Fresh food category management: leveraging strategic options

Agriculture and Food Council of Alberta

The Agriculture and Food Council leads the Alberta Value Chain Initiative in partnership with Agriculture and Agri-Food Canada and Alberta Agriculture Food and Rural Development. The Council is an industry-led, non-profit society comprised of volunteer member representatives including business leaders in the Alberta agriculture and food industry. The Council provides industry input and strategic direction through the Value Chain Action Team.

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Summary

The distinguishing characteristics of fresh food create a number of strategic options for agile retailers and suppliers. Large and small firms are able to develop new ways of doing business that is difficult for competitors to copy.

Tesco, ASDA and Waitrose supermarkets in the UK provide examples of the different strategies developed by different retailers.

Competition based on new ways of doing business also encourages product diversity. New products are easy for competitors to copy whereas innovation in ways of doing business is hidden and more difficult to copy.

Successful fresh food firms develop systems that generate successive waves of product innovation. They execute an integrated suite of strategies where the total is more than the sum of the parts.

This second white paper discusses the strategic options that are available to fresh food retailers and suppliers.

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1. Introduction

Opportunities are available to both large and small fresh food companies.

Imagine an industry where firms have a great number of strategic options, many of which are not size dependent and are available to both small and large firms: where sales and profit increases of 15-20% per annum are highly achievable. Welcome to the fresh food world. Of course such gains are not easy for all players to capture, requiring vision, commitment and the willingness to change the way business is conducted.

Successful fresh food firms – retailers and suppliers - do not simply do things more efficient than their competitors: they conceive and execute superior ways of creating value. The focus of competition shifts from product to business design.

Successful fresh food firms create a system that is difficult for competitors to copy.

Fresh food leader firms do three tasks extremely well. First, they understand the drivers of consumer value for their chosen target market. Second, they identify, develop and control the distinctive capabilities that underpin the value creation process. And third, they assemble the chain or network that brings together all the resources and capabilities to create and deliver value to the consumer. In this process they reconfigure the chain and create a total system that is difficult for competitors to copy. Process innovation along the chain is arguably more important than product innovation. Product innovation on its own is highly visible and easy for competitors to copy.

This white paper, the second in the series, discusses the strategic options available to fresh food retailers and supplier. The first white paper set the scene by outlining the evolution of the supplier into a genuine innovation partner with their retail – and food service – customer.

2. The need for business design innovation

Commodity price volatility reflects the level of alignment between supply and demand.

In traditional commodity based industries auction systems are used to coordinate the interface between supply and demand. Regional livestock saleyards and produce wholesale markets still feature globally in the red meat and produce industries for buyers and sellers to conduct business. The market mechanism is used to establish price, with the degree of price volatility reflecting the level of alignment between supply and demand: in times of excess supply the price drops and conversely a lack of supply results in price increases.

Commodity markets are characterized by a lack of product differentiation.

Such commodity systems have a number of strengths – there are valid reasons behind their enduring presence. Markets provide an efficient price setting mechanism and a price is always set to clear the market. Markets are efficient for capturing and communicating price information to buyers and sellers. Markets also provide strong incentives to decision makers: good decisions are rewarded and poor decisions are penalized under auction systems.

However, commodity-based auction systems have a number of inherent weaknesses.

Commodities – by definition – are highly tradable products with many potential buyers. They are not differentiated products grown specifically for any individual buyer or

consumer segment. Thus commodity markets are characterized by a lack of product differentiation. It goes without saying that a production push orientation will not be highly responsive to changing consumer needs.

Furthermore, whilst auctions are efficient for communicating aggregate supply and demand information they were not designed to communicate the relative importance of consumer attributes such as flavour and tenderness down the chain. Purchasing the elusive full-of-flavour delicious fresh peach remains a challenge in most countries around the world – 40 years after men walked on the moon.

The arms-length nature of the trading relationship leads to a lack of understanding of the needs of the other members of the chain. Firms have strong incentives to reduce their own costs of doing business, but there is no incentive or mechanism to reduce total supply chain or delivered costs.

Limited information, flow up and down the chain.

Firms in the middle of the chain – agents and processors – can generate profit from trading and arbitrage. It can be in their interest to limit information flow up and down the chain. Thus commodity systems lead to predictable firm behavior. Arms-length relationships coupled with trading profit opportunities inevitably leads to adversarial relationships.

The weaknesses of commodity systems are particularly acute for major customers such as supermarkets and food service operators such as McDonalds. Commodity systems do not lead to reliability in supply – quality, quantity or price - nor high rates of innovation on which they can differentiate their offer from their competitors.

Smaller fresh food firms can craft strategies that are difficult for larger competitors to copy.

The opportunity – and challenge – of fresh food product differentiation and accelerated rates of innovation gives rise to a number of strategic options.

Being the lowest cost producer is the only viable strategy in production-push commodity systems.

If a firm (or region or country) is the lowest cost producer then commodity market strategies can be an attractive strategic option. In market pull systems, on the other hand, firms have a great degree of strategic flexibility, with not all options depending on economies of scale. As outlined later smaller firms can sometimes execute strategies in fresh food that their larger competitors find difficult to copy. Smaller size can sometimes be turned into a competitive advantage.

3. Fresh Food Retailing in Practice

Before discussing the challenges in aligning fresh food chains to the final consumer, three case studies highlight the diversity of strategies that can be employed in fresh food.

The UK provides three excellent examples of how retailers are working with suppliers and growers to align the whole chain to the ever-changing needs of consumers. Each retailer is pursuing a different marketing strategy that reflects their position in the market and the needs of their customer base.

Each example highlights that food chain strategies are the means to the end and not the end in them selves. The aim is delivering superior value to specific groups of customers.

Tesco

Tesco's 3-tiered brand strategy appeals to premium, mainstream and discount market segments.

Tesco is one of retail's success stories. Tesco is the UK's leading retailer with annual sales of over £30b and market share in the order of 27%. Growth has been a very impressive 12% compound over the past 14 years.

The ability to appeal to a wide range of shoppers is one of the critical challenges facing market leaders in all countries. Whilst having to appeal to the mainstream, high market share retailers must also attract premium shoppers at one end of the spectrum and discount shoppers at the other. They have to defend both flanks as well as engage in front on assaults with direct competitors.

Tesco has successfully tackled this challenge through a 3-tiered private brand portfolio. Tesco is one of the leading private label retailers in the world with home brands accounting for over 50% of total branded and non-branded food sales.

Tesco works closely with its fresh food suppliers to develop new products across the whole range.

"Tesco" is the main brand with "Tesco Value" the discount brand targeted at price-sensitive shoppers and discount competitors such as Aldi. "Tesco Finest" is the most important premium brand and directly targeted at competitors such as Marks & Spencer. The Tesco Finest brand is supported by other premium brands such as "Tesco Healthy Living", "Tesco Fair Trade" and "Tesco Organic". Specialty niche brands such as "Tesco Kids" appeals to other specific target segments.

Tesco works closely with its fresh food suppliers to develop specific products for each range. For example, the citrus supplier Munoz Mehadrin is trialing new technology in order to provide guaranteed sweet mandarins for the Tesco Finest range. Both the supplier and growers understand the Tesco marketing strategy and their role in the innovation process. They also appreciate that their innovation efforts will not go unrewarded – Tesco is actively seeking new product ideas and is prepared to pay for such efforts.

Neither Tesco nor its suppliers can afford for these categories to drift back into a commodity rut. From a primary producer and supplier perspective the range of brands enables Tesco to work with suppliers to market the total crop or carcass.

ASDA

ASDA is part of the Wal-Mart Group and has displaced J. Sainsbury as the UK's second largest retailer.

ASDA and its suppliers work together to reduce costs, which are passed on to the consumer.

ASDA pursues its now famous every day low pricing (EDLP) philosophy whereby ASDA and its supply partners have a relentless pursuit on reducing costs for the benefit of consumers. Cost reductions are passed on to the shopper. EDLP is more than a simple pricing strategy: it is a dedicated way of doing business.

In the carrot category for example ASDA's aim was to offer consumers British grown carrots for 12 months of the year. But there was a frustrating gap of a bit over a week where it seemed almost impossible to reliably grow carrots in Britain. ASDA worked with a group of three vegetable growers to fill the critical supply gap. The 'locally grown' marketing theme could now be implemented.

ASDA specifications mean that a higher proportion of the crop can be marketed via the supermarket.

At the same time ASDA reduced the number of lines on offer from 8 to 3: loose carrots, bagged carrots and bagged organic carrots. This revolution assists in managing wastage and reduces supply chain costs, but still offering the ASDA big-family shopper sufficient choice. Sales increased by over 15% per annum. The ASDA model is ideally suited for their core family shopper segment.

In addition, ASDA has less stringent specifications than its major competitors such as Tesco and J. Sainsbury which means a higher proportion of the crop is available to sale to the supermarket. ASDA is an attractive customer for the growers.

Waitrose

Any strategy that is difficult for Waitrose to execute will be difficult for larger competitors to copy.

Waitrose is at the premium end of the supermarket spectrum with an emphasis on flavour and taste. The Waitrose fresh food strategy is to work with dedicated suppliers and growers to deliver outstanding flavour and freshness to a quality conscious shopper. The strategy is to do the difficult things well, exploiting Waitrose's smaller size and position in the market.

Waitrose punches well above its weight in fresh food: grocery market share is in the order of 3.5% whereas market share in most meat and produce categories is almost double this at approximately 6.5%.

Waitrose established its first livestock producer group over a decade ago with a pilot scheme to supply 10 branches with Quality Assured Welsh Lamb. By 1998 all of Waitrose's 145 branches were supplied by the group which now consisted of 125 Welsh lamb producers.

Waitrose works closely with suppliers to market the whole carcass and the total crop.

The approach of working closely with committed groups of livestock producers has expanded to other livestock sectors and Waitrose now has more than 30 livestock producer groups: including chicken, ducks, salmon, and venison groups.

The strategy is to tackle the difficult challenges associated with building strong relationships along the whole chain – with suppliers and producers. Any strategy that is difficult for Waitrose to execute will be difficult for larger competitors to copy.

The egg category provides an excellent example of how Waitrose and its suppliers/growers have been able to

Differentiate a traditional category such as eggs. Every egg in the Waitrose egg category is marketed on an appeal that relates directly to the primary producer – and relies on the total chain system to back up the claim.

Examples from the Waitrose egg category include production system (free range and organic are the two main examples); breed (the Columbian Blacktail is the basic egg product sold in Waitrose stores); region of origin or Provenance (Welsh grown eggs); and feeding regime (six grain eggs highlighting the hens' diet).

Four characteristics of fresh food add to the complexity – but also create a number of strategic options.

However, to be believable these promises need to be supported by close relationships along the chain – especially with the primary producers where the foundation of the promise is generated. These strategies require whole-chain collaboration.

4. Crafting Fresh Food Strategy

Aligning fresh food chains to the needs of the consumer and developing a system that is responsive to changing consumer needs sounds logical. So why is it difficult to achieve?

Four distinguishing characteristics of the fresh food industries make the evolution from a production push to a market pull orientation complex. But these characteristics also generate a large number of strategy options and create significant opportunities:

The whole chain is intimately involved in creating value for the end consumer.

Both demand and supply are volatile.

1. The perishable nature of the products places a number of constraints in dealing with sub-optimal demand and supply information

The way the links in the chain are managed is as important as the operations within each firm.

2. The whole crop or carcasses to be marketed.

Developing creative solutions to the bundle of these three challenges creates strategic options and new business opportunities for fresh food retailers and suppliers.

4.1 Creating fresh food value

Fresh food value is created along the whole chain, and is not concentrated in the manufacturing operations as with processed food. The whole chain from genetics through to retailer needs to coordinate their contribution to ultimate consumer value. The genetics of the animal or plant will determine potential value that can be delivered to consumers. For example, a peach that has been bred for yield, disease resistance and transportability with no inherent flavour will not provide a memorable eating experience regardless of how it is grown or retailed.

The whole chain nature of the value creation process also implies that innovation is a whole chain activity. The way the links between the various firms are managed is as important as the operations within each firm along the chain.

There are basically three types of attributes on which promises or brands are built. First are those attributes that can be easily assessed by the consumer before purchasing. The price, colour and marbling of meat for example can be determined before the sale. The second type is attributes that can be assessed after consumption. The tenderness and flavour of steak is certainly known after eating.

The retailer endorses the integrity of the system behind the brand promise.

The third type of attribute is that which cannot be easily assessed even after consumption[1]. There is a high degree of strategic flexibility for agile firms. It is this third type of attribute that is driving fresh food branding around the world. Promises that build on the story behind the food we eat and that we cannot assess easily, even after consuming the product.

Examples – all of which link the consumer directly to the primary producer through the whole chain system - include:

[1] The technical term for the three levels of attributes is search, experience and credence attributes.

Attributes which cannot be easily assessed even after consumption create strategic options.

- Region of Origin or Provenance – this is the staple of wine marketing with regions such as the Coonawarra and Margaret River being identified with strong characteristics. King Island and the Darling Downs are names that conjure up positive fresh food impressions with consumers.

- Production system – Free range and organic eggs are well known examples in the egg category. 'Natural' beef is being increasingly promoted in North America.
- Breed – Certified Angus is probably the best known in the meat category. In the egg category in the UK both Tesco and Waitrose are promoting eggs from traditional breeds such as Old Cotswold.
- Feeding regime – Pasture or grain fed is another theme that is promoted in the meat category.
- Post-harvest handling. The Coop Retail Group in Calgary, Canada for example uses aging as its main beef segmentation strategy – 14 days aging for its main beef offering and 21 days of dry aging for its premium offer.

Ripe 'n Ready peaches and avocadoes are other examples where differentiation is based on post-harvest handling.

Traditional commodity systems simply cannot deliver on this third level of promises. Commodities are anonymous whereas consumers are placing more and more value on the story behind their food from a known source.

The important question is – given that the promise is not easily assessed by consumers – is the promise believable?

Ultimately, it is the retailer who is endorsing (if not making) the promise and who is asking us to believe their claims. They are the logical part in the chain where systems to endorse the advertised promise must be in place. Basically, all these marketing approaches are moving away from anonymous commodities to a source of known supply. The retailer endorses the systems to ensure traceability.

In managed fresh food systems someone takes responsibility for coordinating supply and demand.

The retailer also has the most incentive to give credible promises – if they do not back up their promises in one department – such as seafood or produce – then this lack of trust will be reflected across the whole store.

4.2 Volatile demand and supply

Not only does the whole chain have to be involved in the value creation and innovation process, but both ends of the chain are subject to volatility. In most industries, supply is managed in response to volatile demand, with inventory used to

buffer any inefficiency. In fresh food on the other hand both demand and supply – quantity and quality - are volatile. Toyota for example does not have to manage the impact of droughts on the supply of gearboxes. Dell Computers do not have to cope with a hail storm that influences the quality of computer chips.

With fresh food inventory cannot be used to buffer sub-optimal information management.

Thus value chains essentially aim to replace markets with management as the mechanism to coordinate the interface between volatile demand and supply. This is not easy when both demand and supply vary.

For example, a single supermarket or food service customer is unlikely to take all the crop or livestock produced. The product that does not meet customer specifications still has to find an alternative outlet, usually via wholesale markets. Thus trading and markets still provides a pressure valve outlet when supply and demand is not fully aligned. And trading provides the opportunity to dispose of the whole farm production.

Information inefficiencies are typically exhibited in the middle of the chain – but the root cause is at either end.

Fluctuating prices are part and parcel of the commodity business. There is no 'blame' attached when supply and demand are not aligned and producers receive low prices or buyers have to pay high prices. However, in managed systems someone takes responsibility for forecasting and managing supply and demand. If a supermarket does not program accurately and growers suffer, then the supermarket (or the supplier) will be held responsible. Or if growers do not produce the quality and quantity that they proposed then they will be held responsible.

4.3 Perishable products

With perishable products inventory cannot be used as the buffer to manage sub-optimal Information management. The efficiency of a manufacturing supply chain can be easily assessed by the level of inventory in the chain. This is not as simple with a fresh food supply chain where there are many forms of inefficiency including wastage, repackaging, out-of-stocks, discounted sales and having to purchase from non-preferred suppliers. Many of these inefficiencies – such as out-of-stocks and discounted sales – are hidden costs that may not be managed and monitored. Inefficiencies can be larger than the visible costs of wastage suggest.

Furthermore, information inefficiencies are usually exhibited in the middle of the chain where demand and supply interface. One of the values provided by the meat-processing sector and produce agents is the risk management associated with volatile demand and supply. However, this is usually where the symptoms of the problems can be found – but the root cause of the problem is likely to be at the retail (demand volatility) or producer (supply volatility) ends of the chain. The extent of these problems is often not realized until the chain tries to replace markets with management coordination.

Leading retailers are working with their suppliers to assist in marketing the whole crop or carcass.

For example, retailers can play an important role to assist producers move production peaks. Times of excess production are a feature of many fresh food production systems such as lamb and sweet corn. The retailer needs to work with suppliers/growers to develop strategies to market the additional supply. Alternatively the producer is likely to face considerable losses, as the excess is disposed onto commodity markets at a significant price discount.

4.4 Marketing the whole crop or carcass

Successful fresh food strategies are more than the sum of the parts.

Peach trees produce fruit in a range of sizes – and not exactly to retailer specifications. The whole crop has to be marketed with grower profitability sensitive to the price received for all sizes. Similarly, prices received for all cuts of the carcass significantly influences profitability to meat businesses.

The Tesco, ASDA and Waitrose case studies illustrated that each retailer has strategies for working with suppliers and producers to assist in marketing the whole crop or carcass.

4.5 Strategy development

Retailers and suppliers who together are building new capabilities are reaping the rewards.

Developing a winning fresh food strategy requires a suite of integrated components[2]. The system is more than the sum of its parts. For example, marketing skills need to be complemented with improved demand and supply forecasting capabilities. Similarly, developing a collaborative relationship between retailer and supplier is pointless unless leveraged to generate higher rates of product innovation.

Competition based on new business designs also encourages product/service diversity. Traditional product-based competition in industries such as the food industry inevitably leads to price driven competition. It is difficult to maintain product and quality diversity when all firms are operating under the same business model. In fact it could be argued in the fresh food industry that new products/services will typically be associated with innovation in business design.

The retailers and their suppliers who together are building the capabilities to underpin these new systems are reaping the rewards. They are building agile companies that together form chains that are beating their competitors.

The third and final white paper in the series discusses how the four distinguishing characteristics of fresh food can be leveraged in crafting a winning strategy. The development of a new set of performance measures that allows firms to diagnose and manage new ways of doing business is presented.

[2] The attributes of successful fresh food firms were summarized in the first White Paper in the series.

About the Author

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He is the Chairman of Hortical, an organization that develops and commercializes non-intrusive sweetness testing in fruit. He is also Chair of the Premier Fruits Group, a fruit and vegetable grower and supplier to Australian supermarkets.

O'Keeffe & Associates have developed a number of tools to assist firms develop, execute and monitor fresh food strategies including:

- Relationship Audits
- Fresh Food Category Management manuals
- Innovation audits and NPD processes
- Strategic Planning workshops
- Whole chain metrics and performance measures.

O'Keeffe & Associates has developed and delivered a number of modular training workshops and programs that are customized for individual clients, including: Strategic Planning in Fresh Foods; Understanding and Working with Fresh Food Retailers; and Fresh Food Category Management.

O'Keeffe also serves as an Adjunct Professor of Value Chain Management at the University of Queensland and is on the editorial Board of "Supply Chain Management: an International Journal", published by the Imperial College at Wye. He is co-editor of "New Directions in Corporate Strategy' published by Allen and Unwin in conjunction with the Australian Graduate School of Management.