Store Location – Trading Area Analysis and Site Selection

11

Abstract

Epitomised by the oft-cited saying that the three most important success factors in retailing are "location, loca-tion, location", store location is one of the most important elements in retail marketing strategy, because it is a long-term decision associated with long-term capital commitment. Site selection, therefore, requires distinct planning processes to solve complex location decisions. This chapter focuses on brick-and-mortar retail outlets, discussing the different types of retail locations, the main elements of location decisions and techniques for assessing retail sites.

11.1 The Importance of Location to Retail Companies

Selecting retail store locations is one of the most significant decisions in retail marketing, because in store-based retailing, a good location is key to attracting customers to outlets and can sometimes even compensate for an otherwise mediocre retail strategy mix. A good location, therefore, can lead to strong competitive advantages, because location is a unique element of the retail marketing mix which cannot be imitated by competitors.

Location decisions are highly complex. There are a large number of factors to consider, and the costs associated with, for example, opening new stores can be very high. Site selection is, therefore, a **long-term decision** that implies long-term capital commitment. Once a retail site has been chosen, either to build a store or sign a long-term tenancy agreement, there is little flexibility, because this decision usually cannot be easily changed without incurring significant losses.

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Unlike other elements of the retail marketing mix such as price, customer service, product assortment or advertising, location cannot be changed in the short term due to its **fixed nature**. Other factors can usually be altered if the environment (e. g., consumer behaviour, competition) changes (Wrigley 1988).

Retail location strategies usually focus on the opening of new stores. However, location decisions relate to the entire physical structure of retail outlets and are thus more comprehensive. The main types of decisions are (Hernández and Bennison 2000):

1. **opening** new stores.
2. **extending** the floor space of existing stores.
3. **relocating** or **moving** a store from one place to a better site within a particular town or area.
4. **rationalising** decisions, e. g., closing individual stores.
5. **repositioning** locations, e. g., altering a store's image by changing the name or appearance.
6. **refurbishing**, e. g., improving or updating an existing outlet's physical environment and tailoring the product range and assortment to local customers (**remerchandising**).

Opening new stores is the most complex decision, because it is usually the starting point for activities in a specific geographic area. This section thus focuses on retail location decisions of this type.

11.2 Types of Retail Locations

11.2.1 Overview

There are three basic **types of location** available for retail stores: (1) solitary sites, (2) unplanned shopping areas and (3) planned shopping districts. Each of these basic location types has specific advantages and disadvantages (see Table 11.1), depending on, among other things, the size of the catchment area, occupancy costs, pedestrian or vehicle customer traffic, restrictions placed on store operations or the convenience of the location.

In addition, solitary sites and retail agglomerations such as planned or unplanned shopping districts differ in terms of the possibilities for combined shopping. Retail agglomerations have the advantage that customers can find everything they need in a single shopping trip. This is especially important for multi-purpose shopping trips. For example, if a customer wants to buy a new outfit, they might prefer to shop at a shopping centre with a range of fashion and footwear stores, because there will be more choice and less risk of not finding a suitable combination of clothes, shoes and accessories (Oppewal and Holyoake 2004, p. 61). Also, customers might prefer to combine their shopping for different product categories, e. g., for clothes and food. Solitary sites usually cannot provide customers with such advantages.

Table 11.1 Characteristics of different location types. (Adapted from Levy et al. 2014, p. 184)

	Size (1000 m²)	Trading Area (km)	Shopping Convenience	Pedestrian Travel	Vehicular Traffic	Restrictions on Operations	Typical Format
Unplanned Areas							
Free Standing	Varying	5–15	High	Low	High	Limited	Convenience, drug stores, category killers
Urban Locations/ Central Business Districts	Varying	Varying	Low	High	Low	Limited to medium	Specialty stores
Planned Areas							
Neighbourhood/ Community Shopping Centres	2.5–30	5–20	High	Low	High	Medium	Supermarkets, discount stores
Power Centres	25–55	5–25	Medium	Medium	Medium	Limited	Category killers
Enclosed Malls	35–100	5–40	Low	High	Low	High	Department and specialty stores
Lifestyle Centres	15–45	5–25	Medium	Medium	Medium	Medium to high	Specialty stores and restaurants
Fashion/ Specialty Centres	7.5–25	5–25	Medium	High	Low	High	High-end fashion-oriented specialty stores
Outlet Centres	4.5–40	40–125	Low	High	High	Limited	Off-price stores/ factory outlets
Theme/ Festival Centres	7.5–25	N/A	Low	High	High	Highest	Specialty stores and restaurants

Table 11.2 Top ten global retail rents. (Colliers International 2014)

Retail Strips	Rent in USD per Square Metre per Year
New York, Fifth Avenue	38,212
Hong Kong, Queens Road Central, Central	22,314
Hong Kong, Canton Road, Tsim Sha Tsui	21,646
New York, Madison Avenue	17,685
Paris, Champs Elysées	16,609
London, Old Bond Street	14,424
Hong Kong, Causeway Bay	11,873
Zurich, Bahnhofstrasse	10,742
Milan, Via Monte Napoleone	9580
Moscow, Stoleshnikov Lane	8460

11.2.2 Solitary Sites

Solitary sites are single freestanding outlets isolated from other retailers (Gilbert 2003, p. 288). They are often positioned on roads or near, but not adjacent, to other retailers or shopping centres. Solitary sites are usually characterised by low rental costs or land prices. They usually offer large parking facilities and there is rarely a direct competitor close to the store. However, attracting customers may initially prove difficult and might require high advertising expenditure. Such sites are used, for instance, by convenience shops or by large store formats in food and general merchandise retailing that offer one-stop shopping convenience.

11.2.3 Unplanned Shopping Areas

Unplanned shopping areas are retail locations with several outlets in close proximity to each other that have evolved over time. The retail store mix is not the result of long-range planning, and there is no centralised management (Levy et al. 2014, p. 184).

Fig. 11.1 shows the diverse types of retail locations. The main kinds of unplanned shopping areas are listed below (Berman and Evans 2013, pp. 283–286).

1. **Central business districts (CBDs)** are the traditional "downtown" areas in cities or towns, i. e., "the hub of retailing in a city" (Berman and Evans 2013, p. 283) that offer the greatest density of stores. The rents in CBDs are comparatively high (see Table 11.2), even though the popularity of CBDs differs internationally. For example, they are very popular in Europe but not very popular in many US cities.

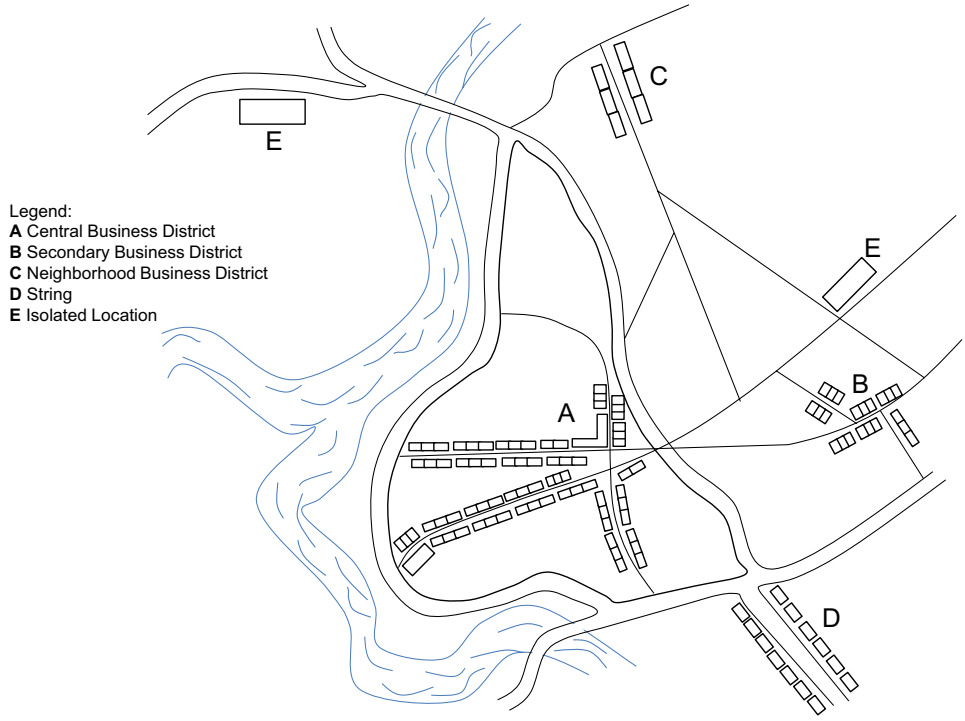

Fig. 11.1 Unplanned business districts. (Adapted from Berman and Evans 2013, p. 286)

2. **Secondary business districts (SBD)** are unplanned shopping districts with less wide and deep assortments than in CBDs, located in larger cities and main streets or high street locations in smaller cities. Larger cities tend to have multiple secondary business districts.
3. **Neighbourhood business districts (NBD)** serve the needs of a single residential area. They are typically situated on major streets. Food retailers are often the leading retailers here.
4. **Strip** or **string locations ("strip mall")** are groups of retail stores situated along a street or motorway. For example, different brands of car dealership are often located next to each other along a major road.

11.2.4 Planned Shopping Districts/Shopping Centres

Planned shopping districts are retail locations that have been architecturally planned to provide a unified theme for a number of outlets (Gilbert 2003, p. 288). These sites are developed deliberately and usually have some large, key retail brand stores (**anchor stores**) and a number of smaller retailers to add diversity and special interest (Reynolds 1992).

The basic types of shopping centres are (1) **retail parks** that consist of a purpose-built cluster of freestanding retail outlets and (2) **shopping centres** that consist of one large building marketed as a unified shopping destination, usually with a single name and logo. Both types offer (large) parking facilities but the retail mix in single building shopping centres is different from that in retail parks, as the range of stores is wider and often includes luxury and leisure items as well as clothing, footwear and other typical central location merchandise (Gilbert 2003, pp. 289–290).

Several specific types of retail parks and shopping centres have been developed (Levy et al. 2014, pp. 189–195): (1) **neighbourhood** or **strip/community centres** that are typically anchored by a supermarket, (2) **power centres** that consist primarily of large format retailers, (3) **shopping malls** that are enclosed, climate controlled and lit shopping centres (regional or superregional shopping malls), (4) **lifestyle centres** that encompass an open-air configuration of upscale specialty stores, entertainment and restaurants, (5) **fashion/specialty centres** that mainly comprise upmarket clothing shops and boutiques carrying highly priced and high quality fashion merchandise, (6) **outlet centres** that contain manufacturers' and retailers' outlet stores or off-price retailers (see Chap. 2 and 3), (7) **theme or festival parks** that typically employ a unified theme shared by the retail outlets, their architectural design and their merchandise and often anchored by restaurants or entertainment facilities, and (8) **omni-centres** that combine enclosed malls, lifestyle centres and power centres to create a new centre type that combines low-price and premium formats in a single centre that allows customers to cross-shop between discount and premium stores. The main types of planned shopping areas are presented in Table 11.3

The decision over which kind of retail location to select depends on the company's strategy. It is an integral part of the retail location decision process.

Table 11.3 Types of planned shopping area. (Adapted from Reynolds 1992, p. 57)

	Types	Examples
Intermediate Centres (10,000–20,000 m²)		
Locational variants	Non-central suburban community greenfield site, transport node	Centro Commerciale Auchan, Torino, Italy Cameron Toll, Edinburgh, UK
Compositional variants	Hypermarket-anchored specialty non-food anchored	Euromarché BHV, Cergy, France
Regional Shopping Centres (30,000 m²+)		
Locational variants	Central area in traditional core central area adjacent to traditional core non-central suburban growth zone greenfield site, transport node	Eldon Square, Newcastle, UK La Part-Dieu, Lyon, France CentrO, Oberhausen, Germany Como, Bergamo, Italy

Table 11.3 (*continued*)

	Types	Examples
Compositional variants	Hypermarket-dominated department and variety-store dominated food, non-food and leisure anchors	A6, Jönköping, Sweden Lakeside, Thurrock, UK Parquesur, Madrid, Spain
Retail Parks (5000–20,000 m²)		
Locational variants	Non-central suburban community greenfield site, transport node	Various Lakeside Retail Park, UK
Compositional variants	Large retail format tenant mix factory outlet tenant mix hybrid tenant mix	Fairacres Retail Park, Abingdon, UK Marques Avenue, Troyes, France Fosse Shopping Park, Leicester, UK
Specialty centres (1000 m²+)		
Locational variants	Central area in traditional core adjacent to traditional core	Galleria, Hamburg, Germany Albert Dock, Liverpool, UK
Compositional variants	Non-food specialty stores department store conversions	Powerscourt Centre, Dublin, Eire Karstadt Arkaden, Mühlheim, Germany

Floor space figures are indicative only; centres providing for local or neighbourhood needs are excluded

11.3 Retail Location Decision Process

11.3.1 Overview

Retail location decisions typically follow a systematic process. Fig. 11.2 shows an example process that can be applied in retail trade area analysis.

The **site selection process** starts with a general assessment of geographic areas and leads to a detailed assessment of specific site characteristics. This process can broadly be described as a three-step selection process (see Fig. 11.3; Brown 1992, p. 16):

1. **Market selection**: the first step is to identify a region that has the potential for a new retail outlet.

2. **Area analysis**: within the chosen region, a potentially optimal area for the store is selected.
3. **Site evaluation**: in the chosen geographical area, the best available site(s) are examined based on all features relevant to store performance. This step concludes with a final decision on the specific site.

11.3.2 Catchment Area

Analysing the catchment area (**trading area, market area**) of a specific region or site is vital at each phase of the retail location decision process. A **catchment area** is the geographic area that contains the customers for a particular site or region for a company or a group of companies for specific goods or services. Thus, it determines the potential demand at a particular site and, among other factors, influences potential sales and profitability.

Catchment areas are usually divided into three parts. The **primary trading area** is where 50 to 80 % of customers are based. The **secondary trading area** contains about 15 to 25 % of customers, and the **fringe** or **tertiary trading area** includes the remaining

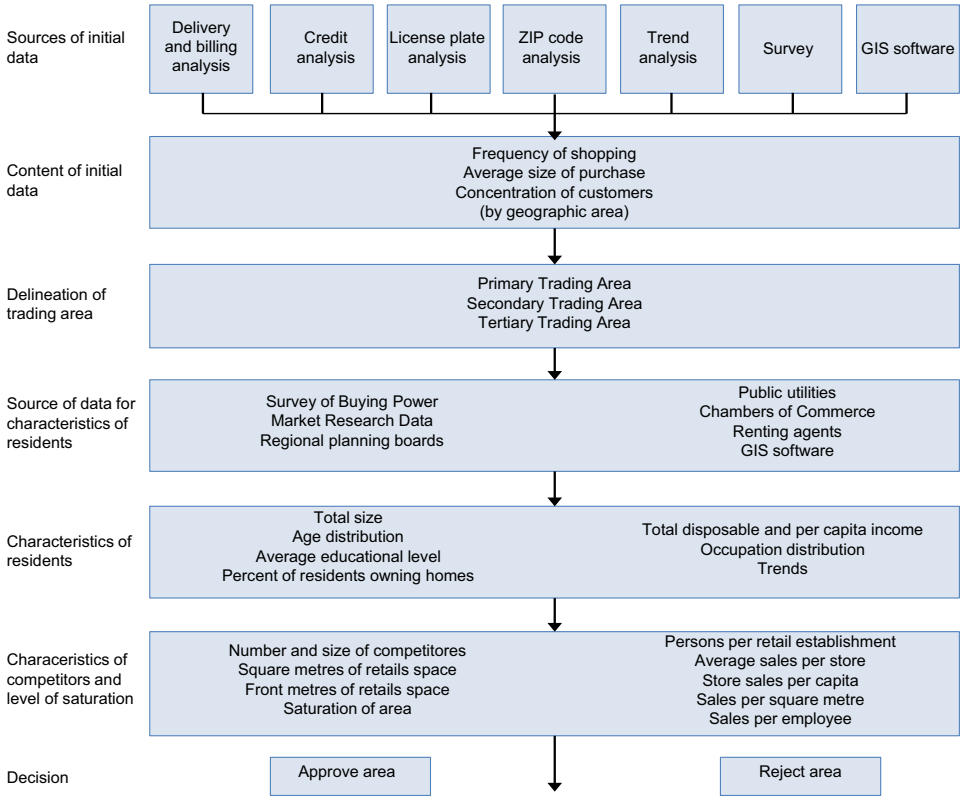

Fig. 11.2 Retail area analysis. (Adapted from Berman and Evans 2013, p. 272)

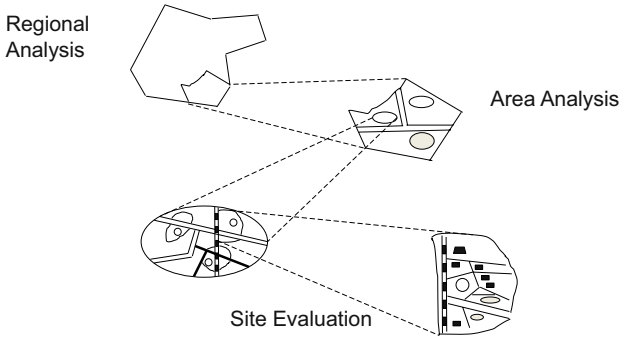

Fig. 11.3 Catchment area assessment. (Adapted from Bienert 1996, p. 115)

customers who shop occasionally at a location as an alternative to local shopping (Berman and Evans 2013, p. 264; Gilbert 2003, p. 280).

These parts of a catchment area are often described in terms of the **distance** between customers' homes or workplaces and the area or site. They are usually delineated by measuring linear distance (e. g., concentric circles drawn around a site), travel distance (by car or public transport) or time distance (by car or public transport). **Mapping techniques** are used to forecast or survey and map such store trading areas (McGoldrick 2002, p. 247).

Geographical information systems (GIS) are important support systems for location research and trading area analysis. These are software systems that combine digitised mapping with key location data to depict trading area characteristics such as population demographics, customer purchase data and competitor locations.

11.3.3 Location Assessment Techniques

The **suitability** of a specific site is based on the retailer's strategy (retail formats, merchandise, pricing strategy, etc.) and is influenced by a substantial number of factors that need to be investigated. A selection of these location factors is presented in Table 11.4.

A number of techniques have been developed to guide retail location decisions and assess or forecast the potential sales or profitability of retail stores in a specific region or area or at a specific site. These techniques range from simple to very sophisticated and computer-based (see Table 11.5). Either way, most are used to identify and evaluate potential **new sites**, but they can also guide decisions on **existing locations** with respect to extensions, rationalisation, repositioning and so on.

11.3.3.1 Managerial Experience

Location is a retail function that requires knowledge and expertise. In practice, managerial experience ("**retail nose**") plays an important role in assessing retail locations. For example, **rules of thumb** are often used as subjective and intuitive guidelines for site assessment. Such rules are developed based on company knowledge (Hernández and Bennison 2000).

Table 11.4 Selected location factors. (Adapted from McGoldrick 2002, p. 240; Gilbert 2003, p. 293; Berman and Evans 2013, p. 270)

Customers (potential/ actual)	Accessibility	Competition	Costs	Availability
Numbers by demographics (e. g., population size, age profile, household size) income level disposable income per capita average education level employment by occupation, industry, trends housing density housing age/type neighbourhood classification home-ownership levels building/demolition plans major employers spending patterns shopping patterns population growth, density and trends lifestyle measures cultural/ethnic grouping	Site visibility pedestrian flows pedestrian entry routes barriers (e. g., railway tracks, rivers) type of location zone car ownership levels road network (conditions, driving speeds, congestion, restrictions, plans) parking (capacity, convenience, cost, potential) public transport (types, cost, ease of use, potential) visibility staff access transport and delivery access	Existing retail activity (direct competitors, indirect competitors, anchor stores, cumulative attraction, compatibility) existing retail specification (selling area, turnover estimates, department/ product analysis, trade areas, age of outlets, standard of design, car parking) saturation level competitive potential (outlet expansion, refurbishment, vacant sites, interception, repositioning, competitor policy) proximity of key competitors, traders, brand leaders	Purchase price building costs rent costs leasing terms site preparation building restrictions development concessions rates payable refurbishment needs maintenance costs security needs staff availability labour rates minimum wages delivery costs insurance costs promotional media/costs turnover loss/ other branches taxes licensing	Number and type of location zoning restrictions owning versus leasing opportunities

Table 11.5 Location planning techniques. (Adapted from Hernández and Bennison 2000, p. 360)

Techniques	Subjectivity	Cost	Technical Expertise required	Computing and Data Needs	GIS
Managerial Experience	Very high	Low	Low	Low	Limited role
Location Evaluation Checklists	Medium	Low	Low	Low	Limited role
Analogue Method	Medium	Low	Low	Low	Limited role
Multivariate Statistical Techniques	Low	Medium	High	Medium	Information
Spatial Interaction Models (Gravity Modelling)	Low	High	Very high	High	Information, analysis and modelling
Knowledge-based Techniques (e. g., Expert Systems/ Neural Networks)	Low	Very high	Very high	Very high	Information

11.3.3.2 Location Evaluation Checklists

Checklists consist of a number of chosen variables (i. e., location factors) to consider when evaluating retail locations. Nelson (1958) developed one of the first detailed checklist evaluation formats.

Companies select factors they believe influence store performance. While some elements of such checklists are common to all types of retailers, each company is likely to have its own list with factors that reflect its particular strategy and situation (McGoldrick 2002, p. 239). Fig. 11.4 illustrates links between retailers' strategic positioning (e. g., focus on price, convenience, variety or proximity), typical locations (e. g., retail parks or high streets) and major influences that are considered important (e. g., population, competitors, demographics, etc.) and which should be analysed in the context of site assessment.

11.3.3.3 Analogue Method

The **analogue method** (Applebaum 1966) compares new store sites to existing ones that have many features in common with the new store (e. g., store size, merchandise or location characteristics). The likely turnover and profitability of the new store site are estimated based on sales achieved and profits earned by similar stores in existing areas. Such comparisons can be performed by **extrapolating** from internal store data or by comparing the new site with existing competing stores (e. g., stores at the prospective location).

11.3.3.4 Multivariate Statistical Techniques

Given the increasingly complex array of data available for location analysis, multivariate statistical techniques can be used to construct models that harness the predictive power of the available predictor variables for (new) store performance (McGoldrick 2002, p. 257).

The most important techniques are various forms of **multiple regression analysis,** which predict store sales and estimate market potential or profit. **Discriminant analysis** can be used to predict category membership. Such sophisticated procedures can identify relationships between store sales and predictor variables such as population in the surrounding area, population spending power, store accessibility, quality of transport links to sites, average distance to population or nearby competition (Moutinho et al. 1993).

These techniques provide more objective and systematic insight into the impact and importance of location attributes, and thus are useful for screening large numbers of loca-

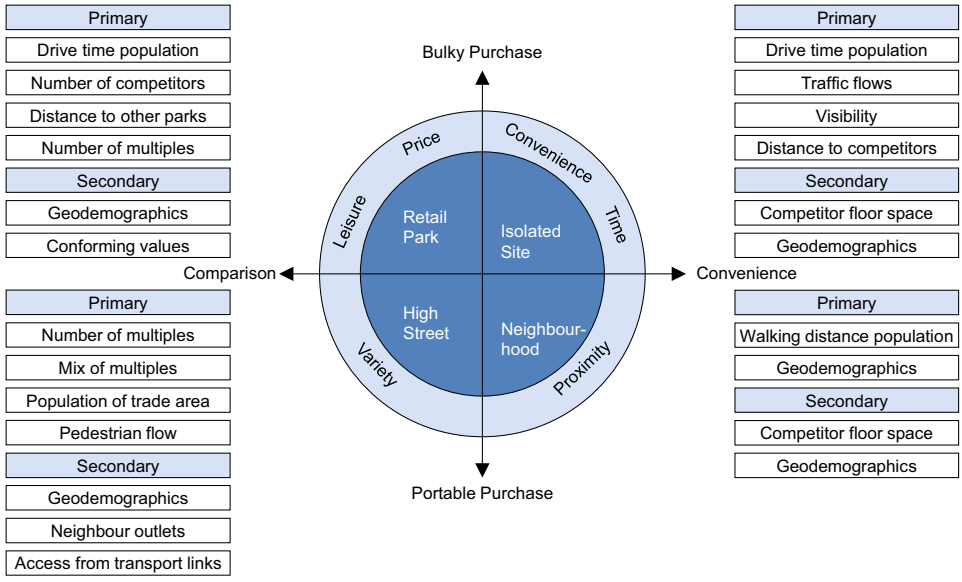

Fig. 11.4 Links between retailer strategies, location factors and location types. (Adapted from Davies and Clarke 1994, p. 7; CCN Marketing 1993.)

$$d_{01} = \frac{d_{12}}{1 + \sqrt{A_2 / A_1}}$$

d_{01} = distance or journey time of the breaking point 0 from town 1
d_{12} = distance or journey time between town 1 and town 2
A_1, A_2 = population of town 1 and town 2

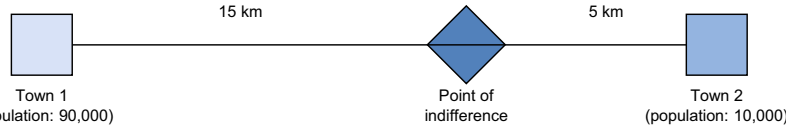

Fig. 11.5 Reilly's law of retail gravitation. (Adapted from McGoldrick 2002, p. 261; Berman and Evans 2013, p. 268)

tions. However, they require more data than simpler methods, as well as a higher degree of technical expertise.

Cluster and factor analysis are techniques which aim to group data or variables to divide a portfolio of stores into similar groups (**cluster analysis**) or a range of variables that can be used to predict site profitability (**factor analysis**). These procedures are particularly suited to developing new store formats or segmenting retail networks. These techniques also require a large amount of good quality data, along with a high degree of statistical expertise and business acumen (Hernandéz and Bennison 2000).

11.3.3.5 Spatial Interaction Models

Spatial interaction models are also referred to as "**gravity models**", because they are based on an analogy with the physical law of gravity. They have evolved as a major stream of development in retail location theory. The basic principle of **spatial interaction** is that the aggregate movements of shoppers are positively related to the attractiveness of a store and negatively related to the distance from the store or other deterrence factors (Craig et al. 1984).

Gravity models can be used to forecast store performance by simultaneously considering factors such as store size, store image, distance, population and distribution. One of the earliest models of this type is **Reilly's law of retail gravitation** (Reilly 1929), which establishes a point of indifference between two towns in order to determine the catchment area of each town. This point of indifference is the breaking point, defined as the point up to which one town dominates and beyond which the other town dominates (see Fig. 11.5)**.** Thus, it is the point at which consumers are indifferent as to which location they use (Rogers 1992).

This model helps delimit the trading area from which retailers draw customers. However, the model has many limitations (see, e. g., Rogers 1992; Craig et al. 1984). For example, the breaking point formula does not provide estimates above or below the break-even point between the two towns. Also, the model cannot predict the trade areas of more than two towns and the shape of the function is not constant for all types of shopping trips. Retailers can offer additional competitive advantages and thus – contrary to the model's assumptions – can differ in terms of location attractiveness (McGoldrick 2002, p. 261; Gilbert 2003, p. 295).

In order to overcome these limitations, several refinements and extensions to the model have been developed, including **Huff's law of shopper attraction** (Huff 1964), which is based on the utility that a shopper derives from shopping at a particular store. It describes catchment areas based on the product assortment carried at various shopping locations, travel times and the sensitivity of the kind of shopping to travel time (trip purpose and type of product sought). Most geographic information systems (GIS) incorporate Huff-type models.

11.3.3.6 Knowledge-based Techniques

Knowledge-based techniques are the most recent models developed to assess retail store locations. The most important techniques are **expert systems** or models developed based on **artificial intelligence**, such as neural networks or computer systems which model the retail environment and shopper behaviour as "software agents" that simulate store performance at prospective locations. Such systems depend heavily on powerful computer capacities and immense data requirements and are still in the development phase.

11.4 Conclusion and Outlook

Location decisions have a major impact on a retail outlet's success, as location is an important factor in consumers' store choice. The location decision also has a **long-term impact**, as it is not very flexible. Thus, location decisions are critical to retailers' competitive advantages. Retail site selection is usually conducted following systematic site selection processes.

To guide and support retail site assessment, the various location assessment techniques have become more and more sophisticated. These improvements have been triggered largely by advances in computer and software technologies (e. g., artificial intelligence).

It should be noted that retail location decisions do not just involve opening new stores; monitoring existing stores is equally important. This entails, for example, decisions concerning repositioning, relocating or closing outlets. This is important, as retail environments change rapidly (e. g., changes in customer behaviour or competitive structure) and companies must respond via location decisions.

However, retail location decisions cannot be made without considering the retail environment in terms of the interests of towns and cities or their residents. Establishing a retail store can, for example, influence shopping patterns, traffic and pedestrian flows or the retail structure of a town. The issue of out-of-town vs. inner-city retail centres is often of major concern to local communities. Also important in this context are **business improvement districts** (BID). BIDs are public-private partnerships (PPPs) made up of property and business owners within a defined area, who try to improve that area via collective contributions to maintaining, developing and marketing their commercial districts.

To ensure that specific objectives are met, retail locations are influenced or constrained by local or central government planning policies. Thus, opening a new store or even chang-

ing or extending an existing store may require planning permission. For example, most European countries have restrictions on setting up large retail formats and out-of-town shopping centres, because of the potentially adverse impact of large stores on small businesses and of new shopping centres on old ones.

However, local authorities do not only restrict retail store settlement. In many city marketing initiatives, an attractive retail mix is recognised as one of the key factors in attracting customers to a particular town or city. Local authorities, therefore, try to encourage retailers with good images to open stores in their towns or cities.

Further Reading

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11.5 Case Study: The Home Depot

11.5.1 Profile, History and Status Quo

The Home Depot[1] is an American retailer of home improvement and construction products and services. It is the world's largest home improvement chain, with net sales of 83 billion USD (see Table 11.6). The retailer is a broad line specialist in the do-it-yourself home repair market with a high level of consistency of product lines to fulfil complementary end use needs. *The Home Depot* offers up to 40,000 different kinds of building materials, home improvement supplies, appliances, and lawn and garden products. In doing so, the retailer offers the expertise of professional home contractors at markedly lower prices than hardware stores (Kim and Mauborgne 1999). *The Home Depot*'s main competitor in their most important market, the US do-it-yourself home repair market, is *Lowe's* with net sales of 56 million USD in 2014.

Bernie Marcus and Arthur Black founded the corporation in 1978. By the end of 1979, *The Home Depot* had opened three stores and generated 7 million USD in revenue. Just

[1] As well as the explicitly cited sources, sources used for this case study include the company's website www.homedepot.com, various annual and interim reports and investor relations presentations.

Table 11.6 Key indicators for *The Home Depot*. (The Home Depot 2015)

	2014 Fiscal Year (in million USD)	2013 Fiscal Year (in million USD)
Total Net Sales	83,176	78,812
Cost of Sales	54,222	51,422
Gross margin in %	34.8 %	34.8 %
Major Product Categories		
Kitchen	8103 (10.1 %)	7978 (10.1 %)
Indoor Garden	7550 (9.1 %)	7176 (9.1 %)
Paint	7300 (8.8 %)	7026 (8.9 %)
Number of stores	2269	2263

five years later, *The Home Depot* broke the 30 store mark and achieved 4.3 billion USD in sales. In the following years, the company grew very quickly, becoming the fastest retailer in history to reach revenue milestones of 30 billion USD, 40 billion USD, 50 billion USD, 60 billion USD and 70 billion USD (Hess 2012). Today, *The Home Depot* is the world's largest home improvement specialty retailer and the second largest retailer in the United States.

The Home Depot operates more than 2200 retail stores in the United States (1977 stores), Canada (181 stores) and Mexico (111 stores) (US Department of Energy 2013). Between 2006 and 2012, *The Home Depot* also operated stores in China. However, in 2012, the company closed its remaining big box stores in China, citing that the Chinese market, with its massive cheap labour pool, is more of a "do-it-for-me culture", which did not fit *The Home Depot's* do-it-yourself model (Wall Street Journal 2012). China's slowing economic growth spurred the company to close the stores. However, the retailer has kept two specialty stores in China, because they expect potential success in the future. A complete withdrawal from China and subsequent re-entry might be more expensive than keeping the door ajar.

In communicating its values, *The Home Depot* puts customer orientation and social responsibility first. The company visualises this system of values as an "Inverted Triangle" which represents how everything and everyone in the company, from senior management to corporate support systems, is designed to support the success of associates and customers (see Fig. 11.6). As this quote from Arthur Black shows, this strategic approach was one of the central motives for founding the company: "Bernie and I founded *The Home Depot* with a special vision – to create a company that would keep alive the values that were important to us. Values like respect among all people, excellent customer service and giving back to communities and society" (Hess 2012).

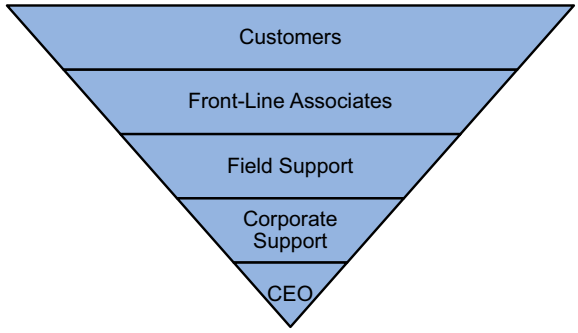

Fig. 11.6 *The Home Depot's* Inverted Triangle. (The Home Depot 2015)

11.5.2 The Home Depot's Store Types and Retail Locations

The average *The Home Depot* store is 106,800 ft² (approximately 10,000 m²) in area with approximately 28,000 additional square feet (approximately 2600 m²) of outside area for garden and landscaping products. The stores have large entrances for customer flow, providing direct store access and room for loading and unloading materials. They also have large aisles, varied inventory and comprehensive in-store centres, such as garden and home decorating centres, all under one roof. To achieve all this, *The Home Depot* almost exclusively employs a warehouse concept outside of city centres with a wide selection and a high in-stock fill rate. In exchange, the stores forgo the convenience of short drives for their customers and also fulfil their customer's expectations when it comes to store design: Instead of nice displays and friendly service, the retailer focuses on a functional, professional appearance and their staff's advisory skills (see Fig. 11.7). This focus on function rather than design has led to the stores being nicknamed "orange boxes".

Thus *The Home Depot's* stores and location complement the orientation of its target group: The *Home Depot* focuses on customers with home improvement needs who choose to carry out the work themselves rather than hire a contractor. The company's store loca-

Fig. 11.7 Typical *The Home Depot* stores: "orange boxes". (Civil Eats 2014; MSNBC 2013)

tions, atmosphere, range of goods and services are chosen to reduce overheads and maintenance costs and generate economies of scale in purchasing (Kim and Mauborgne 1999). This also clearly communicates the stores' price advantage: A luxurious high-street flagship store would not communicate attributes such as lower prices and suitability for professional home contractors as effectively as a functional warehouse outside of the city.

Following this strategy, *The Home Depot* is already represented in all US states, all ten Canadian provinces and Mexico. Such high market penetration means many markets are becoming saturated (Directions Magazine 2006). Nevertheless, the retailer is still relying on an expansion strategy to keep the pressure on competitors, even though growth rates have shrunk in recent years (see Fig. 11.8).

In addition to opening new stores, *The Home Depot* also focuses on optimising the assortments in its individual warehouses to better suit local target groups. Market analysis is key here, particularly looking at how many stores a market can support, evaluating point of sale data and supporting the merchandising function (Directions Magazine 2006). For example, the retailer monitors its sales per square foot in each store. If this value becomes too high, the company assumes its customers may not be well served and competition may be drawn into the market: When the value reaches approximately 400 USD, *The Home Depot* will often open another store in the area, even though this might decrease the existing store's sales (Dunne et al. 2011). Higher and more suitable customer orientation and increased barriers to market entry for competitors compensate for this cannibalisation.

11.5.3 Site Selection Criteria

The following quotation from Mike LaFerle, Vice President of Real Estate at *The Home Depot*, shows the importance of site selection to the company's expansion strategy: "Location is everything … Convenience is the driving factor for most customers" (Directions Magazine 2006). *The Home Depot* decides on a new store location based on a number of site selection criteria, including:

- low costs,
- out-of-town locations,
- convenient access,
- compatibility with store concept and store type.

The Home Depot aims to offer the expertise of professional home contractors at significantly lower prices than hardware stores. To achieve this, it is important to reduce the main cost drivers of the brick-and-mortar stores, i. e., real estate costs. Because *The Home Depot's* "orange box" stores require a lot of space due to their extensive assortments and high in-stock fill rates, the costs of the retail location can be crucial.

This combination of large spaces at low costs is only rarely found on high streets or in cities. Therefore, *The Home Depot* particularly looks for greenfield locations and those

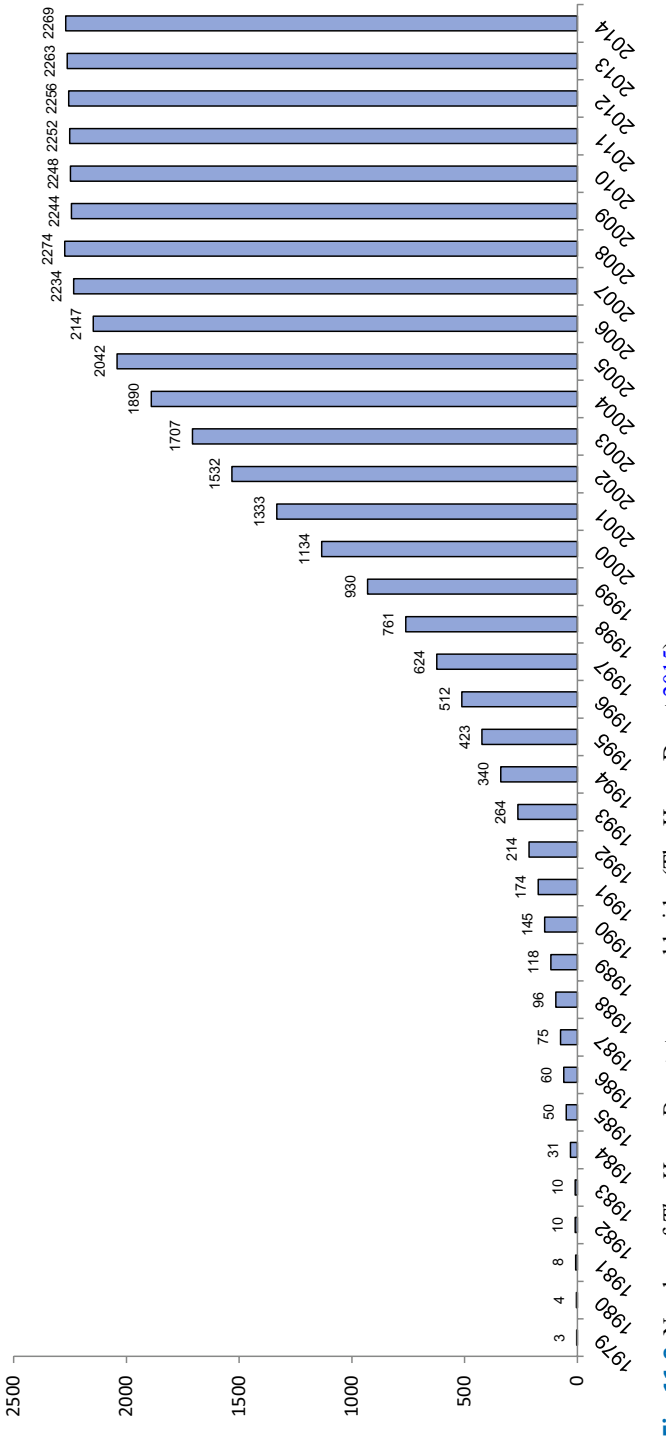

Fig. 11.8 Number of *The Home Depot* stores worldwide. (The Home Depot 2015)

on the outskirts of cities. This strategy is feasible because *The Home Depot* targets DIY enthusiasts who visit their stores with the concrete aim of buying something, rather than walk-in customers or occasional shoppers. Customers generally associate low prices with shops outside of cities rather than those on high streets.

In order to be attractive to customers despite out of town locations, it is important that the stores are convenient to reach. This is especially true for their preferred target group of homeowners. Therefore, *The Home Depot* prefers locations close to highways or within well-connected business districts.

Retailers can profit from an area's store compatibility (Karande and Lombard 2005), which is when stores in the same area offer compatible or very similar assortments. Given this, it is beneficial for *The Home Depot* to establish stores close to direct competitors. Following this approach, one *The Home Depot* store in Lewisville, Texas, experienced a 20 % sales increase after its competitor *Lowe's* opened up a new store nearby (Dunne et al. 2011).

Similar criteria also apply for choosing the location of the retailer's distribution centres. They are usually "selected based on its overall cost, proximity to stores and the opportunity to cost-effectively process ocean containers" (Lee Bandlow, Vice President of Distribution Services for *The Home Depot*, according to Commonwealth of Virginia 2003). Additional criteria include local or regional public incentives or subsidies. For example, *The Home Depot* received 405,000 USD from the Maryland Department of Business and Economic Development and from Washington County to assist with opening a distribution centre in Hagerstown (Blockbuster Deal 2004).

11.5.4 Site Selection and Cross-channel Strategy

Online purchases have become increasingly popular. In this context, customers often use a brick-and-mortar location as a **showroom** (see Chap. 4 and 5), a point of delivery or to pick up goods purchased online (Berry 2012). Consequently, the role of physical stores is changing to integrate more functional features such as order pick-up, merchandise warehousing and product showrooming. This is particularly the case for certain product categories, such as power tools, which are typical products offered by *The Home Depot*. In this case, customers visit the bricks-and-mortar store not only to buy the products immediately, but for a physical or tactile evaluation of a product or for a convenient and prompt pick-up (or, in case, return of online bought products).

Hence, *The Home Depot's* online sales grew by almost 40 % in Q1 of 2014. This result encouraged *The Home Depot* to refocus its attention on building the necessary infrastructure to support increased digital commerce. An essential element of this strategy is its network of approximately 2200 stores. *The Home Depot* can ship goods straight from its inventory to customers on the same day, thus improving its customers' shopping experience (Forbes 2015). Thus site selection must also consider future demand created by electronic or mobile channels. In future, *The Home Depot's* brick-and-mortar stores will increasingly serve as warehouses; thus, sites must be large enough for additional storage room.

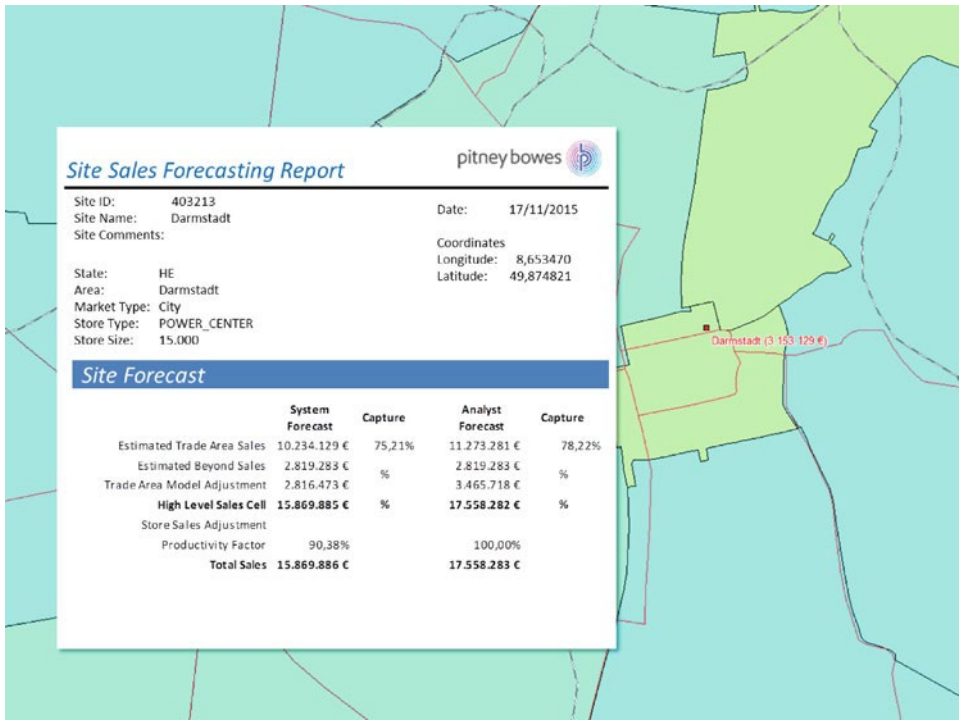

Fig. 11.9 Example of a site sales forecasting report. (Buckner 2004, p. 13)

11.5.5 Predictive Analytics for Reliable Location Intelligence

Early on, *The Home Depot* began to use predictive analytics for reliable location intelligence. The retailer works with the service provider *MapInfo*, who combine retailers' proprietary data (e. g., from loyalty cards) with US census figures and other demographic patterns to calculate statistics like how far customers travel to make their purchases.

Using this data and multivariate analytical methods, software determines spatial models and GIS for *The Home Depot* and offers a strategic outlook on which markets have the best expansion potential, which locations have the highest sales potential and how new stores will impact the retailer's other stores (CNN Money 2004). The results are combined on digital maps, based on which sales projections can be made for specific locations and categories. It is also possible to determine in which locations the retailer can expect the most positive developments (see Fig. 11.9).

The substantial increase in the efficiency of data collection and the development of databases, the use of advanced statistical and modelling techniques and continued rapid evolution of geographic information systems mean predictive analytics have steadily become more important for *The Home Depot's* site selection in recent years (Ladle and Stiller 2009). However, these analytics are based on predictive models, which reflect a

standardised reality and cannot address all of the variations inherent to a particular site. Some factors which are not easily measurable (such as operations) can impact unit performance, while other factors (e. g., visibility ratings) can only be measured imperfectly. While such models can accurately assess standard locations, they are less useful in atypical situations (Berry 2012).

11.5.6 Summary and Outlook

This case study has analysed *The Home Depot's* use of site selection criteria in detail. These criteria clearly reflect the retailer's corporate strategy. The retailer has adopted a very customer-centric position, especially when it comes to real estate costs, proximity to competing stores and the convenience of its locations. Thanks to developments such as "big data", but also improvements in IT and statistical models, *The Home Depot* can now not only determine which location best meets its requirements, but also make predictions about future developments and consider them during the site selection process.

These predictions can be vital to retailers such as *The Home Depot*: The process of siting a new store, building it and merchandising the store floor takes 42 months. Thus, sales forecasting, based on up-to-date demographics and sound spatial interaction models, must accurately predict whether the market can support investment in another store. Therefore, *The Home Depot* tries to predict the need for home improvement supply long before residents start moving into their new homes and planning their first trip to the "orange box" (Directions Magazine 2006).

Questions

1. How do *The Home Depot's* site selection criteria reflect the company's strategy?
2. Which customer data and specific information about the geographic region could be relevant for site selection for a new *The Home Depot* store?
3. How do the company's site selection, assortment and pricing interact?

- Consider the likely motives and occasions for purchase of the typical *The Home Depot* customer.
- Remember, the site selection criteria should be relevant to both customer buying behaviour and the retailer's costs.
- Remember that different locations meet different customer needs and expectations.

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