Target Corporation

Case Synopsis

Business 478

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Group B

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CORPORATION HISTORY

George Dayton founded what would become Target Corporation in 1902. The first Target store was created as a subsidiary of Dayton Dry Goods Company as a discount-retailer in Roseville, Minnesota in 1962. By 1970, twenty-four Target stores operated across the United States with sales over $200 million. Following the 1970s Target continued to expand by acquiring other department stores. Target acquired stores from Arian's department store chain, Mervyns, and 40 discount retain chain stores from Ayr-Way. By 1981, these stores were all operated under the Target brand.

Between 1980 and 2000, Target focused on nationwide expansion. Target continued to use acquisitions to fuel its growth and acquired a number of retailers including Fedco, FedMart, Gemco, Rivertown Trading Company, and Associated Merchandising Corporation. By 1999, Target consisted of 912 units including department stores, hypermarkets, superstores, and Target distribution centers with sales reaching $26 billion.

Since 2000, Target Corporation has become the second-largest discount retailer in the United States with over 1700 stores. Target operates in every state except Vermont. The company offers a range of products including household essentials, clothing, groceries, and private label products. In addition to its retail segment, the company also offers credit and debit card services. In recent years Target was forced to close down stores as a result of the 2008 financial crisis. In 2010 Target began to focus on international expansion when the opportunity to gain access to the Canadian market presented itself. NRDC Equity Partners, the owner of the upscale U.S. department store chain Lord & Taylor had obtained Canada's Zellers discount chain in a deal that brought them Canada's Hudson's Bay Company. NRDC was anxious to dispose of the discount operations (the Zellers chain) and sold Target the rights to purchase the leases on the Zellers locations. As a result, Target plans to open 100 to 150 stores in Canada, starting in 2013. This represents Targets first attempt at international expansion.

EXTERNAL ANALYSIS

An external analysis of the six environmental factors, global, demographic, economic, political/legal, socio-cultural and technological factors will aid in analyzing the key influences of the discount retail industry.

Global

As discount retail industry participants either operate overseas or ship merchandise from outside of North America, global events do have an effect on the industry. Occurrences that would have an effect are discussed below. When a natural disaster overseas, such as the 2011 tsunami in Japan, the event could lead to fluctuations in the cost of raw materials. This, in turn, would directly affect profit margins. A natural disaster may also lead to a loss of inventory and merchandise stock outs. Political or financial instability, trade restrictions and an increase in tariffs or transportation costs would also have a negative effect on the discount retail industry. Additionally, the outbreak of a pandemic in a foreign country, labor unrest or disruptions in port security around the world would slow foreign trade and would slow production for industry participants. An international financial crisis or fluctuations in foreign currency exchange rates has potential to affect the industry, as this would cause an increase in operating costs. Acts of war or terrorism would also adversely affect industry participants.

Technological

The growing popularity of social media has altered the discount retail industry. Companies are now able to connect with guests and provide them with great deals. Social media also allows for a two-way dialogue to be created. This in turn aids in improving the customer service experience. As well, the practice of leveraging innovative technologies aids industry participants in delivering highly relevant and differentiated shopping solutions at anytime and these solutions are viewed as personal, accessible and simple.

As multichannel retailing is rapidly evolving, there is increased pressure on companies to keep pace with changing consumer demands and competitor developments. If one company is able to improve its guest-facing technology before another company, a shift in brand loyalty may arise. As well, increases in fraudulent purchases online and data security breaches have had a negative effect on industry participants. These two things have potential to drive up company costs while simultaneously leading to a drop in consumer confidence and brand loyalty.

Finally, there is a reliance on computer systems to manage inventory, process transactions and summarize various results in this industry. As this reliance continues to increase, damage or interruption to these

systems would adversely affect companies involved. This could arise from power outages, security breaches or computer viruses. Companies that need to repair or replace these computer systems may incur substantial costs. There may also be nonmonetary costs, as companies may experience a loss of critical data.

Demographic

In the United States and Canada, population growth has slowed significantly and the majority of growth is from immigration. This results in an older population than ever before. Discount retailers attract middle-aged women, one of the largest population segments. Furthermore, there are many more women in the workforce and they have more disposable income.

Shoppers at discount retailers like Wal-Mart and Target are nearly 90% women with a median age of 46 and a household income of approximately $55,000. About 38% of these women have children, many of whom will live at home into adulthood unlike generations before.

Socio-cultural

There is a trend towards urbanization as suburban living becomes unpopular and unsustainable due to high-energy costs. Discount retailers must also compete on a variety of platforms as online shopping becomes increasingly popular. Discounters that traditionally rely on operations like big box stores in suburban areas will have to adapt to avoid obsolescence.

Retailers in general are subject to cyclical buying habits. A large share of revenue is generated during the Christmas season as sales peak between Thanksgiving and the end of December and so success during this period can make, or break, a retailer's entire fiscal year.

There is also some social resistance to discount retailers entering new markets. It is typical for consumers to express distaste for big box stores opening near their homes. As well, it is generally believed that Wal-Mart overtakes smaller, established retailers when entering small communities. Some individuals are also resistant to shopping at discount retailers because they believe the stores attract lower socio-economic consumers and they claim discounters products are 'cheap' and low quality. For these reasons, some consumers will refuse to shop at discount stores because they find it socially-unacceptable.

Economic

During the financial crisis, discount retailers were able to maintain stable earnings as they could provide consumers with relatively cheaper prices than other retailers. As disposable income levels are now expected to recover, there will be new opportunity for growth in the discount retail industry; however, products will need to add value that goes beyond cost savings. The current economic conditions have potential to continue to positively impact this industry. The increase in unemployment in the United States lends to the assumption that consumers have increased spending on discount products. Fluctuations in and uncertainty regarding fuel, energy and raw material costs may also affect production costs of industry participants. The reinvigoration of credit card purchasing may also boost sales for companies.

Political/Legal

Retailers with a broad scope of product offerings could face government enforcement action, product recalls, litigation and other liabilities because of product safety concerns from consumers. This includes non-compliance product safety standards and food or drug contamination. This poses a significant risk as costs incurred in litigation and through fines and recalls are high and client confidence may be so badly damaged that substantial sales losses may occur.

Large retailers must comply with a wide array of laws and regulations to avoid incurring significant legal costs. In the United States and Canada, common political and legal issues affecting retailers include:

- Employment laws and regulations such as minimum wage requirements
- Financial regulations such as increased interest rates or consumer credit regulations
- Privacy and information security laws
- Environmental protection laws

Changes to these regulations can cause operations costs to increase and create legal risk for companies, all of which will affect the bottom line.

INTERNAL ANALYSIS

An analysis of Porter's Five Forces helps to outline Target's strategic competitiveness and profit potential.

Threat of Entry

There are high barriers to entry in the retail industry due to a number of factors. These include the ability to establish favorable supply contracts, leases and prime locations. Discount retailers are vertically integrated and have centralized buying power. This gives them the ability to create economies of scale. Furthermore, there are large capital requirements and market growth is slow. Many retailers have already established powerful brands and have differentiated themselves through slogans and partnerships with restaurants and clothing designers. As a consequence of the aspects listed above, threat of entry in this industry is low.

Bargaining Power of Suppliers

In the discount retail industry, suppliers tend to have very little bargaining power as industry participants have strict guidelines as to how they want things produced. For example, a contract with a large retailer such as Wal-Mart can make or break a small supplier. Additionally, buyers in this industry pose a credible threat for backwards integration, which would negatively affect suppliers. A few large companies dominate the discount retail industry; therefore, the bargaining power of suppliers is low.

Bargaining Power of Buyers

Individually, customers have very little bargaining power with retail stores. It is very difficult to bargain with the clerk at Safeway for a better price on oranges; however, as a whole, if customers start demanding higher quality products at cost saving prices, it begins to alter retailer's offerings. The failure of a company to accurately predict changing consumer preferences, spending patterns and other lifestyle changes has potential to result in a loss of sales, the spoilage of products and increased inventory markdowns. All of these factors may lead to a deterioration of revenues and operating costs.

Threat of Substitute Products

The threat of substitute products is high; however, retailers mitigate this threat by differentiation and establishing stores in central commercial locations. Contributing to this high threat is the low switching costs that consumers face between different retailers. Competitors are often forced to compete

on price due to numerous retailers offering homogenous products. New partnerships with restaurants such as McDonalds and Tim Hortons allow companies to enhance the overall shopping experience, in hopes of attracting loyal consumers.

Although there is a high risk of substitute products, there are fewer substitutes for the actual shopping experience at discount retailers. The infrastructure and capital expenditure required for stores to offer a huge range of products such as groceries, pharmacy services, as well as clothing, automotive and electronics is not achievable for most retailers.

Rivalry among Competitors

Retailers face stiff competition due to slow industry growth and a huge number of competitors. In the United States, discount retailers must compete not only with each other but also wholesale clubs, category specific retailers, drug stores, supermarkets and online retailers. Furthermore, most products are homogenous and retailers are forced to compete on price. There are high fixed costs such as leasing requirements as well as employee wages and health benefits. Due to small margins on individual products, firms must spread costs across a large volume of output. This enhances competition, as companies must maintain a large share of the market to maintain a huge volume of sales.

Inventory costs are high and there is risk of misjudging inventory needs. Many goods lose value quickly, especially perishable grocery products and fashion items. If companies misjudge consumer demand, they could face loss of profits due to deep discounts required to move products and spoilage of perishable goods.

There is very little differentiation between large discount retailers. This coupled with slow industry growth and a large number of substitute products increases rivalry in the market. This forces companies to innovate in order to differentiate themselves from competitors. Companies have used partnerships to diversify products offerings such as low-priced, high fashion apparel. Store locations and relationships with suppliers are also vital to maintain market share. Stores must be conveniently located with lots of parking, have easy to navigate store layouts, and offer low-priced, quality goods.

THE CURRENT SITUATION

Being in the discount retail industry, Target faces fierce competition from corporations such as Wal-Mart, Costco, and Safeway. With low prices being a distinctive motive within the industry, Target has positioned itself extremely well, in a way that will maintain profit levels. Target has been able to reduce costs, drive profitability and gain control of the quality and freshness of its products. According to Bloomberg, in August Target was able to surpass Wal-Mart as the cheapest retailer, which is a title Wal-Mart has been able to consistently maintain in the past. Target has taken advantage of technological enhancements by using mobile apps, the company website, and social media to offer more avenues for customers to view products and offer valuable input. The company has begun to take over its food distribution centers from third parties to maintain quality control and limit inventory inconsistencies.

Target has made a huge strategic move in its intention to open 125 to 135 stores in Canada by 2015. It has doubled its capital expenditure from 2010, with the majority contributing to the purchase of Zellers leaseholds in Canada. Its current market share in the U.S. is roughly 3.1%, which indicates potential for growth in the discount retail industry. Furthermore, the credit rating of Target's long-term debt is A2, A+, A-, by Moody, Standard & Poors, and Fitch, respectively. These ratings give the corporation access to credit and provide it with the resources to leverage further activities. Along with its $10 billion share repurchasing plan, it has increased dividends by over 17% from 2010 to $1.15 per share. This is a sign of a healthy and growing company.

In the past, Target has had trouble offering superior customer service compared to its competitors. This is a valuable intangible asset that Target must improve if it wants to stay competitive. All of its revenues are generated within the United States, a situation which poses a competitive threat when compared to geographically diversified corporations such as Costco and Wal-Mart. Even with Target's intentions to enter into the Canadian market, Wal-Mart is outpacing Target in worldwide expansion. The company has made efforts to keep up with its key competitor, Wal-Mart, by remodeling to a smaller store format to manage increasing real estate costs in urban areas and providing attractive lane displays to

increase customer shopping experiences. Target has maintained a profitable brand image in the U.S. and its ability to transfer that to the Canadian market will be a deciding factor in its success.

TARGET'S MAIN STRATEGIC CHALLENGES

Target's challenges are magnified by the intense rivalry in the retail sector from Wal-Mart, Costco and other low cost retailers. Target faces the need to grow internationally to both meet growth targets and exploit potential economies of scale. Critical to Target's success is its ability to meet the challenge of both maintaining the brand domestically and growing it internationally.

Target has been successful in differentiating itself from its competitors by offering more upscale, trend-forward merchandise at a low cost. Target's Bulls-Eye trademark is highly recognizable and the brand promise implicit in "Expect more. Pay Less" is well known in the US. However, the brand awareness must be continually renewed through both innovative advertising and providing a positive shopping experience. The fact that Target views its consumers as guests gives it a competitive advantage as it emphasizes Target's commitment to establishing a relationship with its "guests".

Key to Target's corporate strategy of differentiation is its focus on store and product designs that create a fun and upbeat shopping experience while offering products that are accessible and affordable. Like other major retailers, Target has established designer partnerships. However, it differentiates itself from its competition by making "accessible what once was unattainable" through high profile partnerships.

The Target brand is reinforced by using partnerships as a focus for clever advertising. The challenge for Target is to continue to be innovative and keep up with changing consumer tastes. It has done this successfully in the U.S. where it has developed loyalty among a significant segment of the population; 96% of the population recognizes the brand. The challenge for Target is to develop that loyalty when it expands internationally.

Target is on track to open 60 stores in Canada by April 2013 with branches in Alberta, BC, Ontario, Manitoba, and Saskatchewan. Within Canada, only 70% of the population recognizes the brand

and many of those will have not had a Target "experience". Therefore, the development of brand awareness is critical. As in the US market, this brand awareness will rely on innovative and creative advertising with emphasis on the unique experience guests will have in its Canadian stores.

Part of its success within Canada will depend on its ability to renovate the smaller Zellers stores appropriately. Target stores average 135,000 square feet, whereas the average Zellers is 95,000 square feet. Thus, Target will need to be more selective in its product offerings, while also recognizing the diversity of markets within Canada. As a new entrant in the Canadian market, Target faces the difficulty of capturing market share from Wal-Mart, an established and well-known competitor. The acquisition of up to 220 Zellers locations has quickly given Target significant distribution channels to consumers. However, Target will need to select the appropriate locations to open. Target needs to successfully implement its differentiation strategy within Canada through its value of "Expect More. Pay Less" in order to compete within the Canadian market. By increasing brand awareness and continuing its strategy of designer partnerships, Target can achieve success within the fierce retail market.

Canada poses a significant challenge for Target; a misstep would be a major setback for its vital international expansion strategy. Target has successfully differentiated itself through its apparel and merchandise segment but the stores also compete with other discount retailers on low margin food items. Competition is fierce as cost conscious customers seek value and retailers must avoid intense price wars. The challenge will be for Target to make Canadian customers loyal for both grocery and general merchandise needs; it must cultivate its image and relationship with its guests.

One of the under-appreciated aspects of Target's growth is its response to the challenge of keeping operational costs down. It has teamed with Microsoft to minimize physical infrastructure in each store through Microsoft visualization solution and using a Microsoft system data center. Technological change particularly with respect to online shopping provides both challenges and opportunities. Target needs to continue to improve its multichannel strategy of offering full and mobile versions of its website (Target.com) and applications for mobile phones and tablets. At the same time, Target also needs to use social media as a way to interact with consumers to increase brand loyalty. Multichannel retailing is

rapidly evolving and Target must keep pace with changing guest expectations and new developments within the market. If Target is unable to implement improvements to their guest-facing technology in a timely manner, their ability to compete could be affected drastically.

Most importantly, Target's strategy needs to ensure continuous improvements to its ability to remain relevant to customers as a brand they trust. Meeting, and wherever possible, exceeding, customers' expectations will require them to manage various strategic, operational, and reputational risks.