

PART I

The Theory

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CHAPTER ONE

**EST: A COMPASS
TO AVOID RETAIL'S
BLACK HOLE**



Beware the Black Hole!

The Black Hole is the place where retail companies that are no longer relevant to customers go to die. As you may recall from high school physics, a black hole is a region in space where the gravitational pull is so strong that not even light can escape. That is also an apt description for retailers that have not established themselves as the best store for customers looking to fulfill a specific need: Once they are in the Retail Black Hole, it's next to impossible to get out.

In recent years, the number of retailers entering the Black Hole increased as store productivity slowed and competition increased. Not only the small, regional chains were failing. Big-name retailers with hundreds of stores—some nationwide—were going out of business.

Chapter 11 bankruptcy has become practically a household phrase among U.S. consumers, with Kmart filing the largest such case in business history. Unfortunately, so-called Chapter 22 is becoming nearly as common—retailers who restructured their businesses once, only to meet the same bankruptcy fate a few years later down the line.

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Frankly, it made our Black Hole presentations better, and we spend more than our fair share of time working with the press to explain what these failures mean to retailing and to consumers. It also became clear to us that these stores were failing because they were not properly responding to the way customers were changing: They had not become best at anything (or had ceased to fill that role) for customers.

Now, because of the Internet, extraordinary access to capital, and nearly instantaneous worldwide communications, retail change is happening faster than ever. Winning chains such as Wal-Mart are continuing to grab market share at an unprecedented rate, while foreign retailers with strong track records, such as Ikea, Zara, and H&M, are becoming a larger part of America's retail landscape. Entire retail categories—such as variety stores, regional discount stores, regional electronics chains, and catalog showrooms—have all but disappeared. Once-successful retailers are becoming obsolete at a fast pace.

No retailer is immune. Kmart, the nation's third-largest discount store chain, was forced to file Chapter 11 bankruptcy in January 2002. Less than a decade ago, Kmart was the nation's second-largest retailer. Other large retail chains that may seem a long way from the brink are also in peril. That's because stores like Kmart are adrift in a place that we call the Sea of Mediocrity. These stores aren't best at anything, and they don't have a distinct or sharply defined customer proposition.

It's not easy staying on top, either. Over the years, the examples we use to illustrate winning retailers have gone through constant change. Role model retailers like Circuit City and Toys "R" Us have fallen on hard times, failing to react to their own individual inflection points. Even a gold standard retailer like Home Depot is looking into the rearview mirror, as nimbler competitors like Lowe's do a better job of responding to consumer needs. The immediacy of the retail business and the customer's response to a retailer's offer create a constant scorecard with which to measure

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success. Comparable store sales figures (sales of identical stores currently versus a year ago) provide a running commentary on the industry. We know, almost in real time (Amazon.com showcases a gift meter on its web site), how a company is performing.

The ebb and flow of successful companies is hardly unique to the world of retail. The same phenomena take place every day in any business that serves the consumer. How, though, can one explain this logically, so companies can stay ahead of the curve instead of simply reacting to it? In too many cases, by the time a company is nearing Chapter 11 (or the Black Hole), it is way too late to effect meaningful change with the consumer or on Wall Street. The key, of course, is to determine trouble before it occurs and act accordingly.

EST DEFINED

The breakthrough for McMillan|Doolittle was our drive to articulate retail success in a straightforward way and make sense of the seemingly random changes we were witnessing on a daily basis in the retail world. Our goal was to simplify rather than complicate. We worked hard to be plainspoken and to come up with a better way of explaining things. Ultimately, that led to the development in the early 1990s of what we call the *Est theory for retail success*.

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

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

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

Clearly, customers have less time to shop. They are also more knowledgeable about the products they want to buy and the stores that sell them. They have more choices of where to shop than ever before.

The customers who still frequent mediocre stores probably do so because of a historic attachment—it’s where they or their parents always shopped. Or they were attracted to the mediocre store because of a sales promotion. Or they simply didn’t have the time or energy to drive to a preferred store. Finally, being handy to where they live or work certainly helps. We can hardly dispute the old

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retail adage—location, location, location. Yet consumer research indicates that it is the proverbial kiss of death if location is the primary reason customers shop at your stores—someone else can always get closer.

Whatever the case, these types of customer relationships do not have a bright future, which is why pretty good isn't good enough anymore.

Many of the stores now enshrined in our Black Hole memorial were pretty good stores. (See Figure 1.1.) Montgomery Ward, for instance, ranked third or fourth by consumers as places they'd likely shop for various items. While Wards wasn't anything-Est, at least it was a close also-ran in some categories. That doesn't sound too bad. Not many people *hated* Wards—but even worse, they were simply indifferent. How's Wards on price? "Pretty good." How's Wards on service? "Pretty good." How's Wards on fashion? "Pretty good."

FIGURE 1.1 Black Hole Memorial



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How's Wards on assortment? "Pretty good." Those kinds of results from customer surveys may have seemed pretty reassuring to Wards' executives. Actually, being pretty good at lots of things was the foundation of the modern era of mass retailing for general-merchandise stores. It was a pretty good formula into the 1980s. It's not anymore.

Pretty good stores cannot satisfy increasingly demanding customers. Pretty good stores also cannot compete with today's sharpest retail chains. Stores like Wal-Mart, Target, Costco, and Kohl's have raised customer expectations. Falling short of expectations means not satisfying customers, and that's the most direct path to the Black Hole.

EST IS NOT A MARKETING TOOL

Est is not simply a "marketing thing," a way to position a company in advertising and external communications. The buzzword today is *branding*, and while we believe in the concept, too many companies confuse the articulation of a marketing and/or design message with the essence of the company. Est Retailers devote themselves with laserlike focus to their core customer proposition, what we call their *Est position*. They commit employees from the top to the bottom of their organization to that position. They communicate that positioning to their customers and execute it relentlessly at the store level. Est retailers also base strategic and day-to-day operational decisions on their positioning. An Est positioning is not simply the marketing message du jour—it is a way of life for successful retailers.

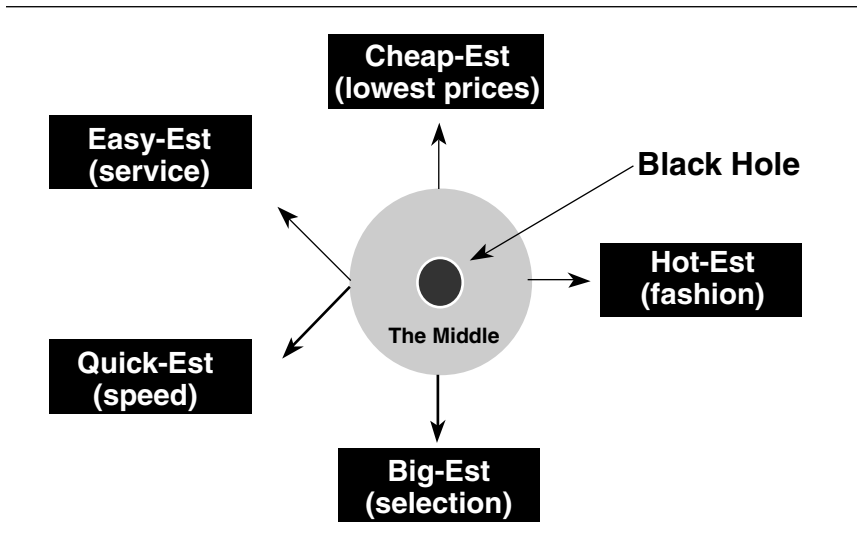
Wal-Mart is the quintessential example. Everything Wal-Mart does is focused on enhancing its position as the low-price leader. With its "Always Low Prices" tagline and "Everyday Low Price" positioning, Wal-Mart wins with customers on price. Yet this is not merely an advertising proposition—the drive for lower prices for the

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consumer defines every action that the company takes. It is at the heart of Wal-Mart's mission, its very reason for being. Sam Walton founded what is now the world's largest company (period, not just in retail) on the simple belief that customers would like to pay less for the products they purchase and that ordinary folks should have the opportunity to buy products that make their lives better. Every single action the company takes is measured against these fundamental principles.

We call that particular Est *Cheap-Est* (and it has served companies like Wal-Mart very well). The other Est positions that win customers are *Big-Est*, having the largest assortment of product in a specific merchandise category; *Hot-Est*, having the right products just as customers begin to buy them in volume; *Easy-Est*, having the proper combination of products and services that makes shopping easy; and *Quick-Est*, organizing the store to make the shopping trip as quick and efficient as possible. (See Figure 1.2.)

FIGURE 1.2 Est Model



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THE INTRODUCTION OF EST

Norm McMillan, one of the company's founding partners, first presented the Est theory in the early 1990s at an international food industry trade show in France. It played well in Paris (and subsequently Peoria), and we've been using and fine-tuning the model ever since. The theory has resonated with our clients (and to audiences throughout the world) for more than a decade because its message is easy to grasp and is actionable.

By further studying these companies, we also recognized they had done much more than carve out a niche. They weren't simply the best among their rivals by default. These retailers had devoted their organizations from top to bottom to becoming the best in one particular area. It was the driving force of their businesses. Once we identified what the winning retailers strove to be best at for customers, the Est theory was born.

We liked the model we had hatched. It made sense to us. But we were waiting for someone to fire a silver bullet, to raise a question or example that Est couldn't easily answer or explain. We're still waiting.

DOES EST CHANGE? ABSOLUTELY

We created Quick-Est in the mid-1990s to recognize the growing importance of saving customers time and to recognize that retailers can win by focusing on providing customers with time savings as a key benefit. While this may have always been true, consumer trends (working women, less free time) finally made time a critical currency that we could effectively model. Who's to say that another driving element won't emerge as the consumer continues to evolve? However, we are cautious in screening between a fad and a key consumer trend.

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In the mid-1990s, we also heard from people who thought we should add a new position to recognize the emergence of entertainment-focused retail stores. Remember “retail-tainment?” At the time, everyone from restaurants to retail stores packaged entertainment as a key selling factor. We considered adding categories like “Exciting-Est” or “Entertaining-Est,” but ultimately we rejected the idea because, regardless of how exciting it is, a store’s ultimate purpose is to sell merchandise. Customers need a more rational reason to visit a store than its entertainment value.

If all a store had going for it was that it was best at entertainment, could it win? We don’t think so—and the customers have voted, too. Warner Brothers shuttered their once-exciting retail stores, and many “eater-tainment” restaurants have scaled back their growth.

We believe a store can win by being clearly best in one of five critical areas: *assortment* (Big-Est), *price* (Cheap-Est), *fashion* (Hot-Est), *solution-oriented service* (Easy-Est), or *speed-oriented service* (Quick-Est). There are other possible niche Est positions (such as Fine-Est, for the high-quality, luxury retail segments), but successful retailers today serving the masses can clearly be defined by one of these core Est positions.

Does an Est retailer exclude a focus on those other retail elements? Of course not. As we discuss in later chapters, all retailers must provide a base level of competency across all factors critical to the consumers. The real winners are the ones who found an Est that they could own.

The advent of e-commerce also forced us to reexamine Est. Remember e-tailers? Certainly, this was no flash-in-the-pan trend like “retail-tainment.” We studied e-commerce and how customers shop online, and we found that e-commerce and some of its winners (Amazon.com, Priceline) in no way disproved the Est theory. In fact, we believe the theory applies as plainly online as it does in the bricks-and-mortar world.

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As we said, the Est model will change over time, but the underlying theory is likely to stay intact. For instance, as customers and competitors evolve, it's possible that Big-Est will no longer be a position that's sufficient to win. Also, if customers become increasingly driven by safety, quality, or product integrity, we may add an Est position to reflect that. Quality, or getting the job done right the first time, is a critical element, particularly in the retail services industry. Part of the power of the theory is that it can easily be altered or adapted, yet still be true to its essence.

Fortune 500 companies such as McDonald's, Procter & Gamble, and The Limited have put Est to work in their businesses. That's because in addition to explaining what it takes to succeed in retail—a critical lesson in these perilous times for the retail industry—the Est model can be used in several actionable ways:

- Est is an analytical tool that companies, both retailers and nonretailers, can use to determine where they stand with customers and how they compare with competitors. In a very simple format, it provides a diagnostic tool to understand where a company stands.
- It is also a prescriptive tool for a company to identify market niches and growth opportunities. If there are available niches, it points them out. If there's not a clear opening available (which is increasingly becoming the case), it identifies where the business will have to come from.
- Finally, Est can be used to form a company's strategic foundation. It's a way to focus strategic decisions and day-to-day operations on one big idea—the Est position.

The Est model is a powerful tool that helps retailers avoid the Black Hole and also helps them attain growth, profits, and enduring success.

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PUTTING EST TO WORK

Our two favorite real-world examples of putting Est to work are Target and Vons supermarkets.

Soon after Target adopted its better-quality strategy in the mid-1970s, the company's chairman at the time stood before a meeting of several hundred company executives and held up a pair of sneakers. He described the shoes as shoddy. The soles fell off easily, and several customers had complained. Then he asked which buyer had bought these shoes. A timid hand went up. The buyer explained that he got a great deal. The shoes were closeout items from China. Target bought them for \$2 and was selling them for \$8. It was profitable for the company and a great price for customers. A relatively small number of customers had complained, especially considering the phenomenal price. The chairman listened, then asked, "What does our strategy say?" No answer. "It says Target sells quality merchandise." At that time, discount stores were known for selling shoddy products, but that's not what Target aspired to be. The chairman then instructed the buyer to have all the shoes immediately removed from the stores and destroyed. The chairman chose a very public place to make a point about positioning and the importance of being true to an Est position, even at the cost of passing up profit opportunities.

In the mid-1980s, we helped Vons supermarkets develop a new retail food concept called Pavilions. It was to be positioned as the "fresh, fashion-forward supermarket for the masses." We suggested that to win at that position required Pavilions to become friendlier to moms. One thing we learned from customer surveys: Moms who shopped at Pavilions hated the fact that gum-ball machines were near the storefront and that so much candy was for sale at the check-outs. Essentially, these customers felt that the candy instigated fights between mothers and their children. We told Pavilions to get rid of

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the gum-ball machines because they were causing problems for key customers. The store managers howled—gum-ball machines and checkout aisle candy provided a great source of income from square footage that would otherwise be inactive. Still, the executives mapping out strategy recognized the importance of simple positioning messages. They got rid of the gum-ball machines and even instituted a couple of candy-free checkout aisles. It told us that Vons executives were serious about positioning Pavilions, because they would not let short-term profits get in the way of doing something right for customers. (We still have one of those old machines in our office—a reminder that positioning is never an easy exercise.)

Having an Est position makes it easier for retailers to communicate effectively to customers and their associates and helps the stores execute consistently. In turn, consistently executing on an Est proposition further strengthens and enhances the Est position. Each example of truly executing Est confirms the store's core purpose. For Hot-Est retailers, it means continually demonstrating that you're the place for the latest fashions or newest products. Once or twice may be a fluke. Year in and year out, it becomes an Est.

It is a perpetuating cycle, but it can happen only after a retailer commits to being great for specific consumers and not so great for others. Nothing is more alarming to us than having clients boast that their stores are good at everything and are shopped by everyone. It means they really don't understand the most fundamental principle of effective positioning.

While the Est theory may appear relatively benign and somewhat self-evident, it's actually quite radical. It runs contrary to the notion of trying to do everything for customers, and it upends the age-old axiom that "the customer is always right." Customers aren't always right. Customers would want a store to have the lowest prices, the best service, the largest selection, and the latest fashions. While that may sound like a winning proposition and a goal worth pursuing, we've seen lots of retailers go out of business chasing that

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kind of strategy. It's simply not a profitable proposition to try to be everything customers want. In fact, though, many retailers do try. They want to be great—they just don't know what to be great at and for whom.

Of course, we don't mean to suggest that retailers should not listen to customers. We are saying that retailers must listen selectively—focusing on the real needs of their core customers. Keep these questions in mind as filters: Who are core customers and who are not? What do core customers want more of? What do they want less of? Deliver more of what core customers want and less of what they don't want. That way, you will be great at a limited number of things. You also will avoid the trap of trying to be all things to all people.

It is no coincidence that the intersection of all five Est positions is right in the middle of the Est model circle. We call it the Black Hole of Retailing. A retailer that tries to be great at everything, at all Ests, may actually wind up good in some areas. But that retailer isn't likely to be best at everything—and most likely won't be best at anything.

For reasons both practical and empirical, it is impossible to succeed in being Est in all key consumer attributes. Great retailers understand that practical sacrifices must be made to achieve an Est positioning. Even if the retailer somehow manages to be best in several areas, it won't make any money, because achieving and maintaining each Est position requires heavy resources and large financial commitments.

THE PROOF IS IN THE RESULTS

Yes, concepts like Est and the Black Hole are catchy and memorable. However, in the pragmatic world of retail consulting, theories don't go very far. Companies demand proof that taking an Est direction is the right financial path. Est does have a powerful impact on

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the financial results of companies. This is not an academic theory—it is based on empirical proof that Est companies outperform and outgrow those that strive to be just pretty good.

Talking dollars and sense, the results for Est retailers over the 10 years from 1993 through 2002 dramatically prove our point. (See Table 1.1.) During this period of time, the broadly defined retail industry in the United States grew at a compounded rate of 5.3 percent, with sales rising from \$1.7 trillion to nearly \$2.7 trillion. A selected market basket of Est retailers grew at well over double that rate during the same time period, with standout performers maintaining growth rates of well over 15 percent. (See Table 1.2.) The best performers on our Est charts grew at well over 30 percent, or six times that of the market.

What about profits? Est retailers deliver on the bottom line as well. Looking at the top 100 retailers in the United States reveals that the average net profit as a percent of sales is 2.72 percent. Breaking out the Est performers shows that they are averaging profits in

TABLE 1.1 Retail Industry Sales Performance

	1993 (\$ billions)	2002 (\$ billions)	Compound Annual Growth Rate (%) 1993–2002
General, apparel, furniture, and other retail sales	\$574	\$935	5.6
Retail and food services sales total (excl. motor vehicle and parts dealers)	\$1,720	\$2,727	5.3
Retail sales total (incl. motor vehicle and parts dealers)	\$1,986	\$3,245	5.6
Retail sales total (excl. motor vehicle and parts dealers)	\$1,504	\$2,393	5.3

Source: U.S. Census Bureau.

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TABLE 1.2 Est Retailer Sales Performance

Retailer*	1993 Sales (\$ billions)	2002 Sales (\$ billions)	Compound Annual Growth Rate (%), 1993–2002
Cheap-Est: Wal-Mart	\$55	\$245	16
Big-Est: Home Depot	\$9	\$58	23
Hot-Est: Target	\$19	\$43	13
Easy-Est: Kohl's	\$1	\$9	24
Quick-Est: Walgreens	\$8	\$29	15

*Discount stores only.

excess of 4 percent, on average. Those in the middle? Their profits creep along at just over 1 percent, teetering precariously close to the Black Hole. Can an average retailer produce above-average profits? Absolutely—for a while. Ultimately, however, the lack of a defined positioning leads to stagnant sales growth, which leads to declining profits.

As this book progresses, we talk both theory and results. Winning with customers also means winning on the balance sheet. Getting to Est is the most enduring way of achieving both.

