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# Retail Leader

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## >BACK TO THE FUTURE:

# Supervalu's Leon Bergmann,

Independent Business president

# Turning a PROFIT

HOW TO KEEP RISING COSTS FROM CLOBBERING YOUR **BOTTOM LINE**.

> By Ann Meyer

**As in any economy, your company's ability to pull a profit** in 2012 will depend on the value you present and how efficiently you deliver it.

Some companies might turn to lower-cost substitutes or try to stretch materials, while others will justify a higher price point by highlighting quality. But with the exception of Walmart, which has largely cornered the everyday-low-price position, those retailers with a singular focus on price are likely to suffer, experts say.

"As we claw our way out of this recession, we're going to see significant change at the macro level at retail," says Jeff Weidauer, vice president of marketing and strategy at Little Rock, Ark.-based Vestcom International Inc., a retail marketing firm serving 30,000 store locations throughout the United States. "If you're selling something at a loss or very nearly a loss, you're not going to make that up on volume."

Instead, retailers need to take a longer-term view of building loyalty through service and product differentiation, says Weidauer, who previously held management positions at Lucky Stores and Albertsons. "Price will always be a component, but it can't be the only trigger."

Whole Foods Market offers proof that quality and service can trump price to lure sales and profits. Thanks to strong sales to health-conscious baby boomers and others who are willing to pay a premium for organic and all-natural foods, the company reported net income of $342.6 million in fiscal 2011, ended Sept. 24, up from $245.8 million the prior year. Its total sales hit $10.1 billion in fiscal 2011, up 12 percent from the prior year, while same-store sales rose 8 percent. Most analysts are bullish about the company's prospects in the year ahead, though some say the stock has become too expensive. It was trading at about $68 in mid-December, representing a 35 percent year-to-date and a five-fold gain from three years ago, *The Wall Street Journal* reports. In addition, the company boosted its dividend 40 percent in November to 56 cents a share annually.

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**—JEFF WEIDAUER,** *Vestcom International Inc.*

Whole Foods' results also reflect its ability to integrate acquisitions well, and analysts expect merger and acquisition activity to accelerate. The announcement in December that 280-store chain Bi-Lo had agreed to acquire the larger Winn-Dixie Stores Inc. for about $560 million suggests financial strength can usurp size. Winn-Dixie, with 480 grocery stores and 46,000 employees, had filed for Chapter 11 bankruptcy protection in February 2005, after being whacked by Walmart's growing grocery presence. While the company emerged from bankruptcy in November 2006 after securing $725 million in new financing, it was back in the red in 2011, when it reported a net loss of $70 million for the fiscal year ended June 29. The deal with Bi-Lo, which creates a chain of 690 stores and 63,000 employees, will deliver $9.50 a share to stockholders, representing a 75 percent premium over the stock's listed price on Dec. 16.

Further consolidation is likely in the year ahead, as stronger players gobble up those battered by the downturn with hopes of buying growth and synergies. "Only the strongest manufacturers with the strongest brands are going to survive," predicts George Young, chief executive at Kalypso, a management consulting firm in Beachwood, Ohio. Some will morph into private label manufacturers, while others will merge or close.

For most companies, delivering higher profits to please shareholders could be a larger challenge, as any new savings are likely to be offset by elevated commodity and energy costs. Food prices are projected to rise 3 percent to 4 percent this year on top of a 4 percent to 5 percent increase in 2011, according to the U.S. Department of Agriculture's Consumer Price Index. Yet most shoppers' take-home pay isn't climbing as quickly, constraining their ability to spend more at the grocery store. They're splurging on occasional luxury items in the supermarket, but they're also clipping coupons, scanning circulars more closely, and signing up for daily deal sites that promise bargain prices.

## SHOPPING SMARTER

Likewise, both retailers and CPG manufacturers are becoming better shoppers as well. "You have to be able to either buy less expensively than your competition or operate less expensively than your competition," says Paul Martyn, vice president of supply strategies at BravoSolution in Chicago.

Still, larger companies have more leverage with suppliers than small ones do, notes Al Ferrara, partner and national director of the retail and consumer product practice at BDO USA. "It's very, very difficult for a small firm to get a competitive advantage."

For some companies, the only option might be passing along the price increases. But those manufacturers that can hold the line on prices are likely to fare better. Princeton, N.J.-based Snack Factory increased the bag size of its Pretzel Crisps crackers to 7.2 ounces from 6 ounces without raising the $2.99 suggested retail price. "We needed to show value to our consumers," says Perry Abbenante, vice president of marketing.

On the retail side, grocers can renegotiate their leases, trim administrative expenses and maximize discounts on purchases, Ferrara says. Increasingly, they're opening smaller stores. "They know how many sales they're getting out of each shelf. And they've come to the conclusion, 'We don't need 100,000 square feet,'" Ferrara says.

While grocers need to be careful about what they put on their shelves, they also should be looking for new products that fit consumers' growing desires for healthy foods, locally produced items and natural or environmentally friendly products. New growth must come from incremental sales at existing locations because "there [are] only so many new stores they can open up," says Steve Gold, managing director with Alvarez & Marsal, a global professional services firm in Chicago.

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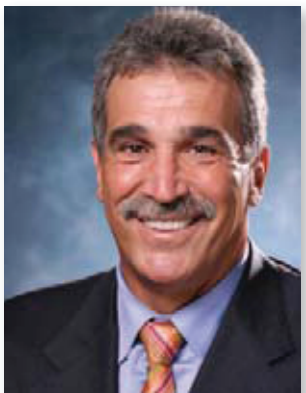
**—AL FERRARA,** *BDO USA*



**"You have to...either buy less expensively than your competition or operate less expensively than your competition."**

**—PAUL MARTYN,** *BravoSolution*

Yet generating more traffic or larger transaction sizes from the same customer base won't be easy unless a competitor is wiped out. "The ability for you to grow in a community once that store is a mature store is very, very difficult," Ferrara says.

## DOING MORE WITH LESS—AGAIN

With profits under pressure, few companies expect to ramp up their workforces with new hires this year. Two-thirds of the members of the Business Roundtable, a group of chief executive officers from large multinational companies, say they don't expect to hire in the first half of the year. "People currently working in the food industry are being asked to do more than they ever have been," Martyn says.

Still, exceptions will crop up in hot growth areas supporting retail expansion. In December, German discount grocer Aldi Inc. announced plans to open a regional headquarters, warehouse and 20 stores in Palm Beach County, Fla., adding more than 600 jobs to the local economy.

And one chain's store closings can be another's gain. Thanks partly to sales gains in locations where other chains had departed, Springfield, N.J.-based Village Super Market Inc. reported a 71 percent increase in net income to $6.7 million in the first fiscal quarter of 2012, ended Oct. 29, from the year-ago period.

## TRIMMING TRANSPORTATION COSTS

Besides soaring commodity costs, high fuel prices also are eating away at profits, spurring many retailers and manufacturers to work together to reduce unnecessary trips and idle time while waiting to unload goods at a distribution center.

New uses of technology are spurring efficiencies, such as dividing truck loads to allow several manufacturers to share a ride and re-evaluating local suppliers by factoring in reduced shipping costs. "We're seeing more sophistication around looking at the total supply chain costs," Martyn says.

By using material resource planning, manufacturers also can lock in better prices. "The more planning you can do with your suppliers, the more favorable they're going to be as it relates to cost," says Kevin Lehrer, managing partner of 5 Horizons Group, a supply chain consulting firm in St. Louis.

Reducing packaging is another way to cut shipping costs, while also appealing to consumers' growing desire to protect the environment. "If you have less packaging content, you can take costs out and you can promote that to the consumer. You're being responsible," Young says.

## WEEDING OUT LAGGARDS

Many manufacturers pare offerings that aren't pulling their weight. Determining which products should stay and which should go requires analyzing hard data and serving customers on the local level. Kroger has been a leader in this regard, developing and manufacturing its own private label products to best meet consumers' needs, Weidauer says.

Often, by devoting more space to premium store brands that differentiate them from competitors, retailers can achieve higher margins. Safeway CEO Steve Burd attributed the giant's fiscal third-quarter profit partly to higher private label sales, including its new Open Nature brand of products that are free of artificial colors, flavors and preservatives.

"I think that it's a good assumption the economy is not going to get materially better and then you've got to play in that environment and utilize the things that you have uniquely developed to win with," Burd told investors and the Associated Press in October. The company's net income rose to $130.2 million for the quarter ended Sept. 30, from $122.8 million in the year-ago period, on a 7 percent revenue gain to $10.06 billion. Excluding fuel, same-store sales rose about 1.5 percent.

"Premium private label is not an oxymoron," Weidauer says, pointing out that Kroger and Target also have found success by developing private label products unique to the market.

While Walmart and Target are duking it out on price, that leaves room for other retailers to concentrate on serving a niche, Weidauer adds. "Everyone wants a good price. But a good price and the lowest price [are] two different things," he says. **RL**

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*Freelance journalist Ann Meyer is editor of SmallBizChicago.com and chief executive of L3C Chicago, L3C. Meyer formerly was a freelance small business columnist for the* Chicago Tribune *and has written for a variety of business publications, including* BusinessWeekSmallBiz, Crain's Chicago Business, Specialty Coffee Retailer, Multichannel Merchant *and* Prepared Foods.