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A Frictionless Marketplace Operating in a World of Extremes

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Exciting Times in Food Retailing

These are both evolving and challenging times for food distribution and retailing. Never before have the same consumers behaved in so many different ways. Consider Sally, a hypothetical shopper, who may begin her food shopping experience by visiting the neighborhood supercenter, searching for items she perceives to be undifferentiated, seeking larger sizes and the best prices for given products. Sally decides to stop at Whole Foods to satisfy particular nutritional needs, social causes, or deeply-held beliefs such as organic food products are safer. On the way home, she stops by the fresh seafood distributor to pick up today's fresh catch for this evening's meal. Waiting for her when she arrives at home is the wine she ordered on the internet three days ago from her favorite vineyard in another state.

Sixty years ago, Sally's shopping experience would have been quite different. Shopping at a limited number of specialized food retailers like the butcher or general store, she would be greeted by name. The day's current events, and mutual friends would be discussed while the retailer assembled her order based on her list and known purchasing habits. Today, consumers face a much different shopping experience. They have increasing choices regarding where to purchase their meal solutions. Sally could just as easily have decided to stop by the local Boston Market or the neighborhood grocery store deli to pick up a ready-to-eat meal in answer to the question: "what is for dinner?"

Where are we headed and what forces have moved us from the shopping experience of sixty years ago? If the forces and trends identified in this paper hold, there are at least, two, inter-related dimensions to describe what future grocery supply chains might look like in a frictionless marketplace, operating in a world of extremes.

Frictionless (2000 and beyond)

The "Frictionless Marketplace" is characterized by a renewed emphasis on the individual shopper. Redundant supply chain components such as warehouses are eliminated and the retailer once again becomes the "Agent" for the shopper, facilitating the transfer of goods and services from manufacturers to end-users (Terbeek, 1999).

Greater customer focus must go beyond the superficial by addressing all the basic building blocks of the organization. The status quo must change from disconnected, multiple channels, and silos to a unified orchestration of the customer experience. Retailers need to be capable of delivering a unified seamless customer experience that treats customers as the unique individuals they are. In a frictionless marketplace:

- Core competency arises out of anticipation of shopper needs.
- The internet, the dominate form of technology, links all supply chain participants.
- Information technology is applied to the individual shopping experience in ways never dreamed of in the past.
- Shoppers are the primary source of information, not manufacturers or retailers.
- Retailer orientation is that of an agent, one who uncovers the needs of customers and then facilitates the fulfillment of those needs.
- Grocery stores are organized in whatever manner that better meets the needs of customers, such as local and intimate shopping experiences.
- Grocery store headquarters return to the store-level, where the greatest interaction with customers occurs.
- The power within the system resides with the customer.

- Store employees are the true differentiators between competing retail entities.
- Success is measured by customer loyalty and shopper performance.
- Profitability is based on how well the customer has been satisfied.
- The manufacturer's focus is on the end-user customer, leading to deeper and longer-lasting manufacturer-retailer relationships.

A world of two extremes

Traditional segmentation no longer works in a complex and divergent marketplace filled with diverse customers and individualism. Customer behavior appears at times to be schizophrenic: they will demand low prices for goods that are viewed as commodities, yet be willing to pay sizable premiums for products that mean more to them personally. This will result in two extremes: 1) huge mega-retail formats dominating one end of the spectrum, and 2) focused specialists dominating the other (IBM Business Consulting Services Group, 2004). Retailers and suppliers caught in the middle with undifferentiated concepts are doomed for failure.

What are the forces driving change in the food system? What key factors are impacting current grocery supply chains, and the evolution of grocery retailing in the United States?

Forces Driving Change in Grocery Supply Chains

Primal forces driving change include changes in the marginal cost of time, economies of scale and scope, dietary practices and needs, the use of consumer technology, and demographic shifts.

The marginal cost of time

The need for convenience. In the 1950s, it took an average of two hours to prepare a meal. By the late 1970s, it still took about an hour, but today, even 20 minutes in the kitchen is too much (Saaristo, 2005). Americans spend an average of 32 minutes per day for meal preparation and cleanup (United States Department of Labor-Bureau of Labor Statistics, 2004).

Grocers and restauranteurs recognize the value of convenience. Approximately 35% of meals eaten and not prepared at home in 2004 were provided by fast-food restaurants. Supermarkets have been very aware of this and have increased their share of meals eaten and not prepared at home from 18% in 2000 to 27% in 2004 (The Food Institute, 2004).

Gatekeepers become more guarded. Overwhelmed, time-strapped customers are seeking greater control over their interactions with businesses. Armed with technology and regulation, they will actively protect themselves from "me-too" marketing tactics. Only retailers offering differentiated, relevant value will gain access to customers' mindshare and personal information.

Economies of scale and scope

Mega retailers break the boundaries. The world's top retailers are rapidly expanding across geographies, channel formats, and product/service categories, blurring market segments and devouring market share. Competitors must differentiate themselves in order to survive.

Partnering becomes pervasive. Companies can no longer compete as an island of one. Leading retailers are evolving their enterprises into flexible "value networks" based on strong integration and collaboration with partners. There will be increased pressure to match the responsiveness and agility of these connected and mutually dependent business models.

Dietary practices and needs

Customer value drivers fragment. Customers are fragmenting into micro-segments as a result of pronounced shifts in demographics, attitudes, and patterns of behavior. These patterns of behavior are shaped by increasing consumer awareness of eating healthy, current diet trends, and social causes. Consumers are "trading down" to low-cost commodities on one end and "trading up" to high-value, premium brands and companies on the other. Retailers serving the needs of "average" customers are doomed to failure.

Use of consumer-focused technology

Information exposes all. Customers continue to gain market power and knowledge by access to information – virtually wherever, whenever, and however they want it. Retailers must provide value propositions and shopping experiences that keep customers coming back even in a world of total information transparency (IBM Business Consulting Services, 2004).

Demographic shifts

Increasingly diverse population. Ethnic diversity continues at an increasing rate. Between 1990 and 2010, the U.S. Hispanic population is projected to grow by 80% and reach nearly 14% of the overall population. The non-Hispanic White share of the U.S. population will decline to 64% by 2020, and by 2030, it will be less than half the population under age 18. The Black population is expected to double by the middle of this century (United States Census Bureau, 1996). Clearly, grocery supply chains can no longer adopt a one-size-fits-all

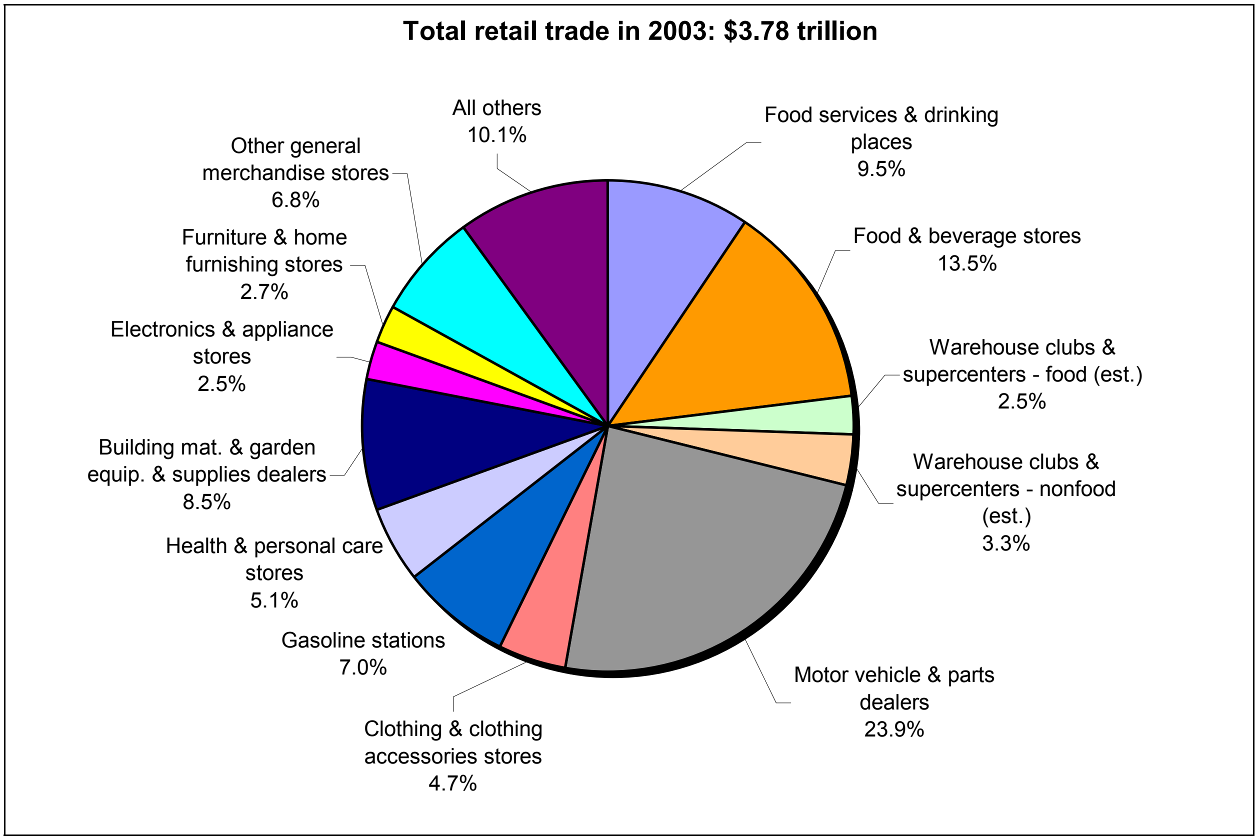

Figure 1. Food-based retailing accounts for 23% of all U.S. retail trade.
Source: 2004 Food Industry Review

mentality to meeting the needs of an increasingly diverse population.

The population saddle. Those between the ages 15-24 and over 55, the largest age groups, are still growing and they have very different needs. Grocery supply chains must identify needs and deliver value to these demographic segments (The Food Institute, 2004). Long-standing life stage patterns are becoming less predictable. People are marrying later, divorcing more, having second families, starting second careers, and even raising their grandchildren.

Money pressures increase. The average American spent only 10.1% of their disposable income on food in 2003 (USDA-ERS, 2004), the lowest of any country in the world. However, most real income gains have accrued to the top 20% of the population. In particular, cost increases in housing and education are putting pressure on food purchasing. Grocery supply chains must continually find ways to cut costs, while maintaining a distinct value proposition.

What Grocery Supply Chains Look like Today

Grocery supply chain channels are blurring as store formats look more alike. Two sets of counter-veiling forces describe the current state of grocery supply chains in the United States: 1) private label/store brands vs. national brands, and 2) channel push vs. channel pull strategies.

Food-based retailing accounted for a 22.8% (Figure 1) of all U.S. retail trade in 2004 (United States Census Bureau, 2005). This is approximately $888.1 billion in retail trade. While this food share is down from 25.5% in 2003, total food-based retail sales continue to grow each year.

Private label/store brand growth

Private label products, or store brands, continue to grow in importance in grocery supply chains. Store brand products encompass all merchandise sold under a retail store's private label. Store brands now account for 20% of the items sold in U.S. supermarkets, drug chains, and mass merchandisers. They represent more than $50 billion of current business at retail and are achieving new levels of growth every year (Private Label Manufacturing Association, 2005).

U.S. shoppers save approximately $15.8 billion annually by purchasing store brands over national brands. The difference is the so-called "marketing tax," which consists of adver-

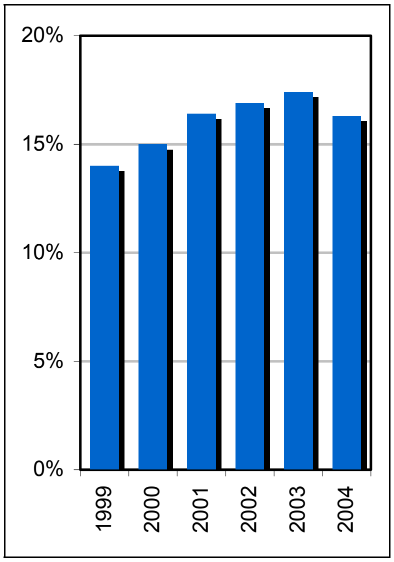

Figure 2. Trade spending as a percent of gross sales.
Source: Cannondale Trade Promotion Study 2005

tising and promotional costs incurred by national brand makers that are passed on in the form of higher prices at retail. Store brands remain important to retailers. Retailers use store brands to increase business and win customer loyalty. Store brands give retailers a way to differentiate themselves from competition (Private Label Manufacturing Association, 2005).

National brands

National brands accounted for approximately 83.7% of all grocery sales in 2003 (The Food Institute, 2004). National brand manufacturers have found it necessary to offer trade and promotional dollars to promote their products, to gain access, and maintain shelf space. Manufacturers spent 16.3 % of gross sales on trade promotion (Figure 2) in 2004. For consumer and packaged goods companies this amounted to 48% of their total marketing budget and the ROI on promotion spending continues to be negative (*Forum*, 2005). The sheer size of trade and promotional allowances has led to a literal dependence on them by grocery retailers. Even retailers that are pushing their own store brands, must think twice about any decision to displace national brands and the trade dollars they bring.

Channel push vs. channel pull

In a channel push strategy, the supply chain starts with the input supplier or manufacturer and ends with the end-user. In a channel pull strategy, the supply chain starts with the end-user and ends with the input supplier or manufacturer.

A channel push strategy relies on suppliers and vendors to introduce and promote products and services to supply chain intermediaries. Trade dollars and promotional allowances are the currency of a supply chain utilizing channel push. Channel push is common in grocery supply chains and may account for as much as 17 % of sales in retailers' budgets. The Albertsons and Kroger supply chains utilize channel push strategies.

Channel pull strategies rely on satisfying demand created by end-user requests. Trade and promotional dollars are targeted to end-users and the demand created by end-users pulls products and services through the grocery supply chain. Every day low pricing, end-user coupons, and advertising targeted to end-users are the currency of a supply chain utilizing channel pull. Examples of grocery supply chains utilizing channel pull include Wal-Mart and Sav-A-Lot.

Two Main Food Systems: Grocery and Foodservice

In the mid 1990s, it appeared that food dollars spent away from home would surpass food dollars spent at home in the early part of this century. This has not happened. In 2004, food at home spending was approximately 53.5% of total food expenditures,[1] while food away from home spending accounted for the remaining 46.5% (Table 1). Food at home spending is predicted to decline to 52.0%, leaving food away from home spending at 48.0%. Increased competition from warehouse clubs, supercenters, drug stores, and the increasing emphasis on meals-to-go have tempered this trend.

The Evolution of Grocery Supply Chains

If grocery supply chains do take on the forms described in the frictionless marketplace, they will come full circle from how they used to be organized. The evolution of the grocery supply chain can be categorized by five phases (Terbeek, 1999): pre-development, development, saturation, and decline. The fifth phase, frictionless, was already discussed.

Pre-development (before 1945)

The pre-development phase was characterized by an individual shopper orientation, where the retailer performed multiple functions. Information resided with the individual employees/owners who knew each customer by name and their shopping preferences. Core competency resulted from creating superior customer satisfaction. Information technology was used for basic bookkeeping, and no single grocer had a

1. *Total food expenditures exceeded \$959.4 billion in 2004, higher than the food-based retailing number (\$888.1 billion) cited earlier because it includes all retail outlets such as money spent in hotels for meals, snacks at entertainment facilities, meals in institutions, and airline feeding (USDA-ERS, 2004).*

Table 1. Projected expenditures for food 2001-2013.

Year	Food at home[a] $ million	Food at home[a] % of total	Food away from home[b] $ million	Food away from home[b] % of total	Total ($ million)
2001	463,600	53.80	398,100	46.20	861,700
2002	485,200	53.90	415,000	46.10	900,200
2003	498,100	53.56	431,900	46.44	930,000
2004	513,000	53.47	446,400	46.53	959,400
2005	526,500	53.18	463,600	46.82	990,100
2006	544,900	53.05	482,200	46.95	1,027,100
2007	562,300	52.86	501,400	47.14	1,063,700
2008	580,900	52.69	521,500	47.31	1,102,400
2009	600,000	52.52	542,400	47.48	1,142,400
2010	619,800	52.35	564,100	47.65	1,183,900
2011	640,500	52.20	586,600	47.80	1,227,100
2012	661,400	52.02	610,000	47.98	1,271,400
2013	688,200	52.04	634,300	47.96	1,322,500

Note. Data from USDA-ERS (2004).
[a] Includes food for off-premise uses.
[b] Includes both meals and snacks.

technological advantage. Grocery stores were organized locally and the focus was on bulk items. Grocery store headquarters were located at each individual store, while power within the system resided with the shopper. The key industry trend was store performance and profitability based on securing and maintaining customers.

Development (1945-1975)

The development phase spawned the birth of a consumer-segment orientation, where new products were introduced to post World War II consumer-product hungry shoppers. The retailer no longer knew the customer intimately. Core competency resulted from creating superior logistics systems. Information technology moved to the back room to handle logistics of emerging grocery distribution systems. The focus was on national brands. Store headquarters were located at the warehouses, while power within the system resided with the manufacturer. Success was measured in cases moved per hour. The key industry trend was how fast the grocery chain was growing. Profitability was determined by the number of national brands items carried.

Saturation (1975-1990)

Customers became consumers in the saturation phase, and cookie-cutter retail locations signaled cost-efficiencies. The "one size fits all" attitude was as pervasive as Tide™ in grocery aisles. Core competency was measured by how well retailers could buy products. Operations were streamlined by information technology at all levels. Point of sale information was collected, studied, and managed. Store headquarters were moved to buildings no longer connected to the warehouses or stores, and power within the system resided with the retailer. Store employees became expensive to have. Success was measured by the amount of deal money buyers could wrestle from manufacturers, while the key industry trend was consolidation and profitability was determined by how efficiently stores managed categories.

Decline (1990-2000)

In the decline phase, consumers found it difficult to differentiate between retailers and consumers were taught to switch retailers for the next lowest price on national brands. Core competency became how to run the most effective committee meetings. Information technology focused on fine tuning, and squeezing as much efficiency out of the system as possible to compete with retailers like Wal-Mart. Chains became too big to react to market changes, while smaller, independent grocery chains differentiated themselves by being innovative and in-tune with their customers. Manufacturers were the critical source of information as retailers tried to make sense of the blurring supply and consumer channels. The power within the system resided with investors on Wall Street. Store employees, as a labor pool, were scarce. Success was measured by the share price, while the key industry trend was globalization. Profitability was all too often based on the trade and promotional dollars garnered from manufacturers.

Coming Full Circle

With the dawn of the frictionless marketplace, we have come full circle from the neighborhood grocer of the pre-development phase, to "agents" of the future who utilize technology and systems to once again become "intimate" with customers. Numerous forces are driving change within grocery supply chains. These forces may ultimately determine which supply chains survive. Survival may depend on: 1) supply chains based on channel push and channel pull strategies, and/or 2) supply chains based on huge mega-retail formats and focused specialists.

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