

Thinking of Retail Business? Just Say “No!”

When deciding what business to start for the first time, retail might seem like the obvious choice. Because people will always need or desire products, retail seems like a relatively safe venture. But the truth is retail is not the high value portion of the supply chain. With so much competition, you'd do best to invest in the upper end or higher value portion of the supply chain: manufacturing and wholesale distribution. When you think about some of the wealthiest people or companies in the world, the names that come to mind usually manipulate a resource and manufacture a product that is to be sold to retailers worldwide. But of those who get the product to the end user, only the big box retailers can get rich. Here are a few reasons why Mom & Pop shops can't compete.

The Competition

The mark-up retailers charge allows them to profit from the products in their stores. The mark-up is the difference between what a retailer pays for a product and the price at which the retailer sells it to customers. Though many retailers might only choose to sell products with a high retail margin, because they have to compete with big box stores they are often forced to sell for less or they are left with unsold merchandise.

Big box stores have saturated the market. These stores offer unbeatable low prices, a huge supply of products, lots of variety, and extended store hours. And because all of their locations offer these same qualities, customers know what they can expect from these stores no matter where they happen to be. This encourages loyalty to the big box name. Also, because these stores buy products in such enormous bulk quantities they get steep discounts and can afford to sell products at prices lower than the recommended retail price, consequently undercutting their competition. This makes it almost impossible for smaller competitors to survive, or even start up in a free-market economy. It doesn't help that big box stores have the space and budget to sell so many different products; with such a selection, once a customer walks in, these stores are almost guaranteed a sale! They can even tolerate the kinds of losses that smaller shops can't because it is worth it for them to stock something unprofitable just to get someone inside.

Sometimes just having an item in stock means it will yield decent profits for big box retailers. Customers are conditioned to shop at these large stores for everything from food to clothing to fishing supplies. They value the ease of a one-stop shopping trip. As they wander through the aisles customers throw more items into their shopping carts, and end up making purchases they didn't expect to make. The sheer number of items available is reason enough for customers to visit these chains, and incredible sales attract foot traffic. Often customers of smaller stores enter with a few items in mind and

don't linger for hours. Smaller stores also tend to cater to one need and often can't afford to accept the losses that come with sales. Mom & Pop shops just can't compete.

What's more, internet shopping and comparison sites have created even more options than ever before, making competition especially fierce in the retail world. For all these reasons, retail is often not worth the effort. Let's consider some statistics. Historically, 50% of small start ups have failed within 2 years and 80% failed within 5 years. That means that only 20% of small start ups survive for more than 5 years. And of those, only 4% survive after 10 years! Remember, it isn't just selling products that you have to worry about; you have to consider the cost of overhead, materials, and hours (yours and your employees'). When you consider the burden that overhead costs have on an individual compared to a big box store, you'll see that the individual can't afford to sell his products for lower prices. Unfortunately this means customers will buy elsewhere.

The Truth about Franchises

Now, you might think that opening a franchise retail store is a better bet; and it is. The failure ratio is drastically reduced when entrepreneurs start their businesses with proven franchises, such as McDonald's and Tim Horton's. But franchises come with a big price and a great sacrifice.

First of all there is a big upfront investment. This can cost anywhere from a few hundred thousand to more than a million dollars. How many people who contemplate going into the retail business have such financial resources? If you do have such resources, there are many investment options you can explore and take advantage of; you might find that other options will prove to be more profitable than becoming a franchised retail operator. One of the reasons franchisees don't earn as much as you'd expect is that royalties and fees take most of the profits earned from a franchise. Remember, you aren't the only one seeking to profit from your franchise; you have to pay your dues. You also have to keep up with the performance and appearance of all the other franchises. Many entrepreneurs don't seriously consider the hidden cost of upgrades, changes, and renovations, which franchise companies require every 5 years or so. Using the excuse of upgrades, many franchisors charge thousands, even hundreds of thousands, to replace equipment, make renovations, or change the seating arrangement at their discretion. Of course these mandatory changes are vaguely spelled out in the franchise agreements, but they can easily be missed or downplayed.

Another thing to keep in mind is your supplier. In the name of consistency, the source of supplies is mandated by the franchisors. Often the cost is higher than the cost of the same products from your neighbourhood store. The franchisors get big rebates from manufacturers and processors, but often leave you with higher costs. Technically, franchisors are supposed to share the benefits they receive from discounts with their franchisees; but in actuality this is not often the case.

So even though franchised businesses offer a good chance of success in the marketplace, the most you can earn as the franchisee is your own wages from long hours of hard work. You will likely see hardly any returns from your investment. I have seen many people invest in franchises that were not well established just because doing

so was within their financial means. Most of these unproven franchises failed as fast as the Mom & Pop shops. Why would you throw away your hard earned money? If you have the money to invest, you may be better off making alternative investments in the upper portion of the supply chain with your financial resources.

Just Say “No”

It's important to understand that retailers receive a product at the end of the supply chain. Before a product hits the shelf it is sold to a distributor, then to the retailer. Both parties want to profit from the product, so there are two mark-ups required before you get to the final price – the distributor's and the retailer's. The distributor sells products at a mark-up price higher than what he paid to the manufacturer. The retailer also sells at a mark-up price, but his price is greatly influenced by the retail competition which, as described above, is pretty steep. The manufacturer and wholesaler are not affected by sales competition in the same way. The original price of the product can remain relatively constant, and if the product is popular sales are unlikely to slow down. The manufacturer and wholesaler, through distributors and retailers, also reach a much wider audience than a single retail store can, so profits are much greater.

So if you're thinking about stepping into the marketplace as a retailer, you'd do best to reconsider. In today's retail landscape, you just can't win.