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Selling Gadgets in a Wal-Mart World

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Author(s): Saul Hansell

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Abstract (Article Summary)

Last year, Wal-Mart nosed out Circuit City as the nation's second-biggest electronics retailer. Now Circuit City intends to take the discounters head-on, but without giving up sales of higher-margin goods.

Wal-Mart, too, is trying to move away from the lowest-priced electronics goods. It is doubling the size of the electronics departments in its newer stores and stocking more advanced items earlier in their life cycles. Most Wal-Mart stores now carry DVD recorders, home theater systems and dozens of digital cameras.

Camcorders at a Circuit City store in Norwalk, Conn. The company is revamping amid brutal competition and slim profit margins. Last year Wal-Mart nosed out Circuit City as the second-largest seller of consumer electronics. Best Buy is the largest. (Photo by Librado Romero/The New York Times)(pg. C1); Circuit City is emphasizing self-service and new private-label brands as it aims to eke out a profit on low-margin products. (Photo by Librado Romero/The New York Times)(pg. C4)

Full Text (1944 words)

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It is probably just a coincidence, but when Circuit City decided to modernize its store here, it moved a quarter-mile away and built a store just across the street from a Wal-Mart.

What is far from a coincidence, however, is how much the inside of the new store resembles a Wal-Mart.

In this model store, as Circuit City calls it, customers grab merchandise from metal shelves and toss it into shopping carts. The staff on the floor are now hourly workers rather than higher-paid commissioned sales clerks. The front of the store is filled with forklift pallets piled with \$45 DVD players and \$99 televisions, much as they are

in that big store across the street.

Last year, Wal-Mart nosed out Circuit City as the nation's second-biggest electronics retailer. Now Circuit City intends to take the discounters head-on, but without giving up sales of higher-margin goods.

Like nearly every other electronics retailer, Circuit City is trying to reinvent itself in an era that has more innovative products and at the same time more brutal competition than ever before.

The rapid succession of digital entertainment devices -- the DVD, the digital camera, the MP3 player -- should have created a golden age for the stores selling them. But these wonders share a common problem with a previous digital product that had been a hit with consumers: personal computers.

Early in each product's life, prices have fallen and models and features have changed quickly, leaving retailers with expensive, out-of-date inventory. Once that happens, the products become a commodity, and profit margins -- always tight in the electronics business -- became virtually nonexistent.

"We are in the most incredible product cycle of the last 25 years," said Jeffrey Stone, chief executive of Tweeter, a chain of high-end electronics shops. "We are selling a lot of new stuff but we are not making any profit margin on it."

A market filled with high-volume, low-margin products would seem to play to the strength of discounters, especially Wal-Mart, over traditional electronics stores, which have trained sales help to encourage customers to buy fancier models, warranties and other high-margin add-ons. (Who buys a warranty on a \$39 DVD player?)

But the challenges are very different selling the next hot electronics products: high-definition and flat televisions, which can cost as much as \$10,000. The fate of the industry rests largely on whether its hourly workers can sell the sets, explaining the bewildering array of formats and technologies. At the same time the companies must keep margins from collapsing, as they have with DVD players.

But the signs are ominous for the retailers. Gateway is making a big push in plasma televisions, and Dell has started to sell them as well. Apex, a brand that helped lead to the collapse of DVD prices, is getting into flat-screen televisions.

And most ominously, Wal-Mart, which already sells high-definition projection televisions, has started testing flat-screen LCD sets and even plasma displays costing almost \$5,000, the most expensive item of any sort in the store.

In the face of the threat from Wal-Mart, Circuit City and Best Buy are, in essence, swapping strategies. Best Buy, which became the No. 1 electronics retailer by deciding 10 years ago to convert to a self-service discount model, is now emphasizing more expensive goods and new services like wiring homes for computer networks.

Best Buy is pursuing this strategy even though smaller chains like Tweeter and Good Guys, which have also focused on the affluent early adopter with a penchant for very large televisions, have had a difficult time. Best Buy will still carry the \$39 DVD players, but they will be at the back of the store, not in the front as they are in Circuit City.

Circuit City, meanwhile, is looking more like the old Best Buy, stressing self-service and inexpensive goods, and hoping to eke out a profit at the low end with new private-label electronics brands. Earlier this year, the company dismissed 3,900 of its sales clerks when it eliminated sales-commissioned workers and started paying a flat hourly wage.

For now, Best Buy is the only major electronics chain that is thriving financially. Two weeks ago, it said it would exceed its previous profit estimates for the third quarter as a result of increased store sales and lower costs.

By contrast, Circuit City reported that its sales at stores open at least a year were down 9 percent in both June and July compared with the previous year. (It also said it would take a loss trying to exit an ill-fated attempt to sell credit cards, unrelated to its store brand, to people with spotty credit.)

Wal-Mart, too, is trying to move away from the lowest-priced electronics goods. It is doubling the size of the electronics departments in its newer stores and stocking more advanced items earlier in their life cycles. Most Wal-Mart stores now carry DVD recorders, home theater systems and dozens of digital cameras.

Wal-Mart's prices for electronics are generally at the same level as, not below, those of other retail chains. But its economics in the business are vastly more favorable. It draws customers with inexpensive groceries, and it makes incremental profits when someone throws a DVD player or a digital camera into the cart as well.

And it is selling advanced technology with hourly sales clerks who receive no training in the products. (The hourly workers at Best Buy and Circuit City, by contrast, are given Web sites to study with product features and selling tips.)

"Our customer is getting smarter about technology and wants to buy it sooner," said Gary Severson, Wal-Mart's senior vice president who oversees electronics.

Moreover, some digital products, particularly at the low end, are standardized around certain specifications without the subtle variations in features and quality of, say, stereo speakers. As a result, Chinese manufacturing plants now produce millions of computers or DVD players, much as they stamp out Barbie dolls and running shoes.

"The combination of the Chinese manufacturers and the rise of the mass market retailers has been a one-two punch that has hit our industry," said Dave Workman, the president of Ultimate Electronics, a regional chain based in Denver.

The expansion of Wal-Mart is no small threat to Best Buy, which pioneered the self-service discount approach to selling electronics out of a big box store. The company is responding by gingerly de-emphasizing the cheapest commodity products.

"It says Best Buy on the door and we have to offer the lowest price in the market," Brad Anderson, the company's chief executive, said. "Yet we are willing to sacrifice share in fully commoditized products."

Mr. Anderson has also sold Best Buy's struggling Musicland chain and now wants to focus on finding ways to get more sales out of the Best Buy brand. That means a new loyalty program, selling products like broadband connections, and making the stores more appealing to women. (For example, it put video games in the appliance department so children will stay occupied while their mother shops for a new dishwasher.)

Mr. Anderson argues that while new digital products may be inexpensive commodities, the company may be able to make money helping customers getting products to work correctly and connect to each other.

One way to do this is to build a network right into new homes: Best Buy is working with several large home builders as a subcontractor, installing video and computer network cabling. Its plan is to have the builder include a basic wiring package in every home in a development and then to try to sell additional features, like in-wall speakers, video security cameras and even a big screen television, all bundled into the home buyer's mortgage.

Best Buy has also moved its repair technicians out of regional centers to walkup counters in all stores. They handle everything from installing hard drives to helping customers get the spam out of their e-mail. And the company recently bought a small company called The Geek Squad, which sends technicians to people's homes.

There is no question that millions of people are perplexed by technology, but it remains to be seen how many will pay \$30 to \$100 to visit a technician in a store or to \$150 to have a member of The Geek Squad dispatched to their living room.

"It may cost \$100 to get a product that costs \$100 set up," Mr. Anderson said, "but at the end of the day that is what the user has to pay to get something that works."

Circuit City, for now, does not have the luxury of thinking too far into the future. In the 1990's, the company became distracted by its failed effort to create DivX, a variation of the DVD format that could be played for a few days. Then it started the CarMax auto superstore chain, which it spun off to shareholders last year. In the meantime, Circuit

City stores languished while Best Buy was building bigger and brighter stores in better locations.

The company's sales and profits from electronics peaked in 1999 and have been heading downward since. It was clear that the stores were a problem, but the solution has been hard to find. It tested some remodeling concepts, but the \$3 million cost was prohibitive. After more experiments, it found that moving stores to newly constructed buildings cost only \$1.7 million and produced greater sales increases. But finding the right real estate for such relocations is time-consuming.

So this year it will relocate as many as 20 stores, build 10 ones in new locations, and add new fixtures and lighting in many others. The total cost for this year is \$150 million.

The chief executive of Circuit City, W. Alan McCollough, said that these renovations would help reverse the company's lagging sales. "Other folks have a much newer store base than we have," he said, "but that is only a temporary advantage."

The other main element of Circuit City's plan to fight Wal-Mart is to take more direct control over low-priced merchandise. It is increasingly trying to buy products directly from factories in China rather than through companies like Apex. Last year it hired Kim Maguire, a senior executive at Target Stores, to be its chief merchant.

And just as Target battles Wal-Mart with can openers designed by Michael Graves, Circuit City is also developing several private label brands of electronics. Two new MP3 players are now selling under the Verge brand.

Some wonder whether Circuit City is emphasizing the mass market just when the rise of new televisions, home networks and the like would be well suited to its previous higher-end strategy and commissioned sales force.

"Of the 20 million DVD players sold this year in the United States, over half will be sold at \$50 or less," Mr. Maguire said. "We can't ignore half the market. That is what gets the feet in the door."

[Photograph]

ON THE FLOOR -- Camcorders at a Circuit City store in Norwalk, Conn. The company is revamping amid brutal competition and slim profit margins. Last year Wal-Mart nosed out Circuit City as the second-largest seller of consumer electronics. Best Buy is the largest. (Photo by Librado Romero/The New York Times)(pg. C1); Circuit City is emphasizing self-service and new private-label brands as it aims to eke out a profit on low-margin products. (Photo by Librado Romero/The New York Times)(pg. C4)

[Chart]

"A Buyer's Market"

As prices on electronics quickly fall to levels that many consumers can afford, retailers must rely on sales volume, not profit margin, to survive.

Graph tracks prices for a standard DVD player* from 1997-2003.

Graph tracks prices for 41-to 43-inch plasma display* from 1998-2003.

*Average prices

(Source by NPD Group)

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