Winning in a Value-Driven World

2005

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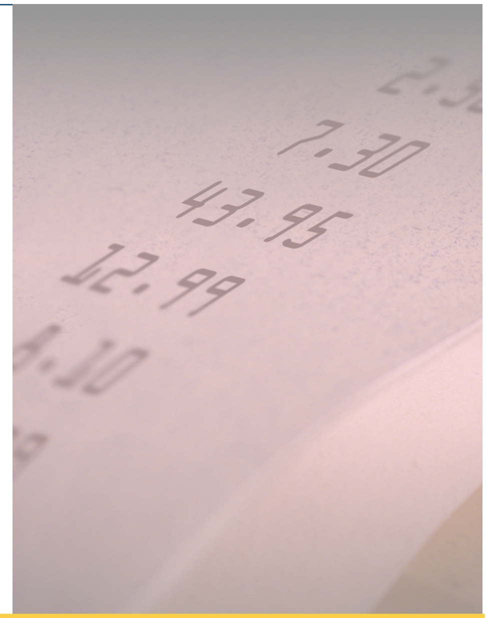


Winning in a Value-Driven World

In our 2003 article "Competing in a Value-Driven World," we described a significant shift in spend to value retailers. As predicted, the grocery industry has continued its rapid shift to value and, to date, responses from traditional retailers have not succeeded in stemming the shift. It is clear that conventional, piecemeal strategies are not enough. Retailers who want to survive – and win – must embrace an integrated, four-part program that creates and delivers Total Value Advantage.

THE SHIFT TO VALUE IS CONTINUING

Over the last decade, value retailers grew faster than any major retail format, nearly doubling their share of US retail sales. Growth has been particularly explosive in the grocery industry, where value retailers have increased their share from 21 percent to 25 percent in the past three years. Our proprietary consumer research shows that value retailer penetration increased across most consumer segments, including non-price segments who have historically favored traditional grocers (Exhibit 1).

Categories continue to "march to value" at a rapid rate – and once "gone to value" they rarely return. Traditional grocers are losing the battle for center store, as consumers increasingly shop value retailers for many of these categories (Exhibit 2).

These major shifts are taking place because consumer reference points for price and quality have forever shifted. Value retailers are competing in this environment from a position of strength, having created a virtuous cycle in which their lower prices attract more customers buying bigger baskets. Their higher productivity means that they can continue to improve their customer proposition by funding lower prices, investing in stores, and improving service. As a result, they achieve much higher ROICs than traditional grocers (Exhibit 3).

However, value retailers' perceived price proposition is only part of the story. Customers have fewer reasons for staying with traditional grocers. Although location is still the biggest reason for not shopping at value retailers, its importance has dropped significantly (Exhibit 4). Looking ahead, location will be even less of a factor. Based on Wal-Mart's current growth trajectory, we expect that by 2015 they alone will have captured more than 20 percent share of the grocery market in nearly every U.S. state.

As if this were not enough, research suggests that price differences – the main reason consumers shop value players – are not fully understood by consumers. Roughly 20 percent of consumers would switch to value players if they fully understood the price gap. Value retailers are also scoring on other non-price dimensions, like quality of merchandise and availability of brands. As a result, it is not inconceivable that by 2015 value retailers will own more than 35 percent of the grocery market.

Exhibit 1

PENETRATION HAS INCREASED ACROSS MOST SEGMENTS

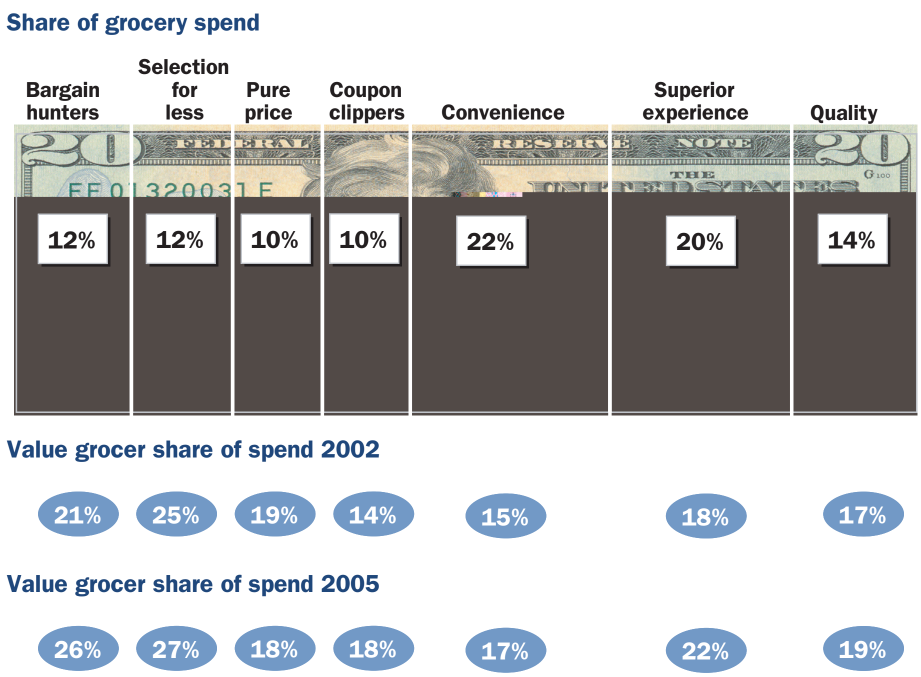


Exhibit 2

THE CATEGORY SHIFT TO VALUE CONTINUES

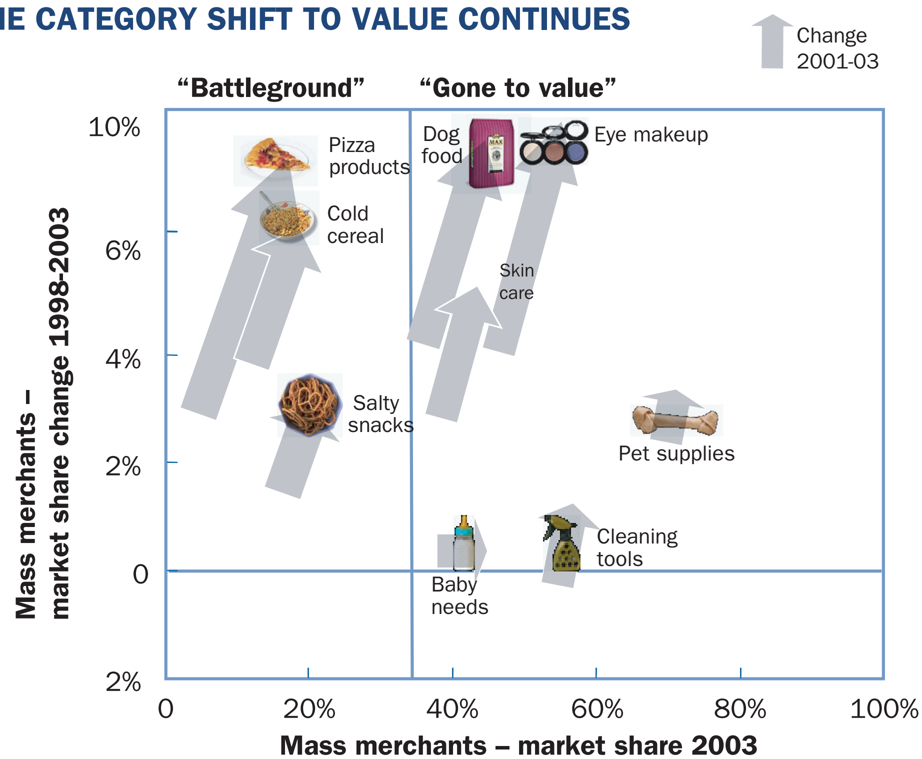


Exhibit 3

VALUE PLAYERS ADVANCING FROM A POSITION OF STRENGTH

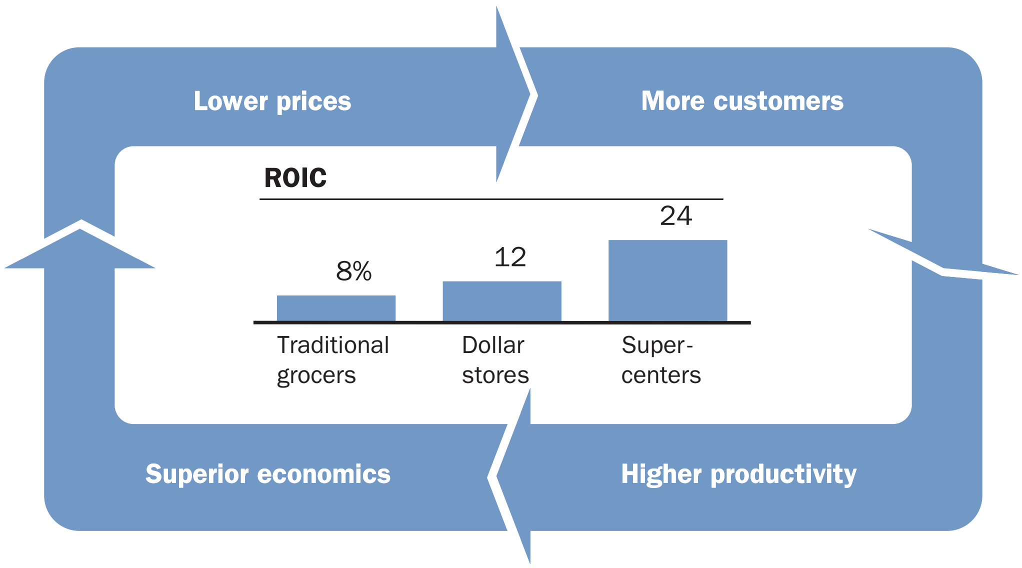
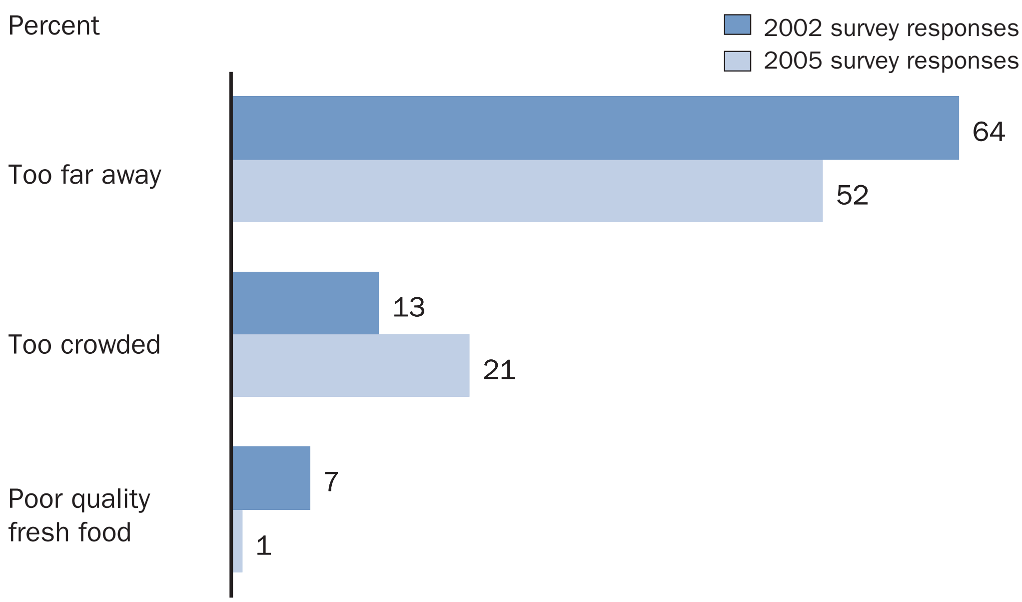


Exhibit 4

REASONS FOR NOT SHOPPING VALUE PLAYERS – LOCATION DECLINING IN IMPORTANCE

Percent



WINNING WITH TOTAL VALUE ADVANTAGE

Traditional grocers are experimenting with many strategies to win in today's value-driven world, but most are not succeeding. For example, concerted cost reduction efforts have not materially improved profitability, as savings reinvested in lower prices and more intense promotions have not resulted in improved consumer value perceptions. In most cases, fresh is no longer a source of differentiation. Finally, investments in format renewals are falling short of consumer expectations and offer poor returns.

To win in the new world, traditional grocers will need to adopt a comprehensive program, not a fragmented set of initiatives. Four integrated elements are necessary, starting with a strategy to differentiate the brand, a proposition that gets credit for value delivered, operations that work customer back, and an organization reshaped to deliver.

1. Differentiate the brand

Traditional retailers must distinguish themselves on one or two of the five elements that make up the value proposition – merchandise authority, service, convenience, in-store experience, and price – while remaining competitive on the others. Clearly, it is impossible to be famous for everything, yet many of today's taglines ring hollow with abstract promises to be all things to all people. As a result, it is difficult for consumers to distinguish one grocer from another.

Traditional grocers have an opportunity to reclaim lost **merchandise authority.** For example, Whole Foods has positioned itself as the leader in natural and organic foods, winning over customers with its organic produce, healthy prepared foods, and "lifestyle" products, including vitamins, yoga books, and cooking classes. Grocers can also tailor their assortment by location as Walgreen's has done by offering beachwear in Miami Beach and flexing their assortment to reflect local ethnic differences. Finally, innovation is essential to draw customers to the center store by making categories easier to shop, offering unique products, and introducing dollar aisles.

Service needs to focus in the areas that most influence the perceptions of target consumers, whether in up-selling at the deli counters or in speeding customers through checkout. Success also requires cracking the challenge of consistent frontline execution.

In addition, grocers need to use format development to deliver greater **convenience** and **improve the in-store experience.** Retailers are increasingly adopting a portfolio approach based on customer segmentations.

Lastly, retailers need to **reenergize their brands** to reflect their revised value positioning and communicate intangible benefits – such as Target's design-led differentiation from Wal-Mart. More recently, Waitrose, the U.K. grocer, has achieved success by modernizing its brand and marketing, with refitted stores and a fresh advertising campaign.

2. Get credit for value delivered

Our consumer research brings to bear techniques used in psychology, coupled with our experience serving retailers and manufacturers. In looking at the issue of value for money, it has become clear that the central question which the industry appears focused on – "Should I be EDLP or high-low to get credit for value?" – sets out a false choice and is, in fact, the wrong question. The answer to getting credit for value is at the intersection of reference price, promotions, range architecture, private label, and the loyalty card.

Getting **reference prices right** is critical, as this is the single biggest driver of perceived value. Grocers should concentrate their investments in the categories and items that drive consumer perceptions disproportionately. Similarly, promotions are not about having the most items on promotion or offering the biggest discounts, but about being **smart** about what is being promoted and how the promotions are executed.

In **defining assortments,** grocers need to hit the price points that matter. Low opening price points communicate value, a broad (but not deep) mid-tier assortment establishes authority, good tiering encourages trading up, and a few higher price points deliver margin. A more judicious and aggressive use of private label is a key part of the solution. For instance, Loblaws has achieved 35 percent private label penetration across categories. Crisp pricing, coupled with a more distinctive assortment and strong execution, is crucial to **reinventing fresh,** the key category driving value perceptions.

Grocers should leverage their **proprietary consumer insight**, whether from loyalty programs or local store manager knowledge. Tesco's ClubCard segmentation and insights are applied across the business, from product development to targeted mailings such as eCoupons for Internet shoppers and baby club discounts sent before birthdays.

All **communications should reinforce** the price position of the store while maximizing the return on investment (ROI) on marketing communications. One example: ASDA has "Permanently Low Prices Forever" carved on a stone outside stores, with reinforcing and consistent messaging on signage, circulars, and advertising to convey its price position.

3. Work customer back

Companies who truly embrace their customers' needs and use these to radically redesign their operations are often able to release significant funds for investment – while achieving breakthrough improvements in the customer experience. Instead of choosing between service, asset levels and cost reduction, managers eliminate waste caused by shrinkage, high inventory, and unproductive labor to drive both top- and bottom-line impact.

The key is to identify the root causes of waste (e.g., lack of process standardization, inadequate frontline performance management). In our work, we have developed an approach centered on the application of lean manufacturing principles from other industries. The results have helped transform performance, creating gains in both efficiency and effectiveness. For example, our clients have seen significantly reduced operating costs and asset levels with cuts of 20 to 75 percent in out-of-stocks, inventory reductions of 10 to 30 percent, and the release of 20 to 30 percent in store labor costs.

Innovating the supply chain means partnering with manufacturers and fully leveraging technology to define radical solutions that result in large improvements. True collaboration can enable grocery suppliers and retailers to innovate products, simplify assortment, eliminate packaging, reduce inventory, ease merchandising, and reduce labor requirements to the benefit of both.

Store labor savings can be reinvested into delivering maximum availability, shorter lines, and better customer service, all of which can improve overall customer satisfaction. In our experience, refocusing resources can result in increases of as much as 5 to 10 percent in store sales. Even simple solutions like perimeter order-takers that allow customers to keep shopping can be very effective.

4. Reshape the organization to deliver

To win in the new environment, grocery organizations need fundamental transformation. This means adopting a relentless focus on delivering value to customers based on true customer insight. Grocers must become assortment architects rather than mere item pickers. Grocers should aspire to truly innovate private label rather than simply buy reactively. Pricing and promotions in the new environment must be surgical and targeted rather than reactive and broad-based. Finally, grocery organizations should move away from isolated initiatives that result in one-time improvements toward cross-functional, cross-category ownership and continuous improvement.

Investment must focus on the capabilities that are central to the retailer's value proposition. For instance, Loblaws has invested significant resources in its private label organization, which operates almost like a packaged goods company.

Leadership must motivate their organization to change – a task that entails evolving mind-sets and engaging the hearts of their employees. This requires inspiring communications to build commitment through the organization and formal mechanisms such as roles and incentives to reinforce this commitment. Grocers will need to rethink their approach to people development and skill building. Finally, senior leaders must role model the desired behaviors critical to the new organization. To sustain the higher level of performance, the company must hard-wire the new capabilities, value, and performance goals into the organization.

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Grocery retail has forever changed, with redefined consumer expectations of value and higher demands on operations. As the shift to value continues, not all traditional grocers will survive. A comprehensive program is necessary for grocers to regain the value advantage they have lost. Senior leaders have a critical role to play in driving this broad change, making it crucial that they stay focused on the key imperatives which the program must deliver. With this in mind, we have developed a simple checklist of what it will take to win (Exhibit 5).

The stakes are high, and the challenge has never been greater. By responding decisively with an integrated transformation program, however, traditional grocers can secure their future in this new value-driven world.

Exhibit 5

TOTAL VALUE ADVANTAGE – CHECKLIST FOR SUCCESS

1. **Famous for what matters**
2. **Innovative fresh proposition**
3. **Differentiated products**
4. **Reinvigorated center store**
5. **Tailored assortment and offers**
6. **Relevant and exciting brand**
7. **Focus on getting credit for value**
8. **Customer-back, IT-enabled lean operations**
9. **Transparent, breakthrough vendor partnerships**
10. **Deep commitment and reinforcing behaviors**

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