Learn how to change
with customers

Finding growth in Europe's shifting grocery landscape

By Marc-Andre Kamel, Nick Greenspan, Andrea Petronio, and Rudolf Pritzl

BAIN & COMPANY

Marc-Andre Kamel, a partner based in Paris, leads Bain & Company's European Retail Practice. Nick Greenspan is a partner based in London. Andrea Petronio is a partner based in Milan, and Rudolf Pritzl is a partner based in Munich.

Learn how to change with customers

Despite slow growth, fierce competition, and razor-thin margins, the European grocery market is not as mature as many industry observers think. (See figure 1.) There's room to grow—both at home and abroad—for grocers that know how to capitalize on their core business, use innovative technology, develop actionable consumer insights, and nurture the best management talent.

Europeans are changing their habits, and that's changing the way they shop. Among the trends, they're more concerned than ever about their health and the environment, and they're eager for a more enjoyable shopping experience. At the same time, Europe's saturated grocery landscape itself is changing. Discounters, with their highly efficient operating model, are cutting into hypermarkets' market share. In response, winning grocers

in all formats have been forced to control operating costs to stay competitive. This is more important as the US economic slowdown threatens to spread across the globe. (See figure 2.)

To discover why some companies are able to consistently grow in the face of intense competition and changing rules, Bain & Company tracked performance by five top grocery chains in the UK, Germany, France, Spain, and Italy. Over a five-year period, we found that these grocers—whether hypermarket, discount, or convenience format—have succeeded by learning how to build on their core strengths or even a winning geographic location.

Also, these market leaders have learned how to mine consumer data to unearth new opportunities for better serving their customers. Knowing precisely what consumers want is the first step in the process of building customer loyalty. Our research shows a strong
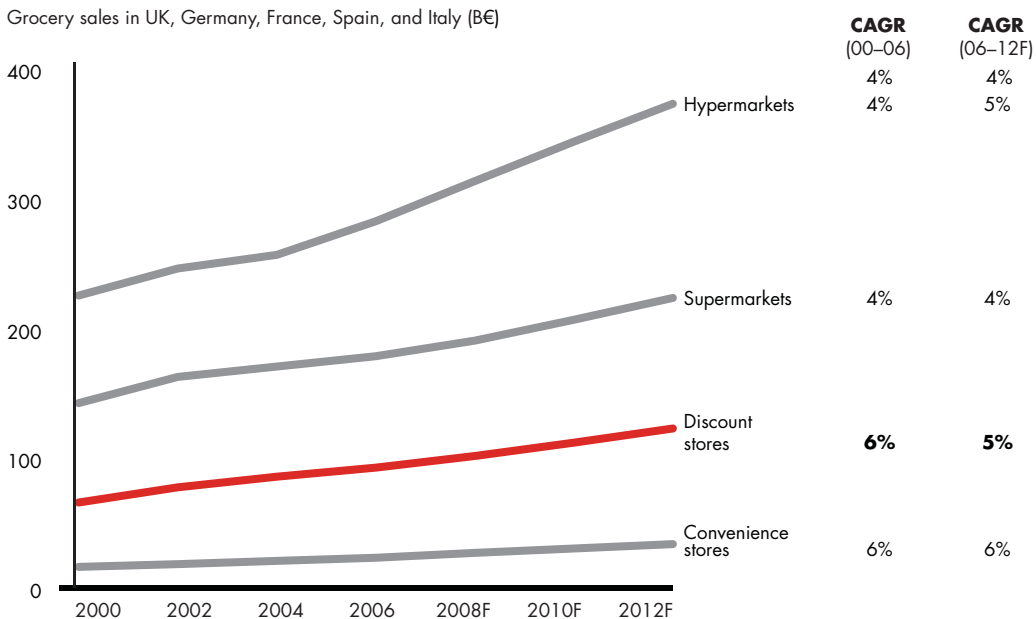
Figure 1: European grocery market is not as mature as many would expect

Organized European grocery sales (in B€)

CAGR (00–06) CAGR (06–12F)

4.2% 4.4%
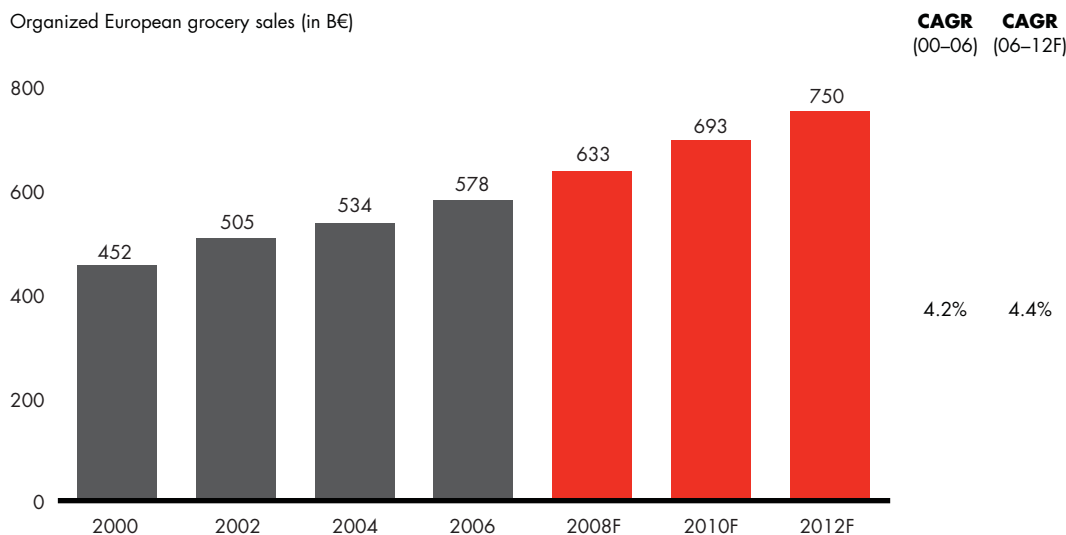
Note: Organized sales include sales from Hypermarkets, Supermarkets, Discount stores, Convenient stores in Germany, UK, France, Spain, Italy
Source: Planet Retail

Figure 2: Discounters are growing in Western Europe but other formats are catching up

Grocery sales in UK, Germany, France, Spain, and Italy (B€)

	CAGR (00–06)	CAGR (06–12F)
	4%	4%
Hypermarkets	4%	5%
Supermarkets	4%	4%
Discount stores	**6%**	**5%**
Convenience stores	6%	6%

Source: Planet retail

correlation between the ability to outperform in a highly competitive marketplace and loyalty. Grocers in several major European markets with top consumer loyalty scores experienced the strongest sales and profit growth.

The focus on the customer allows grocers to profit from changing demographics, consumer tastes, and to identify high-profit segments. For example, Edeka Group, Germany's leading grocer, has responded to two big trends by massively expanding its fresh-food departments and by opening supermarkets customized for the nation's growing elderly population.

Market leaders also understand technology's power to transform the customer experience, while at the same time reducing supply-chain costs. Innovations like "smart carts" and "smart shelves" not only make it easier for shoppers to find items and speed checkout, but they reduce restocking and inventory costs.

Underlying all these efforts is a constant commitment to innovation, influencing thinking on everything from reinventing store formats and designs, reconfiguring product lines, and continually improving the shopping experience.

We found that grocers that consistently out-perform the marketplace have mastered four basic lessons:

- They develop the right foundation for growth;

- They harness consumer insights;

- They use technology to improve the consumer experience and optimize operations;

- They invest heavily in the right talent.

First, build a foundation for growth

Beating the odds in a crowded marketplace starts with laying down a strong foundation for growth. We've found that winners pick a core business and stick with it when expanding locally, regionally, or internationally. They typically have a much harder time replicating success when they stray from their core.

Define a core. Consider France's Carrefour. Historically, the company has been a strong hypermarket performer, generating 60 percent of its 2006 sales from its hypermarkets, while the combined sales of its supermarkets, discount, and convenience stores contributed only 40 percent. Carrefour has had more success opening hypermarkets *abroad* than by launching other formats in France, its home base, where it has faced declining sales in non-food categories. For example, hypermarkets have helped make Spain Carrefour's second-biggest market. In fact, Carrefour's relative market share of hypermarkets in Spain is more than twice that of France. Carrefour has learned how to take its core operating model for hypermarkets and adjust it to the specificities of new markets as diverse as Spain and China, identifying the key elements of its core principles and processes that it needs to maintain and those it needs to change. For example, it might retain its store operations model, its management information system, and its employee career management and training programs while adjusting its allocation of merchandise and store layout to accommodate local tastes.

Carrefour's experience merits a cautionary note. The retailer's growth strategy proved overly ambitious, and the company now is pulling back on some of its expansion. The lesson is that, when expanding based on a core strength, be careful not to overextend yourself. It can be a tricky balance.

Stay with the core. Sticking to the core is also a rallying cry when it comes to launching new products and services. The most successful adjacency innovations are those that naturally complement a company's core—it's a principle that applies to all business segments. In Bain & Company's 10-year study of corporate growth involving 1,850 companies, we found that the most sustained, profitable growth comes when a company pushes out the boundaries of its core business into an adjacent space and develops a formula for expanding in predictable, repeatable ways.

France's hypermarket leader, E.Leclerc, has followed this strategy of moving into adjacencies. The low-price leader has targeted more sophisticated services like an in-store travel agency and optical boutique. For its part, UK-based Tesco is adding in-store health and beauty shops as well as home furnishing and clothing lines in its hypermarkets. Such continual improvements have contributed to a 12.7 percent compounded annual growth rate (CAGR) for revenues over the past five years for Tesco, and an 18.4 percent CAGR in gross profits for the same period.

Become a market leader. Building a foundation for growth also means establishing the company as a local market leader to generate higher returns *before* pursuing expansion. To see this principle in action, look no further than Mercadona, which has taken Spain by storm. Mercadona shook up competitors by innovation: it came up with a new supermarket concept: its 50 percent private label, 50 percent popular brand mix is a hybrid, straddling discounters, hypermarkets, and traditional supermarkets.

For most products, Mercadona stocks only its store brand and one other. The grocer saves money by having 30 percent fewer product varieties on its shelves than a traditional supermarket. By having fewer competing products, it's much harder for customers to make price comparisons—and they tend to buy the private label brand. The hybrid model gave Mercadona a competitive edge and helped

the company establish a strong local presence. Only *then* did it embark on an ambitious expansion plan, rapidly opening stores throughout Spain. Between 2002 and 2006, the grocer's sales shot up 30 percent in direct correlation to its sales area growth. In the UK, Tesco took a similar approach: gaining rapid market share with store openings. Its surface growth was critical to the grocer's success. By more than doubling its selling space in the years 1994-2004, Tesco achieved 8 percent compounded annual growth. By comparison, Sainsbury's was less aggressive in the race for space and achieved a 5 percent CAGR.

Manage costs. While all companies preparing for growth need to rigorously manage costs, it's particularly critical for European grocers facing the increasing presence of discount grocers amid an economic downturn. For example, in Germany, discounters spend on average 9 percent to 12 percent on operating costs, according to our research. But the same costs consume 16 percent to 25 percent of hypermarket and supermarket budgets. As shoppers become more price-sensitive, grocers that curb operating costs gain an edge. They're able to adapt pricing for consumers with reduced purchasing power and avoid the risk of losing them to hard discounters.

Three big-ticket items deliver the largest savings for discounters: labor, rent, and corporate office costs. With fewer product varieties to handle, discounters need fewer full-time employees. Labor is a fraction of their budget: 3 percent to 5 percent. In contrast, labor is the biggest single budget item for hypermarkets, as much as 11 percent. Discounters also save on rent because stores are typically in cheaper locations—as little as 1 percent as compared with up to 4 percent for hypermarkets and supermarkets. Corporate office costs also are low—topping just 4.5 percent for discounters compared with 8 percent for hyper and supermarkets.

European grocers can take a lesson from German discount leader, Lidl. Its lean operating model delivers across-the-board savings, with the discounter standardizing the way it purchases inventory, streamlining store operations, and achieving world-class supply chain management. Generally, the only employees in stores are the cashiers and packing staff. Each task is designed for efficiency. For example, Lidl developed a carton that can be opened with a single quick gesture and put straight onto the store shelf. In addition to saving time, the carton design makes it easy for shoppers to see items. Other keys to cost control: Lidl only keeps high-value products in stock and outsources distribution of non-core products.

Second, boost customer loyalty

Successful grocery retailers understand that to beat out competitors in such an intense marketplace, they must grow the ranks of loyal customers. One of the best ways to gauge customer loyalty is through the use of Net Promoter® Scores (NPS). Customers are asked to rate their likeliness to recommend the store on a scale of zero to 10; respondents are categorized into promoters, passives, or detractors. There's a strong correlation between a grocer's NPS—the ratio of promoters to detractors—and improved sales and profits. In a 2004 study of German grocers, we found that a store's promoters spend more than average, shop there more often, and are more loyal to the brand, frequently recommending it to family and friends. Results were similar when we looked at grocers in France and Italy, finding that, on average, brands with the strongest growth in profits have higher Net Promoter Scores. And in 2007, this connection showed up again in our follow-up survey of Italian grocers, when market leader Esselunga once again was the runaway NPS leader.

While it's always been important for retailers to understand customer needs, it's particularly

critical in markets with low growth and changing consumers. So at a time when European shoppers are becoming older, richer, and more diverse, how do market leaders turn passive consumers into loyal promoters?

Grocery leaders are religious about learning what shoppers want and then fashioning cost-effective ways to continually satisfy their changing needs and tastes. They are experts at gleaning consumer insights from multiple sources, including delving into consumer trends, mining data from loyalty cards and other transactions, and probing shoppers in focus groups. They've learned how to identify which of the multiple trends and demographic shifts will help them successfully reinvent everything from store formats to the way food is grown and packaged to improvements in the shopping experience.

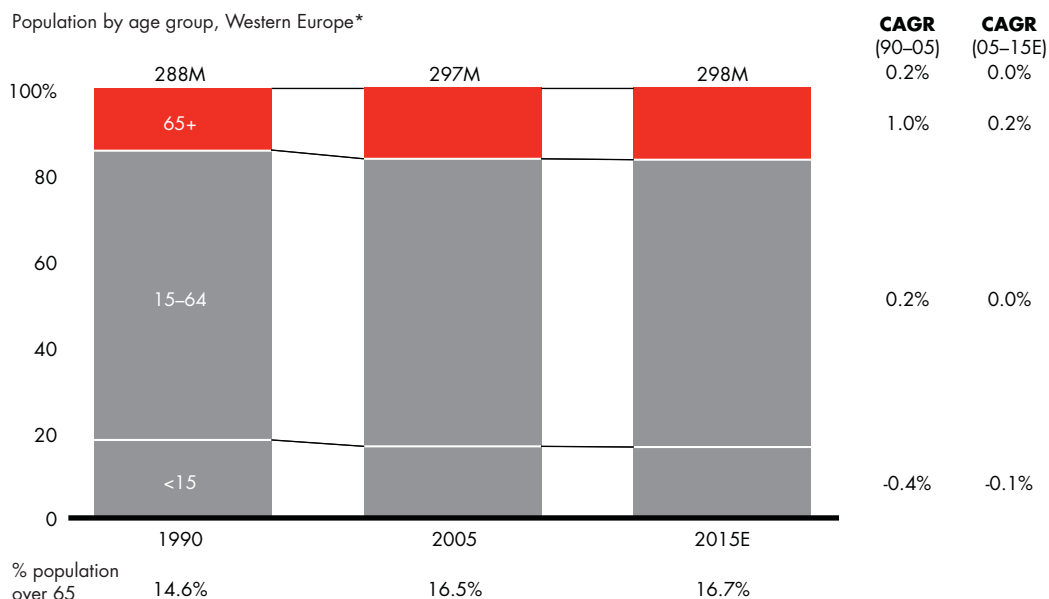**They are making the most of four important trends:**

Europe's population is aging. To tap into the needs of the elderly, Europe's fastest-growing population, Edeka Group opened its first of two "multi-generation" stores in 2005. Elderly and disabled shoppers find a wide range of products with a health emphasis, especially

for special dietary needs. There are slip-proof floors, places to sit, specially trained employees, big-print product labels, magnifying glasses attached to some shelves, and carts that attach to wheelchairs. The payoff for this attention to customer needs: a 50 percent increase in sales since opening day. (See figure 3.)

Europeans increasingly are health conscious and concerned about social responsibility. Shoppers are willing to pay more not only for organic products, but also for fresh food that supports local producers, and animals raised humanly. A case in point is what happened in the UK after a popular TV chef exposed conditions on poultry farms—sales of organic and free-range chickens shot up. Market leaders that have responded to these trends are enjoying impressive results.

Many major grocers have created organic-produce sections. Germany's Rewe has launched supermarkets billed as 100 percent organic. Carrefour has developed its own organic private label, offering products ranging from chemical-free meats and produce to baked goods and frozen foods. Carrefour's goal is to differentiate itself by selling organics, often priced at a premium elsewhere, at competitive prices.

Figure 3: In Europe, the senior population is growing fastest

Population by age group, Western Europe*

	CAGR (90–05)	CAGR (05–15E)
(total)	0.2%	0.0%
65+	1.0%	0.2%
15–64	0.2%	0.0%
<15	-0.4%	-0.1%

	1990	2005	2015E
Total	288M	297M	298M
% population over 65	14.6%	16.5%	16.7%

*Inc. France, Germany, Italy, Spain, UK only
Source: Euromonitor

Tesco, too, has segmented its product line around distinct health issues and groups. The stores stock more diet items for a population struggling with obesity or food allergies, healthier snacks for kids and more organic, unprocessed items like nuts and dried fruits. In Italy, Esselunga has built a strong customer following by making fresh foods its core offering, with more than 3,000 fresh food items. It's a strategy that pays—fresh-food sales now account for 30 percent of sales.

Europeans want convenience. Our research shows that convenience is the top factor in deciding where to shop. Most European consumers, with increasingly hectic lifestyles, are willing to pay 10 percent more for time-saving products and services, according to Bain research. In response, grocers are seeing explosive sales growth around time savers. Winners are re-vitalizing the convenience store format, long a patchy performer. Other winners are designing easier-to-navigate store layouts and offering services like free coffee and Internet access. Some market leaders are pioneering concepts that tap into multiple trends. For example, Italy's Auchan has successfully exported its Rik & Rok children's concept throughout Europe. Parents can drop off kids in special play areas. The retailer sells a healthier, private-label children's brand as well as Rik & Rok comic books and magazines—all bolstered by a Rik & Rok website. (See figure 4.)

In every format, major grocers are making it easier to shop, staying open longer, and innovating ways to speed check out. They also are rapidly developing new channels like home delivery, a service that supports both a brand's traditional stores and online shopping site. To extend their ability to help busy customers, some are offering a range of non-food services that are profit makers, including personal finance and mobile phone services, travel money and personal insurance, credit cards, and even energy deals. In the UK, Sainsbury has partnered with supplier EDF Energy to offer low-cost energy packages.

Figure 4: Consumers believe that convenience is worth paying for

How much extra are you prepared to pay for time-saving products and services?

Percent of respondents
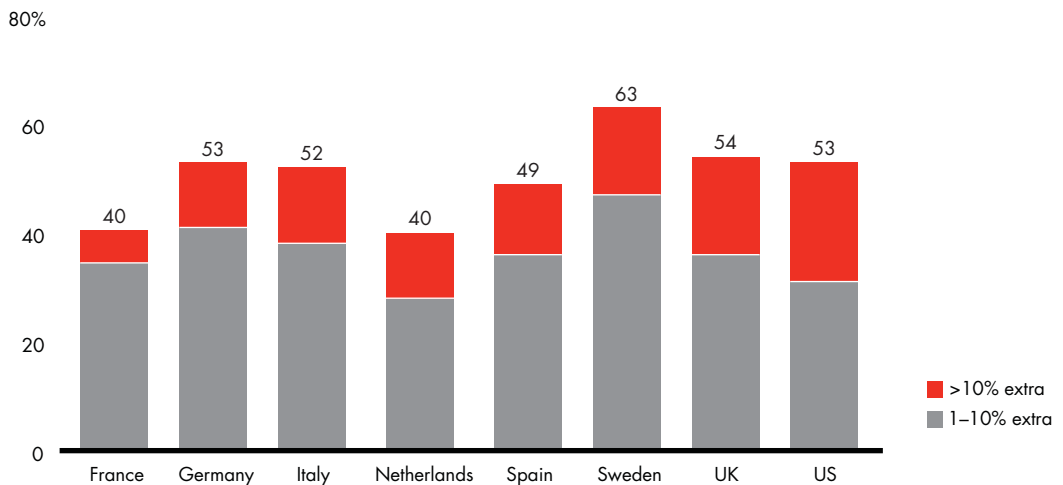
Source: Datamonitor

Shoppers in Europe are socially and environmentally conscious. E.Leclerc hasn't used disposable bags since 1996. Rewe recycles its food waste into electricity and heat. These moves are both good for the environment and a way of communicating their commitment to the growing ranks of environmentally and socially conscious consumers. As part of this movement, Europe's grocers are supporting Fair Trade laws that help developing nations and institute socially progressive labor practices. To demonstrate their environmental commitment, retailers are working to reduce their carbon footprint.

As they pursue consumer insights that will help them make the most of these trends, Europe's leading grocers are relentless miners of data. Winners develop advanced data warehousing capabilities that help them zero in on new opportunities—from targeting foreign markets to customizing store formats, improving product selection, and figuring out taste preferences, neighborhood by neighborhood.

Carrefour credits sophisticated data mining with boosting profits and growth, both at home and abroad. In addition to its loyalty card, the company scrupulously monitors daily customer calls, responses to promotions, supplier product studies, focus groups, and observes customers in its stores. Carrefour continuously slices and dices the data to help recruit new customers, identify and retain its best shoppers, and increase the amount spent and the numbers of loyal promoters. In 1995, Tesco launched the first grocery loyalty card, a move that established Tesco as a pioneer in customer relationship management and data warehousing. From the start, Tesco has used its Clubcard, not just for marketing, but as a broad business tool to grow customer loyalty, tailor offerings, and personalize marketing efforts.

Winners are adept at mining data to localize products. It's no accident that Carrefour's hypermarket next to the Disneyland Paris Resort stocks Disney products. Or that Tesco Express convenience stores cater to local demographics—in neighborhoods with large Asian populations, shoppers find a variety of Asian take-out; single professionals find more upscale offerings including fine wines and single-portion meals. For UK-based Asda, localizing is a way of fighting crime. The retailer analyzes crime statistics per district to assess the risk of theft and evaluate security costs in its stores.

Third, look to technology

Market leaders in Europe are at the forefront of using technology to revolutionize the way customers shop. Early on, Tesco recognized the growth opportunity on the Internet and used its detailed consumer transaction data to create a cybermarket with a local supermarket feel. Tesco.com now ranks as the number-two retail website in the UK, and the world's largest online grocer. Germany's Metro Group has installed smart scales, which automatically weigh and price items, in about 100 locations.

Other companies are starting to invest in wireless devices and RFID (Radio Frequency Identification) tracking chips to marry convenience with a leading-edge shopping experience. Many of these innovations haven't yet hit stores, but retailers are in the process of fine-tuning the technology to address consumer privacy concerns. The promise is tremendous.

Smart carts are outfitted with an electronic store map, making it easy to locate items. Also, by recognizing a product's RFID tag, the cart crosses the item off a customer's electronic shopping list and totals up the cost. RFID readers allow shoppers to tally up their own items.

Flat-screen information terminals help shoppers trace the origin of food items and queue up cooking demonstrations.

Using technology to reinvent the shopping experience is only half of the game. Successful grocers are using the same RFID technology

to streamline supply chains, reduce operating costs, and to improve category management and promotion. Smart Shelves automatically track available inventory, helping ensure that items are quickly restocked—even sending up corresponding shelf-level advertisements. Real-time product data improves supply chain forecasting and planning. RFID tracking speeds warehouse stocking, automatically registering inventory levels, and reducing errors. It also helps reduce theft—RFID chips on products have to be deactivated before shoppers can leave the store.

Finally, invest in the right talent

Without world-class management to drive such innovation, all the consumer insights, state-of-the-art technology, and data mining capabilities in the world are of minimal value. Successful grocers in Europe have learned of the importance in investing heavily to recruit, train, and reward top talent. Asda, the supermarket powerhouse, is a case in point. The retailer is a serial winner of employer awards, including being named one of the UK's top ten employers for three years running by the *Sunday Times*. Asda's secret: the methodology for developing talent.

Asda carefully screens for employees with unexpected management promise. Next, it ensures that its managers are well trained— if promoted from within, novice managers are put through four weeks of on-site training. Asda recruits train for eight weeks. Finally, Asda cultivates loyalty by offering hefty incentives. All employees receive a guaranteed 20 percent annual bonus, plus an additional percent linked to store performance. After 12 months, employees are eligible for the Colleague Share Ownership Plan, which awards free shares equal to 25 percent of an employee's salary. These efforts have helped stabilize Asda's workforce. After implementing its new approach, Asda saw an immediate impact: turnover dropped from 7.5 percent in 2003 to 5.8 percent in 2004 for employees with

over six months on the job, and the company says it now has one of the lowest turnover rates in the industry.

Carrefour, too, strives to develop strong leaders. Each year, over 3,500 managers spend time at the retailer's off-site training center in Sophia Antipolis, France. For the global grocery giant, the center is a crucial hub, helping to integrate managers from abroad, while allowing domestic executives to escape daily pressures and develop a fresh perspective and skills.

By using these approaches to conquer their own maturing markets, winning European grocers also have positioned themselves to expand into rapidly growing emerging markets around the globe. A case in point: while other grocers were shutting their doors in China, often the victims of haphazard expansion, Carrefour has emerged as the number-one multinational retailer in the booming nation. At the end of 2006, Carrefour operated 92 hypermarkets in 34 cities and 255 discount stores in Beijing and Shanghai, for total revenues in China of €2.5 billion (including VAT).

The four growth lessons European grocers have mastered—building a strong growth foundation, harnessing consumer insights, deploying technology to improve the shopping experience and optimize operations, and investing in talented leaders—are allowing them to change and grow along with their customers. ◉

Bain's business is helping make companies more valuable.

Founded in 1973 on the principle that consultants must measure their success in terms of their clients' financial results, Bain works with top management teams to beat competitors and generate substantial, lasting financial impact. Our clients have historically outperformed the stock market by 4:1.

Who we work with

Our clients are typically bold, ambitious business leaders. They have the talent, the will and the open-mindedness required to succeed. They are not satisfied with the status quo.

What we do

We help companies find where to make their money, make more of it faster and sustain its growth longer. We help management make the big decisions: on strategy, operations, technology, mergers and acquisitions and organization. Where appropriate, we work with them to make it happen.

How we do it

We realize that helping an organization change requires more than just a recommendation. So we try to put ourselves in our clients' shoes and focus on practical actions.

BAIN & COMPANY

For more information, please visit **www.bain.com**