Inner Cities Are the Next Retailing Frontier

Their earnings growth declining, many U.S. retailers have concluded that the market is saturated and turned their attentions overseas. And little wonder: With some 19 square feet of retail space per capita, about three times as much as in Europe, the market appears awash with excess capacity. But many U.S. retailers are missing a growth frontier right in their own backyards–America's inner cities.

We have conducted a major research effort aimed at examining the retail opportunities in U.S. inner cities–defined as economically distressed communities, in terms of household income, poverty, and unemployment, within a metropolitan area. When we started, we knew the opportunity was large. But we were still surprised by its magnitude.

We estimate that households in America's inner cities possess more than $85 billion in annual retail spending power (excluding unrecorded income from legal activities, which could add another $15 billion). That amounts to nearly 7% of total U.S. retail spending, far more than Mexico's entire formal retail market.

Inner-city markets are attractive because they are large and densely populated. Despite lower household incomes, inner-city areas concentrate more buying power into a square mile than many affluent suburbs do. But they are badly underserved, often lacking the types of stores that inundate suburban areas–supermarkets, department stores, apparel retailers pharmacies and so forth. We estimate that today approximately 30%, or more than $25 billion, of inner-city retail demand is unmet within the inner city. In some communities, such as Harlem, as much as 60% of demand is unmet.

Thus many inner-city residents must travel outside their neighborhoods for the kind of world-class shopping suburbanites take for granted. Inner-city stores, facing little competition, frequently offer less selection, higher prices, lower quality, inferior customer service, and unappealing ambiance. Our research suggests that inner-city consumers often pay up to 40% more than other urban and suburban shoppers pay for basic grocery items. The indignities inner-city consumers endure spending their hard-earned income contribute to the alienation from mainstream America that many feel. One participant in a Harlem focus group was moved to ask: "Is my money a different color, too?"

Our research suggests that retailers' failure to respond to this market opportunity is a matter less of prejudice than of the absence of a strategy. We uncovered a number of challenges in inner cities that can deter market entry. Retailers are concerned about theft and other crime. They also often struggle with regulatory complications, community resistance, and a neglected business infrastructure. Many inner-city neighborhoods are ethnically diverse, each group with its own preferences.

These challenges have led many retailers to conclude that they can't make a profit in the inner city. Yet others have surmounted the challenges. They earn solid profits by simply bringing good retail practices to inner-city neighborhoods.

The moneymaking potential of inner-city retailing may be one of the industry's best-kept secrets. Sears's Boyle Heights store in East Los Angeles is one of the most profitable Sears stores in the region. Ikea's store in

Elizabeth, N.J., near Newark, is the furniture chain's No. 1 store in North America. Costco's warehouse club in Brooklyn, N.Y., has been an "above average" performer within the chain since its opening a year ago. Many inner-city supermarkets generate sales per square foot up to 40% higher than the regional average. Pathmark stores in Brooklyn's Bedford-Stuyvesant and Newark's Central Ward and the Stop & Shop store in Boston's South Bay Center are all success stories.

Specialty retailers are also thriving. Moo & Oink, a favorite butcher on Chicago's South and West sides, has built a $40 million business offering products like chitterlings (pig intestines) and ham hocks (pig knees) to local residents with Southern tastes. The Lark, a specialty apparel retailer based in Gary, Ind., operates two profitable inner-city locations that maintain theft rates below the national industry average.

The growth of inner-city retailing is profitable not only for retailers. We estimate that urban developers could generate $500 million in additional rental income from successful inner-city retail corridors. Cities could gain additional tax revenue and increase employment and entrepreneurial opportunities for local residents. Filling the unmet inner-city retail demand could create up to 250,000 retail jobs and 50,000 nonretail jobs.

Some retailers have seen this potential and are stepping up plans to open inner-city stores. The Walgreens drug chain indicates that up to 20% of new store openings, or up to 100 stores over the next two years, are planned in inner cities. Kmart has created a separate division to focus on urban and inner-city opportunities.

At the same time, many of the historic impediments to doing business in inner cities are falling. Crime rates are dropping and cities like Indianapolis and Boston are working to reduce regulatory obstacles, improve infrastructure, and spur retail development. The neighborhood business climate is improving as community leaders turn to market-based economic development.

For retailers, the message should be clear: America's inner cities are the next retailing frontier, and they are growing right in our own backyard.

Begin today to target one of the world's largest emerging markets–not China, Indonesia, or Russia, but the inner city of the United States. Create the capability to site select, merchandise, promote, recruit, and profit.

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