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A distribution services approach for developing effective competitive strategies against "big box" retailers

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Abstract

According to one theoretical approach, the primary economic function of retailers is to deliver products together with distribution services. We use this framework to identify competitive niches for smaller retailers competing against big box stores. We compare the distribution services offered by the Home Depot versus smaller retailers using both in-store measures and consumer perception data, and the relative importance of distribution services as determinants of store choice. The results show that the Home Depot's superiority in pricing and assortment attracts a significant market, but smaller retailers can secure niche markets by delivering higher levels of ambiance and information.

Keywords: Small business; Big box retailing; Competitive advantage

Big box retailers have become a powerful force in retailing today, and their impact on the competitive and economic environment has received considerable attention both in the trade press and academic research. For example, both the *Journal of Retailing and Consumer Services* (volume 7, issue 4) and the *International Journal of Retail & Distribution Management* (volume 28, issue 4/5) published special issues devoted entirely to the impact of large-format retailers. Smaller retailers who compete against these large firms face tremendous challenges, and several studies provide prescriptive strategies for carving out a competitive niche (Arnold and Luthra, 2000; Brennan and Lundsten, 2000; Darrow et al., 2001; Litz and Stewart, 1998, 2000b, d; Peterson and McGee, 2000). One of the most frequently mentioned competitive advantage opportunities for smaller firms is their provision of personal, value-added services (Andersen, 1997). However, few studies have either measured these services at the retail level, or assessed consumer perceptions of how well retailers deliver them. In this study, we delineate a theoretical framework that defines a broad scope of distribution services, and we use the theory to identify specific types of distribution services that might favor smaller retailers. We then present an empirical study in which we directly measure and assess consumer perceptions of the distribution services provided by the Home Depot, and compare them to the distribution services offered by smaller competitors. We also measure the relative importance of distribution services to consumers in their store patronage. Results from the study indicate that the Home Depot delivers higher levels of several important distribution services, but niche opportunities for smaller retailers are also present.

1. A distribution services approach to retail strategy

The theory of distribution services explains that the central economic function of retail firms is "to deliver explicit products or services to consumers *together* with a variety of distribution services which determine the levels of distribution costs experienced by consumers in their patronage of retailers" (Betancourt and Gautschi, 1988, p. 133). The merchandise and distribution services that are bundled together by retailers serve as outputs of a retailer's production function and fixed inputs in the customer's household production function (Betancourt and Gautschi, 1986, 1988, 1990, 1993). Based on this framework, retail strategy consists of two primary components—merchandise pricing strategy (including

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promotions) and the distribution services that accompany the merchandise.

The distribution services offered by a retailer can be grouped into five general categories: accessibility of location, assortment, assurance of immediate product delivery at the desired time and in the desired form, ambiance, and information (Betancourt and Gautschi, 1988). Each of the distribution services offered by retailers offsets the distribution costs incurred by customers in their purchase and consumption activities. A customer's distribution costs include direct time and transportation, adjustment, psychic, storage, and information. We will briefly define each distribution service and explain how they offset consumers' distribution costs.

Accessibility of location is typically defined as the distance the customer must travel to a retail establishment. Retailers who provide multiple store locations or who locate their stores closer to consumers provide a greater degree of accessibility, and thus reduce the direct time and transportation costs that consumers incur to shop their establishment.

Assortment is defined both by the breadth and depth of a retailer's product mix. When a retailer provides higher levels of assortment, consumers incur less time and transportation costs because they can reduce the number of multiple shopping trips that are necessary to obtain a market basket of goods. Greater assortment also reduces adjustment costs, which are the costs incurred by consumers when they must settle for a product option that does not match their preferences, as they have to delay their purchase and consumption due to product unavailability, or invest more time and effort in multiple shopping trips to locate the product they were seeking.

Higher levels of assurance of immediate product delivery at the desired time and in the desired form are offered when retailers extend their opening hours, offer credit, and break bulk. Assurance is also enhanced when stores reliably keep products in stock and when they make it easy to find products in the store.[1] These services reduce the direct time costs that consumers incur waiting inside or outside the establishment, adjustment costs due to product unavailability or insufficient resources, and storage costs that result when a product is not available at the desired time in the desired quantities.

Retailers who offer a higher level of ambiance reduce the psychic costs of their patrons, which encompass the hassles of shopping such as drudgery, anxiety or disagreeable social interactions (Betancourt and Gautschi, 1988; Ingene, 1984). The layout of a store, the visual and aesthetic attractiveness of the fixtures and décor, and the friendliness and familiarity of store personnel are formative qualities of ambiance (Bitner, 1992; Eroglu and Machleit, 1990; Kotler, 1973–1974), and enhanced levels of these services reduce consumers' psychic costs.

The final type of distribution service is information, which may include information about prices, availability, product performance, and other elements of the goods and services provided by a retailer. This information can be delivered in two forms: personally via in-store salespeople and impersonally via point-of-purchase materials. Retailers who offer higher levels of information reduce the costs that customers incur in obtaining the information, as well as adjustment and storage costs that customers incur when information is less accessible.

The competitive model that emerges from the distribution services approach can be described as follows. When retailers offer higher levels of distribution services, they incur higher costs (albeit at varying rates, due to different cost functions). Lower levels of distribution services, meanwhile, lead to higher distribution costs for customers. Customers who patronize a retailer offering lower prices but a less convenient location than another retailer incur greater time and transportation costs in exchange for lower prices. In this case, cost-shifting has occurred—the retailer shifts more distribution costs to the consumer, and in exchange, the consumer pays lower prices for merchandise. Competing retail formats offer distinctive combinations of prices and distribution services, and consumers select the format and retailer whose mix best matches their needs and the costs they are willing to bear. These competing retail formats can co-exist to some extent because they appeal to different segments in the market. However, if one retailer can match the mix of another retailer with lower costs, the inferior firm is unlikely to survive. Smaller retailers face this risk due to the economies of scale afforded to big box retailers (Litz and Stewart, 1998). In the next section, we consider whether these economies of scale are universal across all types of distribution services.

2. Potential diseconomies of scale in distribution services

Large-format chain store retailers have presumably achieved economies of scale enabling them to provide a given level of distribution services for a lower cost than smaller competitors (Betancourt and Gautschi, 1986, 1988; see also Darrow et al., 1994; Litz and Stewart, 1998). Furthermore, some of these distribution services benefit from economies of scope, whereby the provision of higher levels of one type of service might lower the marginal costs of providing a given level of a second (Betancourt and Gautschi, 1986).

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