RETAIL HARDWARE INDUSTRY PROFILE

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EXECUTIVE SUMMARY

The following report covers a wide variety of topics in the retail

hardware industry. The main body of this report is broken down into two major sections, "Industry and Business Environment" and "Small Business Factors."

Section I, "Industry and Business Environmnet," covers hardware retailing on an industry wide basis. Topics covered in this section include: the history of the hardware industry, an overview of the industry (# of firms/growth/sales), and a summary of industry trends.

Section II, "Small Business Factors," covers hardware retialing from the standpoint of the independent retailer. Topics in this section include different financial, marketing, and management tactics the independent retailer can effectively implement.

The goal of this report is to be informative, while at the same time, effective in assisting independent retailers in their businesses. It should be added, however, that the author of this report is by no means an expert in the hardware retailing field. Therefore, it is strongly suggested that retailers consult a variety of other sources before following any of the advice given.

NATURE OF INDUSTRY

Hardware retailing in the United States is a highly competitive and continually changing industry. The industry is made up of both chains and independent retailers. All retailers must keep a close eye on such factors as changing trends in the market-place (please refer to Industry Trends section of report) as well as abreast of new and more effective ways of marketing and merchandising their products.

The target market the retail hardware industry serves is the "D.I.Y. Consumer," the do it yourself consumer. DIY consumers are individuals purchasing home improvement repair products and who participate in home improvement and repair activities.

There are many differences in the size and variety of hardware retailers. Many of these differences are due to the highly competitve intensity of the market, compelling the hardware retailers to use these differences to create a niche from which they can compete most successfully. (i.e. retailers catering to low prices verses catering to service) Eventually, three distinct groups have emerged in the retail hardware industry; Hardware Stores, Home Centers and Do-It-Yourself Lumber Outlets.

Hardware Stores

Full Service Hardware retailers sell mainly hardware merchandise. There are about 25,000 hardware stores in the United States, most of these being independently owned and/or affiliated with dealer owned or merchandising group wholesalers. They have a combined retail sales of about $14.7 billion dollars each year, with an average sales volume of $777,000 per individual store. Although these are typical industry averages, there are full service hardware retailers who are much larger and much smaller than this. These can be grouped into Convenience Hardware Stores and Super Hardware Stores.(5)

Convenience Hardware Stores

Convenience Hardware Stores are smaller scale hardware stores. Consumers turn to convenience hardware stores for those last minute project supplies, emergency repair products and for everyday home improvement and repair items. Convenience Hardware Stores are usually located in convenient locations, have adequate parking and convenient shopping hours which usually include evenings and weekends. The Convenience Hardware Store generally operates out of 3500-5000 square feet of selling area and usually utilizes higher margins to compensate for lower than average sales volumes.(5)

Super Hardware Stores

Super Hardware Stores are huge, expanded hardware stores, having a greater selection and selling a much higher volume of merchandise than regular hardware stores. Super Hardware Stores achieve over $1,000,000 in annual sales volume and have over 10,000 square feet of retail sales floor area. Although similar to Home Center Stores in size and sales volume, Super Hardware Stores are not considered Home Center Stores because they do not carry the volume of lumber and building materials necessary to meet NRHA/HCI definitions (National Retail Hardware Association / Home Center Institute).(5)

Home Centers

Home Centers emerged onto the market-place in the late 1960s, many of which were previously hardware stores that had expanded. Home Centers reach at least $1,000,000 in annual sales volume at maturity, have a minimum of 10,000 square feet in retail sales floor area and offer a strong selection of lumber and building material products. According to the NRHA/HCI Annual Cost of Doing Business Study, "The Bottom Line", The Average Home Center's sales volume in 1987 was over $3.5 million, with over one half of this total coming from the sale of lumber and building material products. There are approximately 10,600 Home Centers in the United States with combined retail sales of over $35 billion.(5)

Warehouse Home Centers

Warehouse Home Centers are a larger variation of the Home Center. The Warehouse Home Center contains form 60,000 to 150,000 square feet of retail sales area with a sales volume in excess of $12 million per outlet. These stores implement "Bare Bones" margins and offer very few "frills" such as expensive store decor or individualized service. Warehouse Home Centers have large advertising and promotion budgets, have an annual stock turnover of an average of 12 to 15 times and have a collective sales volume of almost 7% of the "Primary DIY Market" ($5 billion). It is estimated that 350 of the total 10,600 Home Centers operating are of the Warehouse Home Center variety.(5)

DIY Lumber Outlets

DIY Lumber Outlets were always traditionally contractor oriented. Recently, these lumber outlets have actively pursued the DIY consumer while still catering to the contractor business. DIY lumber outlets are mostly independently owned, most still operating in the same manner as traditional lumberyards yet carrying limited lines of hardware products.(5)

According to the NRHA/HCI, there are approximately 13,600 DIY Lumber Outlets operating today with an industry total retail sales of over $30 billion. The average sales volume in 1987 for a typical DIY outlet was over $2.7 million, with over two-thirds of the sales volume through these outlets derived from lumber and building materials. In order to be considered a DIY Lumber Outlet, the store must have convenient consumer hours and must actively pursue the DIY consumer while still catering to the contractor business.(5)

In summary, the Retail Hardware Industry consists of Hardware Stores, Home Centers and DIY Lumber Outlets serving "DIY Consumers". The industry consists of both chains and independent retailers and is highly competitive. Please refer to pages 1 and 2 in the appendix for an overview of DIY Industry sales. Please refer to page 3 in the appendix for an indepth overview of average store operations in the DIY Industry.

INDUSTRY BACKGROUND

In 1744, Captain John Ames, living in colonial North America, decided he could make shovels from metal that would be as good or better than any made in England. This idea sparked the beginning of the Hardware Industry in the United States. The Ames Co., still in existence, is the oldest brand name manufacturer in the hardware industry and one of the oldest continuing businesses in the United States.(1)

In the last 20 years, the DIY Hardware Industry has enjoyed prosperous growth in the United States. Beginning in the 1970s, the energy crises created the "Energy Conservation Market". This greatly boosted the Hardware Industry because homeowners needed to buy tools and materials to insulate their homes.(1)

Another event that greatly boosted the Retail Hardware Industry in the 1970s was instigated by the wholesalers. Wanting to improve their own profitability, wholesalers began to collect exhaustive industry information which, in turn, was given to the retailers in the form of management and marketing services.(1)

The 1970s also saw the growing up of the Baby Boomers. In forming households, the Baby Boomers "spent money rather than saving it," causing a surge on "Doing it Themselves", (projects around the house). In doing this, the Baby Boomers created a "Booming" business for the hardware industry.(1)

The early 1970s also saw the rise of the Home Centers. This group of retailers were much larger and sold much more merchandise than hardware stores. They also sold lumber and building materials in addition to hardware.(1)

However, the late 1970s and early 1980s brought the following danger signals for the Hardware Industry:

- The end of the Baby Boom was in sight
- The Hardware Industry suddenly became competitive with areas becoming saturated with thousands of square feet of hardware space.
- A deep recession hit the entire country and put severe strains on cash flows.
- Prolonged unemployment and high inflation caused consumers become more price conscience than ever, greatly affect in purchasing habits.
- Hardware Retailers were inefficient and ineffective marketers.

Suddenly aware of these danger signals, the Hardware Industry needed information about their target market, the DIY Consumer. In response to this need, a group of publicly owned hardware retailers organized the Hardware Research Institute and contracted with the NRHA to do continuing research on the consumer market.(1)

In the 1980s more marketing programs came into play. Hardware Associations and Wholesalers expanded their Marketing Programs and Services to help independent retailers become more efficient and compete more effectively. During this time, the new theory took hold that to succeed was not constantly expand, but to make current sales floors more productive.(1)

In the middle 1980s, the NRHA and its affiliated state and regional associations began offering strategic merchandising and sales floor reformatting assistance. Retailers began reformatting floor space in more efficient and productive ways than they ever had before.(1) The late 1980s has seen the Retail Hardware Industry recover. Retailers, however, do not enjoy the same "Automatic Success" as their predecessors once did in the 1970s. Retailers in the 80s-90s will compete for business by implementing creative merchandising and marketing techniques. Consumer Research, Marketing Programs and Sales Floor Reformatting have all contributed to this recovery. Today the Retail Hardware Industry is as strong as ever and is looking forward to the 1990s and beyond.

INDUSTRY TRENDS

The Retail Hardware Industry in the United States is growing at a steady rate of about 9% each year. It is projected that it will continue to grow at 9% a year for the next six years and pass $100 billion in annual sales in 1991. What contributes to continued growth trend of the DIY Market into the future?(6)

There are a number of trends existing that currently effect the Retail Hardware Industry, or will in the future. Those trends having the greatest impact on this industry are Demographic Trends, Housing Trends, and Trends within the Retail Hardware Industry.(2) Please refer to page 2 in the appendix for an overview of the pattern of growth and projected further growth of the DIY Industry.

Demographic Trends

The current and future trends in demographics in the United States spell big profits for the Retail Hardware Industry. The demographic factors that will have the greatest impact on the Retail Industry will be the aging baby boomers and the current teenage market.

The Demographic Trend having the greatest impact on the Retail Hardware Industry will be the Baby Boomers. Baby Boomers are a big factor as they are reaching their prime earning and spending years. They are now the nation's homeowners (76 million), aged 35-44. In the next ten years, 45-54 years olds will increase by 50%, with their buying power increasing by $195 Billion to a grand total of $939 Billion.(2)

The trends show that these aging baby boomers will vacate their first homes in favor of larger and often older homes, homes that need remodeling, renovation and refurbishing.(3) Forecasts show that this segment of the population will be more affluent than its parents. These homeowners will have the money it takes to make their homes look the way they want, thus, producing a tremendous boost to the hardware industry.(2)

Another trend having impact on the future of the Retail Hardware Industry is the influence of the current teenage market. Three-fourths of todays teenage population now hold jobs. Studies show that these teenagers are more materialistic than past generations and exhibit strong tendencies toward the "work to spend ethic". They will likely carry over these attitudes into their adult lives in the next 10 years, a time when they will be buying their first homes.(2) Please refer to page 4 in the appendix for an overview of projected future age demographics in the United States.

Other demographic factors affecting the DIY market is the growing economic clout of minorities, the more common occurrence of women buying hardware and building materials and the fact that the average household income for the United States as a whole is expected to rise steadily in the 1990s.(2)

Housing

Now trends in housing create even more growth for the Retail Hardware industry. General Home Improvement, Home Automation and the rise of non-toxic building materials are new trends in housing that will tremenendously boost the DIY market through that the year 2000.

The Housing factor having the greatest impact on the DIY market will be the trend toward doing more general home improvements. Homes are aging. The great number of homes built in the 1960s will be 25 plus years old and will be in need of upgrading. These will be bought by families who will do major remodeling and renovation.(2)

Another housing trend is that of homes being prefabricated models that are pieced together at a lower cost. In many instances the interiors will be left unfinished for the home buyer to install the desired decor and finished touches. Both of these trends towards home improvement will provide a great boost to the retail hardware industry.(2)

Home automation will also have a great impact on the DIY market. While Electronic gadgetry already exists in homes in the form of remote control to open doors and to turn on the T.V., home automation will surpass gadgetry. Total home management, already available, will be used to control elaborate security systems, heating/cooling functions, lighting from room to room and much more.(2)

Security for the home will utilize infrared technology to monitor doors and windows, detect intruders and turn on outdoor lights to protect homeowners and valuables while they sleep or go out. Approaching the turn of the century, a large majority of the population will be 55 or older and will want or need these conveniences.(2)

Finally, the increasing nationwide concern for health and the environment has brought about a trend in building homes using non-toxic materials. Formaldehyde, asbestos and toxic ingredients have created "Indoor Air Pollution" that has affected the health of a home's occupants. There is a new trend toward constructing "preservative free" houses using products such as vinyl, Formaldehyde free wallpaper, Formaldehyde free foam insulation, tile with natural grout, untreated pine and other woods and specially treated paints and varnishes. This trend creates a whole new market for the retail hardware industry.(2)

Industry Trends

Finally, internal industry trends will have tremendous impact on growth. The two factors having greatest impact from within the industry are:

1. The trend toward using more technology.
2. The trend toward providing more convenience and service.

First, the hardware industry is going to experience great technological changes in the next 10 years. This will include increased application of computer technology in the 1990s. The computer will greatly improve efficiency and lower costs of retailers by specializing in information managment. It will keep track of product movement, pricing, employee performance, cash flow, and all other aspects of running the business.(2)

Also, another technological trend to affect the retail hardware industry in the future is "teleshopping." Teleshopping is any type of shopping done from the home. Because shoppers have less and less time to shop, the trend foreseen is home shopping and direct marketing. This gives consumers a way to shop from their homes through catalogues, by watching T.V. and calling in purchases, by using a personal computer to tap in orders, or with soon developed combinations of telephone, T.V. and computers.(2)

Second, the Retail Hardware Industry is showing a trend toward offering more customer services. These services include home remodeling, installation, yard care, appliance repairs and delivery. DIY retailers have realized that service is a marketable product because consumers (especially baby boomers) have become more and more time pressured. Leisure time is becomming less available, causing these time pressured people to buy service as readily as product. Many are forecasting that as the 1980s was known as the Do it Yourself trend, the ninties will be known as the Do-it-for-me trend in hardware retailing.(2)

In summary, the Retail Hardware Industry will show steady growth through the turn of the century. This growth trend will be propelled by changing trends in demographic, housing, and changes from within the hardware industry itself.

NUMBER OF FIRMS/GROWTH/SALES

There are approximately 49,200 firms that make up the Retail Hardware Industry in the United States. Total 1988 retail sales for the "Primary DIY Market" (Retail Hardware Industry) reached $80.7 Billion. Total retail sales are expected to reach $100 billion by 1991. The industry as a whole grew 10.3% in 1987 and 1988, and is expected to grow at an average annual rate of over 9% for the next five years.(5)

The Primary DIY Market can be broken down into Hardware Stores, Home Centers, and DIY Lumber Outlets. There are approximately 25,000 Hardware store in the United States, with the average store boasting annual sales of $799,386. In 1988, Hardware Stores had combined sales of $14.7 billion, up by 14.4%.(6)

There are also approximately 10,600 Home Centers in the United States. The Average Home Center boasted annual sales of $3,750,496. 1988 figures show Home Centers with combined sales of $35.7 billion, up 7.9% from last year.(5)

Finally, there are approximately 13,600 DIY Lumber Outlets. The average DIY Lumber Outlet reported annual sales of 2,776,269. 1988 figures show DIY Lumber Outlets with combined sales of $30.3 billion, also up 7.9% from last year.(6)

There is an optimistic outlook for future growth in the DIY Market. The Baby Boomers have caused growth and will continue to be a major factor. The NRHA projects that the number of households per store will increase in the next few years, thus creating the basis for growth for existing stores and in some markets, the possibility of opening additional stores.(6)

Please refer to page 1 in the appendix for an overview of total industry sales. Please refer page 2 in the appendix for a breakdown of sales by year and type of store. Please refer to pages 6, 7, 8, and 9 in the appendix for individual hardware store financial profiles. Finally, page 5 in the appendix provides information on total industry hardware store sales for the last ten years, along with an overlay depicting the percentage increases in sales each year.

SOURCES OF INFORMATION

There are many valuable sources of information available to Hardware Retailers. Wholesalers, National Shows, National Associations, Computers, and Hardware Publications are just a few of the many information sources available.

Hardware Wholesalers provide not only goods, but also helpful services such as in marketing, sales, pricing, promotions, industry and customer research among many others.

National shows such as the National Hardware Show, National Home Center Show and the International Houseware Exhibition help keep retailers up to date on the latest in industry technology and trends.

National Retail Hardware Association/Home Center Institute publishes "Do it Yourself Retailing", "Hardware Show News", and "World Wide Hardware". The NRHA/HCI also works closely with retailers offering retail services and marketing support services. Together, the NRHA/HCI form the largest retail trade association in the United States.

Computers today in the hardware store can tell you what was sold, how many, how often, to whom, how long to get shipment, etc. Computers are also being developed that would link the entire hardware industry.

Other hardware publications are; "Building Supply Home Center" magazine, "National Home Center News" and "Home Improvement Center" magazine. Please refer to page 10 in the appendix for a list of important sources of industry information, along with their addresses and phone numbers.

FINANCIAL ASPECTS

When looking to enter the DIY Industry, the new retailer must consider whether to lease or to buy. The two factors that determine whether or not a new retailer leases or buys is availability and affordability. However, in many parts of the United States, property is either unavailable or unaffordable.

The first option available to retailers is the option of buying. Buying entails purchasing a piece of property zoned for retail and paying to have a store constructed on the sight. The main advantage of owning the store and property is that the retailer is his own landlord. However, one main disadvantage is that it takes anywhere from 3-6 months to get from an empty piece of land to a hardware store ready for business.(10)

The other option available to retailers is the option of renting. The main reason many retailers rent is that they can't afford to buy the land and pay the construction costs is takes to build a new store.

Other advantages of leasing include bigger tax breaks and the flexibility to be able to move if the market calls for it. The main disadvantage of leasing is that there is no equity being built.(10)

When approaching a bank, the diy retailer should realize that financing will not only have to cover what the business costs, but will also have to cover many unforeseen incremental expenses incurred in the process of setting the store up and running it. Some of these unforeseen expenses can include the purchase of new stock, replacment of fixtures, and interior/exterior construction. It also generally takes at least a year before the new store even begins to turn a profit. Firms also have to secure more than adequate capitalization in order to cover possibilities of the market going soft, the store starting out worse than expected or suddenly coming up against tough competition.

Joel Stevens, the National Sales Manager of Ace Hardware Corporation, estimates the cost of getting a 10,000 square foot firm (ground up store) up and running to be $400,000 over a four period; that is, to the point where it begins to pay for itself. Sources of financing include banks, partnership and various wholesalers. Some wholesalers have programs in existence that will match an investment for a second store, up to a certain amount. Also, once in business, a bank line of credit is often necessary to support the increasing and decreasing purchases from suppliers, due to the seasonal nature of the business.(10)

BREAK EVEN ANALYSIS

In the face of ever increasing competition, it has become more important for diy hardware retailers to be sensitive to their break even point and their margin of safety. The break even point is where total costs equal total revenue, and there is neither a profit nor a loss. The margin of safety, on the other hand, is the amount of business a retailer can afford to lose and still break even.(10)

In order to understand break even analysis and margin of safety, retailers have to distinguish between fixed costs and variable costs. Fixed costs are costs that remain stable regardless of the amount of sales a store has, such as rent. Variable costs are costs that change with the level of sales, such as sales commissions.(10) Because of the difficulty in determining which costs are fixed and which costs are variable, industry analysts have calculated for diy retailers that approximately 70% of all operating expenses are fixed.(10) Step by step procedures on how to figure out both break even analysis and margin of safety are located on pages 11 and 12 in the appendix.

Once the retailer figures out the break even point, he can then determine the margin of safety. By studying the amount of sales above the break even point, retailers will be able to know how much in sales their business can lose, and still stay in business. Retailers must be warned, however, that this number does not take into consideration the different margins of the products sold. For example, if a retailer loses a large amount of this high margin business, he will reach his break even point a lot quicker than if he lost the same amount of his low margin business.(10) In 1987, the average hardware store had a margin of safety of about 10% of sales above break even. High profit hardware stores, on the other hand, had a margin of safety of approximately 30% of sales above break even. Please refer to page 13 in the appendix for an overview of margin of safety averages for hardware stores since 1977.

DIY Retailers have a relatively strong margin of safety when compared to other forms of retailing. Knowing the break even point and margin of safety is beneficial because it helps retailers better understand their business and enables them to develop business strategies. Having a strong margin of safety also more effectively lends a hand to the retailer when negotiating with banks for further financing. Please refer to page 14 in the appendix in regard to how the margin of safety of the DIY Industry compares to other U.S. retailing industries.

CUSTOMER CHARACTERISTICS

A wide range of men and women of all ages and income levels make up the market for the Retail Hardware Industry. Because of this, it is difficult to pinpoint specific customer characteristics. However, the average age of a customer is 43 years old, with an annual income of between $20,000 and $50,000. The average male customer earns $4,000 more in annual income than the average female customer. Men are also more apt to shop for hardware by themselves, while women usually shop in groups. Finally, despite traditional myths, men and women buy similar items.(7) An overview of specific customer characteristics is summarized on page 15 in the appendix.

Although it is difficult to pinpoint the exact customer characteristics of the DIY Hardware Industry, recent studies have been able to more specifically group the wide range of DIY customers. A study recently conducted by the Russell R. Mueller Retail Hardware Research Foundation evaluates the "Do it Yourself Consumer." The main finding of the research is the important differentiation between "Normal Shoppers", and "Impulse Shoppers".(7)

The Mueller Study found that the DIY Market is made up of normal shoppers and impulse shoppers. Normal shoppers are those customers who visit the retail outlet and make only planned purchases. Impulse shoppers, on the other hand, are those who buy what they intended to purchase, in addition to various odds and ends they had no previous intentions of purchasing.(7)

Impulse shoppers spend on average, 70% more time in the store, buy 2 1/2 times as many items and spend almost 70% more money. Studies show that impulse shoppers have higher incomes than regular shoppers, averaging over $40,000 per year as compared to $38,000 for the entire sample. In addition, according to the Mueller Study, those who earn more than $40,000 per year account for over 40% of impulse buying, while consumers with incomes lower than $20,000 account for less than 17% of impulse buying.(7)

The existence of the impulse shopper is of extreme importance to the hardware retailer. In order to capitalize on the impulse shopper, retailers need to keep the customer in the store longer. Of all hardware customers, the impulse shopper spends the greatest amount of time in the store. The Mueller Study also shows that the amount of time a shopper spends in the store directly influences the amount of money spent. Therefore, in order to get more money out of impulse shoppers, retailers must look for new and creative ways to keep the customer in the store longer.(7)

An effective way of keeping customers in the store longer is reformatting current floor space to a "Loop" layout. According to the Mueller Study, the loop layout causes customers to spend 30% more on impulse items. The loop layout forces customers to follow a circular path throughout the store, exposing them to a much larger variety of merchandise and possibly keeping them in the store longer.(7)

Another way to capitalize on impulse shoppers is by improving the sales help. A high level of service or sales help in the store keeps customers in the store longer and has proven to increase impulse buying. The Mueller study shows that most people go to hardware stores in order to run an errand. Skilled sales people have the potential of turning a customer's small errand into a "shopping trip". One way salespeople can turn an errand into a shopping trip is by walking with customers from department to department, suggesting pertinate related items to go along with their original purchase. Another way is by continually pushing small ticket, add on items such as promotional or seasonal novelties.(7)

A third way to capitalize on impulse shoppers can be accomplished by increasing merchandising displays. Increases in displays such as endcaps, dumpbins and project centers lures the shopper into making more impulse purchases. Effective display techniques are further described in the Merchandising section of the report.(7) Please refer to pages 16 and 17 of the appendix for further information regarding diy consumer habits.

In summary, there is a wide range of characterisitics that describe the Hardware DIY Customer. However, the most important characteristic is the difference separating impulse shoppers from regular shoppers. Retailers are finding that it is increasingly important to find ways to capitalize on the impulse shoppers as they spend 70% more time and money in their stores. In order to capitalize on impulse shoppers, retailers need to keep the customer in the store longer, improve sales help and increase merchandising displays.(7)

SUCCESSFUL EXISTING MARKETING APPROACH

Independent DIY Retailers currently have a very successful approach to marketing in that the majority are members of wholesaler groups. By being a member of a wholesaler group, retailers are able to take advantage of a national image, receive help in the form of marketing and store identification programs, while still being able to be entrepreneurs and very much in control of their own businesses.(10)

Wholesalers are able to give independent retailers the power of a common identity, national advertising on television and in consumer magazines and the cost efficiency of mass-produced circulars.(1)

Wholesalers also offer DIY Retailers total integrated store marketing programs combining advertising, store identification, interior design, salesfloor layout, feature and displays, point of sale signing and much more into one program.(1) Wholesalers also assist in designing new salesfloor formats that make customers have to walk through most of the store, increasing time spent in the store and impulse purchases.(1)

However, retailer members of these organizations are highly independent. They make their own buying decisions and often buy from several sources. They decide what products they will stock,

how they will advertise and how they develop local marketing strategies.(9)
Some common wholesaler groups associated with independent retailers are:

- Ace Hardware Corporation
- Standard Hardware Inc.
- Cotter and Company
- Servicestan Corporation
- Pro Hardware

Wholesalers are motivated to collect information and give it in the form of management and marketing services because in the end, their productivity improves and they too become more profitable.

In summary, independent retailers are able to successfully work with Warehouses to gain a national image and to improve sales and marketing techniques. However, the member DIY Retailers are still able to remain completely independent.

DISTRIBUTION CHANNELS

The Do-It-Yourself independent retailer channel is a two-step distribution channel. About 70% of shelf goods are purchased from wholesale distributors, with the remaining 30% of the merchandise being purchased directly from the manufacturers.(6)

Two major types of wholesale distribution have evolved: Dealer owned Wholesalers (also known as "Voluntary Chains" or "Co-Ops) and Wholesaler Merchandising and Buying Groups.(5)

Members of Dealer owned Wholesalers are independently owned retailers who are also stockholders of the wholesale operation. The wholesale companies sell only to their members. The member retailers, however, commonly purchase from other wholesale sources in addition to their themselves with their dealer owned wholesaler through store programs.(5) Please refer to page 18 in the appendix for a profile of selected Dealer Owned and Volunteer Chain Hardware Wholesalers.

The wholesaler merchandising and buying groups are made up of traditional, privately owned wholesaler companies. All function as buying organizaitons while some also offer marketing and store identification programs to retail customers of their member wholesale companies.(5)

The individual member company of the wholesaler group will sell to accounts that do not identify with the retail marketing program. Retailer members of these programs also buy from several wholesale sources.(5)

Merchandise Delivery

Full-line wholesalers generally deliver merchandise under the following 3 systems:

1. The Out-of-Warehouse system
2. The Pool/Relay system
3. The Drop-Ship system

Out-of-Warehouse

Retailers may buy small quantities of regularly stocked merchandise at normal prices for better turnover rates and order "service items" and "seldom called for" products out of warehouse.(5)

Pool/Relay

In this system, the wholesaler combines or "pools" several retail orders before placing the order with the manufacturer. Merchandise is then shipped to the wholesaler, and then immediately "relayed" to the retailer. The merchandise does not go into the distributor's inventory. Retailers use this ordering method for seasonal specials. Pool/relay orders carry a lower cost than warehouse shipments because of fewer handling cost.(5)

Drop-Ship or Direct-Ship

These are larger quantity orders, shipped directly to the retailer by the manufacturer. Orders are placed and billed through the wholesaler for a small add-on charge, normally called an "adder". Very bulky goods, seasonal merchandise, introductory offers including displayers, new assortment programs, etc., are frequently sold this way. Minimum purchase requirements are established to enable an order to qualify for direct ship.(5) Please refer to page 20 of the appendix for an overview of the distribution of purchases by the primary diy channel.

PRICING

In recent years, with the advent of the cut throat pricing policies of warehouse home centers, price competition for independent retailers has become tough.(8) The independent retailers came to realize that they would never be able to undercut the warehouse home center's prices, and that they needed to somehow come up with a new pricing strategy.(8) In order to come up with a pricing strategy, the independent retailer must first do the following.

The independent retailer should first ask themselves what kind of image they want to present to their customers. Do you want to be known for low prices, fair prices but good service, fair prices with frequent low price promotions, etc. This decision concerning image becomes the "pricing mission" of the retailer.(8)

Second, retailers need to define the customers they are trying to reach with their pricing strategy. In doing this, retailers must study what proportion of their customers are homeowners, contractors, industrial/commercial accounts etc. After having a clear idea of who their customers are, the retailer must find what is important to these customers. They need to evaluate how important factors of fair prices, good service, immediate availability of merchandise or service support is to their customers.(8)

Finally, independent retailers need to study their competition. Which competitor serves the same customers? How are they going about it? What are their pricing strategies? Finally, after deciding on an image, studying their customers and evaluating their competition, the independent retailer is prepared to set a pricing strategy.(8)

In order to survive the "cut throat" pricing strategies of the warehouse home centers, many independent retailers have concentrated on convenience and service. By adding convenience and service to their products, the independent retailer has added "value" to their products and is able to justify charging higher prices. This added value could be in the form of the advice from a salesperson, better quality products or better availability of products. If the independent retailer is after an image of good service and after customers who desire it, this is a good pricing strategy to implement.(8)

Another pricing technique independent retailers often use is the practice of variable pricing. Variable pricing is a technique of dropping margins on price sensitive items and making them up on non-sensitive items. Price sensitive items are "high visibility" products that are advertised frequently and carried by a large number of stores. These items are price sensitive because consumers recognize these items and know what they are supposed to cost. Consumables such as light bulbs, batteries and trash bags are price sensitive because people buy a lot of them and are aware of their price. Big ticket items such as expensive appliances are also price sensitive because consumers are likely to shop around and compare prices. Wholesalers often provide retailers with lists of price sensitive items.(8)

On the other hand, non-price sensitive items are those items that do not attract much consumer attention. These items are not advertised often and are generally slower to move from the shelf.(8)

Once the retailer is able to identify the price sensitive items, he lowers their margin. By doing this he is able to improve the pricing image of his store. The retailer makes up the margin by charging higher prices for non-price sensitive merchandise, continually pushing non-sensitive product prices higher and higher until they face customer resistance.(8)

Jim Warren, owner of Leader Hardware in Zion, Ill., raises the following points about margins:

- What do you carry that the competition does not?
- What have you never heard a price complaint about?
- What items sell slowly?
- What items are never advertised?

In all previous cases, Raise The Margins.

Jim Warren also adds that retailers should review the wholesaler's list of price sensitive items to make sure these item margins are not being raised.(8)

In conclusion, independent retailers are having tough times competing with the low prices of warehouse home centers. However, by keeping an image of convenience and service, independent retailers have been able to justify charging higher prices for products with customer acceptance. Through variable pricing, independent retailers lower prices on price sensitive items and make up the profits by charging more for non-price sensitive items. By doing this, independent retailers are still able to keep a good price image.(8)

MERCHANDISING TACTICS

Effective merchandising in the retailing industry is a key element for the success of retailers. In 1987, the Point of Purchase Advertising Institute in New York conducted a study a supermarket customers. They found that consumers buy 15-20% more in stores they thought were well merchandised and run to be in. This idea of the supermarket study parallels to the retail hardware industry. A consumer shopping study by the Russell R. Mueller Retail Hardware Research Foundation in Indianapolis indicates that a well merchandised store promotes impulse purchases, impulse shoppers spending as much as 70% more.(3)

In order to merchandise on the most competitive level possible, hardware retailers have implemented what has been termed "power merchandising". Power merchandising incorporates a combination of an effective sales floor design, displays, signing, product positioning, as well as numerous other factors. The purpose of power merchandising is to make the sales floor more productive and attractive.(3)

Sales floor Design

The cost of retail space, along with the cost of carrying merchandise, is continually rising in the United States.(6) In response to these rising costs, hardware retailers have been striving to make sales space as productive as possible, with the goal being to make more money using less space. The following paragraphs describe current trends existing in retail hardware sales floor design.(3)

The "Grid Layout" is the oldest type of sales floor design. The grid layout consists of rows of merchandise, divided by isles running parallel and horizontal. This layout is increasingly disappearing as retailers are implementing more imaginative and productive sales floor designs.
Loop Layout

The "Loop Layout" is increasingly becoming the most popular sales floor design. This layout leads customers though the store in a circular pattern (loop pattern) and gives every major department a front position on the main shopping isle. The Loop Layout exposes customers to more merchandise as they pass through the store, the idea being that the more the customer sees, the more they will be tempted to buy. The Loop Layout has increased the amount of impulse sales and has led to retailers taking advantage of between 5-10% more sales space.(3)

A study recently published by the Russell R. Mueller Retail Hardware Research Foundation had the following findings when studying the Loop Layout:

- The Loop Layout allows customers to move through the store more quickly and efficiently.
- The Loop Layout generates more sales in departments where customers stopped.
- A greater number of items were bought on impulse in stores with Loop Layouts.
- The amount of money spent by impulse purchasers was higher on the Loop Layout.
- Customers shopping in a Loop Layout spent 35% more on impulse items than those in stores with traditional grid floor plans.(3)

Diagonal Layout

A diagonal Layout has been effective in stores with corner entrances. This design pulls customers into the store's corners and creates triangular areas throughout the store to locate product groupings.(3)

Power Aisle

When dealing with smaller retail areas, a "Power Aisle" has proven effective. A Power Aisle is a double width, main aisle that stretches down through the center of the store. This aisle, often designated by special floor paint or markings, pulls customers through the store and exposes them to most of the major departments. This aisle also gives smaller stores the opportunity to make use of endcaps.(3)

Retailers can seek floor plan design assistance from almost any major wholesaler or wholesaler group. Store design services are also offered by organizations such as the state and regional hardware associations affiliated with the National Retail Hardware Association (NRHA).(3)

In summary, the grid layout is an old fashioned and unproductive retail floor design. The loop layout has been becoming the most popular technique used to increase sales floor productivity. Diagonal layouts are being implemented by stores with corner entrances and the power aisle has proven effective in smaller stores. Help with layout design is available from a variety of sources. Please refer to page 21 in the appendix for an overview of how the likelihood of customers passing, stopping, and investigating store departments in affected by a number of different factors.

Displays

Effective product displays also play a large role in productive merchandising. Endcaps or Dumpbins, Project Centers and Demontration Areas, and Landscaping have all been effective in displaying hardware merchandise.

Endcaps/Dumpbins

Endcaps are groupings of promotional, seasonal or consumable goods displayed at the end of an aisle. The display "caps" the aisle in that it is situated on the end of the aisle as you turn the corner. Dumpbins are mainly promotional displays. They consist of a prominent sign, under which lies a large bin stuffed full of the advertised product. Endcaps and Dumpbins are a great lure for impulse shoppers and should be located in the front of the store and in the high traffic aisles. It is also important that they are kept full and changed frequently.(3)

Project Centers/Demonstration Areas

Years of research show that consumers like to physically touch products before they feel comfortable making a purchase. Retailers can offer this opportunity through project centers or demonstration areas. In these areas, consumers are able to test what they will be buying whether it be a door bell or a security alarm system. These areas can also be used for live demonstrations or special promotions.

Landscaping

Landscaping is a practice of designing aisles so that endcaps or displays extend into the main aisle or the loop. Landscaping is an effective eye catcher as you can't avoid seeing displays that jet out into the main aisle of traffic. The practice of landscaping also presents additional area for promotional displays aimed at luring the impulse shopper.

In summary, displays have proven to be an effective method of merchandising and especially good at luring the impulse shopper into making purchases. Some common display techniques include endcaps or dumpbins, project centers and demonstration areas, and landscaping.

Signing

In order to effectively practice power merchandising, retailers also need to incorporate effective signing. Signing on endcaps and dumpbins need to be large, in bold, and professional looking. Signs should co-ordinate in color and design with the overall store decor and color. Project "how to" signs are beneficial in areas where customers often have questions.(3)

Visibility is an important factor when placing signs. Signs over departments should be visible from the front of the store because customers are often time pressured and need to find something fast.

Also, retailers can make use of airspace by fixing signs much higher in the back of the store in order to call attention to merchadise not immediately visible.(3)

Product Positioning

Product positioning is another important merchandising technique. Some methods of product positioning are grouping related items together, implementing cross aisle merchandising, implementing vertical merchandising and taking advantage of prime selling space.

Retailers will often group items together on shelves. For example, power tool accessories may be displayed with the power tools that use them. This makes it more convenient for the customer and may trigger impulse purchases. Retailers also often implement "cross aisle merchandising". Cross aisle merchandising entails putting similar items on both sides of the aisle. With cross aisle merchandising the customer can see a broad selection of merchandise in the same or related product category.(3)

Another product positioning technique is "vertical merchandising". Vertical merchandising consists of grouping merchandise vertically in relatively narrow rows or gondolas so that customers can see the complete selection at one stop. When products are of various sizes, items of the largest size are generally placed on the bottom and smaller items towards the top.

Finally, just as commonly practiced in grocery retailing, hardware retailers make use of their "prime selling space". Prime selling space is that shelf space between eye and waste level. Retailers often place their best selling, higher priced and better quality items in this space because it is easiest at this level for consumers to see and reach for this merchandise.

Other Merchandising Techniques

Another common merchandising technique retailers practice is the idea of making it as easy for the customer to shop as possible. This includes keeping aisles clean of obstacles. Providing carts and baskets is another way to make shopping easier for the shopper and more profitable for the retailer. People commonly only buy as much as they can carry. If they have a basket or a cart, they will tend to shop until it's full.(3)

It has also proven successful for hardware retailers to sell projects rather than products. By planting ideas of projects customers can do (with the help of the retailer), retailers are able to sell all of the related items that go with the project. The technique of selling projects usually requires extensive use of signage and displays. Some retailers have incorporated entire do it yourself areas in remote spaces of the sales floor. By drawing customers to remote areas of the sales floor, retailers have been able to boost sales floor productivity and increase sales.(3)

Finally, effective merchandising takes place under proper lighting. Today, lighting not only lets customers see merchandise, but sets the mood of the shopping environment. Brightly lighted stores creates a sharper price image, making the store look cleaner and better kept.

In conclusion, Hardware retailers have many merchandising options. Power merchandising, a successful combination of effective sales floor design, displays, signage and product positioning almost assures the retailer merchandising success. Please refer to pages

22 and 23 in the appendix for an overview of how different merchandising factors may have affect on impulse buying.

COMPETITION

There is widespread competition in the DIY Retail Hardware Industry. From the viewpoint of the independent retailer, there are two main competitors; the Warehouse Home Center and the Discounter.

First, with the advent of the cut throat pricing policies of the warehouse home center, price competition for independent retailers has become much tougher.(8) It is also much more difficult for independent retailers to compete being that the home centers carry a much wider selection of merchandise. The independent retailer can compete with the warehouse home centers by either concentrating on service rather than pricing and/or implementing variable pricing. (please refer to the pricing section of this report.) Independent retailers can also become more competitive by evaluating their merchandising practices. A combination of implementing more effective sales floor design, displays, signing and product positioning will also have a large affect on the level of competition in which the independent retailer competes. (Please refer to the merchandising section of the report.)

Second, independent retailers have met increasing competition with the discounter. Discounters are stores offering giftware, houseware, sporting goods and small appliances. These discounters are buying their merchandise at the lowest possible prices, therefore able to turn around and sell to the customer much cheaper than the independent retailer is able. Discounters such as Wal-Mart and Big Lots have been successfully preying on smaller town DIY Retailers. In recent years, the higher prices mom and pop diy retailer has had no chance against a new discounter moving into town, eventually forcing the small diy retailer to go out of business.(14) Please refer to page 24 in the appendix for a chart that shows the growth of the discounter between 1980 and 1987. Page 25 of the appendix further gives an overview of the financial profile of a typical discounter.

There are, however, many ways the independent retailer can readjust their product mix, service offering and other efforts to effectively counter act the discount store. First, with regard to product mix, hardware stores competing with discounters should not be trying to sell housewares and appliances. The discounter can buy and reseall these items at the lowest possible process, virtually killing any competing diy retailers carrying them. Instead, the independent retailers should concentrate on centering the store merchandise around the service categories such as plumbing, electrical and basic hardware. The independent retailer should also carry the hard to find hardware items such as plumbing parts and hard to find tools.

Second, in order to effectively compete, the independent retailer needs to readjust in order to concentrate much more in service offerings. In order to compete, hardware retailres need to be able to tell somebody how to hook up a faucet. Wal-Mart and other discounters can't do that.(14)

Some other efforts the independent retailer needs to accomplish in order to compete can be to redesign the store in order to make it more efficient, relocate in order to take advantage of increased consumer traffic caused by the discounter, and increase buying by drop-ship direct from the manufacturer instead of through the more expensive wholesaler.

Most importantly, however, the diy retailer should not go neck and neck with the discounter selling housewares and appliances, nor should the retailer pretend that the discounter doesn't exist. The best policy for an independent retailer to follow when the discounter moves in is to readjust their product mix and service offering along with making other efforts in order to be able to successfully compete.

PERSONNEL

In order to survive, the diy hardware industry depends on good quality employees. Employees are the diy industry's greatest asset because good experiences with employees bring people back while bad experiences drive the customer away forever. Good employees can also have a tremendous impact on sales floor productivity.

However, according to the U.S. Department of Labor, the latest demographic changes do not bode well for the employers in the service industries. (Retailing is one of the leading service industries) Business week further reports that, "A slower growing population is propelling the country into a period of labor scarcity that could last until the turn of the century.(11)

Between now and 1995, the number of 16-24 year olds entering the job market will be down by 10%. At the same time, the economy as measured by GNP, is expected to expand over to create 10% more jobs. Therefore there will be 10% less people to fill 10% more newly created jobs. To make matters worse, new technology will make many of these new retail jobs require some college of specialized training. However, the job market is heading for a surplus of under-skilled and underqualified workers, leaving very few that are qualified to work.(11)

Finally, because of the law of supply and demand, retail positions will command higher salaries because of their difficulty to fill. Time magazine predicts, "At least until the next recession, the days when employers could pick and choose among hundreds of youth lined up outside their doors seeking low paying jobs are over."(11)

When dealing with this problem of demographics, DIY Retailers have the following options. First, they can continue to hire qualified employees. Second, they can begin to hire less qualified employees or third, they can look elsewhere for employees.

If retailers choose the first option of continuing to hire qualified employees, they will be competing with many other types of industry for the same people. This competition for qualified people will force the diy retailer to increase employee hourly wages.(11) It is highly unlikely that independent retailers will choose this option because even at the present time, the diy industry is not very competitive at paying its employees. For example, in many markets, gas stations and fast food outlets are paying entry level, part-time teenagers $6.50/hour where diy retailer outlets are paying only $5.00/hour.(11)

It is more likely that the diy retailers will choose the second option of hiring less qualified employees. By hiring these less qualified employees, retailers would get away with paying a much lower hourly wage. Employers would, in turn, train the less qualified employees. The NRHA, as well as wholesaleers, offer a wide selection of educational materials for training retail hardware employees. However, one drawback is that employee training can also be very expensive for the retailer.(11)

Third, diy retailers can choose to look elsewhere for their employees. Some of these non-traditional employees could include the senior citizen market. Senior citizens will have the greatest growth rate in the 1990s. Retailers can also target women/mothers, as they will be responsible for 43% of the growth of the labor force between now and the year 2000.(11)

Advantages of hiring retires and mothers is that they don't demand to be paid as much as skilled workers. They also usually have a long history of work experience, are capable of learning a new job and are not likely to move away. However, some disadvantages are that they do not want to work full time and want retailers to tailor their hours to their personal lives. Other labor possibilities that can be explored are high school training programs, acquaintances of present employers, immigrants and job fairs.

In summary, the employee is the diy retailer's greatest asset.

However, demographics are going to make it tougher and tougher for diy retailers to find employees who are well qualified. Therefore, in the future, retailers will have to either hire well qualified employees and pay more, hire less qualified people, or look elsewhere for their workers. Please refer to pages 26 and 27 in the appendix for an overview of the age distribution of typical diy employees.

LABOR PRODUCTIVITY ANALYSIS

In the years ahead, labor productivity analysis will be a critical issue because employees will be fewer and more expensive. Productivity must improve in order to protect the profitability of the business and to generate growth. Two common practices of measuring employee productivity are as follows: 1. measuring the amount of sales per employee; and 2. measuring the number of customer transactions per employee. Current statistics show the average employee sells $85,000/year in hardware stores, $70,000/year in home centers and $45,000/year in lumberyards. In addition, the average hardware store employee serves 6,190 customers/year. The average home center employee serves 4,152 customers/year and an average lumberyard employee serves 2095 customers/year.(11) Please refer to page 28 in the appendix for an overview of the number of sales per diy employee and the amount of customer transactions per diy employee.

Employee productivity has been on the rise for the last few years. This rise in productivity is said to be caused by a number of factors such as; the increased use of computers in the store, self service display techniques which allow customers to get into and out of the store with less need for sales help, longer store hours, more effective advertising practices, better product presentation on the sales floor, and the economy.(11)

Although the current trend points to trying to maximize employee productivity, retailers should be warned that there is definitely a point of diminishing returns. Retailers need to keep in check that high employee productivity statistics do not result in lack of service and unrealized suggested or add-on sales.(11)

EMPLOYEE COMPENSATION

DIY Retailers have not been known for paying well. Each year, a huge number of talented diy employees are attracted to better paying industries. This occurs because the average amount diy retailers spend on salaries and benefits is between $14,000 and $21,000 per employee per year.(11) Considering that median family income is $31,000 per year in the United States, a retail hardware hardline industry income doesn't stand up well as a single source of income and may be why employee turnover is higher than the national average for non-manufacturing companies.(15) Please refer to page 29 and page 30 in the appendix for average hourly and yearly wages for DIY hardware industry employees.

Benefits retailers offer as reported by a survey by hardware age includes; 92% of retailers offer paid vacations, 77% offer medical benefits and 17% offer a pension plan. Finally, owners will allow employees to purchase merchandise from the store at or very near cost.(15)

EMPLOYEE THEFT

Hardware retailers are having increasing problems with pilferage. However, consumer shoplifting is the least of the retailers' problems as the typical shoplifter pilfers goods worth only a few dollars. The majority of the pilferage problem stems from internal employee theft.(13)

Employee theft accounts for almost 70% of retailer losses to all kinds of causes. Employee theft ranges from the pocketing of a packet of fasteners to the theft of items like outdoor power equipment, building materials and even actual embezzlement. The majority of retailers don't even know their employees are stealing from them as most merchandise is taken from the store room rather than the sales floor. A Hardware Age study of 200 retailers of various sizes found that 76% of the retailers surveyed have the problem of employee theft. Of those who responded, 28% reported theft of merchandise, 6% reported theft of funds and 45% reported theft of both.(13)

Experts say the control of internal theft is a matter of inclination and opportunity, both of which the independent retailer has control of. First, diy retailers can reduce problems from employees that are inclined to steal by preventing them form even being hired. This group can be squeezed out through the use of lie detector tests, reference checks, credit checks, police checks and psycholotical tests. Second, retailers can reduce employee pilferage by removing the opportunity. This can be accomplished through double checking lay-away items, doing spot inventory checks, having two people check balance sheets and rewarding employees for pointing out thieves.(13)

Finally, retailers can reduce employee theft by not giving employees a reason to steal. This can be accomplished by making employees feel like a part of the store. Also, by giving regular pay raises, fringe benefits, bonus plan, and discounts on employee purchases, retailers can reduce the amount of internal theft in their store. Please refer to page 31 in the appendix concerning employee theft.

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