Retail Management
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Lecture – 10
Retail Business Models by Ownership

Hello everybody, welcome to this retail management. This is Dr. Swagato Chatterjee from VGSOM, IIT Kharagpur, who is taking this course on the platform of Swayam NPTEL. Today we are in week 2. This is lecture 10 and we will be discussing retail business models by ownership. So, there are various kinds of retail and retail varies based on the format of the retail, based on the products that you keep, based on the services that you provide.

But one of the key factors that differentiate between one kind of retail with another kind is called the ownership, who owns the retail. Now, who owns the retail will basically impact the level of the degree of involvement of the owner in the day to day operations of the retail. It will also impact that how much profitability is required.

If I do not own the retail, if somebody else on the retail and I am only in a leased phase or I am rented the retail outlet, then I have to make more profit too because I have to give back a little bit to the owner and then I have to make money out of the risk. So, the more number of people gets involved in the retail operations and retail profitability, the more will be the requirement of profit percentage or profit margin.

Because otherwise if that is not there, then not many people will be satisfied with the money that is generated out of this retail activity and that is why ownership is important. On the other hand as the retail grows, see retail farms generally if it is a brick and mortar retail, there are issues related to the scalability, how big a retail chain can you have? Can you manage 10 stores? So, okay let us say you manage this 10 stores.

Can you manage 100 stores? So, as the number of stores go up, as the catchment area that you are trying to serve grows, it becomes difficult for one single owner to deal with all the catchment area because often this job is repeated. Whatever retail activity one particular store is doing and another store is doing they might not be very different from each other, but you have to do it every day.

You have to be involved every day. There are some people, some managers, some manpower has to be involved every day and there is also some amount of capital investment. So, the money that gets generated is generated over time, it does not get generated at a small period of time. So, you have to invest a certain amount of capital, take the risk, and then you will get to reap the benefit of the risk over time.

Now not one person have that kind of ability to run a retail store over a longer period of time. Given this, this retail business models by ownership becomes an important factor.

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So what are the ownership formats? So independent retail that is the first one. Then the chain retail, then the franchise, leaded department, vertical marketing system and consumer cooperative. These are the 6 things that we will be discussing today.

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So what is an independent retail? Independent retail is the easiest form of retail. While it is a small store or a big store, it is owned by one single person who is an independent retailer. So 2.3 million independent US retailers are there which account for one-third of total store sales in USA and 70% of the independent retailers are operated by owners of the families. Now, this is the scenario for USA.

The scenario is probably more prominent in India or emerging markets where most of the retail stores if you see the small brick and mortar retail stores that are there. Small to big or medium sized brick and mortar retail store at various parts of the country will be basically independent stores. They are owned by the family members. The ownership shifts from the father to the son or daughter and so on and that is why often these retail stores face problem in terms of the scalability.

In terms of what kind of products they can keep, in terms of how big they will be, how many retail stores they can open up. But one basic advantage this retail store has is there is an ease of entry. So, you do not have to do a lot of paperwork before you want to enter the market. You have a retail space which is accessible by people you know that okay there are enough number of people in and around this particular retail space, you can open a retail store that is easy to enter.

But because it is easy to enter because the number of retail stores are so many, it is almost a perfect competition market. There is very less amount of collusion that happens here. People actually try to get market share as much as possible and that is why for this kind of retail store the location matters a lot because if you do not have price advantage. So, based on what do you generally go to a normal retail store into mom-and-pop store or medium sized grocery store, how do you decide that which store will you choose from.

So, one important factor is the distance. So, how much distance it is from your home, how distant it is from your home or wherever you are staying that is one factor. Because it is price competition, it is perfect competition almost price will not vary a lot, but the products that you keep, what kind of products you keep might vary. Another important thing that impacts these particular independent retail store's operations is customer relationship management.

So, personalized customer relationship management or services that you provide to the customers because products are same, but services that you provide, do you give an home delivery, do you give credit, do you maintain a book where the customers can pay at the end of the month. So, these kind of which is credit facility basically, these kind of services that we provide.

Now, do you know this person, sometimes in BOP sectors specifically the retailers are generally a little bit of well to do in the family, in the locality in the village. So, they are also people who have cash in their hand and who can give you cash for a short loan. So, if that is the case if I know that okay this retailer gives me I would say micro financing loans and if he charges interest, but whenever I require some amount of money informally he gives me that money.

Then I will be bound to this particular person, sometimes the BOP customers gets bound to this particular person too because that is the time that is the specific I would say condition in which you feel that okay I am attached to this particular retailer and because the retailer is giving me certain other kinds of benefits, I should not go to another retailer for the retailing activity.

For the purchasing of the products, I will go to this retailer only because you feel oftentimes in a social structure of bottom of pyramid customers then feel obligated to go to this kind of retailers who have given some benefits in outside the retail world. For example, probably this retailer is also the teacher because a retailer will be a person who knows a little bit of maths. So, in a BOP market, this particular retailer can be the teacher of the kid of the customer.

The customer is poor basically and the customer's kid **is** basically goes to get a private tuition in that particular retailer's house. So, then this particular person who is the customer gets obligated to purchase from the retailer. So, personal relationships, personal favors, if he is the family member; these kind of things also creates a certain kind of obligations for which people go to this independent retailer.

So, this is another sector where the independent retailers basically compete with each other. How to create personal connections with more number of pupils, catchment area is easy. See once you decide the location the catchment area will not change a lot, but personal relationships is something where you can play with so that is what independent retailers do.

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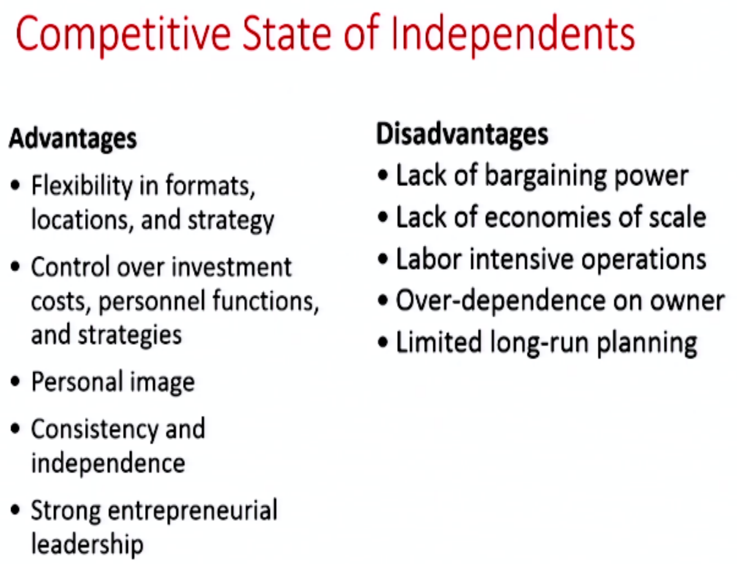

What are the advantages and disadvantages as I told? Flexibility in formats, locations and strategy. So you are the owner of yourself, you do not have to answer to anybody. So you have flexibility in terms of the management of the retail activities. Control over investment, costs, personnel function that is implied functions and strategies. Again you do not have to follow any policy.

Certain labor laws and etc there, but it depends on how strongly those labor laws are imposed in your country. So, investment costs are something that you can manage. So, whether you do a lot of investment or less amount of investments and you will try to be organic and your personnel functions that means how the employees work that will also impact. The image of the person, the human being often often leads the image of the retail store.

So, who is the person? What is his social identity in the social sector as I told whether whether this person is the person who is benevolent person, he gives loans to everybody and they does not basically push people to pay back or something like that, whether this person does a lot of charity activity or community activity inside the community that sometimes also impact the brand image of that particular retail store.

So, it is a human intensive or human driven image I would say that you have consistency and independence and you have strong entrepreneurial leadership. So, the person who who is running the show, his or her entrepreneurial skill sets or entrepreneurial leadership will define the success or failure of this organization. So, it is not defined by something else, it is defined by how good an entrepreneur this particular person is.

But there are certain disadvantages as well. One of the disadvantage is, so generally these are small, if it is family run then the family has a capital constraint. It cannot input all the money that it has in the business. So, there will be lack of bargaining power. If I have less capital, if I have less power in the market, then my bargaining power will be low. My lack of economies of scale that is another issue because I cannot grow big.

It is because generally these retail stores are family driven. So, these are made not to make profit, but in order to meet the needs of the family that is all or probably a little bit more than that. So, as long as that is being said many peoples feel that okay we are doing good, why do you want to increase or why will I take risk and open another retail store? Who will run the retail store? Here I am sitting, I do not have a son, my daughter is married.

Right now, I do not have anybody to support in my family who will sit there or my son or daughter is a kid now. So, I cannot believe on some employees who will sit in another store, he can probably take money from the locker or etc. So, these kind of feelings comes up, the risks and the risks become so high that, people's perceived risk become so high that people stop taking risk and that is why they cannot grow.

And if they cannot grow the economies of scale, that cost does not come. It is labor intensive operations as I told just now. So, the manpower whether you can work or not or your family members can work or not impacts the success of the of the retail store. You will see often the family members let us say the 3 brothers in a family will sit in the retail store turn by turn.

So this is an activity that they are doing not only to make sure that the money is in control or the operations is in control, but also to cut the manpower costs. So they rely on the retail store there. As long as the retail store is working well, all the three families of the three 3 are fed and they share the profits and etc, but they sit in the retail store. Over-dependence on owner that is another disadvantage.

Limited long-term planning, so you generally do not have a long-term planning, you get stuck with whatever activities you are doing. So, these are some of the disadvantages of independent retail store.

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Now, just opposite to that which is absolutely corporatized, absolutely growth oriented is called the chain retail store. So it operates multiple outlets under common ownership. So one single owner or it can be a company, it can be a corporate, it can be a partnership firm which runs multiple outlets at various places, various locations within a city, in multiple cities, etc. So you know like for example it is a Big Bazaar or Aditya Birla Stores will be this kind of stores.

Engage in some level of centralized or coordinated purchasing and decision making. So, see one of the major factor of retail is sourcing, purchasing of the product. You can sell the product at various markets based on the price that the customers are willing to pay in those markets and these markets can vary, but the purchasing part you want to do in one go because if you can accommodate the purchase of multiple retail stores in one particular centralized space, you can get bargaining power.

The same things like the bargaining power, the economies of scale, all these things goes up because let us say one particular retail store requires 10 products in a month and there you have 10 such retail stores. So, if you come to buy 10 products separately that particular person will probably charge 5 rupees per 10 products per product when you are buying a bunch of 10 products.

But if we accumulate them and buy 100 products together and then you sent based on your requirement, then you can probably buy at a lower price probably 3 rupees per product. So then 100 products into 3 rupees 300 rupees your expenditure. And if the cost of delivery and etc is something that you have to incur, let us say they will not give you 10 here, 10 there, sometimes they will do that, sometimes they might not.

So if they do that, if the manufacturer agrees to do that, then you are safe, you do not have any problem. But if the manufacturer is not ready to do that then the cost of transportation is also something that you have to consider but that will not be that large. So it is always better to centralize your sourcing, your purchasing. And another thing is that decision making is all also centralized.

Sometimes lots of policy decisions are centralized, which product I will keep, which kind of productive I will not keep these are centralized. The centralization of decision making has certain advantages, certain disadvantages as well, we will talk about that. In the US there are roughly 1 lakh retail chains operating about 1 million establishments. So almost every retail chain has in an average 10 retail outlets.We do not have that many, but it is still growing, this particular space is still growing and there is a huge scope.

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Competitive State of Chains

Advantages
- Bargaining power
- Cost efficiencies
- Efficiency maintained by computerization, warehouse sharing, and other functions
- Defined management philosophy
- Considerable efforts in long-run planning

Disadvantages
- Limited flexibility
- Higher investment costs
- Complex managerial control
- Limited independence among personnel
- Excessive standardization due to extreme concern for bargaining power

What are the advantages and disadvantages? Obviously as I told bargaining power. Whatever was the disadvantage in the independent one will become advantage here. Bargaining power will be high, cost efficiencies, economies of scale will be high, management policy will be defined, long run planning will be there and efficiency maintained by computerization, warehouse sharing and other functions.

So, overhead costs will be shared by the retail stores. If I have multiple retail stores that will be the management costs, the warehousing, transportation, computerization, ERP; these kind of costs will be shared. So that gives a little bit of benefit. But there are disadvantages as well. What kind of disadvantages? Again, whatever was the advantage in the independent store becomes the disadvantages here. So, you have less flexibility.

Investments are high, managerial control is complex. It was simple, you can do personnel management very easily, you do not like this employee, you have fire him, here you cannot do that. There are labor laws, there are rules that you have to follow. Llimited independence among personnel, so that is why the personnel does not have a lot of independence when they are running the show. And excessive standardization due to extreme concern for bargaining power, so this is very important.

So, if all my decision making are centralized, then the employees in various retail stores will not be enabled to take decisions of customer services, to take decisions of what kind of products to be purchased, so they do extreme standardization sometimes. That means in whatever language or whatever behaviour or whatever policy, whatever operational instructions that will be given in retail 1, the exactly same thing will be done in retail 2.

Now retail 1 and retail 2 might be two different places. The people who are working in these retail stores might be different. The structure of the retail store might be different. The customers who come to this retail stores might be different. So if you do extreme standardization that creates problem, but you do that so that you can get bargaining power with the purchaser, with the customer, with the supplier but that does not work always.

So, this is a very key place that where do you will hold control, where you will keep the control and where do you will relax it. So, this becomes very important decision key decision for the retail chains and that is why they differentiate with each other.

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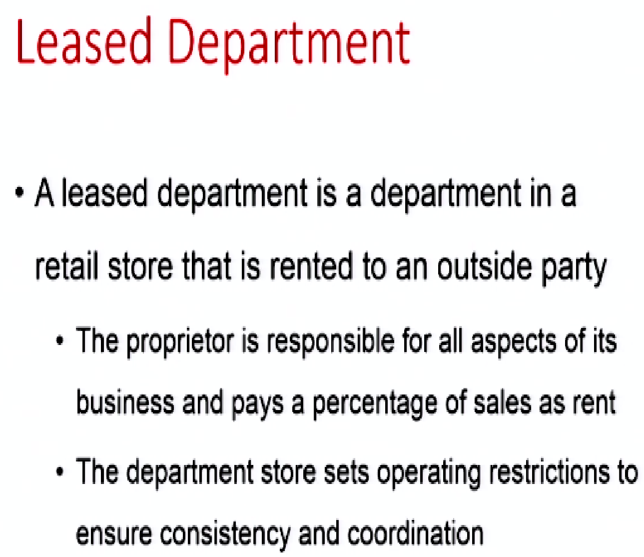

Now, other than that so I talked about four. So we talked about independent and chain. Franchise I will talk about the whole thing it takes time in a different presentation or different lecture. But there are other three systems, right, leased please department, vertical marketing and consumer cooperative, we will discuss about them. So, what is leased department store? A leased department store is a department in a retail store which is rented to an outside party.

So, you have leased out. You have a retail store and you leased out to somebody else, why? Because you want the ownership, you do not want to let go the ownership, but the operational activity you want to give to somebody else. Now sometimes it is the retail store of your company, which is leased out, but the products that is sold to the departmental store are your company's products only.

Sometimes it happens that you have leased out the space, not the operations, the space and you let them do whatever, but you have to give me some money. So this happens oftentimes let us say you have a plan, let us say I am a brand, I have a plan to enter in this market, but I am not ready yet. But I know that the real estate costs will go up at some point of time, so I invested and maintain with real estate.

Now, I have the real estate space with me and I know that I will come here 2 years later. So, what will I do with this real estate space? Will I keep it vacant? What I do is that I will give it 2 years lease. So, after 2 years, either I will remove the retail store whoever is here and I will come here, enter the market or I will in this 2 years I will let the particular lessee sell my products only, some other products or products which is related to my brand, so this is the leased department stores.

The proprietor is responsible for all aspects of its business and pays a percentage of sales as rent. So, whoever has taken the lease, lessee is responsible for all aspects of the business. And department store sets operating restrictions to ensure consistency and coordination. So, if it is basically running your store already, you are given it in lease, but the brand that is there is your brand, then you will also impose certain operational restrictions.

So you have to do these, do that, blah, blah, blah, that blah, blah, blah you just tell. So, under these only sometimes franchises comes up, sometimes franchises does not come up under this. So, in certain cases franchisee will be part of it, in certain cases franchisees might not be part of it. So, leased department might not be exactly franchises. The **(()) (23:29)** difference between a franchisee or a leased department is that who owns the space.

So if the space is owned by the company and then the operations is given to somebody else that is leased dependent, but if the space is owned by somebody else and the operations and space both are somebody else's and you are just allowing him to use your brand name and you are suggesting the operations, but you are not putting your nose inside it then that is a franchisee. So, that is the very basic difference between it.

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Competitive State of Leased Departments

Benefits

- Provides one-stop shopping to customers
- Lessees handle management
- Reduces store costs
- Provides a stream of revenue

Potential Pitfalls

- Lessees may negate store image
- Procedures may conflict with department store
- Problems may be blamed on department store rather than lessee

Now, what are the benefits of leased department? Provides one-stop shopping to customers, so you basically get lots of shopping options. Lessees handle the management. Management is handled by the lessee. Reduces store costs for the original brand and provides a stream of revenue. So even if you have a space which you are not using right now, you can generate revenue out of it. But potential pitfalls are lessees may negate store image.

The person who is running the show may basically do some massacre which can impact your other stores which are actually owned by you and the brand name itself. Producers may conflict with departmental stores so there can be conflict between the owner of the store and the lessee and problems may be blamed on department store rather than the lessee. So, these are some of the basic different problems that we have.

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Vertical Marketing System

- A vertical marketing system is the type of cooperation between the members of a distribution channel. It includes a producer, a wholesaler, and a retailer collaborating to deliver necessary products to their customers and aims at achieving better efficiency and economies of scale.

https://sendpulse.com/support/glossary/vertical-marketing-system

The next one is called vertical marketing system. So, vertical marketing system is another kind of ownership. Here people who are in a vertical chain of supply chain; who are there in vertical chain? How does the supply chain looks like? The supply chain looks like that there is a manufacturer, there is a wholesaler, there is a dealer and retailer then customer. So, manufacturer, wholesaler, retailer, customer, let us talk about these four.

So, if the manufacturer who produces the product, wholesaler who stores and sends the product, retailer who sells the product; these three people comes together form some kind of cooperation and create a retailing activity together then that is called vertical marketing chain. So, they have to come together, they do not compete with each other, they have to come together.

In current conditions that does not happen, in current conditions wholesaler decides periodically whom I will give my my warehouse and whom I will give by supply chain tracks and these and that whom I will give. So wholesalers are often transporters also, wholesalers are often I would say a warehouse person also or they have access to warehouse at least.

So they decide that whether I will do wholesaling for this particular brand or that brand and blah blah blah and the brands also compete to get a wholesaler who is the highest seller, who has the more amount of capital to invest on and etc. So, they compete with each other. So, that is why there is always a bargaining game that is going on between the retailer and the wholesaler. Similar bargaining game goes on with the wholesaler and the retailer.

Wholesaler also decides that okay I have so many retail stores in my catchment area whom will I provide? So, the product that I will be giving to, the services that I will be ensuring to a brick and mortar store which is a corporatized brick and mortar store and the one that is independent store I will deal with them differently because I know that Big Bazaar may pay less to me part per product, but economies of scale is there, they will buy in bulk and they will also look for services.

On the other hand independent stores will not look for services are interested to pay a little bit more than me but the volume will be lower and also independent stores might not be keeping some premium products, Big Bazaar might keep some premium products. Now, I am a wholesaler, I have to decide whom to give what and how much. How much of my time, my investments, my resources I will spend on which kind of retail and there is again the bargaining game going on.

Now, if you keep on bargaining as you know that more the middleman is there the less is the benefit that comes out to the retailer because every middleman will take some bit of it. So, to reduce the number of middlemen what sometimes the companies do and generally it is driven by the member of the retail chain who is stronger, the member of the supply chain who is stronger, if the manufacturer is stronger then the manufacturer will drive this thing.

If the retailer is stronger then the retailer will drive this thing. So, whoever is stronger drive this thing. They combine these two and these three members and create a vertical marketing chain. What is the outcome? Better efficiency and economies of scale.

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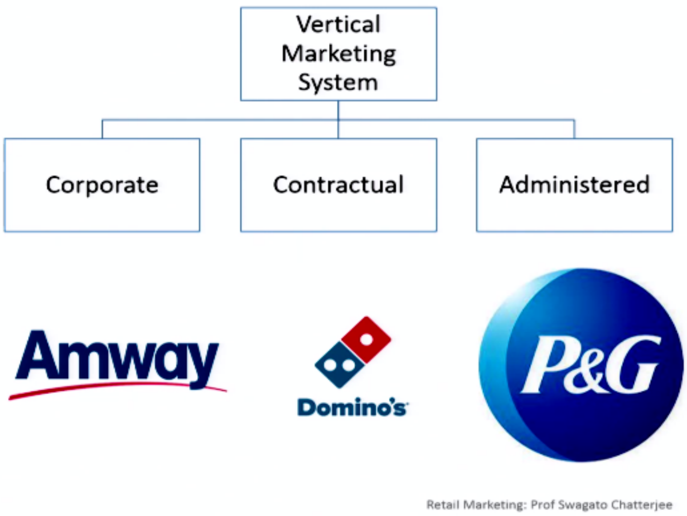

So, there are three types of vertical marketing system like the first one is corporate world. One organization actually owns all these three. The manufacturing is done by the organization, the whole selling is also done by your organization and the retailing is also done by the same organization. So, you cannot separately see that they are three different entities. So that is called for one example will be Amway. Amway does that.

Amway has their own manufacturing system, own distribution system and own retailing also. The second one is contractual where th manufacturer has a contract with the retailer or the wholesaler or the retailer has a contract with, so anyone they come with a contract. For example Domino's is a classic example, Domino's retailing activity is done by either

Domino's or the departmental stores or the franchises of Domino's, so that is one part there are contracts there.

And Domino's is also running contract with the suppliers that they come there. For example, who will supply the cheese or who will supply the flour and who will supply the meat and etc. So, they will have contracts with them. So, all these contracts are driven by the key Domino’s who manages this vertical marketing system. So, that is one type. The third one is administered. Administered is that all these things have three different entities.

The retailer, wholesaler and distributor; manufacturer, wholesaler and retailer are three different entities. But one entity governs the whole marketing chain. As I told that whoever is stronger between these three will administer, will govern the whole thing. So, P and G is the manufacturer here, P and G does not own the whole selling part, P and G does not own the retailing part at all, but he dictates, the P and G dictates terms how this retailing activity will be done.

So, before I stop I have the one more left which is the last one which is called company cooperatives. Consumer cooperatives are what? Where the consumers comes together and do the retailing. So, what they do? So retailing has two parts you understand. Retailing has the sourcing, stocking and then selling. You have the three things, no, yyou have to purchase the product, you have to store it for some time for in the inventory or somewhere and then you sell.

Now, there are two major activities that or three major activities where the consumers come together. If the consumers have come together in the sourcing part, let us say all the consumers tell their requirements and the requirements are stored in one go and then they go together and source it from some manufacturer, then that part is a cooperative activity. Then once that is purchased, at the same cost it is distributed towards to the individual consumers.

On the other hand, sometimes consumer cooperatives also comes together and they run the retail store itself, all these three things and the profit is also shared among consumers. So, they said that okay we will not ask you what you need or what you do not need, we will run the retail store as if it is a normal retail store, but the sourcing will be done by us and the selling will be done by us.

So, even if you are buying at the same price of the market, the profit margin that is getting generated will be shared with you, so you do not have to worry then. You do not have to worry there whether I am purchasing at a cost price cost or cost plus profit because even if you are buying at a cost plus profit, you are getting equivalent of the profit as per the memberships.

So every consumer who is the part of that particular membership association gets the share of the profit. So that is another kind of format which is coming up very strongly in various places where consumers are coming together and forming consumer cooperative retails. So that is all, I will stop here. And in the next lecture, we will discuss about franchising. Thank you very much.