



Wholesale Grocery Buying: *creating value in a hypercompetitive market*

Declining supermarket share is forcing a sea change in grocery “buying” with profound implications for the underlying culture. Some supermarket chains embrace the new dynamic more quickly than others. Few independents have begun the transition. Cash & Carrys, and their customers, are largely unfamiliar with the techniques and benefits of the practice improvements.

Historically, buyers were industry “rock stars.” Buyers relied on intuition to source deals that set merchandising and product strategy. In the absence of management accounting, bragging rights were based on volume rather than profitability.

An example at \$4.5 billion Giant Food is illustrative. When Mike Broomfield (CCA Board of Advisor member) toured Giant’s warehouses in early January shortly after being brought-in as COO by Sainsbury, he spotted a vast supply of frozen turkeys. The buyer defended his decision to buy a year’s supply of turkeys the week after Thanksgiving because the turkey farm, desperate to unload an oversupply, sold them at fire sale prices. From the buyer’s perspective, the deal made perfect sense because – never mind freshness issues – he’d figured out how to charge interest and storage costs to someone else’s cost center.

Practices among independents have traditionally lagged behind supermarkets. During the mid-1990s, Merle Coe (CCA CEO) discovered, while installing inventory control in a Washington, DC area Cash & Carry, that 800 of the 12,000 products carried were unknowingly being sold below cost. He also discovered that stocks were seriously out of balance because the Cash & Carry did not practice category management or have a product category schema – and that 2,000 items did not make a single sale during a three month period. Five years later, he found, while installing inventory controls in bodegas, that approximately 35-40% of the SKUs stocked sold fewer than 5 items per quarter and stock outages on fast moving products averaged 25%.

In the late 1980’s, Wal*Mart introduced modern category management and customer relationship

Less Inventory Is More

Industry outsiders are often surprised to learn that the continuing benefits of perpetual inventory control outweigh the benefits of a one time cash bump – which can be substantial: equal to 50% of total inventory value in some instances (Wal*Mart has 7 days of in-store grocery inventory; Safeway, 18.)

Annual inventory carrying costs (as much as 10% of the reduction) are decreased. Sales increase because fewer sales are lost to out-of-stocks – knowing needed items are consistently in-stock has a powerful psychological impact on customers. Duane Wolter (CCA CFO) increased sales 20% a month for three years at a chain by simply raising service factors on key items.

Unintentional stock overages from ordering mistakes (usually accompanied by stock outage on another product) are reduced. So is shrink (packaged goods quickly become dog-eared; produce and dairy have short shelf lives.) Numerous other sources of shrink beyond the scope of this paper – selling non-deal product at deal prices, for example – are also eliminated.

More Sales & Profits, an interactive practice guide for neighborhood grocers, examines the subject in detail. Vendor relations are improved and product cost is reduced.¹ Earnings surprises, and revenue and earnings volatility – especially detrimental to exchange listed firms – are reduced.

¹ *Even vaulted Wal*Mart makes mistakes. When Don Watt (CCA Board of Advisor member) was CEO of Cott Design, a Cott Beverage subsidiary, Wal*Mart forced Cott to take back \$50 million of close-dated Sam’s Choice due to a glitch in their inventory system. Ultimately the cost of the return was made-up in higher product cost, but the burp caused Cott a significant earnings surprise which adversely affected their stock price.*

Figure A

management¹ (“CRM”) to the “practice challenged” USA grocery industry. A decade later, Wal**Mart’s* grocery sales surpassed the total sales of Kroger, the largest supermarket chain.

The supermarket industry is in the very earliest stages of introducing CRM. When used, customers are typically classified by sales volume and targeted for special offers based on prior purchases. Few CRM practitioners segment customers by profitability to maximize service factors for the most valuable. Fewer still segment customers by type (Teton Sands,² for example, segments customers into three types: Intrinsic Value; Extrinsic Value; and, Strategic Value (Figure B.)

In 1995, CCA’s COO, Don Vehlhaber, was engagement manager for a project to train inventory managers at Kroger headquarters in category management. The project was expanded to include inventory management fundamentals when it was discovered Kroger personnel did not understand that service factors (percentage time in stock) need to be greater on some products than on others. At that time, Kroger was awakening to such needs as in-store inventory control and centralized – versus regional – buying. Currently Kroger is struggling to implement in-store inventory control and reduce inventory below a 17 day supply (Wal**Mart* averages 7 days). It has yet to begin integrating category management with CRM.³ Its operating cost is 22% versus Wal**Mart’s* 17% (Table A.)

	<i>Wal*<i>Mart</i></i>	<i>Kroger</i>	<i>Albertson’s</i>	<i>Safeway</i>
Sales	\$81B*	\$53B	\$36B	\$32B
Operating Cost	16.6%	22.1%	24.1%	25.9%
Operating Profit	5.2%	4.9%	5.1%	5.2%
Gross Margin	22.2%	27.0%	29.2%	31.1%
Net Income	2.3%	2.2%	1.4%	(2.5%)

*USA food only
Source: SEC 10K filings; Kroger & Albertsons thru 3 quarters; Wal**Mart* & Safeway full year

Table A

A project conducted by Teton Sands principals for a \$3.5 billion supermarket chain in Maine is another example: 15,000 non-perishable items were examined across 153 stores for 13 weeks – 4,700 items had no movement. An additional 4,100 moved only 1 unit per week. Subsequent inventory control efforts resulted in a 40% one-time inventory savings and annual carry cost savings of \$16 million.

The point is, modern inventory practices transform buying from an art form into an analytical science. In this new world, buying is inseparable from the overall product offering/operating/logistics mix – instead of being an island. As products are perceived to be interchangeable, for example, customers place increased value on their preferred acquisition environment – product and service are integral parts of the value proposition. Boundaries between customer and supplier become as important as “product.” Mastery of the new paradigm produces faster growth, higher margins, less volatility, and fewer earnings surprises (see Figure A.)

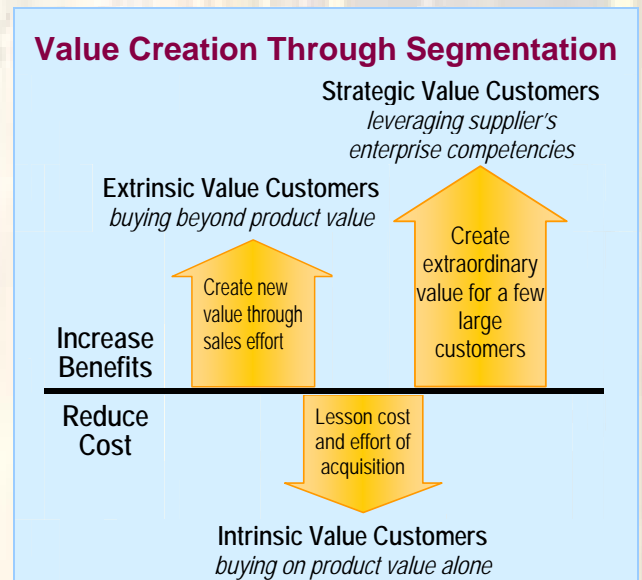


Figure B

¹ Not all customers are the same. CRM is the practice of categorizing customers to improve operating efficacy and efficiency.

² Teton Sands’ chairman, Tom Snyder, led numerous projects that reengineered sales practices of Fortune 500 companies using methods based on statistical “Deming-like” transactional analysis. He has unique food industry perspective based on having founded a Cash & Carry.

³ Figure D shows a CCA report subordinating inventory category management to customer needs (integrating CRM and category management.)

Culturally, a “Willie Lowman” to MBA-like shift is underway. A vendor’s willingness to redesign boundaries is often as important as “price.” Further, inefficiencies in suppliers’ operations – as well as those in customers’ operations – result in higher prices to the ultimate consumer: which translates into lower sales and margins for both parties.

To quote Tom Snyder,⁴ “Sales forces that see their mission as value communications are living in the past.” By his yardstick most food industry sales forces live in the past and were caught flat footed when Wal*Mart classified suppliers by assigning products to one of four classifications (Figure C.) The move enabled Wal*Mart to dramatically reduce the amount of time its buyers spent in meetings with vendor sales personnel. The implications for food manufacturers (“CPGs”) were also dramatic – 3,000 industry sales positions were eliminated and the bulk of the savings (\$300 million annually by some estimates) was passed back to Wal*Mart in the form of lower prices.⁵

CCA principals have long recognized that the fast growing independent retail grocer segment faces three major challenges related to “buying:”

- suppliers have rigid, one dimensional boundaries (efficient national distributors set the volume bar and electronic trading requirements too high for small grocers; DSD provides unneeded service at high cost)
- technology and practices are antiquated and supermarket technology does not “scale down” (store owners partially compensate by working long hours)
- Cash & Carrys – the principal suppliers – have certain deficiencies which are unlikely to be remedied by the current generation of owners

To address the buying needs of small grocers through the Cash & Carry format, CCA obtained a perpetual, worldwide license to highly scaleable chain management technology (\$20 billion enterprise to bodega level.) CCA principals embedded the technology within a proprietary set of best practices – practices superior to those in most supermarket chains.

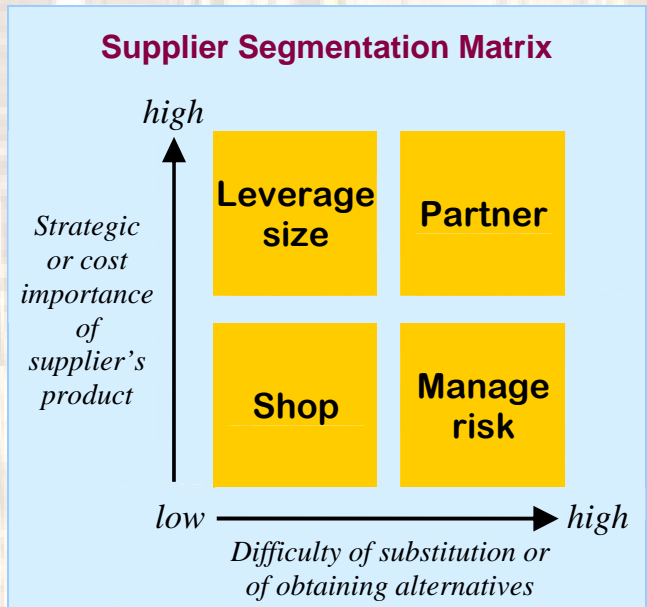


Figure C

CCA ¹ Suppliers: Example Terms		
Supplier	Terms days	Products Supplier Profile
Gold Kist	7	meats, poultry – one of largest USA poultry suppliers
XYZ Seafoods	14	shrimp, tilapia
SE Wholesale	7	retail pack dry groceries, frozen foods, paper products, and household chemicals – a leading supplier to supermarket chains such as Food Lion, A&P, IGA, Winn Dixie, Brunos, Piggly Wiggly, Community Cash, Save A Lot
Excel	10	meats – one of the two largest USA meat packers
XYZ Dairy	7	milk, eggs, cheese, cultured products – a large regional dairy supplying Florida, Michigan and Wisconsin
Cheney Bros.	30	commodities – one of the top 4 SE USA wholesalers

¹ “stalking horse”

Table B

⁴ As Teton Sands chairman, and previously as CEO of Huthwaite (one of the worlds leading sales strategy consultancies), Mr. Snyder pioneered statistical transactional analysis of sales processes. His books – including the recent best seller, *Escaping the Price Driven Sale* – have been translated into 20 languages.

⁵ Grocery stores pay twice when called-on by vendors: first in the cost of their buyers’ salaries; and, second in the cost of the sales person’s compensation and travel expenses (which are “paid for” in the form of higher product cost.)

The resulting “package” is promulgated under the auspices of the National Neighborhood Grocers Association.

As a result, CCA’s value proposition (product/ service offering) for small grocers is flexible – up to six customer types (twice the Teton Sands schema) may be automatically managed, each with unique pricing and service attributes.

Boundaries between CCA and Strategic Value Customers (Diamond Stores, in CCA parlance) are largely eliminated by installing the “CCA process” in Diamond Stores at no charge. CCA’s strategic offering to these stores is rounded-out with access to private label product and promotional funding from CPGs. Education and training centers in CCA Cash & Carrys bring additional service, at low cost and only as needed, to Extrinsic Value Customers (Platinum Stores.) Rigorous inventory management and other modern best practices reduce overall acquisition costs for Intrinsic Value Customers (Gold Stores.)

CCA principals operate a distribution firm as a “stalking horse” to establish relationships and credit terms with suppliers – and to test the limits of available terms and conditions for several thousand products. Actual results significantly beat plan projections.⁶ Availability of credit is not an issue: CCA acquires established businesses with credit lines. The question is, “can credit terms be improved?” With no prior credit history, superior terms were established with major suppliers (Table B) and with primary importers and source-country manufacturers of Hispanic product.

Actual pricing also beat plan. With less than 10% of CCA’s projected initial volume, the stocking horse obtains products at costs allowing margins from 7-30% with an average of 16% (between 3 and 11 full percentage points above average wholesale margins of 5-13%.) Table C shows examples.⁷ As a result of bypassing the distributor of pork butts, Gold Kist, and purchasing directly from the packer, Excel, gross margins increased from 17% to 30%. It was not anticipated that special deals could be negotiated with Sam’s Club. In the case of beef cheek, however, a price \$0.29 per pound less than the “best” wholesale price of \$1.19 was negotiated based on certain commitments.

Most vendors offer volume discounts for which CCA will qualify as additional Cash & Carrys are acquired. Further, much logistics and buying cost is fixed, rather than variable; the additional volume will therefore lower fully loaded product cost. Stocking horse relationships and techniques are proprietary to CCA principals and are not realistically available to individual Cash & Carry owners – nor are the professionalism and experience that CCA management bring to negotiating and buying. The favorable gap between supplier terms for CCA versus non-CCA centers is anticipated to continue widening.

CCA¹ Suppliers: Example Pricing
low volume, relationship based, terms

	<i>Shrimp 31/40 Per lb</i>	<i>Milk Gallon</i>	<i>Eggs Large 15 doz</i>	<i>Pork Butts g/m</i>	<i>Beef Cheek Per lb</i>
Wholesale					
<i>Target Cost</i>	5.00	3.00	12.50	20%	1.00
<i>Favorable Variance %</i>	14%	3.6%	16%	50%	10%
Empire ²					
Sam’s Club		2.99	12.65		31.19
Velda Farms		3.19	13.00		
XYZ Dairy		2.89	10.50		
SE Frozen			12.70		
Gold Kist				17%	1.15
Excel				30%	
US Food	5.20				
XYZ Seafood	4.30				
Retail					
Publix		4.35			

Table C

¹ “stalking horse”

² terms with all suppliers other than Empire

³ negotiated \$0.90 per pound with quantity commitment

⁶ The project produced additional benefits. Relationships were established with the owners of four previously unidentified Cash & Carrys with combined revenues of approximately \$160 million.

⁷ Table C is a snapshot in time. The table is included to show concept. While it accurately reflects actual results at the time of the snapshot, it should be recognized that grocery wholesale prices fluctuate.

Value creation methods discussed to this point are refinements of practices that have been used for some time by best practice operators in the supermarket industry. CCA is also implementing an advanced innovation developed by Teton Sands – the integration of inventory management and CRM. Figure D shows the concept. In medium sized operations the practices have proven to increase sales approximately 4% and net income approximately 5% without increasing inventory or pricing. The enabling software and practices are described in proprietary Teton Sands White Papers.

Category Analysis by Customer Profile																										
category sub. cat sku	customer profile A (diamond)								customer profile B (platinum)								total									
	\$	percent (%) of cat.			item count		percent (%) of prfl total			\$	percent (%) of cat.			item count		percent (%) of prfl total			\$	percent (%) of cat.			item count		percent (%) of prfl total	
baby food	4,724	42	0.9	0.39	3,913	43	2.6	0.70	3,149	28	1.67	0.26	2,366	26	3.82	0.58	11,249	100	0.94	9,100	100	2.2				
juices	288	2.56	0.05	0.02	271	2.98	0.18	0.07	187	1.67	0.90	0.02	173	1.91	0.28	0.05	720	6.4	0.06	713	7.84	0.18				
hnz apl, 6oz	16	0.15	0.00	0.00	14	0.16	0	0	8	0.08	0	0.00	7	0.08	0.02	0	41	3.7	0.00	39	4.29	0				
coffee	9,771	75.8	1.85	0.81	712	20	0.48	0.17	4,948	38	2.63	0.41	1,673	47	2.70	0.41	12,897	100	1.1	3,560	100	0.9				
tea	4,186	67	0.79	0.35	828	30	0.55	0.20	1,062	17	0.57	0.1	883	32	1.43	0.22	6,249	100	0.52	2,761	100	0.7				

Figure D

The Teton Sands Group is seasoned C-level managers with partner-level “big-six” experience. We bring ideas, perspective, and best practices from numerous industries to your business.

Our Sales Strategy Practice focuses on helping sellers thrive in a flatter world of hypercompetitive markets where: brand allegiance is virtually nonexistent; buyers are a click away from price and feature information; great products earn low margins; and, competition is global.

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