RETAIL WATCH™

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In this issue...

25 Years of Retail Watching

In July of 1986, McMillanDoolittle opened its doors at 240 East Ontario Street in Chicago, signaling the official physical opening of a boutique retail consulting firm.

To say that a lot has changed in retailing during the last 25 years would be an understatement: some of the major forces that shape the retail environment today didn't even exist then, from the emergence of Walmart Supercenter as the world's largest retail format to the advent of e-commerce, which is actively reinventing retailing today as we write.

This brief piece, which is long on history, is designed to provide a mildly indulgent look back at our business and a bit more strategic look at the changes in retail during the past quarter century as well as a brief look forward at what we might expect to see during the next 25 years.

We've had a front row seat analyzing and, (in a small way) helping to shape retail history. We have had some wonderful successes with our clients, and we learned from those successes; we have also had some failures along the way, and learned from those as well. We've never minced words, sometimes to the detriment of a client relationship and certainly to some bruised feelings. And long ago, we adopted an informal motto: "Occasionally wrong, but never in doubt!"

Enjoy the ride-we certainly have!

A Brief History of McMillanDoolittle

Norm McMillan and Sid Doolittle first worked together in the late 1970s, when Norm took the assignment of leading one of many turnaround efforts at Montgomery Ward & Co. Sid, a veteran of Chicago-based Wards, was part of the team. In the span of four decades, Wards had gone from being one of the nation's largest merchants to being a retailer in desperate need of a turnaround. Part of Norm and Sid's mission was to survey the retail landscape, and figure out what separated the winners from losers.

The two men brought different skills to the job. Norm began his career in advertising, and then cut his retailing teeth developing a strategy for a struggling discount chain called Target. Before joining Wards, Norm led a team in the mid-'70s that articulated a new mission and vision for Target-the "upscale" discounter. The result was a strategy the retailer hasn't strayed from yet - and it's grown from being a struggling unit of a department store company to becoming one of the leading US retailers. Sid had spent his entire career with Wards. He ran merchandising, buying and catalog operations, and also participated in long-term strategic planning. The two men shared a passion for retail stores and retail customers. Norm was proficient with the then-unnamed concepts of positioning and branding, and what those things meant for retailers. Sid knew the day-in, day-out of retail, and understood how to make stores and catalogs run smoothly and profitably.

Norm's efforts at Wards were short-lived. Wards rallied a little, as it would do numerous times before finally closing down in early 2001. Sid left Wards in 1981 to become a retail entrepreneur. He co-founded a regional chain in the nascent warehouse club industry. Norm went on to help position retailers owned by a company called Household Merchandising, including such wellknown stores as Vons supermarkets and Coast-to-Coast hardware stores. The two men re-united for a brief time at Household, before they set out on their own in 1986. Armed with their massive file cabinets that tracked retail's winners and losers, a huge slide database of best (and worst) practice retail examples, the two men formed McMillan|Doolittle LLP, a retail consulting firm.

Norm McMillan & Sid Doolittle

1986

Peak of the Mass Merchant Era: Everything for Everybody Dominates Rankings

We had to comb through our physical files to develop a top 10 retailers list beginning in 1986. It gets a little easier to track as the years go by.

Looking at this list, a few immediate observations struck us:

· *There remained a real "category" classification system in 1986. Most retailers were divvied up by store type-discounters, general merchants, department stores, supermarkets, etc. And clearly, these were the chains that dominated the early top 10 list. And, no surprise that Sears led the list-many forget that for a lengthy time, Sears was even a more dominant retail force in the U.S. than Walmart is today, accounting for a greater portion of overall retail sales.*

· *Category killers were not on the top 10 list. We found Toys R Us at number 39 and Lowe's at number 42. Where were they? Many were just getting started at this point, including all three office concepts (Staples, Office Depot and Office Max). Other notable debuts in 1986 included Dollar Tree and many, like Costco and Whole Foods debuted just a few years earlier.*

· *We will comment later on the obvious changes that occurred over the past 25 years but consolidation and bankruptcies have always played a major role in the retail landscape. Retailing in the '80's was still very much a regional phenomenon with the exception of Sears and JC Penney. Prominent names in the top 50 list that are no more included Woolworth (14), Zayre (18), Montgomery Ward (23), Carter Hawley Hale (24), Grand Union (30), Revco (31), Wickes (35), Service Merchandise (37), Best Products (44) and Ames (46).*

Top Retailers - 1986

Retailer	Sales
1. Sears	$27 billion
2. Kmart	$23.8
3. Safeway	$20.0
4. Kroger	$17.0
5. American Stores	$14.0
6. JC Penney	$13.9
7. Wal-Mart	$12.0
8. Federated Department Stores	$10.5
9. May Department Stores	$10.3
10. Dayton Hudson (includes Target)	$9.2

Source: Forbes

What We Were Working On

At McMillanDoolittle, we began our business working on some key accounts that would remain important clients for nearly a decade:

· *Vons Supermarkets, where we worked on pioneering new concepts like Pavilions (one of the first upscale supermarkets)* *and Tianguis (the first Hispanic supermarket from a mainstream chain).*

· *Staples, which had two stores when we began working with this upstart chain on productivity enhancements and later, on their urban store strategy.*

We also did work for a few chains that joined the historical footnotes above. Montgomery Ward became a client and enjoyed a brief renaissance with a strategy that developed specialized approaches in historically strong categories like electronics and automotive. F&M Distributors was one of the leaders in a now largely defunct segment-deep discount drug stores (Phar Mor, anyone?). And, we worked on strategic planning for Otasco (Oklahoma Tire and Supply Company), which had automotive and general merchandise stores in small town America. Their strategy? Avoid places where Walmart was going. We don't think you need a lot more explanation as to how that turned out.

The Origins of *Retail Watch*

One of the early projects at McMillanDoolittle was to read every major retail publication and then summarize the headlines for our clients (yes, the Internet has made a slight change in the transmission of information). We would dutifully publish NewsBriefs monthly. Shortly into this process, we began to add a small editorial section to this publication, focusing on a new store that we had seen and giving a critical analysis. After six months or so, clients began to tell us that they weren't reading our clippings but really enjoyed the feature on the "store of the month". *Retail Watch* was officially born in 1987. Over the next twenty plus years, *Retail Watch* has covered every significant concept innovation in retailing, always with a critical eye. It became the go-to source for concept tracking.

After almost 25 years (and 1,600+ articles) *Retail Watch* represents, to our knowledge, an unparalleled body of work about retail stores - particularly new concepts and prototypes for established retailers. When we write about stores, we focus on the retailer's strategy and positioning. We also look for basic execution, but most importantly, we watch customers to get a sense of store performance. We're like the art critic who explains how he can tell whether a painting is good or not by saying: "When you've seen 50,000 paintings, you know whether the 50,001st is any good."

What did we begin to see during this period of time?

· *1988 signaled the introduction of European style hypermarkets into the U.S. We reported on the struggles of Carrefour (Philadelphia) and Auchan (Houston, Chicago) as they failed to adapt their formats to the U.S. market. Of course, U.S. retailers didn't fare too well either. Remember American Fare (the joint venture of Kmart and Bruno's) and Hypermart USA, Walmart's first large store attempt? We do, as we chronicled these historic events.*

· *In April 1988, we wrote a prescient* Retail Watch *headline called "We may have seen the future and we're impressed". The store? The first Walmart Supercenter in Washington, Missouri, which has certainly altered the retail landscape. We actually visited this store with a client of ours at that time, Target. Their reaction was something to the extent of "we'll never add food to our stores". While they changed direction a decade later, who knows how much further retail would have been altered had they seen the store the way we did.*

· *We always tracked the Clubs, with Price Club being the industry leader at the time. Our first Costco article in 1988 concerned the addition of a scratch bakery, one of the many game changers that transformed the Club business.*

· *Other late '80's articles of interest: Nordstrom and the Power of Customer Service; Bed Bath & Beyond-Can it Make Money? (yes, as it turns out…); Container Store-The Industry Standard; and in early '90, Best Buy's Generation II store in Rockford that ultimately revolutionized consumer electronics (non-commissioned sales people, media in store, etc.)*

· *We've always had a retail vision broader than the U.S., making multiple trips annually overseas. In 1990, we reported on a new Tesco in the U.K. and entitled the article "Worth the Price of the Ticket". Value-added premium private label and meal solutions were all well advanced in the U.K., even 20 years ago.*

The formative years of McMillanDoolittle provided many glimpses of what was soon to be a sea change in retail.

1996

The Emergence of Walmart and the Transformation of Food Retailing

In 1996, Bill Clinton was President and the country was experiencing another bout of economic prosperity. As far as retail goes, what a difference a decade makes.

Top Retailers - 1996

Retailer	Sales
1. Wal-Mart	$93.6 billion
2. Sears	$35.2
3. Kmart	$34.6
4. Kroger	$23.9
5. Dayton Hudson	$23.5
6. JC Penney	$21.4
7. American Stores	$18.3
8. Costco	$18.2
9. Safeway	$16.9
10.Home Depot	$15.5
11. Federated	$15.0
12. Albertsons	$12.6
13. May Department Stores	$12.2
14. Winn Dixie	$11.8
15. CVS	$11.5
16. Walgreen	$10.4

Source: Forbes

Something did happen that profoundly changed the retail environment. That Walmart Supercenter turned out to be a pretty good idea after all, and it changed the face of retailing in a very significant way:

· *Walmart's growth remains unprecedented in retailing. The formula for growth dwarfed all other retailers and forced change in both the general merchandise and supermarket retailing industries. Or, as it turns out, it pressured these companies to change and they couldn't do it fast enough. Kmart embarked on an ambitious diversification program, at one time owning Pace Membership Wholesale, Builders Square, Sports Authority, Office Max, Borders, etc. Not a bad idea except that they never fixed the core retail business or made the transformation to food like Walmart.*

· *Supermarkets remained a regional phenomenon. Major deals occurred around 1998, with various mergers and buyouts happening among the major chains. But the scale differential in size against Walmart was never really narrowed as these chains still operated (perhaps necessarily) with a regional mindset.*

· *The first category killer, Home Depot, makes the top 10 list. Their meteoric growth was nearly as impressive as Walmart's and category killers began to dominate a more diverse retail scene. Office supplies, sporting goods, home improvement, consumer electronics joined the parade of category killers who systematically siphoned business away from general merchandisers and department stores.*

What We Were Working On

- *Sears was still a formidable retail force and our work with their Brand Central team actually enabled significant market share gains in appliances (nearing 40% of the business at its peak) even as the whole house struggled. The Softer Side of Sears did buy the company time and a brief resurgence.*

- *We continued to work with some of the best regional supermarkets in the country, including format and strategy work with Publix, helping that chain expand outside the state of Florida for the first time. They remain today one of the top supermarket chains in the country as well as one of the best managed and operated retailers.*

- *The convergence of food and foodservice had begun in earnest, as did a nearly twenty year relationship with McDonald's. Our work with that company has touched everything from menu to format to service innovation.*

- *We began to broaden our definition of retailing, working extensively with General Motors on reinventing the dealer network and tackling one of the most change resistance retail categories-automotive retailing.*

- *We also continued our work at transforming another industry-convenience, with (at the time) groundbreaking work first with Amoco (and the development of Split Second) and later with ChevronTexaco. While we tackled the core convenience store, we also had the opportunity to develop a brand new format, Foodini's, that tilted at the windmill of home meal replacement-a concept that still eludes retailers today.*

- *Internationally, we helped open the first hypermarket in Thailand and were one of the early members of Ebeltoft Group, which significantly strengthened our International reach. Today, Ebeltoft has 18 member companies in sixteen countries, giving us instant International reach and significant global expertise. While Ebeltoft was a novelty in 1990, today it is an essential part of our consulting practice.*

What We Were Writing About

- *1996 had us writing about several interesting new concepts of note, including CarMax (at the time, a fascinating diversion from Circuit City), Babies R Us (a closer in spin-off from Toys R Us) and Rooms To Go, which signaled a major change in the furniture segment.*

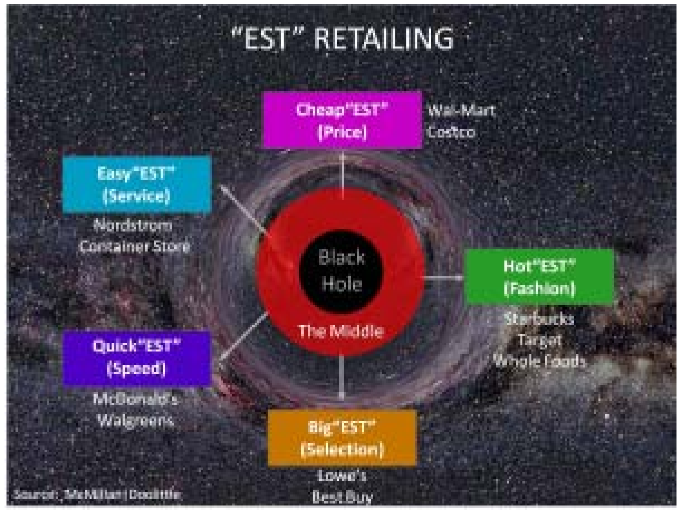
- *Eatertainment was all the rage, spurred on by the success of Hard Rock and Planet Hollywood. But, we also covered The All Star Sports Café, Harley Davidson Café, the Jekyll and Hyde Club, Rainforest Café and a favorite, The (oxymoronic) Fashion Café, started by waif thin supermodels-hard to believe it didn't work.*

- *Health care superstores emerged on the scene as boomers got older (and they're still getting older!). Take Good Care, MedMax, Centex Life Solutions-we were rightly skeptical. We did make (mostly) the right calls.*

- *We began a special annual edition on electronic shopping (we should have coined e-commerce but didn't). We wrote about Peapod in 1996 and did the first of many articles on Amazon in 1997. When e-commerce exploded, we covered it every inch of the way, culminating with our April 2000 article entitled Stop the Insanity, correctly predicting the Internet bubble bursting.*

The Origins of EST

The breakthrough for McMillanDoolittle was our drive to articulate retail success in a straightforward way and make sense of all the seemingly random changes we were witnessing on a daily basis in the retail world. Our goal was to simplify, rather than complicate. We worked hard to be plainspoken, and to come up with a better way of explaining things. Ultimately, that led to the development in the early '90s of what we call the "-Est Theory for Retail Success."

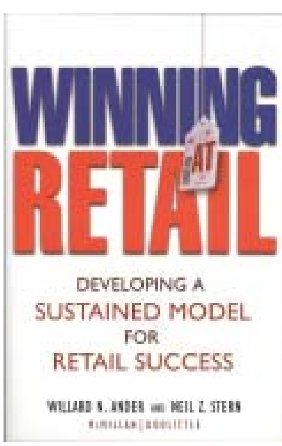


"EST Theory for Retail Success"

The EST Theory derives from the word "best," and essentially says that a retailer must be best at one proposition that's important to specific groups of customers. Retailers must strive for a specific positioning to a specific set of customers, rather than attempting to be great at everything to everybody. In order to accomplish this, it might mean targeting a specific customer at the exclusion of others, or giving up on merchandise categories that today might still be yielding profitable sales, or forgoing short-term growth and profits with an eye towards long-term success. These were heretical thoughts for most retailers at the time and are still concepts that most struggle with, even today.

EST originated through an analytical exercise where we systematically studied winning retailers (as defined by sales growth and profitability) to determine what made them tick. As we tried to discern the key attributes that made them successful, a rather startling pattern emerged. In those companies where we could discern a singular defining characteristic from a consumer perspective, we saw well-above average financial results, even among companies pursuing seemingly disparate aims. For those companies where we could not isolate any one defining reason for being, their results almost inevitably wound up somewhere in the middle of the pack. It became clear to us that being the "Best" with consumers also had a clear impact on the bottom line.

Do you really have to be "Best" to succeed? We are often asked that by our retail and service company clients who proudly show how "good" they are in many areas. As Jim Collins proclaimed in his book Good To Great, "Good is the enemy of great". We agree and take it one step further. "Pretty good" are words retailers should dread. Because if you are not an EST Retailer and you're still in business, that's probably how customers describe you: "Pretty good." That means you are mediocre. And that means customers have other stores they'd rather shop. Sooner or later (most likely sooner) they will find those stores or those stores will find them, and they won't come back to you. Today's time-starved shoppers don't frequent mediocre stores anymore.



Winning At Retail

EST formed a foundational piece of how we think about positioning (even today) and was the basis for our seminal book on retail strategy, Winning at Retail, which was published in 2004.

By 2006, the retail landscape began to take a similar shape as exists today:

· *Walmart was three times the size of its closest competitor, continuing its remarkable growth.*

· *Retailers across categories essentially became national forces, either through organic growth (Walgreens, Home Depot) or acquisition (Kroger, Safeway, CVS). The big got bigger-Sears was acquired by Kmart, etc. Discounters were nearly an unstoppable force and the department stores fell off the top 10 list-their total business dwarfed by value driven retailing.*

Top Retailers - 2006

Retailer	Sales
1. Wal-Mart	$226.3 billion
2. Home Depot	$90.8
3. Kroger	$66.1
4. Costco	$60.2
5. Target	$59.5
6. Sears Holdings	$53.0
7. Walgreen	$47.4
8. Lowe's	$46.9
9. CVS/Caremark	$43.8
10. Safeway	$40.2

Source: Forbes

· *Retail customer experience is now a common expression and buzzword. We were leaders in development of that in the late '90's and early 2000's with our 5 C's, which evolved into our 8 C's framework for assessing and developing a branded "just right for me" customer experience.*

· *Multi-channel retailing became the key watchword, as companies began to understand the huge impact of the internet on information, shopping and ultimately commerce.*

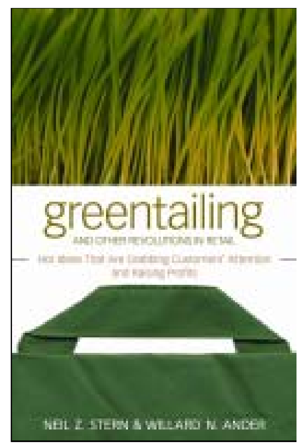
What We Were Working On

· *We branched out into services retailing in an even greater way, helping T-Mobile transform its retail business in the wireless business.*

· *We were on the forefront of brands exerting more influence on retail space, working with companies like Procter & Gamble, NFL, Nike and Intel.*

· *We greatly expanded the notion of retailers expanding beyond traditional brick and mortar, going where customers are...in hospitals, college campuses, cities and event venues.*

· *We went International in a big way, working with the largest Korean retailer (E-mart) in their strategy and private label development. We also created a formative piece on the future of European retailing for the Coca Cola Retail Research Council. This became a jumping off point for our second book,* Greentailing and Other Revolutions in Retail, *published in 2008.*



Greentailing

Today

The Evolution of Customer Centricity: The "Just Right for Me" Retail Experience

No surprises but we've come a long way since 1986. Walmart's US sales alone in 2010 are nearly double the entire sales of the top 10 list in 1986. The number 1 and 2 retailers from that time now comprise the combined entity Sears Holdings, with less sales in aggregate than they had 25 years ago.

Top Retailers - Today (2010)

Retailer	Sales
1. Wal-Mart	$260.3 billion
2. Kroger	$82.2
3. Costco	$77.9
4. Home Depot	$68.0
5. Walgreen	$67.4
6. Target	$67.4
7. CVS Caremark	$57.3
8. Best Buy	$49.7
9. Lowe's	$48.8
10. Sears Holdings	$43.3

Source: Forbes

The overall list is dominated now by discounters, drug stores, food and category killers, a considerably different composition than two decades ago.

The Future?

It certainly becomes a lot more interesting to begin to look ahead and imagine what a top retailer list might look like in 2020:

- *We will undoubtedly see Amazon on the list of top retailers as their meteoric growth and systemic advantages over brick and mortar retailers continues to amplify.*

- *Apple might be on the list as well, as they transform not just retailing but have begun to create a global mobile lifestyle.*

- *The way we interact with retailers is going to profoundly change as new commerce platforms (social, mobile, flash, crowd-sourced, group purchasing, etc.) proliferate. While brick and mortar is never going away, the role of the store and the omni-channel aspects of retail is going to continue to evolve. It will look downright revolutionary when we look back a decade from now.*

- *The list will undoubtedly be International, as global expansion, mergers and acquisitions truly make retail a global (as opposed to at best a multi-national) business today.*

- *The role of health in American lives as we age will also shift the landscape as pharmacy, wellness and home health will play a greater role in consumers lives and consume a bigger portion of their wallets.*

One thing we know for sure is that retailing will remain a dynamic and ever-changing business.

McMillanDoolittle's Point of View

From the beginning, McMillanDoolittle has had a few core principles. All come directly or indirectly from our founders.

- *We preach positioning, which we define as owning something in customers' minds. It also entails identifying specific customers, and delivering something meaningful to them that the competition isn't.*

- *Another core principle of our practice is the notion that retail is all about customers. From the beginning, we've worked with supermarkets, gas stations and department stores because we've always contended that customer behavior and trends remain constant, regardless of the retail format. Our customer focus also has allowed us to do work for companies that serve retailers, like consumer product manufacturers, advertising agencies, investment banks and real estate companies. No matter the client, our common sense approach to retail remained the same: Give customers more of what they want, and less of what they don't want.*

- *We are voracious students of global retailing. We are passionate about retail, passionate about stores and would match our knowledge of retail trends against anyone's. Why do we spend so much time in stores? That's where customers are!*

- *Finally, we strive to be honest and straightforward. We also keep things simple, and we tell it like it is. Our candor is a value to clients. It's also made us sought-after speakers and commentators on the retail industry, and made* Retail Watch *a popular publication.*

What we enjoy most about our place in retail is that we get to live in the thrill of the business' immediacy, while we also get to explore the strategies and positioning that's crucial for future success. We have the luxury of being able to look forward, while many of our retail clients do not. It provides us a unique perspective to try and bridge that gap, because we understand day-to-day retail issues, yet we also understand that stores must develop forward-looking strategies or risk not being around in the future.

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