Impact of Efficient Consumer Response (ECR) on Marketing

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It's a pleasure and an honor to address the Annual Conference of FDRS. The enthusiastic response to the conference clearly indicates the importance of Efficient Consumer Response to grocery marketing and retailing.

My assignment this morning is to step back and speculate about the impact of ECR on marketing. I am pleased to address this topic, because it seems to me that the way we adjust our marketing strategies will have a major impact on the ultimate success of ECR and, for that matter, the future of the retail grocery business.

In preparing for this morning's presentation, I've looked at how marketing is evolving in North America and have identified what I hope you’ll find as some helpful insights into the relationship between ECR and marketing.

Where to begin? Some three years ago, I met one of my neighbors in a new warehouse club, like Price Costco or Sam's, in our town. The warehouse club created a lot of excitement by its sheer size and its merchandising of large packages of product. After we talked for a while, my neighbor said to me, “Bill, I just don’t shop at the supermarket any more.”

As you can imagine, I was a little taken aback by that statement. It seemed to me that she was sending an important message; a message that would eventually be heeded by most of the manufacturers, retailers, wholesalers and manufacturers in North America. That message was: “You’re not keeping up with consumer needs.” Now that’s a hard message to hear, but the facts supported it.

At that time, competition was rapidly gaining market share in food and groceries. Supermarkets were losing sales to not only warehouse clubs but also to mass merchandisers and deep discount drug stores. All three of these formats offered shoppers not only better prices but in many instances more exciting and convenient shopping experiences as well.

The magnitude of it, however, was revealed when we learned through a major industry study that the warehouse clubs and the mass merchants were doing business at a significantly lower cost than supermarkets, i.e., about five percentage points. So, competition looked very strong!

Turning to the topic of shopping behavior, it was also becoming evident that in some ways the supermarket wasn’t geared to the changing patterns.

Let’s talk first about types of shopping trips. Way back in 1991, we conducted a project for the Food Marketing Institute entitled, How Consumers Shop the Supermarket. Part of that project involved analyzing the types of shopping trips people made to the store.

Figure 1. Types of Shopping Trips

As we prepared to do the project, we assumed that most of the trips were either stock-up trips, i.e., accounting for 60% or more of the household’s weekly grocery requirements, or fill-in trips, accounting for less than 20% of the household’s weekly purchases.
We were wrong. In fact, what we found was that the largest category of trips fell somewhere in between, i.e., routine trips that accounted for between 20% and 60% of a household’s weekly grocery purchases.

This was a surprise then, but it has become increasingly clear that today there are probably other types of trips, such as a purchase for immediate consumption. The question then arises, are supermarkets organized to market to and serve consumer needs other than the traditional fill-in or stock-up business? For many, at least today, it appears that the answer is, “no.”

Let’s now look at another type of shopping behavior, i.e., degree of purchase planning. Here, I think there’s a chance that we’re even more out of sync with the changing consumer. Also, more than four years ago, we studied 4,200 individual purchase decisions that consumers made at the shelf. Now remember, these are not decisions made off special displays -- only the shelf.

Figure 2. Types of Purchases

Unplanned 17%
Partially Planned 22%
Planned 61%

What we found was somewhat surprising and leads to a very different conclusion from much of the other research that’s been done in this area.

Fully 61% of those purchases made from the shelf were totally planned. That is, the consumer had made a decision prior to entering the store to buy that specific product.

Twenty-two percent were partially planned, that is, the consumer planned to buy a product in that category -- but not that specific product -- before entering the store.

Seventeen percent were unplanned, that is, the consumer hadn’t planned to make a purchase in that category prior to entering the store.

While retailers and manufacturers can certainly influence purchase decisions through in-store signage, pricing, etc., it’s evident that when it comes to purchases from the shelf, the majority of decisions are made largely prior to entering the store. This points out that branding, or at least product loyalty, has an enormous effect on purchase decisions. It also suggests that this loyalty can be to either advertised or store brands.

Do our current marketing and merchandising strategies reflect this important aspect of consumer behavior? In too many instances, they do not. And this will be a problem if retailers and manufacturers do not make the necessary adjustments to get back in step with the consumer.

Marketing must evolve even without the influence of ECR, and that is clearly what’s going on. This evolution is being driven primarily by the changing lifestyles that put a tremendous premium on the availability of time, which, in turn, impacts both food preparation and purchasing behavior. Changes in technology are also playing a role.

Looking specifically at the food retail business in North America over time, it appears that business-building strategies are changing and with them, the relationship between retailer and manufacturer.

Promotional or high/low strategies are still very popular in North America and have been exceptionally effective under certain circumstances. Operating under a promotional strategy, it appears that while the retailer decides what to promote, manufacturers really drive the relationship through their offers of promotional allowances.

Some supermarkets have adopted an everyday low-price strategy in which the store promises the shopper the lowest overall market basket cost. Operating under this strategy, the manufacturer and the retailer seem to hold joint responsibility for driving the relationship, i.e., the retailer creates the pricing strategy and the manufacturer provides products at a delivered cost that profitably supports that strategy.

As more retailers move into a true marketing strategy to drive the business, the retailer be-
comes the driver because his primary goal is to differentiate his stores from the competition and possibly even "brand" those stores.

Now that we’ve looked briefly at the evolution of retail marketing, let’s focus for a moment on ECR. I can’t speak for what motivated the acceptance of ECR in Europe, but in the United States, it was clearly motivated by the strong, competitive challenge posed by warehouse clubs and mass merchandisers, i.e., Wal-Mart, Kmart, Target.

Under the vision and leadership of David Jenkins of Shaw’s Supermarket, the grocery business developed a program designed to ultimately take upwards of $30 billion of expense out of the grocery marketing/distribution channel, i.e., this is equal to about 8% or 9% of sales.

As ECR unfolded over the last several years, the primary focus -- as might be expected -- has been on the supply chain. Replenishment issues top the list of activities as they have at this conference, and there has been tremendous progress made with respect to EDI and other supply chain initiatives.

Importantly, category management provides the consumer focus and orientation of ECR, whose middle initial, coincidentally, calls out the consumer.

Looking over the last several years, category management can be a powerful tool both by itself and within the ECR process. It’s bringing consumer focus to a continuous improvement effort; it’s also providing help in terms of guiding the rationalization of assortment and in developing ideas to improve sales and profit. There’s at least one company in the United States who has reported that, “Every time I add a new category manager, I drop $1 million to the bottom line.”

At the same time, category management can have some negatives. There’s no question that the process of category management can be labor-intensive. The demand for time and attention has made some retailers and manufacturers hesitant about making a full commitment to category management.

In addition, some retailers find the category management process a little intrusive. They’re not comfortable sharing their data with suppliers, and perhaps even more importantly, are reluctant to allow their supplier partners to have a significant influence on their retail marketing strategy.

There appear to be several open questions regarding category management:

* Does category management have a role in marketing?
* Is category management essential for ECR?
* Can a retailer skip category management?

Let’s now turn to the issue of retail marketing and how supermarkets are changing their approach to marketing. Generally, retail marketing involves both differentiation strategies, i.e., separating the stores from competition, and segmentation strategies, i.e., dividing the customers into meaningful categories.

Differentiation strategies help the store stand out in the marketplace. Put another way, how do we get shoppers to go past another store to visit our stores?

Typically, there are three major bases of differentiation. The first and probably most common basis for differentiation, at least today, is an emphasis on fresh product, i.e., produce, meat, bakery, deli and seafood. Most successful supermarket operators have developed fresh strategies that clearly separate them from the competition, and a few -- such as Wegman’s and Ukrop’s in North America -- have extended that fresh strategy into prepared foods very effectively.

Another effective differentiation strategy focuses on customer service. This is typically a strategy used more effectively by smaller retailers because of their advantage in controlling service. However, in North America, department stores like Nordstrom’s and even mass merchants like Wal-Mart differentiate themselves from their competition on this basis.

Management of price reputation is emerging as another important basis of differentiation. We’re seeing an increasing number of retailers use this tool to consciously manage their price image.

It’s important to emphasize that his is not a traditional retail pricing strategy where the retailer typically reacts aggressively to neutralize any price advantage of competition. Instead, under the process of managing price reputation, the retailer becomes a price leader, not a follower.
That is, the retailer makes a conscious decision about the price differences that he wants to communicate to consumers and then manages the price communication accordingly. This places a primary focus on the consumer perception of price rather than on managing all the prices, and there is a difference.

### Table 1. Management of Price Reputation Can Drive the Business

<table>
<thead>
<tr>
<th>Year-to-Year Same-Store Sales Changes</th>
<th>Chain A</th>
<th>Competitor</th>
</tr>
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<tbody>
<tr>
<td>--- Price Advantage ---</td>
<td>11.8%</td>
<td>0.6%</td>
</tr>
<tr>
<td>1993</td>
<td>40%</td>
<td>+4.6%</td>
</tr>
<tr>
<td>1994</td>
<td>-3.5%</td>
<td>+10.9%</td>
</tr>
<tr>
<td>1995</td>
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Here's one example of how management of price reputation can drive the business. In the past, Chain A aggressively matched its major competitor's prices on popular identical branded items. In fact, even in 1993, they were within 2% of their primary competitor but still had a high price reputation.

When Chain A used a different measure, however, i.e., price per unit, e.g., per pound, or per ounce, it was evident that their competitor had a major price advantage, i.e., almost 12%.

This surprised the operators of Chain A, and they immediately went to work to neutralize their competitor's price advantage. As you can see over a two-year period, Chain A made a major change in the price reputation they were communicating, and it resulted in a significant increase in same store sales.

The important think to keep in mind as we've reviewed these three differentiation strategies, is that there is really not much of an opportunity for major suppliers to play a role.

Now, let's turn to the retailer marketing effort to segment consumers. Here, we'll look at two ways to segment consumers; that is, segmenting by trade area and segmenting by household.

In the North American market, we're seeing segmentation activities along both dimensions, and it's really a little early to report on which is proving to be most cost-effective.

The trade area focus on segmentation can be very helpful in revealing a store's problems and opportunities -- with particular emphasis on vulnerability and competition.

#### Figure 3. Insight into Vulnerabilities

Do you buy most of your condiments/dressings in this store?

First, let's get some insight into vulnerabilities. Here, we've got the results of some store-specific market research that told this retailer that only 44% of their primary shoppers, that is shoppers who do most of their spending at that store, buy most their condiments at that store. This clearly shows that they are very vulnerable in terms of selling condiments and salad dressings and that they need to do something about it.

The same store-specific study highlighted the fact that the competition for this store was somewhat different from what the chain management had expected. While most of their focus was on the supermarket across the street, they found that more than 20% of their primary shoppers regularly visited the mass merchandisers, the supercenter, and the warehouse clubs to purchase groceries. This study helped them see their condiment and dressings business probably wasn't going to another supermarket but rather to a competitor of the supermarket.
Figure 4. Insight into Competition

“Other” Stores Shopped for Groceries

<table>
<thead>
<tr>
<th></th>
<th>Primary Shoppers</th>
<th>Non-primary Shoppers</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mass Mgr.</td>
<td>27%</td>
<td>22%</td>
</tr>
<tr>
<td>Super K</td>
<td>26%</td>
<td>22%</td>
</tr>
<tr>
<td>Sam’s Club</td>
<td>12%</td>
<td>22%</td>
</tr>
</tbody>
</table>

Segmentation along household lines allows the retailer to target selected segments. A lot’s been said as to how this can be a big job, but it’s becoming increasingly evident that a retailer can do a lot of target marketing by just dividing shoppers into three categories.

1. Best customers, i.e., those who do a significant amount of spending at the store.
2. Almost best customers, i.e., those who are just below the best-customer spending level.
3. Previous best customer, i.e., those who used to spend a lot and no longer do it.

Focusing on these three categories alone gives the retailer tremendous leverage.

Please keep in mind as you think about this opportunity that of all the consumers who shop in a typical North American supermarket in a year, on average each spends less than 25% in that supermarket. Put another way, 75% of the spending by households shopping in a store is now being done with the competition. What an opportunity!

One program that powerfully illustrates segmenting on a household basis is the Regards® program, developed by Dayton Hudson’s department store in Minneapolis. This program concentrates primarily on the store’s best customers, and caters to those customers through a series of services, including:

* quarterly newsletters that are informative -- not promotional efforts;
* exclusive services, including information seminars;
* advanced opportunities and exclusive purchase opportunities for signature items.

This retailer is very pleased with the program, and I believe it serves as a model for other, non-department stores interested in moving into this area.

Now, what are the implications of all this for retailer/manufacturer relationships? Differentiation, as we’ve seen, is almost always created by the retailer alone. That is to say, there is very little opportunity for cooperative relationships. On the other hand, segmentation -- at least as we’re seeing it developed so far -- is typically controlled by the retailer, but can be, under certain circumstances, informed, guided, and perhaps even executed with the help of a manufacturer.

Let me give you an example. Here’s an Exclusively Yours promotional brochure. It was created and is controlled by the Jewel Food Stores in the Chicago market. As you’ll see, it is segmented and delivered directly to the households, and the pages indicate that there are both store features and branded products offered in the program. Exclusively Yours is an example of retailer/manufacturer cooperation illustrating the new way of marketing.

After looking at the evolution occurring in marketing and the development of ECR throughout the business, it’s evident that your challenge is to harness ECR to keep up with changing consumer needs. This could well be a survival issue for the retail grocery business. The supply side savings are substantial and are going to be helpful in funding the changes we need to make. Joint marketing and the benefits from joint marketing, however, are probably even larger. The trick is to develop a way to do both that will produce a win for both the retailer and the manufacturer.

Thank you.