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Strategies of Growth: Forms, Characteristics and Returns

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STRATEGIES OF GROWTH:
FORMS, CHARACTERISTICS AND RETURNS

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Abstract

A model of corporate growth is proposed which is composed of three components: geographical scope, breadth of product line and diversity between divisions. The article examines the role of breadth of product line and geographical scope for the effect they have on firms' operating ratios, strategic stances and economic performance. Data gathered and analyzed on 96 diversified retailers demonstrates that key financial and operative ratios vary by the degreee of both geographical scope and breadth of product line. Further, this paper demonstrates that business level strategies can be determined by these same variables. Analysis of economic returns shows marked differences in performance based upon a firm's breadth of product line and geographical scope. Analysis reveals that narrow product lines and national scope are associated with higher economic performance. Analysis also suggests that discount pricing strategies lead to very low performance. The paper suggests that new views on the components of strategy are warranted both for research and for practice.

STRATEGIES OF GROWTH:
Forms, Characteristics and Returns

Recently attention by students and practitioners of strategy has shifted toward the problems and needs of growth by businesses. Concurrently much attention has been given to several strategies or patterns by which firms can grow. Among these pathways to growth are increased geographical scope, broadening of product lines market and growth by diversification. This study addresses issues associated with the major strategic pathways to growth. In particular, we have examined diversified retail firms and found that firms follow distinctively different pathways to growth which lead to fundamentally different strategic postures or forms. Each of these forms is uniquely different from other forms in terms of its problems, opportunities and capabilities demanded of its management.

Work by Schoeffler (1971) and Schoeffler, Buzzell and Heany (1974) has drawn broad-based attention to the fact that market share appears to have a strong positive relationship with profitability. It appears that some firms have apparently known or sensed this fact for many years. Examples which would suggest this condition would include GE in home appliances, Anheiser-Busch in the beer market, Coca-Cola and Pepsi in the soft drink markets, Boeing in the commercial aircraft market, IBM in computers, Crown Cork and Seal in the beverage filler market, Proctor and Gamble in many consumer markets and GM in the automotive market.

As the work of Schoeffler <u>et al</u>. at PIMS has become more broadly spread, the attention which both practitioners and students of policy paid to the effects of market share rose. Questions are raised as to whether higher market shares caused higher returns or whether economies of scale or experience curves were causing the increased returns. Abell and Hammond (1979) cogently suggest that all three effects are inextricably interwoven and comprise an important part of business strategy. Others such as Fruhan (1972) and Porter (1980) have argued that increased market share affects profitability, but that the costs of increasing market share may be inordinately costly or risky. Nonetheless, increases in market share, increases in market span or broader geographical markets remain major options for firms wishing to grow.

Another strategic option for growth is the route of diversification. That is, firms can choose to grow by building or buying their way into altogether new products/market segments. Wrigley (1969) and Rumelt (1974) sampled the Fortune 500 and discovered that a significant percentage of U.S. manufacturing firms had aggressively moved themselves from single product or market strategies in the 1950's to multi-product/multi-market strategies by the late 1960's. Rumelt's study reconfirmed Wrigley's findings that the late 1950's and 1960's was a very active period of diversification, but also suggested that different forms of diversification were likely to lead to better economic performances. In particular, Rumelt's findings suggest that firms which added new products/markets which had some important link or connection to the "base" business of the firm outperformed those firms which added lesser-related or unrelated business activities. Rumelt's study is particularly important for the discovery of the various forms or patterns of diversification which firms in fact pursue.

Interest by firms in diversification still remains high as a cursory examination of the Wall Street Journal will establish. Although interest remains high, firms are now rethinking the guidelines, expectations and management efforts required to make a given business unit succeed. Porter (1975), (1980) and Harrigan (1979) have suggested that rigorous analysis of economic and other forces operating in an industry segment can help predict the likelihood of succeeding or failing in that business. Biggadike (1979), using

PIMS data, suggests that firms entering into new businesses (diversified business) tend to perform poorly and demand significant infusions of cash and management effort for at least several years. Miller and Kerin (1980) classified diversified retailers by the degree of heterogeneity in the product offerings and the markets served by different retail divisions of the firm. The findings indicated that firms with higher diversity (more heterogeneous products or markets) did not perform better than firms with less diversity. There was some data to suggest that increasing diversity may in fact hinder economic performance. A number of firms have apparently discovered the dilemmas of inappropriate diversifications. A recent Wall Street Journal (1980) article reported on a number of firms who were analyzing and attempting to sell off diversified businesses which showed a limited strategic "fit" or growth possibilities for the firm in question. As the article noted, though, the interest in diversification as a major pathway of growth was not abating, rather firms appear to be more analytical or strategic in the selection of businesses to buy and operate.

Another pathway to growth has received limited attention by policy researchers. Firms may well look at broadening or expanding their product line to serve the needs of existing and/or new customer segments as an important pathway to growth. Some noted examples of this strategy would include Gillette adding shaving cream and other toiletries to its safety razor business, or Coca-Cola adding other carbonated beverages (Fanta, Sprite, Mr. Pibb) as well as orange juice and coffee to its product lines. One observes the same strategic phenomena in the automotive market as GM introduces Sevilles and Chevettes to broaden its product and market offerings. This strategic stance has been very successfully applied in industrial products by Boeing with the successive introductions of its 727, 747, 737, 757 and 767 airplanes and by

IBM's entry into the minicomputer market. Unfortunately, far too little research has been done to examine the strategic impact of broadening product lines as a major means of growth.

THIS STUDY

It appears clear that increased market penetration, adding diversification or broadening product lines, are three major vehicles by which firms can choose to grow. This study addresses the role of geographical scope and breadth of product lines as central features of firm strategy. A central concern of this research has been to determine whether a firm's strategy and operating characteristics vary by whether the firm's geographical grasp is local, regional or national in scope. A concurrent interest is the determination of whether a firm's strategy and operating characteristics vary by the product line strategy pursued. And finally, this paper examines the effect of geographic scope and breadth of product line on economic performance.

Inasmuch as the study was undertaken to examine the strategies of growth and the role of diversification in growth patterns, Fairchild's Financial Manual of Retail Stores (1976, 1977, 1978) were examined exhaustively. From the several thousand major retail firms listed, we found 96 firms which fit the criteria for inclusion in the universe which we call diversified retailers. Data was collected and analyzed for all 96 firms. The criteria for selection included the following:

1) 75% of sales and profits must be derived from retail operations.
2) Firms must have at least 3 distinctively different retail operations which offered different products, and/or different price levels, and/or serve markedly different markets.

The firms studied ranged along various size measures as shown in Figure 1 below.

Figure 1

SIZE OF FIRMS IN STUDY

Dollar Figures in Thousands

	Minimum	Maximum	Mean
Average Sales 1974-1978	\$19,458	\$14,240,000	\$976,825
Average Fixed Assets 1974-1978	\$ 1,077	\$ 2,309,462	\$131,225
Average Number of Stores 1974-1978	13	4,048	455

The universe includes a very broad array of firms ranging from relatively small to the world's largest retailers. To gain a deeper understanding of the firms and their strategies, data was examined from Fairchild's, Annual Reports, and 10-K's of the various firms as well as a questionnaire sent to the firms. To define and classify the strategies of firms and their patterns of growth, three major aspects of their businesses were examined and classified.

AVENUES OF GROWTH

Geographic Scope

In line with our previous description, it was assumed that three major options or avenues to growth are open to retailers. The first major growth option is for the firm to undertake to increase the regional or geographic scope of its operations. Virtually all retail firms begin operation, of necessity, in local or confined regional markets. If the concept of the business and its execution is reasonably successful, the firm may choose to extend the franchise into a broader base or ultimately to take the business nationally. This research categorized the geographical scope of firms' businesses into three phases. Local firms were defined as those operating in up to five contiguous states whose markets and demographics were reasonably homogenous.

Firms were defined as regional if they extended beyond five contiguous states and/or served demographically heterogeneous markets, but did not serve all major regions and the top 20 SMSAs. National firms were defined as those firms which served all major regions and had representation in the top 20 SMSAs.

Thus a major strategic direction which retail firms can and do choose to pursue is the extension and development of the firm into new and heterogeneous geographics and markets. Thus, some firms with successful retail concepts feel that their distinctive competence is knowledge of their local or regional markets and choose to remain in those areas, but grow in other ways as will be described later: Examples would include firms such as Walgreen, Big Bear Stores, R. H. Macy's and Federated Department Stores. Other firms will equally diverse product offerings and strategies apparently feel their distinctive competence resides in their merchandising and marketing skills and thus choose to take their product/market concept and extend it nationally. Sears, K-Mart, Tandy Corp., Zale Corp., and Cole National are particularly strong examples of these strategic stances.

Breadth of Product Line

A second major avenue of growth for a retail firm was found to be the expansion in the breadth of product line offered by the firm. Historically, retail firms begin their histories with a relatively limited or narrow product line. With some success in operating with a given line of merchandise, a firm can strategically choose to expand or broaden its line of offering to varying degrees. This not only alters its strategic stance in the market place, but can change its target markets as well. In this study, we classified firms into three categories based on their breadth of product line in the firm's major division(s). Firms whose merchandise offering was a broad array of merchandise in both soft goods (clothing plus other fabrics such as towels or draperies, etc.) and hard goods (appliances plus tools, cookware, etc.) were classified as full line merchandisers. Firms which carried broad lines of merchandise in either soft or hard goods were classified as single line merchandisers. Those which carried less than a full or broad line in either soft or hard goods were classified as specialty stores.

Thus some firms choose to maintain narrow or very narrow product line and grow by expanding the concept nationally. Examples would include such firms as Tandy (Radio Shack), Cole-National (key stores and optical departments in all Sears stores). Other firms, through their histories, choose to broaden their product line in order to capture customers and serve several of their needs. Examples include grocery chains purchasing or developing "drugstore" chains to operate next door to the grocery business (Skaggs-Albertson, Giant Foods, etc.). Other firms such as Sears, Federated, Allied and others become full line merchandisers to meet much or most of a customer's retail needs which enables them to draw customers into their stores and to then cross-sell the same customer many items.

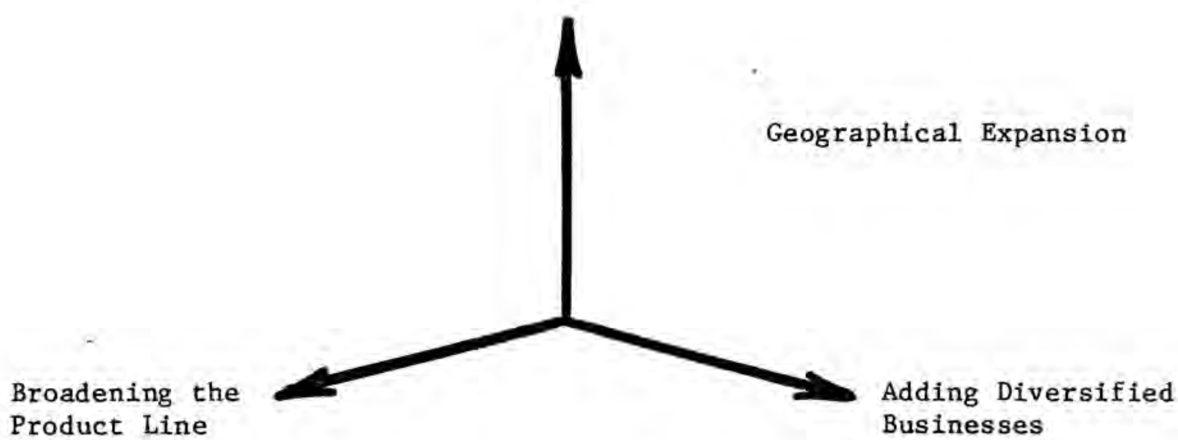
Diversity Between Divisions

A final pathway to growth is incorporated in the idea of building or acquiring businesses which are significantly and fundamentally different from the base business of the firm in either the product line carried, the target market sought, or in the method of serving the market. Thus a firm may choose to grow not by increasing geographic scope or adding to the breadth/product line within a business or under a company name, but may feel the firm's distinctive competence is to serve many customers with many different specialty or single line firms which are unconnected from each other. Particularly potent examples of this strategy can be seen in firms such as Zale Corp. which operates firms such as Zale Jewelry, Guild Jewelry, Butler Shoes, Cullem & Boren Sporting Goods and Skillern Drug Stores. Other examples include Dayton-Hudson, J. C. Penney and Gamble-Skogmo.

Thus we have suggested that firms, particularly retailing firms, have three fundamental avenues of growth. The model of this process is shown in Figure 2 below. The model depicts the growth strategies as being composed of three independent components. Thus a firm may choose to grow by means of addition of one or more of the avenues. At a given point in a firm's history, it could have developed and extended itself in all three dimensions.

Figure 2

AVENUES OF GROWTH



To test the independence of these strategies, a three dimension chi-square test (TRI-CHI), Kerin, Woodward and Reeves (1975), was employed as shown in Figure 3 below. The analysis demonstrates that the three components are essentially independent of each other.

Figure 3

INCIDENCE OF GROWTH STRATEGIES

GEOGRAPHICAL SCOPE

BREADTH OF PRODUCT LINE		DIVERSITY (Limited)			DIVERSITY (Moderate)			DIVERSITY (High)	
	Local	Regional	National	Local	Regional	National	Local	Regional	National
Specialty	Excluded by Definition	3	2	2	5	4	1	0	2
Single Line	15	6	1	3	16	1	2	8	1
Full Line	4	1	3	3	8	1	2	2	0

$\chi^2 = 5.65$ df = 4 p = .226

When two way analyses are performed on the pairwise relationship of growth components as shown in Figure 4 below, a close relationship is discovered between geographical scope and breadth of product line and between geographical scope and diversity between divisions. The strategic, statistical and economic impact of this relationship will be examined in some detail below. Figure 4 shows a strong association between breadth of product line and geographical scope. The pattern of association is clearly that local and regional firms tend strongly to operate with a single line of merchandise. As a secondary pattern, both regionals and locals tend to be made up of dual line stores. National firms tend notably to be comprised of specialty stores.

Figure 4

INCIDENCE OF GROWTH STRATEGIES (TWO WAY)

FREQUENCY OF BREADTH OF PRODUCT LINE

FREQUENCY OF GEOGRAPHICAL SCOPE		Specialty	Single Line	Full Line	
	Local	3 9.4%	20 62.5%	9 28.1%	32 33.3%
	Regional	8 16.3%	30 61.2%	11 22.4%	49 51.0%
	National	8 53.3%	3 20.0%	4 26.7%	15 15.6%

$\chi^2 = 14.84$ df = 4 p = .005

FREQUENCY OF DIVERSITY BETWEEN DIVISIONS

FREQUENCY OF GEOGRAPHICAL SCOPE		Limited	Moderate	High	
	Local	19 59.4%	8 25.0%	5 15.6%	32 33%
	Regional	10 20.4%	29 59.2%	10 20.4%	49 51.0%
	National	6 40.0%	6 40.0%	3 20.0%	15 15.6%

$\chi^2 = 13.52$ df = 4 p = .009

FREQUENCY OF DIVERSITY BETWEEN DIVISION

FREQUENCY OF BREADTH OF PRODUCT LINE		Limited	Moderate	High	
	Specialty	5 26.3%	11 57.9%	3 15.8%	19 19.8%
	Single Line	22 41.5%	20 37.7%	11 20.8%	53 55.2%
	Full Line	8 33.3%	12 50.0%	4 16.7%	24 25.0%

$\chi^2 = 2.69$ df = 4 p = .611

Analysis of the patterns of association diversity between divisions and geographical scope indicates another important set of relationships. Local firms tend strongly to have only limited to moderate diversity. Regional firms on the other hand tend noticeably to have moderate to high diversity. National firms like local firms, tend to have low to moderate diversity although the relationship is relatively weak.

More important than the simple association of growth strategies though are the questions of the differences required to manage these different forms and the performance differences between the types. We examine these in the next section.

OPERATING AND PERFORMANCE CHARACTERISTICS BY TYPE

A number of important characteristics were examined which related to the internal characteristics which accompanied each growth strategy. Included in this examination were the firms' return on total assets, equity, total capital and return on sales as measures of the economic viability of each growth avenue. Further analysis was conducted to examine the components of business level strategies associated with the corporate growth strategies. Variables examined in this regard included gross margin/sales, interest/sales, inventory turnover, sales/stores, sales/fixed assets, sales/total assets, sales/total employees, sales/managerial employees, sales/corporate personnel, market share and price/quality relationships.

This last variable is one of some importance and uniqueness and thus warrants some explanation. As described previously (Miller and Springate, 1978), firms were sent questionnaires asking a wide array of questions regarding their corporate and business level strategies. Three such questions asked the firms to define its market share, its price levels and merchandise quality levels relative to that firm's main competitors in their principal markets. Early analysis (Miller and Springate 1978 and Springate and Miller 1978) had suggested an important relationship between both market share and price/ quality relationships to economic returns among these firms. In this study we combined relative prices and relative quality levels into a new variable called priqual. If a respondent reported that merchandise quality level was higher than price levels relative to its competition, we defined that business as having a discount price strategy. If, on the other hand, relative price <u>and</u> quality were at the same level, i.e., both lower than, equal to, or higher than the competition, the firm was categorized as having a congruent price strategy.

OPERATING AND PERFORMANCE CHARACTERISTICS BY REGIONAL TYPE

The analysis of operating characteristics and tactics employed by different geographic growth strategies was quite dramatic. Many of these relationships were statistically significant, others were not. Nonetheless each was quite suggestive of the demands, problems encountered and the tactics employed in each growth phase. It should be remembered that statistical significance levels are important only as a suggestion of this degree of difference between types inasmuch as the data represents the total universe of diversified retailers in the U.S. and Canada. The operating characteristics of each stage of the geographical growth strategy are shown below in Figure 5.

Figure 5

OPERATING CHARACTERISTICS BY STAGE OF GEOGRAPHICAL GROWTH STRATEGY

Dollar Figures in Thousands

Operating Characteristics/Tactics Five Year Average Values (1974-1978)	Geographic Stage Local (n=32)	Regional (n=49)	National (n=15)	Overall Mean (n=96)	Analysis of Variance Significance Level	
Gross Margin (% of Sales)	30.96	28.09	37.97	30.53	.002	
Inventory Turnover Ratio	6.29	6.18	2.64	5.66	.065	
Average Sales $ per Store	$3,322.	$3,925.	$4,800.	$3,860.	.636	
Average Sales $ per Fixed Assets $	$11.45	$11.78	$8.45	$11.15	.294	
Average Sales $ per Total Assets $	$2.69	$2.92	$2.08	$2.71	.034	
Average Sales $ per Total Employees	$32.08	$45.67	$36.24	$39.99	.118	
Average Sales $ per Corporate Employee	$2,438.	$10,657.	$5,855.	$7,314.	.672	
Average Sales $ per Corporate Professional Employees	$7,134.	$8,603.	$4,861.	$7,318.	.513	
Market Share (% of Group Above Equal Market Share)	11%	25%	29%	22.2%	.723	x^2
Price Quality Strategy (% of Group Using Discount Strategy)	58%	70%	50%	62.5%	.576	

Thus from Figure 5 we can begin to see that the operating characteristics, problems and tactics at each stage of geographical growth are quite different. Several of these characteristics are statistically quite dramatic while others are less so. Those which are not statistically extreme are less clear as to their effects, although the pattern which exists between these variables is quite suggestive of some important differences between these stages.

The National's Strategy

In particular we note from Figure 5 that national firms have substantially higher gross margins (38%) than locals and regionals. Some of this may be due to their size and the purchase economies available to them, but, notice that the national group has fewer firms with a discount price strategy (more congruent price strategies) and a substantially greater percentage of firms with predominant shares of market. This data would suggest that most nationals may well have substantial purchasing economies, but push activity toward reasonably high prices to support high gross margins. More nationals appear to be aiming for and perhaps achieving predominant shares of the markets in which they compete which enables them to sustain and control the price leadership exhibited by the high gross margins they have. As one would suspect, national firms, with this high price, high gross margin strategy have very low inventory turnover ratios. In fact national firms' average inventory turnovers are only 43% as high as regional firms and 38% as high as local firms.

In terms of average annual sales (in dollars per store) it is interesting to note a linear relationship from local to national. Locals have the smallest sales per store ratio while nationals have the most. The broader the area served, the greater the firm appears to center its focus on utilizing its stores as an important competitive edge. This conclusion is supported by the sales per fixed asset and sales to total asset ratios in Figure 5. Here it will be noted that locals and regional stores have nearly equal and above average sales per fixed asset dollar whereas national firms have substantially lower sales per fixed asset dollar. Apparently, national firms invest in substantially more dollars per store per sales dollar expected. Thus, national firms apparently spend a great deal of money (in relation to sales) in buildings and fixtures as a central competitive component of their strategies.

Nationals' sales per fixed asset ratio are substantially lower than regionals or locals. Thus comparatively, nationals' strategies appear to be that of high overhead, high cost, high service, non-discount, high gross margin operations.

The Regionals' Strategies

The regionals' strategies appear as the near opposite of the nationals. Regional firms are archtypically discounters. Over 70% of the regionals defined themselves to us as discounters and their operating data confirms this assessment. They have the lowest gross margins of any type (only 28%). This figure is 26% lower than the nationals and 12% lower than locals. Regional firms' inventory turnover ratios are above the average though still below the locals. Likewise, regionals' sales dollars to stores is slightly above average though less than national firms.

The data on sales/fixed assets, sales/total assets and sales/employees strongly support the assessment that regionals employ discount price strategy. Regional firms have the highest annual sales per annual fixed asset and total asset dollar ratio of any type. In fact regionals' sales to fixed asset ratios are nearly 40% higher than national firms, equally dramatic as the total asset and the annual sales/employee ratios. Regional firms have the highest sales per employee ratios of all type firms. Particularly dramatic are the very high sales to manager ratios and sales to corporate employee ratios for regional firms which are respectively 77% and 82% higher than national firms. Thus regional firms appear to be disproportionately composed of low overhead business with inexpensive facilities and proportionately few employees. The archtypical regional firm then is the low overhead, low service type and low gross margin operation associated with discount businesses.

The Local Strategies

Until we introduce an analysis on the breadth of product line, it will be difficult to make clear what the locals' strategies are. For now let us note that they are composed of about 60% discounters and few report having a predominant share of market. As a group they have slightly above average gross margins, very high inventory turns, low sales/stores, high sales to fixed assets. They have low sales per employee and very low sales per corporate employee but very high sales per professional/managerial employee.

The typology of locals appears to be predominantly that of entrepreneurial firms still seeking an identity and clear cut strategy to pursue. That is, no distinct picture emerges regarding either discount versus congruent price strategies or gross margins. Inventory turns are very high indicating a very close attention to choosing merchandise or lines which will be sought actively by the market they serve. In fact, this appears to be the strength of the local, i.e., the intimate knowledge of the market and what it will buy regardless of the price strategy or gross margins involved. Likewise, locals tend not to generate much in terms of sales per stores though they have relatively low cost stores. They don't generate high sales per employee or corporate employee indicating they have a proportionately high number of employees. But when it comes to sales per corporate professional and manager, their ratios are very high. Apparently, locals have very "thin" managerial structures. That is, they are closely held and/or managed by a proportionately few managers or executives much in the standard form of early, entrepreneurial style firms.

ANALYSES OF THE THREE STAGES AND PERFORMANCE DIFFERENCES

Thus we have seen that the geographical scope or stage of a firm is strongly associated with distinct operating strategies. Thus national firms tend to be congruent pricers with high gross margins, very low inventory turns, with large, expensive stores, high total asset bases, proportionately large selling staffs, large corporate offices and many corporate managers. They also tend to have or attempt to have large market shares. Regional firms are almost the opposite with many discounters with low gross margins, high inventory turns, proportionately low cost facilities, low total assets and low ratios of employees in all categories particularly corporate employees. Locals, as we have noted, are less clear cut though they appear to be tightly held and/or managed by a limited number of executives whose main efforts appear to be in merchandising to their particular market which they handle well. They tend to have low fixed assets, but have a high number of employees (excluding managers) to help sell merchandise.

The important question remaining is what if any performance differences exist between these three types of firms. In Figure 6, below, four major measures of performance are shown for each type of firm. Data from each firm was gathered to analyze the five year average return on sales, total assets, equity, and total capital employee. The first three measures are relatively well known and little explanation is necessary except to say that return on sales was included because previous work done by the senior author had indicated that the predominant concern and target which many retail managers sought was return on sales. The fourth measure, return on total capital employed, is a Barnardian (1973) measure extended by Rumelt (1974) and others. It assumes that the best measure of a firm's performance is its capacity to generate returns to all classes of long term funding sources (debt and equity). Thus return on total capital is the pretax profits plus interest paid divided by total long term debt and equity.

Figure 6

5 YEAR AVERAGE PERFORMANCE BY GEOGRAPHICAL GROWTH STRATEGY
(expressed in %)

	Geographical Stage				Analysis of Variance
	Local	Regional	National	Overall Mean	Significance Level
Return on Sales	1.84%	1.93%	3.71%	2.18%	.000
Return on Total Assets	4.53%	4.76%	6.77%	5.00%	.055
Return on Equity	8.94%	10.03%	14.61%	10.38%	.027
Return on Total Capital Employed	11.23%	10.57%	12.06%	11.02%	.524

Examination of Figure 6 clearly indicates that the national firms with their high cost, high gross margin, non-discount strategies are clearly superior to very superior performers no matter what criterion is chosen. Nationals perform well above the mean in all categories and are the top ranked performer in all but return on capital. The regionals on the other hand with their low cost, low gross margin, discount strategies tend to be poor performers regardless of criteria. They perform below the mean in all criteria and rank last or very near to last on all but return on equity. The locals on the other hand remain an interestingly mixed bag. Their return on sales, total assets and equity is poor, but their return on total capital ranks second among the groups and is above the overall average. Apparently locals, being tightly held and closely managed, do not do well in terms of return on sales, assets, or equity, but they do a creditable job of utilizing the total capital they employ. Whether this is due to the fact that owners and executives are more closely related and thus more directly communicating concerns with return on total capital is not known for sure or whether it is due to the difficulty they experience in terms of raising capital. It must be noted that variance in performance by firms was notably higher for locals than other forms, suggesting that some locals were reasonably high return businesses and some were quite low in returns.

Nonetheless, the clearer picture as we have shown is that national firms do have markedly different strategies on the whole than do regionals. And with these strategies go a substantially better economic return. Several questions suggest themselves from this analysis which are in need of further examination. First among these is the question of whether the national scope of firms determines the strategy (and performance) or vice-versa. There are clearly deviant models which exist in each strategy. Among the nationals are such classic discounters as K-Mart and Woolworth (Woolco) pitted against such non-discount strategies as Sears, Wards, and Federated Department Stores. Only two of the fifteen nationals are clear cut discounters suggesting that the discount strategy is either too difficult or as yet too new a phenomenon to effectively operate nationwide. My guess is that the former is true in that the discount strategy appears to require low managerial overhead dollars to sustain the low gross margins of such a business. The problem of managing nationwide businesses would appear to require large corporate staffs to help coordinate buying, shipping, promotional advertising, etc. Thus national discount operations may be economically stable forms for only very few excellently managed businesses. The failure of W. T. Grant tends to support this argument.

Another question in need of further examination is whether the strong economic performance of nationals is due to their strategy or their national scope and any advantage which that may give. Although this paper shows the national scope and strategies are linked it cannot definitely determine causality. As a matter of speculation, I am prone to believe that the high overhead, high sales staff, high gross margin strategy, though not necessarily the least expensive form of retail outlet for the consumer, may in fact be the form which best satisfies and/or serves the consumer in fact. Our performance data suggests that over a five year period incorporating two of the worst and best retail years in current history (1974-1978), the consumer was willing to reward the high cost, high service strategy with very high returns. PIMS data suggests that firms with higher quality products than competitors tend to outperform, over time, firms with lesser quality products. Consumers appear to be willing to pay for the extra service and overhead costs associated with this strategy. A CEO of a major fast food chain once confided to the senior author that discounting and being aggressively price competitive was a pointless strategy because as he put it, "The consumer you draw is a price loyal customer. He's more interested in price than he is in what it is you can distinctly do to serve him." Perhaps this is a lesson which the nationals have learned and codified into their strategies. Further investigation is clearly warranted.

Other issues in need of examination include the managers' strategic problem of moving from stage to stage. Whereas it appears from this investigation that each stage (other than local) has a distinctive set of strategies, what then are the implications for growing from a local to a regional? A regional to a national? In addition to the financial problem of supporting a geographically expanding business, what strategies are necessary? What market conditions must be met? The current day national firms ostensibly grew to national status many decades ago. Sears and Wards grew by being the only national firm which could serve the majority of American markets. They offered good quality merchandise, with good service and competitive price in a period when few good alternatives were available. The growth in the 60's and 70's of discounters was phenomenal. The growth of local discounters to a regional basis appeared to draw on a distinctive competence of low overhead and low price. Is that the only way to grow in regional status? The most effective way? Or is it the easiest way? Further work clearly needs to be done to determine the patterns and problems as firms move from stage to stage. Clinical work with a few firms, examined closely, would be of major help to clarify the problems and opportunities to growing geographically.

OPERATING AND PERFORMANCE CHARACTERISTICS BY PRODUCT BREADTH

We have seen that two differences in geographical scope of retail firms has a marked effect on these firms' strategies, operating characteristics and economic performance. Even more dramatic is the relationship of these characteristics and the breadth of product line. Figure 7 below presents the operating characteristics by breadth of product line by these firms.

Specialty Stores' Characteristics

Examination of Figure 7 results in a clear and definitive picture of the strategic stance and operating characteristics of specialty stores. As one might expect from retail firms specializing in narrow, hard to find or unique lines of merchandise, the firms in this category tend to have very high gross margins (37.4%), very low inventory turnover ratios, and very low sales to stores ratios. Furthermore, specialty strategies tend to call for a very large number of stores (850) of relative "normal" cost. In terms of the sales to fixed assets and sales to total assets, specialty firms showed up just slightly below average. Likewise, sales to total employees, corporate personnel and managerial personnel ratios were slightly below the mean. Thus, specialty firms tending to specialize in carrying unique specialized and hard to

Figure 7

OPERATING CHARACTERISTICS BY BREADTH OF PRODUCT LINE STRATEGY

Operating Characteristics Five Year Average Values (1974-1978)	Breadth of Product Line Stage Specialty (n=19)	Single Line (n=53)	Full Line (n=24)	Overall Mean (n=96)	Analysis of Variance Significance Level
Gross Margin (% of Sales)	37.41	27.76	31.48	30.53	.000
Inventory Turnover Ratio	3.44	6.36	5.88	5.66	.1341
Interest Cost (% of Sales)	.81	.79	1.32	.92	.0085
Average Sales $ per Store (in thousands)	$1,129	$2,475	$9,083	$3,860	.0000
Average Sales $ per Fixed Asset $	$10.85	$13.89	$5.33	$11.15	.0000
Average Sales $ per Total Asset $	$2.37	$3.23	$1.84	$2.71	.0000
Average Sales $ per Total Employees	$38.31	$47.45	$32.79	$39.99	.0731
Average Sales $ per Corporate Professional Employees	$5,921	$1,764	$13,438	$7,314	.414
Average Sales $ per Managerial Employees	$6,815	$4,812	$9,855	$7,317	.168
Market Share (% of Group Above Equal Market Share)	29%	27%	14%	22.2%	.415 χ^2
Price Quality Strategy (% Group Using Discount Strategy)	57%	78%	47%	62.5%	.175 χ^2

find merchandise operate strategically by clearing high gross margins, having many stores of regional or national scope (Figure 7). Further, they tend to have moderately expensive facilities and relatively large total assets to sales to support the gross margins they command. They also tend to have relatively high selling expenses to sales dollar volume. Despite this apparently "unproductive" use of assets, this category, as we shall see later, has quite strong economic performances.

<u>Single Line Store Characteristics</u>

Single line stores comprised the largest ($n = 53$ or 55% of the total) and most confusing categorization in this study. Nearly 78% of this group reported themselves to be discounters whereas less than 50% of the specialty or dual line stores reported themselves as such. The data in Figure 7 would seem to substantiate the claim of discounter for this group. They had extremely low gross margins (28%), very high inventory turns (6.4), high sales to store, sales to fixed and total assets and high sales to employee ratios.

Further examination revealed though that single line firms were made up of two separate categories based on their gross margins. By dividing firms on the basis of whether their five year average gross margins were less than or greater than 30% a new picture emerged. Of the 53 single line firms, 37 (70%) had gross margins less than 30% ($\overline{x} = 24.3\%$ $\sigma = 3.5$) and 16 (30%) had gross margins greater than 30% ($\overline{x} = 34.5$ $\sigma = 3.4$). Thus the self reports of discount strategies appear roughly correct.

More dramatic though are the differences in strategic stances and economic performances of these two groups as shown in figure 8 below. In particular, it is noteworthy that the low gross margin, single line firms have extremely high sales to fixed asset and total asset ratios. They also have very high sales to total employee ratios. Likewise, inventory turnover ratios were the highest for any grouping. Interestingly, low gross margin, single line firms reported fairly low to quite low sales to corporate employees and sales to managerial employees. The data indicates that like regional firms, this classification clearly includes the vast majority of the classic discount store operation. Examination of some of the firms in the group corroborates this conclusion. Firms sorted into this category include K-Mart, Roses, Zayres, Skaggs, Fed Mart, Super Dollar Stores and Woolworth, among others.

Figure 8

OPERATING CHARACTERISTICS OF SINGLE LINE FIRMS - LOW vs. HIGH GROSS MARGINS

Operating Characteristics Five Year Average Values (1974-1978)	Low Gross Margin (n = 37)	High Gross Margin (n = 16)	Overall Mean (n = 53)	Analysis of Variance Significance Level
Inventory Turnover Ratio	6.55	5.93	6.36	.73
Average Sales $ Per Store (In Thousands)	$2,699	$1,957	$2,475	.22
Average Sale $ Per Fixed Assets $	$14.67	$12.11	$13.89	.28
Average Sale $ Per Total Asset $	$3.40	$2.82	$3.23	.05
Average Sales $ Per Total Employee	$52.58	$29.47	$47.45	.05
Average Sales $ Per Corporate Employee	$2,016	$946	$1,764	.10
Average Sales $ Per Managerial Employee	$5,919	$1,768	$4,811	.13

The high gross margin, single line firms are markedly different in operating characteristics as was noted in Figure 8 above. All of their productivity ratios (sales to assets, stores, employees etc.) tend to be low to very low. These firms, though offering similar breadth and lines of merchandise, have been able to strategically establish themselves and their operations such that they can command quite handsome gross margins. The result of this will be seen in Figure 9 below which demonstrates that the low gross margin single lines are by far the poorest group in economic performance, whereas the high gross margin single lines are clearly superior performers.

Full Line Store Characteristics

The full line stores are composed almost completely of what has come to be known as the full line, general merchandise stores such as Macy's, Federated Department Stores (Bloomingdales, Filenes, Bullocks, etc.), Sears, Wards, etc. As a group, they tend to have moderate gross margins, moderate to high turnover over ratios, high interest expense to sales ratios (due to large inventories and company owned credit cards). As expected they tend to have large, expensive stores (downtown stores and shopping center anchor stores) with high sales to store ratios but very low sales to fixed asset \$'s and total asset \$. Furthermore, they tend to have extensive salespeople as noted by the low sales to total employee ratio. As a group (especially if excluding Sears and Wards) they tend to be geographically organized with most managerial people reporting to the geographical unit and relatively few corporate personnel. As a group they tend to eschew discounting and justify their gross margins by means of elaborate buildings and facilities, extensive inventories, credit services, and store sales support.

ANALYSIS OF THE FOUR STRATEGIES AND OPERATING CHARACTERISTICS

The analysies of the four product line strategies demonstrates distinctly different strategic stances taken by firms in each group. The specialty stores tend to have many small stores and carry unusual or specialized merchandise which is offered at very high gross margins. Few of the specialty group attempt to discount. Their "productivity" ratios tended to be below the mean for all categories though they were never the lowest ranking of any group.

The single line firms tended to divide into two distinct camps. The largest group was composed of the classic discount store group which operated with limited lines of merchandise offered as discounted items. These firms have very low gross margins, very high inventory turns. Their "productivity" ratios on all except sales to corporate and managerial employees was extremely high.

The other single line strategy was composed of firms who either offered merchandise similar to the "discounters" or offered specialty items, premium priced clothing or furniture. Those that offered traditional "discount" type merchandise appeared (though not tested) to choose locations, especially rural, where competition was less intense and thus not demanding lesser prices. The other group appeared to differentiate themselves by offering a broad line of hard or soft goods but with more "premium" quality.

The full line stores were the clearest to classify inasmuch as they comprised the highly visible and quite familiar general department store. As a whole, their strategies and operating characteristics are midway between the extremes of either specialty stores and the discount single line stores.

The remaining question then is, given the clearly different strategic stances which firms can take in terms of breadth of product lines, how does this affect their long term economic performance? As seen in Figure 9, the single line high gross margin firms have the best economic performance while the low gross margin, single line firms ("discounters") are by far the worst economic performers. Specialty stores perform strongly, performing well above the overall mean in all categories and ranking second behind the high gross margin, single line firms. Full line firms (general department stores) perform above the average in returns on sales, but perform below average on returns on assets, equity, and total capital.

Figure 9

5 YEAR AVERAGE PERFORMANCE BY BREADTH OF PRODUCT LINE STRATEGY
(Expressed in %)

	Specialty Store	Single Line, Low Gross Margin	Single Line, High Gross Margin	Full Line	Overall Mean	Analysis of Variance Significance Level
		Product Line Stages				
Return on Sales	2.93%	1.16%	2.74%	2.77%	2.18%	.000
Return on Total Assets	6.15%	3.73%	6.86%	4.81%	5.00%	.002
Return on Equity	12.27%	8.05%	13.69%	10.29%	10.38%	.024
Return on Total Capital Employed	11.50%	10.34%	13.20%	10.26%	11.02%	.151

From Figure 9, we note that returns vary significantly by group. One very strong conclusion to be drawn is that despite their very high productivity ratios (turns, sales/assets, sale/employees, etc.) discount operators as a whole perform very poorly no matter what performance criteria one chooses. There are exceptions of course; K-Mart, Inc., Skaggs, Inc., Super Dollar Stores, Hecks and several other firms' five year performances were well above the overall sample's mean in all measures of performance. Nonetheless, for the group as a whole it seemed clear that without a very unique and tightly controlled strategy, discounting is a strategically unviable form of long term operation.

The best economic return accrued to the single line, high gross margin firms. These firms have apparently chosen one of two strategies as the basis upon which they choose to compete. As noted previously, about half of this group carried very similar lines and types of merchandise as the discount group, but sold them at much higher margins in less competitive geographical areas or markets (rural areas for example). The other half of the group operates more like specialty stores by carrying a broad line of relatively specialized merchandise. Apparently these strategic efforts pay off handsomely. This group's performance was 20% to 37% above the overall mean on various measures of return. On all measures except return on total capital, the statistical level of significance was high.

Specialty stores also performed quite well overall. On all but the return on capital measure, specialty stores performed 18% to 34% above the overall mean. The strategies of specialty stores is revealing. They have slightly below average productivity ratios and very low turnover ratios. Their strategy is not to gain economies of scale or strong overhead utilization. Rather their strategies are geared toward picking specialized unique or hard to acquire product lines around which the target consumer is relatively price inelastic. The main source of profitability then is to be found in the maintenance of their very high gross margins. This strategic stance works apparently because these firms have been able to maintain a choice of merchandise and a method of delivery which enough consumers are willing to support this stance.

This final category is the familiar full line, general department store firms. Their strategies are based upon carrying a broad range of both hard goods and soft goods, having large, expensive stores and relatively large sales staffs. On the whole, this group attempts to be anchor stores or points of attraction for consumers into shopping centers by being a one stop facility. The broad array of merchandise encourages the one stop shopping as well as attempts to cross sell the consumer other merchandise than was contemplated when entering the store. As a group they have about average gross margins and turnover ratios. Their sales to store ratio is very high. But their productivity ratios are consistently low. Sales to fixed assets and sales to assets are extremely low. Sales to employees is likewise low, although sales to corporate personnel and sales to managerial employees are quite high. Performance of this group is relatively weak reflecting the weak productivity ratios. Return on assets and equity is below the overall mean and return on total capital is the worst of all the groups. Only in return on sales do the dual line firms perform moderately well.

CONCLUSIONS

This study has suggested that two major variables, regionality and breadth of product line are important tools to discriminate both the strategic stance of retail firms as well as their economic performance. This study has shown that major operating characteristics and ratios of firms vary significantly by the breadth of product line they carry and by the geographical scope of the firm. Analyses of these ratios strongly suggested that the strategic or competitive stances of firms could be inferred or determined from the breadth of product offering and geographical scope. Even more dramatic was the clear relationship between product line and geopgrahical stances and economic performance.

This study found that regionally based firms perform slightly better than locally based firms. On the other hand, firms which are national in scope tend to be very high performers. Despite the complexities and management demands of operating nationally, there appears to be an important payoff for those firms pushing to national strategies.

In terms of breadth of product line, this study indicated that the narrower product line strategies on the whole outperformed the broader product line strategies. The narrowest product line strategies, the specialty stores, were clearly very strong economic performers. Further, it was found that single line strategies yielded very high or very low performance depending on the gross margins achieved by the product line. Thus single line strategies were very successful if they were associated with high gross margins and were very poor if associated with low gross margins. Firms with full line strategies performed slightly below average.

It appears that well defined and targeted pathways to growth are the most viable ones. Thus it would seem that strategies aimed at growing in any direction (regionality, diversity or product line) would be very ill advised. Rather the choice of fairly narrow product lines which are well defined and capable of sustaining substantial gross margins in the marketplace and which are taken to either regional or national status would seem to lead to the best returns.

It has been demonstrated that regional scope and breadth of product line in and of themselves are clearly central features of strategic posture and are important determiners of economic performance. As we consider that these two variables represent two of the major growth vectors or opportunities available for a firm to choose to grow, the importance of these variables in strategy formulation as well as strategic research becomes clearer. Further research is clearly needed and currently underway to examine the interaction of these components on economic performance. But further research is clearly warranted on these variables and their role on strategies and performance among non-retailing firms. Clearly, the scope of market operations, breadth of product lines carried and the amount and kind of diversity in the firm's product/market offerings are key and central elements of corporate strategy and warrant far more research and effort than has been generated to date. This study and a few others are beginning to suggest that these same components are also central determinants of the strategic growth opportunities open to firms and are important determinants of economic performance. Given the strategic centrality, oportunity and impact, far greater research needs to be given to the role these elements play in the strategy formulation process.

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