SECOND EDITION

STOREWARS

THE WORLDWIDE BATTLE FOR MINDSPACE AND SHELFSPACE, ONLINE AND IN-STORE

AHOLD ALBERTSONS ALDI AMAZON ANHEUSER-BUSCH AUCHAN BAT CARREFOUR COCA-COLA COLGATE COSTCO DANONE DIAGEO EBAY GENERAL MILLS HENKEL JOHNSON & JOHNSON KELLOGG'S KODAK KRAFT FOODS KROGER L'OREAL LECLERC LIDL MAGNIT MARS METRO NESTLE NOKIA PEPSICO PHILIP MORRIS P&G RECKITT BENCKISER SEARS TESCO WAL-MART X5 RETAIL GROUP 7-ELEVEN *

GREG THAIN &
JOHN BRADLEY

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Greg Thain
April 2012

INTRODUCTION

SINCE THE ORIGINAL edition of *Store Wars* was published in 1995, much has changed in the fast-moving consumer goods (FMCG) industry, both for manufacturers and retailers.

Many iconic brand companies, such as Gillette and Cadbury, have lost their independence, swallowed up by bigger players, who see size as crucial in dealing with another of the major changes: gigantic retailers. Wal-Mart's 1995 sales of $93 billion more than quadrupled to a staggering $405 billion in 2010, with $100 billion coming from outside the United States. This leads to another massive change in the FMCG industry: the rise of emerging markets such as Russia, China, India and Brazil, which have been, and still are, a modern-day Klondike goldrush for FMCG players, where fortunes can be made and lost. The rapid development of such markets is the prime reason behind global retail sales space more than trebling from 40 million m^2 in 2001 to 130 million in 2011.[1]

Many of the tools used by both manufacturers and retailers in 1995 now have dramatically different levels of potency. Television advertising, the mainstay of the branded manufacturer, can now no longer be relied upon to drive retail listings; instead, marketing budgets have been moving to the Internet and social media. *Private label*, an almost insignificant factor in 1995, has ascended to undreamt-of heights and is the cornerstone of virtually every major retailer's strategy, in some cases over 50% of their sales. Behind the tools, the information war has swung decisively in favour of the retailer as the combination of product scanning with loyalty cards has given the retailer almost perfect buying information at the level of individual shoppers.

The purpose of this second edition is to come to the aid of FMCG professionals, both manufacturers and retailers, to put into context and perspective the key events and changes which have taken place within their industry since the mid-1990s. This book will also be invaluable to academics and students who wish to better understand the shifting dynamics within the FMCG, retail and consumer-facing industries.

We shall see that much has changed at the operational level, and we will dig deeper to uncover and highlight the underlying strategic factors of these changes, while demonstrating how they should now be applied in the new reality of the twenty-first century. With over 100 examples and case studies from dozens of markets, we present the most comprehensive insight into the modern-day FMCG industry.

In Chapter 1, we take a strategic overview of the evolution of the FMCG industry and see how power has shifted not just in one direction from manufacturer to retailer but also in both ways at various times, driven by technological innovation, social change and, most crucially, innovation within the industry itself as each party seeks to increase its share of transaction profits. A crucial constant in the battle between manufacturers and retailers for a share of profits is the battle to win and hold consumer trust in an era when brand loyalties are more fragile than ever before.

In Chapter 2, we take a close look at the differences between manufacturers and retailers, and we learn how the friction characterising most of their dealings is not a result of similar organisations pursuing different, conflicting goals but of very different organisations pursuing the same goals by very different means. In particular, a lack of understanding of their contrasting financial structures is often the reason why they can respond acrimoniously to the same set of circumstances.

We focus on the manufacturing side and examine how and why manufacturers adopt the types of strategies they do, in Chapter 3. We look at the crucial role of *segmentation*, when properly applied, in moving companies from the deadly battlefield of price competition to the sunny uplands of profitable growth. However, such markets are very dynamic and we see how companies can easily be tempted by the siren-song of price competition to address failing top and bottom lines. But we also see how price competition can be a profitable and attractive strategy in the fast-moving *emerging markets*.

We then switch to look at retailer strategic positionings, in Chapter 4, to see that they are much more limited than manufacturers are. Retail chains need to occupy very broad swathes of the market, so tend to be much more closely grouped than manufacturer brands, which can profitably occupy many small differentiated niches. We then examine the emergence of the retailers' ability to segment their store types by shopping need, meaning that one retail banner can cover anything from a 100 ft^2 convenience outlet to a 100 000 SKU hypermarket, and see how this *multi-format strategy* is affecting the retailer–manufacturer interface.

In Chapter 5, we examine in detail the two retailer–manufacturer battlegrounds of *shelfspace* and *mindspace*. Previously, these two commodities were fought over between manufacturers, but now the battle rages between retailers and manufacturers. We see how the combination of retailer size, brand-building and robust private label strategies has tilted the playing field heavily in favour of the retailer. Manufacturers now have to be savvier in their approach to winning mindspace, including the retailers' brands within their competitive sets.

In Chapter 6, we go on to dig deeper into the battle for mindspace and the relative advantages held by manufacturers and retailers. We explore different strategies in building mindspace and look at categories where one or the other player has a built-in head-start. We also highlight the increasing skills overlap between manufacturers and retailers, a consequence of brand-building becoming a core strategy for retailers in recent years.

We deep-dive into the fight for shelfspace in Chapter 7, where we expose the overused delisting threat as being largely hollow. We encourage a systematic approach based on the relative concepts of the cost of switching brands versus the cost of switching stores so that both parties better understand where they have leverage and where they don't. We show how manufacturers must seek to increase the consumers' cost of switching brands through their brand-building activities and reduce their cost of switching stores through their distribution strategies. Similarly, retailers must strive to achieve the opposite.

In Chapter 8, we dissect the various means by which retailers can build a sustainable advantage in a category where dominance has been fleeting. The world's two largest retailers were both founded in the 1960s, a situation unthinkable on the manufacturer side; they tend to be much older and more enduring. We explore the possibilities of fresh produce, multi-segmentation, loyalty cards and price as defendable strategies, we also show how each market has three price positionings, one of which every retailer must choose.

Chapter 9 concentrates on providing an in-depth understanding of the retailer's single most important competitive weapon: private label. We explain the roles of the five different types of private label offering and how each has a specific role to play in positioning the retailer against its competitors and against manufacturer brands. We also explore the impact on manufacturers of the resurgence of private label as a retail strategy and their need to have a clear strategy on the matter and how its impact can be mitigated.

We then look, in Chapter 10, at the thorny issue of *trade marketing* for manufacturers, which for some has become their second-largest expenditure, as an interface between their business and the retailers. We explore how trade marketing and brand marketing inherently conflict as they serve different groups – consumers and retailers – who have different interests. Strategies for controlling the spiralling costs of trade marketing are explored, tied into the organisational challenges of accommodating it within a brand-focused organisation.

In Chapter 11, we step back to look at the internationalisation of the FMCG industry, especially with regard to emerging markets, with examples and illustrations from China, Russia, Brazil, India and further afield. We contrast the different rates of internationalisation of manufacturers and retailers, showing how this creates opportunities for the manufacturer. We show how internationalisation for the retailer can be a huge challenge, demanding a new set of skills and attitudes. As we focus on the emerging markets, we show how those markets are evolving at a much faster pace and along differing paths compared to the history of developed markets. We also note the emergence of strong manufacturers and retailers from those markets and the threat they pose to the established global players.

We switch, in Chapter 12, to the virtual marketplace of the Internet and examine the rapid rise of *e-retailing* and the emergence of *e-grocery*. We explore the reasons behind the phenomenal growth of *e-commerce* and look in detail at lessons from successful and unsuccessful e-retailing and e-grocery ventures to better understand the impact this channel will have on the FMCG category. We see how having the right business model is critical for retailers and how mobile presents enormous opportunities for retailers.

Finally, in Chapter 13, we pull together all the insights and predict what the future will be like for manufacturers, retailers and e-retailers. We see how consumers will be much more brand-neutral, in that they will be happy with the right branding from any party. This will force manufacturers to make much harder choices about their brand portfolios and force them to adopt genuine premium, value or industrial strategies, and we explore the organisational implications of each. Similarly, retailers will have to embrace e-retailing and fight off the challenge of the vertically integrated specialist, category-killer retailer, or suffer the consequences. Finally, we make a series of predictions of how we see the FMCG category evolving in the next 5 to 10 years.

The insights and lessons from this *Store Wars* book can be explored in a highly realistic setting in the StoreWars Business Simulation, which, since the mid-1990s, has been recognised as one of the world's leading business simulations for executives, senior managers and directors of consumer-facing businesses. The simulation has been run in 43 countries in excess of 700 times and has been used by 60% of the world's leading FMCG and retail businesses. Academically, the StoreWars simulation has been used by universities across five continents. Full details can be found at the website (www.STOREWARS.net). In addition, this website contains all the charts and tables in this book in full colour, and these will be updated annually to keep you abreast of the inevitable changes in the FMCG world.

Greg Thain
John Bradley

Note

1. http://www.atkearney.com/index.php/Publications/retail-global-expansion-a-portfolio-of-opportunities2011-global-retail-development-index.html. Accessed 12 December 2011.

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Chapter 1

SHIFTING OF POWER IN THE VALUE CHAIN

DURING THE LATTER half of the twentieth century, manufacturers had control of virtually all the marketing variables – such as price, promotions and presence on shelf – that resided within the retail environment. Brand-positioning strategies always included the consumer price point for the brand, which could then be counted on to appear in-store. A shortfall in distribution was seen as a tactical failure of the manufacturer's sales department to negotiate properly with their customers, a failure that could be easily rectified. Manufacturers cared little in whose shops their brands were bought as distribution was near universal. However, shifts in the balance of power between manufacturers and retailers have made this era obsolete. In June 2009, Progressive Grocer reported:

> Five years ago, manufacturers and retailers say they held equal shares of power in their partnerships, but today, manufacturers believe that retailers control almost two-thirds of the overall power and will extend their control to 71 percent five years from now, while retailers believe they currently control 60 percent of the overall power, and expect to control nearly two-thirds in five years' time.[1]

Manufacturers' sources of power from the past no longer work today. They used to be the sole provider of consumer knowledge, but they have been overtaken by retailers' own information, analysed by experts. For example, 28.5 million shoppers use Tesco's loyalty programmes.[2] In 1994 Tesco's hired dunnhumby to help them analyse their database, and within three months then Tesco Chairman Lord MacLaurin was moved to say, 'What scares me about this is that you know more about my customers after three months than I know after 30 years.'[3]

The conversation between retailers and manufacturers used to be dominated by the manufacturers' latest brand initiatives, but it is now dominated by retailers' latest supply chain initiatives. Retailers used to welcome brand innovation for the store traffic it would drive, now they often lead the way innovating under their store brands. Whereas the marketing budget used to be dominated by television advertising, now manufacturers pay more for retailer-related costs than consumer-related costs, spending anywhere between 10 and 25% of their annual revenues on trade deals, the second-biggest cost after manufacturing. Savings from reducing overheads and improving productivity have been generated to help offset the increase in trade spending, but many manufacturers are forced to spend less on consumer marketing to balance the books and remain profitable.

The outcome of these shifts is that manufacturers now have to consider retailers as a separate and dominant force in the market rather than compliant minions who could be relied upon to do their bidding. Thanks to the success of private label strategies (see Chapter 9), five of the top eight FMCG manufacturers in the world are actually retailers; giants such as Unilever and Coca-Cola are no longer even in the top ten, their global sales dwarfed by products under the names of Wal-Mart (now the world's largest FMCG manufacturer), Carrefour, Tesco, Aldi and Lidl. The branded manufacturers who have been tempted to produce private label are in no doubt where the power now lies. Indeed, it is rare for a branded company to even admit to being involved in private label; Weetabix are an example of one being open about their involvement.[4] Unilever, PepsiCo, Nestlé, Heinz, Playtex, Ralston Purina, Hershey, RJR Nabisco and McCain are less public about their move to the dark side.

But such shifts are neither a recent phenomenon nor an irreversible tide of history. To better understand how and why they have occurred we need to analyse the basis of retail power and examine how and why the balance of power in the value chain has shifted over time between manufacturers, distributors and retailers.

The emergence of branding as a value chain weapon

The history of trade is dominated by a struggle for the control of profits between producers, distributors and retailers. In the early days of the consumer economy, 'Mom and Pop' retailers were serviced by a complex network of middlemen who supplied mostly generic products sourced from a multitude of small-scale manufacturers. The anonymity of the products meant that manufacturer accountability for product quality was non-existent; shoppers neither knew nor really cared who made them. Retailers were the key players. Since they were the last stop in the supply chain, they were the only party the shopper could hold accountable as guarantor of the quality of goods purchased. As a counterbalance to retailers' necks being on the line with regards to quality, they had the ability to set prices, most often individually by shopper, which gave them a large degree of control on the transaction profits.

The more enlightened retailers realised they could increase turnover and hence profits by becoming an attractive destination. One way of achieving this was by gathering themselves under one roof, where their combined pulling power benefited all with the extra shoppers who thronged in their thousands. While the first recognisably modern shopping mall was the Southdale Shopping Centre, opened in Minneapolis in 1956, London's Royal Exchange, opened in 1568, fulfilled a very similar purpose. The invention of plate glass revolutionised retailing and was used to impressive effect in Paris' Palais Royal in the late eighteenth century, which spawned the nineteenth-century retail cathedrals that were to be found in London, Paris, Vienna and most large cities, attracting shoppers from far and wide.

The only way for distributors and manufacturers to end this relative dictatorship of the retailers on the size of the cake and their taking the biggest slice, was to take away their status as the 'agents of trust'. If a member of the supply chain was willing to take responsibility for product quality and to stake their reputation on it, they could then inform the consumer of the product's quality by placing some kind of mark on the product and (it was hoped) thus create a demand for their products as opposed to anyone else's – and the notion of brands evolved.

The first brand used on packaged goods was created almost 2000 years ago in Pompeii. The product, Vesuvinum, which combined Mt Vesuvius with the Latin word for wine, *vinum*, was a type of red wine – a category highly vulnerable to middlemen adulterating the quality with cheaper wine, water or worse. Rome's brick-makers also employed branding devices imprinted onto the bricks such that buyers in the city's brick market could recognise those bricks built to last. The United Kingdom's first brand trademark was registered in the late eighteenth century: the red triangle on bottles of Bass Pale Ale Beer, sold around the world.

It was essential that the branded manufacturer be able to package their product securely if their guarantee of quality was to be worth anything. Many packaging breakthroughs came about as a result of the demands of warfare. Foods became practical for mass manufacturing and branding with the invention of airtight food preservation in bottles by Nicholas Appert, in response to a prize offered by France's Napoleonic government as a means of feeding the Emperor's armies. The process for canning food was patented in 1810 but was slow to catch on, not least because the can opener was not invented for another 45 years. Similarly, the American Civil War gave a huge boost to embryonic food producers as the massive military orders forced them to scale up and reap huge economies of scale; prices consequently plummeted, making their products much more affordable when peace returned.