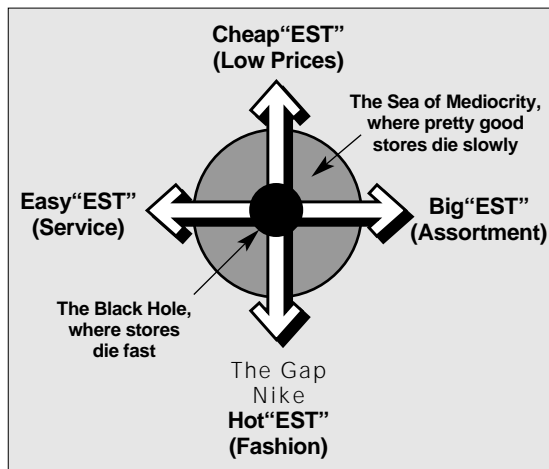
These are well-known retailers whose sales figures make the point that stores who achieve fame as CHEAP-EST in their categories win big with customers.

Winners of the '80s

"EST" Category:	Sales (Billions \$)		
	1980	1990	1992
<i>CHEAP-EST</i>			
Price Club	\$0.2	\$ 5.4	\$ 7.5
Costco	0.1	4.1	6.5
Wal-Mart	1.6	32.6	55.0

The second category we will look at is HOT-EST, where we look at retailers who win with fashion.

Figure 6: HOT-EST



When we speak about fashion, we are not talking about the latest designs from Paris or Milan. We define fashion to mean the following:

- Having the right items just as customers begin to buy them in volume.

Fashion, then, is all about having the right stuff. And having it in stock in enough depth so customers can get what they want, and the store can achieve sales in volume. In most retail categories, fashion is the great energizer of sales.

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The Gap, which sells basic apparel, is a fashion store. It has the right colors, the right styles, and the right look for the U.S. today. There’s even a Baby Gap!

Nike Town is one of the great fashion stores we’ve seen. Its store on Michigan Avenue in Chicago makes it very clear: Nike sells sportswear fashion in every dimension — color, design, sights, sounds, and feel.

- There are 14 different rooms, each dedicated to a specific sport.
- There is continual change, an integrated sense of style.
- It is also wonderfully fun. Fashion merchants sell change, excitement.

Fashion Leaders Among Supermarkets

Supermarkets have probably been the slowest segment of retailing to respond to their customers with the products they find fashionable, but this is now changing rapidly. The stores who responded early have been winning big as fashion leaders in their markets: Larry’s in Seattle, Bristol Farms, Mrs. Gooch’s, Pavilions in Southern California, Harry’s in Atlanta, Wegmans in northern New York, and Ukrop’s in Richmond. These are the supermarkets who have been winning by being on top of all the trends in the food business, the stores customers turn to because they are the HOT-EST.

We do not have the sales figures on most of the stores mentioned because they are private. We will look at the figures on some of the other retailers who win by pursuing fashion as their “EST.”

Retailers in all segments can win by owning the HOT-EST position. We think Target is a good example from the discount stores. They beat out both Wal-Mart and Kmart by having the latest fashions (throughout the store) first.

Winners of the '80s

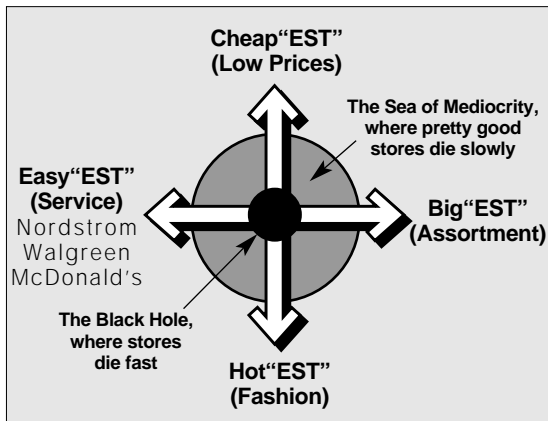
"EST" Category:	Sales (Billions \$)		
	1980	1990	1992
<i>HOT-EST</i>			
Gap	\$0.4	\$ 1.9	\$ 3.0
Nike	N/A	2.2	3.4
Target	1.8	8.2	10.4

When we speak of being the EASY-EST, we are talking about all of the elements of convenience. How close is your store to the customer's house? How easy is it to park? How easy is it to get information on the products I want to buy? How easy is it to traverse the store? How easy (or hard) is it to get through the side stack bottlenecks the store built in? Does the store run out of the stuff I came for? How long are the waits at the register? These are the elements that add up to a short and productive trip for the customer, or a long and frustrating one. Chief among these, of course, is having the products customers are looking for.

"These are the elements that add up to a short and productive trip for the customer, or a long and frustrating one."

Now here are a few winners in the Easy "EST" direction.

Figure 7: EASY-EST



- Nordstrom is the retailer we mentioned earlier who probably wins on three "EST" directions. They win on EASY-EST with an absolute commitment to sizes, with the simplest return policies in the business, and the best person-to-person service in the business.
- Walgreen is the largest drugstore chain in the U.S. Much of their business is in prescription drugs. All of their stores are linked together by computer, and many are open 24 hours. They are the number one or two market share leader in every market they are in. They are even experimenting with drive-thrus. We think they win on easiest.

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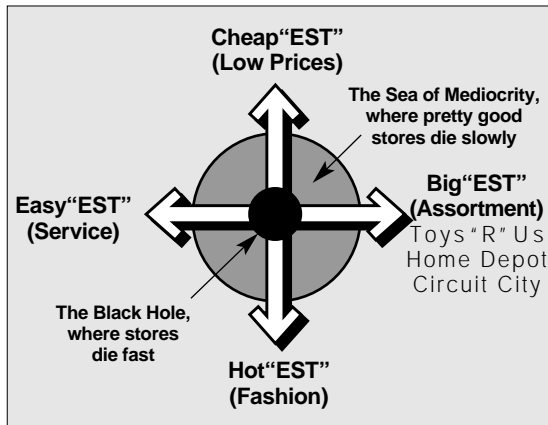
- McDonald's built a chain of 12,000 locations by being the easiest. Consistent food delivered fast. Almost half of their business is in drive-thrus. Domino's has taken this one step further — guaranteed home delivery in 30 minutes or less.
- Publix Supermarkets has built their reputation and wins on wide aisles, clean, well-lit stores, superior in-stock position, and no-line waits. All of these are examples of being EASY-EST to customers.

Winners of the '80s

"EST" Category:	Sales (Billions \$)		
	1980	1990	1992
<i>EASY-EST</i>			
Nordstrom	\$0.4	\$ 2.9	\$ 3.4
Walgreen	1.4	6.1	7.5
McDonald's	6.2	18.8	21.9

Finally, we talk about retailers who win by being the BIG-EST. They have the biggest assortments, the most selection for the customers to look over before choosing. We are very careful to talk about biggest selections in specific categories of merchandise, not just the biggest stores. Big stores often have poor assortments, and get to be big by having many categories, none (in the consumers' eyes) of which is very good. What counts to the consumer is being able to see a lot of assortment in the category that interests her.

Figure 8: BIG-EST



These stores are also known as Category Killers. They are so good, so dominantly assorted in the merchandise categories they carry, that competitors look incomplete — puny by comparison — to customers. So, from the standpoint of competitors, they are “category killers.”

The best example to cite is probably Toys “R” Us. They have taken the toy business and completely dominated it with overpowering assortments. They do it in each subsection of toys. Nobody beats Toys “R” Us, and customers know it.

“Nobody beats Toys “R” Us, and customers know it.”

Home Depot follows the same principles in the home improvement category: Big assortments, good prices, surprising levels of service. In fact, they excel at more than one “EST.” If you can do that profitably, there is potential for a big win.

Circuit City does essentially the same thing in home electronics, and also wins big.

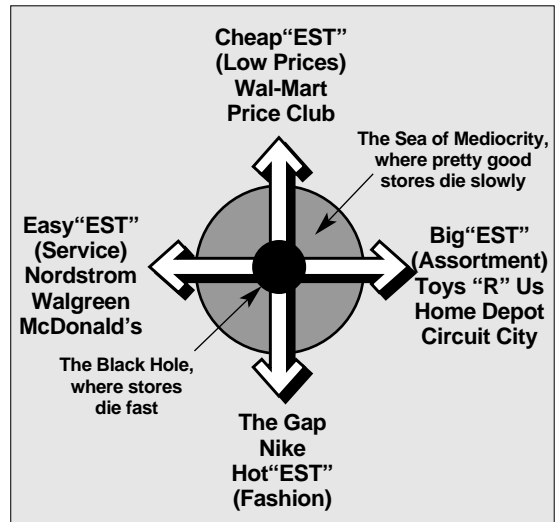
The successes of the biggest stores, the category killers, have been phenomenal as shown below.

Winners of the '80s

“EST” Category:	Sales (Billions \$)		
	1980	1990	1992
<i>BIG-EST</i>			
Toys “R” Us	\$ 0.6	\$ 5.5	\$ 7.2
Circuit City	0.2	2.4	3.3
Home Depot	0.02	3.8	7.1

Now here is a final look at the “EST” model.

Figure 9: The EST Model



Many retailers want to win all of the “EST”s. However, some of the “EST”s are in conflict with each other. It is hard to be the hottest, the cheapest, the biggest, and the easiest, all at once. It is probably impossible. Yet, many retailers try.

Be Best At Something

That leads to the fifth and summary Rule of Thumb.

- FIFTH. Figure out your customers’ specific needs, pick out an “EST” direction built on these needs and the strengths of your organization, and build the plan in detail that will get you there. Do not under any circumstance yield to the temptation to pursue all of the “EST” directions. Or, for that matter, think that you can solve all customers’ needs. The message is get good at something, become the best, but don’t think you can do it all.

“It is hard to be the hottest, the cheapest, the biggest, and the easiest, all at once.”

Managers who try it end up in the middle because they’re not great at anything. Keep in mind that the “middle” is the address of the Black Hole.

Our message is simple — develop and own an “EST” positioning, and stay out of The Black Hole!