Supermarket Strategic Alert
Special Report

2002

FROM THE REGULAR AND SPECIAL EDITIONS

January through December 2001

Consolidation & Globalization

FROM THE 2001 REGULAR AND SPECIAL EDITIONS

Special Report: 2002

Consolidation & Globalization

P. O. Box 331
New York, NY 10021-0331
Phone (212) 734-0753 • Fax (212) 202-3501
E-mail info@supermarketalert.com

Table of Contents

Special Report

2001

Consolidation & Globalization

2001 brought Republican domination to the FTC and other regulatory agencies—prompting many to think continued consolidation would be likely. Still, actions did not follow thoughts, in part because industry leaders were still digesting acquisitions from 1999 and 2000. Consolidation did accelerate in the foodservice sector—where Ahold is fast gaining share-of-stomach. Consolidation has hit elsewhere in the US—sales and marketing companies (brokers) are becoming more national. And elsewhere in the world, the biggest players are growing through acquisition and learning from prior mistakes about importing an operating model without tweaking for local culture.

2000 was inactive

According to a report from Arthur Andersen Corporate Finance, 2000 was a relatively inactive year for supermarket mergers, with activity down 45% from just one year earlier. Arthur Andersen predicts further consolidation, primarily of 10-to-50 store regionals, so that by 2005 the top five supermarket chains will control 50-60% of total industry sales. The report attributes the downturn in acquisition activity to: (1) the declining stock market, (2) tightening of credit markets, (3) added FTC scrutiny because of earlier heavy activity and (4) difficulty in establishing valuations that buyers and sellers can agree on.

Source: *PG Daily News*, January 9, 2001. Report: Top Five Supermarkets Will Command 60 Percent of Sales by 2005.

Safeway an active player

Contrary to prior announcements that it would focus its acquisitions in the Northeast, Safeway will purchase 11 ABCO stores in Arizona from Fleming. Safeway already operates 90 stores in its Phoenix division and will give ABCO employees first priority in jobs at the new Safeway locations. The stores that Safeway acquired will solidify its #2 position in Phoenix and Tucson—both behind Kroger's Fry stores.

Fleming's April 2000 strategic plan called for selling virtually all of its 161 conventional stores while it focused on its value-price outlets and wholesaling. Later in the year, it decided to retain Rainbow Foods, but it is still selling most of its Sentry operation in Wisconsin, Baker's in Nebraska and ABCOs in Arizona. Fleming is in various phases of discussions to sell the 42 remaining ABCO and 24 Sentry stores to multiple retailers, and recently sold the Baker's chain to Kroger. The company expects to gain $200 million from the sale of the conventional operations.

Source: *PG Daily News*, January 06, 2001. Safeway to Purchase 11 ABCO Stores in Arizona from Fleming. *SN*, January 15, 2001. Safeway Deal Leaves Fleming 42 Abcos to Sell, by Elliott Zwiebach, p. 1, 71.

Activity down during 2000

According to an Arthur Andersen study, supermarket mergers were down 40% from 1999 to 2000. Last year only 500 stores were involved—down substantially from the 3000 in 1998. The study attributes the decline to: (1) tightening of the debt market, (2) 20% drop in the value of supermarket stocks, (3) increased FTC scrutiny, (4) more store closures and bankruptcies. Andersen predicts that fill-in consolidations will continue (chains of 10-50 stores) and that regional companies may combine.

Source: *Progressive Grocer*, February 2001. Mergers down, In the trade, p.10.

Regulatory climate changing

The Federal Trade Commission (FTC) and the Financial Accounting Standards Board (FASB) are altering their standards, which could lead to increased merger and acquisition activity in the supermarket industry. Specifically, the FTC no longer requires premerger notification on acquisitions of less than $50 million, up from the prior threshold of $15 million. In the supermarket industry, where transaction prices range from 20-50% of annual sales volume, this could result in acquisitions of chains of 15 or fewer stores requiring no premerger clearance from the FTC. This change is likely to accelerate smaller acquisitions but will have no effect on larger consolidations.

The revisions for recording financial results proposed by the FASB would eliminate the pooling of interests accounting method (where assets and liabilities are combined) and require buying companies to treat acquired companies as investments. This change, coupled with the elimination of the requirement to amortize goodwill, is also likely to step up the merger pace. The biggest beneficiaries would be those companies that could report higher earnings per share—Safeway, Albertson's, Whole Foods and A&P.

Still, few expect antitrust sentiment to change with the Bush Administration. There is likely to be a majority of Republicans on the FTC when a Democratic member's term expires in September. The FTC will continue to examine the following factors in proposed mergers and acquisitions: (1) competitive concentration, (2) proximity of competing sites, (3) efficiencies, (4) the 'two-year' effect.

Source: *SN*, February 5, 2001. New Rules Could Pick Up Pace of M&A Activity, by David Ghitelman, p. 1, 58. *SN*, February 12, 2001. Antitrust Approach Won't Change Under Bush, by Elliot Zwiebach, p. 1, 55.

Ahold builds on foodservice foothold

Through its US Foodservice unit, Ahold has extended its reach in western Florida by acquiring 100% of Parkway Food Service. With sales of $85 million annually, Parkway will increase Ahold's economies of scale and grow sales to restaurants, schools, universities and healthcare institutions.

Source: *Dow Jones Newswires*, February 6, 2001. Ahold Buys Parkway Food Service In U.S., by Neil Moorhouse. *PG Daily News*, February 6, 2001. Ahold Buys Florida Food Service.

McDonald's betting 'upscale'

McDonald's, betting that hungry, time-starved consumers will be looking beyond the bun, has acquired a one-third stake in Pret a Manger, a UK-based sandwich chain that offers upscale sandwiches, sushi and salads. There is one store in New York City and more than 100 in Britain. Company and industry watchers register no surprise, since McDonald's has declared its intention to capture a greater share of meal occasions. The deal fits nicely with other recent ventures into Donato's Pizza, Boston Chicken, Aroma Café and others. Pret a Manger's Web site says it puts 'quality ahead of profits,' with no central production. McDonald's admits it does see the concept as 'clearly franchisable' and its real estate clout can't hurt. Production method modifications will be observed when they occur.

Source: *The Wall Street Journal*, February 1, 2001. McDonald's Buys Stake in Pret a Manger, U.K. Chain Offering Sandwiches, Sushi, by Jennifer Ordonez, p. B7. *The New York Times*, February 1, 2001. McDonald's to Acquire Stake in Sandwich Store Chain, p. C4.

Becoming a Superleaguer

McKinsey consultants Jevin Eagle and Elizabeth Lempress outlined what will make a retailer a 'superleaguer.' According to the McKinsey study, retailers—especially in Europe—have strong brand identities. In fact, when polled, shoppers say they would believe that Wal-Mart and others would be better banks, restaurants, providers of travel and other services than existing companies in those businesses. The winning retailers will create an 'ecosystem'—serving an integrated set of consumer needs through alliances and partnerships, but under a single brand or umbrella. An example would be an ecosystem based on home ownership needs, providing installation, repair, cleaning, gardening, home security and architectural/design/decorating services, among others. Superleaguer retailers will be those that seize the opportunity and do this, becoming the dominating brand across a broad geography. While other retailers will coexist under the new system, there will be no more than five superleaguers creating more than 60% of the total retail sales value within ten years.

While today it is still an execution game, the McKinsey representatives pointed to the following developments that confirm the endgame: (1) Retailers are already entering new industries, including travel services, telecom services, banks, insurance, etc. (2)Tesco has already re-invented its front end, which does not sell candy. Front-end displays contain brochures for other Tesco businesses, including pensions and insurance. Tesco's insurance staff roam the store selling insurance, but also directing shoppers to the groceries they need. (3) Other retailers are positioning themselves in broader categories: Radio Shack for technology, Home Depot for anything related to the home and Staples as a small business resource.

Source: *FMI MarkeTechnics Presentation*, February 18-20, 2001. Jevin Eagle and Elizabeth Lempress.

Changes to continue in Canada

Although Canada is the second largest country in the world in terms of physical size and important because of its 5500-mile shared border with 12 US states, its food retailing industry totals only US$35 billion, growing annually at less than 3%. The industry is fragmented with more than 25,000 outlets—including chain supermarkets, convenience stores, independent grocers and non-traditional grocery outlets (mass merchandisers, warehouse clubs, drugstores and specialty food stores). Supermarket size averages 26,000 sq ft with 18,000 SKUs, well low the 40,000+ sq ft and 40,000 SKU US averages.

Six companies control 80% of the market. Two players are national—Loblaw with a 35% share, Sobeys with 19%. Regional players are Canada Safeway at 9%, Metro at 7%, A&P Canada at 6% and Overwaitea at 4%. Two companies have majority ownership by non-Canadian companies: Safeway and A&P. Canadian competition law limits share domination to 35%, which is good news for shoppers so the government is satisfied with the system. All the major players except for Sobeys are predominanly unionized. All are vertically integrated meaning that have both retail and wholesale divisions.

Analysts predict the following: (1) After a major round of consolidation in late 1998 (Loblaw purchased Provigo and Sobeys bought Oshawa), there will be fewer large-scale mergers as both companies focus on increasing operating margins. Still, rumors abound centered around the trend toward globalization. Ahold is on everyone's mind, but fear is tempered by the strong government position. (2) Independent food store market share will continue to decline from a high of 48% in 1991 to 43% in 1999. Warehouse clubs will increase their market share from 8% and non-traditional food store share—stable since 1994 at 11%—may rise.

(3) Average store size of 26,000 square feet will increase, particularly in the highly populated Ontario area where Loblaw dominates. (4) National and regional chains will focus on non-food products and services as well as private labels. (5) Investments in new technologies will increase, especially in warehouse management, supply chain applications, front-end and electronic retailing. With average margins of 1-2%, there is room for operating improvements. (6) Wal-Mart will become a more aggressive player, perhaps doubling its expansion pace and introducing Neighborhood Markets.

Source: *Progressive Grocer*, March 2001. Face Off: Canadian grocery retailers are positioning themselves to become stronger, smarter and more influential players, by Barry Janoff, p. 14-20.

More excitement in Britain

Speaking at a London conference, Carlos Criado-Perez—ceo Safeway UK, the fourth biggest player in the British market with a 7.4% market share—said that Britain lacks a dominant operator because 'the differences between the four or five big players are not so big they cannot be overcome.'

Acknowledging that the players are 'formidable competitors,' he added that Safeway's sales volume has grown 41% since October 1999, resulting from its hi-lo strategy, which produced pricing advantages over the competition, and reformatted stores.

Safeway UK will also be opening superstores and hypermarkets. The company will decentralize somewhat giving store managers full control of sales forecasting, ordering and stock.

Criado-Perez, with global retail experience with Wal-Mart and others, believes that UK retailing is dull and merchandise presentation not as interesting as elsewhere. Believing that 'insularity in trading can only lead to failure,' he suggests that the UK retailing sector not give up because Wal-Mart has arrived, but look for more creative ways to tantalize customers beyond Asda's price strategy.

Source: *Dow Jones Newswires*, March 7, 2001. Safeway Chief Executive Throws Down Gauntlet To Rivals, by James Hall. *PG Daily News*, March 8, 2001. Safeway U.K. Chief Reveals Hypermarket Expansion Plans/Says Wal-Mart Can Be Overcome.

70% consolidation in 10 years

In the keynote address at the Western Association of Food Chains conference, Steve Burd, ceo Safeway, predicted that consolidation in the US will continue, with the top five players owning 70% of the market within ten years. These multiregionals (Ahold, Albertson's, Kroger, Safeway and Wal-Mart) will increase their market share by adding regional players, many of whom will retain their names and niches. Burd said that Safeway looked at nine possible acquisitions in 2000, although it only went forward with two—Genuardi's and a company that ultimately was not sold. Going forward, Burd believes that (1) valuations may decline because there will be fewer bidders and (2) consolidation will include other retail channels.

Source: *SN*, April 9, 2001. Burd: Regionals Likely to Align with Nationals, p. 1, 58.

Tesco: Winner at Asian retailing

According to *The Economist*, two changes are transforming Asian retailing: the move from wet markets (stalls and carts that sell freshly grown perishables along streets and canals) and small shops to hypermarkets and the arrival of Western companies with skills, technology and management culture to run the giant units. Looking back just ten years, locals dominated Asian retailing. Today Asian retailing is an international business—dominated by foreigners—especially European companies.

Besides the obvious advantages of air conditioning that the new malls and stores provide, it appears that Asians are just as interested in convenience–all under one roof—as their Western counterparts. Asians are also more price-conscious because they are poorer, forcing the megastores to match wet market prices. In the mid-90s, Carrefour, Wal-Mart, Royal Ahold, Makro, Casino and Tesco invaded. With little local competition, things were fine until the Asian financial crisis in 1997-8, when all investments suffered as a result.

What the multinationals lacked in local connections, they made up for in logistics and centralized purchasing. Still, deep pockets and technology were not enough to deter local competition: Carrefour pulled out of Hong Kong; Casino and Carrefour have walked away from the Philippines. Now these multinationals are worrying about returns: Although France, Thailand and Korea have similar population bases, France has 1100 hypermarkets to Korea's 96 and Thailand's 77. The giants end up racing to open stores—often right across the street from each other—starting price wars.

The Economist labels Tesco the surprise 'unofficial winner.' It says Carrefour made a series of 'small mistakes,' including selecting poor locations and making stores 'too French.' Wal-Mart and Royal Ahold suffered from the same lack of localizing in the *Economist* survey.

Source: *The Economist*, April 7, 2001. A hyper market, p. 68-9 *The Wall Street Journal*, April 23, 2001. In Asia, Going to the Grocery Increasingly Means Heading for a European Retail Chain, by Michael Flagg, p. A19.

Outlook for Japanese retailers

The supermarket industry in Japan is under more sales pressure even than the US: sales have fallen for 27 consecutive months. The consensus is that the gap between winners and losers is likely to widen further, given fierce competition and dormant consumer spending.

Still, analysts see bargains in the hard-hit group: (1) Ito-Yokado—parent of US 7-Eleven—and an investor in technology and creative loss leader pricing, most recently in prepared foods. (2) Jusco, the most aggressive merchandiser in the group, which is shoring itself up with store brands for the onslaught of foreign competitors Carrefour and Wal-Mart.

The one key player on no one's hit parade: Daiei. Despite a three-year restructuring plan, its plans are overly ambitious given its high debt.

Source: *The Wall Street Journal*, April 4, 2001. Japanese Supermarket Stocks Might Be Deal You're Seeking, by Yumiko Ono. *Dow Jones Newswires*, April 6, 2001. Japan Sector Outlook:: Gap To Widen Between Supermarkets, by Hiroyuki Kachi.

Performance after consolidation

Tim Carroll, Philip Evans and David Snyder of Arthur Andersen reported on consolidation trends in global retailing and how consumer satisfaction is affected. According to Andersen analysis, merger and acquisition activity worldwide will remain high even though deal value and deal volume has declined recently. Although food retail consolidation is at different levels worldwide, it is driven by the same factors: economies of scale, buying clout and share growth. 'Top 5' concentration varies from 96% in Israel to 81% in France to 77% in Canada to 58% in Germany to a low of 40% in the US. Consolidation in the US differs from that elsewhere in that domestic players are interested only in domestic expansion. Elsewhere, consolidation takes place across national borders. There is consensus that further US consolidation will take place, but will likely be among regional players or be of smaller companies. This results from the bigger deals already having been made and the big companies needing to digest them. Further, the smaller deals will be easier and faster to consummate since they will be below FTC dollar scrutiny level and likely not require extensive financing.

In the end, it is consumer satisfaction that matters and that is often perception and not reality. Andersen examined five recent deals for which it provided consulting services. The survey included national, regional and independent operators…and across all five, 51% of those consumers polled said they believed that consumer satisfaction declined. However, that overall number is misleading. In fact, three of the five chains showed increases in consumer satisfaction ranging from 5% to 8%. It was the two remaining chains—which reported losses in consumer satisfaction ranging from 16-23%—that dragged down the ratings overall.

In examining the numbers more closely, price satisfaction declined for both the winners and losers, although the winners did perform better on this measure. (41% of the presentation audience thought that price satisfaction would improve for winners and decline for losers.) Product quality satisfaction among winners increased sufficiently to offset any price dissatisfaction. Among losers, product quality satisfaction declined—and when teamed with price problems—was disastrous. For consumer satisfaction with the facility, winning acquisitions increased satisfaction, overall losing acquisitions demonstrated declines in facility satisfaction. The same outcome existed for merchandising (where decline of national brands was mentioned as the worst problem in losing mergers), marketing and promotion (where worsened community image was mentioned for losers) and service levels. The overall level of consumer satisfaction after the mergers predicted sales performance—strongly demonstrating that perception is more important than reality and that overall atmosphere, availability of national brands, attentive checkout clerks, new product availability and other factors are more important in the end than just prices alone.

Source: *FMI presentation*, May 7, 2001. Global Trends in Retailing: Consolidation and the Consumer, by Tim Carroll, Philip Evans and David Snyder.

Analysts' predictions for 2001 consolidation activity

SN-Supermarket News polled retail analysts asking them to predict what would happen in the second half of this year. Among the predictions: (1) Pathmark will be acquired this year, in part due to its excellent fourth quarter. Most likely the acquirer will be Safeway. However, other possible buyers include Sainsbury (with cash on hand after selling Home Base and looking to build is Northeast stronghold from Shaw's). (2) Also possibly on Safeway's shopping list: Weis Market, Harris Teeter. (3) Wal-Mart appears as yet unsatisfied with its Neighborhood Markets as signaled by the slow expansion of the concept. (4) The only potential action in the mega-merger category would likely include European companies such as Carrefour or Tesco and could include other European companies or US operators.

Source: *SN*, May 7, 2001. Everything You Always Wanted to Know About Second Half 2001, by David Ghitelman, p. 150, 154.

Globalization Lessons

Hypermarket, malls and discounters quickly expanded in Poland after the fall of communism and now claim 11% of total retail sales and 25% of food sales. As in France, small shop owners are lamenting their fate and have banded together to pass legislation restricting expansion of hypermarkets. Still, the foreign owners of the hypermarketers learned from earlier experience: they had already gotten planning commission clearances for future stores prior to the ruling. Not quite France yet: the top five retailers, all foreign-owned, claim only 12% of the total Polish retail market.

Six years after being criticized for trying to import American shopping preferences to Brazil, Wal-Mart is demonstrating how fast it learns from its mistakes. With 20 outlets compared with Carrefour's 200, Brazil is now the giant's growth focus: it is opening Neighborhood Market equivalents in working class areas that will sell goods for 5% less than local merchants. These smaller units can be built in three months…and take advantage of existing distribution centers.

Source: *The Economist*, May 19, 2001. Hype on the Vistula, p. 61. *The Wall Street Journal*, May 25, 2001. Wal-Mart Gets Aggressive About Brazil, by Miriam Jordan, p. A8, A12.

Casino in Venezuela

French conglomerate Casino is betting that Venezuelans are going to take to hypermarkets as others have. Casino, along with Venezuelan and Colombian minority partners, has opened a 100,000-sq ft unit near Caracas. Hardly hyper by some standards, it is the first of four-plus stores (some up to 200,000 sq ft) that are planned for the next year. The belief is that bulk buying will yield prices up to 8% less than competitors' prices. The relatively small population and entrenched mom-and-pop shopping culture have deterred the majors, making Venezuela virgin hypermarket territory. The country poses additional challenges: Because of government currency intervention, the cities are some of the most expensive in the world to live in, yet the wage levels are the 13th lowest of 58 cities measured. Still, the newcomers are undeterred. They run busses from the shantytowns to the store, and with the help of more affluent SUV-driving shoppers, sales at the Caracas store are 35% above expectations.

Source: *The Wall Street Journal*, June 28, 2001. Will Venezuelans Shun Mom and Pop for the Hypermarket? by Marc Lifscher, p. A13.

Pit Stop restyling

'Pit Stop' is the program Albert Heijn (Netherlands division of Royal Ahold) undertook to restyle its stores and offer broader products and services. The Heijn stores attract the quality end of the market, and the updated design reflects the changing tastes of the busier, wealthier Dutch consumer. Included is an upgraded assortment of goods and products and more value-added ready-made meals. All 670 of its stores in the Netherlands have been closed for the transformation for three days. Similar transformations have taken place elsewhere as the trend for ready-to-eat meals takes hold. Dutch shelves now contain examples of US solution selling, including grouping products by meal—for example, milk for coffee no longer in the dairy section but next to the coffee, pasta with Italian sauces instead of next to the rice.

Source: *Dow Jones Newswires*, July 6, 2001. Dutch Supermarkets Undergo Facelift To Woo Customers, by Maaike Veen.

Sainsbury & Boots team up

Perhaps further signaling the tough retail environment and channel blurring, the British drugstore chain Boots announced supermarketer Sainsbury will open 2800-4200 sq ft Boots stores and pharmacies in six Sainsbury's supermarkets outside London. This would more than double the number of HBC products that Sainsbury sells.

Both companies' spokespeople say they are not discussing a merger. British market observers say Boots has been under siege as supermarkets have begun selling more of its core toiletries. Still, Sainsbury gains because it gets to capitalize on the trusted Boots' healthcare brand, while Boots gains recognition outside London. Shoppers would be able to use both the Boots Advantage and Sainsbury Reward loyalty programs.

Source: *The Wall Street Journal Interactive Edition*, July 9, 2001. Boots, Sainsbury Discuss Joint Venture For Cosmetics and Pharmacy Products. *SN Daily News*, July 10, 2001. Boots, Sainsbury Ponder 'Store-Based Trials,' by Mark Hamstra. *Dow Jones Newswires*, July 18, 2001. J Sainsbury, Boots Agree Health & Beauty Store Trial, by Joyanta Acharjee.

Domestic Rearrangement

Albertson's will close 165 (of 2541 total) underperforming retail stores in 25 (of 39) states, reduce corporate overhead (15-20% of managerial and administrative jobs above store level) and consolidate 19 divisions into 15, resulting in pretax charges of about $585 million. The action will result in no major market exits and will better position the chain for future growth. New chairman/ceo Larry Johnston (from GE)described the announcement as 'a first step.' Harris Teeter sold underperforming stores in non-core markets to Kroger, Bi-Lo and Piggly-Wiggly Carolinas to devote funds to profitable growth in core markets. Analysts say this is a good example of the importance of critical mass in a market, economies of scale and market dominance.

Source: *Dow Jones Newswires*, July 18, 2001. Albertson's To Close 165 Underperforming Retail Stores, by Daniel Martinez. Albertson's Sees No 'Significant Market Exits,' by James Covert. *SN*, July 23, 2001. Albertson's Closing Units To Improve Performance, by Elliot Zwiebach, p. 1, 42.*SN*, July 2, 2001. Harris Teeter Sells Non-Core Markets, by Elliot Zwiebach, p. 1, 33.

Spotlight on Brokers

A lot has changed since 1999 when four national sales and marketing companies (Marketing Specialists, Acosta, Advantage and Crossmark) were established to better serve manufacturers. In May 2001, publicly held Marketing Specialists filed for bankruptcy, focussing on the viability of all the companies.

The numbers are stark: last year Marketing Specialists had a net loss of $365 million on sales of $381 million. Industry insiders attribute the Marketing Specialists problem to excessive debt and underbidding to get contracts. The debt came primarily from going public and paying too much for acquisitions. Underbidding to get contracts compounded the situation because ultimately the company couldn't service its debt. Sales and marketing executives (still called brokers, despite attempts to redefine themselves and their roles in the supply chain) believed that their consolidation was inevitable as manufacturing companies consolidated and a sure way to improve financials because of elimination of redundancies. The reality was less overlap than expected, resulting in fewer operating cost reductions coupled with the challenges of integrating cultures and processes.

Others believe that manufacturers share the blame: Packers believed national contracts were a way to lower full service brokers' rates about 2.5% from 4-5% of the value of the product. The 4-5% cost is close to what a manufacturer would pay to a direct sales force. In this respect, manufacturers were shortsighted in trying to get brokers to do the job for so much less than it cost them.

The end of the story remains unclear: Of Marketing Specialists' 5,700 employees in 65 locations, Acosta said it had hired 1,700. Skeptics say this number is high. Retailers perennially complain that service has declined—consolidation and bankruptcies aside. Some believe regional brokerages will gain given the negative sentiment toward national operations resulting from the bankruptcy. But the reality remains that if manufacturers can get by paying less than 5%, the nationals do have a future.

Source: *Supermarket Business*, July 16, 2001. Death of a Sales Company, by Bob Ingram, p. 1, 8.

Moscow: Hotbed of innovation ?

Moscow—home of drab stores with clever names like 'food' and 'furniture'—is beginning to revel in Western retailing. As the economy expands and improves, foreign retailers are opening stores, including Ikea of Sweden, Ramenka of Turkey, Auchan of France and Metro of Germany. With the nation's population and wealth concentrated around Moscow, the foreign businesses are focussing there first. Outsiders were wary about moving in because of the political instability and vacillating fortunes, but based on the experience of early entrants, more are coming. The number of supermarkets in Moscow has increased 50% in the last year, as outdoor markets have dwindled.

The government has gotten into the act as well. Twenty sites around Moscow have been designated for shopping malls. Early arrivers have an edge because so much business in the area is based on relationships and cultivating local suppliers. Still, local talent is limited and managers are generally imported. Theft is high with security a major issue. Coupon counterfeiting has forced an end to that promotional practice. Skeptics say that few places outside Moscow have the wealth to support the retailers.

Source: *The New York Times*, August 10, 2001. Moscow Is Getting a Taste of the Mall, by Sabrina Tavernise, p. W1.

Tesco: Winner at understatement

The Economist credits 'understatement and quiet confidence' for making Tesco into a global retailing giant. Understatement includes a spartan world headquarters in rural Britain. Quiet confidence comes from listening to customers and surveying data and customers before bucking conventional wisdom. Terry Leahy, current ceo who started stacking shelves as a summer job before joining full-time in 1979, says his perspective comes from having seen 'all layers of British life.' Under his leadership, Tesco has done at least three things counter to conventional wisdom: (1) In 1993, the chain introduced a Values line, which analysts believed a bad move. Although the company stock sank for the short term, the line was a success with customers who had come out of years of recessions and were pleased to finally find a bargain. (2) The next year, Tesco promised 'One in front'—meaning it would open a new checkout lane if there were more than two carts in line. The extra staffing was expensive, but customers loved it. (3) Tesco committed heavily to loyalty cards despite complaints from competitors that they would drive down already thin margins. Today there are 10 million cardholders. (4) Tesco's online shopping venture is exemplary—the only one to be profitable despite many other predecessors and followers.

Leahy's marketing vision is more apparent in how he has built the company beyond just the food it stands for by keeping margins flat and investing in ancillary areas. Opportunistically, Tesco now sells TVs, computers, clothes and more—always sticking to a few popular items. This allows the company to outgun small specialty stores, but also puts it on more equal footing with Wal-Mart's Asda. Expanding beyond low-margin groceries, the company now sells more over-the-counter medicines and toiletries than renowned British drug chain Boots. Its investment in The Nutri Centre will round out its natural remedies offerings. Tesco will distribute 85 Nutri Centre products in 50 Tesco stores immediately and more products into its 210 stores during the next two months. Tesco will also sell The Nutri Centre's complete 22,000-product selection on its Web site. All of these non-grocery offerings now total 20% of company sales. Service expansion is also a trademark of Leahy: Tesco offers its own brand banking through The Bank of Scotland. It will soon offer utility bill payment services, following the success of Seven-Eleven in Japan. Also there's international expansion. The company's overseas business—although still in its infancy and accounting for 13% of sales and 6% of profits—grew by 29% in Europe outside Britain last year and by 85% in Asia.

Source: *The Economist*, August 11, 2001. Leahy's lead, p. 53. *SN Daily News*, August 8, 2001. Tesco Acquires Majority Stake in Natural Products Retailer.

Loblaw: Canadian innovator

Canada's Loblaw has long recognized that selling food is not a high-margin business and has looked for ways to get people to spend more when they come into Loblaw stores for food regularly. It launched President's Choice Financial to offer financial services and is now opening three supercenters in Ontario province. Analysts say the units will be similar to Loblaw's 50 warehouse-size stores in western Canada. Those stores devote about 35,000 of their 115,000 sq. ft. to expanded existing categories including apparel, housewares, electronics, bed and bath and a photo lab. Analysts agree that this format is important to Loblaw because Wal-Mart Canada, Zellers and Costco all offer this kind of shopping experience nearby.

Source: *SN*, August 6, 2001. Loblaw To Open Three Supercenters, by Brian Dunn, p. 19.

Global overview

Business Week warns naysayers who point to Wal-Mart's early missteps in international expansion that it is a new ball game. Facts: Wal-Mart is now the biggest retailer in Canada and Mexico. Its international sales totaled $32 billion in 2000 (17% of total), its international profits topped $1.1 billion (up 36%, although only 12% of total) and 26% of $9 billion in capital expenditures will be spent outside the US.

With management accustomed to double-digit sales and earnings growth, Wal-Mart has no alternative except to expand outside the US. John Menzer is in charge of the invasion and has been credited with tightening US financial controls and increasing return on assets. Challenges remain: (1) In Germany, the two chains acquired earlier must be integrated and upgraded. Wal-Mart has stopped predicting when the German operation will be profitable, focusing instead on learning from its mistakes and understanding cultures, regulators and consumers overseas. (2) In England it was more successful at installing new technology and bringing ADSA into the global buying program. Market share grew from 7.4% to 9.6%. (3) Menzer wants operational authority to reside in the individual countries and is cutting the international staff in Bentonville. That also means exporting best practices and applying them as needed.

Critics still argue that there is a Bentonville-knows-best mentality, that few managers abroad are non-American and therefore still not totally in touch with local ways of doing business and customers. Enthusiasts argue that foreign knowledge has been brought to the US, citing the adoption of ASDA's fresh food replenishment system to the States and the arrival of George clothing in time for the holidays.

Source: *Business Week*, September 3, 2001. How Well Does Wal-Mart Travel? by Wendy Zellner, p. 82-4.

Wal-Mart: Acceptance as Canadian

Canadians, once suspicious of the interloper from south of the 49th parallel that took over the ailing Woolco stores, now consider Wal-Mart their own. In contrast to the US, where communities petition to keep the giant of town, Canadians petition to get Wal-Mart to move in. Smaller towns want a Wal-Mart store—even one smaller than the 125,000 sq ft average—to bring shoppers and other businesses to them.

In 1994 Wal-Mart took over 122 units; now there are 179 and sales are up 265%. Although competitors may complain, Wal-Mart's entrance paved the way for Home Depot, Costco and others to enter and also grow handsomely. Canadians themselves admit that what Wal-Mart does, it does well—raising the stakes/standards for the homegrown including Zellers, which has grown, and Eaton, now defunct and part of Sears Canada.

Small manufacturers in Canada don't know whether to thank Wal-Mart or NAFTA more for opening up the broader North American market and teaching them about retail partnerships—including sharing data through RetailLink. Wal-Mart adapted to Canada, stocking stores differently by region and by time of year and by keeping many of the Woolco managers in place. Now that Wal-Mart has given C$194,000 to build a monument in Normandy France to commemorate the landing of Canadians on D-Day, Canadians now think of Wal-Mart as its own.

Source: *The New York Times*, September 1, 2001. Canada Warms to Wal-Mart, by Bernard Simon, p. C1, C3.

Wal-Mart, Mexico and NAFTA

The confluence of various circumstances has led to Wal-Mart's success in Mexico. These include its founder's willingness to take a chance, the company philosophy to stick with it through tough times, legislative boosts and faith that consumers worldwide respond to fair, low prices. All this has paid off as Wal-Mart de Mexico today includes everything from warehouse clubs to supercenters to neighborhood limited assortment stores and is a model for further global expansion. Sales increased 5.6% in the last year while rivals saw their sales fall. The country's 520 stores have annual sales of over $9 billion and provide a full third of the parent's $1.1 billion in international profit.

The story begins in 1990 when founder Sam Walton found kindred spirits in the Arango family, founders of Cifra, the home-grown discount stores of Mexico. He formed a joint venture with them, and his successors finally bought out the family, but not before cultural clashes, rampant inflation and currency devaluations made for ups and downs that would have frightened others off.

Among the learning experiences provided by Mexico: (1) The much-touted inventory system needs human supervision and intervention. Local managers often reduced slow-moving, non-compatible merchandise to move it out to free space for needed goods only to find it automatically reshipped. As in the US, store assortment had to be aligned to shoppers. (2) Mexican employees did not perk up to the 'Give me a W' cheer daily, but clearly embraced the work ethic when they were able to create their own mantra. (3) Legislation can be a windfall—when the opportunity is seized. Even before the passage of NAFTA, Wal-Mart was quick to embrace local producers of everything from TV sets to food to motorcycles because the lines could be priced significantly lower than imported items. By 'giving back' its savings to customers, Wal-Mart cemented itself as the low cost leader below the Rio Grande. (4) Wal-Mart took advantage of the cheaper available labor in Mexico and built local distribution centers. Company officials say its Mexico City facility is the most efficient in the world. (5) Locals make good partners as well as good customers. When Wal-Mart needed logistics help navigating the roads and infrastructure in Mexico, it turned to a local trucking company, introduced it to a US company willing to make an investment and is now reaping the benefits of 25% savings. (6) Shoppers respond: The early Cifra partnership gave Wal-Mart the local credibility it needed early on, and now that it has bought out Cifra, Wal-Mart has come to stand for low prices always—such low prices that some believe middlemen and small operators will be driven out of business. Some local merchants find it cheaper to buy from Wal-Mart and resell in their neighborhood stores than to work with wholesalers with less efficient and more expensive distribution networks. The result is that once again, brightly lit, wide aisles win out over chaotic local alternatives. Sticking it out through rampant inflation and currency devaluation in 1994 has reaped big benefits.

Source: *The Wall Street Journal*, August 31, 2001. How Nafta Helped Wal-Mart Reshape the Mexican Market, by David Luhnow, p. A1, A2.

Ahold: Increasing US share-of-stomach

Netherlands-based Royal Ahold is continuing its American share-of-stomach campaign through its acquisition of Alliant Exchange and Bruno's Supermarkets. Alliant is Ahold's second major foodservice acquisition after US Foodservice, giving it about $20 billion in total revenue and 10% of the US foodservice business. The seller—Clayton Dubilier & Rice—paid $690 million when it acquired Alliant as Kraft Foodservice from Philip Morris in 1995 and is selling it for $1.5 billion in cash and the assumption of $700 million in debt. Bruno's operates 184 supermarkets in the southeast, with revenue of about $1.6 billion.

Analysts are divided on the moves: (1) Some say in the long run, the foodservice acquisitions will help retail operations with new products and faster introductions. (2) Some say Bruno's, although not expensive, is a 'broken' LBO with longstanding operating problems. Ahold expects increased sales of about $1.6 billion annually from the Bruno's acquisition. Synergies will result in $35 million in savings the first year, $50 million by the third year.

Source: *The Wall Street Journal*, August 31, 2001. Royal Ahold Is in Talks to Acquire Alliant, p. A3. *The Wall Street Journal*, September 5, 2001. Ahold Confirms Deal For Alliant Exchange Valued at $1.45 Billion, p. B2. *The New York Times*, September 5, 2001. Ahold to Acquire Alliant and Bruno's Supermarket, p. C4. *SN*, September 10, 2001. Ahold Makes Double Play In Retailing, Food Service, by Elliot Zwiebach, p. 1, 76.

Ahold: Why Grand Union was different

The New York Times observes that Ahold's acquisition of Grand Union stores may be more difficult to integrate than its other US acquisitions. Although figures are not available, an informal *Times* survey suggests sales at some acquired units are 35% below their prior Grand Union levels. This may result from the non-announcement of their re-opening as Stop & Shops.

Ahold's US acquisition spree has not been without frustration. Beginning in 1988, Ahold acquired First National stores in Ohio and Connecticut, assuming it could turn them around quickly. The company did not anticipate consumer disgust with the dirty stores and out-of-stock conditions. Subsequent acquisitions of Tops, Bi-Lo and Giant Food were less problematic because the stores were in better shape. Still, Ahold's attempt at getting Pathmark, a major player in the NY metro market, was so complicated by FTC intervention that it walked away from the deal. The Grand Union stores were cheap by comparison, but came with a tarnished reputation and big renovation bills.

To date, analysts are disappointed in the Grand Union units as well as established US chains, looking for greater attention to building topline sales rather than the single-minded focus on improving backend operations. Ahold's share price dropped on news of its acquisitions of Alliant (foodservice) and Bruno's (supermarkets)—in part due to analysts' negative reaction to the company not separating out costs for prior acquisitions throughout their integration into the whole.

Source: *The New York Times*, September 8, 2001. The Dutch Uncle of Groceries, by Suzanne Kapner & Greg Winter, p. C1-2.

Lessons from Overseas: From supermarketers

Based on interviews and observations of leading overseas supermarket operators, *Grocery Headquarters* compiled several hints for domestic companies. (1) Customer service tips from Superquinn: umbrella service to cars in inclement weather, tie-in on loyalty programs with a local gas station, full service meat and bakery on the assumption that they provide customer interaction and are not a pure labor cost. (2) Private label tips from Sainsbury and Tesco: leverage the store brand in center store as well as in value-added services, prepared foods and gourmet offerings.

(3) From Ahold: share product—particularly perishables—knowledge across the organization to help with buying, transportation and display. (4) From IGA: share best practices, especially any relating to community involvement. These overseas operators are also learning from the US; enhancing convenience, whole health...and how to survive Wal-Mart.

Source: *Grocery Headquarters*, September 2001. Beating us at our game? by Molly McLaughlin, p. 16-8.

Lessons from Overseas: About the HBC category

According to 'Health & Beauty to 2006,' a report issued by Verdict Research, drug specialty chains in the United Kingdom will lose about 10% of market share of the health and beauty market segment (from 43.7% currently to 32.7%) by 2006. Supermarkets will be the recipients of the gain. Further, mass market pharmacies are projected to see modest HBC sales growth as supermarkets build their departments. The prediction reflects supermarkets' successful encroachment into health and beauty products.

Boots, the largest UK pharmacy chain, has mounted a two-pronged effort: (1) Focusing on higher-margin, valued products and services including dentistry and foot care. (2) Premiering a new store concept in the premium end of the beauty market, called 'Pure Beauty.' Boots is also testing stores inside Sainsbury supermarkets outside central London.

Source: *Dow Jones Newswires*, September 9, 2001. UK Supermarkets Seen Advancing In Toiletries War, by James Hall.

Boon to supermarket foodservice

According to a Technomic report updated after the September attack, supermarket foodservice (hot and cold prepared foods) will grow 4%—up from the August forecast of 3.5%. The increase will be attributable to consumers trading down—taking a bite out of trips to full-service restaurants. Supermarkets will be winners since shoppers will be there anyway…and appreciate the convenience of being able to pick up the prepared foods.

Source: *SN*, October 8, 2001. Forecast: Stronger Growth for Supermarket Meals, by Roseanne Harper, p. 32.

Argentina: Competition and the economy

Supermarket retailing in Argentina may reflect what will happen elsewhere. Native retailers are competing head-to-head with global behemoths. Carrefour — through mergers and acquisitions – has become the leading retailer in the country with a 30% market share, although Royal Ahold — through joint ventures and Argentine-owned Coto — also has sales over $1.5 billion.

However, all this competition has led to some scary numbers, according to data reported by ACNielsen: sales per square foot at supermarkets/hypermarkets in Argentina have fallen from a high of $1100 in 1996 to $800 in 2001. The average transaction has been almost cut in half from $33 to $17. Unemployment runs at 15% and the economy has been in recession for several years.

Still, there appears to be further potential for global operators. As recently as 15 years ago, 70% of retail food and beverage purchases in Argentina were though mom-and-pop stores. Today (according to the USDA), that is down to 45%. Supermarket/hypermarket acceptance spans all economic classes in Argentina, although the wealthier are more likely (95%) to shop these stores than lower classes (65%). Other trends reported by ACNielsen: (1) incorporation of more home meal replacement choices including frozen and hot meals, (2) increased thematic shelving, sorting foods by ethnicity or origin, (3) more home delivery/phone ordering and (4) adding non-foods business to build traffic. Some stores have bowling alleys, amusement parks/video arcades and movie theatres.

Source: *Progressive Grocer*, November/December 2001. Argentina Gets Hyper, by Michael Friedman & Al Urbanski, p. 104.

Canada: Zellers carves a niche

When Wal-Mart bought a bankrupt operator in Canada in 1994 and zoomed into the market, many counted Zellers, the mass merchant arm of Hudson's Bay, out. Contrary to conventional wisdom, seven years later, the two big chains are still in the fight.

Prior to Wal-Mart's arrival, Zellers was known for its dark, poorly organized warehouse stores that attracted low-price shoppers who like the 'lowest price is the law' advertising slogan. Wal-Mart changed the game: Zellers now offers weekly bargains to undercut rivals' prices while charging higher prices than rivals on other merchandise. Wal-Mart's policy was and is everyday low prices so Zellers management realized that fighting Wal-Mart in an all-out price war could be fatal. Instead, they decided to transform Zellers into a more fashionable alternative to Wal-Mart, while still keeping prices low. They upgraded decor and began offering coordinated lines of branded clothing.

Although Wal-Mart is growing faster in Canada than Zellers, Zellers is still in the game. Unlike other Wal-Mart competitors that throw in the towel after shoppers discover the service, prices and wide aisles of Wal-Mart, Zellers bought the floundering Kmart chain in Canada to bolster market share. The president of Kmart Canada, George Heller, came with the deal. He closed underperforming stores to boost margins. With a 1998 market-research effort in hand, he remade Zellers as 'mum's store,' catering to women with children under age 12. The objective was 'to come up with a value proposition that would differentiate us from Wal-Mart,' said the successor to Heller, who became ceo of Hudson's Bay in 1999. Hudson's Bay, which traces its past to the 17th century when it started as a fur-trading company, is the oldest still-existing corporation in North America.

Now Zellers' aisles are wider to accommodate baby strollers, energy-efficient lighting with brighter lighting improves ambiance, displays are only eight feet high (not 14 feet) to lessen clutter, and a fashion director leads the development of private label lines. Zellers' next act will be to add housewares and home electronics to raise sales per square foot from C$155 to C$200.

The recent economic downturn in Canada has been hard on all retailers, with Zellers' same-store sales showing a downturn in the last quarter ending October 31. Operating profit slid to C$27 million from C$29 million the prior year. Zellers accounts for more than half of Hudson's Bay's revenue and most of its earnings before interest expense and income taxes. Wal-Mart's Canadian division is among its most profitable international operations and was one of only three foreign units to post an increase in operating margin last year.

> Source: *The Wall Street Journal*, December 10, 2001. Canada's Zellers Retools Itself In Bid to Battle Wal-Mart Stores, by Elena Cherney & Ann Zimmerman, p. B4.

Aldi to enter Atlanta

Local newspapers report that Aldi (German operator of limited assorted stores, primarily in the US Midwest) will enter Atlanta with six stores early in the coming year. Kroger and Publix currently dominate. A&P, Harris Teeter and Cub Foods have all announced their departures or already left. Analysts believe that Aldi could fill the price-shoppers niche.

> Source: *SN*, December 3, 2001. Aldi Looking to Enter Atlanta Next Year: Report, by Martin Schneider, p. 7.

Be ready for a price war

Supermarket watchers believe a price war is looming among supermarkets, in part because of Wal-Mart's successful move into food retailing and in part because of the soft economy — making consumers flock to outlets offering rock-bottom prices.

Some suggest it is the consumer who stands to win as companies compete on lower prices, especially with inflation slowing. With Kroger's recent announcement to streamline, industry analysts applauded its use of size and clout to aggressively take market share — but that everyone else better watch out. Safeway has also signaled its intention to sacrifice gross margin in favor of building sales.

Analysts view these announcements as additional signals that power is continuing to consolidate in the hands of fewer big retailers that are not shy about exercising it. Packaged goods manufacturers are sure to feel the effect on their margins because of large retailers' increasing demands and because under new federal accounting standards, funds paid to retailers must be reported in a way that dilutes sales.

Source: *Reuters*, December 12, 2001. Supermarkets Set for Price War, by Jean Scheidnes.

Remaking Albertson's

About one month after announcing it would shutter 165 underperforming supermarkets nationwide, Albertson's provided the following specifics: (1) In Florida, three of its four Miami-Dade supermarkets will be sold to Publix and Sedano's. The units will close for remodeling. Albertson's will spend $125 million to build six new supermarkets in the state and remodel 11 of its 120 stores. According to a Lehman Brothers report, Albertson's (5%) ranks a distant fourth in the Miami-Dade grocery store market behind Publix (44%), Winn-Dixie and Costco.

(2) In Arizona and Nevada, Albertson's will expand its dual-branded (Albertson's-Osco, Albertson's-Sav-On) stores. Early reaction in these markets to the move of the drug stores next to the supermarkets has been positive. Further, research in Chicago uncovered increased sales potential in marrying a supermarket brand with a well-known drugstore name.

(3) Albertson's will sell 80 Osco drugstores in New England. The buyer is Maxi Drug, operator of the Brooks Pharmacy banner and a subsidiary of the Jean Coutu Group — the largest drugstore chain in Canada. (4) Albertson's will increase spending in the Northern California market from $60 million this year to $185 million in 2002 to renovate 23 stores and build new stores and fuel centers. Northern California was identified as 'a strategic market in Albertson's future.'

Source: *Miami Herald*, November 30, 2001. Albertson's sells Dade stores to Publix, Sedano's, by Douglas Hanks. *SN*, December 10, 2001 Albertson's Expanding Combo Store Concept, by Elliot Zwiebach, p. 1, 42. *The New York Times*, December 7, 2001. Albertson's to Sell 80 Osco Drug Stores to Maxi Drug, p. C3. *MorningNewsBeat.com*, December 7, 2001. Albertson's Sells Off Osco Drug Stores In New England. *SN Daily News*, December 7, 2001. Albertson's Sells 80 New England Oscos to Coutou Group. *MorningNewsBeat.com*, December 13, 2001. Albertson's 2002 N. California Commitment Increases By 200 Percent. *GroceryNetwork.com*, December 12, 2001. Albertson's to Increase 2002 Northern California Capital Investments by 200 Percent. *SN Daily News*, December 1, 2001. Albertson's to Boost Northern California Investment in 2002. *The New York Times*, December 13, 2001. Albertson's Plans Northern California Expansion, p. C4. *San Francisco Chronicle*, December 13, 2001. Albertson's plans $185 million expansion: Grocer plans big Bay Area buildup, by Victoria Colliver & David Baker.

Kroger reaffirms share quest

During the coming year Kroger will cut 1500 management and clerical jobs on the heels of a 34% drop in quarterly net income. The announcement attributed the cut to economic conditions and the need to better position the company for sustained long-term growth. Kroger operates some 2,300 stores and employs 312,000 people. The Nashville and Atlanta regional offices will merge to cut costs and increase efficiency.

Operating problems were greatest in the Western states: Kroger took an $81 million pretax charge for California energy contracts that provided more energy than needed. Sales of jewelry (Fred Meyer group), flowers and general merchandise were softer than expected. Further centralization of merchandising and procurement in Cincinnati is planned for economies of scale. The announcement led to a 14%+ drop in Kroger's stock price.

According to *Morning NewsBeat.com*, until now Kroger has been able to maintain market share in the face of Wal-Mart's expansion by seizing share from smaller, regional players and through acquisition. But as Wal-Mart continues expansion, the situation gets tougher — especially because if there is a price war, historically Wal-Mart wins.

Source: *The New York Times*, December 12, 2001. Kroger to Cut 1500 Jobs, p. D4. *MorningNewsBeat.com*, December 12, 2001. Kroger To Cut 1,500 Jobs & Gird For New Supercenter Warfare. *The Wall Street Journal Interactive Edition*, December 12, 2001. Kroger Stock Slides More Than 14% On Lowered Forecast, Plan to Cut Jobs, by Joseph Hallinan. *GroceryNetwork.com*, December 12, 2001. Kroger's Nashville Division Office to be Merged Into Offices in Atlanta, Louisville. *SN*, December 17, 2001. Kroger Aims to Build Sales.., by David Ghitelman, p. 1, 44. *Business Week*, December 24, 2001. Cut to the bone, by Monica Roman, p. 42.

Supermarket Strategic Alert

ORDER FORM

Name ____ cd

Title ____

Company ____

Street ____

City ______________________ State/Zip ______________________

Phone ______________________ Fax ______________________

1 Select the items you want to order

select	product	price	total
	One year subscription to Supermarket Strategic Alert	$795.00	
	Two year subscription to Supermarket Strategic Alert	$1500.00	
	2001-1997 CD-ROM Archive (60+ issues) for subscribers for non-subscribers	 $400.00 $500.00	
	2002 Edition: Year In Review 2001 for subscribers for non-subscribers	 $400.00 $500.00	
	TOTAL		

2 Choose your method of payment:

☐ check (on a US bank) or money order made out to Pollack Associates

☐ credit card: circle one : VISA MasterCard AMERICAN EXPRESS

Card # ______________________ Expiration date ____________

Signature ______________________________

3 Send us your order:

Fax or mail your credit card order to:
(212) 202-3501

Questions: (212) 734-0753
taxpayer ID: 13-3607819

Mail your check or money order to:

Supermarket Strategic Alert
P. O. Box 331
New York, NY 10021

For more information go to www.supermarketalert.com