

# **Competing with the Discount Mass Merchandisers**

**A Study by**

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## IMPACT OF WAL-MART STORES AND OTHER MASS MERCHANDISERS IN IOWA, 1983-1993\*

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### INTRODUCTION

The nature of retailing has changed dramatically in the last decade, compared to previous decades. In the last decade there has been a great proliferation of discount general merchandise stores as Wal-Mart, K Mart, Target and several regional chains. In addition there has been a great expansion of membership warehouse clubs, such as Sam's, Pace, Cosco, and Price Club. There has also been rapid expansion of "category killer" stores such as Home Depot, Circuit City, Best Buy, Toys "R" Us and others. These stores are called category killer stores because they have a very large selection within a narrow category of merchandise, along with low prices, and they "kill" smaller local stores within the same "category". We have also seen the development of many new factory outlet malls and the spread of specialty mail order. The net result of this expansion is the saturation of many retail markets, or what is commonly referred to as the **overstoring** of America. Many retail markets have more retail stores than can possibly be supported, and it would appear that a major shakeout is coming in the not-too-distant future.

### Why the Study?

This study is an annual update of my original study of the impact of Wal-Mart stores completed in 1988. The 1988 study was conducted at the request of several Iowa merchants and chamber of commerce executives. Wal-Mart stores began locating in Iowa in 1983 and local residents did not know much about them, thus prompting requests for information. Iowa has an excellent sales tax reporting system, but because of a lag in reporting and in the initial slowness of the Wal-Mart expansion, it was 1988 before enough data was available to conduct the first study.

The purpose of the studies was to document changes in retail sales in the host community and in surrounding communities. Once the changes were identified, then educational programs could be designed to assist local business people better cope or co-exist in the new mass merchandiser environment.

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## STUDY METHODS

Initially, it was decided to study the impact of Wal-Mart stores in communities between 5,000 and 30,000 population, because in 1988 that was where most of the stores were located. Since the original study, Wal-Mart stores have located in all the larger cities, but the impact there will be the subject of a separate study. This update through fiscal year 1993 will continue to examine the impact on communities with populations between 5,000 and 30,000 population.

### Data Sources.

Retail sales data came from the *Iowa Retail Sales and Use Tax Reports*, published annually by the Iowa Department of Revenue and Finance. The department has a long history of publishing this data for virtually every town and city in the state. Sales of all taxable goods and services are reported by two digit Standard Industrial Classification (SIC) Codes for communities over 2,500 population, if the community has five or more businesses within the category. The two digit classification is a broad description of businesses such as food, general merchandise, building materials, etc. Statewide sales are also published at the more detailed three digit SIC level. For example, in the building materials category, statewide sales would be reported for hardware stores, lumber yards, paint and glass stores, etc.

### Comparison of Data.

The simplest method of analysis would have been to compare retail sales for each of the communities. However, this is not a very satisfactory method since it does not take into account changes in price inflation, population and economic cycles. Instead, we chose to use a derivative called the pull factor in this comparison. The pull factor is merely the per capita sales of the community divided by statewide per capita sales. Community per capita sales are calculated by dividing the community's retail sales by the community population. Likewise, the statewide per capita sales are computed by dividing the total state retail sales by the state population. The equation for determining a pull factor is shown below.

$$PF = \frac{PCSc}{PCSs}$$

Where: PF = pullfactor  
 PCSc = per capita sales for a community  
 PCSs = per capita sales for the state

For example if a town had a per capita sales of \$8,500 per year and the statewide per capita sales were also \$8,500 per year, the pull factor for the town would be calculated by dividing the community's \$8,500 by the statewide \$8,500 and the pull factor would equal 1.0. The interpretation would be that the community's retail sales amounted to selling to the equivalent of 100 percent of the community population in terms of full time customer equivalents. When a pull factor is less than one (say 0.6, for example) the interpretation is that the community is selling only to the equivalent of 60% of the community population. Conversely, when a pull factor is greater than one (say 1.5, for example), it would be concluded that the community is selling to the equivalent of 150 percent of the community population, a fair sized trade area.

In fact, in most cases, some community residents would purchase some or all of their retail goods in other communities, while other people from the surrounding area would purchase some or all of their retail goods in the subject community. As was stated before, the pull factor makes adjustments for changes in population, price inflation and economic cycles. Pull factors can be computed for total sales and for two digit SIC codes.

### **Comparison by Time Period.**

The first Wal-Mart stores opened in Iowa in 1983, and then a small number were opened each year thereafter, reaching a total of 45 by fiscal year 1993. This study analyzes 34 towns with populations between 5,000 and 30,000 population. We thought it important that we be able to measure the change in sales for different types of stores, both in the host community and other communities for successive years after a Wal-Mart opening and then to generalize as to the average impacts after one year, two years, three years, etc. However, with the store openings spread over such a long period of time, a method had to be devised to make equitable and meaningful comparisons. That method is discussed below.

**Base Year.** The base year for comparison for each community was the last full year before a Wal-Mart store opened there. For example, if a store opened in Marshalltown in 1983, the base year was 1982. Each successive year of operation would then be compared to the base year of 1982, using the pull factors. For example, if Marshalltown's pull factor for total sales in 1982 was 1.50 and in 1983 after one year of Wal-Mart it increased to 1.56, an increase of four percent was calculated. The pull factor for 1984 would then be computed and compared to that of 1982 to see the cumulative change after two years, etc. In other words, successive year changes vary among towns, but in each year's comparison, changes in price inflation, population, and the state's economy are always taken into consideration. The first year changes for different communities are then averaged as are the successive year changes, even though they may be for different calendar years.

**A Basic Premise.** A basic premise lies at the heart of this study. The premise is that in areas of somewhat static population (such as in states like Iowa) the size of the retail “pie” is relatively fixed in size for a given geographical area. Consequently, when a well-known national chain like Wal-Mart opens a large store in a comparatively small town, it invariably will capture a substantial slice of the retail pie. The end result is that other merchants in the area will have to make do with smaller slices of the retail pie, or get out of business. In areas of the country where the population is growing rapidly, there is room for more retail establishments and the effect will be diluted considerably.

## RESULTS

The study found both plusses and minuses for the merchants in the host town. The major plus for most businesses was that in virtually all cases, total sales in the town increased at a rate greater than average for the state. Apparently Wal-Mart stores attracted customers into town from a greater radius than had occurred before their entry into the town. After the first two or three years, however, most Wal-Mart towns reached a peak in sales and then began a decline, with about 25 percent declining below the pre-Wal-Mart level. This decline appears to be caused by a saturation of Wal-Mart stores and other competing stores. Two simple rules of thumb explain the winners and the losers among host town merchants.

**Rule 1.** Merchants selling goods or services different from what Wal-Mart sells become natural beneficiaries. In other words, since they are not competing directly, many of them benefit from the spillover of the extra customers being pulled into town by Wal-Mart.

**Rule 2.** Merchants selling the same goods as Wal-Mart are in jeopardy. In other words, they are subject to losing some trade to Wal-Mart unless they change their way of business.

Retail sales for non-Wal-Mart towns declined in all categories except food stores after the opening of Wal-Mart stores. The magnitude of the sales declines for non-Wal-Mart towns was found to be much greater in this study than it was in earlier studies. The probable reason for the larger decline in sales is that the density of Wal-Mart stores has increased substantially. In earlier studies, the few Wal-Mart stores were widely scattered and residents of the non-Wal-Mart towns were sometimes 50 or more miles from Wal-Mart towns, a disincentive for traveling to shop. At the time of this study, few non-Wal-Mart towns were more than 25 miles away from a Wal-Mart store, and apparently more people were traveling to the Wal-Mart towns to shop.

Smaller outlying towns (populations below 5,000) appear to have borne the brunt of all the new Wal-Mart stores and others. For example towns with populations between 500 and 1,000 lost nearly 47 percent of their sales from 1983 to 1993. The results of the 1993 study are discussed below.

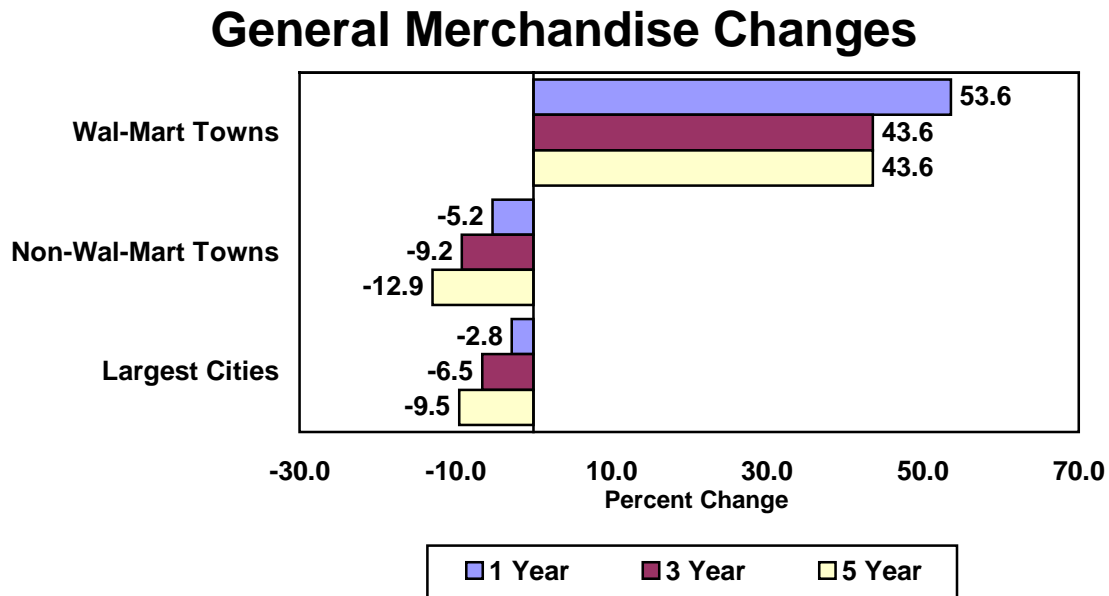
### General Merchandise

General merchandise stores consist of department stores and variety stores and include discount general merchandise stores such as Wal-Mart, K Mart, and Target.

**Wal-Mart Towns.** Figure 1 shows that Wal-Mart towns experienced a huge increase in sales in the general merchandise category in the years following the opening of a Wal-Mart store. On average, the sales after the first year increased by 53.6 percent. Obviously, most of this increase in sales goes to the Wal-Mart store. It is interesting to note, however, that the large initial increase in sales is not maintained and sales increases over the base year drop from 53.6 percent the first year to 43.6 percent in years three and five, respectively. This is probably due to a curiosity factor the first year that brings in casual shoppers, as well as a steady saturation of general merchandise stores that dilutes the sales of all.

**Non-Wal-Mart Towns.** The non-Wal-Mart towns are towns between 5,000 and 30,000 population that do not have a Wal-Mart store. Typically they have a K Mart store or a regional discount store such as Pamida, Alco or Places.

Figure 1



\*Changes are cumulative from base year.

As shown in Figure 1 general merchandise stores in non-Wal-Mart towns did not fare well after Wal-Mart stores came into the area. On average, sales declined by 5.2 percent after the first year and slipped to a 12.9 percent cumulative decrease after five years. It appears that the Wal-Mart stores captured sales from the general merchandise stores in the non-Wal-Mart towns.

**Cities.** In this study, cities were defined as municipalities with more than 50,000 population. In Iowa, there are eight cities over 50,000 population, with Des Moines being the largest at approximately 200,000 population. It was surprising to find that general merchandise sales declined in the cities after Wal-Mart stores came into the state, since they had been increasing up until that time. Figure 1 indicates a decline of 2.8 percent after one year, but that deteriorated to 9.5 percent cumulative decrease after five years. One explanation for the decrease of general merchandise sales in the cities is that as Wal-Mart stores increased in numbers, more and more local residents stayed at home to shop, rather than traveling to larger cities. Another possible explanation is that the category killer stores in the cities captured some of the sales that previously were made in the general merchandise stores.

### **Home Furnishings**

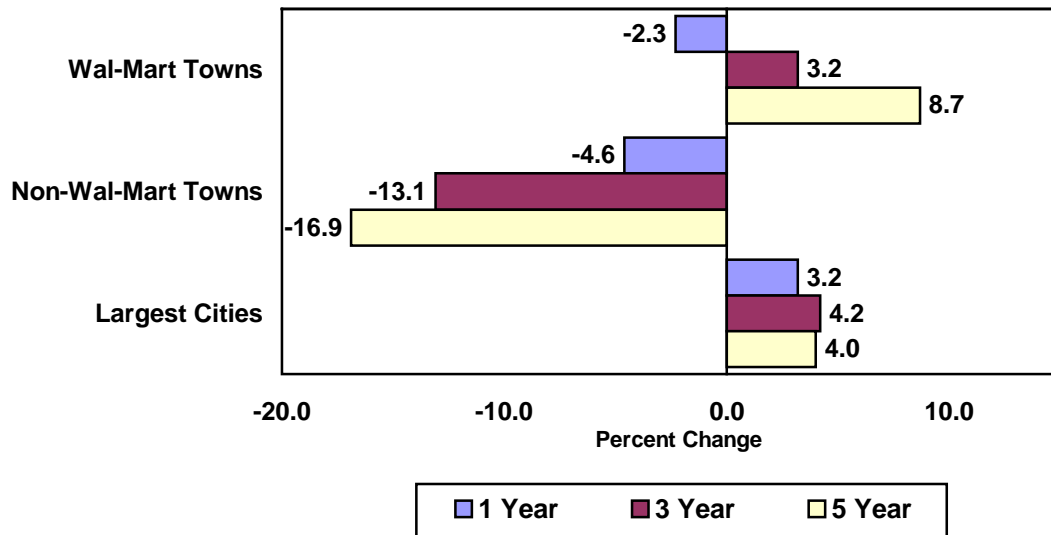
The home furnishings category is made up of furniture stores, major appliance stores, consumer electronics stores, floor covering stores and miscellaneous others such as drapery stores. Note that very little of this merchandise is sold in a Wal-Mart store.

**Wal-Mart Towns.** Home furnishings stores in Wal-Mart towns fared well after the opening of the Wal-Mart store. Figure 2 shows that after a first year setback of 2.3 percent, home furnishings sales increased by 3.2 percent over the base year after three years and enjoyed an 8.7 percent cumulative increase after five years. **Anecdotal evidence suggests that towns with good home furnishings stores experience an increase in this category because they benefit from the spillover of additional shoppers drawn to town by the Wal-Mart store.**

**Non-Wal-Mart Towns.** Home furnishings stores in towns without a Wal-Mart store suffered substantial reductions in sales in the years after Wal-Mart's opening. Figure 2 shows that sales declined by 4.6 percent after the first year, 13.1 percent after the three years and 16.9 percent after five years. **Apparently consumers are drawn from these towns to Wal-Mart towns and larger cities to shop and they choose to purchase some of their home furnishings in these towns also.**

Figure 2

## Home Furnishings Changes



\*Changes are cumulative from base year.

**Cities.** The eight cities in the study showed an average increase in home furnishings sales of 3.2 percent after one year of Wal-Mart stores. After three years sales were up 4.2 percent, but they declined slightly to 4.0 percent after five years. Although the percentages are relatively small, the dollar amounts are significant.

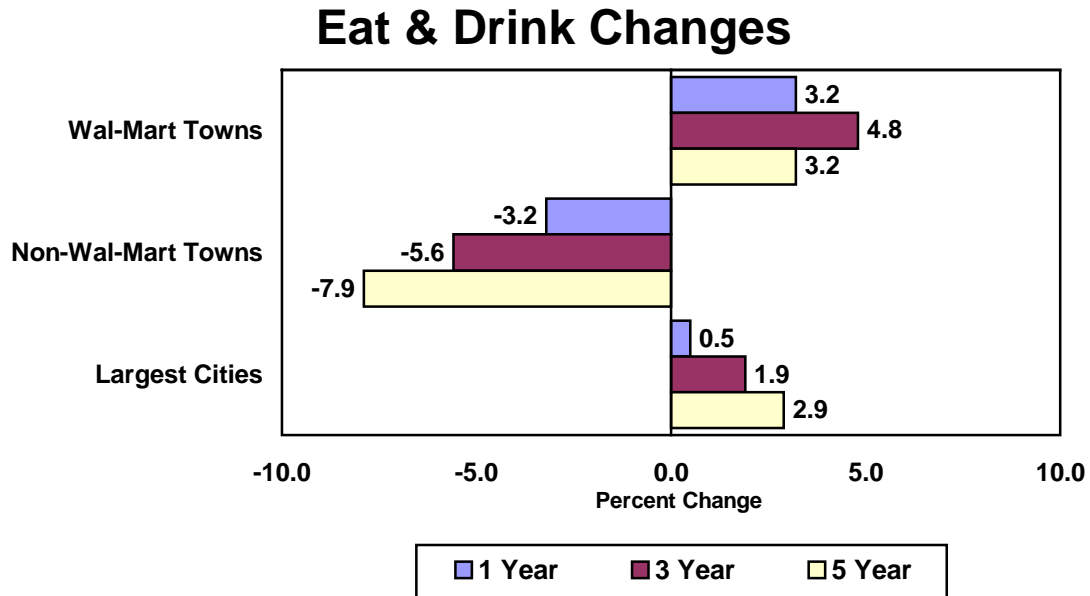
### Eating and Drinking Places

Eating and drinking places obviously are restaurants and bars. Restaurants have been and continue to be a growth business because more and more people are eating away from home.

**Wal-Mart Towns.** Restaurant sales in Wal-Mart towns grew faster than the state average. Figure 3 shows that after one year, restaurant sales were up 3.2 percent, then climbed to a gain of 4.8 percent after three years, before declining to a 3.2 percent gain after five years. **Apparently the Wal-Mart stores were drawing more people into town to shop and before going home, some consumed meals at restaurants.**



Figure 3



**Non-Wal-Mart Towns.** Non-Wal-Mart towns experienced a decline in restaurant sales after Wal-Mart stores opened in the area. Figure 3 indicates that sales declined 3.2 percent after one year, 5.6 percent after three years and 7.9 percent after five years, in spite of the fact that restaurant sales were rising statewide. **Apparently residents of non-Wal-Mart towns were out-shopping in Wal-Mart towns and larger cities and consuming meals there instead of in their hometowns.**

**Cities.** The cities in the study showed a continual increase in eating and drinking sales. Figure 3 shows that they were up 0.5 percent after one year, up 1.9 percent after three years and up 2.9 percent after five years. **These figures would seem to reflect the normal growth pattern of sales in cities and were probably not affected one way or another by the opening of Wal-Mart stores around the state.**

### Apparel Stores

Apparel stores consist of men's, women's and children's clothing stores as well as shoe stores. Miscellaneous apparel and accessory stores such as western wear would also be included in this category.

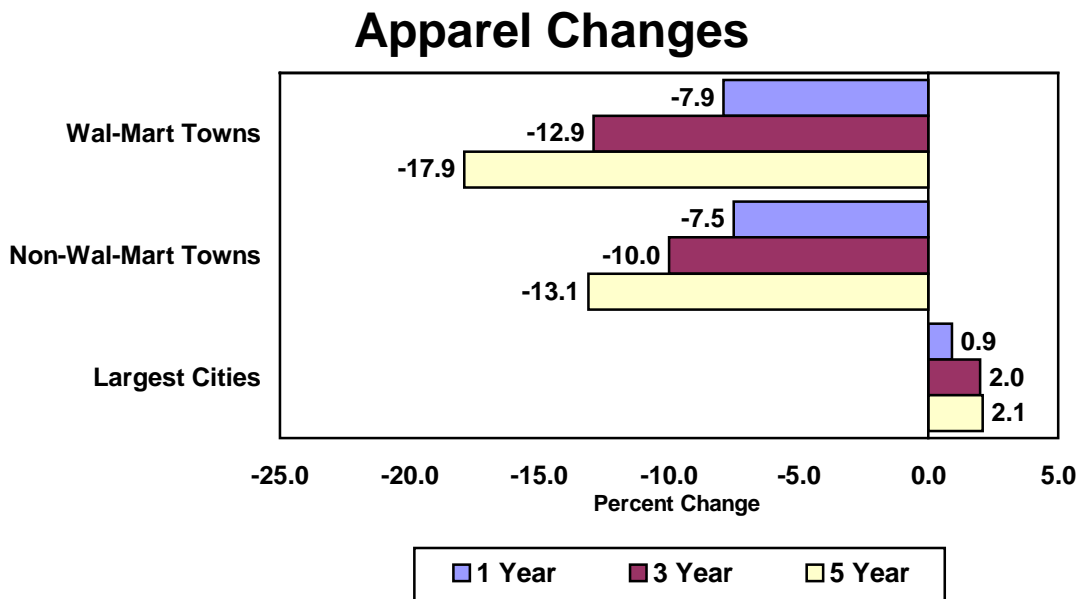
**Wal-Mart Towns.** Apparel store sales in the Wal-Mart towns declined by 7.9 percent after the first year of a Wal-Mart store, as shown in Figure 4. Sales were

down 12.9 percent after three years and declined further to 17.9 percent after five years. These are large losses and probably indicates that many of the local apparel stores were positioned at the low end of the market, thereby competing directly with the Wal-Mart apparel departments. **In a few towns where there was a good mix of upscale apparel stores, sales increases were enjoyed by apparel stores since they were not competing directly, but benefited from the additional traffic generated by the Wal-Mart store.**

**Non-Wal-Mart Towns.** As shown in Figure 4, apparel store sales in non-Wal-Mart towns showed a steady decline over the first five years. The losses were 7.5 percent after one year, 10 percent after three years and 13.1 percent after five years. **Again one would have to conclude that the loss of sales to the apparel stores was probably at the low end since that is primarily what discounters like Wal-Mart handle.**

**Cities.** Iowa cities showed gradual gains in apparel sales and appeared to be little affected by the growth of Wal-Mart stores. As shown in Figure 4, sales were up 0.9 percent after one year, and increased to 2.0 and 2.1 percent after three and five years, respectively.

Figure 4



\*Changes are cumulative from base year.

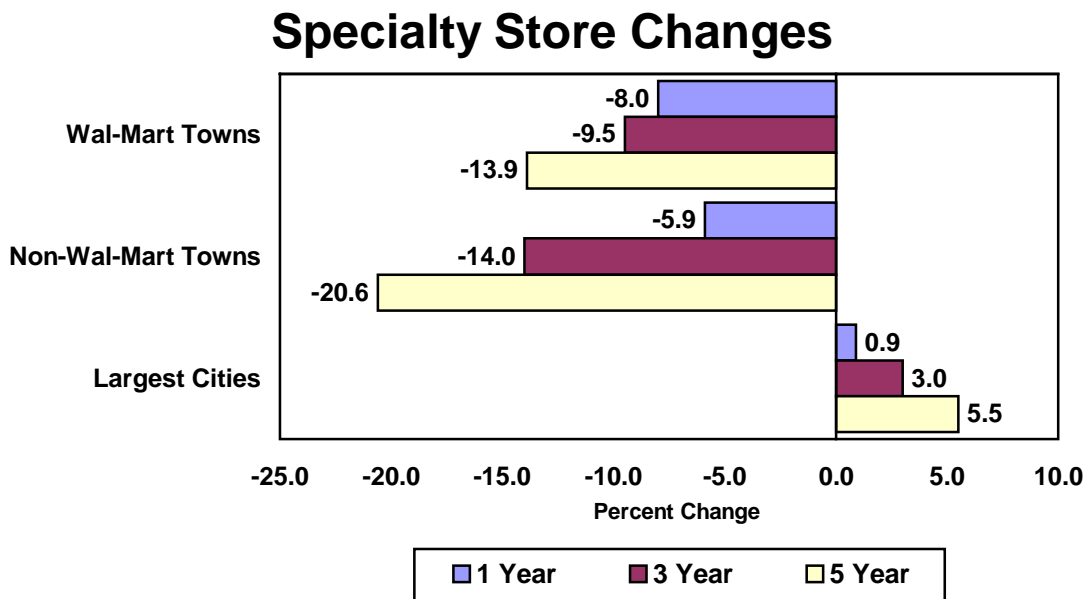
## Specialty Stores

Specialty stores consist of drug stores, sporting goods, books and stationary stores, jewelry stores, gift and novelty shops and a few others. These stores were severely impacted in both the Wal-Mart towns and the non-Wal-Mart towns. This is because most of these stores sell the same merchandise that is being sold in a Wal-Mart store.

**Wal-Mart Towns.** Figure 5 shows an 8.0 percent decline in specialty store sales the first year after a Wal-Mart store opens. The cumulative decline was 9.5 percent after three years, but jumped to 13.9 percent after 5 years. Only a few towns escaped this decline in specialty store sales. These were towns such as Pella, a Dutch town, and Spirit Lake, a lake resort town that brought in a large number of tourists, who apparently patronized the specialty stores.

**Non-Wal-Mart-Towns.** The first year loss of sales in non-Wal-Mart town specialty stores was 5.9 percent, but widened to a 14.0 percent decline after three years and slipped to 20.6 percent decline after five years. During the five year interim, more and more Wal-Mart stores were opened and it appears that people in the non-Wal-Mart towns chose to shop in Wal-Mart towns since they could reach one with minimal travel.

Figure 5



\*Changes are cumulative from base year.

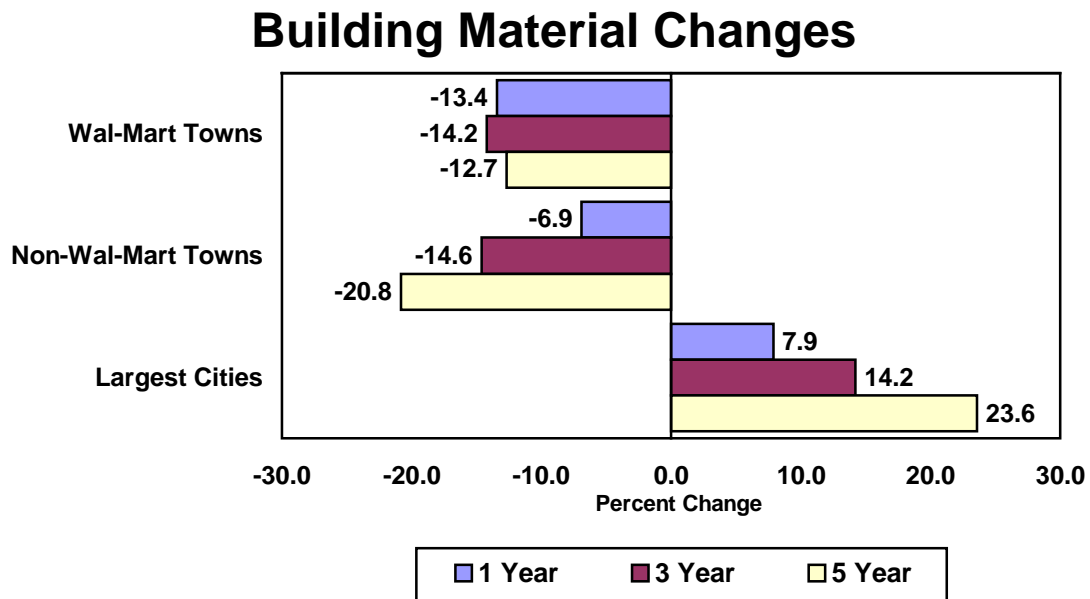
**Cities.** Specialty stores in Iowa cities continued to enjoy growth and apparently were little affected by the introduction of Wal-Mart stores. After one year, sales were up 0.9 percent and continued to increase by 3.0 percent after three years and by 5.5 percent after five years.

**Building Materials Stores**

Building materials stores consist of lumber yards, home improvement stores, hardware stores and paint/glass stores. These types of stores are being impacted by discount general merchandise stores to some extent, but the category killer home improvement stores such as Home Depot, Builder’s Square and Lowe’s, seem to be having a more severe impact on local smaller stores. Iowa does not yet have Home Depot, Builder’s Square or Lowe’s stores, but has some strong regional category killer stores such as Menard’s and Payless Cashways.

**Wal-Mart Towns.** Figure 6 shows that sales of building material stores in the Wal-Mart towns dropped an average of 13.4 percent after the first year of a Wal-Mart store. The cumulative decline was 14.2 percent after three years, but recovered slightly to a 12.7 percent cumulative decline after five years.

Figure 6



\*Changes are cumulative from base year.

**Non-Wal-Mart Towns.** As shown in Figure 6, building material stores in non-Wal-Mart towns experienced a 6.9 percent reduction in sales after one year of Wal-Mart stores, but the sales losses slipped to 14.6 percent after three years and further declined to a cumulative reduction of 20.8 percent after five years.

**Anecdotal evidence suggests that people from non-Wal-Mart towns were switching the purchase of some items such as housewares, toys, sporting goods, etc. from local hardware stores to Wal-Mart stores and switching the purchase of lumber, tools and building supplies from the local lumber yards and hardware stores to the category killer stores in the cities.**

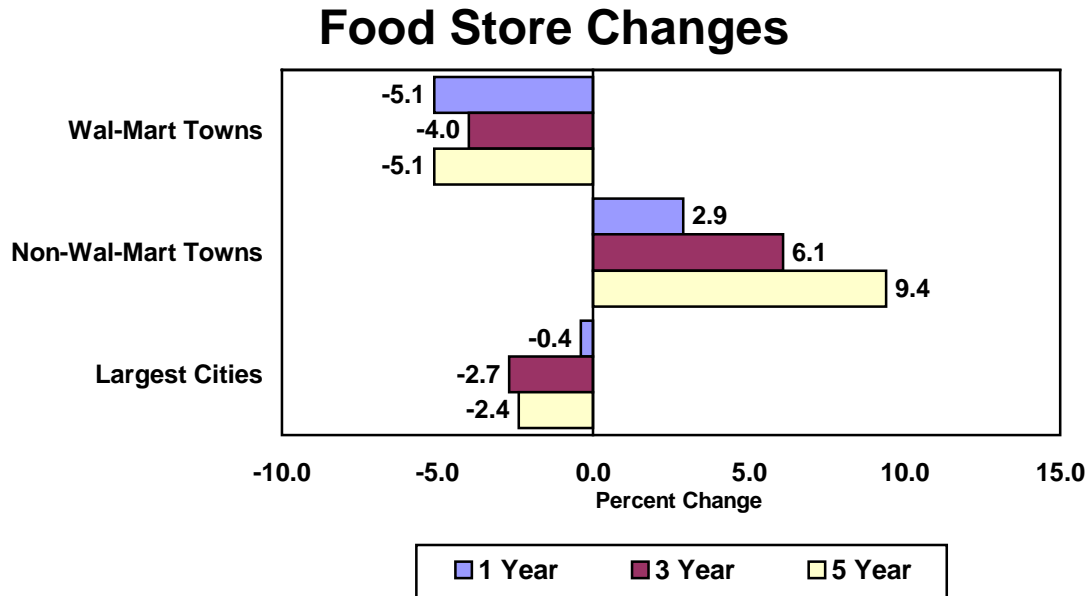
**Cities.** Figure 6 shows the very rapid growth of building material stores in the cities. Sales increased by 7.9 percent after one year, by 14.2 percent after three years and by 23.6 percent after five years. There can be little doubt that the category killer building materials stores are rapidly capturing a good share of the market.

## **Food Stores**

Food Stores are primarily grocery stores or supermarkets. Structural changes have been happening in this segment of the market for some time. For example, in the last 15 years, Iowa has had a net loss of 845 grocery stores, a 43 percent reduction. Most of these losses have been from small towns of less than 1,000 population. When a small town loses its grocery store, town residents have no choice but to travel to a nearby larger town to shop for groceries. Therefore, towns of 5,000 population and above have typically shown an increase of grocery sales over this period.

**Wal-Mart Towns.** Wal-Mart towns experienced an average 5.1 percent decline in grocery store sales the first year after a Wal-Mart store opened, as shown in Figure 7. After three years, cumulative sales were down 4.0 percent, but after five years had slipped to 5.1 percent again. This is contrary to the trends for other towns of this size. **About 25 to 30 percent of the sales of a traditional supermarket are non-food items such as health and beauty aids, cleaning supplies, pet supplies, greeting cards and magazines and it appears that people in the Wal-Mart towns are switching the purchase of these items from the local grocery store to the Wal-Mart store. It also appears that people attracted to the Wal-Mart store from outlying areas do not spill over to shop at the grocery stores.**

Figure 7



\*Changes are cumulative from base year.

**Non-Wal-Mart Towns.** Figure 7 shows that grocery stores in non-Wal-Mart towns enjoyed nice increases in sales. After one year sales were up 2.9 percent. The cumulative increases were 6.1 percent after three years and 9.4 percent after five years. This is what one would expect to happen, given the large loss of grocery stores in the smaller towns, but the Wal-Mart towns did not benefit like the non-Wal-Mart towns did. This finding also seems to indicate that people shop for groceries as close to home as possible.

**Cities.** As shown in Figure 7, food store sales decreased by 0.4 percent after one year of Wal-Mart stores, by 2.7 percent after three years and by 2.4 percent after five years. Food is the only category, besides general merchandise, that declined in the cities. This was probably caused by the membership warehouse clubs such as Sam's and Pace that captured some of this business. If in fact, people from the outlying areas were making less trips to the city after getting Wal-Mart stores in their area, this too could account for some of the reduction of city grocery sales.

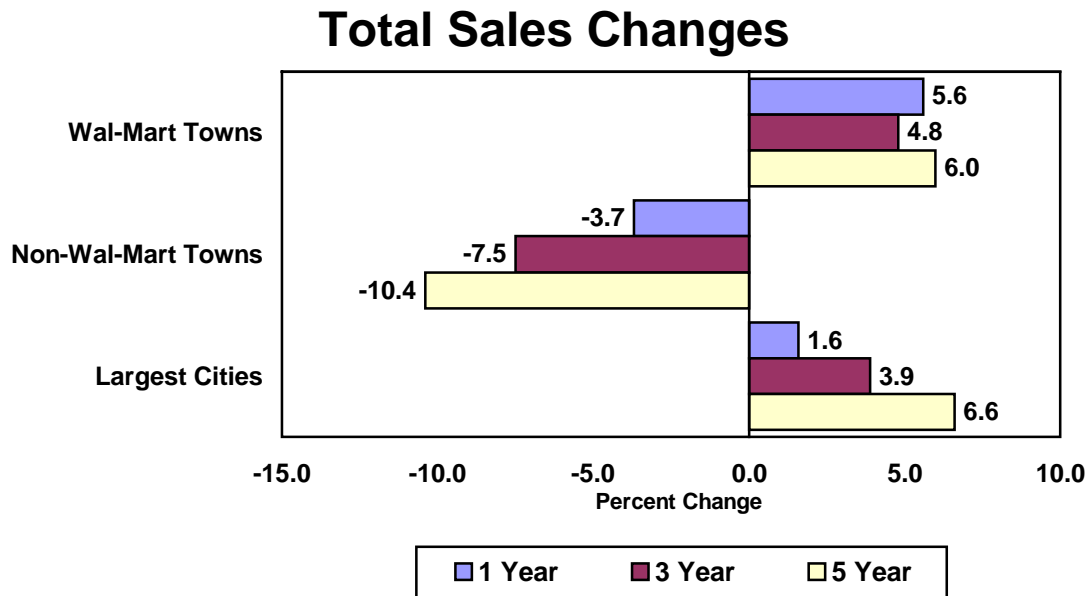
### Total Retail Sales

Total retail sales includes the categories discussed above plus categories such as automotive, services and miscellaneous that were probably little affected by the introduction of Wal-Mart stores in the state.

**Wal-Mart Towns.** Figure 8 shows an increase in total sales, on average, for towns with Wal-Mart stores. Sales were up 5.6 percent after the first year, 4.8 percent after the third year and 6.0 percent after the fifth year. As will be seen later a big share of this gain accrued to the Wal-Mart stores.

**Non-Wal-Mart Towns.** As shown in Figure 8, the non-Wal-Mart towns did not fare very well as Wal-Mart stores opened across the state. Total sales were down 3.7 percent after one year, slipped further to a 7.5 percent decline after three years, and ended up down 10.4 percent after five years. As was earlier postulated, shoppers in non-Wal-Mart towns probably left their towns to shop in Wal-Mart towns more often as time went on since new Wal-Mart stores were established closer and closer to the non-Wal-Mart town.

Figure 8



**Cities.** Total sales in the cities continued to grow after the introduction of Wal-Mart stores. Figure 8 shows a 1.6 percent increase after one year, a 3.9 percent increase after three years and a 6.6 percent increase after five years.

### Additional Effects on the Wal-Mart Town

The previous analysis determined the percent change in various merchandise groups. This section will examine the impact on the host town in terms of dollars and will look at longer-term effects.

**Dollar Impact on Business in the Wal-Mart Town.** Figure 9 shows the average change in dollar sales of merchandise categories in the Wal-Mart towns after three years. The average size town in the study was 15,141 population. On average, the following types of stores experienced losses of sales as shown, compared to the year before Wal-Mart opened.

Apparel stores	-\$659,000
Building Materials stores	-\$961,000
Food stores	-\$1,356,000
Specialty stores	-\$1,845,000
Miscellaneous stores	-\$693,000

The following types of stores in the host town, on average, experienced gains of sales three years after the opening of a Wal-Mart store, as shown.

Home Furnishings stores	\$223,000
Eating & Drinking firms	\$663,000
General Merchandise stores	\$11,474,000
Total sales	\$8,230,000

Figure 9 did not account for Wal-Mart's share of these sales. Figure 10 nets out the sales to see how much was captured by the Wal-Mart store and what the net change was on the other local businesses after three years. To construct Figure 10, Wal-Mart's sales had to be taken into consideration. Wal-Mart, like most other companies will not release individual store sales, therefore an estimate was made. The Wal-Mart store sales estimate was made assuming an average store size of 70,000 square feet at an average of slightly less than \$300 sales per square foot per year, thus arriving at estimated store sales of \$20 million per year. The total sales increase of \$8.23 million was rounded off to \$8 million for this chart.

**The interpretation of Figure 10 is that if the average Wal-Mart store in the study had annual sales of \$20 million and the average increase in the host town's sales was \$8 million per year, then there was a resulting reduction of sales of \$12 million per year to existing merchants. Further analysis shows, however, that about 70 percent of the \$12 million reduction was suffered by existing general merchandise stores. That means that smaller local merchants suffered average combined losses of \$3.5 million of sales annually. These figures are averages; some towns fared better, some fared worse.**



Figure 9

### Sales Change For Average Wal-Mart Town of 15,141 Population After 3 Years\*

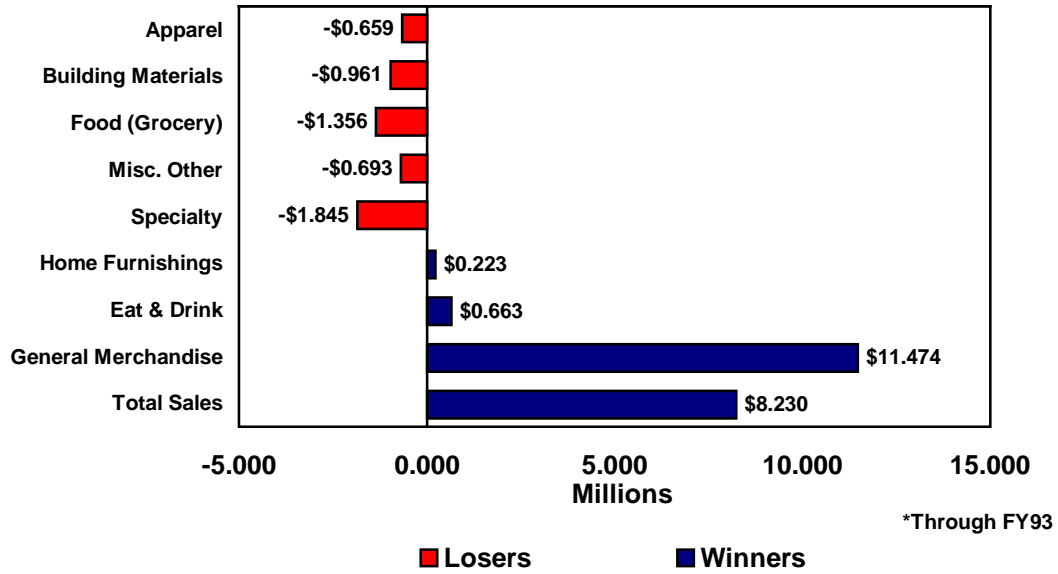
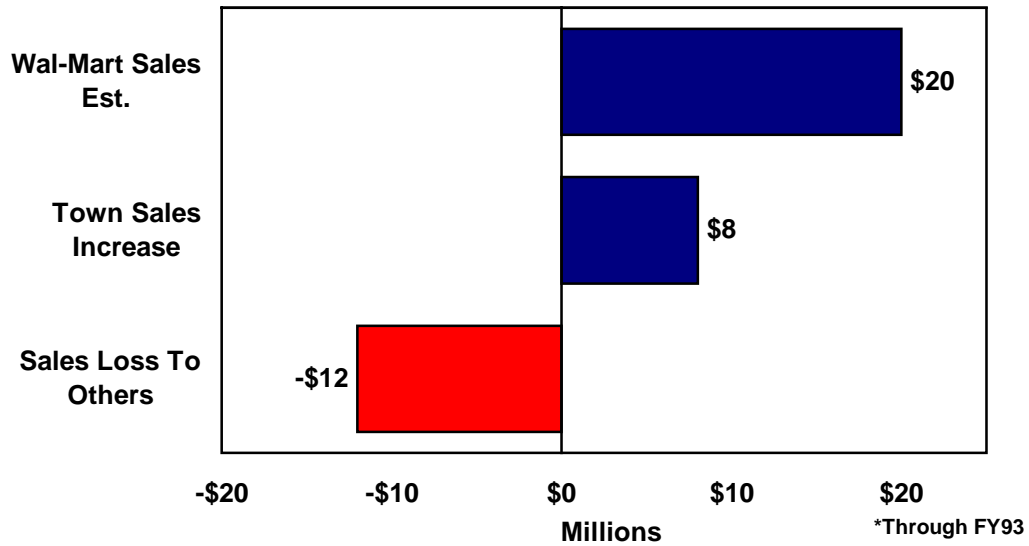
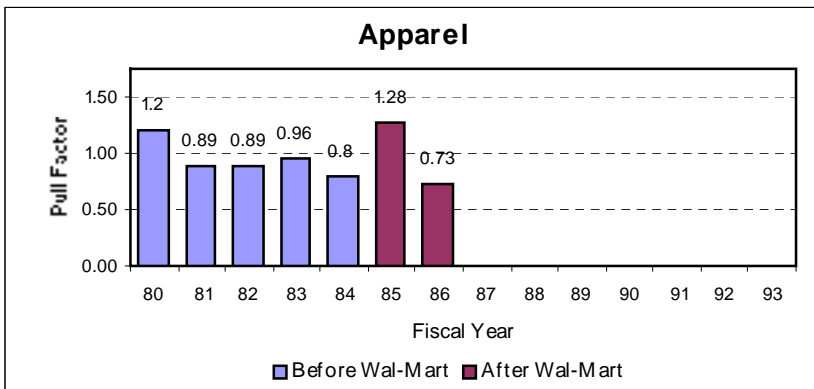
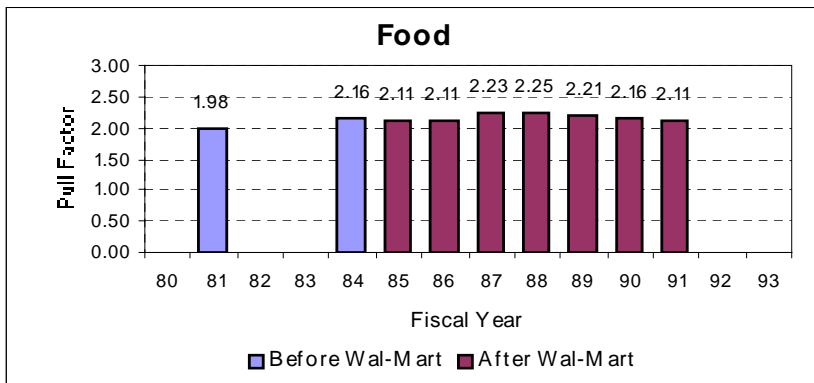
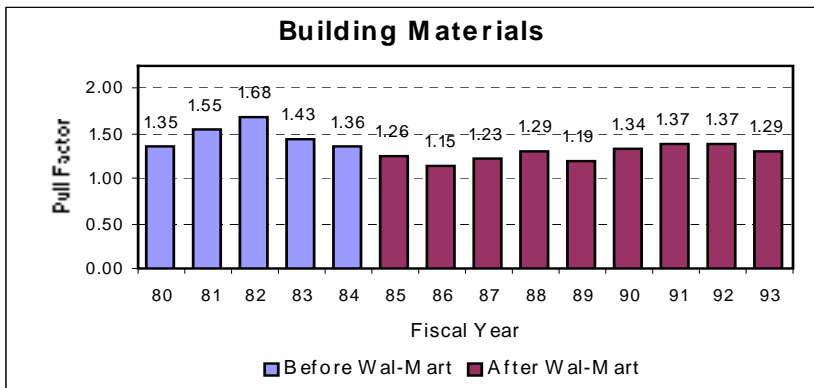
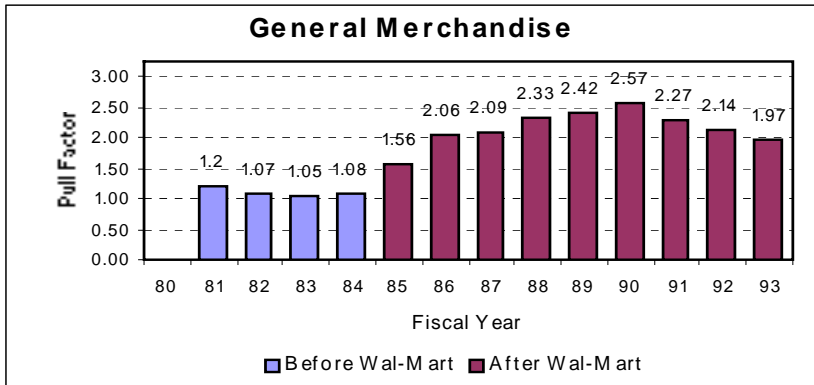


Figure 10

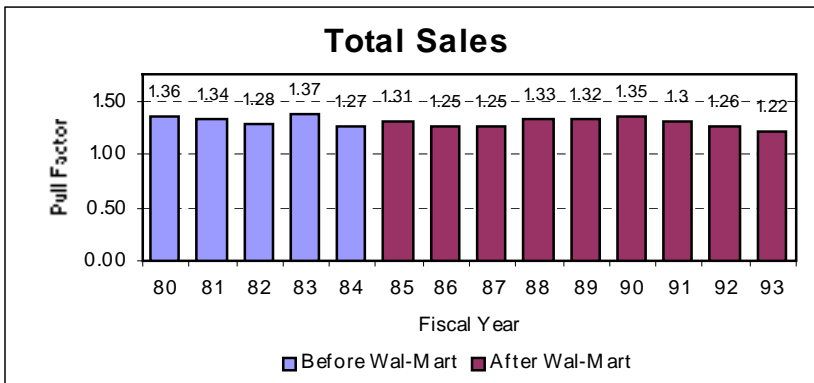
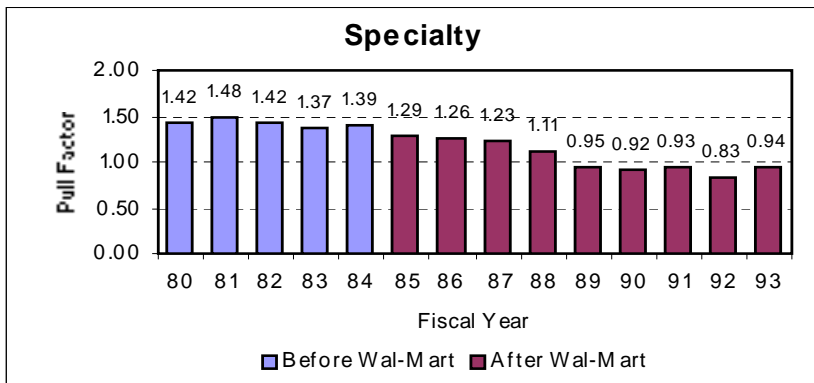
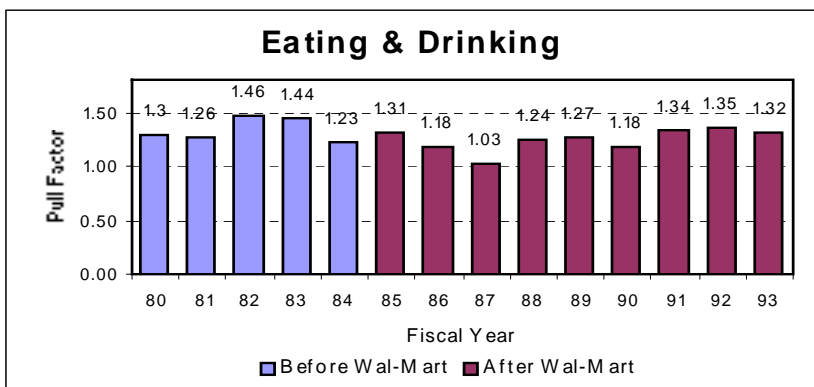
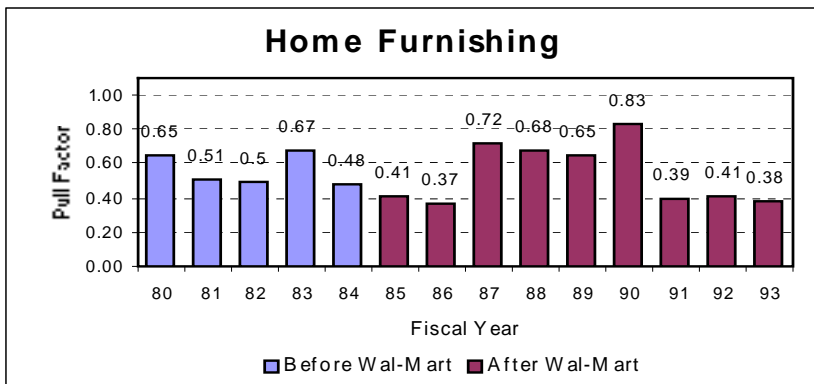
### Average Net Sales Change After 3 Years In Wal-Mart Host Town\*



**Figure 11a**  
**Change in Sales for Independence, Iowa**

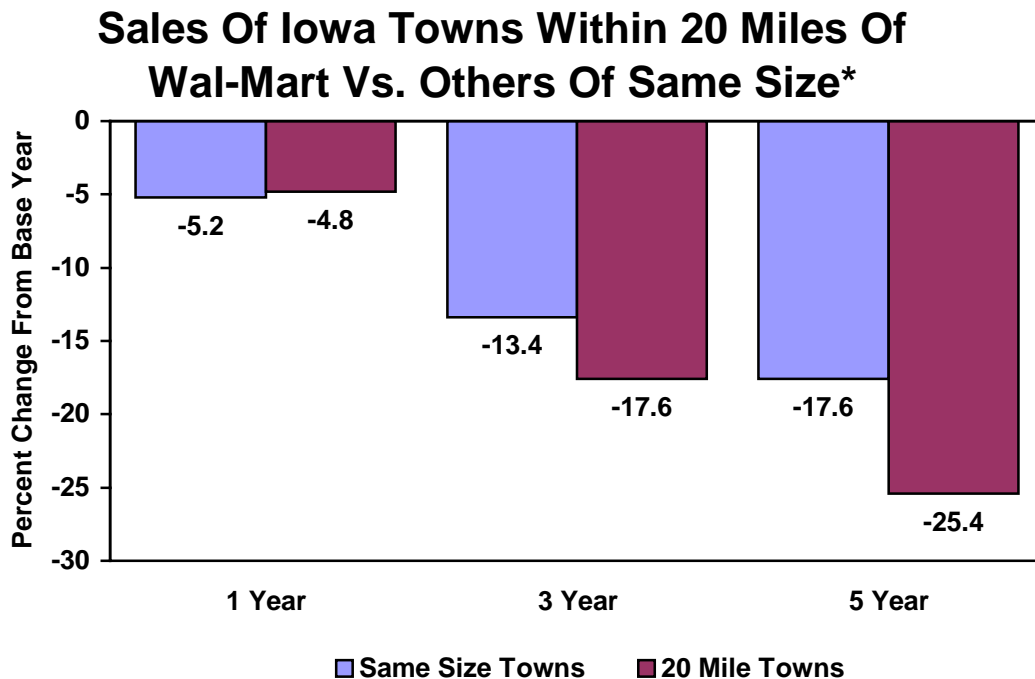


**Figure 11b**  
**Change in Sales for Independence, Iowa**



**The Saturation Effect.** Nearly all of the 34 towns in this study showed an initial increase in pull factor (trade area size) in the first year after the Wal-Mart store opened. This is due to the curiosity factor (many people in the area checking out the new store) and to the capturing of trade from nearby smaller towns. This was particularly true in the early years when the few Wal-Mart stores were widely scattered and shoppers would travel long distances (50 or more miles) to patronize them. However, as time went on, the gaps between the stores were filled with more new Wal-Mart stores. This meant that many of the early stores that drew customers from long distances now might draw from only 12 to 15 miles as new stores were sometimes placed 20 to 25 miles from the old store. Eventually nine of the 34 towns ended up with smaller pull factors (smaller trade areas) as the saturation of stores became a fact. Figure 11 shows pull factor charts for Independence, Iowa, typical of the nine towns with shrinking trade areas. It can be seen that the 1993 pull factors were lower for all categories except general merchandise and eating and drinking than they were in 1984, the year before the opening of the Wal-Mart store. The chart for general merchandise clearly points out the year that new stores were built on either side of Independence. The general merchandise pull factor peaked at 2.57 in 1990 and then declined 23 percent to 1.97 in 1993, as sales were recaptured by the new Wal-Mart stores that opened in Manchester and Waterloo, approximately 25 miles east and west, respectively.

Figure 12



\*Towns 500-5,000 Population

## Impact on Smaller Towns

It seems fairly clear that smaller towns suffer the brunt of the discount mass merchandisers. To verify this premise, all small towns (less than 5,000 population) within a 20 mile radius of a Wal-Mart store were examined for sales changes. These changes were compared to all other small towns that were more than 20 miles from a Wal-Mart store. Figure 12 shows the change in sales for these towns. In the first year after a Wal-Mart store opening, both near and distant small towns had sales reductions of approximately five percent. After three years the small towns within 20 miles of Wal-Mart stores showed cumulative sales declines of 17.6 percent versus 13.4 percent for those further away. It appears that merchants in the nearby small towns may have continued to operate the first two years, but began closing their stores by the third year, thereby causing the greater decrease in sales than in the distant towns. After five years, sales in the 20 mile small towns had declined by 25.4 percent versus 17.6 percent for those further away. These are large losses for small towns, but are worse for the nearby towns.

**Loss of Sales by Town Size.** Table 1 shows the actual change in sales for small towns, delineated by population group, from 1983 to 1993. This data is taken from *Iowa Retail Sales and Use Tax Reports*. The total sales declines are divided by the average sales per business to determine the number of businesses lost. This number is an accurate portrayal of the actual businesses lost, but will not correlate with the number of businesses shown in the sales tax reports. This is because many of the original businesses lost were relatively large and their vacant space was often filled by very small businesses. For example a hardware store with sales of \$400,000 per year may have quit business, but the resulting vacant space may have been filled with a hobby shop and beauty shop with combined sales of \$40,000 per year.

**Table 1. Change in Sales and Number of Businesses in Small towns, 1983-1993**

Population Group	% Change in Sales 1983-1993	\$ Change in Sales 1983-1993	Total Number of Businesses Lost	Average Number of Businesses Lost per Town
5,000-2,500	-16.90%	(\$311,724,829)	1,068	20
2,500-1,000	-27.60%	(\$534,385,422)	1,832	12.5
1,000-500	-46.80%	(\$488,853,303)	1,679	9.3
<500	-39.30%	(\$244,926,652)	839	2.5
Rural	-43.40%	(\$556,651,481)	1,908	N/A
TOTAL		(\$2,136,541,687)	7,326	

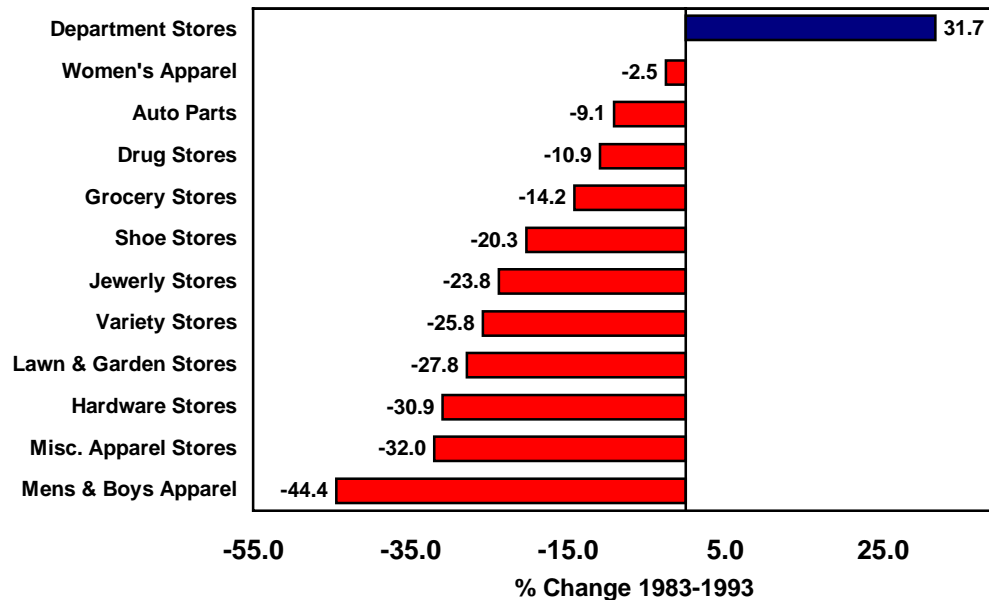
Table 1 shows the percent sales loss varying from 16.9 percent for towns of 2,500-5,000 population to 46.8 percent for towns of 500-1,000 population. Rural businesses (those outside towns) had the largest dollar sales loss at \$556,651,481

for the 1983-1993 period. The total sales for towns below 5,000 population plus those in rural areas was over \$2.1 billion less in 1993 than they were in 1983. This indicates a huge shift of sales to larger towns and cities, with substantial amounts captured by mass merchandise stores.

The total number of businesses lost was derived by dividing the lost sales by the 1993 average sales per business in the state. The numbers varied from 839 for towns of less than 500 population to 1,908 for rural businesses. The estimated total number of businesses lost in small towns and rural areas is 7,326 from 1983 to 1993. By dividing the businesses lost by the number of towns, the average number of businesses lost per town was derived, and varied from 2.5 per towns of less than 500 population to 20 for towns of 2,500-5,000 population.

Figure 13

### Percent Change In Market Share In Iowa Stores 1983-1993



### Changes in Consumer's Buying Habits

The State of Iowa lists statewide sales for stores by three-digit Standard Industrial Classification (SIC) code. In other words, the change in statewide sales is listed in more detail than the sales by town that are listed by two digit SIC code. Therefore, it was possible to determine the change in per capita expenditures in different types of stores in more detail than has been discussed heretofore. Figure

13 shows the present change in per capita sales from 1983 to 1993 for selected types of business. Department stores were the big winner, with a 31.7 percent increase. These increases undoubtedly accrued mainly to the discount department stores (primarily Wal-Mart), since they were in an expansionary mode during this period. Figure 14 shows that this increase in spending meant that Iowans spent over \$425 million more in department stores in 1993 than they did in 1983.

At the other end of the scale, the average Iowan spent 44.4 percent less in men's and boy's apparel stores in 1993 than they did in 1983. As shown in Figure 14 this amounted to \$47.8 million less sales and translated to a loss of nearly 43 percent of the stores going out of business during that period. As can be seen from Figures 13 and 14, several other types of businesses sustained heavy losses of sales from 1983 to 1993. The net loss of these types of stores for the State of Iowa during this period are shown in Table 2.

**Table 2. Iowa Statewide Losses of Selected Retail Stores, 1983-1993**

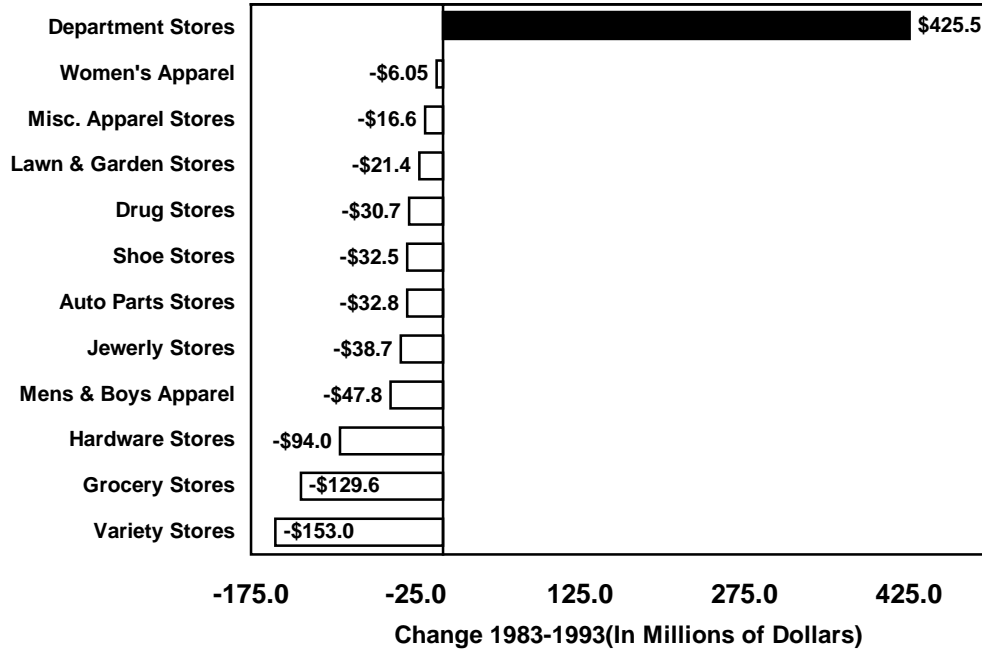
<b>Type of Store</b>	<b>Number Lost</b>	<b>Percent Lost</b>
Men's and Boy's Apparel	-111	-42.9%
Variety Stores	-161	-42.4%
Grocery Stores	-555	-33.6%
Hardware Stores	-298	-33.4%
Shoe Stores	-153	-29.5%
Department Stores	-88	-26.2%
Building Materials Stores	-293	-25.7%
Women's Apparel	-158	-18.5%
Lawn and Garden Stores	-94	-17.9%
Jewelry Stores	-111	-16.8%
Drug Stores	-116	-16.0%
Miscellaneous Apparel	-22	-6.1%
Auto Parts Stores	-29	-2.4%

### **Summary and Conclusions**

When a discount general merchandise store opens in a smaller-to-medium size town with little population growth, there will be both positive and negative effects. The retail trade area size will expand. Businesses selling merchandise different from the discounter usually benefit from the increased traffic flow the first few years. Businesses selling the same merchandise as the discounter usually lose sales. Unfortunately, the discounters usually saturate the market with their stores which causes some towns' trade areas to shrink to a smaller size than before.

Figure 14

### Dollar Change In Market Share In Iowa Stores 1983-1993



Towns of a similar size without a large mass merchandiser have suffered sales losses in nearly all categories except food, as residents either outshop to the nearby discount store or travel to the cities to shop at a category killer store.

The largest towns and cities continue to gain sales in all categories except general merchandise and groceries. It appears that discount mass merchandiser stores are holding customers in the local area to shop for general merchandise to a greater extent than before, thereby causing fewer shopping trips to the city.

The smallest towns suffer heavy losses in sales, ranging from 16 percent to over 46 percent over a 10 year period.

The shopping habits of customers fundamentally change after the introduction of discount mass merchandisers. They purchase more of their merchandise at the mass merchant and less at local merchants. The result is the loss of many stores across the state.



## How Merchants Can Compete

### Attitudes and Actions.

In general it is best to take a positive attitude toward the opening of a new mass merchandise store in your area. The following thoughts are offered in this regard.

- **In a free enterprise economy, all firms are free to compete.**  
However, local officials should be careful not to offer unduly generous incentives to large firms that could place smaller firms at a disadvantage.
- **Recognize that a discount mass merchandise store will probably enlarge your town's retail trade area size.** Try to figure out ways to capitalize on the increased volume of traffic to town.
- **It is possible to co-exist and even thrive in this type of environment.**
- **You may need to change your methods of operation as described below.**

### Merchandise Tips.

The following suggestions are offered with regard to merchandise mix.

- **Try not to handle the exact merchandise.** For example, at least three of the largest mass merchandisers sell a particular brand of men's jeans for around \$10. There are cases where smaller merchants sell the same brand jean for \$15. Customers automatically detect that the smaller merchant is 50 percent higher priced and often assume that everything else in the store is 50 percent higher. A better strategy would be to sell another brand that is not directly comparable. Consider private label merchandise.
- **Sell Singles instead of Pre Packaged Groups.** Mass merchandisers often sell pre packaged merchandise that contain multiple items. Customers often need only one item. Independent merchants can often meet these needs by unbundling packages and selling items as singles. For example, a crafts store may gain new customers and make more profit by selling singles of various supplies such as templates, paint brushes, etc.
- **Try to handle complementary merchandise.** In many departments such as hardware, electrical, plumbing, lawn and garden and others, the mass merchandisers handle only fast moving merchandise. Astute competing merchants should expand their lines to be more complete than their giant competitors. Customers will soon learn to go directly to the more complete store if their needs are out of the ordinary. For example, a customer building a back yard storage shed requiring 15 pounds of nails and 100 bolts will be sadly disappointed if he or she

shops at a discount general merchandiser and finds only small pre-packaged assortments. Their needs will be much better met by a hardware store that has a wide assortment of these items in bulk quantities.

- **Look for voids in the mass merchandiser's inventory.** For example, Most discount general merchandisers do not handle the higher priced name brand athletic shoes desired by so many today. A smart competing sporting goods dealer would handle a full line of better athletic shoes.
- **Consider upscale merchandise.** Not all customers desire or demand lower priced merchandise. For example, there are cases of smaller children's wear stores which prosper in the shadow of a discount general merchandiser by catering to the tastes and preferences of middle-to-upper income clientele and to the "grandparent trade" where money is often not as much of a factor as it was when they were young parents.
- **Get rid of the "dogs".** Nearly all businesses end up with merchandise that does not sell and ends up cluttering the shelves. This is bad for at least two reasons, 1.) merchandise must turn to generate a profit, and 2.) old merchandise tarnishes the image of your store. Merchants should identify the "dogs" and clear them out by whatever means possible.
- **Buy Well.** From time to time, nearly all merchants have an opportunity to purchase merchandise at exceptional prices. If the merchandise is something they know they can sell, they should take advantage of the good buys. They can enhance their pricing image while making better profit margins. Store owners should also be on the lookout for opportunities to purchase cooperatively with other local merchants or through a larger buying cooperative.
- **Find a niche that you can fill.** Smaller merchants can often succeed by merely finding the various voids in the mass merchandisers' inventory and filling them as described above.

### Marketing Tips.

There is always room for improving marketing practices. The following tips are offered to merchants regardless of their competition.

- **Know Your Customers.** It is important to know the demographics of your trade area in order to have the optimal merchandise mix. The breakdown of the population by income and age is available from census data kept on file at libraries and governmental agencies. However, computer marketing firms can quickly generate a detailed report, tailored to your specific trade area for a nominal fee. One such company is CACI Marketing Systems at (800) 292-CACI. In addition

you may want to conduct customer focus groups where diverse groups of customers under the direction of a third party discuss what they like and dislike about your business. These can be done by community colleges, other colleges and universities and private consultants.

- **Extended opening hours are a necessity!** Lifestyles have changed dramatically in the last generation. Now it is quite common for a household to have multiple wage earners working outside the household. Most of these people simply cannot get to local stores to shop if they stay open from 8:00 a.m. to 5:00 p.m. and by necessity they shop at mass merchandisers and shopping malls where the opening hours are more in tune with today's societal needs. Downtown merchants and other independent merchants can not seriously compete in this environment unless they cooperate and offer similar convenient opening hours.
- **Look for ways to improve your returns policies.** Most mass merchandisers have very liberal returns policies. Unfortunately, many smaller independent merchants cannot offer comparable policies because of their lack of leverage with major suppliers. In the long run they need to work through trade associations and buying groups to achieve comparable leverage with suppliers. In the short run and at all other times, they need to use common sense with regards to returns policies. For example, if a customer purchases a piece of lawn equipment in May and brings it back shortly thereafter complaining of a malfunction that required factory repair, the dealer would be well advised to give the customer a new replacement immediately or at least offer a loaner until the repaired item is returned. I know of a case such as this where, the customer was left empty handed until August when the repaired item finally came back from the factory. Needless to say, he was not happy.
- **Sharpen your pricing skills.** (E.g.; lower prices on items that people purchase frequently). It is my contention that many consumers do not know the "going price" of much of what they buy. They tend to know the price of the things they purchase frequently, or the things they have seen advertised recently. Discount mass merchandisers recognize this and tend to focus their lowest prices on these items. The average customer then assumes that prices on all other items must also be less. Conversely, many local merchants have gotten a "bad rap" on price image when they have not been careful in pricing some of the "hot items" and consequently, consumers then infer that everything else in the store is also high priced. Independent merchants need to carefully consider what items customers tend to know the price of and make special efforts to keep these prices competitive both through prominent displays and advertising.

- **Focus your Advertising.** Stress your competitive advantage. Every business must have one or more competitive advantages, in the eyes of the customer in order to succeed. For example, Sears established a huge competitive advantage when it adopted “Satisfaction Guaranteed”, many years ago. With Wal-Mart, “Everyday Low Prices”, is a strong competitive advantage. Large firms incorporate these competitive advantages into nearly every advertisement. Unfortunately, many smaller merchants do not get their full money’s worth from their ads because they often fail to promote their competitive advantages. For example, a drug store with 24-hour prescription service and free delivery ought to incorporate those facts into every ad. Likewise, an apparel store that features special orders and in-store credit should stress those features in its ads. The point is that after awhile, customers will automatically know your competitive advantages and may patronize your store when the need arises.

### Service Tips.

Superior service can become an important competitive advantage for many smaller businesses. Large chain stores usually don’t have the flexibility to offer many of these services.

- **Emphasize expert technical advice.** It is difficult to find workers in discount mass merchandise stores who know the merchandise. There are many examples of smaller merchants who build a loyal clientele because they are able to help customers analyze their problems and help them find the tools, supplies and equipment needed to meet their needs.
- **Offer deliveries where appropriate.** A certain segment of our population has need for the delivery of certain items such as prescription drugs, and heavy or bulky items. Typically mass merchandisers cannot respond to these needs. Some smaller merchants can carve out a certain market share by offering delivery service.
- **Offer on-site repair or service of certain items.** Nearly everyone has a need to have some item repaired or serviced occasionally. Larger discount stores usually cannot readily provide this service. Independent merchants can draw a substantial volume of trade to their stores by providing repairs and service of merchandise.
- **Develop special order capability.** It is not possible for merchants to carry every conceivable item in inventory. However, they can make arrangements with certain suppliers or cooperating partner stores to priority ship needed items. Fax machines and express delivery services are making this feasible today. So rather than let a customer walk out the door when an item is not in inventory, it is better to say, “I’m sorry I do not have it in stock, but I can get it for you in two days.”

- **Offer other services as appropriate.** Independent merchants can develop many loyal customers by offering “how to do it” classes, gift wrapping, rentals of certain items that will boost sales of collateral merchandise, etc.

### Customer Relations Tips.

In past years, small businesses had the reputation of excellent customer relations. However, nowadays many consumers perceive that they are treated no better in small firms than in larger ones. Research has shown that poor customer relations is the primary reason that customers quit doing business with a store. The following suggestions are offered for all businesses.

- **Make sure customers are “greeted”.** According to surveys in Iowa the primary thing that offends customers is the failure to be greeted or acknowledged when entering a store. This is particularly acute when the customer is in the buying mood. All store personnel should be trained to “greet” customers when they enter a store, determine their needs, and assist them.
- **Offer customers a smile instead of a frown.** All customers prefer to do business where they are treated in a friendly manner.
- **Make employees “associates”.** Firms like Wal-Mart and J.C.Penny call their employees associates and treat them as part of a team. Independent merchants can emulate this. In particular, regular store meetings should be held where everyone is apprised of the latest happenings and plans and where all problems can be aired.
- **Solicit complaints.** Many times customers have a bad experience in a store, but they are reluctant to complain to store personnel for various reasons. Instead, they go around complaining to other people. Good merchants would rather hear of the complaint first so they can find a remedy. They can provide an environment where customers feel comfortable in complaining by soliciting complaints through ads, through signs at the checkout counters, by signs on shopping bags, etc.
- **Learn how to handle irate customers.** Dealing with irate customers is something few people enjoy, but is crucial to the success of the business. The worst thing store representatives can do is argue with or be rude to an irate customer. The following process with the acronym of LEAR is recommended. (L) Listen. It easy to become defensive and to turn off the customer while you are thinking of your response, but it pays to set everything aside and listen intently. (A) Ask questions to get all the facts on the table. (R) Resolve the situation to the satisfaction of the customer. Most merchants have found that by merely asking, “What do you see as a reasonable solution?” they can achieve a win-win solution.

- **Train employees (often).** In the eyes of the customer, the employee **is** the business. Training employees can have one of the highest payoffs of any investment in the business. Training is available through Small Business Development Centers, university extension services, community colleges, parent companies, franchisers, and others. Also, there is a wide array of videotapes available today where training can be conducted in the store.

### **Continually Improve the Efficiency of Your Business.**

Businesses may be doing all the right things as mentioned above, but unless they are efficiently operated, they are probably doomed to failure. Some of the top mass merchandisers such as Wal-Mart and Home depot continually strive to improve their operating efficiency.

- **Adopt modern technology.** Mass merchandisers have improved their efficiency dramatically by adopting new technology. Much of that technology is now available and affordable to smaller merchant. For example, powerful computers are available at ever decreasing prices. Software packages to handle nearly all store functions are also available. Computers reduce the need for people, improve accuracy and provide quick analysis of the business' performance. In addition, point of sale (POS) scanner equipment is also now available and affordable to all but the smallest businesses. In addition to scanning prices and speeding customers through the checkout line, they can revolutionize inventory control when tied in with the store computer and ultimately with supplier's computers.
- **Become familiar with your financial statements.** Many merchants do not like to deal with the finances of the business. If they can "farm" this operation out to a bookkeeper or accountant, they feel "out of sight, out of mind". Good merchants must become intimately familiar with the finances and operations of their businesses. They should constantly monitor gross profit margins, operating expenses, net profits and the various ratios important to the business.
- **Relentlessly find ways to reduce operating costs.** One of the reasons that the mass merchandisers can lower prices and still make a profit is that they continually reduce their operating costs. In addition to adopting technology, they find ways to save on utilities, insurance, transportation, etc. They are also always finding ways to reduce "shrinkage" by reducing shoplifting, pilferage and damage to merchandise. Smaller merchants can do the same thing.