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Industry Report | Retail Grocery

Food for thought

By Andrew Clarke, Richard Wildman and Julian Allen

By anticipating changes in consumer demand and quickly innovating to meet emerging needs, the high performers in this industry have been able to shape and dominate the market.

Profitable growth is a strategic imperative for all industries. But for mass-market food retailers in the mature and oversupplied markets of the United States, Western Europe and Australia, it's getting especially hard to achieve.

That's not to say that all market segments are static. In developed markets, for example, health-conscious and environmentally sensitive shoppers have powered a boom in organic and "natural" products. And many emerging economies still offer plenty of room for growth.

But food retailers everywhere are caught in a brutal cost crunch between inflation in fuel prices, wages and rents on the one hand and consumers' natural resistance to price increases on the other. The name of the game is to maintain tight control over relentlessly rising costs while driving higher revenues.

But how can companies pull this off in an era of both skyrocketing commodity prices and increasingly demanding consumers?

Customer schizophrenia

Mounting concerns about the environmental impact of food choices are driving demand for changes in product labeling and sourcing. The quest for shopping convenience requires different store layouts and even locations. And because customers tend to shop somewhat schizophrenically—using different stores for different shopping needs or the same store for different purposes—mass-market grocers have to cater to multiple demands in a single retail format.

Successful food retailing in these circumstances requires exceptional customer insight. According to Accenture's research into what constitutes high performance in the grocery business (see sidebar, below), it also demands a degree—and consistency—of strategic thinking that only a handful of grocers worldwide have managed to muster.

Food is an essentially local business where players with strong local structures can respond quickly to new trends. The high performers understand the dynamics of their home markets much better than their competitors do—and that superior understanding has given them the first-mover advantage to achieve strategic market domination, which, in this industry, is the essence of market focus and position, one of the three building blocks of high-performance business.

Texas-based Whole Foods Market, for instance, has successfully positioned itself as the food retailer of choice for health- and quality-conscious American consumers. And Australia-based Woolworths Supermarkets has been able to leapfrog its rivals by setting the standard for fresh food at low prices—indeed, the company is popularly known as "The Fresh Food People." Thanks to its success in its core food business, Woolworths had the financial clout to expand into nonfood areas as well. In addition to dominating the Australian retail food industry, Woolworths occupies a leading position in the Australian gas station and liquor store markets.

Leading companies are much better than their peers at reading market signs. When ALDI and other German discount stores entered the UK market to take advantage of the higher margins available in Britain during the economic recession of 1990–91, UK-based Tesco responded with its own "Value" line of economically priced products. The company again led the market when it subsequently introduced its "Finest" line for shoppers prepared to pay more for high quality. This inclusive approach to customers draws 60 percent of all UK households to Tesco for some or all of their shopping.

About the research

The peer group for Accenture's study of high performance in retail grocery comprised 23 publicly traded companies, all with revenues greater than $2 billion, a significant proportion of which were generated by food sales.

Accenture measures high performance across six dimensions—profitability, growth, longevity, consistency of stock market performance, total returns to shareholders and positioning for the future—and usually over three, five, seven and 10 years. Because of the exceptionally short industry cycles in the highly competitive and fast-moving retail grocery industry, however, we focused on three and five years only.

The high performers in this industry distinguished themselves primarily through outstanding revenue growth—on average, nearly double the growth rates of competitors over five years. And it is, of course, strong revenue growth that generates the free cash flow to reassure the marketplace that the company can adjust quickly to changes in consumer demand.

The high performers also delivered substantially better TRS than their peers over five years—more than 50 percent better than those companies whose performance was only average.

Whole Foods: Cultivating the grass roots

Founded in Austin, Texas, in 1980, Whole Foods Market has become America's leading organic food retailer and one of the most successful grocers in the world. The company's strong ethical stance—its motto is "Whole Foods, Whole People, Whole Planet"—has captured the imagination of the swelling ranks of health-conscious and environmentally aware shoppers across the United States, from California to New York, as well as in Canada and the United Kingdom.

Remarkably, each Whole Foods store—there were more than 270 of them at last count—remains a "local" business, not only customizing its own product mix to reflect local sourcing but also participating in local communities through various activities, such as supporting food banks and sponsoring neighborhood events. Whenever the company acquires a new store, it retains the local management to help keep existing relationships intact. Each store, moreover, uses customer feedback to make it even more responsive at the local level—a key differentiator in an industry where acute market-sensing skills are so exceptionally significant (see story).

An in-store feedback board, soliciting customer questions and concerns and posting the company's answers, is one way Whole Foods gathers invaluable insights. In return, customers receive information on food safety and sustainability, as well as recipes, cooking tips and serving suggestions—directly and personally, from teams of employees who are recruited for their passion for food.

Sensing the market

Acute market-sensing skills underpin such deep customer understanding, though leading companies develop this distinctive capability (a second building block of high-performance business) in different ways.

Tesco takes a centralized approach, supplementing the spending and shopper behavior information derived from its famously well-managed Clubcard—the company's membership rewards card—with external research data, customer advice centers and lots of survey work at both store and product levels. By contrast, Whole Foods gathers data at the decentralized, local level, eliciting direct and personal customer feedback to nourish its understanding of the market (see sidebar, above).

Thanks to their exceptional customer insight, the high performers in this industry respond to threats and challenges not only rapidly but also appropriately, with a steady stream of small-scale product and offer innovations that directly address constantly changing customer needs. Tesco, for example, knows that getting its staff to make continuous small improvements sustains its drive to win the "lifetime loyalty" of customers. So it designs jobs that are easy to do and clearly communicates its goals to staff. "Simpler for staff" is one of three principles that guide the grocer's operating model—"Better for customers" and "Cheaper for Tesco" are the other two.

Incremental innovation

Continuous innovation in the core offering—the second distinctive capability that identifies high performers in retail grocery—must not, of course, occur at the expense of product quality, range and availability at the right price. Leading grocers push through the sorts of incremental changes and improvements at the store level that customers can immediately appreciate and respond to.

Woolworths' promotion and private-label strategies, for example, encompass all the categories where consumer brand response is strongest, from the basic household items in its "Homebrand" line, to the specialty food products sold under its "Organics" and "Naytura" labels.

Growth agendas

The payoff: high customer loyalty (the Holy Grail for any retailer),

Woolworths: Changing for the better

For a company that will soon be celebrating its centenary, Australia-based Woolworths shows few signs of slowing down. Woolies, as it's affectionately known to both customers and staff, launched Project Refresh, a multi-year change program, back in 1999.

The project began as a line item cost-reduction program—but by 2003, it had developed into a drive for improvements in supply chain efficiency and has become, over time, a catalyst for refocusing the ways in which Woolworths does business. Supply chain improvements to date include common, integrated supply chain systems; a smaller, more efficient cluster of regional distribution centers; significant improvements in transport management; and process improvements, such as phased replenishment, shelf-ready load devices and other restocking capabilities.

Project Refresh's impact on operational effectiveness and efficiency has been key to the success of Woolworths' multi-pronged growth strategy (see story). The systems and processes that revolutionized the company's Australian supply chain operations are now being rolled out to Woolworths' other lines of business, including its New Zealand supermarkets.

continuous same-store sales increases and high sales productivity. These strengths, moreover, help sustain the consistent agenda of growth initiatives that is the third distinctive capability in this industry—and probably the supreme hallmark of its high performers.

There are three main routes to non-core growth for retail grocers: adding products and services, adding formats and channels, and entering new geographies. No single route guarantees success; it all depends on individual starting points, opportunities and ambitions.

Leading companies employ dedicated teams that focus on developing market-leading growth initiatives across all aspects of the business. These companies also ensure that the right initiatives are implemented by systematically weeding out less promising projects and prioritizing the best of them. Each, however, has approached growth from a slightly different angle.

Whole Foods expanded to the United Kingdom in 2004 but still has plenty of room for growth in its core US food business. The company has mushroomed in the United States both organically and (until very recently) via small-scale, relatively easy to integrate acquisitions like the three stores that comprise Harry's Farmers Market in Atlanta, which Whole Foods bought in 2001. (Last year's acquisition of Wild Oats Markets, a substantial business, marked a departure from this strategy.)

Tesco, meanwhile, has expanded steadily into nonfood areas like clothing and household products as well as embarking on a major international expansion. The company's Fresh & Easy stores launched in the United States late last year.

Woolworths, for its part, has a multi-pronged growth strategy. The company has been growing organically, expanding its existing chains, which include BIG W department stores and Dan Murphy's liquor stores, as well as supermarkets. It has also boosted its presence in New Zealand. But Woolworths has made bolt-on, nonfood acquisitions as well, like the Taverner Hotel Group, acquired in 2005, and established a consumer electronics joint retail venture with India's Tata Group.

Agile operating model

Without a simple, highly effective and agile operating model—the fourth distinctive capability in this industry—

such ambitions could not be realized. Nor would the high performers be able to execute as successfully as they do. Woolworths' Project Refresh typifies leading companies' prowess in making continuous incremental changes in their operating processes and periodically updating their operating models to achieve operational excellence (see sidebar, page 4).

All the high performers design their business processes to ensure that they achieve low costs and high asset utilization. They also use clearly defined and easily understood operating methods across the entire organization. And they measure and benchmark the results using balanced scorecards that cascade down to all levels of the business so everyone understands the targets to which they will be held accountable; Tesco's scorecard, for example, is known as the "steering wheel."

Simple processes and systems facilitate a shared understanding of what is to be achieved—the key to the strong, highly cohesive and customer-focused organization that characterizes leading retail grocers' performance anatomy, the third building block of high-performance business. These companies leave no room for interpretation. Each business function is aligned through shared goals and objectives, and managers adhere strictly to performance measurement processes and key performance indicators.

This uniquely disciplined organizational mindset, in combination with strong and decisive leadership, is a key differentiator for high performers in an industry where everyone pays more or less the same for labor, land, transport and other fixed assets. So is a culture that views change more as an opportunity than a threat and that encourages risk taking from its employees.

High-performance businesses in retail grocery successfully combine the two, managing change as a journey and creating environments that challenge their people to think outside the box. Senior managers at Tesco, for instance, are taken out of day-to-day operations and given full support to spend four to six weeks investigating an issue or problem. The managers' subsequent recommendations are regularly accepted and implemented.

High-performance businesses among retail grocers are constantly pursuing new growth opportunities. They set market trends, anticipate changes in consumer demand and quickly innovate in their core business to meet emerging needs. These capabilities define their competitive essence—the unassailable formula for business success that distinguishes high-performance businesses in all the industries Accenture has studied.

This formula must, however, be constantly refined, rebalanced and refreshed. And in a business as ferociously competitive as this one, the ability to do so is being increasingly challenged. For now, the high performers in retail grocery remain forces to be reckoned with. But as food and fuel prices continue to soar, their dominance will become more and more difficult to defend.

About the authors

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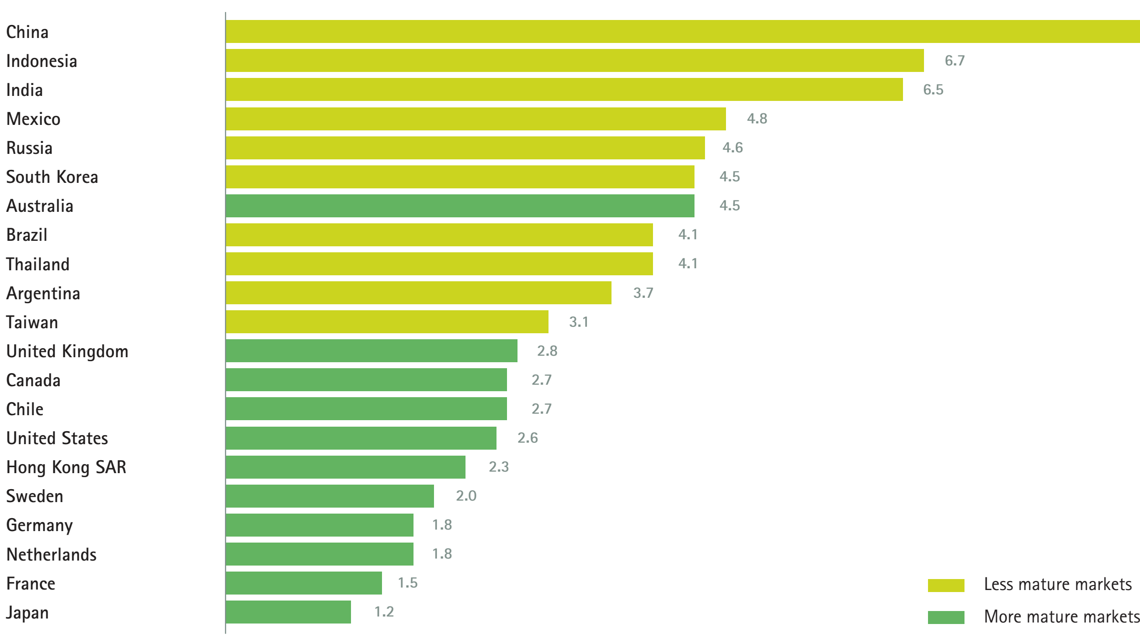
By the numbers

Gravy train

Although suffering from low growth and low profitability, the retail grocery industry is being boosted by high-growth subsectors, such as organic foods and drinks.

The majority of food markets, particularly those in mature economies, show slow overall economic growth.

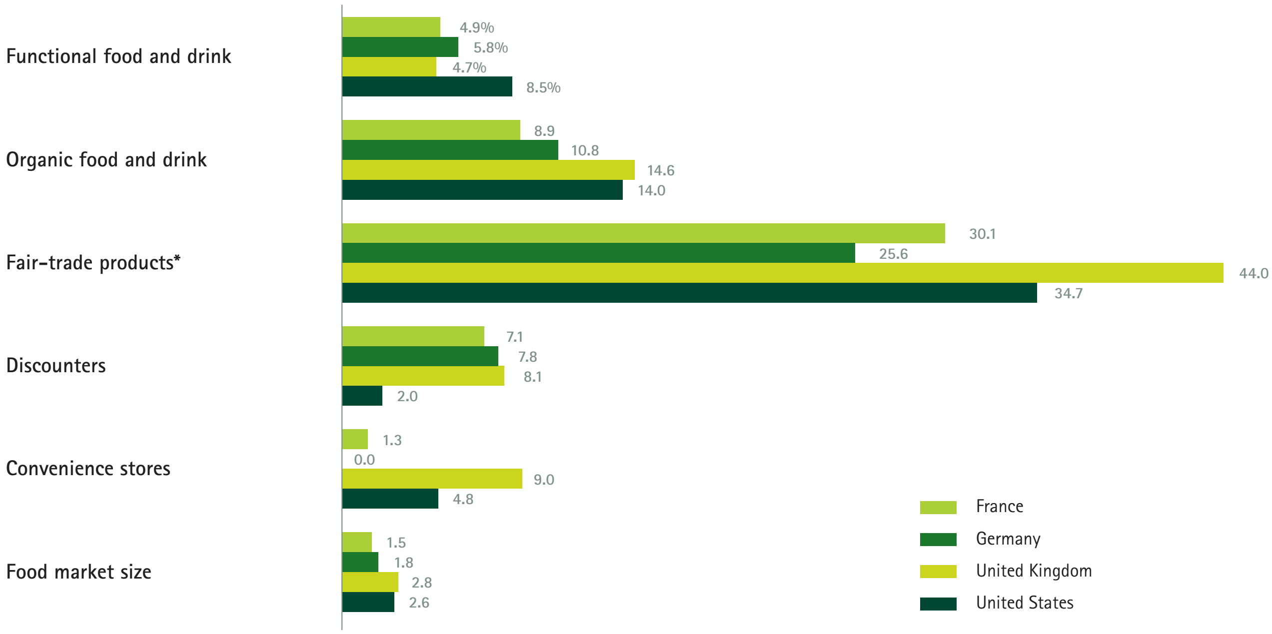
Food market CAGR growth, 2000–2007



Source: Datamonitor; Accenture analysis

Even in low-growth markets, however, some subsectors—such as organic and fair-trade products—show attractive growth rates.

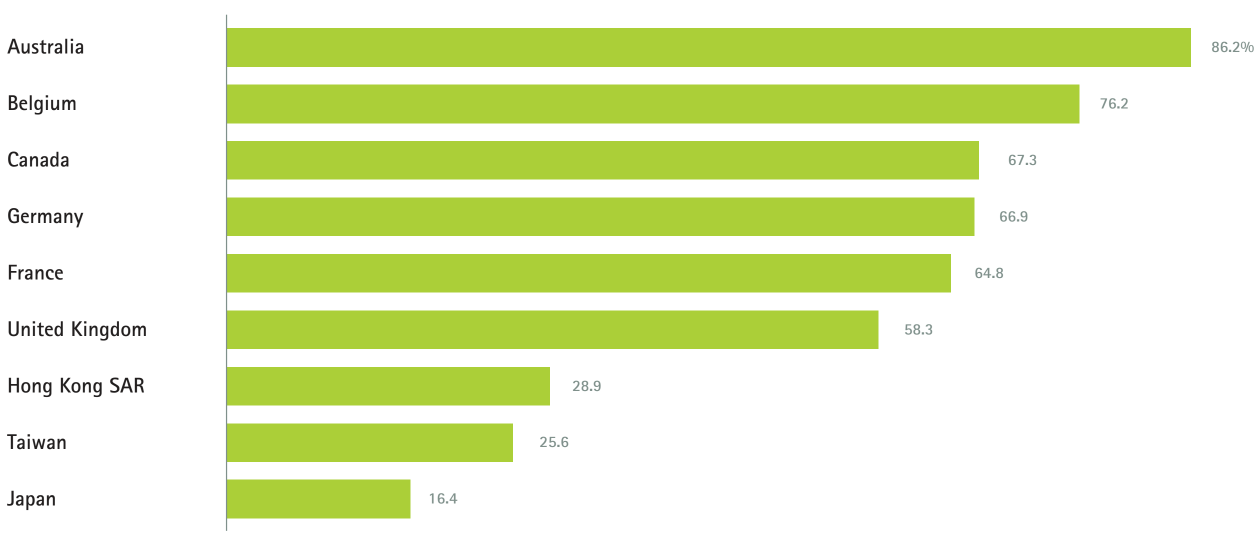
Subsector and overall food market CAGR growth, 2002–2007



* Goods produced in developing countries and traded in accordance with sustainable development, environmental, pricing and other standards set by various fair-trade organizations.
Source: Euromonitor International; Datamonitor

In mature markets, the top five retailers have more than a 50 percent market share—making this a very concentrated market in those economies.

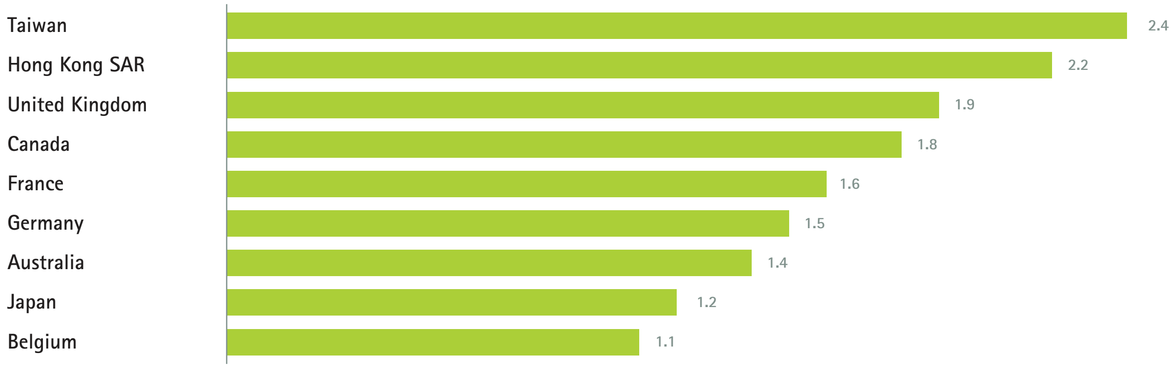
Food market share* of top five food retailers, by country, 2008



* Most retailers do not break out food sales from non-food and petrol sales. Therefore, these are estimates or the nearest proxy. US data not available on comparable basis.
Source: Planet Retail

And in many markets, the No. 1 player is significantly bigger than the No. 2 player.

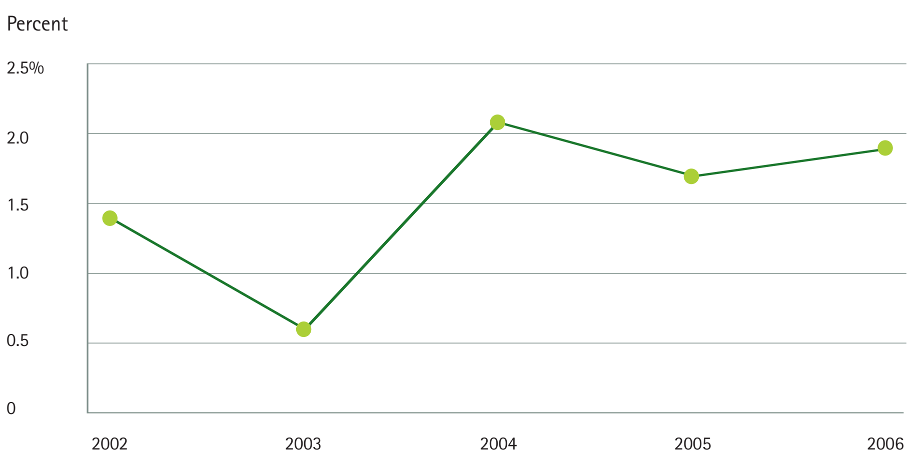
Ratio by which the No. 1 player is bigger than the No. 2 player, by country (grocery sales only)



Source: Planet Retail estimates of grocery sales in the home market

The retail grocery industry is notorious for low economic profitability.

Profit margin



Source: S&P; Accenture analysis

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