

Behavioral Economics

Tutorial 3

Creative Destruction and the
Institutions of Shopping

Task 1

In small groups reflect on the following mindful of Chapter 3 of *Principles of Behavioral Economics*:

- To understand how ‘creative destruction’ works in retailing, we need to understand why retailers exist: so, why do buyers not always deal directly with producers?
- How has the role that retailers play been affected by processes of creative destruction in production and by industrialization and economic development more generally?

The Retail Intermediary's Role

- Intermediaries can reduce communication and transport cost by operating as hubs and having their staff handle multiple suppliers' products rather than sales staff working as part-time employees for multiple suppliers at transaction cost-reducing locations where demand is insufficient to warrant suppliers having full-time sales staff of their own
- Bounded rationality of buyers: retailers devise systems to make information overload less of a problem
- Help buyers deal with lack of knowledge/ expertise
- Finite imagination of buyers: 'suggestive' role of retailers about consumption combinations of different manufacturers' products

Creative Destruction and the Shopper's Problem

- Buyers' knowledge keeps getting outdated as new products appear
- Growth in the range of products and in the features of products increase the shopping challenge
- Growth in per capita incomes increases the range of products that consumers can buy
- Population growth increases the range of products that can be viably offered in a particular geographical area
- So, with development, the shoppers problem keeps getting more challenging but 'factory outlets' become more viable with growth in size of market – but they are at odds with enabling consumers to compare rival brands side-by-side
- How can retailers help consumers cope while keeping the cost of retailing down – spreading staff thinly will only work if retail environment is set up to help customers mostly solve problems themselves, and keeping retail costs down by having few staff requires systems for limiting shoplifting

Task 2

- In small groups, attempt to assemble a list of the different forms of retailing that entrepreneurs have developed over many centuries
- For each retailing mode that your group identifies, attempt to identify why it posed problems for pre-existing retail modes and/or what problems with pre-existing modes the originators of the new modes were trying to solve

Retailing innovation (1)

- Bazaars and travelling tinkers
- Specialized shops that sell particular kinds of products (not necessarily branded or pre-packaged) over the counter
- Shops that sell branded products from open shelves, payment at checkout
- Wide ranges of products for open browsing: department stores
- Branding applied to stores (chains)

Retailing Innovation (2)

- Franchised dealerships (supplying finance, solving that problem as well as dealing with knowledge issues for new products such as sewing machines)
- Supermarkets (extreme product range and no advice about products)
- Discount retailers (e.g. electrical appliances) with minimal pre- and after-sales service) – aided by specialist consumer magazines
- Pedestrian shopping precincts with plenty of parking

Retail Innovation (3)

- Indoors, climate-controlled shopping malls
- Urban fringe 'big-box' retailers (e.g. giant hardware stores) that apply supermarket principles to other product areas
- 'Factory outlet' complexes
- Aldi-style supermarkets with very limited choice (so customers have to trust the store chain's ability to shop on their behalf)
- Online retailing

Institutionalist view of Retailing

History and culture shape retail economics:

- Life(styles) before supermarkets – their success depends heavily on cars and fridges/freezers
- Significant international cultural differences: retail chains that succeed in one country may bomb in another (as with UK supermarket giant Tesco in the USA and Australian big-box hardware chain in the UK)
- Japan's slow uptake of supermarkets: partly a consequence of limited storage space in homes favoring shopping many times a week (e.g. on the way home from the railway station)
- Planning role of local government and extent of determination to keep traditional 'high street' environments or more modern pre-indoor mall shopping precincts alive

(Photos that follow are of Stevenage, UK)

Traditional High-Street Retailing



Traditional high-street retailing (old style hardware store still operating in early 2000s despite emergence of non-high street 'big-box' hardware chain)



Traditional high-street retailing still operating in 2000s: Still some non-chain specialist stores; parking rather limited





1960s UK new town
built by public authority
development
corporations: their
shopping centers were
post-high street but
pre-indoor mall:
pedestrianized and lots
of parking with many
major chain stores, but
exposed to weather

1960s UK new town shopping centers: post-high street but pre-indoor mall





Some stores survive as ‘institutions’ – there has been a fish shop at the site since this shopping center was built in the late 1950s/early 1960s

1960s UK new town pedestrian shopping centers: post-high street but pre-indoor mall: in trouble by 2010s



Where in the 1960 and 1970s there was a full-service standalone retailer of hi-fi equipment, there is now a 'pay-day loans' kind of operation as the shopping center's fortunes decline. Electrical appliance retailing has largely gone to big stores on greenfield sites operated by national chains



1960s UK new town pedestrian shopping centers: post-high street but pre-indoor mall: by 2000s, trying to smarten up but no change in core concept



1960s UK new town shopping centers: post-high street now refreshed, but still not an indoor marble shopping palace!



The Rise of Supermarkets and Chains

- Self-service: a major innovation that saves labour → now to self-check-out
- Significance of IT and transport system for stock management
- Chains of stores (and franchised retail brands) facilitated by rise of national media and economies of scale in advertising and leverage of large buying group over suppliers

Discount retailing of appliances

- ‘Search goods’ and the Arrow Paradox
- The full-service retailer vs the discount retailer
- The rise of search-assisting magazines
- Now, with the internet, why don’t appliance manufacturers typically let customers buy directly from them, and eliminate intermediaries?

Post-discount warehouses: The edge-of-town, greenfield site for 'big box' retailers that offer some service



This is the Australian retailer Harvey-Norman's store on the outskirts of Cork, Ireland (having a tough time when the photo was taken in 2013 in the aftermath of Ireland's banking crisis



Task 3

Department Stores and Malls

- In what ways were department stores ‘revolutionary’?
- In other words (in terms of the material in Chapter 11 of *Principles of Behavioral Economics*), what were the ‘macro’ (in the micro-meso-macro sense) implications of the department store ‘meso’? (See the conclusion to Chapter 2)
- Department stores can be viewed as mini-malls (and sometimes contain stores run by other firms, just like malls), so do department stores have a future in the age of the shopping mall?
- Are shopping malls designed to facilitate one-stop shopping by purposive consumers, or to extract money from consumers led to engage in impulse buying?

Task 4

Internet Shopping

- What is the future for bricks-and-mortar stores in the age of the Internet?
- What do malls offer that online shopping doesn't offer?
- Why don't producers simply sell direct to customers online, rather than via online retailers?