1985

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Larry N. Bitner
University of Richmond

Judith D. Powell
University of Richmond

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Larry N. Bitner
E. Claiborne Robins School of Business
University of Richmond

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THE HIDDEN CHALLENGES OF RETAIL EXPANSION

Abstract

Successful small retailers invariably are tempted to test the adage "more is better." While the expansion allure is more than many can resist, it must be tempered by the realization that many hidden challenges await the unsuspecting entrepreneur.

Success of the new organization will require not only more but a different kind of effort than used in managing the single store. First, successful operation will now depend on delegating operating decisions to professional managers. The autonomy given these managers is a complex decision and may be placed anywhere within a three dimensional continuum depending on the desired image, supervision, and buying patterns for each store. Second, the accounting information required for proper control and performance evaluation of the organization will increase dramatically.

Adequate pre-expansion planning can expose many of the hidden challenges and make the transition one more likely to prove that more is, in fact, better.
THE HIDDEN CHALLENGES OF RETAIL EXPANSION

At some point in the life of a successful retailer the question of expansion arises. While retailing is one of the last territories of the small owner-run business, current economic and market trends make it more and more difficult to remain small and successful. In their attempts to expand, too many retailers ignore or fail to identify strategic decisions crucial to orderly and profitable expansion.

Strategic factors influencing success have been well documented for large firms and in the manufacturing sector, but as Hise\textsuperscript{1} states, "few such studies have been done in the retailing sector." The dearth of information is particularly noted concerning small retailers. Despite a changing economy, small and primarily independent businesses continue to be prominent in retailing. Half of all retail firms in 1982 were sole proprietorships, only a slight decrease from the 54 percent in 1977. In 1982, 95.8 percent of retail firms operated from a single unit. These one-location stores accounted for 44.9 percent of retail sales.\textsuperscript{2} An identity of ownership and management, therefore, still exists in the retail sector.

Small successful retailers tend to be successful because they build their business around "advantageous locations, or the qualities of the owner or manager."\textsuperscript{3} Autonomy in decision making gives the independent retailer the


flexibility to adapt to "local patterns of competition and demand." The small store which knows its market well enough to "buy with individuals' lifestyles in mind, that have a one-to-one relationship with their customers" compete well in most markets.

In order to compete in an economy dominated by large chains and franchise organizations, small independent retailers at some point examine the opportunities available through expansion. With expansion, advantages are gained in multiple store economies. Bucklin states that "overhead" type costs are shared, spreading costs for advertising, personnel, and accounting over several outlets. The cost per unit is, thus, reduced.

Size also generates bargaining power and wholesale function efficiencies. The ability to "accumulate" orders among units results in larger orders and, therefore, the power to negotiate improved terms and conditions of sale from manufacturers and wholesalers.

Expansion also permits growth through geographic extension into varied locations. "If the concept of the business and its execution is reasonably successful, the firm may choose to extend the franchise into regional or, ultimately, a national area of operations." Or, as Hirschman suggests,

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expansion allows one to move beyond areas of "natural dominance" to add outlets under different names to cover diverse market segments. As markets increasingly vary in wants, needs, and buying power, a single way of doing business may not appeal to all market segments.⁹

While the positives of expansion may overwhelmingly justify the move, there are negatives which must be given equal consideration. Probably one of the most frustrating changes will be the lessening of clientele contact. Success of owner operated units is often attributed to the owner's informal information gathering from customers and the owner's ability to respond quickly to such information. Likewise the customer contact may have been a major motivating force in beginning the business.

In addition, management positions will need to be created within the organization. Up until the expansion, the owner has probably served as the major managerial force with only limited auxiliary managers needed. With expansion the selection of qualified managerial talent may be a major challenge. The difficulty includes not only the cost of managerial talent, but the search and hiring task.

The owner/manager of a multiple unit operation may, therefore, become much more a manager of paper than the front-line entrepreneur he once was. Span of control becomes a major concern. With growth, the owner/manager's ability to directly supervise personnel and their tasks has been surpassed. New evaluation criteria must be developed. Specialization of responsibilities becomes necessary. Delegation of tasks and responsibilities must be made in a way that the operation retains its success. Too often, the decision criteria

for relinquishing tasks are the owner's personal preferences for certain tasks, rather than the melding of his abilities and the abilities of the newly hired management.

Once the decision to expand has been made, the next decision involves the level of autonomy given to each unit. Too often this decision is seen as merely locating a placement on a single dimension continuum somewhere between total centralization and total autonomy. More realistically the decision includes many variables, and thus, the continuum is more like the one shown in Table I. Control of units, therefore, includes many different components, three of which seem to explain the major levels of autonomy. These three decisions include the transferability of the store image, the level of day-to-day supervision, and buying independence.

The initial decision on the autonomy of the unit is how much the additional unit will be a clone of the original operation. Is the concept of the operation universal enough that a carbon copy of the original will work, or will adaptations be necessary? Is the basic image of the operation transferable, or will each unit establish a separate image for a distinct market? With the diverging of markets with respect to wants, needs, and buying power that Sheth\textsuperscript{10} mentions, a single way of doing business becomes more and more unlikely to appeal to many market segments.

The owner must then decide on the extent to which he is willing to relinquish day-to-day supervision of the establishments. Traditional variations on the basic Mazur organizational chart have been limited to the main store,

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Table 1
CONTINUUM OF CONTROL

<table>
<thead>
<tr>
<th>entrepreneurial manager</th>
<th>universal image</th>
<th>consolidated buying</th>
<th>owner managed</th>
</tr>
</thead>
<tbody>
<tr>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>I</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>✓</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

individual buying
continuum of control
unit unique image
the separate store, and the equal store.\textsuperscript{11} In the main store organization, total control of branch stores is maintained by the "main" store. "Separate" stores function independently, tailoring operations to meet local needs. The equal store approach centralizes authority, with finance, buying, promotion, and operations controlled from headquarters. Selling becomes a decentralized function managed by separate sales units (stores).

Supervision is not limited to these three alternatives. The autonomy continuum shown in Table 1, encompasses the supervision decision as one component. At one end of the continuum, supervision of units may exist with the units serving merely as separate departments, just geographically dispersed, under one strong manager. At the other end, establishments may be considered to be totally separate, entrepreneurially managed units with only the bottom line of interest to the owner. As shown in Table 2, supervisory levels between these two extremes are likely.

The most limited level of autonomy is where expanded units serve as satellite units of the "mother" or "flagship" store. Little, if any, autonomy is given to the units; they serve primarily as auxiliary distribution sites. Slightly more autonomy may be shown when the owner/manager directs the operation of two or more geographically separated units. Some minor decisions may be made by the unit purely because the owner/manager cannot physically be at all units at the same time. When the owner establishes a separate "headquarters" to manage several units, autonomy of the units grows. He is relinquishing much of the day-to-day decision making and typically concentrates on organizational management. Nearly total autonomy is achieved, as shown

\textsuperscript{11}Dale M. Lewison and M. Wayne DeLozier, \textit{Retailing} (Columbus, Ohio: Charles E. Merrill, 1982).
Table 2
LEVEL OF SUPERVISION

Direct Supervision

a. 1-0 \rightarrow 2a
- expansion as satellite units

b. 1 \leftrightarrow 0 \rightarrow 2
- owner manages 2 geographically separated "departments"

c. 1-0 \rightarrow 2
- separate unit closely supervised by owner from original unit

d. 0
- owner supervision of units from "headquarters"

e. 0
- separate entrepreneurially managed units with "bottom line" returned to owner

Nearly Total Autonomy

0 = owner
1 = initial unit
2 = additional unit
in the final figure of Table 2, when the manager removes himself from the operation of the units, with financial evaluation his major criterion of performance.

The extent of supervision will be based, in part, on owner preferences and talent, established management style, actual physical dispersion of the units, the availability of managerial talent, the ability to transfer the concept of the operation to new management, and the ability to establish workable information channels. Information gathering will of necessity have to be formalized. No longer will the owner/manager be able to informally assess the market situation. Stock management information, consumer reactions, and activities of the competition will need formal monitoring and planned responses.

The third major component of the autonomy continuum is buying patterns. If in organizational structure, buying and selling functions have been separated, then the autonomy of unit buying becomes a separate decision. As shown in Table 3, buying structures can take several forms. If the scale advantages of expansion are to be gained, then some consolidation of buying is necessary. On the other hand, with the maturity of many consumer markets and the subsequent need to adapt to each market, many firms are breaking up monolithic corporate buying groups. Consolidated separate orders may thus provide the optimum efficiencies.

Regardless of the position on the autonomy continuum that the owner expects to operate the newly expanded business, control of the total operation will suddenly become much more complex. Previously nonexistent problems will begin to appear immediately. For example, since the owner obviously cannot be present at more than one site at a time, measures must be developed
Table 3
BUYING PATTERNS

Total Consolidation of Buying

a. 1 owner/buyer → vendor
   2

   owner buys merchandise and distributes to units

b. 1 consolidated order → vendor
   2

   units consolidate separate orders

c. 1 vendor
   2

   each unit deals separately with vendors

Individual Unit Buying

0 = owner
1 = initial unit
2 = additional unit
to assess the performance of those who manage in his absence. Further, there is the new problem of interstore transactions. For instance, merchandise may be shifted from store-to-store for purposes of meeting special orders or to relieve overstocking.

In order to control a business, an index of performance must be decided upon following which a standard must be developed against which the index may be compared. With a one unit operation, a single measure, net income, may well have been the only index needed. Net income or any of its transformations (e.g., profit margin, return on assets, or return on equity) may give the owner all the information desired for performance assessment. However, even with only two units in operation the number of performance measures required increases to four. For each unit the performance of the manager as well as the owner's investment must be measured. It is important to recognize that the same index will not serve to measure the performance of both manager and owner's investment. As Horngren\(^{12}\) states, "Many proponents of responsibility accounting distinguish sharply between the segment (department, division, store, motel) as an economic investment and the manager as a professional decision maker. Managers frequently have little influence over many factors that affect economic performance." The degree to which any one index does not serve both purposes depends largely on the degree of decentralization installed.

As the degree of decentralization increases, that is as movement progresses away from the origin on the autonomy continuum, more and more costs become controllable by the segment manager. Costs are controllable when a given

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manager has influence in decisions involving those costs. For example, if the store manager makes all of the advertising and promotion decisions for his store, that manager may be held responsible for those costs. However, the manager may not be held responsible if, for example, all advertising and promotional decisions are made by the owner. As a manager is given more and more of a free hand in decision making, monitoring his performance becomes proportionately more critical.

Given the increased evaluation requirements, a need for a significantly expanded set of accounting records is created. Specifically, detailed records for each unit must be maintained in addition to those for the entire operation. The implementation of a sound system for keeping subsidiary records requires careful planning, more planning than the owner would likely anticipate. Four areas requiring special attention as the accounting system is being prepared to handle financial data for the newly expanded business are subsidiary record keeping, interstore transactions, adequacy of automated accounting system, and the treatment of indirect costs.

If the performance of each unit as well as its manager are to be evaluated, subsidiary records must be maintained for each unit. Specifically, the assets, revenue and expenses directly traceable to each unit must be identifiable. The assessment of each store manager's performance may best be made by comparing actual direct revenues and expenses with predetermined or budgeted figures. Thus, the budget becomes the standard for controlling store manager performance. Variances from budget figures become better indices of managerial performance than, for example, a comparison of profit between stores. Such interstore comparisons are invalidated by such unit differences as location and length of operation. Further, budgets provide more realistic goals for
the manager and thus are more likely to elicit desired behavior.

As suggested earlier, the owner will not only want to monitor manager performance but the efficiency with which his capital is being utilized as well. For this type of measurement, each unit may be treated as an investment center and as such subsidiary records of the investment in (or assets employed by) each segment must be kept. For investment decisions, the owner will continuously want to determine whether the investment in each unit is currently yielding (or potentially will yield) a return greater than that of any alternative uses of his capital. Each unit's contribution to overall profits (or segment margin) becomes an essential ingredient to this part of the performance evaluation process. Segment contribution is measured as the difference between a unit's direct revenue and direct expenses. Segment yield then relates segment contribution to segment investment as a measure of profitability. Segment margins are also useful for making interperiod comparisons within each store. For example, the owner may be interested in comparing first quarter results of the current year with those of previous years as a means of establishing trends.

Once in operation, a certain amount of interstore transactions will surely take place. If this activity is substantial, accurate records must be maintained to insure no distortion of segment data. The most significant of these transactions will normally relate to merchandise or inventory transfers. The cost of inventory transferred from store-to-store to relieve overstocking or to meet special orders must be accounted for and incorporated into performance reports. Items of lesser significance relating to merchandise transfers would be those customer transactions initiated at one location and completed at another. These would include gift certificates purchased at
one store and redeemed at another or merchandise purchased at one store and
returned for credit at another. Additionally, other types of interstore
transactions are possible. For example, employees may routinely split their
work schedule between two stores. It may be possible for the owners to assume
that all (or some) interstore activity will cancel out or at least have no
material affect on performance measures. Further, the cost of obtaining
this information may outweigh its benefits (e.g., better decisions). The
important point to be made here, though, is that this issue should at least
be addressed while planning the expansion.

Even if the current accounting system is not already automated, the
amount of postexpansion paperwork will probably increase to the degree that
an automated system will soon be installed. Assuming, however, an in-house
automated system is already in place, the owner must determine whether both
the existing hardware and software is adequate to handle the increased pro­
cessing requirements.

First, the owner will want to establish whether existing software is
capable of handling the departmental or segment data which will be generated
as input to the system. Likewise, the software must be capable of generating
segmented reports as system output. If the current system cannot handle
such data, software is available which can perform these tasks.13

Second, at this point in the growth of the business, a perpetual inventory
system may now be warranted as a means of maintaining a competitive edge.
According to Stuart Gollin, Director of Retail Consulting for Laventhal and
Horwath, a national accounting firm, "As soon as you have more than one store,

you should think of putting in point-of-sale terminals.\textsuperscript{14} Such systems are invaluable for ordering on a timely basis, producing periodic inventory reports and handling interstore transactions as well. However, installing a perpetual inventory system will not only require additional software but substantially increase the memory required for storing information. The cost of upgrading the computer system hardware may be substantial. However, as Herbert J. Kleinberger, Director of Retail Systems Consulting for Price Waterhouse, states, "The development of less expensive computers and more versatile software has now made automation, particularly inventory management, available for businesses doing as little as $200,000 a year in sales."\textsuperscript{15} Given these points, the assessment of the adequacy of the existing system should not be a minor part of the pre-expansion planning.

With a one unit operation, the owner would be accustomed to charging all costs of operation against revenue in computing profit. This makes sense since all operating costs are directly traceable to a single unit. With a multi-unit operation, however, common costs become a complicating issue. Common costs are those costs incurred in behalf of all segments of the firm. These costs are only indirectly related to each unit and thus cannot be assigned to them except on some arbitrary basis. Any such allocation may well distort performance measures. Instead, the performance of each unit is more logically based on its segment margin. As previously noted, a unit's segment margin is measured as the difference between the direct revenue and direct expenses of that segment. Common costs are appropriately charged only against the

\textsuperscript{14}H. Bacas, "High Tech Power for Small Firms," Nation's Business (November 1985), pp. 72-75.

\textsuperscript{15}Ibid.
firm’s total revenue in an overall performance analysis. It is the combined segment margins for all units which contribute to covering the common costs of the business. Any segment with a positive margin is then helping to cover costs which otherwise would have to be absorbed by other units thereby reducing overall profits. Thus, allocating common costs to individual stores as suggested by Sheth\textsuperscript{16} can lead to dysfunctional decisions.

A brief example may clarify this point. Assume a new store has been opened this year in a newly expanded business. Direct revenue and expenses for the new as well as the old store are exhibited in Table 4. Further it may be noted that common costs of 60 are arbitrarily allocated one-half to each store. These common costs may be assumed to be travel and promotion expenses. Under this allocation scheme, it would appear that the new store is losing money for the firm. However, a closer investigation reveals that, if the new store is eliminated and the old store must absorb all of the common costs of 60, a profit of 10 converts to a loss of 10. Thus, one can see the importance of classifying costs as direct or indirect (common) and appropriately using each in controlling the firm. Proper classification of expenses as direct or indirect for performance evaluation purposes becomes an important consideration in setting up the new accounting system.

The retailer who is considering expansion must, therefore, look beyond the much quoted advantages of economies of scale. A necessary component of the expansion decision focuses on the question of how autonomously each unit shall function. Autonomy of necessity includes decisions as to the image of the separate units, the level of day-to-day supervision, and the extent of

Table 4
SUMMARY OF STORE PERFORMANCE
WITH FULL ALLOCATION OF COMMON COSTS

<table>
<thead>
<tr>
<th></th>
<th>Total</th>
<th>Old Store</th>
<th>New Store</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Revenue</td>
<td>700</td>
<td>500</td>
<td>200</td>
</tr>
<tr>
<td>Direct Expenses</td>
<td>630</td>
<td>450</td>
<td>180</td>
</tr>
<tr>
<td>Segment Margin</td>
<td>70</td>
<td>50</td>
<td>20</td>
</tr>
<tr>
<td>Common Costs</td>
<td>60</td>
<td>30</td>
<td>30</td>
</tr>
<tr>
<td>Profit</td>
<td>-10</td>
<td>-20</td>
<td>-10</td>
</tr>
</tbody>
</table>

integrated buying. These variables and such possible supporting variables as: diversity of target market, vendor contact, location characteristics, shared receiving and personnel policies; complicate the expansion process.

The expansion decision will further place much heavier demands on the accounting system. In order to properly evaluate performance and to control the organization, accounting information needs will increase dramatically. A major part of the pre-expansion planning process, then, should involve an evaluation of the current system's ability to handle the increased processing requirements. A well conceived expansion plan will expose the potentially disruptive hidden challenges and significantly improve the chances for a smooth and successful transition to a multiple unit operation.
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Census of Business, Retail Trade Reports (1977), U. S. Department of Commerce, 62, 127.

Census of Business, Retail Trade Reports (1982), U. S. Department of Commerce, 55, 146.


