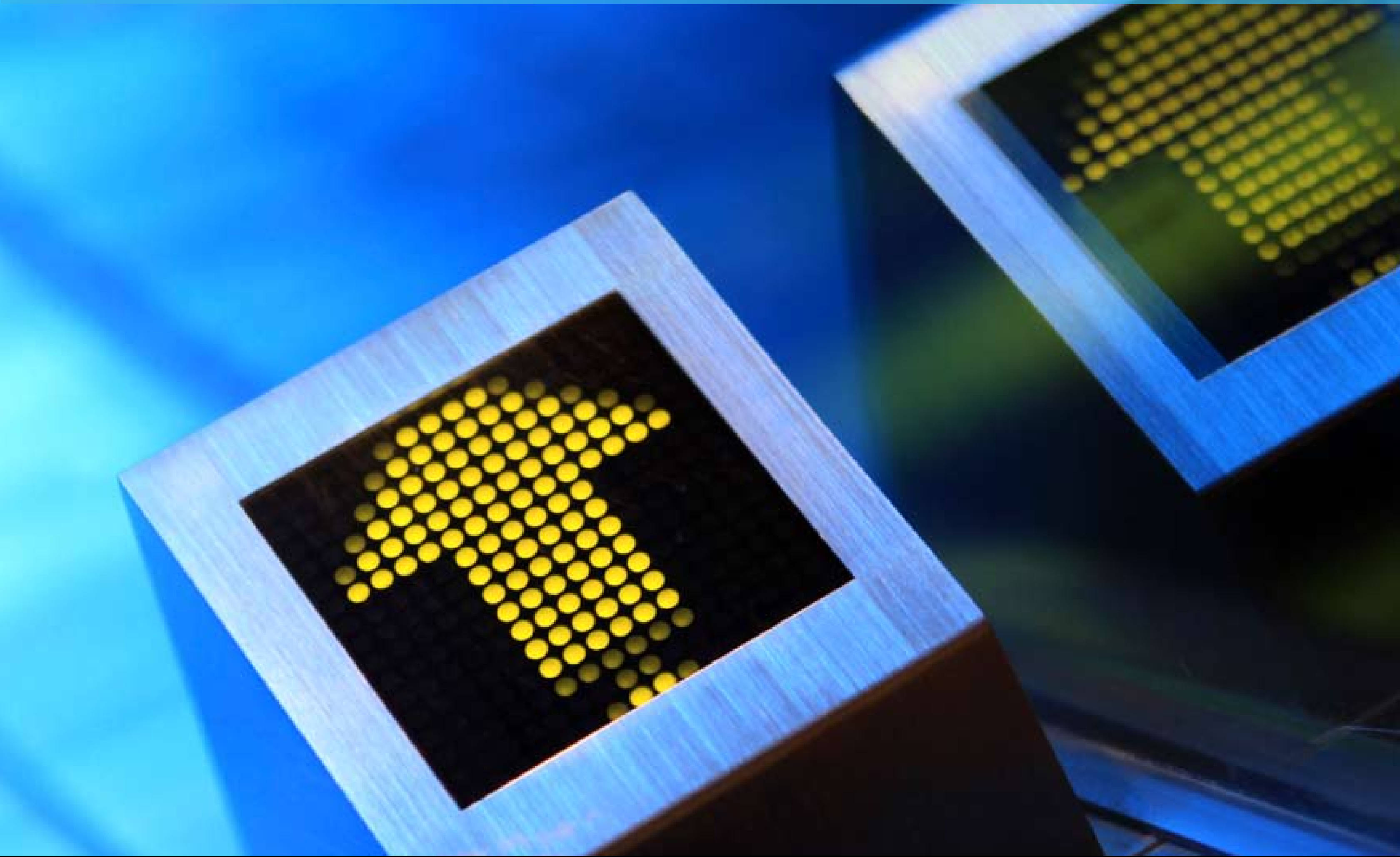
BREAKTHROUGH Insights

Second Half 2009 | The Way Forward



KANTAR RETAIL

MVI Retail Insight A Kantar Retail Company

In This Issue

Editor
Elizabeth Lee

Design
Jennifer Watson
Megan Handley

Research Team
Carine Bourdarie
Caroline Doyle
Ray Gaul
Vadim Khetsuriani
Marc Kinder
Sara Korn
Brendan Langan
Jim Leonard
Susan Loughnane
Stephen Mader
David Marcotte
Leon Nicholas
Mike Paglia
Pawel Raiter
John Rand
Robin Sherk
Lauren Story
Paulina Terrazas
Vincent Verdier
Lisa Wiltshire
Anne Zybowski

Special Contributors
Gary Carp
Ken Harris
Mandy Putnam

Foreword

When the rhetoric of success . . . replaces penetrating understanding and insight . . . decline will very likely follow.
– Jim Collins, *How the Mighty Fall*

As 2010 approaches, one word springs to mind as more important than any other: "forward." The work in 2010 will be to ride the fragments of economic recovery in the scaled markets of the US, Europe, and Asia while capitalizing on resurgent growth in places like China. As this edition of *Breakthrough Insights* addresses, finding this growth will require new approaches – not repeats or optimizations of our old strategies. In particular, your retailers are moving forward with a host of format, merchandising, and shopper insight initiatives that will require suppliers to bring new tools, capabilities, and resources to the table to capitalize on them.

A key element to this, of course, is that many of our processes and systems today are designed to focus backwards not forward. In particular, category management is a system designed to make incremental improvements to a category by carefully assessing historical data – everyone's key challenge headed into 2010. The real objective, however, is to take our tools and feed them with insights about where the world is going – and to make sure that our approaches can turn these insights into robust predictive scenarios. Those scenarios must focus on shoppers, economics, and operations: Will shoppers respond? Will that response make everyone higher returns? Can the idea as drawn up happen?

To better meet this objective, MVI and our parent company (Kantar, the information and insight division of WPP) see the need for MVI to work more closely with some of our historic sister companies: Cannondale Associates, Glendinning Management Consultants, Retail Forward, and Red Dot Square. Effective January 1, 2010, these companies will join together to form Kantar Retail. Kantar Retail's aim is to fuel our clients with transformational insights that can drive their business forward. In this issue of *Breakthrough Insights*, we bring you forward on a variety of platforms.

Shoppers – Retail Forward contributes a piece around the importance of Gen X/Y shoppers to the US economic recovery, as a focus on growth pushes retailers (and suppliers) away from the Baby Boomers who have fueled expansion for most of the last 15 years. We also look at how retailers seek to understand their shoppers through in-store research and at a new approach for the warehouse club industry to drive member retention.

Formats – The US supermarket, Chilean pharmacy, and global consumer electronics industry are profiled with an eye toward understanding how and from where growth is being driven.

Retailers – After releasing its annual PoweRanking® study, Cannondale discusses how the top-ranking companies (both retailers and manufacturers) distinguish themselves over the long term. MVI revisits our previous insights on Walgreens' strategic shifts that have had significant supplier implications, and we look at Walmart's high-efficiency prototype, a very different type of store that may fuel this retailer's growth.

Retailer/Supplier Work – Glendinning describes strategic areas to focus on to ensure the health of your business.

Markets – MVI highlights our key economic indicators for Europe and the US, and we continue our in-depth analysis of the Russian retail marketplace – one of the most challenging but fastest-growing retail markets in the world.

In addition, *Breakthrough Insights* profiles one of MVI's best-known forward thinkers, John Rand, who leads much of our research on the US marketplace.

2009 is a year no one wants to optimize: Even those of us that had stronger-than-market performance know that those results came from tactics that probably can't be repeated profitably forever. 2010 represents a watershed year in our industry, as we all seek to become more forward-thinking. Companies that do not adapt to this new requirement for actionable foresight will struggle to keep up – particularly those of you that work with the world's smartest retailers, who are getting sharper and more forward-looking every day.

Bryan Gildenberg, Chief Knowledge Officer
MVI – A Kantar Retail Company

Surveying the Shopper

A Cross-Channel Overview of What Retailers Watch

By The MVI Research Team | Originally published on July 31, 2009

Customer feedback surveys are used by many retailers. The questions within these surveys give clues to retailers' areas of concern. This article examines the participation criteria, shopper characteristics, stores, and additional opinions surveyed across five retailers. Comparing the surveys against each other and in terms of each retailer's own strategy, MVI assesses the elements that the surveys focus on and the subsequent implications for suppliers.

In July 2009, MVI analysts from across the drug, grocery, mass, and club channels collected and assessed key retailers' customer satisfaction surveys. These questionnaires—solicited through customers' receipts—ask for shoppers' opinions and experiences of their recent trip. This article studies and compares these customer surveys from July 2009 for a Sam's Club, Target, Walgreens, Walmart, and a Supervalu banner. It outlines the understanding that various retailers collect of their shoppers' experience, illuminates the differing areas of focus across channels, and offers advice about the supplier implications that this study provides.

Participation Criteria – Participation criteria was broad. Each retailer required a current store receipt with a survey invitation from participants (to show they were recent customers). All retailers required respondents to be at least 18 years old, except for Supervalu's Star Market banner. This banner's survey was also the only one collected through the phone; all the other retailer surveys were taken online. Of note, each of the retailers offered the survey in Spanish and English, indicating widespread attention to Hispanic groups.

Key takeaway: Grocers seemed to offer the least-developed customer satisfaction survey program of the channels assessed. At the time of data collection, the first and second largest US grocers, Kroger and Safeway, were not conducting customer satisfaction surveys via invitations on receipts in the regions assessed. For this reason, the third largest US grocery chain, Supervalu, was included in this study. This appears to suggest that leading US grocers tend to focus on other means, such as loyalty card data, when assessing their shoppers.

Shopper Characteristics – The amount of data requested about shopper and trip characteristics varied widely. Full details are outlined in Figure 1.

If looked at as a continuum, Walgreens and Supervalu's Star Market asked the fewest shopper questions: The only demographics these retailers assessed were age and gender, and both retailers essentially ignored assessing reasons for the trip. Target and Sam's Club asked a few more, adding in questions around personal living and trip motives. Perhaps unsurprisingly, Walmart probed the furthest. The retailer assessed the shoppers' education, family detail, employment status, and spending behavior at other discount, mass, and club retailers.

	Walgreens	Supervalu*	Walmart	Target	Sam's Club
Demographics	Age Gender	Age Gender	Age Kids at home and ages Education level Employment status Ethnicity Gender Hispanic background Household size Income Urban/suburban/ rural Zip code	Age Kids <18 at home Ethnicity Gender Income Living situation	Age Gender Income Type of membership Zip code
Trip Characteristics	None	Time of day trip taken	Frequency of shopping at Walmart Past month shopping at competitors Proportion spent at Walmart vs. others Reason for trip Shop with kids/others Monthly spent at various retailers	Pre-planned purchases Regular trip Time of day trip taken	Frequency of shopping at Sam's Membership at other warehouse clubs Reason for trip Shop with kids/others

Figure 1: Shopper Characteristics | Source: MVI research and analysis
**Supervalu's Star Market banner*

The only demographics Walgreens and Supervalu assessed were age and gender, and both retailers essentially ignored assessing reasons for the trip. Target and Sam's Club asked a few more, adding in questions around personal living and trip motives. Perhaps unsurprisingly, Walmart probed the furthest.

Although Wal-Mart, Inc. is focusing on improving its "fast," "clean," and "friendly" scores, this retailer is also assessing its ability to go to the next level. Target, in contrast, focused primarily on determining ways to continuously enhance its in-store experience.

Key takeaway: The drug and grocery retailers studied seem least interested in segmenting who hold opinions about their in-store experience. In contrast, Walmart collected the most shopper detail of the retailers surveyed, going so far as to assess spending behavior at competitor stores. As Walgreens' Customer Centric Retailing (CCR) initiatives take hold, MVI expects the retailer to shift the focus of its shopper survey from purely operational to more consumer-focused questions.

The Store – Several themes emerged across the retailers. All retailers asked for an assessment of the departments shopped, overall satisfaction, staff performance, store cleanliness, and whether the store offered a convenient trip (such as a fast checkout). Full details are outlined in Figure 2.

Each retailer seemed to have specific areas of interest:

- Walgreens focused primarily on product offerings, in-stocks, and store presentation/tidiness. This seems to be a reflection of product mix and store presentation shifts under its Customer Centric Retailing (CCR) initiatives. Apparently, price was less of a concern: Walgreens did not ask shoppers about the perceived value of its offering in the survey.
- Supervalu's banner appeared more interested in whether its store was clean.
- Wal-Mart, Inc.'s Walmart and Sam's Club banners probed about the experience created. These surveys asked whether the trip was "fun," the "atmosphere" was pleasant, and the bargains were "exciting." It seems that this retailer is looking to give shoppers an enhanced experience.
- Sam's Club was particularly concerned with assessing the perceived value of its membership, which is consistent with its initiative to improve renewals.
- Target's primary concerns related to guest satisfaction with store employees, efficient service, store cleanliness, and in-stocks, as questions probing these aspects of the store experience were placed at the beginning of the survey. Interestingly, Target prides itself on creating and maintaining a fast, fun, and friendly store experience for its guests; however, notably missing from this survey was any question related to fun.

Key takeaway: To varied degrees, each retailer assessed its ability to offer a fast, clean, and friendly experience. Although Wal-Mart, Inc. is focusing on improving its "fast," "clean," and "friendly" scores, this retailer is also assessing its ability to go to the next level. Target, in contrast, focused primarily on determining ways to continuously enhance its in-store experience.

Additional Opinions Surveyed

Of the channels reviewed, only the mass retailers asked shoppers' opinions pertaining to areas beyond the store shopping experience:

- Walmart asked shoppers about their general use of financial services and whether they have used these services at the retailer.

	Walgreens	Supervalu*	Walmart	Target	Sam's Club
Overall Impression	Cleanliness Product available Trip satisfaction	Cleanliness Convenient Open question of how to serve better Product quality Products available Trip satisfaction Value	Cleanliness Convenient Products available Store atmosphere Trip satisfaction	Cleanliness Convenient Open question of how to serve better Products available Trip satisfaction Value	Cleanliness Convenient Products available Store atmosphere Trip satisfaction Value
Checkout	Checkout used Cleanliness Fast Friendly, helpful cashier	Cleanliness Fast Friendly cashier	Cleanliness Fast Friendly cashier	Fast	Fast Friendly cashier
Amenities	None	Cleanliness	Cleanliness Parking ease Services awareness	Cleanliness Ease of returning merchandise Fast, convenient service	Cleanliness Fast, convenient service Parking ease
Staff	Friendly, helpful employees	Friendly, helpful employees	Friendly, helpful employees	Friendly, helpful employees	Friendly, helpful employees
Departments	Departments and services shopped Product availability Satisfaction	Departments shopped Friendly, helpful employees Product selection Quality	Cleanliness Departments and services shopped Ease of shopping Fast Helpful employees Product availability Product selection Value	Cleanliness Departments, products, and services shopped Fast Friendly, helpful employees Loyalty Open-ended for feedback Product availability Product selection Quality Value	Cleanliness Departments and services shopped Ease of shopping Fast Helpful employees Product availability Product selection Value

Figure 2: The Store Characteristics | Source: MVI research and analysis
**Supervalu's Star Market banner*

This appears to be not only an examination of the opportunity for its MoneyCenter and offerings among the diverse shopper base but also a subtle form of marketing.

- Target solicited feedback in terms of shopping experiences in the following departments (listed as they appeared in the survey):
    - Electronics
    - Food Avenue snack bar
    - Guest services
    - Jewelry
    - Starbucks
    - Photo Center
    - Pharmacy
- Given Target's longstanding focus on developing the food and consumables side of the business, as evidenced by its P2004, P2009, and even PFresh formats, the absence of the food and/or consumables department here is peculiar. (Note that the survey was provided by a P2004 store format.)
- Interestingly, Target asked whether guests researched products online – in this case for electronics – at Target.com or other websites before coming into the store. This suggests that the retailer is evaluating the effectiveness of Target.com as an educational outlet. But, what if the guest was unaware that Target.com was available as an informative tool? This survey did not take into account that possibility.

Key takeaway: At least in the mass channel, retailers are using shopper surveys as a means to learn about their shoppers' behavior outside of stores. Their extensive customer bases essentially provide them with a wide, continuous, and accessible survey panel. Potentially, suppliers could use such survey results to assess the effectiveness of their in-store promotions and campaigns.

Supplier Implications

Figure 3 outlines the key insights and implications for suppliers calling on the retailers assessed.

At least in the mass channel, retailers are using shopper surveys as a means to learn about their shoppers' behavior outside of stores. Their extensive customer bases essentially provide them with a wide, continuous, and accessible survey panel.

	Insight	Supplier Implications
Walgreens	Product focused – Centered largely on Walgreens' operational efforts, the survey asked about categories shopped and product availability. As the retailer rationalizes SKUs, it will continue to focus on inventory management and customer expectations. Lacking customer questions – None of the questions asked about the trip type or motives, and very few demographic characteristics were assessed.	With Walgreens' focus on products, it is critical for suppliers to maintain in-stock levels. To support the retailer's SKU rationalization efforts, proactively help Walgreens manage its supply chain by attending to the retailer's inventory position and days of supply at the DC. While the survey may be revamped later, there is now opportunity for suppliers to consider strategically sharing shopper insights. This may develop positioning within the store to suite core shoppers' aims.
Supervalu*	Limited survey scope – Customer satisfaction surveys do not appear to be the primary vehicle for measuring Supervalu shoppers' experience, as questions around their trip type, demographic characteristics, and wants were lacking.	Suppliers who have complementary data (e.g., own shopper insights) have an opportunity to provide an "eye on the shopper" for grocery retailers.
Walmart	Building atmosphere – Though measuring a fast, clean, friendly experience are still clearly important, Walmart also explored the atmosphere and whether shoppers felt they received exciting bargains. Probing outside – The survey probed beyond the shopper trip to ask about the customers' behaviors and uses of other stores and services.	Creating an appealing, exciting atmosphere appears of interest to Walmart. Explore ways to build such an atmosphere through enhanced, interactive displays or with surprising product comparisons to highlight the value of the deal offered. Given that Walmart questioned beyond the trip, suppliers should consider the possibility of using Walmart customer receipts or Walmart's experience survey as a panel to probe the impact of their in-store promotions.
Target	Lacking consumables questions – Food and consumables should be among Target's top concerns, but the surveys assessed lacked attention to these categories. Looking for more – Target's survey asked its guests, with open-ended questions, how to improve the department and general store experience.	Suppliers may help their relationship with Target by leveraging their shopper data to further educate the retailer on its guests' experience and on the perception of its grocery and HBA offering. Knowing that Target is looking for advice from its guests, suppliers may find the retailer is more open to hearing insights about how to meet its guests' expectations.
Sam's Club	Primarily about perceived value, item mix/availability, and in-club experience, questions from the Sam's Club survey all relate to the central issues the retailer is currently trying to address while refining its strategy: 1) Who shops their box? 2) What are they looking for, in regards to items and experience, that will make membership more resonate? 3) How does Sam's differentiate from Walmart?	Suppliers should leverage their customer insights to help Sam's 1) understand need states driving purchases in the box and marry that data to survey results about in-club experiences and 2) offer items more finely attuned to member needs. Suppliers should work with Sam's to construct event days and in-club demonstrations that add experiential value to in-club experience and that are informed by suppliers' own knowledge of members. Look to these events and in-club demos as opportunities to gain insights into member wants, and consider training demo teams to ask a limited range of research questions. Suppliers should look to partner with Sam's to add a premium element to either the in-club experience and/or the item on the rack that differentiates the experience from Walmart.

Figure 3: Supplier Implications | Source: MVI research and analysis
**Supervalu's Star Market banner*

Excerpt from American ShopperScape™ 2009

Post-Recession Shoppers

Contributed by Mandy Putnam, Retail Forward | Originally published August 2009

The recession has changed how shoppers allocate their money, how they shop and – in some cases – where they shop (Figures 1 and 2). However, as the recession continues, fewer shoppers overall report changing their shopping behavior as a result of the economic downturn. Even though this likely signals a shift to previous shopping patterns by some shoppers, more than two-thirds (69%) of all shoppers still report altering their shopping habits at least somewhat, if not significantly, since the recession began.

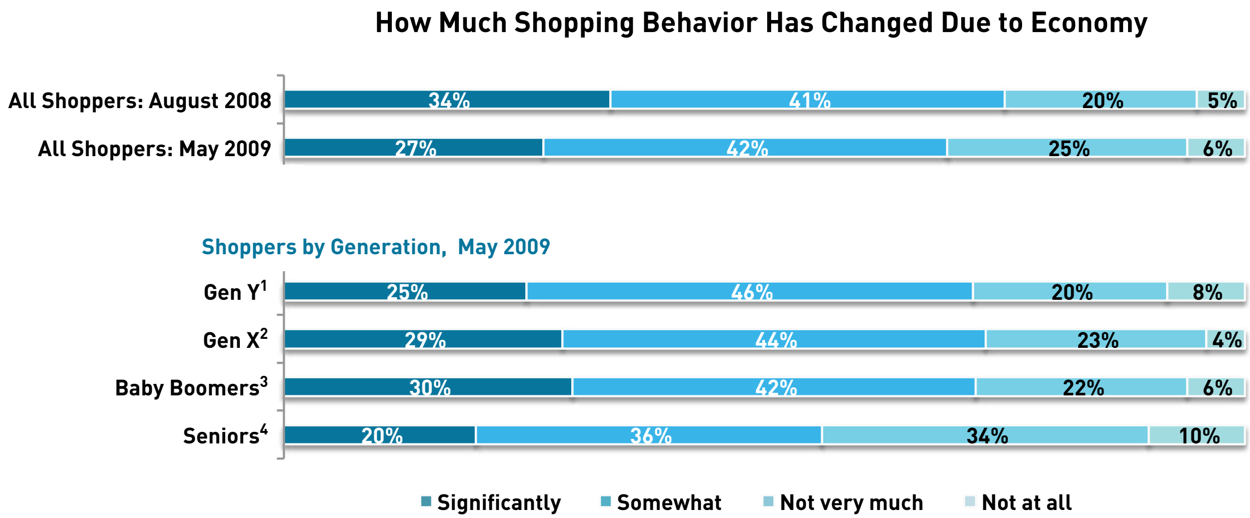


Figure 1: How Much Shopping Behavior Has Changed Due to Economy | Source: Retail Forward ShopperScape™, August 2008 and May 2009

[1]Shoppers born 1982 to 2000; Gen Y shoppers included in this report are 18–27 years old; [2]Shoppers born 1965 to 1981; [3]Shoppers born 1946 to 1964; [4]Shoppers born prior to 1946

Shoppers are employing three types of tactics to save money:

1. **Limiting behaviors** – e.g., buying only "needs" instead of "wants," buying less, and shopping less
2. **Deal-seeking behaviors** – e.g., taking advantage of good deals, using coupons, and comparison shopping
3. **Trading-down behaviors** – e.g., buying less expensive products, buying more store brands, and shopping more often in discount stores

Each generational cohort is changing its shopping behaviors in distinct ways. Seniors are least likely to report making changes because their shopping is disproportionately focused on consumables and other non-discretionary goods. At the other end of the age spectrum, many adult Gen Y shoppers (many of whom have no long-term financial obligations yet) are already showing signs of abandoning savings tactics they adopted last year. The Gen X and Baby Boomer cohorts have the highest proportion of shoppers participating in limiting, deal-seeking, and trading-down behaviors. However, the shopping behavior similarity of these two cohorts ends there: Since the beginning of the recession, fewer Boomers have consistently indicated plans to spend more in the coming months than all shoppers while Gen Xers seem more willing than average to pick up the spending pace.

Hit hard by the effects of the recession at a point of its life stage when financial commitments (as parents or as children of aging parents) are growing and retirement is on the horizon, the huge Baby Boomer cohort will not be able to quickly lead the way out of the recession as it had in the past two recessions. During the early 1990s, the Baby Boomers were at a life stage when spending is high: Their appetite for material goods seemed insatiable. In the early 2000s post-dot.com bust, many Baby Boomers were in prime earning years and able to resume pre-recession spending behaviors relatively quickly after that less severe downturn.

How Shopping Behavior Changed This Year

Limiting Behaviors	All Shoppers	Generation Y[1]	Generation X[2]	Baby Boomers[3]	Seniors[4]
Buying only things I truly need	42%	34%	44%	46%	36%
Buying fewer things	37%	28%	39%	41%	30%
Shopping less often	34%	33%	36%	36%	26%
Postponing purchases	29%	23%	32%	34%	20%
Buying fewer luxury items	29%	24%	33%	30%	25%
Buying only items needed in the near term	22%	20%	23%	23%	18%
Using/keeping items longer before buying replacements	20%	15%	22%	21%	17%
Deal-seeking Behaviors					
Taking advantage of good sales/deals	40%	31%	41%	43%	36%
Using more coupons	31%	28%	34%	32%	25%
Doing more price comparison shopping before making a purchase	29%	24%	31%	31%	26%
Buying in bulk quantities	14%	14%	17%	14%	10%
Stocking up on items expected to rise in price	12%	7%	14%	13%	11%
Trading-down Behaviors					
Buying less expensive versions of products	23%	25%	26%	23%	17%
Buying more store brands instead of national or high-end brands	21%	19%	21%	23%	20%
Doing more shopping at discount and value retailers	19%	14%	20%	22%	15%
Trading down to less-expensive brands	16%	13%	19%	16%	12%
Other/some other way	2%	5%	2%	3%	1%

Figure 2: How Shopping Behavior Changed This Year | Source: Retail Forward ShopperScape™, May 2009

[1] Shoppers born 1982 to 2000; Gen Y shoppers included in this report are 18–27 years old; [2] Shoppers born 1965 to 1981; [3] Shoppers born 1946 to 1964; [4] Shoppers born prior to 1946

With future Boomer spending handcuffed by circumstances, marketers will need to look to the smaller Gen X generation and large Gen Y cohort just coming into its household-formation—and consequently, relatively high-spending—years to fuel growth in the post-recession recovery (Figure 3).

However, many of the price-driven shopping behaviors adopted during the recession will have a lingering impact into the recovery:

- Even though many shoppers will keep spending on "wants" in check, the data shows "wants" are steadily being introduced into the equation.
- Trading-down behavior related to the choice of retailer, product, or brand will lose some traction in the recovery, but private brands (especially in FMCG categories) will remain a significant factor.
- Couponing and bulk-buying are the adopted behaviors most likely to stick; however, most shoppers will take advantage of sales and comparison shopping.

The difference is that post-recession shopping behavior will more

	Gen X	Gen Y
Positive	Entering peak spending years Big spending life stage: kids and homes	Younger = more discretionary income Tech lifestyle is a need not a want; i.e., will spend on technology Entering household-formation years
Negative	With Boomers staying in workforce longer, harder for Gen X to advance Paying down debt Serious about saving	Less recession falloff = less recovery rebound Spending shaped by tighter credit A fragmented and difficult cohort to reach with conventional marketing approaches

Figure 3: Characteristics of Gen X and Gen Y Post-Recession Spending Power | Source: Retail Forward, Inc.

appropriately be characterized as purposeful, rather than panicked, as it so often seemed in recent months. Severe limiting—of spending, shopping, and store sets—will give way to more mindful choices. Rampant deal-seeking will give way to more selective deal-seeking that leverages the tools and techniques shoppers have discovered in the recession. Broadscale trading down—across products, brands, and retailers—will give way to more reasoned and rational trading down.

About Retail Forward's ShopperScape™

The Retail Forward ShopperScape™ database is a unique source of information about shopping behavior based on a monthly survey of 4,000 nationally representative households. The extensive survey measures a wide range of shopping behaviors and attitudes. Survey respondents are the self-designated primary shopper for their household. Surveys are conducted online using the TNS 6thdimension™ interactive panel. For details on how to access the complete database and other ShopperScape™ reports available, contact Katherine Clarke, Vice President Marketing, at 614.355.4009 or KClarke@retailforward.com.

MVI's 2010 Events Calendar - Americas

MVI's unbiased strategic retail insight and analysis gives you a clear understanding of how retailers operate as well as their key initiatives and supplier expectations. MVI's thought leadership delivers topical ideas, frameworks, and planning tools that will help you achieve both supplier and customer objectives.

Q1

Executive Forum — Tampa, FL

Jan 14 General Session

Year-End Forum Special Session NEW — Los Angeles, CA

Jan 20 General Session

Chain Drug SuperSession — Orlando, FL

Feb 23	Kantar Retail Keys to Vendor Success: Chain Drug 2010 (PM)
Feb 24	General Session (AM) CVS Workshop (PM) Walgreens Workshop (PM)
Feb 25	Shopper Marketing for Chain Drug (AM) Negotiation Skills to Maximize ROI (PM)

Latin American Retailing Forum NEW — Miami, FL

Mar 2	General Session
Mar 3	Kantar Retail Keys to Vendor Success: Latin America 2010 (AM) Negotiation Skills to Maximize ROI (PM)

Kroger SuperSession NEW — Cincinnati, OH

Mar 16	Kantar Retail Keys to Vendor Success: Your Customer, Your Team & The Internal Sell
Mar 17	Kroger's Competitive Context: Where Else Has the Shopper Gone? (AM) Seeing Around the Corner: Kroger 2015 (PM)
Mar 18	Negotiation Skills to Maximize ROI

Q2

Walmart SuperSession — Rogers, AR

Apr 6	Partnering with Walmart Walmart – A Foundation
Apr 7	Wal-Mart International (AM) Sam's Club (PM)
Apr 8	Sessions TBD

Costco Workshop Series — Seattle/Bellevue, WA

Apr 20	Costco – A Foundation
Apr 21	Partnering with Costco

Value Discounters Workshop Series NEW — TBD

May 4	Sessions TBD
May 5	Value Discounters Workshop
May 6	Sessions TBD

Shopper Forum — Chicago, IL

May 12 General Session

Mid-Year Forum East — Boston, MA

Jun 15	Breakouts TBD
Jun 16	General Session
Jun 17	Breakouts TBD

Mid-Year Forum West — California

Jun 22	Breakouts TBD
Jun 23	General Session
Jun 24	Breakouts TBD

MVI–A Kantar Retail Company Tel: 1.800.370.3261 or 1.617.588.4100 Fax: 1.617.499.2723 Web: MVI-Worldwide.com

Q3

Mexican Retailing Forum — Mexico City

Jul 6	Sessions TBD
Jul 7	Sessions TBD
Jul 8	Sessions TBD

Walgreens Workshop Series — Chicago, IL

Aug 3	Sessions TBD
Aug 4	Walgreens Workshop

CVS Workshop Series NEW — Rhode Island

Aug 10	Sessions TBD
Aug 11	CVS Workshop

Safeway SuperSession NEW — Oakland, CA

Aug 17	Sessions TBD
Aug 18	Sessions TBD
Aug 19	Sessions TBD

East Coast Grocery SuperSession NEW — Florida

PUBLIX, DELHAIZE

Sep 14	Sessions TBD
Sep 15	Sessions TBD
Sep 16	Sessions TBD

Target/Supervalu SuperSession — Minneapolis, MN

Sep 21	Sessions TBD
Sep 22	Sessions TBD
Sep 23	Sessions TBD

Q4

Consumer Electronics Workshop Series — Los Angeles, CA

Oct 6	CE Workshop
Oct 7	Sessions TBD

Future of Category Management Forum — Chicago, IL

Oct 19	Sessions TBD
Oct 20	General Session
Oct 21	Sessions TBD

Canadian Retailing Forum — Toronto

Oct 26	Sessions TBD
Oct 27	Sessions TBD
Oct 28	Sessions TBD

Walmart SuperSession — Rogers, AR

Nov 2	Partnering with Walmart Walmart – A Foundation
Nov 3	Wal-Mart International (AM) Sam's Club (PM)
Nov 4	Sessions TBD

Year-End Forum — Atlanta, GA

Dec 7	Breakouts TBD
Dec 8	General Session
Dec 9	Breakouts TBD

Clubs' Real Competition

A New Approach to Drive Member Retention

By Susan Loughnane
Originally published on July 6, 2009

In this article, MVI offers suppliers an approach to evaluating clubs' competitive positioning. First, we outline a framework for how to define the relevant competitive set for any club retailer. We then apply that framework to Costco, defining its strategic position relative to competitive retailers across channels, and discuss ways to retain new members at Costco for the long term.

Worried by prolonged economic weakness, American consumers are engaged in a search for value not seen in decades. This search has led to some positive results for the club channel, particularly increased traffic and new membership (Figure 1). Costco's, BJ's, and Sam's Club have all enjoyed increased traffic— generated not only by current members shopping the club more frequently but also by new members joining the club. In the first three quarters of its FY 2009, Costco opened only 11 new clubs but added half a million new paid members and 300,000 spouse cards, resulting in 800,000 total new cardholders.

New members are "trading in" to clubs, seeking value and bringing expectations from their former primary shopping destination with them. To formulate the strongest possible strategy for retaining these members beyond the recession, the clubs must understand where these new members are "trading in" from and for what items. This requires thinking more expansively when developing today's relevant competitive set than simply examining rival retailers within the channel.

MVI has developed a three-step test for defining a relative competitive set for any club retailer:

1. **Geographic overlap –** Does the potentially competitive retailer have sufficient outlets in the same region where the club can steal market share?
2. **Demographics –** Does the potentially competitive retailer have shoppers or a subset of shoppers who share significant demographic traits (i.e., age, income, and education level) as the club members?

Traffic	Nov '08	Dec '08	Jan '09	Feb '09	Mar '09	Apr '09	May '09
BJ's Wholesale Club	6%	6%	6%	7%	7%	5%	5%
Costco Wholesale	2.8%	3.5%	4%	5%	4.5%	6%	4.5%
Sam's Club	*	*	*	*	*	*	N/A

Figure 1: Club Traffic, November 2008 to May 2009 | Source: MVI research and analysis
**No specific % given. Sam's Club stopped reporting comps and traffic in June 2009.*

3. **Item overlap –** Does the potentially competitive retailer have a merchandise mix that overlaps significantly with items in a given club?

Defining the players is a first and fundamental step. For any of the three club operators, this list likely includes retailers from the grocery, mass, and consumer electronics channels as well as other more specialized retailers. The next step is to establish a set of comparative metrics that captures what a shopper considers in deciding where to shop, why to shop, and ultimately where to be a loyal shopper and then to apply them to the competitive retailers. MVI suggests the following four metrics to capture the decision drivers of today's shopper in comparing a club retailer and any potential competitor.

1. "Needs" vs. "Wants" Items
2. Established Value Image
3. Private Label Performance
4. In-store Shopping Experience

The final step is to qualify the rival's areas of strength and areas of weakness, which would then suggest competitive positioning that can drive member retention at the club.

Identifying Competitors

In applying the three-step framework to Costco, we identified Safeway, Target, CVS, and Best Buy as relevant competitors. Here, we apply the three-step test to Safeway as an example.

Step 1: Geography

Both Costco and Safeway are heavily concentrated in California. In fact, both retailers have their highest percentage of outlets in that state: Costco with 113 warehouses and Safeway with 519 stores (Figure 2).

/Shoppers

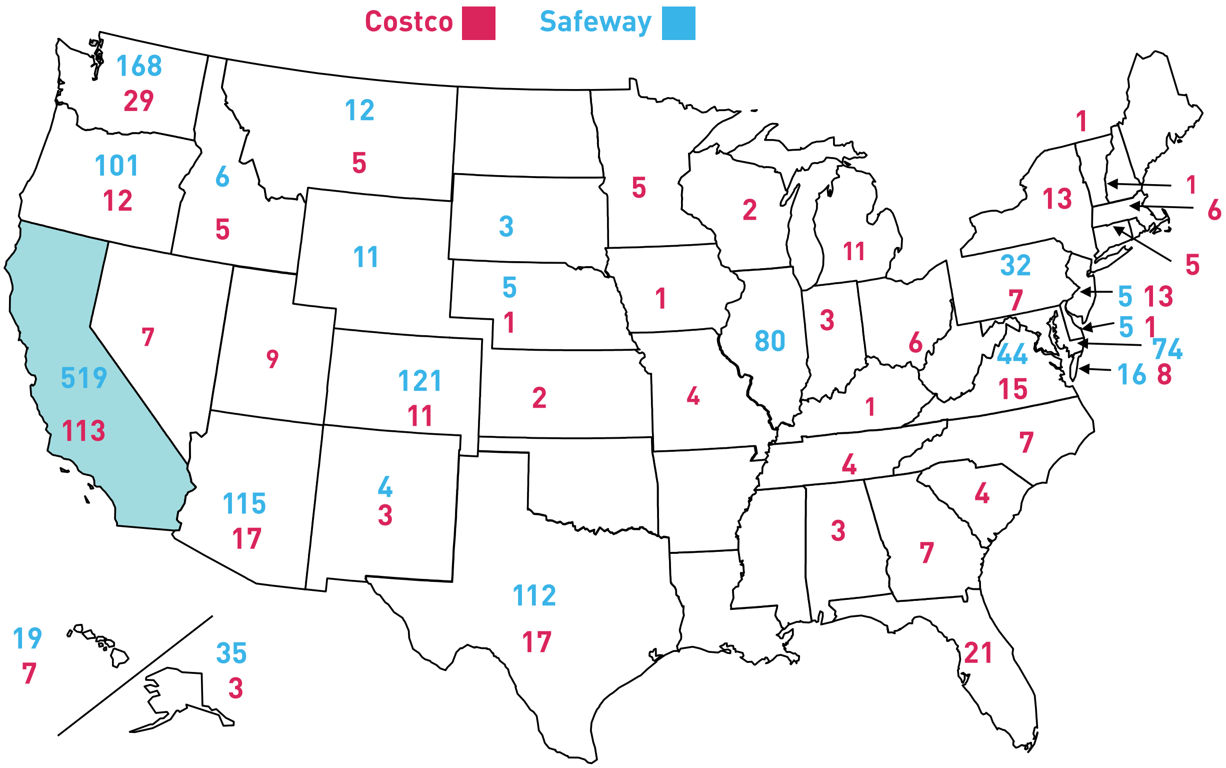


Figure 2: Costco and Safeway Locations
Source: Costco.com (as of April 6, 2009) and Safeway.com (as of January 1, 2009)

Step 2: Demography
How do Costco members and Safeway shoppers compare demographically? In regards to income distribution (one demographic variable), a majority of both Safeway's (53%) and Costco's shoppers (69%) make more than USD 45,000 a year (Figure 3). Safeway shoppers with considerable assets and steady employment are likely looking to scale back spending (particularly since many of them are in California, the state perhaps hit hardest by the recession), and Costco is already successfully catering to customers with similar income profiles.

Step 3: Item Mix
In 2008, 54% of Costco's total sales were in consumable categories, as highlighted in Figure 4.

Given Costco's past sales performance within these consumable categories, there is overlap between the items that drive a grocery trip and those that are selling at Costco.

Costco vs. Competitors

The next step is to apply a set of comparative metrics designed to capture decision drivers that will illuminate Costco's competitive strengths and opportunity gaps. Comparing Costco to other retailers in their competitive set using our scorecard decision drivers yields additional insights that could inform Costco's competitive approach.

Costco vs. Safeway

- Safeway's strategy of emphasizing "wants" over "needs" to drive gross margin hurts the perception of it as a "needs" retailer in these tough economic times. Costco should continue to look for ways to communicate value to new members who had been Safeway shoppers. Moreover, Costco's value advantage should drive even more Safeway shoppers to (Costco) membership and suggest an effective means of attracting them.

Income	Total US All Shoppers	Percent of Shoppers Safeway	Percent of Shoppers Costco
$9,999 or less	6.50%	4.70%	2.40%
$10,000 - $11,999	3.30%	1.90%	0.30%
$12,000 - $14,999	4.50%	3.10%	0.60%
$15,000 - $19,999	5.70%	4.40%	2.20%
$20,000 - $24,999	8.80%	6.60%	4.90%
$25,000 - $34,999	16.60%	16.90%	12.30%
$35,000 - $44,999	11.40%	9.40%	8.50%
$45,000 - $54,999	11.90%	10.30%	11.10%
$55,000 - $64,999	8.60%	8.90%	10.20%
$65,000 - $74,999	8.00%	9.80%	11.80%
$75,000 - $99,999	7.60%	11.10%	15.60%
$100,000 +	7.00%	12.90%	20.20%

Figure 3: Income Distribution of Safeway and Costco Shoppers
Source: MVI research and analysis, IRI data

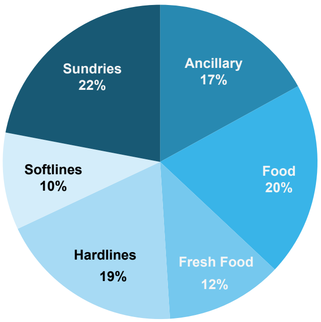


Figure 4: 2008 Costco Sales by Category | Source: Costco's 2008 Annual Report

Ancillary *– gas stations, pharmacy, food court, optical, one-hour photo, hearing aids, travel;* ***Food*** *– dry and institutionally packed food;* ***Fresh Food*** *– meat, bakery, deli, produce;* ***Hardlines*** *– major appliances, electronics, health & beauty aids, hardware, office supplies, garden & patio, sporting goods, furniture, auto supplies;* ***Softlines*** *– apparel, domestics, jewelry, housewares, media, home furnishing, cameras, small appliances;* ***Sundries*** *– candy, snack foods, tobacco, alcoholic and non-alcoholic beverages, cleaning and institutional supplies*

- Costco should learn from Safeway's "fun" experience in its Lifestyle format and look for smaller, more accessible treasure hunt items to mirror that appeal in a club-appropriate manner. Some measure of in-store signage or limited POP may also make sense. MVI does not believe that Costco should remodel its clubs – in fact that minimalist atmosphere helps to reinforce its value image. However, the retailer should adopt and adapt elements from the Safeway in-store experiences that will help new members acclimate to clubs and that have helped inspire past loyalties.

Costco vs. Target

- In comparing the two retailers on private label performance, they both exhibit distinctly different strengths. Where Kirkland Signature enjoys a reputation as high quality, it does not have the same "fun" element of some of Target's private label brands like Choxie. As Target shoppers become Costco members, there is an opportunity for Costco to expand the appeal and item mix of Kirkland into more fun, occasion-based items.

- Target has a multiple brand, multiple price-point private label portfolio that includes signature lines such as Archer Farms. Costco might consider using a sub-brand under the Kirkland Signature umbrella to expand

	Costco	Safeway
"Needs" vs "Wants" Items	✓	
Established Value Image	✓	
Private Label Performance	✓	✓
In-store Shopping Experience		✓

	Costco	Target
"Needs" vs "Wants" Items	✓	
Established Value Image	✓	
Private Label Performance	✓	✓
In-store Shopping Experience		✓

	Costco	CVS
"Needs" vs "Wants" Items		✓
Established Value Image	✓	
Private Label Performance	✓	✓
In-store Shopping Experience		✓

	Costco	Best Buy
"Needs" vs "Wants" Items	✓	
Established Value Image	✓	
Private Label Performance	✓	
In-store Shopping Experience		✓

the positioning opportunities and appeal of its own private label items.

Costco vs. CVS

- With its acquisition of Longs, CVS has arrived on the West Coast and made itself a viable competitor to Costco. In examining the scorecard results, CVS wins over Costco when the shopper is motivated by convenience ("needs" vs. "wants") or in-store shopping experience. Consequently, Costco might look for items that redefine or broaden former Longs/CVS shopper definitions of convenience. A more accessible and shopable health & beauty department might be a start.
- Costco should look at ways to add capacity and convenience to its website for serving prescription demand. Prescriptions are trip drivers: Any steps the retailer can take to lower the hurdle of prescription transfer by adding convenience or extra value will ultimately make it more competitive with drug retailers.

Costco vs. Best Buy

In comparing in-store shopping experience, it's clear that the interactive elements of Best Buy's stores are key drivers of its competitive positioning – despite Costco's value perception. Costco could adapt interactivity into product demos in-club to restore "fun" elements that members are losing; this would also limit secondary shopping trips to Best Buy. Member education—through direct mail, Costco Connection, and other member appeals—is another way for Costco to deliver value and make the club more engaging.

Applying MVI's Approach

For Costco, the current economic downturn has created an opportunity for them to engage shoppers new to the channel. To maintain the interest of its new members, Costco must understand where they are coming from and what elements from those competitive retailers will make membership more valuable. Suppliers who can leverage their experience and insight gained in serving these other retailers through club-appropriate items and effective in-club member interactions will ultimately create opportunities for their own business serving Costco.

MVI's framework forms a useful means of helping Costco attract and retain targeted members. At the same time, the cross-channel criteria and ensuing decision drivers can be applied to any retailer. As channel definitions blur and competitive dynamics force retailers and their suppliers to develop increasingly innovative marketplace strategies, the approach is particularly relevant today.

MVI's Top 10 Consumer Electronics Retailers

Key Players in the European, US, and BRIC Markets

By Anne Zybowski & Marc Kinder | Originally published on July 24, 2009

MVI evaluates the state of consumer electronics, as leading retailers around the globe – across all formats – evolve their response to what has been a difficult year for the industry.

Europe: Top 10

The European consumer electronics (CE) landscape continues to be dominated by Media-Saturn and several multi-format buying groups, of which the most significant are Euronics, Expert, and Electronic Partner (Figure 1). Other major electronics specialists are Kesa Electronics and DSG, which are both looking to divest unprofitable parts of their businesses since sales are stagnating. US-based Best Buy recently entered the European market via a joint venture with Carphone Warehouse as a base to drive growth in Europe through the addition of big box stores beginning in the second half of 2009 in the UK and Turkey.

- Carrefour is the only grocer featured on the Top 10 CE list. Its CE sales share will decline slightly over the next few years, however, as it places additional focus on food vs. the rest of the box.
- Growth potential has increased through online sales, as specialty e-tailers – such as Amazon and Pixmania – continue to grow ahead of the market. While not in the Top 10 in 2009, Amazon continues to increase its share of CE sales in Europe; MVI expects the pure online retailer will be #9 by 2014. This is a growing threat to Media-Saturn, which has thus far resisted the e-commerce channel for fear of conflict with its stores division.
- Growth of other major consumer electronics retailers will continue at a slower speed, as people cut their CE expenditure. Media-Saturn is shifting focus from its core markets to developing markets (e.g., Eastern Europe and China) to capitalize on growth opportunities, while DSG and Kesa Electronics are exiting markets and struggling for profitability. This will require a fundamental change in its business model, as it looks

		2003	2009E	2014E	2003-09E	2009E-14E
1	**Media-Saturn**	10.6	19.5	24.9	10.7%	5.1%
2	**Euronics**	7.6	11.9	13.2	7.7%	2.0%
3	**DSG**	8.9	8.3	8.3	-1.1%	-0.1%
4	**Expert**	5.7	7.4	7.9	4.4%	1.3%
5	**Carrefour (CE only)**	5.3	5.7	6.1	1.3%	1.4%
6	**Kesa**	6.1	5.4	5.9	-2.0%	1.9%
7	**Electronic Partner**	3.4	4.7	5.2	5.7%	1.7%
8	**Fnac**	2.6	3.7	5.0	5.8%	6.3%
9	**Best Buy Europe**	—	3.7	5.6	—	8.7%
10	**Eldorado Russia**	1.3	3.3	3.7	16.9%	2.5%
	Average Sales Growth	—	—	—	**5.5%**	**3.1%**
	Amazon Europe	0.90	2.03	3.39	14.4%	10.8%

Figure 1: Top 10 European Consumer Electronics Retailers (across all outlets), 2003-2014E
Ranked by 2009E CE Merchandise Sales in EUR Billions
Source: Company reports, MVI analysis

		2003	2009E	2014E	2003-09E	2009E-14E
1	**Best Buy**	22.2	36.3	48.1	8.5%	5.6%
2	**Walmart Stores**	18.5	27.5	33.0	6.9%	4.0%
3	**Target**	6.4	10.2	12.2	8.0%	3.3%
4	**Costco**	4.5	8.6	12.8	11.6%	7.6%
5	**Apple**	5.3	6.5	9.0	3.4%	6.2%
6	**Gamestop**	5.3	6.2	8.6	2.7%	6.3%
7	**Sam's Club**	6.7	6.3	5.9	-1.1%	-1.1%
8	**Dell.com**	0.6	5.6	7.9	44.5%	7.1%
9	**Amazon.com**	1.3	4.6	7.5	22.9%	11.7%
10	**RadioShack**	4.6	4.2	4.5	-1.7%	1.2%
	Average Sales Growth	—	—	—	**11.9%**	**5.2%**
...	**Circuit City 2003-08**	9.74	9.18			

Figure 2: Top 10 US Consumer Electronics Retailers (across all outlets), 2003-2014E
Ranked by 2009E CE Merchandise Sales in USD Billions
Source: Company reports, MVI analysis

to optimize operations to remain profitable.

US: Top 10

To anyone familiar with the US CE landscape, it's no surprise that Best Buy is #1 on the list and will remain there for the foreseeable future (Figure 2). More interesting is what the rest of the list looks like now that Circuit City, which generated just over USD 9 billion in sales in 2008, is out of the picture. Mass merchandisers, clubs, and Internet retailers round out the rest of the list, with RadioShack as the only regional electronics specialists making the list at #10.

The mass merchandisers' strength in CE continues to grow. If you combine the 2009E CE sales for Walmart Stores (#2) and Target (#3), they would surpass Best Buy by nearly USD 1.5 billion. Clearly, the lion's share of that comes from Walmart. With over 10% of its overall sales coming from CE products, the retailer is an increasing threat to Best Buy. For Walmart, electronics is now a "win" category. It continues to dedicate more space to electronics even though the overall box size is shrinking. Shoppers are starting to notice: Walmart is gaining share particularly among shoppers with a household income below USD 55,000, according to ShopperScape™ data.

- As the leading club operator, Costco continues to drive growth in electronics. In 2008, it sold USD 1.9 billion in televisions alone and will continue to grow over the next five years to rival Target for the #3 position. Sam's Club is not far behind at #7.
- Online retailers are growing quickly, as more and more shoppers are looking to the Internet for more than just product information and price comparison. Amazon.com is growing strong with Amazon prime and more third-party vendors.
- Electronics specialists continue to struggle for both profitability and sales growth: RadioShack will remain flat to slightly down over the next few years, unless it makes a fundamental shift to its current business model. 2009 was a good year because it sold more converter boxes than anyone else – not a sustainable model. hhgregg and Fry's would be the next largest regional specialty retailers but don't have the scale yet at 112 and 34 stores, respectively – though hhgregg is gunning to get there with rapid expansion plans of 21 stores in 2009 and 45 in 2010.

	2003	2009E	2014E	2003-09E	2009E-14E
1 Casas Bahia	1.4	9.6	18.7	38.2%	14%
2 Ponto Frio	0.7	3.7	6.7	31.5%	12%
3 Magazine Luiza	0.2	2.5	5.8	52.0%	18%
4 Carrefour	0.4	2.2	4.1	35.5%	13%

Figure 3: Top 4 Consumer Electronics Retailers (across all outlets) in Brazil, 2003-2014E
Ranked by 2009E CE Merchandise Sales in USD Billions
Source: Company reports, MVI analysis

	2003	2009E	2014E	2003-09E	2009E-14E
1 Eldorado Russia	1.4	4.0	4.4	19.1%	2%
2 Euroset	0.6	3.4	3.6	33.1%	1%
3 Svyaznoi	0.3	2.3	2.8	41.9%	4%
4 M-Video	0.4	2.1	3.0	33.4%	7%

Figure 4: Top 4 Consumer Electronics Retailers (across all outlets) in Russia, 2003-2014E
Ranked by 2009E CE Merchandise Sales in USD Billions
Note: USD sales are down approximately 30% since last year due to currency devaluation.
Source: Company reports, MVI analysis

BRIC Countries: Top Retailers by Country

The fast-growing and developing BRIC (Brazil, Russia, India, and China) markets offer growth opportunities in consumer electronics (CE) as well (Figure 3). Here are the top players by country:

Brazil

In Brazil, the electronics specialists as we know them do not exist on a large scale. Most stores have a combined offer of CE goods, credit, furniture, and sometimes even food. The Top 3 specialist players (Casas Bahia, Ponto Frio, and Magazine

	2003	2009E	2014E	2003-09E	2009E-14E
1 Emart India	0.07	0.28	0.43	55.4%	9%
2 Pantaloon	0.03	0.18	0.44	84.1%	19%
3 Reliance	0.01	0.14	0.45	176.6%	27%
4 Infinity	0.01	0.06	0.11	110.2%	13%

Figure 5: Top 3 Consumer Electronics Retailers (across all outlets) in India, 2006-2014E
Ranked by 2009E CE Merchandise Sales in USD Billions
Source: Company reports, MVI analysis

	2003	2009E	2014E	2003-09E	2009E-14E
1 Suning	1.5	18.3	38.9	52.0%	17.2%
2 Gome	2.2	14.2	16.6	36.9%	1.3%

Figure 6: Top 2 Consumer Electronics Retailers in China, 2003-2014E
Ranked by 2009E Sales in USD Billions
Source: Company reports, MVI analysis

Luiza) fit that description. Their assortment consists of approximately one third of pure CE, one third of white goods, and one third of other products that include child accessories, furniture, and other goods. In addition, most of these retailers have a combined offer of retail, credit, and financial services where most shoppers can't afford the items without credit – and the credit business generates higher profits than the retail side.

- Casas Bahia focuses in particular on working class shoppers (classes C and D), which are most apt for financed purchases.
- Carrefour (#4) reports significant CE sales and could overtake Magazine Luiza, if the company decided to embrace the CE channel more than in Europe where CE sales are decreasing.
- Grupo Pão de Açúcar's acquisition of Ponto Frio in early June now places it among the largest retailers overall in Brazil.

Russia

The Top 4 in Russia consist of two big box CE stores and two mobile retailers: Euroset and Svyaznoi. They have been expanding very quickly in recent years, but growth has come to a halt. Both Euroset and Eldorado have been expanding partly on the back of franchising, which is expected to slow down. Currently, the franchising growth in Russia is slowing down due to the lack of available credit for small businesses.

- Most Russian mobile phone retailers (such as Euroset and Svyaznoi, among others) sell phones over the counter, due to a high theft rate in Russian stores. This is beginning to change, as Svyaznoi started operating mobile phone shops where shoppers can touch the merchandise. This trend is expanding, as the mobile store model is changing—similar to that of Media-Saturn and M-Video stores—to create more excitement in stores.
- Eldorado, the largest consumer electronics player in the market, has adapted its concept to that of Media Markt after the German retailer announced its entry into Russia in 2006. Eldorado aligned its brand colors, in-store architecture, and marketing strategy to those of Media-Saturn. As a result, Media-Saturn changed its look and strategy to differentiate its brand.
- Electronics specialists such as Eldorado continue to be under significant cash flow and debt pressure, which only increased due to the recent currency devaluation. As a result, Eldorado sold a majority share to a Czech investment fund PPF, headed by Petr Kellner. The fund has a long history of supporting Eldorado by financing consumption through credit offers. Kellner's fund will focus on Eldorado's financial health, while original owner Igor Yakovlev continues to run the store operations and increase efficiencies to survive the economic recession.

India

Today, the restrictions on FDI in multi-brand retail in India drive the fact that all four key players (Emart India, Pantaloon, Reliance, and Infinity) are part of Indian conglomerates and that the main specialty players are probably more similar than different in their layout and merchandise selection.

Multi-industry conglomerates Reliance and Tata own the third and fourth largest chains, Reliance Digital and Croma (through the Tata-owned Infinity Group). Reliance Digital stores are heavily influenced by the European medium-sized CE outlets, and Croma runs a variety of footprints from the standard 20,000 square foot store all the way down to express stores operated in airports.

In second place today is the Pantaloon Group, which is the largest retail-focused business in India. It operates a variety of formats:

- Electronics specialty (bannered E-Zone)
- Department stores (which are predominantly apparel and home goods, and do not sell significant amounts of electronics)
- Supermarkets and hypermarkets (Food Bazaar and Big Bazaar) – Big Bazaar in particular has a significant electronics business. It's important to remember that even though electronics are an infrequent purchase, they are viewed as a trip driver by hypermarkets since consumers are more likely to buy electronics from the modern trade than they are food.

The market leader, Next, is owned by Emart India, which is in turn a venture owned by Videocon, the largest manufacturer of CE/white goods in India. Private label products, which have been largely unsuccessful for most electronics specialists (with the exception of Best Buy), continue to increase share – especially in the lower price ranges to meet needs of the price-sensitive Indian consumers. Videocon as a manufacturer has a significant advantage here, and private label brands within the Next chain are gaining share quickly and disproportionately.

Obviously, changes in the FDI rules in Indian retail will massively reconfigure all of Indian retail, including the electronics sector, but these changes do not appear to be imminent in the short-to-medium term.

China

2009 may well be a pivotal year for electronics retailers in China. Chinese consumers have been on a recent buying spree boosted by a government economic stimulus package with generous subsidies for household appliance replacement for consumers in the rural areas. Sales of all white goods in Suning's Beijing outlets jumped more than 200% in June 2009 vs. 2008. (Meanwhile, appliances have been in double-digit declines in most other countries around the world.)

- Suning is expected to surpass Gome as the largest consumer electronics retailer in China this year. Its plans to expand aggressively include opening 200 new stores in 2009 (primarily in rural markets) and an additional 220 stores in 2010 (which would bring it to 1,300 outlets).
- Gome (#2) has been the largest consumer electronics specialist in China (until this year) with over 1,300 stores, dominating first-tier cities with 40% share. It has been struggling lately since its founder and chairman Huang Guangyu is under investigation for alleged wrongful share dealing. The company has resorted to looking for additional financing and closing stores to generate cash.

The competition for CE growth in China will continue to intensify over the next few years, as a number of international retailers have aggressive expansion plans:

- Best Buy currently operates six Best Buy stores and 164 Five Star appliance stores, with plans to open "a few hundred outlets in the next five to 10 years," according to Best Buy International CEO Bob Willett.
- Media-Saturn has partnered with electronics manufacturer Foxconn Technology Group in China and plans to open 13 Media Markt big box stores in 2010, with the first one in Shanghai. It plans to grow to "300 in the medium term."
- Yamada Denki, Japan's largest electronics retailer, plans to open its first outlet in China during 2010.

MVI Interpretation

Though there are some differences by market, we are seeing a common trend among the top consumer electronics retailers: competition from other channels continues to intensify. Electronics specialists are struggling to drive growth via their existing models, as consumers cut back spending. In addition, ASPs (average selling prices) have rapidly declined in a couple of key product categories, such as flat-screen televisions and computing. Electronics specialists from all over the world are feeling the squeeze, as they look at relatively flat sales over the next few years. The solution requires retailers to be innovative in regards to not only products but also their business model; they must reposition to drive growth – and profitability.

Internet retailers, hypermarkets, and clubs have become particularly competitive. While the pure-play Internet retailers (except Dell and Amazon in the US) are too small today to make the Top 10 list, their rapid growth is changing more than share: it's changing the price competitiveness of the industry and the way shoppers want to shop. At Best Buy, for example, over 4% of its 2008 revenues came from online sales. Pixmania in Europe has leveraged its supply chain and price competitiveness to drive aggressive growth across Europe, particularly in southern Europe where national retails tend to be higher.

The availability of online research, independent product review sites (such as CNET and which?), and price comparison sites (PriceGrabber, PriceRunner, mySimon, and many others) have commoditized many items away from the expert-based selling model that was a critical element of the electronics selling model for so long.

Whether it's Carrefour in Europe and Brazil or Walmart and Target in the US, hypermarkets (and clubs) have another competitive advantage over specialists that transcends their reputation for low and/or competitive pricing: the trip and cross-shopping opportunity. As consumers continue to consolidate trips, a reinvigorated electronics department within a hypermarket that the shopper is already in is a compelling incentive to purchase, especially if the shopper has researched the product online and doesn't need to rely on store associate expertise to assist in the purchase decision. For some shoppers, even when the pricing is competitive, the perception of low price and value of the hypermarkets and clubs may overshadow the electronics specialists' reputation for expertise – and association with "want" purchases. These retailers realize the opportunity and have implemented strategies to increase their share of CE. Globally, CE represents a huge opportunity for Wal-Mart, especially in markets where it has a strong grocery share. The retailer's South Rogers, Arkansas prototype store in the US, for example, leaves little doubt of its ability to drive significant growth in consumer electronics.

Vendors must show some sensitivity across channels and markets. The power drivers (such as Best Buy) are between major products or format introductions, so they are weaker than in the past but will recover in 2010. The hypermarket and club channels are driving volume today but in the future will treat CE as one more department, not an area of expertise. Selling cycles should reflect these realities in both the short and long term.

Pharmacies Behaving Badly

Price-Fixing Scandal in Chile May Create OTC Opportunity

By David Marcotte | Originally published on September 16, 2009

The price-fixing scandal in Chile involving both the country's three largest drugstore chains and nine largest manufacturers of pharmaceuticals has gained new energy with compromising e-mails becoming public. The products in question, almost all "general remedies," are over the counter (OTC) in other countries, which may create a huge opportunity in 2009 for the right retailer.

Retailer	Sales in Billions of Chilean Peso			CAGR
	2008	2011E	2014E	'08-'14E
Cruz Verde	431.15	552.16	670.86	7.6%
FASA	341.63	412.97	475.06	5.6%
SalcoBrand	300.33	338.62	397.48	4.8%
Total	1,073.11	1,303.75	1,543.40	6.2%

Figure 1: Drugstore Chains in Chile | Source: MVI research and analysis

For the past year, a major scandal has been unfolding in Chile. The three largest pharmacy chains (FASA, Cruz Verde, and SalcoBrand), which control 92% of the trade in the country, have been accused of having in collusion raised prices. All of the major Chilean-based pharmaceuticals have also been accused of the same. The products were general remedy product, which in Chile are kept behind the counter and handled by the pharmacist or assistant. One retailer has already admitted full guilt, and the others have been re-indicted in the past month based on new revelations found in e-mails between companies.

The end result is that general remedies will come out from behind the counter. Should that happen, Wal-Mart is the one company with a pre-existing portfolio of over-the-counter (OTC) products that has the means to move rapidly into the new market. Others will try to legally stop this, but their position is eroding rapidly.

The Players – The drugstore business in Chile is location intensive with over 4,000 stores in total. The majority of the volume is in Farmacia Ahumada, Farmacia Cruz Verde, and Farmacia SalcoBrand (Figure 1).

Due to a history of strong tariffs and weak international patent observance, a strong domestic pharmaceutical industry emerged in the 1970s and 80s (Figure 2). Despite the reconciling of patent laws to match those globally established, it continues to dominate the percentage of trade, particularly in general remedies. This category, which includes drugs that elsewhere would be OTC and drugs for long-term conditions such as diabetes, forms the bulk of sales for the drug chains.

The Set-Up – Most employees in drugstores are on commission for sales, so there is an incentive to sell that can create conflict to responding to customers' needs. Without prices being posted and with these drugs being behind the counter, price awareness is low and employees are inclined to suggest the most expensive product due to their incentives. Customers are generally very location driven, so there was not very much store-to-store price checking prior to the scandal breaking.

Interestingly enough, the one company that tried to break out of this pattern was D&S: It launched its Farmalider banner with a layout that had OTC products. The other three companies worked successfully via litigation to have D&S stopped and finally, not being able to make the concept profitable without OTC, D&S sold the 60 stores to FASA in 2006.

The Hook – The three companies were all involved in a very aggressive growth and remodeling program from 2002 through 2008, as they followed consumer spending. The competition for locations, expense of continued remodels, and very low product prices made margins low to non-existent. One solution pursued by FASA was to buy into the Mexican and Peruvian markets, but the funding for growth is – for the most part – still coming out of the Chilean market volume and investments. A partial change of ownership at SalcoBrand by Chilean pharmaceutical company Sofor (in 2005), along with Falabella buying into FASA, were both moves to inject more money.

In early 2007 "una guerra de precios" (a price war) started, quickly drawing in all three companies into a highly public dropping of prices across the board. At one point, Cruz Verde was on television listing prices versus the competition. Others responded with 50% discounts in spot markets. Margins that were already tight shrank to nothing.

The Tale – In November 2007 the war suddenly stopped, apparently at the instigation of Sofor. Along with owning SalcoBrand, it also supplied a range of products to the other two retailers. In December, prices for key general remedies started to rise in groups on a monthly basis. By the beginning of the second quarter of 2008, prices for 222 different products had increased 200-300% – even more in some cases. Since prices were no longer advertised and most consumers tracked promotions closer than the individual products, the change went mostly unnoticed.

The Wire – Bloggers in the market credit a D&S employee—while shopping for contraceptives in December 2008—with uncovering the unusual pattern of multiple products all rising at the same time in different retailers. By the end of 2008, the Fiscalía Nacional Económica (FNE) via the anti-trust board Tribunal de Defensa de la Libre Competencia (TDLC) was already starting a large investigation against all the major players.
In February 2009 it released its finding with a detailed list of all the products, manufacturers, and price changes over time that had clearly been coordinated amongst all the different companies. It then fined the three pharmacy chains USD 15 million each, which was the legal limit that it could impose.

FASA, with Falabella management in attendance, admitted full guilt in March and confirmed all accusations that price rises had been coordinated, which the other two companies continued to deny.

Figure 2: Pharmacies in Chile | Source: MVI market visit

Its fine was reduced to USD 1 million for working with the FNE. All parties agreed to a 60-day period of intense promotions on all listed products to "return" some of the money back to the public.

The Shut-Out – The media has featured this topic as a "page one" story since January, and the public reaction has been intensely hostile. Non-colluding pharmacies have reported sale increases of 35% in 2009 according to government statistics. Websites have sprung up showing a much wired country "where and where not to shop" for drugstore items. Share prices for all three retailers, including FASA, have dropped by almost half: FASA appears not to have benefited from its admission of guilt.

This issue has also become a political one, with calls for increased funding and prosecution of this type of anti-competitive behavior. The most threatening legislation, to take general remedies from behind the counter and put onto the general sales floor and to make the same product available in supermarkets and hypermarkets, has stalled but may be getting new life due to recent revelations and legal moves on the part of the government.

The Sting – In early July the FNE started to release an edited copy of e-mails that have gone between the companies. These showed not only the collusion of retailers but also the active involvement of the pharmaceutical manufacturers.

E-mail from a laboratory employee sent to a pharmacy executive in 2008, names deleted: "Pursuant to your request, I spoke with [names redacted] and they [are] willing to adjust the price of sales to the public, following our suggestion. They hope you will confirm the dates and take action first. Once they evaluate the situation, they will set their prices that same day." Source: FNE.

Given the mass of new information and that the financial reports of the companies in question did not reflect illegal gains, the Chilean security and exchange commission (SVC) has also gotten involved. The media continues to carry news on the scandal on their front pages; protests continue to be organized; and the likelihood of legal changes in product handling is increasing.

MVI Interpretation

Drugstores have an elevated position in the consumers' sense of trust since they deal so extensively with areas of health and wellness on a very personal level. When that trust is broken, the results can be catastrophic – as what is unfolding in Chile shows. Aside from the fines and the temporary loss of business, drugstores are in very real danger of losing exclusivity of their highest volume product: general remedies. This exclusive status has been maintained by means for political support; that support now is quickly disappearing. It is also fueling the growth of the far smaller pharmacy chains, such as Farmacia Similares and PreUnic, which are not only gaining share but also expanding into new product offerings such as quality cosmetics and health supplements.

The real winner will be the supermarkets, which will finally have an opportunity to start selling OTC. In a small market with slow growth, the opening of such a large category of products will mean major changes and volume increases. The largest supermarket chain also has the greatest access to OTC products to bring immediately to the market: an oddly quiet D&S, owned by Wal-Mart.

D&S is letting the Asociación Gremial de Supermercados de Chile (ASACH) do the talking. In May, ASACH again made public its desire to sell general remedies as an OTC item stating that, at the very least, it could lower the average price sold by 20%. Given the public mood and the steady unfolding of the scandal, it's hard to see how legislation will not occur in the near future.

John Rand

Carving Out A Prosperous Future

By Elizabeth Lee, MVI Editor

For MVI's John Rand, change has always been a part of his life. A good thing, considering the industry in which he works and what's on the horizon with his company and his role.

Growing up, Rand's family moved often (four times in his high school years) because of his father's career. More than anything, Rand wanted to be at the same place for his entire college experience. At Bates College in Lewiston, Maine, he met his wife and became a lifelong New Englander. Rand has been in the retail business for 42 years and has seen many exciting changes in that time, and he has many more to look forward to.

Rand got his start, interestingly enough, as a teenager who worked after school and during summers bagging groceries (the "bagboy network," he calls it).

His first real break, however, came in the early 80s – when he took a job with Hannaford Bros. to work on the early versions of (computerized) space management. That's when Rand began to think of retail as a career and not just as a job.

"That was a very exciting time when I learned something that not a lot of people had experience with and built an expertise that carried me forward ever since," he says. "It engaged me intellectually and awoke my analytics side."

In his dozens of years in the retail business, Rand has worked on "both sides of desk" in various roles: retailer, salesperson, category analyst, and consultant. He's been able to leverage all those experiences to a path that has led him to his current title, director of retail insight. He's worked in everything from convenient stores and the hardware industry to restaurants, foodservice, and grocery.

"The depth and breadth of his experience and thinking makes him both effective in strategic conversation with senior management and able to discuss tactics in detail with field resources," says MVI's David Marcotte. "His expertise is based on the hard-earned knowledge of decades in a tough business."

Rand, who joined MVI seven years ago, today enjoys a reputation for knowing retail and knowing it well: speaking at events, writing articles that focus on actionable insight, and training clients and analysts. He's also been quoted in countless newspapers, *Boston Globe, Supermarket News*, and *The Wall Street Journal* to name a few.

"John has been a hands-on participant, strategist, and analyst in the retail industry… and brings that insight experience and perspective to all of his work at MVI," says Bryan Gildenberg, MVI Chief Knowledge Officer. "John's knowledge of the retail industry and ability to communicate it in a memorable, insightful, and entertaining fashion are unparalleled."

Though Rand speaks easily about the retail landscape, he'd be the first tell you that the industry is increasingly complex.

"Most leading retailers are grappling with some level of new segmentation in their business, either segmenting their focus on different groups of shoppers or segmenting their offering – by creating clusters of stores or by rethinking the stores they have. This in turn creates new forms of complexity for both retailers and our supplier clients. A host of issues are attached to this – SKU optimization, the increased effort of retailers to create brands, and the remodeling and redesign of stores.

"All this change would have happened anyway, but the increased strains of the recession have accelerated it," he says. "We certainly have our work cut out for us to track all this action and bring useful insights to our clients."

Rand doesn't deny, however, that all the "heavy thinking and intellectual work" require some rest and relaxation. A self-proclaimed wintertime woodworker and summertime gardener (his two-car garage is no car and all tools), Rand enjoys spending time with his wife of 37 years, Paula, and their three children, two grandchildren, and any number of adopted pets. He'll need to take that R&R now because, in his career, things will be moving very quickly very soon.

"John's knowledge of the retail industry and ability to communicate it in a memorable, insightful, and entertaining fashion are unparalleled." *Bryan Gildenberg, Chief Knowledge Officer, MVI*

As of January 2010, MVI will have integrated with its four partner companies to become Kantar Retail. Rand couldn't be happier about the prospect of combining the "brilliant work" of Cannondale, Glendinning, Retail Forward, and Red Dot Square with that of MVI.

"It makes all the sense in the world and probably on some level is overdue," he says. "Each company brings unique resources, viewpoints, and areas of knowledge that will make us smarter, better, and able to do more for our clients and to do it well."

Over the years, Rand has been able to get more involved with ideas that go beyond the facts and into the insights and frameworks of retailing.

"MVI has opened opportunities for me to really see the retail landscape as a single ecosystem, where all the moving parts impact each other, to see how strategy and tactics play out in all the different formats," he says.

This experience should serve him well, as he's been asked to step into an expanded role, being moved from "a practitioner with an area of concentration" within MVI into a more wide-ranging role "integrating all these different retail insights and helping the rest of our team carry our research to the next level" within Kantar Retail.

And many agree that John Rand is just the man to do it.

US Grocery Forecast Stubbornly Unconsolidated

By John Rand | Originally published on July 14, 2009

MVI's latest forecast of the top-performing supermarket chains reinforces a view of a fragmented supermarket industry, where many regional players continue to thrive and grow alongside national chains. In this article, we will briefly look at the reasons why grocery is still unconsolidated and is likely to remain that way.

For most channels of retailing, you can reach 90% of the channel with two or three customers. Only a handful of significant retailers make up the club channel. The same is true for the mass and drug channels. Department stores have largely consolidated. Supermarkets, however, remain a highly fragmented channel (Figure 1).

As our latest top 20 list shows, many vigorous regional retailers are growing and competing successfully (Figure 2). Still, these top 20 retailers added together do not quite capture 90% of the projected increase in volume between now and 2014. For a number of years, MVI has consistently recommended that suppliers must get to a much deeper level of complexity to take full advantage of the wider spectrum of grocery opportunity.

But the questions remain: Why has this channel behaved differently from all the others? Why is grocery still stubbornly unconsolidated?

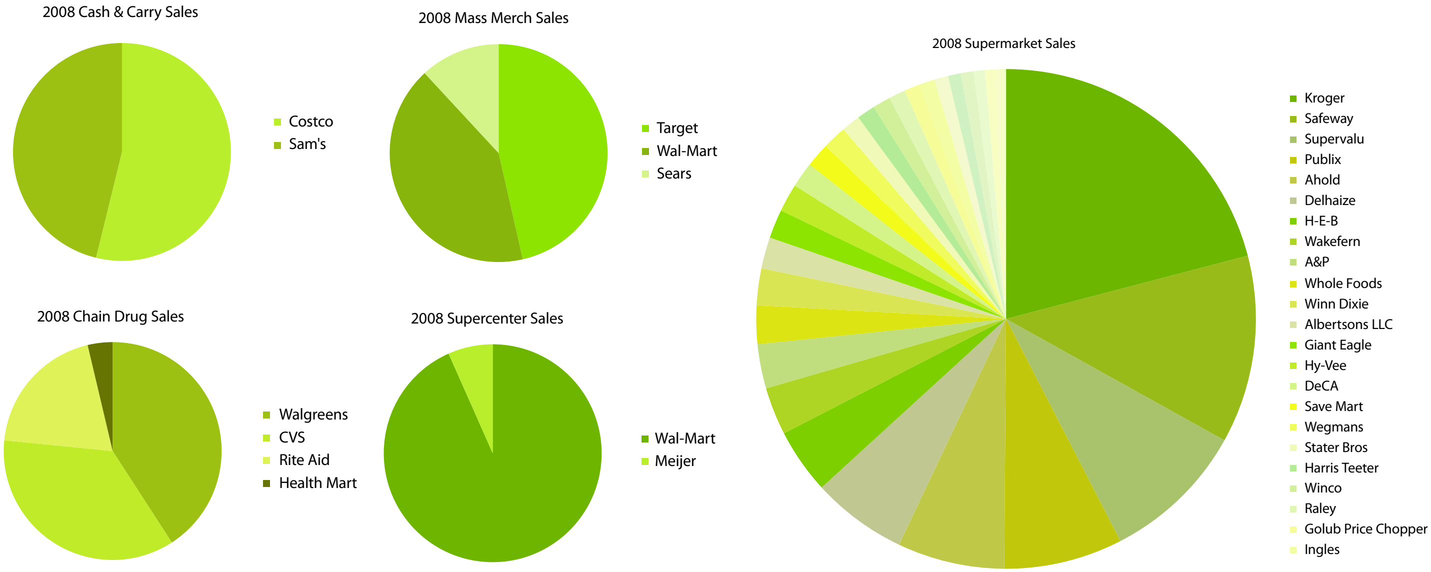


Figure 1: Relative Channel Fragmentation | Source: MVI research and analysis

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The answers are threefold: historical, financial, and rooted in shopper preference.

Historical

Part of the reason for the widespread nature of successful supermarket operators is that the channel is, as it is so often called, the "traditional" channel. Supermarkets were a saturated channel long ago: There were few communities that could not support a market of some kind and even fewer that wanted to try, since the core mission of providing food is not really optional. As the small local operators formed regional chains, they tended to develop the local real estate possibilities. This leaves very little "white space" left for a new operator to enter a market, and most of the easily available niches are quickly filled. The movement to suburban living was matched by the development of thousands of retail supermarkets in strip malls and shopping centers, most often by the existing local chains.

For a new format to be a real "game changer" and have enough advantage to break into a market and take share from existing players, there must be a sustainable advantage in at least two of the three basic areas of retailer activity: brand, finance, or operations. Most supermarket operators who run essentially similar formats have some ability to differentiate by brand, but both finance and operations are either neutral or tend to favor the incumbent, who has a "home field" advantage.

This has been especially true for privately owned operators, such as family-owned chains. As private companies, they are not subject to shareholder pressure. Although successive generations are not always interested in continuing the business, those who do so are often able to resist even lucrative offers

	Retailer	Sales 2009E (USD billions)	Sales 2014E (USD billions)	Sales Added 2009E-2014E	% of Total Sales Added 2009E-2014E
1	**Kroger**	$68.5	$91.8	23.3	26.0
2	**Publix**	24.3	31.9	7.6	8.4
3	**Safeway**	37.0	43.6	6.6	7.4
4	**Delhaize**	20.2	26.3	6.1	6.7
5	**Ahold**	22.2	27.8	5.6	6.2
	Top 5 Total	*$172.2*	*$221.4*	*$49.2*	*54.8*
6	**H-E-B**	13.5	17.8	4.3	4.8
7	**Wakefern**	10.3	14.5	4.2	4.7
8	**Walmart (Marketside & N Mkt.)**	3.4	6.9	3.5	3.9
9	**Whole Foods**	7.7	10.6	2.9	3.2
10	**Supervalu**	27.8	30.4	2.6	2.9
11	**Winco**	3.9	6.2	2.2	2.5
12	**A&P**	8.9	10.9	2.0	2.2
13	**Wegmans**	5.1	7.0	1.9	2.2
14	**Harris Teeter**	3.8	5.4	1.6	1.8
15	**Giant Eagle**	6.0	7.5	1.5	1.7
	Top 15 Total	*$262.7*	*$338.6*	*$75.9*	*84.5*
16	**Ingles**	3.2	4.3	1.2	1.3
17	**Hy-Vee**	5.8	6.8	1.1	1.2
18	**Stater Bros**	3.9	4.8	0.9	1.0
19	**Tesco**	0.5	1.3	0.8	0.9
20	**Schnucks**	2.7	3.5	0.8	0.8
	Top 20 Total	*$278.8*	*$359.4*	*$80.6*	*89.7*

Figure 2: Top 20 Supermarket Chains by Sales Added | Source: MVI analysis, MVI-Insights

from competing chains to merge or be bought out.

Financial

Although other formats – notably supercenters and clubs – have different financial models than supermarkets, it is more difficult for a supermarket operator to have a sustainable advantage over other similar operators within the channel. Once a chain grows to the level at which it can manage a supply chain and warehouse operation and is able to take advantage of truckload pricing, there are only a few areas where there is an advantage in scale. For example, HEB runs a much smaller operation than either Kroger or Safeway but competes with both quite nicely, as the scale of HEB is enough to neutralize the size advantage of either of the national chains. Indeed, any chain with more than about 100 stores is more or less equal for cost of goods.

There are "dis-economies" of scale as well. More employees do not always mean better-trained employees. More locations do not necessarily mean better-maintained locations. And more operating complexity certainly does not mean more operating efficiency or effectiveness.

There are some areas where scale does indeed confer an advantage. All other things being equal, access to capital at the best possible rates ought to be easier for large companies. Of course, all other things are not equal, and a well-run smaller company can raise funds for expansion quite well.

Retailer	Gross Profit Margin	Profit/$ Volume	Return on Assets (ROA)
Kroger	22.9%	3.2%	5.4%
Safeway	28.4%	4.2%	5.5%
Supervalu	22.7%	-4.8%	-16.2%
Publix	27.5%	6.5%	13.5%
Harris Teeter	31.1%	4.9%	5.7%
Ingles	23.1%	3.8%	3.8%
Weis Markets	25.9%	2.8%	5.5%

Figure 3: Levels of Supermarket Profitability | Source: MVI research and analysis

Marketing can also be a scale advantage, both in terms of cost of producing and placing advertising. However, the intensely local nature of grocery advertising (home-delivered circulars, primarily) is actually not a scale advantage above the local market area. The retailer who has local scale can actually have an advantage over a larger operator whose scale may be larger nationally but not locally.

As for promotional funding from suppliers, large-scale national players might seem to have an overall advantage. Since most of the players in the channel drop a great deal of promotional funding into their profit, not their shelf price, the regional operator does not suffer nearly as large a price disadvantage from other grocery chains as from Walmart. The presence of Walmart as a competitor has had a much greater effect on the survival of regional chains than other grocery channel competitors.

In the end, if we examine the level of actual profitability between large and small supermarket chains, we see that scale does not confer an economic advantage. In Figure 3, we look at a range of selected public retailers. Retailers as large as Kroger and Safeway do not show a significantly higher level of profitability as a percentage of sales than much smaller and more regional companies. Publix and Harris Teeter both show higher levels of return, while Supervalu is certainly larger but considerably less profitable than the much smaller companies.

Rooted in Shopper Preference

The final reason for the continued health of regional retail supermarkets is related to regional shopper preference. Most supermarkets carry thousands of similar items that are advertised and promoted on a national basis; however, tastes and preferences vary considerably across regions of the country. A comparative handful of items can make or break a shopper's loyalty to an outlet. Ethnicity varies widely in different areas, even more than income levels. Preferences in cuts of meat, types of cheese, flavors of ice cream, beverage preference, cooking styles – all add up to a series of regional and even store-by-store variations that can, if poorly managed, neutralize a larger company's potential scale. Regional retailers are usually much better at identifying which items distinguish local preference and, perhaps just as importantly, which items are not locally appropriate.

Combined with this ability to key into the local palate, regional retailers are usually very good at maintaining strong community ties and awareness of local community values, which also reinforces their advantage as locally sensitive. And last but not least: A familiar and comfortable local retailer (if it is a competent operator) has the simple advantage of being familiar and comfortable. The (familiar) layout, store design, shopping pattern, and employees are often the difference in making outlet choices when the formats are essentially similar.

A familiar and comfortable local retailer (if it is a competent operator) has the simple advantage of being familiar and comfortable.

MVI Interpretation

There is clearly room for more than one chain in a trading area – not unlimited numbers of similar competitors. In the next phase of retailer differentiation within the supermarket channel, the key is not only to be different from Walmart but also to be sufficiently different from one another. If finance (including price) is not going to be a source of competitive advantage, then the retailer must distinguish itself through branding and operations. Suppliers who call on regional operators will often miss how critically important it is to move beyond price and item offerings and to focus on supporting the retailer brand and operational excellence as a way to improve the partnership process.

The Cycle of Success

How Companies Distinguish Themselves Over The Long Term

Contributed by Ken Harris, Cannondale Associates | Originally published on November 9, 2009

On October 30, 2009, Cannondale Associates released its annual PoweRanking® study. First published in 1997, the PoweRanking® study asks retailers and manufacturers to rank each other on the areas where they interface (Figure 1). The result is a top 10 composite ranking for manufacturers and retailers as well as rankings on each metric for both trading partners (Figure 2).

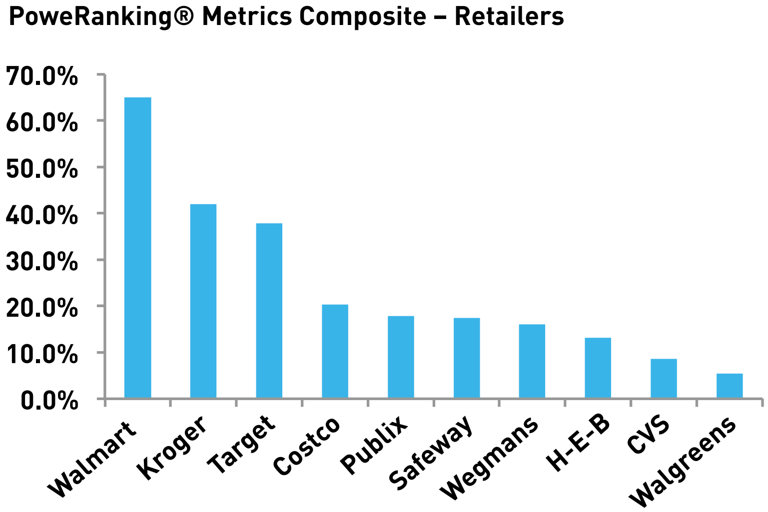
Retailers were asked to rank manufacturers on the following criteria:

Strategic	Business Fundamentals
Clearest company strategy	Best consumer/sales teams
Most important consumer brands to retailers	Most innovative marketing programs
Best combination of growth and profitability	Most helpful consumer/shopper insights; category management
	Best supply chain management
	Best shopper marketing programs

Manufacturers were asked to rank retailers on the following criteria:

Strategic	Business Fundamentals
Clearest company strategy	Best retailer with which to do business
Best job of branding their stores	Best CMAR/category management/buying teams
Projected to be Power Retailers in the next 15 years	Most innovative consumer marketing/merchandising programs
	Best supply chain management
	Best practice category management/CMAR

Figure 1: PoweRanking® Metrics | Source: Cannondale research and analysis



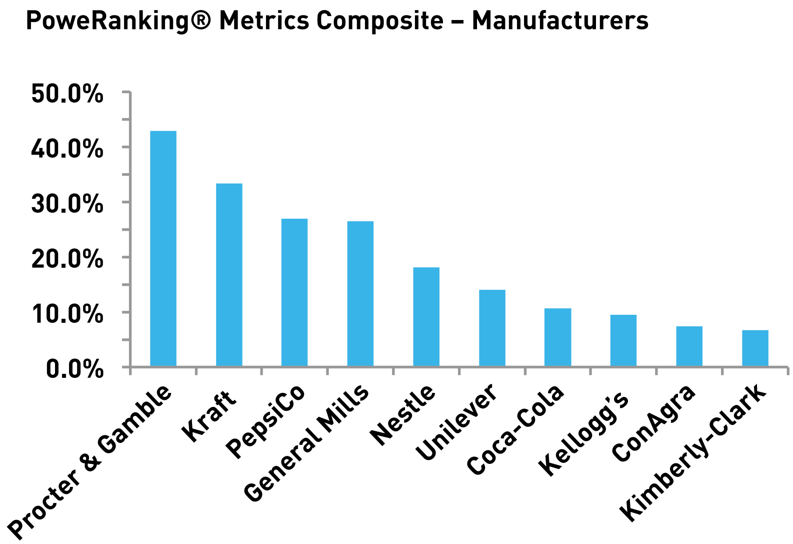


Figure 2: PoweRanking® Metrics Composite – Retailers & Manufacturers | Source: Cannondale research and analysis

This year in the PoweRanking®, General Mills and Nestle gained. Both companies are cited for programs that enhance meal creation at home, which has proven to be important in the current economy. On the retailer side, value-focused retailers including Walmart benefited from the economic downturn and consumers' desire to find value in their retail purchases. Although Walmart's business was recovering prior to the downturn, the economy catapulted them into high-performance mode. Kroger also recorded gains, as it continued to leverage shopper insights.

For the first time, Cannondale also identified those manufacturers and retailers that have consistently performed in the top 10 of the PoweRanking® composite since the original PoweRanking Survey was fielded in 1997 (Figure 3).

This year's PoweRanking® examines the character traits that enable top-performing companies to create the Cycle of Success and win with trading partners over time. Collaboration is the key thread running through the short- and long-term Cycles of Success. The best retailers and manufacturers have embraced a more cooperative mode of doing business. Beyond the operating philosophy of collaboration, Cannondale identified five character traits common to those companies that have achieved the greatest success over time.

1. **Simplicity –** Retailers and manufacturers that develop a simple go-to-market strategy, simple message, and simple way of doing business establish a firm foundation for collaborating with their trading partners.
2. **Consistency –** Using a consistent approach not only helps to build trust and respect but also enables each partner to develop and recommend strategies that will stand a higher likelihood of gaining agreement.
3. **Follow Through –** Results are fundamental to success, and they are based on trading partners following through on what they say they are going to do.
4. **Creativity –** Thinking creatively to identify new techniques and technologies helps differentiate the leaders.
5. **Involvement –** Understanding trading partners' business, objectives, and issues goes a long way in developing a collaborative relationship and creating the Cycle of Success.

Conversely, two traits that undermine success in a trading relationship include:

1. **Lack of Flexibility –** Trading partners want to feel that there is some give and take and a willingness to bend. Inflexibility blocks the collaborative process.
2. **Surprises –** Delivering against expectations is critical. Surprises erode trust and destroy collaboration.

Identifying leadership characteristics may be helpful, but the Cycle of Success ultimately depends on how those traits are put into practice. Cannondale's examination of the top PoweRanking® Survey performers identified three basic improvement recommendations.

1. **Economize the message.** Consistent with the success trait of simplicity, successful companies must be able to identify areas for which they want to be famous and – in a sound bite – communicate how their strategies can bring these areas to life.
2. **Own a few things, and do them well.** Most successful companies, while assuring that a minimum ante is set, concentrate resources in a select set of areas on a repeated basis that will help them achieve a competitive advantage and enable them to stand out with their partners over the long term.

Top PoweRanking® Performers over the Past 10 Years

Manufacturers	Retailers
P&G	Walmart
Kraft Foods	Target
PepsiCo	Kroger
General Mills	Publix
Unilever	Safeway
Nestle	Wegmans

Figure 3: Top PoweRanking® Performers over the Past 10 Years | Source: Cannondale research and analysis

3. **Drive actions through insight.** Although insight continues to be the most valued collaborative currency, insight without action is simply noise. The best trading partners ensure that every link in the chain—from problem identification to related insight to indicated action—is seamlessly connected.

In addition to the PoweRanking® study, Cannondale publishes industry benchmarking studies on trade promotion spending strategies, category management, and foodservice. If you wish to learn more about the PoweRanking® study or any of our other studies, please contact Ginny Valkenburgh at 203.834.2800.

Getting It Right: The Transformation of Walgreens

By Brendan Langan
Originally published on September 25, 2009

In 2006, MVI first identified several key changes at the macro, industry, and company-specific levels that would have a profound impact on Walgreens' go-to-market strategies, competitive positioning, and vendor partners in 2007 and beyond. We also made several recommendations for suppliers to consider at that time. Here, we revisit our insights and look at what has transpired at Walgreens since our initial review.

Over the past year, significant changes have taken place at Walgreens following a decisive shift in strategic direction to get "More from the Core," the overhaul of the executive suite, and the adoption of consumer-centric marketing and merchandising strategies. These changes did not occur overnight nor were they driven solely by the economic downturn. Rather, the genesis of Walgreens' transformation dates back more than three years.

Marketing: Walgreens Taps Catherine Lindner to Run New Marketing Department

When did Customer-Centric Retailing (CCR) start taking shape? Many point to the flurry of changes that occurred last fall—culminating in the sudden departure of former CEO Jeffrey Rein, a massive overhaul of the organization and top executive personnel, and a decisive shift in strategic direction. We feel the work began in 2006 when Walgreens promoted Catherine Lindner to the position of Vice President of Marketing Development.

At that time, MVI highlighted organizational change as a major development that could have profound implications for the retailer's go-to-market strategies. In this newly created role, Lindner was tasked with a singular but vital objective: to better understand, develop, and market relevant products and services for key customer segments. This seemingly ordinary announcement demonstrated a willingness to change and marked the emergence of a more shopper-centric Walgreens focused on "listening" to its customers. Acknowledging the need to improve the overall shopping experience is at the heart of CCR.

MVI highlighted organizational change as a major development that could have profound implications for the retailer's go-to-market strategies.

Lindner assembled a diverse team of talented marketing professionals and merchants from academia and retail, adding necessary depth to Walgreens' marketing organization. Her team has played an integral role in reshaping the culture, with a more targeted focus on consumer insights, brand messaging, products, services, and in-store experience. This department's work would later form the foundation of Walgreens' emerging customer insights platform and shopper/trip segmentations that have informed CCR decision making.

What can we expect over the next three years? Simply put, expect more. With the appointment of Kim Feil to the post of Chief Marketing Officer last fall, the role and importance of marketing across the Walgreens enterprise has been elevated and has gained vital c-level support. The recent debut of Walgreens' new communication program and slogan "There's a way" as well as its recent flu campaign illustrate what shoppers, patients, payers, and suppliers can expect from Walgreens. In this new world, suppliers should prepare to engage and be engaged by a more brand-aware and customer-centric Walgreens – where shopper and patient insights will play a much larger role.

Merchandising: When Less Is More

In MVI's article "Walgreens 2006 and Beyond," we highlighted the retailer's dissatisfaction with inventory levels and plans to reduce the assortment while improving profitability in the front end. As former CEO Jeff Rein said, "We do not need to carry everything we carry. We currently carry too many products. Our customer is confused." That year, Walgreens reduced its SKU count by 2% to 5% yet continued to add a growing assortment of private and exclusive brands to the mix. This year, Walgreens got serious about SKU optimization: It reduced the number of items offered by approximately 18%, doing away with 4,500 SKUs in the process. According to CEO Gregory Wasson, efforts to optimize the assortment have yielded four wins: helping to achieve better sales, taking work out of the stores, reducing capital deployed, and achieving the ultimate goal of offering a better customer experience.

In the years to come, suppliers must plan for more thoughtful, deliberate choices about products and services offered in a Walgreens. They must have a solid understanding of the role their product plays – be it margin, traffic, or brand. Through CCR, not all categories (or vendors) will be given equal status. Walgreens will continue to place bets using its category identifiers (Signature, Power, Staple, and Complement) and shopper-based principles to create a simpler, more productive and shopable store.

Healthcare: Skating to the Puck

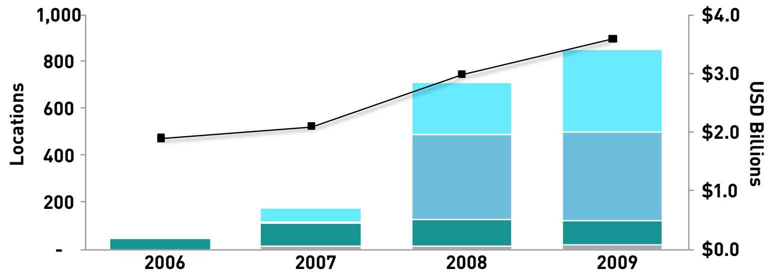
In 2006, MVI wrote about the rapid growth and increasing strategic importance being placed on the pharmacy and related healthcare businesses, Walgreens Health Services (WHS), and the unique challenges and opportunities this would pose for suppliers selling into the front of the store. At that time, WHS was led by current CEO Wasson (then Corporate EVP and President, WHS), generating just under USD 1.9 billion through its mail order business, 38 home care facilities, 6 specialty pharmacies, and 3 mail service facilities.

Since then, Walgreens has invested heavily to extend its healthcare presence and capabilities beyond the traditional pharmacy. It has pursued a largely acquisition-fueled strategy to grow its footprint and gain necessary economies of scale across a spectrum of healthcare offerings.

As we wrote in 2006, "What will the drugstore of the future look like?" That is still being fleshed out. What is certain is that drugstores have gradually assumed an increased level of importance as a primary provider of healthcare in the US. The introduction of in-store health clinics and ancillary service offerings are just a few of the innovations that will reshape the look and feel of the drugstore, as they take steps to fill a void and further differentiate themselves from alternative formats.

"Management has and will continue to aggressively grow its small but highly strategic portfolio of managed-care businesses, placing a particular emphasis on the fast-growing specialty market.

"In 2007 anticipate an increased focus on healthcare, on providing customers with an expanded assortment of products and services with a focus on [private and exclusive brands]. MVI anticipates these drivers will accelerate in 2007, sparking further consolidation, format innovation, and changes in what has long been one of the most stable and consistent operating strategies in retail."



	2006	2007	2008	2009
Take Care Clinics	-	62	217	350
Health and Wellness	-	3	364	377
Home Care	38	101	115	105
Other	9	11	12	17
Non-Retail Revenues	$1.9	$2.1	$3.0	$3.6

Figure 1: Walgreens Health Services (WHS) and Health & Wellness 2006-2009E
Source: Company reports, MVI research and analysis

How has this strategy played out? Over the past three years, Walgreens has grown the healthcare business at more than twice the rate of the retail business – more than doubling in size to an estimated USD 3.6 billion at the close of fiscal 2009 (Figure 1).

More significant than the top line, Walgreens has built a first-class and industry-leading network of healthcare assets across the country led by a team of seasoned and well respected thought leaders. It is well positioned to maintain and grow this foundation to play an active role in reshaping healthcare delivery in the US. Whatever the future holds for Walgreens, expect healthcare to play a much larger role. During a recent presentation to the investor community, CEO Wasson cited sustained efforts and investments necessary to "skate to where the puck will be in healthcare."

While traditional pharmacy will certainly play an important role in treating acute and chronic conditions, the future will lie in not only the treatment but also the prevention of chronic conditions and more complex specialty and infused pharmaceuticals. The specialty pharmacy market, where Walgreens holds a leading position, represents an enormous growth opportunity for Walgreens and is projected to increase at a rate of 20% per annum and reach USD 100 billion by 2010. To support these efforts, Walgreens is freeing up more space in the store for health and wellness services. It is also investing in time-saving technologies to unlock the value of its more than 16,000 trained pharmacists and nurse practitioners to effectively influence consumer behaviors, lower healthcare costs, and improve outcomes.

Vendor Collaboration: A Shared Ownership of the Future

In 2006, we wrote about cultural changes that were starting to take shape, as Walgreens began to reach out to trusted vendor partners (a major shift for a retailer with a historically insular culture) and the opportunity this presented for vendors to create true partnerships toward a shared future. These changes have accelerated in recent months: Walgreens is once again reaching out, leveraging its vendor relationships to support a myriad of initiatives. Going forward, the retailer has pledged to foster an environment that not only rewards but also requires higher levels of collaboration with vendor partners. This collaboration will entail a greater emphasis on shared insights and joint solution development.

> Walgreens has grown the healthcare business at more than twice the rate of the retail business – more than doubling in size to an estimated USD 3.6 billion at the close of fiscal 2009.

While many have enjoyed healthy, longstanding relationships with their buyers, DMMs, and GMMs, the dialogue is changing. Bigger ideas will require a deeper yet broader dialogue that goes beyond the buyer's desk or team leader. Future success will require more strategic collaboration, transparency, and accountability; in other words, a shared ownership of the future.

As greater resources are being allocated to square footage optimization, this environment of transition, slowing store growth, and emphasis on SKU reduction presents the single most strategic and challenging opportunity for vendor partners: Intellectual capital and ground-breaking ideas will often trump moderate product innovation. The way forward with Walgreens will be about gaining alignment with broader strategic initiatives, as this customer attempts to get "More from the Core" through the realignment of costs, cultures, and capabilities. These improvements will come not from "more of the same" but from building new capabilities that start with shopper insights and collaborative efforts.

The New Path

The economic crisis, hyper competition, and rapidly changing wants and needs have accelerated the rate of change at Walgreens and have imposed a new sense of urgency; however, efforts to get "More from the Core" began taking shape back in 2006. The signs may not have been as visible, but those who invested in the future instead of the past are better positioned for the new path to partnership with Walgreens.

MVI 2010 Events Calendar - EMEA

MVI believes that the only successful way for manufacturers to grow in the modern retail environment is by engaging with their retail customers in a collaborative, value-added business partner basis. Our calendar features training workshops and forums across a variety of markets and retail channels, all designed to enable our clients to build such relationships with those retail organisations that are driving growth across the EMEA region.

EVENTS MARKED STREAM WILL BE AVAILABLE VIA LIVE WEB STREAMING

Q1

NEW European Retail Outlook STREAM — London

Jan 26 — The Recession & Beyond - Outlook for 2010
Geographical coverage - Europe

France Retail Forum — Paris

Feb 2 — French Retail Trends Overview
Geographical coverage – France

Auchan Global Workshop STREAM — Lille

Mar 9 — Business Planning for Auchan
Geographical coverage – Global

Carrefour G4 Workshop — Paris

Mar 11 — Business Planning for Carrefour
Geographical coverage – G4 (Belgium, France, Italy, Spain)

Metro CEE Workshop — Warsaw

Mar 23 — *NEW* Selling to Metro C&C
Geographical coverage – Central & Eastern Europe

Q2

Russia & Ukraine Retail Forum — Moscow

Apr 20 — Russian Retail Trends Overview
Geographical coverage – Russia & Ukraine

UK Channel & Retailer Workshops — London

Apr 27 — Business Planning for Tesco Global STREAM
Geographical coverage – Global

Apr 28 — UK Discounter Channel Workshop
Geographical coverage – UK & Eire

Apr 29 — *NEW* Business Planning for Alliance-Boots
Geographical coverage – UK & Eire

European Shopper Forum STREAM — London

May 18 — European Shopper Forum
Geographical coverage – Europe

Discounter Channel Workshop — Leeds

May 20 — Business Planning for ASDA
Geographical coverage – UK & Eire

Russia SkillBuilders Workshop — Moscow

Jun 10 — Retailer Financial Models
Geographical coverage – Russia

MVI-A Kantar Retail Company
Tel: +44 (0)207.031.0251 Fax: +44 (0)207 031 0270 Web: MVI-Worldwide.com MVI-Insights.eu

NEW European Grocery Retail Forum — Geneva

Jun 15 European Retail Trends Overview
Jun 17 Streaming only session STREAM
Geographical coverage – Europe

NEW European Non-Grocery Retail Workshop — London

Jun 29 European Retail Trends Overview
Geographical coverage – Europe

Q3

Auchan & Metro Russia Workshops — Moscow

Sep 21 Business Planning for Auchan
Sep 22 Business Planning for Metro C&C
Geographical coverage – Russia

CEE SkillBuilders & Channel Workshops — Warsaw

Sep 27 Retailer Financial Models
Sep 28 CEE Discounter Channel Workshop
Geographical coverage – Central & Eastern Europe

NEW Spain Retail Forum — Madrid

Sep 30 Spanish Retail Trends Overview
Geographical coverage – Spain

Q4

Lidl & Metro Global Workshops — Dusseldorf

Oct 13 Selling to Lidl STREAM
Geographical coverage – Europe
Oct 14 Business Planning for Metro Cash & Carry STREAM
Geographical coverage – Global

Carrefour Global Workshop — Paris

Nov 16 Business Planning for Carrefour STREAM
Geographical coverage – Global

Buying Groups Workshop — London

Nov 30 Buying Groups Workshop
Geographical coverage – Europe

Private Label Workshop STREAM — London

Dec 2 Private Label Workshop
Geographical coverage – Europe

Walmart's New High-Efficiency Prototypes:

Key Points Suppliers Should Know

By Robin Sherk | Originally published on September 23, 2009

This summer, Walmart converted a few discount stores to pilot a format that has a full grocery offering and markedly reduced space for general merchandise. MVI discusses key learnings from visits to two of these prototypes and suggests areas suppliers should consider, as these tests move forward.

Walmart's newly opened High-Efficiency prototypes indicate an extension of Project Impact's initiatives. In October 2008, Eduardo Castro-Wright, Walmart's Vice Chairman described plans for these stores as "the second platform of our future growth" aside from ongoing Supercenter remodels. These pilots appear to be an effort at developing a Supercenter type of store within the confines of its discount footprint. Of the handful of discount stores to be converted into prototypes this year, this article covers the two that MVI visited in August and September: one in Bloomington, Minnesota and another in Mt. Prospect, Illinois. These High-Efficiency stores have the typical Project Impact store remodel features. They also extended the efforts in three key ways:

1. **Even smaller size** – Newly built Project Impact stores average about 10% to 25% smaller than the Supercenters, which are typically 185,000 square feet. These converted discount stores take this further, standing at about 35% to 40% smaller than the average Supercenter.

2. **Exaggerated department space** – Project Impact stores feature select areas through Win, Play, Show category arrangements. These test stores are spaced to clearly emphasize grocery; they have drastically reduced space for many general merchandise departments. Of its remaining offerings, Electronics, Home, Apparel, Toys, and Seasonal were more prominently featured. (See Figure 1 for detail of the store layout.)

3. **Site to Store convenience** – Project Impact stores commonly move the Site to Store desk to the customer service counter at front of the store. These prototypes further its convenience with a drive-thru Site to Store pick-up lane as well as several in-store Walmart.com ordering kiosks. Speaking of the High-Efficiency plans in October 2008, Castro-Wright explained that these stores present "a very different vehicle" to shoppers because "it would be the online opportunity."

Two additional points suppliers should recognize about these stores are their upscale appearance and focus on fresh, convenient grocery:

- **Attractive Outside** – Eschewing the "big box," the stores' inviting appearance may give a more upscale impression to passersby. This is achieved by curved, textured brown and grey facades, rectangular paned windows, white light fixtures, and landscaped foliage by the parking lot. Though this presentation is featured in the High-Efficiency format, it is not unique to these test stores.

- **Fresh and Quick Focus** – These smaller, spacious stores seem to target a more convenience-oriented shopper. The shopping trip might be considered as somewhat mixed between that for

Figure 1: High-Efficiency Walmart Store Layout, Mt. Prospect, Illinois
Source: Walmart in-store brochure

a Supercenter and a Neighborhood Market (grocery store). As is common in Project Impact stores, entering customers are greeted with the Produce section followed by Bakery and Deli to the right. This deli service counter and nearby stands of grab & go options underscore that these prototype stores also work to provide shoppers fresh, readily prepared meal options (Figure 2).

Why Walmart is conducting these tests:

This early testing of High-Efficiency prototypes shows that Walmart continues to develop its formats, even with the ongoing Project Impact remodels. The reasons for the retailer to develop such a format appear threefold:

1. **Store Optimization** – Increasing return is Walmart's first and foremost motive. Chief Executive Officer Mike Duke explained that two of the big priorities for Walmart now are "re-energizing the productivity loop" and to be "very smart" about growth by figuring out "how to optimize formats of growth." Having these smaller Supercenter type of stores aim to increase the retailer's sales per square foot productivity by taking less space to sell more. It also increases the retailer's capital efficiency by letting the company leverage its existing footprint and to build less costly stores to maintain. These smaller, reduced assortment stores may also reduce operating costs by allowing the retailer to have fewer staff and inventory demands than a traditional Supercenter requires.
2. **Site to Store** – Castro-Wright explained in October 2008 that these prototypes involve developing the growing "online opportunities" Walmart anticipates: "Online is, without any doubt, a very significant opportunity for us and one that you will see us invest much more in the future." MVI recently assessed Walmart.com's Site to Store growth and expansion: The retailer is working to develop its capabilities in the online realm and to leverage its store base in the process.
3. **Building Market Presence** – Smaller, more productive stores may help Walmart enter previously unviable markets. Castro-Wright has previously detailed that Walmart sees 15 "opportunity markets" in the US where the retailer is working to develop its presence (though he did not identify the markets). Places where Walmart has a relatively weak presence include urban locations and areas in the Northeast.

Areas for suppliers to consider about the High-Efficiency format:

Where do your categories fit in the box? Know whether your items look like they will be cut or expanded and proactively plan internally about the potential shifts ahead. Be prepared with shopper insights to detail why shoppers want and care about your brands to defend against rationalizations.

What opportunities does this create at other retailers? As Walmart alters its department's space and SKU offering, many shoppers will likely turn to other stores to buy those needs. As a result, new sales and promotional prospects may arise at local competitors.

What do shoppers think of these store changes? Given the exaggerated grocery section, consider whether shoppers have a different type of shopping trip at a High-Efficiency Walmart than at a regular Supercenter. Anticipate how shifts may alter desired pack-sizes, promotions, and product assortments.

How is your online presence at Walmart? Review your online assortment and presentation, as these stores feature Walmart.com and Site to Store integration. Developing capabilities and promotions that encourage trial of Walmart.com's Site to Store may support both the retailer's aims for its services and your range of online offerings.

Figure 2a: Walmart Produce Section
Source: Company marketing material

Figure 2b: Walmart Grab & Go Stand – Bloomington, Minnesota
Source: MVI store visit

Figure 2c: Walmart Full-Service Deli Counter – Bloomington, Minnesota | Source: MVI store visit

Winning in the New Retail Landscape

Contributed by Gary Carp, Glendinning Management Consultants / Originally published on October 29, 2009

In today's volatile environment, many companies are focused on the area of promotional evaluation: encouraging their people to analyse their data to death and to identify trends as to what promotions work best. However, the retail landscape is changing so quickly that it is unlikely that any relevant insight for the future will be drawn from analysing micro details of individual activities. Instead, greater sustainable value can be generated by focusing on practical strategic issues that can be leveraged more quickly and more effectively. Glendinning believes there are four areas you should be focused on to ensure the health of your business:

1. Brand and SKU Portfolio Optimisation
2. Better Cash Flow Management Through Efficient Trade Terms
3. Invest Behind Excellence of Execution
4. Energise, Equip, Engage

Brand and SKU Portfolio Optimisation

No one can afford to carry passengers in the current climate. Though brand managers are battling for every last SKU, don't let emotional attachment cloud your judgement. Enforce a new set of 4Ps: "Prudent pruning promotes profit."

- Optimise your procurement and production efficiencies.
- Drive out waste and duplication.
- Reduce working capital.

Focus on your power assets and take a long hard look at your brand portfolio, both at the macro level and within each SKU. Justify every SKU (and every brand) on the basis of a demonstrably relevant and compelling consumer and shopper proposition, or remove it. Plan for this before your customers do it for you.

Better Cash Flow Management Through Efficient Trade Terms

Letting customers hold back payments up to 60 days could jeopardise your entire future. Thoroughly reassess your trade terms structure and look for opportunities to improve the systemic efficiency of your business model. The critical wins are to get paid faster by your customers and to get your debtor days down. This is especially important across the wholesale and cash & carry sectors, for which survival relies on the continuance of the independent trade. If the ability of your customers to pay you is dependent on the ability of their downstream customers, then bank your cash as quickly as you can. Secure better terms from your suppliers as well. If you can't, be prepared to find new, more efficient suppliers that offer more flexibility.

Invest Behind Excellence in Execution

Retailers only have two places to go hunting for cash: shoppers and suppliers. When demand falls, the pressure on suppliers intensifies. Suppliers must make choices on where to prioritise resource and investment, and where to dial back.

Ideally, these choices should be made from a principle-centred approach. A useful guiding thought for everyone contemplating customer investment strategy is "fewer, bigger." The more you spread your investment, the weaker its likely impact and the greater your exposure. Two crucial factors must be counter-balanced: *volume potential*, the customers who deliver your volume and those that offer you future growth opportunities, and *executional capability*, the customers who can practically and consistently deliver their promises where it matters. For those who have identified their most strategically valuable customers, there are significant opportunities ahead (Figure 1).

Great in-store execution is always critical to success: All customers should be managed and incentivised against point-of-purchase growth drivers. This principle has direct relevance in helping you make smarter investment choices. Retailers want bigger promotions, and you may want to run them as well. But, will you get value for money and how do you measure it?

1. The most obvious question is "Do they offer you profitable business?" Customers who fail this test will either be Q1 (Disinvest) or Q2 where at best you should be thinking about tactical activation.
2. The second question addresses the executional imperative: "Can they and will they deliver their commitments?" If the answer is affirmative, the chances are that you can and should be proactively building mutually rewarding programmes. However, a customer who is recognised as Q3 (offers you growth potential but can't be relied upon to make things happen), will need a secondary investment to

drive implementational success – and if you can't or won't do this, then you need to rethink the viability of the core activities. Don't rely on customers' abilities to change their behaviours. If they couldn't do it in good times, they've got even less chance now.

3. The third measure tests your own negotiation capabilities. Assuming that short-term activities by their essence can only have short-term impacts, the real challenge is to leverage your investment and trade exceptional promotional activities for sustainable long-term improvements in your point-of-purchase presence. Q4 customers offer the opportunity to transcend the question of compliance. Both sides are likely to have already recognised the centrality of executional excellence to ongoing success and have built a supporting business process to manage this as part of the day-to-day engagement. The real upside comes by exploiting the transformational opportunities made available by developmental shopper marketing and commercial efficiency partnerships.

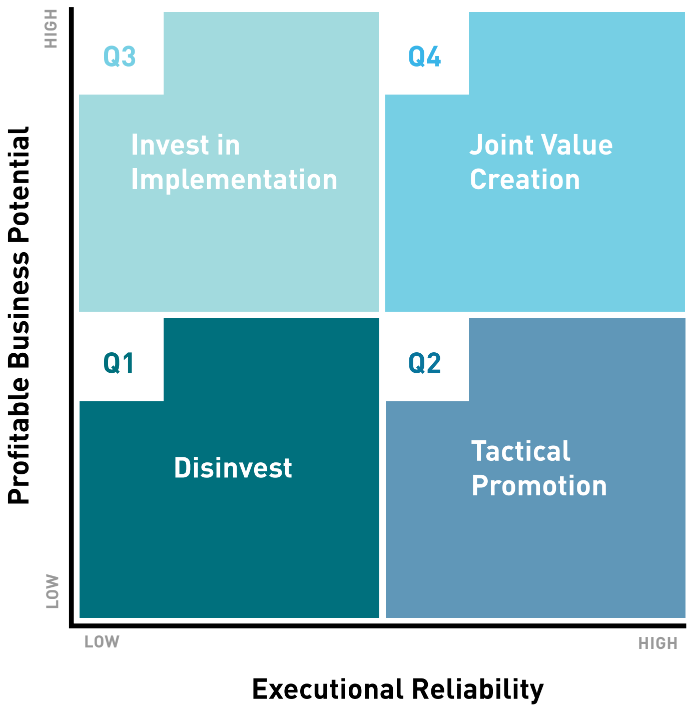


Figure 1. Identifying Your Most Strategically Valuable Customers
Source: Glendinning research and analysis

Customers can play an important role in signalling where you should allocate them on your grid.

- Q1 customers will often make outrageous requests that can be readily pushed back by all but the desperate.
- Q2 customers will leverage their size and scale and make demands for basic terms improvements.
- Q3 customers will emphasise their value proposition and sell the growth potential of their business.
- Q4 customers know their value to you and will push it. There are no easy choices here, and expect no favours.

But it is your money to invest, not your customers to demand. Make sure it's working hard for you, and make sure your customers are working hard for everything they're getting. Start from a principled plan that emphasises executional excellence. Getting principled will save you heartache and might even keep you out of jail.

Energise, Equip, Engage

Many companies have demonstrated early signs of manic depression: hunker down, cut training budgets, and analyse, analyse, analyse. Madness! Having to justify your performance and explain the unstable economy to management in monthly reports of ever-increasing gloom, it's easy to get sucked into a negative spiral. You need more cut-through than ever, and your team needs to be at peak performance: Sharp swords beat blunt blades.

Get your people's heads up and skills up, and get them out into customers. From head office to stores, you need to go to war for every box you can win. Everyone can make a difference, not just your sales teams. Don't underestimate the power and impact a few more CEOs getting in their customers' faces can have in engaging them to support your cause.

If you aren't doing so already, start tracking your competitors. Watch their results. Listen to customers. The slightest wobble may offer the opportunity to negotiate contracts in your favour. As the shakedown intensifies, the questions to ask are:

- What are you doing to energise and equip your people to lock down your contracts and win more business?
- How much time are they spending networking with customers?

> Darwin's theory of evolution is often misunderstood. It isn't the fittest who survive; it's the most adaptable.

Take Control of Your Destiny

Darwin's theory of evolution is often misunderstood. It isn't the fittest who survive; it's the most adaptable. To sustain demand, companies must rethink their total value proposition and focus on efficient business operations; they must make tough decisions in all areas to deliver consistent consumer-value improvements. In the end, smart choices on how to adapt will separate those who emerge stronger from structural changes in the market and those who don't emerge at all.

About Glendinning

Glendinning is well known as a world class sales and marketing consultancy, developing solutions for both B2C and B2B clients, whether they are local or global. Glendinning will work to find the most pragmatic solution for you - whether you are looking to optimise your route to market, serve your customers or consumers better, or improve the capabilities of your team. For more information about our services, please contact Director of Consulting Gary Carp at Gary.Carp@glendinning.co.uk.

US Retail Sector Faces Gradual, Jagged Recovery

By Caroline Doyle | Originally published on October 28, 2009

After a dismal first half of 2009, overall US economic conditions have recently shown signs of improvement. One particular sign is an uptick in consumer spending, driven in part by government stimulus packages such as Cash for Clunkers and the housing credit. However, the “recovery” process will be anything but vigorous, as unemployment rates, stagnant hiring, and frozen or declining wages will moderate spending and suppress any substantive strengthening on the consumer side. In other words, while we have past the bottom, upward momentum will be gradual and jagged.

The Details

Recovery will be gradual: Unemployment and housing will take some time to rebound.

In September 2009, unemployment reached a 26-year high of 9.8% (Figure 1). Although the rate of increase has tempered since the first half of 2009, this figure is expected to rise into the New Year. Some analysts conceive that US unemployment could even reach 10% in 2010. Despite this, initial unemployment filings declined approximately 1.5% in September, suggesting that layoffs could be moderating.

The housing sector has been plagued by an inventory surplus, devaluation of housing prices, and high levels of "unstated" inventory (i.e., housing that does not go on the market because of devalued prices). That said, prices have begun to stabilize, which in turn will reduce uncertainty about home and mortgage values. This will potentially influence banks' willingness to lend, gradually firming the net worth of housing and spurring consumer spending.

Recovery will be jagged: Consumer confidence, pricing, credit, and stimulus packages combine for a more erratic recovery path.

Although the Present Situation Index plunged in September 2009, the Expectations Index has reversed its course since February 2009, coming in at 73.3 in September* (Figure 2). With the exception of August 2009, the last time Expectations were this high was in December 2007. This implies that consumers are, at least, somewhat optimistic for a brighter future or perhaps just tired of feeling down. Either way, this confidence will continue to fluctuate below historical levels.

Inflation and deflation cycles have also been somewhat varied. An overall deflation of 1.3% in September

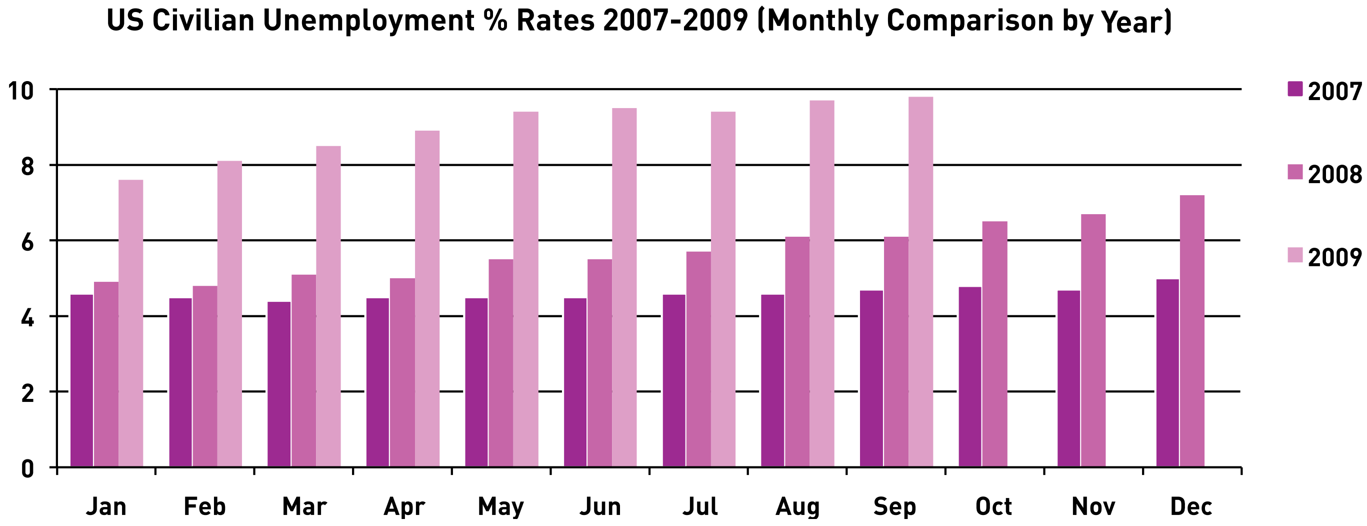


Figure 1: US Civilian Unemployment % Rates, 2007-2009 (Monthly Comparison by Year) | Source: BLS.gov

2009 was driven primarily by energy (21.6% decline) but also by food. Particularly dairy and, to a lesser extent, fruits & vegetables have brought food deflation down to -0.2% year over year. These resultant price decreases have influenced top line retailer sales growth; they have also intensified pressure on suppliers to bring prices down. However, this has been a global recession: The dollar is under considerable pressure, and imports such as commodities have become more expensive. Conversely, domestic services have decreased in price to become more attainable for consumers.

On the credit side, government intervention has intended to simplify terms and conditions. Still, revolving consumer credit in the US dropped 9.7% in Q2 2009, as terms and limits tightened. It then plummeted down 13.1% in August 2009, as more consumers opted to pay cash for back-to-school needs. Non-revolving credit was also down by 4.8% during this period but was less negative in August (down 1.6%), likely influenced by the Cash for Clunkers program. In any case, the supply of bank credit remains extremely limited, and credit activity will be difficult to predict.

The government stimulus packages will also contribute to a more jagged and unpredictable recovery. For example, the lowering of taxes and increased transfer payments roused consumer spending, but uncertainty remains about the timing or the nature of any future packages.

What About Retail?

High levels of debt caused a contraction in consumer spending during H1 2009, contributing to negative economic growth. This trend has reversed with upticks in consumer spending, particularly in the retail sector—thanks in part to a mild spending surge for back-to-school items. To those who haven't been tracking retail, September results for comparable store sales and retail/food services sales may be misleading. These monthly results are actually better than what they've been, and there are in fact winners in this environment (Figures 3 and 4).

Today, aggressive pricing, value orientation, and successful private label collections have been the keys to retailer success. Additionally, the health & wellness theme has particularly resonated, in that seasonal flu shots have driven traffic in-store. Given the current state of unemployment, hiring, and wages, consumers can not afford to be out of work and therefore have taken action to maintain their health, benefitting retailers who successfully leverage their pharmacy business. To maintain profit, keen expense management has become the new norm: Retailers have reset inventory levels and cut unnecessary costs.

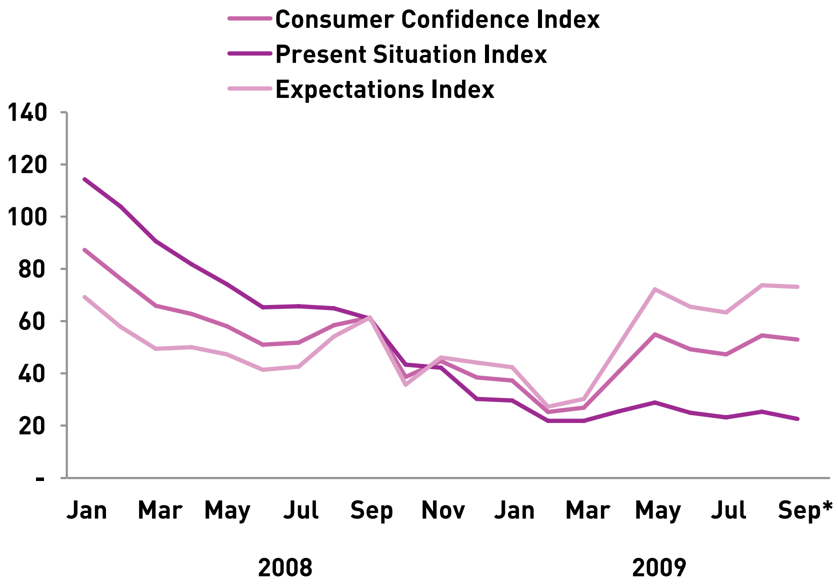


Figure 2: Consumer Confidence | Source: Pollingreport.com
**September 2009 results are preliminary as of October 27, 2009.*

MVI Interpretation

With unemployment high and not expected to improve dramatically in the near future, MVI does not expect a sudden surge in consumer spending. However, we do see the overall retail sector returning to a more predictable norm, characterized by a more practical shopper and even the emergence of "frugalistas." Consumers appear to have moved past the shocks of the early recession and are starting to return to a more balanced shopping trip—one that encapsulates both need-based consumables and need-based discretionary items (e.g., replacement shirt or pair of shoes). This type of selective replacement shopping has recently augmented, and consumers' buying for more than just survival is an early sign for a hopeful upcoming holiday season.

	August		Percent	September		Percent
	2008	2009	Change	2008	2009	Change
Retail Sales & Food Services Totals	384.8	360.2	-6.4%	352.6	333.4	-5.4%
Retail Sales (Excl. Autos)	314.3	291.7	-7.2%	291.2	277.5	-4.7%
Retail Sales	344.5	320.5	-7.0%	315.5	295.8	-6.3%
Durable Goods						
Building materials & garden equipment dealers	27.2	23.4	-13.9%	26.9	23.3	-13.4%
Motor vehicle & parts dealers	70.5	68.6	-2.7%	61.3	55.9	-8.9%
Electronics & appliance stores	9.2	8.1	-11.6%	8.2	7.4	-9.9%
Furniture & home furnishing stores	9.1	8.0	-12.3%	8.3	7.8	-6.1%
Nondurable Goods						
General merchandise stores	50.4	49.4	-1.9%	44.2	45.3	2.5%
Food & beverage stores	50.8	49.9	-1.8%	47.7	48.2	1.2%
Gasoline stations	46.6	34.1	-26.8%	42.8	31.9	-25.4%
Clothing & clothing accessories stores	19.0	17.9	-5.8%	15.9	15.9	-0.4%
Food services & drinking places	40.3	39.7	-1.4%	37.0	37.5	1.4%
Department stores (excl. leased)	16.5	15.4	-6.5%	14.0	13.7	-1.9%
Grocery stores	45.4	44.5	-2.1%	42.7	43.1	0.8%

Figure 3: US Census Monthly Sales for Retail and Food Services | Source: Census.gov
Note: All figures in USD billions

Retailer / Division	Monthly Sales in Millions (LCU) Sep '08	Sep '09	% Change	Comparable / Identical Sales Growth Sep '08	Sep '09	Two-year Average	Fiscal Year-to-Date Sales (YOY % Change)	Comps/IDs	Latest Store Count
Mass Merchants, Clubs, and Discounters									
BJ's	892.8	928	4.10%	10.40%	-0.50%	5.00%	-1.70%	-4.40%	184
Costco	6,670.00	6,850.00	3.00%	7.00%	1.00%	4.00%	3.00%	1.00%	528
Costco International	-	-	-	2.00%	6.00%	4.00%	-	6.00%	121
Costco USA	-	-	-	8.00%	-1.00%	3.50%	-	-1.00%	407
Target Corporation	5,320.00	5,392.00	1.30%	-3.00%	-1.70%	-2.40%	-0.70%	-4.30%	1,743
Drugstores									
Rite Aid	1,971.00	1,941.00	-1.50%	1.70%	-0.30%	0.70%	-1.90%	-0.30%	4,809
Rite Aid Front End	632.7	611.4	-3.40%	3.40%	-2.30%	0.60%	-4.80%	-3.10%	4,809
Rite Aid Rx	1,338.30	1,329.60	-0.70%	1.00%	0.70%	0.80%	-0.50%	1.10%	0
Walgreens	4,854.00	5,349.10	10.30%	4.70%	5.30%	5.00%	10.30%	5.30%	7,543
Walgreens Front End	1,592.10	1,733.10	8.90%	1.30%	2.00%	1.60%	8.90%	-	7,543
Walgreens Rx	3,261.90	3,616.00	11.20%	6.50%	7.00%	6.80%	11.20%	7.00%	7,543
Department, Apparel, and Sporting Goods									
Dillard's	568.5	519.3	-9.00%	-12.00%	-6.00%	-9.00%	-14.00%	-12.00%	0
Gap	1,340.00	1,330.00	-1.00%	-11.00%	-1.00%	-6.00%	-6.00%	-6.00%	3,100
JCPenney	1,446.00	1,438.00	-0.60%	-12.40%	-1.40%	-6.90%	-5.90%	-7.50%	1,109
Kohl's	1,335.80	1,464.00	9.60%	-5.50%	5.50%	0.00%	2.80%	-1.70%	1,059
Limited Brands	673.4	654.8	-2.80%	-6.00%	1.00%	-2.50%	-8.50%	-7.00%	3,015
Macy's	2,093.00	2,043.00	-2.40%	-6.60%	-2.30%	-4.40%	-8.50%	-8.20%	840
Nordstrom	718	720	0.30%	-9.60%	-2.40%	-6.00%	-6.10%	-9.80%	179
Ross	561	629	12.00%	-2.00%	8.00%	3.00%	9.00%	4.00%	992
Saks	273.2	242.1	-10.20%	-10.90%	-11.60%	-11.20%	-19.70%	-20.60%	107
TJX	1,830.00	2,000.00	8.00%	-1.00%	7.00%	3.00%	4.00%	4.00%	1,834

Figure 4: September Comparable Store Sales | Source: MVI-Insights

European Economic Indicators: Is the Worst Over?

By Paulina Terrazas | Originally published on November 2, 2009

After being dramatically hit by the global financial crisis, the European economy seems to be on the way to recovery from the second quarter of 2009. Yet, the speed of this recovery and its sustainability are contested. The International Monetary Fund, for example, warns that for Europe "a sluggish recovery lies ahead" and raises concerns regarding whether the recovery is structural or a consequence of counter-cyclical policies. Similarly, the European Central Bank expects a stabilisation period that will come with a "very gradual" recovery. The output decline is linked with a drop in cash availability and investment mixed with lower levels of regional trade and falling demand. Additionally, countries such as Ireland, Spain, and the UK have dealt with real estate price abrupt reversals. Others – such as the Baltics, Romania, and Bulgaria – have suffered from a massive drop in capital inflows. Currency depreciation has occurred in many non-euro markets.

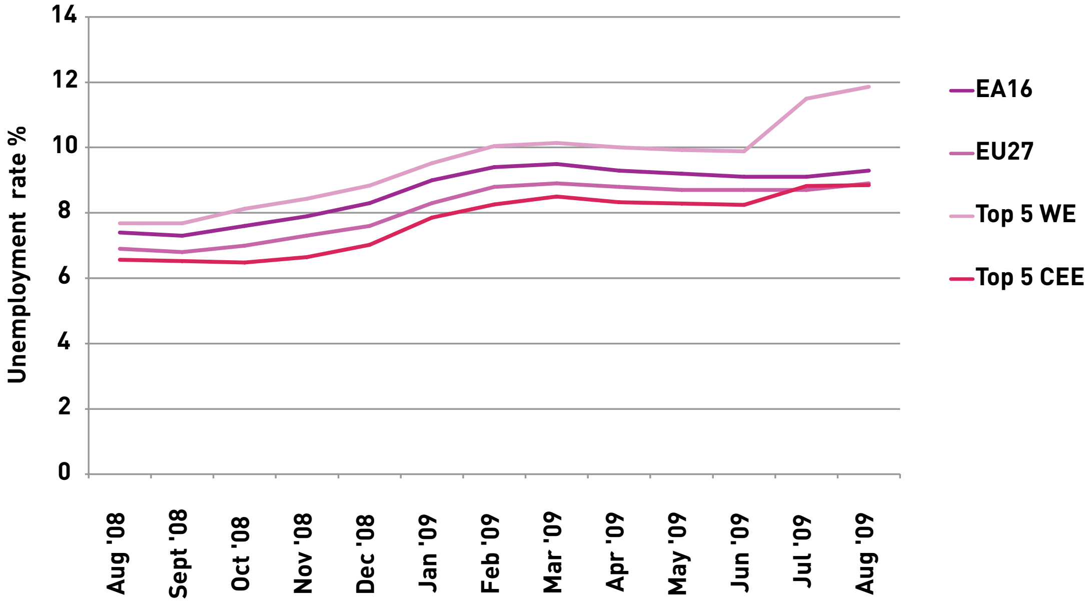


Figure 1: Unemployment rate | Source: MVI-Insights

Figure 2: Inflation – All Items | Source: MVI-Insights

Overall, economic decline has stopped, consumption expenditure has stabilized, and inflation is adjusting. Wages, however, are rarely keeping up with inflation; thus, consumption capacity is falling. Western Europe will be severely affected by high levels of unemployment, while Central and Eastern Europe is also coping with currency depreciation. Countries able to implement consumption-boosting policies are under pressure to reduce intervention amid the high levels of public debt. In general, macroeconomic indicators for Central and Eastern Europe show that this region might be capable of recovering faster.

The following indicators were taken from Eurostat's database and are compared by region:

Gross Domestic Product

In local currency, only Poland, Bulgaria, and Greece showed positive results during the second quarter in comparison with the previous year. The top 5 Western European countries in terms of size—France, Spain, Germany, Italy, and the UK—had an average decline of 4.3%. The European Union (27) reported a decline of 7% compared to a 4.5% in the euro area. The top 5 Central and Eastern European countries—Poland, Hungary, Czech Republic, Slovakia, and Romania—reported a 2.7% decline in the second quarter of 2009.

Final Consumption Expenditure

In local currency, 14 countries presented a positive year-over-year change in the second quarter of 2009 compared to 2008. The average drop reported for the top 5 countries in Western Europe was 0.9%. The average in Central and Eastern Europe was 0.2%, a positive increase showing a slight growth in consumption. EU27 countries had a 3.3% drop on average, while euro area countries had a 0.2% drop. The Baltics reported the most dramatic drops in the region, with a 12.5-16.2% reduction from the second quarter of 2008.

Unemployment

Monthly unemployment rates have grown since mid-2008 to reach 8.9% in EU27 and 9.3% in EA16 by August 2009. The most notorious jump observable in the top 5 for Western Europe occurred after June 2009 – driven by Spain's 18% rate. In the top 5 countries of Central and Eastern Europe, the average was 8.9%.

Inflation

All-category inflation monthly change was positive in more than half the markets, with an average of 0.3% growth both in EU27 and in EA16. The top 5 Central and Eastern European markets had a negative change of 0.3%. The top 5 in Western Europe had on average a 0.38% increase. Food and non-alcoholic beverages prices have dropped slightly, reaching an average of -0.7% in EU27 and of -0.5% in EA16. The top 5 in Western Europe had a food price drop of nearly -0.5%, while the top 5 in Central and Eastern Europe fell 1.6%.

Consumer Confidence

Consumer confidence reached bottom in February 2009 and has recovered ever since reaching a positive change in Western Europe and a negative change in Central and Eastern Europe. The EU27 average increased by 7.2 points since last October, and the EA16 average increased by 5.2 points.

Formal Retail Sales

Total unadjusted retail sales (excluding motor vehicles and motorcycles) have stopped decreasing in Western Europe, reaching a year-over-year decline of 4% in the second quarter of 2009. In Central and Eastern Europe, the reported decline was of 8.9%. The future for grocery retail remains more optimistic than that of non-food retail, as shoppers focus on essential products and lower prices.

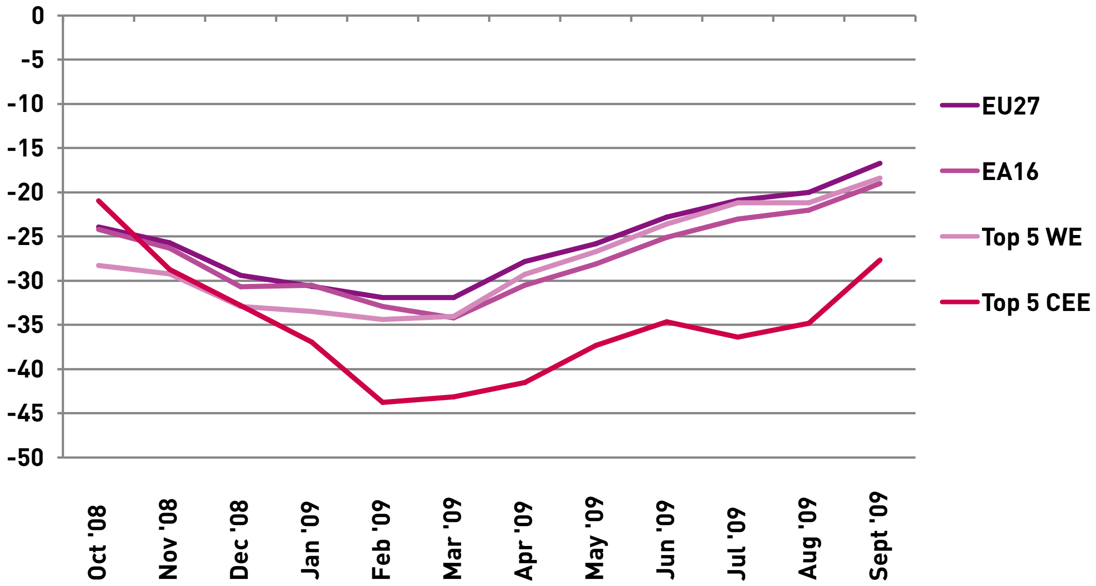


Figure 3: Consumer Confidence | Source: MVI-Insights

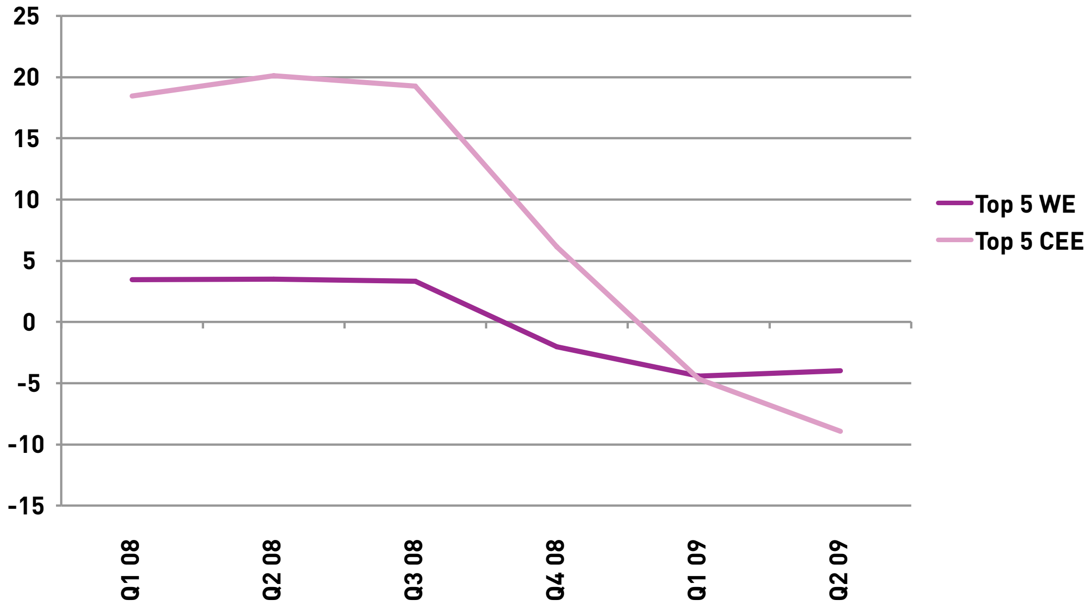


Figure 4: Retail Sales | Source: MVI-Insights

MVI Interpretation

While there are signs that we are reaching the bottom in terms of economic contraction, the growth in unemployment will have an effect on the retail market for the next 18 months. Europe has seen a loss of several million jobs that will take some time to reappear. In the meantime, inflation looks like it may continue or not decline by much. The end result is a loss in purchasing power for a sizeable minority of the European population, which will force retailers to continue thinking about price as the centre of their value proposition.

Furthermore, the means of arresting the sharp decline in the economies should not be overlooked. The improvements of the past few months have come after significant costly stimulus in the form of car purchase subsidies and extremely low interest rates. While these steps were necessary and have provided a critical respite from the free fall of late 2008, they have not fixed the core issues facing the economies: 1) Contraction in credit for businesses and consumers 2) A shrinking workforce. Therefore, it is unlikely that we will see a recovery in 2010.

At the same time, it is unlikely that things will get materially worse in Europe. The strong euro will provide some relief for consumer prices. More importantly, retailers and manufacturers are adjusting their models and offers to grow again with a poorer consumer base. 2010 will certainly be a year of transition: one which will see some new growth models take hold in the markets.

The Russian Retail Market: Prospects for Economic Recovery, Drivers for Growth in 2010

By Vadim Khetsuriani | Originally published on August 3, 2009

Many emerging markets are in a recession, which has had a negative effect on all major sectors of the economy – from manufacturing and retail to construction and natural resource mining. At the same time, occasional analytical and press reports are discussing positive growth momentum for emerging markets in 2010. In this article, MVI looks at Russia as one of the largest emerging markets; analyses the prospects for growth next year; and presents a forecast for 2010 modern trade development.

The Economic Dilemma

The Russian retail market has mirrored other industry trends with a small delay: Retail growth at the end of 2008 and first month of 2009 was not affected by the economic crisis that started in the early fall; instead, stagnation came in February, March, and April and continued into the summer. Other sectors of the economy struggled from the beginning of the crisis in the fall to either find new financing for growth or to cut production capacity without losses due to the inability to leverage fixed costs.

The Russian government is pushing banks to sustain businesses' credit lines and pushing businesses not to downsize, but both banks and businesses are not convinced that they can do it. The reason: Apart from several industries and a few businesses that got government loans, there is no viable system that allows the government to support the economy. There are simply not enough resources for a systematic approach because of the budget deficit (due to declined global prices on resources such as oil, iron ore, etc.).

It is fair to assume that global prices for oil have hit the lowest point in the beginning of 2009; they will remain stable at USD 60-70 per barrel by the end of the year 2009 and beginning of 2010. This will also result in a stabilization of the ruble exchange rate and inflation, which will most likely be controlled by the Russian government's actions. Although the Russian economy remains in a very difficult situation, it seems that uncertainty around government spending and fears of budget deficit are in the past. Instead, the government has adjusted its plans to the new economic reality.

Yet, the private sector of the economy remains stagnated in a deep "cash crunch." Fearing a wave of businesses' bad credit at the end of the year, banks are refraining from giving out loans and playing on the currency exchange markets to create a financial cushion. Businesses are forced to cut production, delay salaries, and eventually cut workforce. This is in fact the biggest risk to the economy as a whole and the retail sector in particular – once manufacturing, construction, and mining businesses cut production in fear of losing more money, the country gets thrown back to the nineties when businesses refrained from longer-term, capital-intensive projects. These developments pushed unemployment up and affected the shoppers' purchasing power – and therefore the demand that affects retail growth.

The Retail Dilemma

For retail, the problem is twofold. The first and most immediate problem is to refinance the old debts and get some immediate funding to escape legal actions and bankruptcies. Retailers such as Mosmart and Kopeika are solving this issue by:

- Selling the stake in their business to the government banks or
- Using the real estate they have as collateral to get funding from these banks.

Essentially, if you take away the low brand and operational equity of the Russian retail chains, the market value of many retailers is almost the same as the value of these retailers' stores, offices, and distribution centres. Thus, when Russian retailers use their assets as collateral, it often becomes an indirect "sale" of the assets to the government banks.

Interestingly, the government-backed financial institutions (for example, Sberbank) may soon own a substantial portfolio of retail locations throughout the country. Sberbank already has interest in Alpi, a troubled Siberian hypermarket chain; Kopeika, a Moscow-based discounter; and Mosmart, a hypermarket and supermarket operator. The logic behind the government action is clear: The takeover of retail assets assumes a long-term ability to play an important role in the modern retail industry. This can be an effective political mechanism to

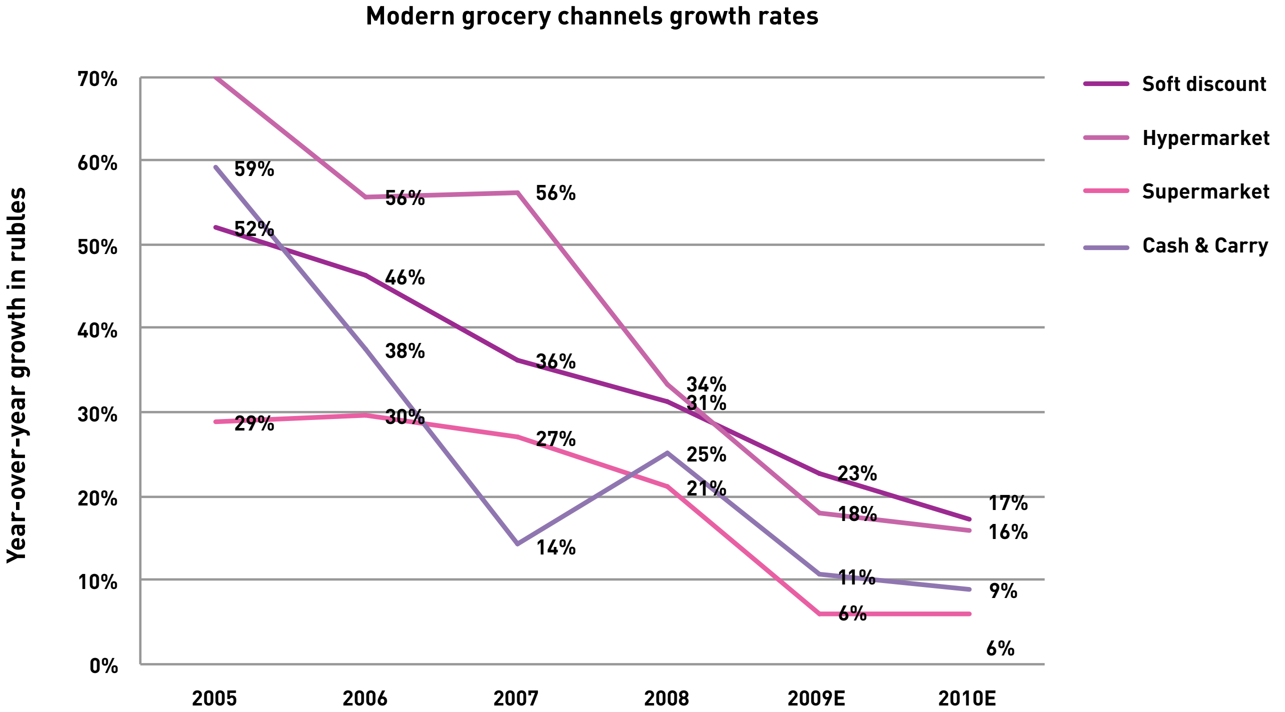


Figure 1: MVI Growth Forecast, Modern Trade Channels, 2009 and 2010 | Source: MVI research and analysis

manage social issues such as food price inflation.

In non-food, the government-owned telecom company, Svyazinvest, has an indirect stake in the largest mobile phone shops network, Evroset. This is also a strategic move to protect the telecom industry from foreign companies' stepping into the market. Overall, the retail industry has become a strategic interest to the Russian government. It is unclear whether this means that the government will 1) choose to develop and control a large retail chain to influence modern trade or 2) sell these assets separately. Clearly, the economic crisis in Russia has led to increased government interest in the retail industry that can be later used as a political power tool.

Assuming most retailers will manage to secure funding in exchange for control over their assets, they still have the second fundamental problem to overcome: make enough operating profit to pay on the interest of the government loans. For many retailers, this task is more difficult than securing the financing, because past growth was mostly a function of increased shopper wealth rather than successful selling strategies and past tactics.

Looking at 2010, even if the top 10 grocery retailers are able to stock the shelves with product and keep the stores open for business, the real winning factor will be driving shopper traffic and spending power. Retail chains that can align the assortment offering and pricing to the customers will grow faster than the rest of the trade. However, all this growth is merely about "stealing" shoppers' share from each other and not about growing spend any time soon.

What's Next for the Russian Modern Trade?

Assuming inflation in Russia stays at the same level in 2010, MVI's growth forecast for the modern trade channels for 2009 and 2010 is shown in Figure 1.

The decline in growth rates in ruble terms will continue; however, there is no expectation of a major collapse of the modern trade. The reasons for the decline of retail growth rates will be the further decline of shopper's purchasing power (due to the depressed economy in 2009), and – as stated earlier – the retail industry lagging behind but mirroring other economic trends. If you assume that the ruble will be stable, the growth rates of 6-17% are quite attractive compared to low single-digit growth rates in Western Europe. For global and European retailers, Russia is still an attractive market in which to invest – assuming these retailers can make the economics of their retail format work.

The following trends can also be expected in 2010:

- **A more rigorous redistribution of growth between competitive retailers.** Retailers with business models that are more immune to the prolonged economic depression will win market share. Among the retailers with the winning business model, Magnit and Auchan stand out as clear winners. These retailers are in good financial shape and low leveraged compared to the rest of the market. They have the right formats to develop during a recession and have an efficient operating model.
- **A reverse growth from regions back to the big cities such as Moscow or St. Pete.** Before the economic recession, regional retail markets were growing faster than big cities because chains were actively building up stores backed by easy financing. However, financing has become very tight. In addition, regional markets lost shopper purchasing power the most during this recession. This makes retailers refocus on big cities where the economic crisis has not been so severe. The growth is expected to reverse from the small regional towns of the Southern, Ural, and Central regions back to the capitals.

/Contacts

Global Headquarters
10th Floor
245 First Street
Cambridge, MA
02142
USA
+1.617.588.4100

EMEA Operations
6 More London Place
Tooley Street
London, England
SE1 2QY
UK
+44.207.031.0251

MVI Leadership
Wayne Levings, Chief Executive Officer
WLevings@mventures.com

Mayer Danzig, Chief Digital Officer
MDanzig@mventures.com

Bryan Gildenberg, Chief Knowledge Officer
BGildenberg@mventures.com

Paul Kamisky, Chief Financial Officer
PKamisky@mventures.com

Ethan Sinick, Vice President/Managing Director, Europe
ESinick@mventures.com

Scott Butterfield, Senior Vice President of Sales & Events
SButterfield@mventures.com

Global Sales & Services Contact
CustomerService@mventures.com | 1.617.588.4100

Media Contact
Jennifer Watson, Design & Communications Manager
JWatson@mventures.com | 1.617.588.4112
