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COVER_STORY

Lost in the Supermarket

GROCERS MOVE FROM PAPER TO PLASTIC IN MORE WAYS THAN ONE

by Rick Ferguson

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DESPITE CHANNEL BLURRING, THE SLOW DEATH OF NEWSPAPER PRINT CIRCULARS AND THE COMMODITIZATION OF THEIR CORE PRODUCT, MOST GROCERS STILL RELY ON TWO-TIERED PRICING. BUT A FEW GROCERS BIG AND SMALL ARE BEGINNING THE HARD WORK REQUIRED TO ANALYZE THE CUSTOMER DATA THEY COLLECT, AND TAKING WHAT HAS BECOME AN OVERCOMPLICATED BUSINESS BACK TO THE BASICS: UNDERSTANDING THEIR CUSTOMERS BETTER AND GIVING THEM WHAT THEY WANT. JOIN COLLOQUY AS WE HELP RETAIL GROCERS TAKE STOCK OF THE FUTURE.

In his 35-odd years in the grocery business, Norman Mayne, CEO of Dayton, Ohio-based Dorothy Lane Markets, has done his share of press interviews. Every so often, a marketing publication—anyone from *Fast Company* to *COLLOQUY*—will ring him up and ask him about the secret of success for his three-store upscale food chain. How is he able to hold market share against the Krogers and the Meijers of the world as they move their volume-buying power and world-class logistics into his

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territory? Mayne patiently retells the story of that momentous day on October 27, 1995, when the company bid farewell forever to newspaper circulars and sales cherry-pickers with the launch of its *Club DLM* loyalty program. *Club DLM*, which treats members to lavish special events and makes prodigious use of shopper data to target offers to the chain's best customers, was then hailed repeatedly as the most radical innovation in grocery store marketing since Ukrop's introduced the first modern-day grocery loyalty card in 1987.

And guess what? Eleven years later, *Club DLM* is still the most radical innovation in grocery store marketing. How sad that is, we'll leave for you to decide.

"It's basically what it was in '95," Mayne says of *Club DLM*. "How much you spend gets you better deals, and what you buy gets attention from us.

By working with you on your purchase history and your purchase dollars, we hope to maintain or increase your business with us. We really use the KISS method: Keep It Simple, Stupid."

In Mayne's estimation, grocery retail marketers have overcomplicated what is in essence a pretty simple business. He tells the story of an annual trade conference in which he sits at a table with marketers from the big grocery conglomerates. In these meetings, the marketers bare their souls to each other, revealing the reams of consultant findings, market studies and focus group reports upon which they base their marketing strategies. Rather than engage in the simple task of looking at their own customers' behavior to understand them better, these marketers spend hundreds of thousands of dollars every year to get other companies to tell them how their own customers are behaving.

"They buy reports on product movement, on who's buying what—that's the one I love—on how many kids are in the family, on how many families have dogs," says Mayne. "They pay national firms a lot to glean all this information, which, I might add, is not always very accurate. I was in a group with a friend of mine who spent a hundred grand on customer interviews for his chain. He was so proud of this information that he was pretty sure was correct. It made him feel like a million bucks. He could show it off to everybody. His team could have meetings and discussions and ask themselves how they were going to leverage this expensive information. It makes you crazy." When Mayne wants to know which of his customers just got a dog, he literally just presses a button to see a list of *Club DLM* members who made an inaugural purchase of dog food. When he wants to know which families the stork has visited, he looks at the customer file to see who's stocking up on diapers. Database marketing can get as sophisticated as your resources allow—but at its heart, it isn't exactly rocket science.

"People in our industry are protecting their jobs," Mayne says. "They go to market the way they have always gone to market, the way that Dorothy Lane went to market prior to '95. In fact, they don't have to do any of that stuff."

Easy as one-two-three:

Kroger's* Plus Card *and* 1-2-3 MasterCard *create the foundation for the 1-2-3 punch of the data-mining and loyalty marketing strategy: 1) Identify their best customers; 2) segment those customers; 3) deliver specific content and offers to each of those segments.

Cleanup in aisle seven

On the surface, there's certainly nothing wrong with the retail grocery industry. Groceries are a $479 billion business in the U.S., and grocers have built multi-billion dollar brands on the strength of their operational expertise and a distribution system that is the envy of the world. As chains began to gobble up one another in the late 1990s, the U.S. grocer landscape evolved from a fragmented, patchwork quilt of regional players into a tri-level system of massive multi-nationals, strong national companies who operate multiple brands, and smaller regionals who defend their turf by catering to high-end consumers or specializing in niche markets such as Hispanics or organic food enthusiasts. There's enough room for everybody, and U.S. consumers enjoy unprecedented choice, quality and selection in their quest for calories.

But there is an 800-pound gorilla in the room that has grocery marketers quaking from the deli to the frozen food aisle—and that monkey's name is Wal-Mart. The Arkansas-based discount retailer recently supplanted the Kroger Co. as the number-one grocery seller in the country. Likewise, warehouse clubs, which sell forklift skids full of staples at wholesale prices, have made serious inroads, with wholesaler Costco now the third-largest grocer in the nation behind Kroger. Traditional grocers control a mere 52 percent of the nation's grocery sales, down from 81 percent a decade ago, according to Willard Bishop Consulting. Nontraditional food sellers—including Wal-Mart, dollar stores and wholesale clubs—now control 31.9 percent, up from 8.9 percent in 1994.

Wal-Mart's relentless focus on price has placed tremendous pressure on an industry that historically suffers from wafer-thin profit margins—1.16 percent of sales after taxes in 2005, according to the Food Marketing Institute (FMI). But the Wal-Mart effect merely masks the dirty secret of the grocery industry: grocers have commoditized their product. Seventy-five years of selling on volume, and of conditioning consumers to shop for the lowest prices on everything from filet mignon to toilet paper, have left them immune to any grocery promotion that doesn't focus on price. This despite the long period of low inflation that saw U.S. food price prices rise an average of 2.5 percent a year from 1994 to 2004, according to FMI. Grocers hammer consumers with price promotions even though we're spending a smaller percentage of our annual income on groceries than ever before—from 16.9 percent in 1950 to only 6.1 percent in 2003, according to the U.S. Department of Agriculture.

With margins so thin, grocers hoping to grow their profits can do so only through relentless expansion—an increasingly difficult proposition, considering that there is currently 200 square feet of retail space per consumer in the U.S., as opposed to an average 25 square feet per consumer in Europe—or through acquisition. Taking that latter option, a group of investors led by number-nine grocer SuperValu purchased number-four grocer Albertsons for $17.4 billion in January 2006. Jeff Noddle, the Chairman and CEO of SuperValu, trumpeted the "sizable increase" in the combined company's retail footprint and supply chain network—but what about the benefit of the move to the retailer's customers?

Babying the best customer:

Innovations in supermarket loyalty programs include the Albertsons

***duckling program** aimed at expentant moms and moms of kids under 5. Members receive a quarterly glossy magazine filled with tips and coupons. The program, in its third year at Shaw's, is being rolled out to Jewel-Osco, Albertsons Southern California and other stores.*

A simple plan

Of course, there is a third way to grow profits: organic growth—capturing market share and a larger slice of customer spend. To that end, grocers' decades-long focus on loyalty card programs and customer databases would seem to put them in prime position to compete by building strong customer relationships that reward customers for profitable behavior and by targeting promotional dollars on those with the most potential value.

But anyone who shops at a chain grocer knows that the loyalty card is merely an extra hoop you have to jump through to get pork loin for $1.99 a pound. Rather than focus on relationships, most grocer loyalty programs still keep the spotlight fixed on their moldy two-tiered pricing model. Grocer loyalty cards are certainly ubiquitous—70 percent of grocery shoppers surveyed by marketing firm Vertis in its Customer Focus 2006 study use one. Not surprisingly, a 2005 Forrester Research study also revealed that 80 percent of loyalty card members say low prices are the most valuable program reward. If that's the case, why make the estimated $30 million investment that McKinsey says it takes for a major grocer to launch a loyalty card program? Why not punt the cards and just offer the discounts to everybody—especially since there's no evidence that retailers are using the data they're collecting?

"A loyalty program is an expectation of retailers these days by American consumers," says Jim Litwin, Vice President of Market Insights for Vertis. "And grocers are creatures of habit. To a certain degree, they're lemmings; they follow what appears to be working. The culture of the grocer is operationally-driven, where you've got people working their way up through the stores. That's great, but they don't always have time to think about marketing. If your program is totally based on discounts, it's only as good as this week's deals. There's no real incentive to shop with one grocer. It amazes me that these folks stick with that model."

Actually using data collected via discount cards is so challenging that some grocers simply give up, citing consumers demanding low prices rather than loyalty cards. Washington-based Brown & Cole, which ended its *Reward* card program in February 2006, for example, sent loyalty program director Jane Hubring to tell the *Bellingham Herald* that "we have been listening to our customers who don't want to be bothered with a card program." No wonder, when consumers see that the cards have no value in the store—if you forget yours, chances are the cashier will scan a spare card to give you the lower prices, or a good Samaritan in line behind you will kindly lend her card to help out a fellow shopper. The charade behind many discount card programs is increasingly transparent—on both sides of the checkout aisle.

“The truth is, up to 50 percent of data that grocers collect through their discount card programs is useless,” says Gary Hawkins, CEO of Syracuse, New York-based Green Hills, which launched its own biometric-based *SmartShop* program in 2004. Single-store Green Hills is at the forefront of using loyalty program data to effectively target its offers, and as a result has beaten back challenges from Wal-Mart and Wegmans, among others. Rest assured that most of the Green Hills data isn’t useless. “I can confidently say that without our focus on using shopper data, we wouldn’t be here,” says Hawkins.

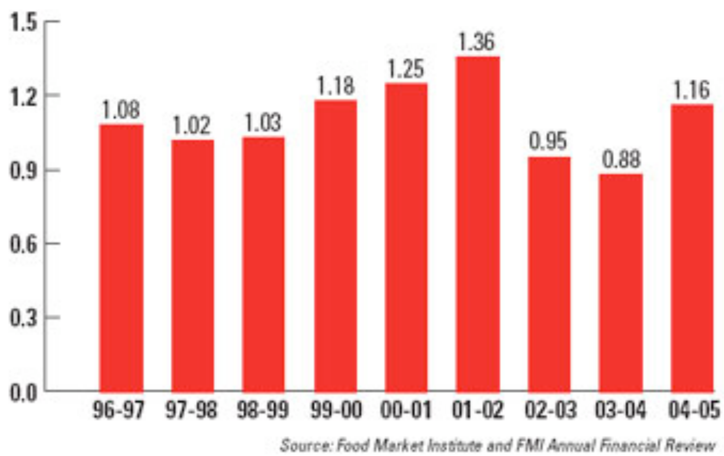
The answer to building real value into grocer loyalty programs, the experts say, is not to end them, nor is it to simply switch from a discount card to one that awards points or airline miles or even gold doubloons. The answer is simply to use the collected data to understand your customers better and target your discount dollars where they can most effectively influence profitable customer behavior.

“The programs fail because they’re considered promotions and not critical elements of corporate strategy,” says industry consultant Brian Woolf. “But even the best ones will not save a company if they lose the value side of the equation. I’ve seen great programs get hurt when a low-price leader competes against them. So you can’t treat the program in isolation.”

In other words, don’t give up the price side of the equation—just stack it in your favor. As industry insiders know, the undisputed master at maximizing loyalty card data at minimum marginal cost is U.K. grocer Tesco, which has leveraged that data to fundamentally change the way it does business. Launched in 1994, Tesco’s *Clubcard* helped move Tesco’s market position in the U.K. from third to first; today, over 40 percent of U.K. households are members. Tesco segments its *Clubcard* shoppers into six behavior categories: Price-Sensitive, Traditional, Mainstream, Healthy, Convenience and Fine-Foods. Every aspect of the in-store and direct-mail marketing is geared to delivering relevant offers to specific sets of shoppers who behave in different ways. As a result of these efforts, *Clubcard* sends 5-6 million unique mailings to their 10 million members annually, and enjoys a 20- to 40-percent redemption rate.

Thin sliced deli cut:

Supermarkets don't have a lot of margin movement to give consumer. The Food Marketing Institute (FMI) reports after-tax net profits of about 1% in the past decade. "To earn a dollar", FMI reports, "supermarkets would rather sell a $1 item 100 times making a penny on each sale, than 10 times with a dime markup." The goal is to drive volume with low markup.



Despite Tesco's massive size, its basic approach is still simple enough that Norman Mayne would approve. For example, the company uses Clubcard data to identify new pet owners who buy into the premium pet food segment, and then sends them a mailer containing information on pet care and an offer for Iams pet food. Again, it ain't rocket science. The price offer is still part of the equation; the difference is that Tesco understands what you have bought so well that they're able to accurately predict what you will buy in the future–and they do it on a budget of 1 percent of gross sales.

"The area where we are creating breakthrough is in identifying specific sets of shoppers that behave in a certain way," says Claudia Magielsen, Business Manager for Tesco. "For example, innovators—people who are always into new things, be it in skin products, home care or gadgets. How do you identify those people, and how do you keep the communication lines open with them?"

On this side of the Atlantic, grocers long gun-shy of replicating the Tesco model for fear of the costs involved are finally taking up the charge. Safeway, for one, has publicly stated its desire to leverage frequent-shopper insights to drive center-store shopping. Perhaps no grocer is further along, however, than Cincinnati, Ohio-based Kroger Co. In 2003—a mere ten years after Tesco launched *Clubcard*—the company saw enough merit in Tesco's approach to co-found a U.S.-based office for Dunnhumby, the analytical firm helping the British retailer refine its database marketing strategy.

"It's always amazing to me that when we explain what we do, it sounds like common sense," says Simon Hay, President of Dunnhumby USA. "Let's try to engage customers in the store and make their experience better. But big organizations are always so inwardly focused that they sometimes have a hard time grasping it."

Dunnhumby helped Kroger launch the *1-2-3 MasterCard*, which eschews two-tiered pricing for a points-based equity approach to loyalty, and has advised Kroger on a three-dimensional approach to data mining: first, they identify the 6.5 million out of 42 million households that drive 50 percent of their sales; next, they segment them by purchase propensity for 27 different sample products; and finally drop them into one of seven shopper categories, including Traditional, Budgeter and Finest segments. The resulting quarterly mailers include informational brochures and branded coupons targeted by category. Kroger isn't talking, of course, but the word on the street is that the company is pleased with the results. But does it have the stomach to stick with this approach for the long haul?

"Change doesn't happen overnight," says Hay. "The key is to keep working your priorities in customer data, channels and technology and follow your processes consistently to be better and faster than your competition."

Kermit the Frog was wrong:

It's no so hard being green, Kermit, if you design a fundamentally sound loyalty offer.* Greenbax *built its current reward program on the basic appeal of its trading-stamp predecessor, featuring portability and instant redemption of member rewards.

Coalitions 'r us

Tesco's proprietary approach to loyalty is a rarity for grocers in most mature economies. Many of the world's grocers—including Coles and BI-LO in Australia, A&P/Dominion and Safeway in Canada, Real in Germany, H&L Supermarket in Malaysia, New World in New Zealand, Wong in Peru and Sainsbury's in the U.K.—anchor multi-merchant loyalty coalition programs with everyday-spend partners in the fuel retail and financial services sectors that help consumers earn lots of promotional currency quickly. In the U.S., no major grocer has stepped up to anchor a national coalition; the rumor is that a major grocer's withdrawal from the *Jaz*

Rewards program in 2002 sealed that ill-fated coalition's doom. But coalition loyalty is thriving in the U.S in a low-key, slow-cooked kind of way, and there are enough tasty recipes simmering in the loyalty crock pot to predict that the model will find long-term success in the States.

The closest thing to a national coalition today is the well-regarded *Upromise* program, which (at participating merchants) rewards consumers with cash back that gets deposited in a 529 savings fund for your child's college education. Since its 2001 launch, the coalition has grown to 7.2 million members, and is now the country's second-largest administrator of 529 plans with $10 billion in assets. More than 23,000 grocery and drug stores hand out *Upromise* cash, although the model is a little different —rather than funding the rewards themselves, the grocers merely act as a pass-through for the packaged goods vendors, such as Coca-Cola and Tide, who actually fund the program. Still, the company is helping grocers break through the data ceiling by providing real insight on shopper behavior.

"Many grocer loyalty cards are really price discount cards, but *Upromise* provides a real loyalty component to their execution," says David Rochon, Senior Vice President of Partner Management for *Upromise*. "Four *Upromise* retailers provide full t-log data so we can help them and our CPG partners measure behavior. We do test versus control groups and look at pre-year and post-year behavior of members versus non-members, and we've seen transaction balance increases in the high teens to twenties. We don't win every battle, but we're delivering real value."

There are other coalition programs both nascent and thriving in the U.S.: *S&H greenpoints*, which counts six regional grocers among its stable of 100+ partners, and *Club Mom* and *Gold Points Rewards*, which have both partnered with a bevy of online food retailers. These third-party operators work closely with their grocer retailers to parse data and deliver insight to help them manage their communications, operations and merchandising.

"The *greenpoints* program has really evolved mainly because of the advanced services we provide to retailers," says S&H Solutions Vice President of Marketing Kimberly Mernovage. "Our retailers have become extremely proficient at utilizing the data and the customer reporting to manage their loyalty programs."

The green green grass of home

Perhaps the most intriguing coalition offering to spring up in the past few years is South Carolina-based *Greenbax Customer Rewards*, which began life in the 1950s as a trading-stamp program for sister retailer Piggly Wiggly Carolina Co. The program has evolved into a thriving regional coalition that facilitates earning electronic stamps at 120 Piggly Wiggly locations and at more than 275 merchant partners in the fuel retail, family entertainment and dining sectors. The coalition network, which now covers 139 communities in North and South Carolina, Colorado, Georgia and Texas, boasts 1.1 million active customers, all earning and redeeming currency in real time through a proprietary network built on VeriFone terminals.

And boy, is it working. Customers in Charleston, South Carolina, can earn *Greenbax* stamps at their local Piggly Wiggly, and then take their cards to Joseph P. Riley, Jr. Park ("The Joe") to purchase box seats to see the Charleston River Dogs (the New York Yankees' single-A affiliate) at five books each. You can earn additional Greenbax stamps at the park's souvenir shop and then drive back to Piggly Wiggly to redeem them for free groceries. It's the coalition's focus on easy access to local merchant redemptions with a strong emphasis on family rewards that sets it apart, says *Greenbax* Vice President Barney Henderson.

"It's the Wal-Mart effect," says Henderson of the coalition's appeal to local merchants. "National brands are invading rural markets, and they buy more and sell cheaper. A lot of mom-and-pops are fighting the same thing. We provide strength in numbers."

And as those merchant numbers grow, so does the program's influence. For a monthly fee per location, merchants can reward their customers by issuing

Greenbax for qualifying transactions at a small percentage of the sale. All partners can redeem stamps at the point-of-sale, with Greenbax reimbursing them at flat rate per book. The results have been impressive thus far, with the coalition influencing $33 million in network spending in South Carolina and Georgia alone. And like true loyalty marketers, the Greenbax team is eager to help Piggly Wiggly dive into the data and target its markdown dollars more effectively.

“The future of grocer loyalty marketing is carrying the items that your most profitable customers want,” says Henderson. “We need to link people to product. Likewise, our partner merchants will have intelligence about their business the likes of which they’ve never had before. It’s interesting—the hungry will innovate. Those in danger will stretch the limits.”

Simple is as simple does

What Dorothy Lane, Tesco, Kroger, Green Hills and Piggly Wiggly share is a common-sense, back-to-basics approach to customer loyalty. While the execution can get complex, the concept is simplicity itself: look at what your customers buy, reward them for their loyalty, and then give them offers that resonate with them personally. If you need to be convinced of the approach, look no further than Wal-Mart itself, which recently announced a five-point plan to build customer loyalty and better understand the shopping habits of its 130 million weekly shoppers.

Back in Dayton, Ohio, Norman Mayne is smiling.

“We probably have more fun than most people,” Mayne says. “We strike out more than most, but we also hit a few more home runs. We don’t do a lot of sophisticated market research. If it feels good, we try it.”

Rick Ferguson is the Editorial Director for* COLLOQUY*.

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