The retail life cycle

Although it is an evolutionary process that cannot be counteracted, it provides retailers and suppliers with opportunities to sustain profits

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Retail executives know about the "wheel of retailing" concept, the notion of the "marketing mix," the product life cycle, the so-called consumer revolution, and a number of other theories and philosophies, all of which have proved helpful in understanding business success in retailing. The following article introduces a concept that may be more significant still to retailers and suppliers. This is the concept of an *institutional* life cycle in retailing, a predictable series of stages that every major form of retailing is destined to go through. After describing the theory of this cycle, the authors look at some of its practical implications, including the kinds of strategies and policies needed to sustain profits at each of the four stages. For both retailers and their suppliers, turbulence and uncertainty are going to continue for some time to come, the authors believe, but the retail life cycle can be a helpful tool for adapting successfully to change.

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For many years executives in manufacturing and retailing have sought to explain patterns of evolution among retail organizations and to forecast future retail innovations. Several meaningful efforts have been made to explain retail development, the most important being the "wheel of retailing" concept, originally advanced by Malcolm P. McNair.[1] In McNair's view new retailing concepts are oriented toward low costs and prices at first. Over time, the retail institution gradually trades up in terms of store decor, services offered, and merchandise stocked. Eventually the institution becomes vulnerable to a newer form of retailing operating with lower costs and prices.

Much of the progress in understanding institutional change can be attributed directly to the spark of controversy ignited by McNair's hypothesis. Efforts to expand, modify, or disprove the wheel of retailing concept have led to the development of numerous explanations of institutional development.[2] Some of the most widely discussed explanations are:

☐ *Demographic trends*—As the standard of living increases, retailers are naturally attracted by market segments with higher levels of income. This leads to increases in merchandise quality, prices, and the array of services.

☐ *Imperfect competition*—In efforts to avoid direct price competition, retailers place increasing em-

1. Malcolm P. McNair, "Significant Trends and Developments in the Postwar Period," *Competitive Distribution in a Free High-Level Economy and its Implications for the University*, edited by Albert D. Smith (Pittsburgh: University of Pittsburgh Press, 1958).

2. For a more detailed discussion of these different hypotheses see Stanley C. Hollander, "The Wheel of Retailing," *Journal of Marketing*, July 1960, p. 37.

phasis on additional services, which can only be supported with higher margins.

□ *Scrambled merchandising*—As retailers diversify their merchandise assortments, they tend to add higher-margin items that create the illusion of an evolutionary trading-up process.

□ *Managerial evolution*—As company founders are replaced by second generation management, cost consciousness gives way to concerns over store appearance and image, thereby creating upward pressures on costs and prices.

Each of these approaches has merit as a basis for understanding the evolution of retail institutions. However, none of them seems entirely sufficient for explaining contemporary retail developments, which are of a decidedly different character from earlier retailing innovations. For instance, the wheel of retailing concept suffers from two important limitations:

1
It focuses almost exclusively on changing cost and gross margin relationships as the key to understanding evolutionary retail behavior. It assumes that breakthrough retailing institutions begin as low-cost concepts that gradually mature into higher-cost distribution mechanisms. This cost focus tends to make the concept somewhat limited in explaining the evolutionary behavior of newer, less price-oriented retail innovations, such as the convenience food store and the home improvement center.

2
It was never really intended to determine the pace with which retail innovations rise and fall. Given the somewhat frenetic rate at which new retailing concepts appear today, it is important to have a basis for appraising future developments.

The changing character of retail innovation and the apparent acceleration of innovative retail activity suggest that another expansion of the wheel of retailing concept is needed. We believe that the life cycle concept has considerable utility as a method for explaining and predicting institutional actions. In fact, detailed analyses using life cycle concepts can help management to project the direction and magnitude of future evolutionary processes.

Four stages of the life cycle

The product life cycle has a long and rich history in marketing and serves as a basis for many product line decisions, particularly in the consumer packaged goods field.[3] Much less well understood is the concept of the institutional life cycle. This theory argues that retailing institutions, like the products they distribute, pass through an identifiable life cycle.[4]

As *Exhibit I* shows, the retail life cycle, as we see it, is divided into four distinct stages. While the stages are similar to those for the product life cycle, they have their own unique characteristics. We shall examine each stage in turn.

1 Innovation

The first and most exciting stage of retail development is characterized by the emergence of a new, usually entrepreneurial, retail institution. The new concept typically represents a sharp departure from existing retailing approaches and as a result tends to enjoy a significant advantage. The advantage may arise from a tightly controlled cost structure that results in a favorable price position, but not always. The advantage may derive from a unique feature offered, such as a distinctive product assortment, ease of shopping, locational advantages, or even different advertising and promotional methods.

During the innovation period the new advantage produces a level of customer acceptance that causes sales to rise sharply. Profits, on the other hand, may lag as the new institution struggles with the operating problems associated with new ventures. Profits may also suffer because the company lacks the size to produce significant economies of scale, or because it incurs relatively large levels of start-up costs, many of which cannot be capitalized. Toward the end of the innovation period sales volume begins

3. See, for example, Joel Dean, "Pricing Policies for New Products," HBR November-December 1950, p. 44 (repeated as HBR Classic in this issue, p. 141). Theodore Levitt, "Exploit the Product Life Cycle," HBR November-December 1965, p. 81; and Eberhard E. Schering, *New Product Management* (Hillside, Illinois: The Snyder Press, 1974). For a contrary view of the traditional approach, see Nariman K. Dhalla and Sonia Yuspeh, "Forget the product life cycle concept!" HBR January-February 1976, p. 102.

4. See William R. Davidson, Alton F. Doody, and Daniel J. Sweeney, *Retailing Management* (New York: The Ronald Press Co., 1975), p. 71; William R. Davidson, "Changes in Distributive Institutions," *Journal of Marketing*, January 1970, p. 9; and Bert C. McCammon, Jr. and Albert D. Bates, "Emerging Patterns of Distribution," *Strictly Wholesaling*, Spring 1971, p. 22.

to increase even more rapidly, and profits also grow as the initial operating problems are overcome.

Let us look briefly at two examples with which many readers may be familiar:

□
The supermarket of the 1930s is a classic example of a retail innovation based primarily on a cost and price advantage. By eliminating services such as credit, delivery, and telephone ordering, by utilizing self-service, and by achieving economies of scale, the supermarkets were able to operate on a gross margin of only 12% compared with 20% for more conventional food outlets. As the same time, the supermarkets produced a net profit margin fully 50% above conventional outlets, and some generated as much sales volume in two weeks as conventional food stores did in a year.

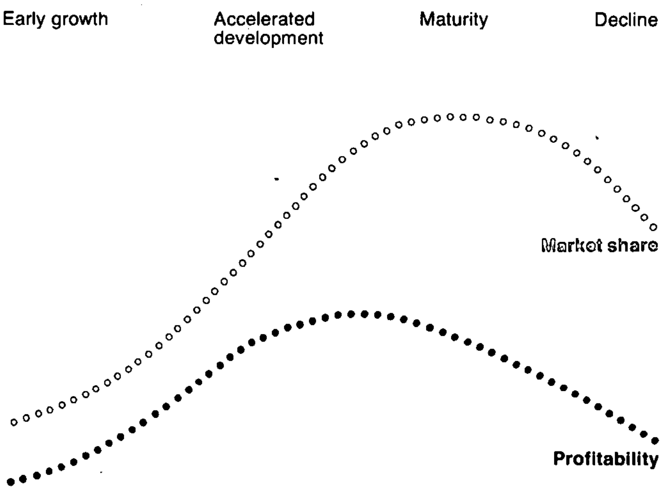
□
In contrast to the supermarket, the home improvement center focused primarily on the "offer" of better combinations of related merchandise and services. Specializing in the sale of home repair and related do-it-yourself items, the home improvement center brings together at one place the tools, the application products, and the information necessary to do an entire home improvement job. The center's product variety and assortment cannot be matched by either hardware stores or building materials dealers. In addition, many home improvement centers provide extensive customer counseling, sponsor in-store seminars on home improvements, and often provide contractor assistance to do-it-yourselfers. Price in this total offer is a factor, but a relatively minor one.

As a result of its marketing efforts the home improvement center has been almost as spectacular a success as the supermarket. From a handful of outlets in the mid–1960s, such stores now account for more than 20% of total home improvement product sales, and they can be expected to increase that percentage steadily in future years.

2 Accelerated development

In the second stage of retail evolution, both sales volume and profits experience rapid rates of growth. During this period companies already established in the business are usually actively engaged in geographic expansion. Also, companies that were not innovators typically enter the new field. For example, once the discount department store was firmly established as a dynamic new form of retailing, mature corporations such as Kresge, Woolworth, Federated, and Dayton-Hudson made major comitments to their own discount operations.

Exhibit I
The institutional life cycle in retailing



Note: The duration of the stages (horizontal scale) is variable, depending on many circumstances. The four stages are portrayed equally on the time scale for schematic purposes only.

As interest in the new concept surges, the market share of the innovating stores increases steadily and conventional outlets get hurt. As a result, companies that earlier had ignored the innovation begin to develop retaliatory programs. In most instances, though, the retaliatory programs are not completely thought through and are often ineffective. For example:

□
In the accelerated development phase of the discount department store, conventional department store outlets frequently attempted programs of retaliation on the theme of "we will not knowingly be undersold." This often proved ineffective because it focused on only one dimension of discount department store competition and did not give proper recognition to the discounter's nonprice advantages, including a suburban location, the convenience of night and Sunday operating hours, and the availability of open merchandising under a self-service formula.

During the early part of the accelerated development period there is normally a favorable impact on profits. Additional sales volume results in high levels

Exhibit II
Management activities in the life cycle

	Area or subject of concern	Stage of life cycle development: 1 Innovation	2 Accelerated development	3 Maturity	4 Decline
Market characteristics	Number of competitors	Very few	Moderate	Many direct competitors Moderate indirect competition	Moderate direct competition Many indirect competitors
	Rate of sales growth	Very rapid	Rapid	Moderate to slow	Slow or negative
	Level of profitability	Low to moderate	High	Moderate	Very low
	Duration of new innovations	3 to 5 years	5 to 6 years	Indefinite	Indefinite
Appropriate retailer actions	Investment/growth/risk decisions	Investment minimization–high risks accepted	High levels of investment to sustain growth	Tightly controlled growth in untapped markets	Minimal capital expenditures and only when essential
	Central management concerns	Concept refinement through adjustment and experimentation	Establishing a pre-emptive market position	• Excess capacity and "overstoring" • Prolonging maturity and revising the retail concept	Engaging in a "run-out" strategy
	Use of management control techniques	Minimal	Moderate	Extensive	Moderate
	Most successful management style	Entrepreneurial	Centralized	"Professional"	Caretaker
Appropriate supplier actions	Channel strategy	Develop a pre-emptive market position	Hold market position	Maintain profitable sales	Avoid excessive costs
	Channel problems	Possible antagonism of other accounts	Possible antagonism of other accounts	Dealing with more scientific retailers	Servicing accounts at a profit
	Channel research	Identification of key innovations	Identification of other retailers adopting the innovation	Initial screening of new innovation opportunities	Active search for new innovation opportunities
	Trade incentives	Direct financial support	Price concessions	New price incentives	None

of fixed expense leveraging, and substantial economies of scale are produced. However, toward the end of the period these favorable factors tend to be counterbalanced by cost pressures that arise from the need for a larger staff, more complex internal systems, increased management controls, and other requirements of operating large, multi-unit organizations. Consequently, near the end of the accelerated development period both market share and profitability tend to approach their maximum level.

3 Maturity

The third and most significant stage of development witnesses a dissipation of the earlier vitality of retailers. Market share levels off. As a result, a number of factors come together to create important operating problems.

First, entrepreneurial managers begin to face difficulties in controlling their large and complex organizations. Although they were excellent at maintaining the vitality and excitement of their organizations in the first two stages, they often lack the management skills necessary to direct large organizations in stable markets. Consequently, the quality of operations begins to slip.

Second, too much capacity becomes a problem. Retailers expand beyond the levels justified by the size of the total market, and in doing so they increase the level of total square footage to unprofitable levels. This situation persists until a major shakeout occurs, such as happened in the fast-food field in the late 1960s and among discount department stores in the early 1970s.

Finally, management finds itself facing direct frontal assaults from new forms of distribution. The upstart challengers run off with needed sales, creating profit problems which magnify other difficulties.

The result of such difficulties is a severe reduction in profitability. The discount department store industry offers a case in point.

This concept was pioneered by companies such as Masters, E. J. Korvette, and Two Guys from Harrison in the early 1950s. From this small base the industry grew quite rapidly, led for the most part by dynamic, highly creative, but not technically sophisticated managers. By 1960, the earliest year for which detailed trade data are available, the discount industry had more than 1,300 stores producing a total sales volume of approximately $2 billion. This volume put the industry well into the accelerated development stage of growth.

Sales and profits continued to advance during the early 1960s, spurred on by growth-oriented managements. Sales per store, sales per square foot, and market share rose continually, although not at the dramatic rates characteristic of previous years. At the same time, however, profitability started to fall as expenses outraced sales volume. In other words, the first signs of impending maturity were becoming apparent.

Despite this warning, entrepreneurs in the industry continued to open stores at an uninterrupted pace. "Overstoring" became an economic reality. Between 1965 and 1972, for example, the number of square feet of discount store space per household almost doubled, rising from 3.6 square feet to 6.5 square feet. As a result, sales per square foot fell precipitously throughout the 1960s and 1970s, as did profitability, despite the fact that market share continued to show increases through 1970.

Corporate executives did not start to correct these problems until about 1973, following a significant shakeout of weaker stores. As discount department stores continue to adapt to maturity as a way of life, profitability results can be expected to stabilize at economically sufficient levels. However, they are not likely ever to return to the exciting levels associated with the early stages of the life cycle.

4 Decline

The last era in the life cycle process is often avoided or greatly postponed by repositioning. By modifying its marketing concepts, management prolongs maturity and avoids decline. However, not all retail species are so lucky. Years ago, central city variety stores went into a downhill stage in most regions. In addition, some of the accustomed industry leaders may contract in size and importance. For example, the announcement in 1975 by A&P that it was closing approximately 1,250 stores was a concession that many of its units were economically obsolete in today's marketplace.

When decline occurs, the consequences are traumatic. Major losses of market share occur, profits are marginal at best, and a fatal inability to compete in the market becomes apparent to investors and competitors.

Is the life cycle growing shorter?

As the preceding discussion suggests, the institutional retail life cycle is a natural evolutionary process that is impossible to stop. Given the inevitability of the life cycle, management's responsibility in any one company is to anticipate changes in the stages and to adapt the organization to them as effectively as possible. *Exhibit II* highlights some of the activities that become important in different stages.

By utilizing different strategies at different stages of life cycle development, and by anticipating shifts from one stage to the next, both retailers and suppliers can maintain adequate profit levels. Difficulties arise in anticipating future developments, though, as the life cycle is far from being a stagnant concept.

Furthermore, innovative retail companies are typically small and relatively difficult to identify. Consequently, they are seldom given widespread notice until they reach the accelerated development stage. However, two widely discussed retail concepts are still at the innovation stage in the United States; both of them are in the food field. The first is the food warehouse, as exemplified by the Grocery Warehouse operation run by Allied Supermarkets in Detroit or the Magnamart division of Lucky Stores in San Antonio. The second is the hypermarket—very large-scale combination food and general merchandise stores—such as Jewel Grand Bazaar in Chicago or the newer units of Meijers Thrifty Acres in Michigan.

What is more, there is ample evidence to suggest that the length of the life cycle is contracting. The time between the introduction of a retail concept and the point at which it reaches maturity is growing progressively shorter.

Exhibit III
Life cycle characteristics of five retail institutions

Institution	Approximate date of innovation	Approximate date of maximum market share	Approximate number of years required to reach maturity	Estimated maximum market share	Estimated 1975 market share
Downtown department store	1860	1940	80	8.5% of total retail sales	1.1%
Variety store	1910	1955	45	16.5% of general merchandise sales	9.5%
Supermarket	1930	1965	35	70.0% of grocery store sales	64.5%
Discount department store	1950	1970	20	6.5% of total retail sales	5.7%
Home improvement center	1965	1980 (estimate)	15	35.0% of hardware and building material sales	25.3%

Sources: National Bureau of Economic Research, U.S. Department of Commerce, *Progressive Grocer*, *Discount Merchandiser*, National Retail Hardware Association, and Management Horizons, Inc.

At maturity, retailers tend to develop sophisticated inventory control procedures, develop five-year plans, and employ other modern management concepts. For suppliers, the main challenge is to hold on to the existing network while beginning to actively search for the next round of innovative companies that may eventually make existing relationships obsolete.

It is difficult to pinpoint the exact year in which a particular retail institution was established, since most innovations have important historical antecedents that can be traced back to the very beginnings of commerce. It is even more difficult to determine when a particular institution reached maturity. Market data are usually not sufficiently precise to indicate maturity, different geographic areas reach maturity at different points in time, and many individual firms run counter to prevailing trends.

Despite these limitations, it is possible to draw on trade data and historical studies to make realistic estimates of the approximate time of innovation and maturity for major retailing institutions.[5] *Exhibit III* documents the life cycle patterns for the downtown department store, the variety store, the supermarket, the discount department store, and the home improvement center.

As can be seen, the downtown department store enjoyed approximately 80 years of uninterrupted development from the time of its introduction to the time of achieving its maximum market share. But the pace of economic activity accelerated, the innovation and accelerated development stages contracted to 45 years for variety stores, 35 years for supermarkets, and 20 years for discount department stores.

Present patterns of change lead to the conclusion that the home improvement center probably will achieve its maximum market share by about 1980, only 15 or so years after the time of introduction. For future innovations, the period of market share growth could contract to as little as 10 years.

The institutional life cycle is not the only facet of economic activity that is accelerating. Futurists such as Alvin Toffler, Herman Kahn, and others have documented the accelerating pace of change in American society.[6] In addition, the product life cycle seems to be contracting. As an illustration consider the following observation made by the chief executive of General Electric Company:

"The honeymoon cycle of the new product is becoming shorter and shorter. We introduced the GE automatic toothbrush just two years ago. There are now 32 competitors. Our slicing knife, a product that we introduced approximately one year ago, now competes with 7 others, and at least that many more manufacturers are preparing to enter the marketplace." [7]

A sophisticated management group can slow the pace of its company's evolution, and it can hold profitability at adequate levels for an extended period of time. However, a return to exceptional levels of profitability can be achieved only by converting to new forms of distribution or by entering new lines of trade.

Implications & opportunities

The institutional life cycle represents more than just another way to conceptualize changes in retailer behavior and profitability patterns. It can be quite useful in projecting retail developments and planning marketing strategy. In particular, an analysis of current life cycle patterns suggests four important areas of management attention during the next decade.

Stay flexible

For retail executives, the shortening life cycle puts a premium on being able to adapt to changing trends and to work with new management ideas. To cope with continual change, retailers must consider the use of different management styles or even different management groups during succeeding stages of development. In large organizations with multiple types of outlets in various stages of development, this need could greatly increase the complexity of management. It also means, though, that a company can never afford to get "locked in" to some particular approach or philosophy.

An excellent example of a company that has employed different management styles in operations at different stages of development is Federated Department Stores. When setting up its Gold Circle discount division, the company established a management task force that was completely autonomous from the existing Federated management group. The task force was free to try new management concepts and operating procedures. With this approach, Federated had an innovative, free-wheeling management style for its discount division and a more conservative, controlled style for its conventional department store operation.

Merchandise suppliers are likely to have similar concerns about not being locked in to one type of retail outlet for a product. As a result of this concern suppliers probably will become more responsive to new retail ventures than they have been in the past. When, as in the past, manufacturers and wholesalers refrain from selling to new types of retailers for fear of disrupting existing channel relationships, they leave the door open for minor suppliers. The latter can proceed to take market share away from the larger companies by selling to the innovative stores.

Analyze risks & profits

In order to lower the potential risks of failure in new ventures, retailers will become more analytical and innovative. To cut their risks, they are likely to utilize a variety of techniques for increasing sales and profits and decreasing investment requirements. For instance, they will:

☐ Look for second-use space—such as abandoned supermarkets—for new retail ventures.

☐ Place more emphasis on self-service in tasks where clerk service has been the mode.

☐ Emphasize more efficient merchandising techniques.

☐ Try to shift a greater portion of the investment burden back up the channel to merchandise suppliers. (This approach is especially important for financing inventory and fixture needs in the future.)

Suppliers face a dilemma in dealing with new retail concepts. While inclined to respond quickly to new forms of distribution which exhibit a strong customer appeal, they will need substantial financial support through the form of extended datings, floor planning of initial inventory, or even direct term loans. At present, few supply organizations have the ability to evaluate the prospects for innovations with any degree of precision. In order to do so, suppliers are going to be forced to become much more knowledgeable about retailing activities and possibly directly involved in the early operation of retail innovations.

Attempt to extend the maturity stage

As noted earlier, the duration of the four stages shown in *Exhibit I* on page 87 is variable. This fact is especially important for retailers in the third or maturity stage of the life cycle. As recognition of

5. For example, data on the sales and market share of retail institutions in the latter part of the nineteenth century and the first half of the twentieth century are found in Harold Barger, *Distribution's Place in the American Economy Since 1869* (New York: National Bureau of Economic Research, 1955).

6. See Alvin Toffler, *Future Shock* (New York: Random House, 1970), and Herman Kahn and Anthony J. Wiener, *The Year 2000: A Framework for Speculation on the Next 33 Years* (New York: Macmillan, 1967).

7. Speech by Fred J. Borch quoted in Philip Kotler, *Marketing Management* (Englewood Cliffs, New Jersey: Prentice-Hall, 1972), p. 466.

the life cycle grows, therefore, many retail executives can be expected to devote more attention to ways of attracting and appealing to new market segments; also, many managements will work on ways of renewing and recapturing the interest of their existing customers so as to keep their loyalty in the face of new forms of competition.

For an example of what can be done by alert maturity-stage retailers, consider the department store industry:

□
Originally, the department store was a discount-oriented purveyor of a relatively wide range of basic merchandise. Over time the concept evolved into a mechanism for selling a broad variety of apparel, home furnishings, and general merchandise to a broadly defined middle-class customer base.

But today, leading department stores are giving much more time, attention, inventory investment, and floor space to the sale of fashion merchandise—particularly apparel, fashion accessories, and fashion home furnishings. Many of them see their main market as a more mobile, more affluent section of the middle class. While engaged in these changes and transitions, some conventional department stores have been able to maintain quite acceptable rates of profitability and interesting growth rates.

The marketing programs of key suppliers must evolve with the retail concepts they service. In the latter stages of the life cycle this means that suppliers must be able to cope with buying committees, vendor analysis programs, and similar efforts to assess the relative desirability of alternative supplier relationships. In addition, they must be able to function in programmed merchandising arrangements. Finally, they should be able to provide the product variations and other refinements that retailers will be looking for in order to shield conventional customers from innovative competitors. While doing all this, suppliers must also be able to service less mature retail outlets with less precise methods of operation.

In short, manufacturers will work up programs to satisfy multiple channel requirements. Like several of the other changes outlined, this development should result in a marked increase in the complexity of supplier operations.

Emphasize research

Given the risks in developing new retailing concepts, many retailers may prefer to leave the hard task of experimenting with new approaches to smaller, more entrepreneurial companies. The concepts that prove successful can then be copied—at least, if the large retailers discover the innovations soon enough.

Monitoring experimentation and innovation in the manner required calls for a more substantial and more sophisticated commitment to research than most retailers now employ. Such capabilities must be expanded in the future. Suppliers face an almost identical challenge in developing a monitoring system to identify potential new customers and anticipate their impact on the market.

In summary

The retail life cycle is a natural evolutionary process and executives can do very little to counteract it. What they can do is plan more effectively in order to sustain profitability in the different stages. Such planning implies continuous rethinking and revision of operations. This in turn means that retailing will continue to be an area of turbulence and uncertainty for some time to come.