Nathan Dahlin
Molly Garboski
Kathryn Hughes
Lauren Mercado

Palm Partners
Strategy Consultants

Industry Analysis
Benjamin Rockmore
Strategic Management
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Executive Summary

In this report we discuss the Department Store industry as a whole. What external factors affect companies within the industry, their main competitors, what makes companies within the industry successful, and the overall attractiveness of the industry.

Through the PESTEL analysis we established some of the biggest external threats to this industry. We see tariffs having an impact on goods and raising prices available to consumers. Also a decline in department store revenue due to the shift of the biggest companies expanding into the Warehouse and Supercenter industry. Consumer shifts to online shopping also pose threats to department stores, as well as consumer knowledge regarding the environment and the effects of the products they consume.

Consumers are crucial to the retail industry's profitability. A consumer's needs, time, preference and disposable income essentially drive these companies. The biggest industry players, Target and Walmart, have realized that consumers prefer to shop in one location and have expanded their facilities to carry grocery items. Similarly, consumers have found a preference in the simple act of shopping online. E-commerce businesses have become one of the largest competitors of department stores because they provide convenience to the consumer and therefore satisfy their needs. In contrast we see companies like JCPenney who are struggling to stay afloat because they do not provide enough value to consumers. They market to the same mid- to low-income people that companies like Target and Walmart do, making it difficult to prosper in this industry.

However, there are factors that allow companies in this industry to succeed. Location, effective supply chain and differentiation are all factors that have proven most effective.

Businesses have to be easily accessible to the consumer and provide items to the consumer in a way that will make them want to buy and continue buying. Similarly, the way a consumer is treated by employees in a store, on social media and even through customer complaints will determine customer loyalty and the business's success.

From our research it is clear that this industry is declining. Although the low unemployment rate has continued to increase consumer disposable income, we see an increase in competition from larger companies and online businesses that will ultimately be the places consumers decide to shop. Due to this, the department store industry, already declining, is expected to continue declining by 1.8% annually until 2024.

Industry Dominant Features

This industry operates under NAICS code 45211 (naics.com). Firms within this industry operate out of physical retail locations. Products that are sold by this industry include clothing, footwear, cosmetics, electronics, toys, and home decorations; each of these product lines usually has their own department. There are three main segments within the Department Store industry, upscale, mid-size, and discount (persistancemarketresearch.com). The major companies within the Department Store industry include Target, Macy's, Walmart, Nordstrom, Sears, and JC Penny's, with Target having the highest market share of 38.1% (Kaylani, D).

The Department Store Industry is slowly declining and is expected to continue this decline over the next four years (Kaylani, D). This has a lot to do with the fact that Walmart and Target, firms that have a large market share within the industry, are branching off into the Superstore and Warehouse Clubs (Simon, R). The industry also faces the threat of e-commerce and having to find new ways to encourage customers to come to their store instead of buying products online from businesses like Amazon. Many brick-and-mortar stores are having to branch into new industries or close all together because of the growing threat of e-commerce (Simon, R). A lot of the major firms within the industry are adopting digital distribution channels in order to compete with e-commerce. One of the main tools that the industry has introduced is in-store pickup that allows customers to purchase products online and pick them up in the store when they are ready. This allows customers to not have to pay shipping, while still allowing retailers to maintain their sales.

The E-commerce threat has now grown into the industry's largest sales period, holiday shopping. Over the last 20 years, e-commerce has continued to gain a share of the holiday purchases, which is hurting the Department Store industry by taking away sales during its most profitable season (Miles, R). The threat of e-commerce is predicted to decrease holiday season profits by forcing brick-and-mortar stores to compete with e-commerce and possibly lower prices or lose sales all together (Miles, R).

Environmental Analysis

Political Factors

In the United States, much of the proposed changes to regulations, interest rates, and law come from economic and social pressures.

Current regulation shifts are very notable with the introduction of high tariffs on foreign imports, particularly Chinese (Nassauer, S.). Many of the goods carried by big box stores or department stores are sourced from regions affected by these tariffs. As the price of goods go up as caused by government intervention, creating a steady supply or buying goods at fair prices becomes more challenging. This causes the power of the buyers to decrease and creates tighter margins for the retail industry across the board.

As the Federal Reserve (the Fed) monitors economic trends and predictions, they enact monetary policy accordingly. Fed officials are currently deliberating an appropriate cut in response to declining economic data (Smialek, J.). For the retail industry, this lower interest rate is meant to ignite business growth and limit factors such as inflation and unemployment.

There are also debates about how to handle current environmental protection laws and whether we need to create more stringent ones. The direction of these policies seems very uncertain and the results of them are equally as mixed. Certain proposed policies can make environmental taxes or fines very costly to business. Other proposed policies can encourage businesses to be greener, which actually can be very good for attracting customers and creating good feelings among shareholders (publicpolicy.wharton.upenn.edu). The effect on the retail industry could be significant depending on which regulations are bolstered, enacted, or removed.

Economic Factors

The stronger an economy is, the more disposable income consumers have to spend at retail stores and the higher profits that the industry will see. With U.S. unemployment rates for 2018 and 2019 reaching lows that have not been seen since before the 2008 economic crisis (Brainerd, J), consumers are spending more money on nonessential products, leading to higher profit trends in the industry (pestleanaylis.com).

Within the retail industry, however, the Department Store Industry has seen a steady decline since 2014 (Kaylani, D). There is a decline in the revenues of the Department Store industry due to a larger number of the bigger companies in the industry adding groceries to their product range, which would move them to new industries, either Warehouse Clubs or Supercenters (Simon, R). Over the next 10 years, the industry is expected to decline at a 2% annual rate, while U.S. Gross Domestic Product is supposed to grow at a rate of 2.2% annually, which is an indicator that the Department Store industry is on the decline (Kaylani, D).

Sociocultural Factors

The major changes within this industry have been a result of both company and consumer shifts. With the transformation of department stores into supercenters, some companies within the industry have been forced to close facilities with over 7,000 stores closing from 2014 to 2019. This shift has caused a decline in employment over the past five years at a rate of 2.1% annually and totaling over 920,000 unemployed workers. Similarly, department store revenue has decreased because of consumer shifts from brick-and-mortar stores to online shopping (Kaylani, D).

To ensure consumer spending, companies within this industry have focused on appealing to their largest market (ages 26 to 45), which totals 33% of the industry demand. This market consists mainly of parents who have a steady income and prefer buying all their items in one place. Similarly, the second largest market (aged 46 to 65) totals 30.1% of the industry demand and consists mainly of parents and grandparents who have a higher disposable income and are known for buying higher quality items for themselves and their families. (Kaylani, D).

Overall, spending at department stores is determined by the amount of disposable income available to consumers, their amount of leisure time, fashion trends, weather conditions and seasonality. Department stores see their highest sales during the last quarter of the year, mainly during the holiday season. (Kaylani, D).

Technological Factors

In the retail and department store industry, the use of a variety of technologies is mandatory to ensure smooth day to day operations and efficiency. From point of sale computers to logistics and supply chain systems, the use of rapidly advancing technology is an imperative factor for companies to implement in this industry.

For sales and inventory management, the standard for companies is shifting away from classic cash registers to computerized point of sale systems that enable efficient sales, merchandise control and tracking, and monitoring of sales and stock records. The invention of radio frequency identification technology enables department stores to keep real time information on inventory, reduce shrinkage, and improve efficiency (Kaylani, D).

Another major development in retail and department store tech is the use of the internet to reach consumers. Most companies will have a business website that shows their products and facilitates the selection, purchase, and shipping to the customer's home or nearest store. This development has greatly benefited the retail industry allowing for streamlined services and the ability to reach audiences worldwide (pestleanalysis.com).

In order to prevent losses from theft and other issues, retail department stores have had to make developments in security and loss prevention technology. New advancements have been made in closed-circuit TV cameras, source tagging, signature-capture technology, and fingerprint scanning systems. These systems allow stores to track and monitor their products along every step of the supply chain to ensure maximum efficiency and security (Kaylani, D).

Environmental Factors

Retail/Department Stores are required to meet environmental requirements that are set by the government in order to ensure consumer and employee safety (pestleanalysis.com). Consumers are becoming increasingly concerned with the environmental impact of the products that they buy. 71.4% of consumers say that they consider the effects that the food and grocery products that they purchase have on the environment (Retail, G.D.).

Legal Factors

The laws of the United States tend to limit the retail industry. The United States has some of the highest corporate taxes among developed nations in the world (Ross, S). This causes retailers to pay costly taxes on their revenues. In addition, there are many state property taxes and sales taxes to anticipate in having a physical location. This gives a great advantage to those who are exempt from such taxes or do not have the brick-and-mortar stores to maintain.

We also have strict minimum wages that make labor particularly costly. Physical retailers have to spend greatly to have a staff, let alone retain quality employees. Brick-and-mortar locations also must accommodate for the safety and well-being of their shoppers, lest they can expect lawsuits over store security, injuries, defective products (Shaw, M.).

Porter's Five Forces Model

Intensity of Competitive Rivalry in the Industry

Competitive rivalry in the department store industry is very strong. Department stores are one of the largest employers in the US, accounting for nearly 29 million people, and millions more when including marketing, security, and technology sectors. Per estimates, they contribute to nearly two thirds of the US GDP, 1.2 trillion dollars (Pratap, A). In this environment there are a large number of firms of varying sizes in the market, a wide variety of firms in the range of products they offer, and high aggressiveness amongst firms competing for business (Greenspan, R). Both large and small brands feel the pressure from growing competition in the industry. Increased competition leads to constant changes in prices, weaker margins, and internal external players entering and exiting the market. In addition to this, e-retail has added a new horizon to the market, making it difficult for traditional retailers to beat the compelling prices found online (Pratap, A).

Threat of Substitute Products

The threat of substitutes in the Department Store industry is weak. This is mostly due to the fact that department stores have a lot of branded merchandise that is exclusive to them. The main threat is the ecommerce industry (Chanon, R., Henley, D., & Neel, J.). There is a correlation of -33% between the retail industry and the ecommerce industry suggesting that there is a moderate inverse relationship between the two (Chanon, R., Henley, D., & Neel, J.). Department stores are trying to adopt e-commerce departments in order to compete, but are unable to provide free delivery due to a weakness in their supply chain, which is why the e-commerce industry remains a threat.

Threat of New Entrants

In the retail and department store industry the threat of new entrants is moderately low. A large portion of the market share is dominated by the large scale, established retailers such as Walmart and others. These companies already have significant financial strength and brand awareness that can seem daunting to new entrants. However with the rise of online retailing, entrance and exit costs are relatively low. With the recent economic growth, the rise in consumer spending can allow for new entrants to target niche markets and specialty sectors, providing a more depth in product lines. Online sales are low cost and easy to set up for both established and new players in the market, however end users are likely to compare prices and find the best deals, causing strong competition which can also be a repellant to new entrants (Marketline).

The Power of Buyers

The power of buyers in the retail industry is significantly weakened because the buyer has little power to negotiate due to many competitive buyers vying for the same sales and they have few suppliers to choose from (panmore.com). In the retail industry, there are many competitors and the markets for buying goods are very saturated. The buyers must devise incentives, create relationships, and follow aggressive strategies in order to secure deals that are most beneficial for their stores. Their power is relatively low because of the intensity of the marketplace and their desire to offer the same goods on a consistent basis.

Most big box stores and national retailers follow the sophisticated just-in-time (JIT) method of inventory management which places emphasis on only ordering as many goods to hold in inventory as the store plans to sell in a given period of time (spscommerce.com). This reduces the power of the buyers even more, as they must be very conscious of their connection to the supplier as not to create any shortages and stockouts of their product offerings. It also makes the industry less attractive to those entering, as it is difficult to jump into new relationships with suppliers as well as differentiate their brand without exclusive branded products.

The Power of Suppliers

Purchases make up the largest expense for department stores, and have remained stable due to increasing store offerings and the substitution of high-priced items with low-priced alternatives (IbisWorld).

Companies within this industry attempt to avoid long term contracts with suppliers and minimizes switching costs. The largest companies are also a big part of supplier's revenues, so they have the power as buyers to negotiate lower prices with suppliers. However, when it comes to luxury or organic items, it is more difficult for companies to demand lower prices since switching costs are higher (Marketline).

Supplier power has also been affected by many retailers creating their own private labels as well as implementing backwards integration. Kroger has its own production plants which produce 33% of their private label items, and other companies like Walmart have improved efficiency by integrating storage and warehouses (Marketline). However, due to consumer awareness it is important for manufacturers to buy from suppliers that allow them to add

Fairtrade, Utz Certified, etc. to their packaging. This has allowed suppliers to gain some power, but supplier power throughout this industry is generally low (Marketline).

Summary of Forces and Attractiveness

The retail industry is not a particularly easy or attractive industry to enter and presents a variety of challenges to even its strongest market share holders. Intensity of competitive rivalry in the industry is strong because of the broad horizons of the industry and the vastness of firms. Threat of substitute products is weak because there are many exclusive brands, though ecommerce may change this in the future. Threat of new entrants is weak due to the dominant brands in the market commanding much of the market share, despite the decreasing barriers to entry with the rise of online shopping as a cheaper alternative to opening a retail storefront. Power of buyers is weak because of their need to deliver just-in-time, consistent inventory of select products from specific suppliers and power of suppliers is weak because of short-term contracts leading to shifts in pricing and consumer awareness of quality. Overall, there are many challenges to overcome in building and maintaining a successful retailer.

Competitor Strength and Weakness Positions

Target is a general merchandise retailer that operates only in the US and has a market share of 38.1%. One of the biggest attributes of Target is its development of different store formats. Their first format is a general merchandise store that consists of clothing, home items and electronics. While their second format, SuperTarget, is larger and has a bigger variety of items including groceries. However in recent years, Target has expanded all its general merchandise stores to include groceries. This expansion is appealing to consumers who prefer to do all their shopping in one place, and has led to an increase in Target's profits. Due to Target's shift into the Supercenter industry, revenue for the Department Stores industry has declined (Kaylani, D).

Walmart is the world's largest retailer in terms of sales and has a market share of 12.6% in this industry. They use their large size as a way to leverage power over suppliers in order to buy products at a low price and provide consumers with discount items. They have three different divisions including Walmart US, Sam's Club and Walmart International. However, only the Walmart US discount stores, which do not include groceries, are part of the Department Store industry and are declining due to Walmart's focus on expanding into the Grocery Stores industry, as well as the Supercenter industry like Target. This explains why they have such a small amount of market share in the Department Store industry (Kaylani, D). Walmart has also created its own private label and implemented the use of backwards integration by creating its own distribution centers to ensure better supply chain efficiency (Marketline).

JCPenney is a department store with locations in the US and Puerto Rico and holds 6.9% of this industry's market share. They carry items like clothing, shoes, accessories, and home furniture, many of which are from their own JCPenney brands. Their private-label brands make up a large part of their profits, including 46% of their 2018 sales. However, JCPenney has gone through management changes with one CEO eliminating clearance and coupons. This led the company to decrease revenue by 25%. Since then they have reinstated their clearance and coupons program which worked well with customers before, but even with this change JCPenney has continues to operate at a loss and is expected to continue declining (Kaylani, D).

Overall, Target and Walmart have continued to succeed and even expand into new industries by appealing to consumers' preference to shop for all their needs in one location. While JCPenney's inability to appeal to consumers has left the company unable to prosper in recent years. All these companies also market to mid- and low-income households which has left JCPenney to compete with its largest industry competitors, Target and Walmart (Kaylani, D).

Key Success Factors

What are the 3-4 key success factors that have the strongest relationship with success and profitability?

Location is an important factor to a department store's success. Businesses need to ensure that they are located in a place where their target market can find them and is willing to travel to.

Effective supply chain management is another factor that can make or break department stores. Having too much inventory increases the cost of storing the inventory, but having too little means that a business is losing sales (Sherman, F). It is also important that the inventory that is on hand is displayed on shelves in a way that will draw customers in and make them want to buy those products, as well as encourage them to buy complementing products as well.

Differentiation from competitors will help distinguish a business from the others within the industry and help bring in customers. Quality customer service can be one of the most distinguishing characteristics of a business. Making sure that the customer feels as if they have a connection with the store that they frequent will ensure that they continue to return instead of going to a competitor. Whether it be a staff that goes out of their way to help the customers, social media that customers can interact with and stay up to date with sales and promotions, or websites where they can communicate their suggestions/complaints, a business that makes the effort to include the customer will see higher rates of customer loyalty (Sherman, F).

Do these KSFs vary by segment, if there are segments in the industry?

The department store industry can be divided up into three major segments. These segments include upscale department stores such as Bloomingdale's and Neiman Marcus, discount department stores, which include TJ Maxx and Marshalls, as well as mid-range stores like Kohls and Steinmart. There are also big-box stores like Target and Walmart. The key success factors for upscale department stores focuses more on creating a quality atmosphere and high end brands to attract wealthier customers. Discount department stores would have the opposite focus and their key success factors would include having the best deals for customers. Big-box department stores are going to be most concerned with achieving economies of scale in order to reduce overhead costs as much as possible as well as ensuring that they have a variety of products to make sure that customers can get most of their needs in one trip (Hayes, A).

How are these KSFs likely to vary over time?

With the increasing popularity of e-commerce, location will become less significant to the success of a business. While it will still be a success factor, online shopping will minimize the effects of customers that are unable to be at the physical location of the store by allowing them to shop from wherever they are.

What are the implications of this evolution?

As e-commerce becomes more and more popular, the department store industry could see a decline in physical customers and will need to adjust their marketing strategies, as well as their business plans to most effectively use their resources. If customers continue the trend towards relying more on e-commerce, businesses will need to not only reevaluate the number of brick-and-mortar stores that they have open, but will also need to compete with companies such as Amazon in order to maintain their customer base.

Industry Prospects for Long-term Profitability

Over the past five years the industry revenue has declined by 4% annually and this trend is expected to continue. The industry's top competitors, Target and Walmart, are expected to get stronger but they are also expected to fully expand into the Warehouse and Supercenter Industry with their implementation of groceries into all their facilities. This movement into a new industry will still pose threats to department stores since consumers prefer stores that have all their necessities in one place. However, this industry's loss of revenue is mainly due to e-commerce businesses and online shopping, which are only getting stronger (Kaylani, D).

Online businesses can provide low prices to consumers because they don't incur operating costs. This has led brick-and-mortar department stores to shift their marketing, lower selling prices and provide more promotions to customers to try to compete. As consumer disposable income increases over the next five years, department stores will see an increase in revenue but the industry will continue to decline by 1.8% annually until 2024. Overall, this industry is not an attractive one to enter because of the increasing competition and declining revenue (IbisWorld).

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