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The stores eating Whole Foods' lunch and other tales of transient advantage in the grocery business

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Dear Colleagues,

Food is big business. According to Statista, total retail and food service sales in the United States are around $5.32 trillion with the portion coming from grocery stores at $606 billion and supermarkets accounting for $649 billion. It is also a tough business – margins are thin, customers are unforgiving, and changes in customer preferences have made prevailing assumptions obsolete.

Cutthroat competition in the grocery aisle

Be careful what you wish for: The Case of Whole Foods

Whole Foods Market, founded in 1980, enjoyed tremendous growth by offering organic and natural products that were then not widely available. It appealed to an upscale demographic that was willing to pay more for products they felt they could trust. Indeed, according to Morningstar reports, Whole Foods Market earned an average gross margin north of 30% and the nickname “Whole Paycheck”. Competitors Kroger and Walmart have to make do with gross margins in the 20% range.

For a long time, being the only game in town paid off (kale chips, anyone?). Sales of organic food more than tripled from 2005 to 2015, to $43.3 billion from $13.8 billion, according to the Organic Trade Association.

But, the transient advantage effect applies here as well. Whole Foods’ high prices created a powerful price umbrella, meaning that competitors could come in with lower-priced offerings that, for many customers, are ‘good enough.’ As companies like Kroger and Wal-Mart expanded their organic offerings, shoppers defected from Whole Foods to these more conventional markets.

Now, Whole Foods is fending off activist investors Jana Partners LLC, who are less interested in organic, locally sourced tomatoes than they are in getting Whole Foods to behave more like a conventional supermarket. On the table are things like customer loyalty cards, discount coupons, advertising and promotions and more large-scale sourcing of items. Whole Foods fell victim to the sustainable competitive advantage trap. As CEO John Mackey observed:

“When you average 8% same-store sales [growth] for 35 years, it can breed a sense of, ‘Why do we need to change? Things are working.’”

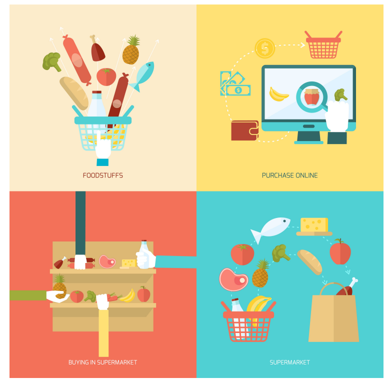
Like Starbucks before it, Whole Foods created a new value proposition for a certain type of consumption. And, like Starbucks, it has perhaps over-expanded. Let’s see what they do to set the “reset” button.

Whenever Amazon enters your category, it is never a good thing

Meanwhile, over in Seattle, Amazon is getting into brick and mortar grocery shopping. It recently announced that it is experimenting with three new formats: convenience stores called Amazon Go, the drive-in grocery kiosks, and a hybrid supermarket that mixes the best of online and in-store shopping.

Its Amazon Go format, as described by the Wall Street Journal, works like this:

In a video Amazon released Monday, the Amazon Go store, at roughly 1,800 square feet in downtown Seattle, resembles a convenience store-format. It features artificial intelligence-powered technology that eliminates checkouts, cash registers and lines. Instead, customers scan their phone on a kiosk as they walk in, and Amazon automatically determines what items customers take from the shelves. After leaving the store, Amazon charges their account for the items and sends a receipt.



A second format is brick and mortar with a twist – you don't actually go into the store at all. Instead, you drive through and pick up groceries you've pre-ordered and paid for. The third concept would be familiar to those who shop in European chains such as LIDL or ALDI, which offer a very limited selection of fresh basics in the store with more available for delivery at some other point.

The person thought to be behind the idea, who now works at Amazon Fresh, is Brittain Ladd, who wrote a concept paper on the topic when he was still employed at Deloitte. He recommended that the stores focus on "the top 20% of lines that generate 80% of sales in a traditional supermarket - eggs, meat, milk/dairy, fruits, vegetables, and breads." The reason consumers are still wedded to shopping the old-fashioned way, he argued, is that they don't trust the providers of those all-important 20% of items to provide them with sufficient quality. Hence, the brick and mortar venture. Amazon hopes to open 2,000 stores nationwide. By comparison, the largest grocery chain in the United States is Kroger, with 2,800 stores.

The opportunities are vast – the Food Marketing Institute projects that 20% of all food could be bought on-line, in some way, by 2025, representing $100 billion plus revenue potential. Shopping online for groceries is now something 7.7% of the American public does, and those numbers are climbing every year, particularly among millennials.

Going up against Jeff Bezos, with his "customer first" and "Day 1" mantras is going to be tough for grocers who don't start to prepare to compete now.

Meal Kits – Niche or harbinger of things to come?

Another big potential shift in consumer behavior is the increasing popularity of meal kits. Companies such as Plated, Blue Apron, and Hello Chef package all the ingredients needed to prepare fresh meals at home, without the hassle of menu planning, shopping for ingredients or finding the right recipes.

Technomic, a food industry consulting firm, observes that the meal kit business is booming, with billions of dollars in sales worldwide. The boxes are most popular among urban millennials, with the target customer being people who don't know how to cook or don't have the time to shop, but have become convinced that food produced by the so-called American Industrial Food Complex is not healthy for them. Indeed, millennials reportedly spent $50.75 per week on food prepared outside the home, representing a very attractive market.

While there is a great deal of hype (and an enormous amount of investment) going into these meal kit companies, there are many downsides to the model. Home delivering anything perishable is a major operational headache. With the food kits, this results in a lot of packaging waste. And, while the kits may be less expensive than comparable takeout, they are a lot more expensive than the same meal would have been had the ingredients been purchased in a conventional grocery store. As one moves out into regional centers without concentrated urban populations, efficient delivery to the home becomes more expensive and more difficult.

Boston Market's story (formerly Boston Chicken) offers a cautionary tale to the meal-kit people. Once a high-flying darling of the stock market, the firm expanded very fast and its competitors noticed. Once Boston Market demonstrated that there was strong demand for food with the convenience of McDonald's, but the health benefits of home cooking, pretty much every grocery store followed suit in offering their own, cooked-in-store variant. The company ended up going bankrupt.

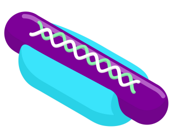
Since there is nothing to stop conventional grocery stores from offering their own meal kits in store, at lower prices than are required by the delivery model, it's only a matter of time before they do. In fact, that competition is already underway.

Oh So Social and Mobile

As traditional advertising continues to give way to interactive, social advertising, grocery executives need to figure out how to connect with consumers in entirely new ways. Wal-Mart has over 33 million fans on Facebook, Amazon has 27 million and

Target has 23 million fans. Traditional marketing messages through advertising, flyers, the radio and so forth are likely to give way to spending where consumers are directing their attention, such as social media.

If you don't know what you're doing, it is very easy to go wrong on social media. For instance, last year ALDI Australia published a tweet that said "I became an ALDI lover when I first tasted _______________ for the first time". While it sounded innocent enough, the trolls pounced, creating a veritable tweetstorm of unpleasantly filled in blanks.



Or, how about this well-intentioned but ultimately off the mark tribute to Prince (a confirmed vegetarian). A British butcher created a special batch of purple sausages as a tribute to the singer, which set off angry reactions from other Prince fans and various animal rights groups.

Opening the kimono – consumers want to know a lot more than they used to

It used to be enough to have a trusted brand. Today's shopper wants more than that. They want to know who provides certification if a product makes a certain claim. They want to know where the food comes from. They want to know what ingredients are in it, and whether these are safe. Among the industry's responses has been an initiative dubbed "smartlabel" that allows consumers to look up a great deal of information about products.

Just for fun, I looked up Campbell's Chicken Noodle Soup and was able to get information on how nutritious it is, what's in it, any allergens it may have and other information. Interestingly, while Campbell's sells dozens of different kinds of soup, only a limited number were represented on the smartlabel site. Land O'Lakes had a lot more products listed. I found it interesting that their salted whipped butter product contains only two ingredients – sweet cream and salt.

What should food-related retailers be thinking about now?

Focus on the Customer

No company ever goes wrong by thinking about the jobs their customers want to get done and how to help them do those jobs better and better. This is part of Amazon's DNA, and one reason why they have been able to sustain their growth. An

DNA, and one reason why they have been able to sustain their growth. An interesting example of how a grocery store did this by experimenting with an “urban foodie” format can be found here at Innosight’s website.

Deliver an appealing experience, whatever your channel or format is

Even though the company had reinvented itself many times over the decades, a reason commonly given for the decline and subsequent bankruptcy of the A&P brand is that its leadership simply did not evolve to create the experiences its customers would value. Customers found dark stores with out-of-stock goods, haphazard product placements, demoralized employees and long waits at the cash register. Historically hostile relationships between A&P and its suppliers didn’t help either.

Instead, consider Wegman’s, a privately held, rapidly growing grocery store that regularly wins accolades and even case studies from Harvard. Among many other things they get right, the customer experience in the store is nice, while their prices are very competitive. As one observer noted, the joke in Buffalo is that when the weather is really unpleasant, people will go to Wegman’s just to cheer up. That’s the kind of experience customers are looking for.

Combine good jobs with operational excellence

My colleague, Zeynep Ton, has done amazing research on the relationship between treating employees well, in what she calls the “good jobs” strategy and company performance. She finds that when companies utilize “human centered operations strategies,” they can be just as profitable as companies that go down the path of providing minimum wage, uncertainty, and high-turnover jobs to their workers. She cites Spain’s Mercadona, Trader Joe’s and QuickTrip as companies that get the very best out of their employees by offering decent pay, predictable schedules and opportunities for skill-building and job enrichment.

Just offering good jobs isn’t enough – it’s the combination of good jobs and operational excellence that allow companies, even in price-sensitive segments, to thrive. Back to Wegman’s again. They use economies of scale (their stores are huge), vertically integrated supply chains (so they can control operations) and their own store brands, combined with the kind of relationship with their employees that regularly wins them “best company to work for” status to compete on numerous fronts. As a result, they can compete against Whole Foods for freshness, against fronts. As a result, they can compete against Whole Foods for freshness, against Trader Joe's for own-brand products and against just about anybody else for selection and price.

Do something about the center of the store

Finally, a dilemma that most conventional supermarkets face is that most of their profits are made in what is called the 'perimeter' of the store, where fresh goods are sold. The middle aisles of most stores are pretty much an uninviting parade of cans, boxes, bottles and the like. Industry experts have studied shopping behavior and many customers avoid 'center store' completely, except for staples that they believe they can get cheaply from Wal-Mart or Target. Unfortunately, you can't just get rid of the center store offerings – for one thing, they are important to the large consumer packaged goods players that supply the items. For another, customers don't like to have to make multiple trips to multiple places to get staples.

Wegman's and Trader Joe's have tackled this in different ways. Wegmans, as noted above, has put a big emphasis on its own-branded offerings that its loyal customers trust. Trader Joe's also has its own brands and a carefully curated selection of other goods – far fewer than a conventional store. In any case, there is a lot of work to be done to make this part of the footprint a profit generator.

Leading Strategic Growth and Change

Two of the greatest challenges I find my clients face are 1) discovering new sources of growth and 2) transforming their organizations in order to stay competitive. During this one-week course, we'll cover the latest thinking on these topics, including:

- How to manage the entire cycle of competitive advantage
- How to manage growth portfolios
- Design thinking and inspiration from unusual places
- Two-sided platform strategies
- Managing organizational politics

The program runs in New York City during the week of May 15th. Participants bring a real organizational challenge to the program and work on it throughout the week. Click here for more information. Or drop me a line.

week. Click here for more information. Or drop me a line at rdm20@gsb.columbia.edu.

Mastering Corporate Entrepreneurship Online now running

Launching on May 15th, the second module of Mastering Corporate Entrepreneurship focuses on Incubation. Participants will be equipped with the tools for establishing their venture team, creating a learning plan, and initiating the prototyping phase. Participants will receive best practices for A/B testing and lessons on how to create an action plan for in-market experiences with your prototype. Participants walk away with valuable insights into how to prepare for a successful venture, or if necessary how to fail intelligently. This is perfect program for teams.

It is not necessary to have taken module one in order to take module two. Participants in this 7-week program will learn from myself, colleagues and, in live sessions about how to make corporate entrepreneurship a systematic capability. Here's the link to find more information.

Recent press coverage:

On Toshiba's fate and the dangers of being a conglomerate. The issue here is that, through no fault of their own, when one business goes wrong, all the others get dragged down.

Discovery Driven Planning noted as an important advance in planning under uncertainty.

The Opportunity Portfolio featured in an article on selecting UX projects.

Rita cited in a blog about the need for customer differentiation.

Rita makes the list of top 10 strategy gurus cited by the Strategy Institute.

Upcoming Events:

Columbia Executive Education's Advanced Management Program

April [illegible]-May [illegible], 2017 at Columbia University, New York, NY

April 30-May 26, 2017 at Columbia University, New York, NY

Thinkers50 - 2017 European Business Forum
The Davos of Business Thinking
May 9-10, 2017 in Odense, Denmark

Leading Strategic Growth and Change
My revamped Executive Education Columbia Business School program
May 15-19, 2017 at Columbia University, New York, NY

DRUID Conference
Danish Research Unit for Industrial Dynamics
June 12-14, 2017 in New York, NY

Growth & Inclusive Prosperity - The Secular Management Challenge
The 9th Global Peter Drucker Forum
November 16-17, 2017 in Vienna, Austria

As before, where there is uncertainty, there is also opportunity

Piggly Wiggly, the first truly self-service grocery store in the United States, opened in 1916. This is reportedly how we came to have the checkout stand, shopping carts and prices marked on every item. A&P followed, essentially industrializing the American grocery store, with over 16,000 locations at its peak.

Fast-food entered our world in 1921 with the establishment of the White Castle chain, who invented and helped commercialize the hamburger sandwich. Pre-packaged cake mixes came along in 1933, and it is rumored that sales plateaued until savvy marketers realized that adding the requirement to put an egg in the batter made women feel as though they baked the cake (rather than cheating). This is deemed to be a rumor, but what we do know is that real eggs make better cakes. In the 1950s, so-called TV dinners, popularized by the Swanson company came along at scale.

Incredibly effective advocates for the art of fine cooking, Julia Child, and others such as Craig Claiborne, transformed everything from what was stocked in the grocery aisles to what was considered ‘gourmet’. In 1967, the home microwave oven was introduced by the

Amana company. Home delivery of groceries – long a holy grail for companies like the failed WebVan – finally became reality with the early 2000's founding of Peapod and FreshDirect. Companies like Seamless and GrubHub, founded in 2005 and since merged, partner with restaurants to provide take-out delivery on demand. Today, their revenues top $675 million.

Every one of these innovations impact how dinner gets on the table and represents millions – and sometimes billions – of dollars of opportunity, ready to be captured by customer-focused entrepreneurs.

Here's to your next advantage!

Rita

Here's to your next advantage!

Rita

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