Breakthrough Insights

MVI
Retail Insight

A Look At The New Retail Landscape

Science

Shopability

Simplicity

Shareholder Returns

Structure

First Half 2009

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In This Issue

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Foreword

With the economic situation as the backdrop, changes in the retail landscape have taken place from top to bottom: from the macro, market, and continental levels down to specific initiatives of retailers and thus suppliers. Here, MVI focuses on core themes—driven by broader, more permanent, dynamics—that underpin these changes.

Science

In everything from pricing to assortment to format design, global retailers are applying more systematic discipline and rigor to understand their shoppers. To participate in strategic conversations, suppliers must continue to bring more specific and comprehensive fact-based insights to their retail partners. Pricing is becoming a much more significant issue, as retailers work to achieve price competitiveness or price leadership. Pricing strategy is particularly critical for suppliers. Without science to get to a stronger economic assortment, retailers will put intense pressure on suppliers for funding to support a more aggressive pricing strategy.

Shopability

At the store and on the shelf, retailers continue to focus on enhancing shopper choice. This enhancement can come from not only format prototypes but also experimentation within a retailer's existing box. MVI profiles Wal-Mart's Project Impact, illustrating a key retailer trend that is enhancing choice by reducing SKUs. Retailers (and suppliers) are increasingly finding that shoppers often react to SKU reductions with the feeling that the selection has in fact been enhanced. As this continues to gain steam, the challenge for suppliers in keeping SKUs in distribution will become more intense, as retailers both add their own private label items and seek to reduce the total number of items available.

Simplicity

The economic flip-side of enhanced shopability is simplicity, along with the operational efficiencies and cost savings associated with this efficiency. Retailers are continuing to find ways to drive complexity out of their operations. This means either they run a more simple business, putting pressure on suppliers to meet the need for fewer bigger opportunities, or they outsource complexity back to the suppliers.

Shareholder Returns

Retailers are getting more pressure from their shareholders to generate stronger operating cash flow. This may come from shareholders in general or, as in Carrefour's case, a specific shareholder group concerned about maximizing asset utilization. Retailers pushing to optimize returns in a challenging economy are engaged in two primary behavior types:

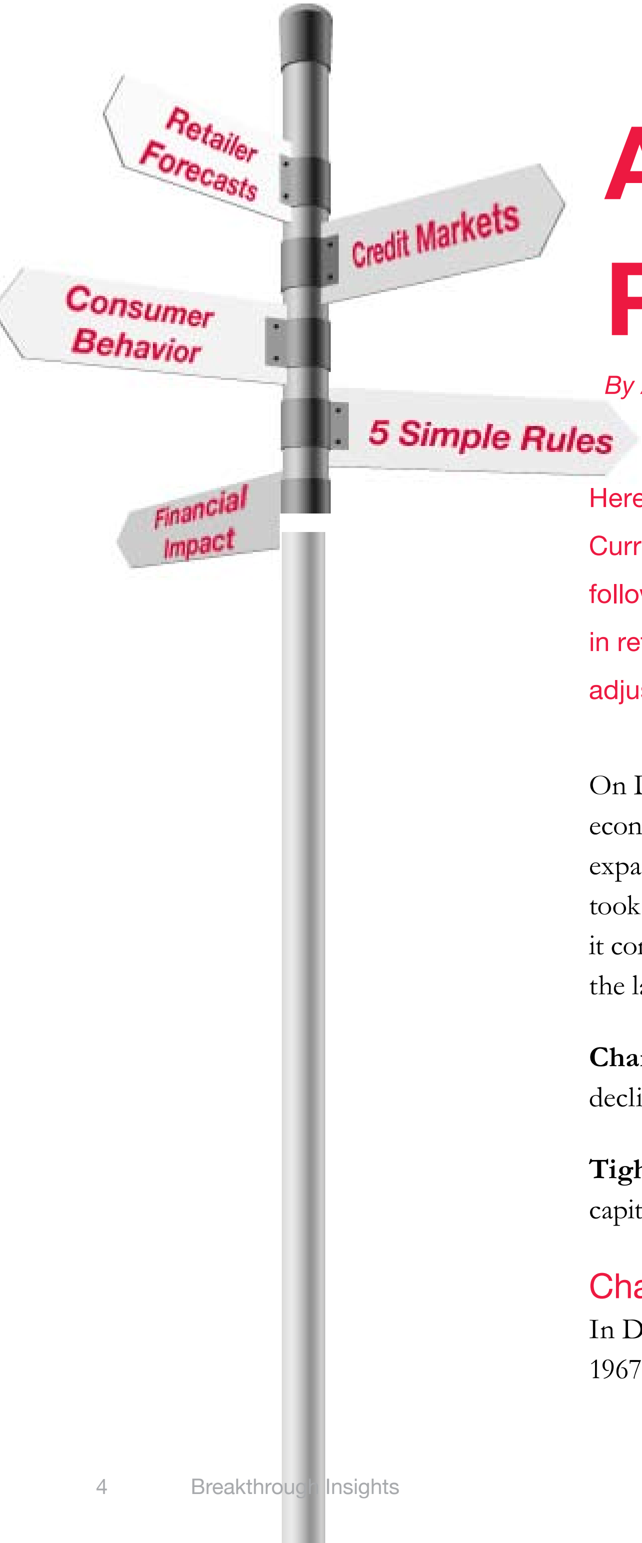
1. Profit certainty and an increased focus on margin rate to lock in profit targets
2. Asset avoidance and an intense focus on managing inventory levels down

Structural Change

The US drugstore industry, for example, is going through a significant structural shift, as it becomes a more integral part of the US health care industry. Suppliers must understand how this transition is driving the strategy and viability of the key players in the US market.

In challenging times, insights become more critical to suppliers looking to maintain and grow their partnerships with retailers. Among the content featured in this publication is a selection of analyses that our clients have been able to access and use to their advantage. MVI is always prepared to bring suppliers the vital insight, fact, or idea they need to help expand and grow their relationship with key retailers around the world.

Bryan Gildenberg
Chief Knowledge Officer



A Roadmap to Retailer Performance in 2009

By Anne Zybowski | Originally published on January 23, 2009

Here at MVI, we continue to track ongoing changes across the retail landscape. Current sales and capital investment are key inputs to our retailer forecasts. The following article provides a roadmap to understanding the factors driving changes in retailer growth prospects, and the foundation for how we will continue to make adjustments to our five-year retailer forecasts over the coming months.

On December 1, 2008, the National Bureau of Economic Research announced that the US economy had been in a recession since December of 2007 – when 73 months of economic expansion came to an end. For most businesses and consumers, the only surprise was that it took a full year for the recession to become official. As this recession prolongs and deepens, it continues to impact businesses across the board – and retail is no exception. Throughout the last quarter of 2008, retailers were continually affected in two primary ways:

Changing consumer behavior – causing a sharp contraction in consumer spending and decline in retailers' sales performance

Tighter financial and credit markets – driving ongoing changes in short- and long-term capital investment plans (e.g., new stores, remodels, etc.)

Changing Consumer Behavior

In December 2008 the Consumer Confidence Index fell to 38.0, the lowest level since 1967 when index tracking was initiated. As consumer confidence continues to hit new

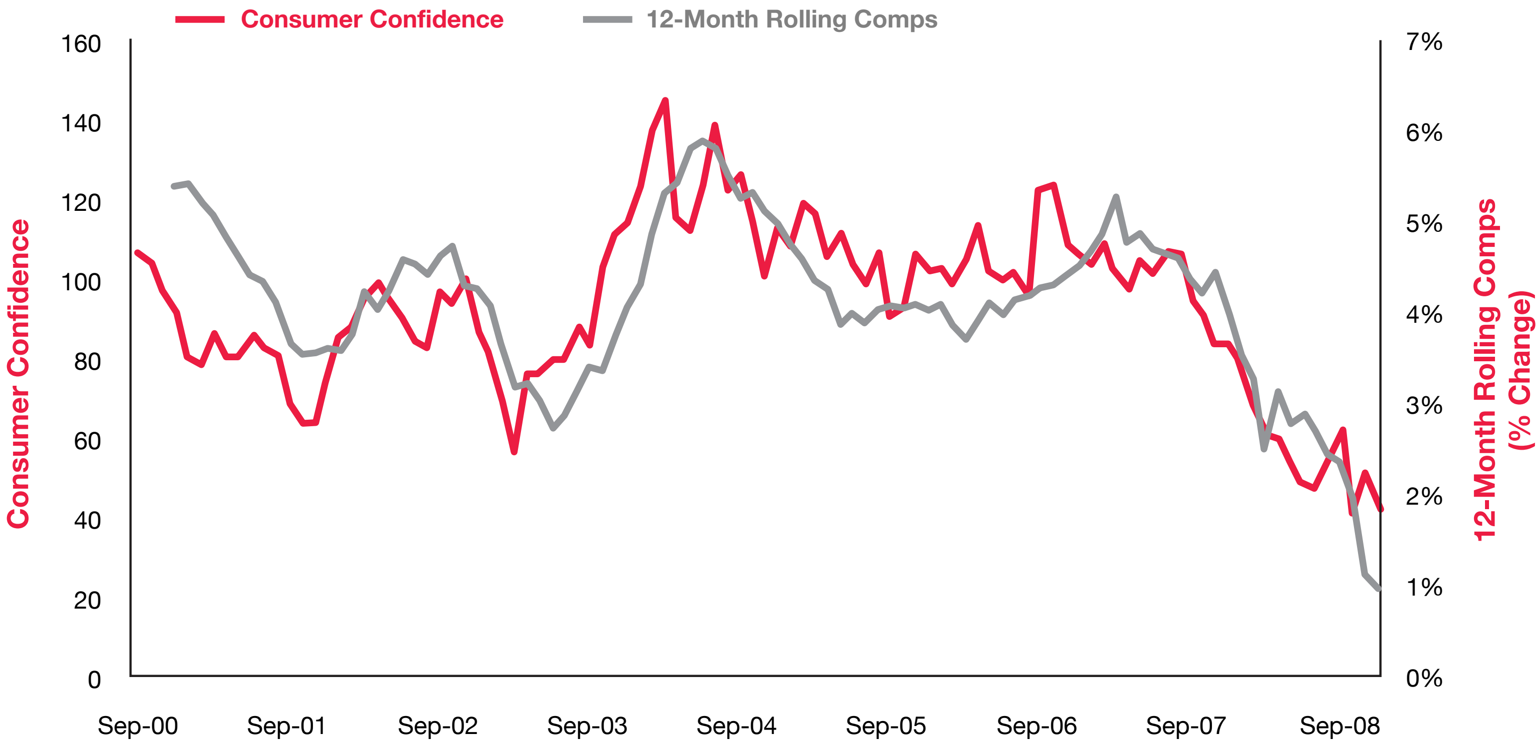


Figure 1: Consumer Confidence Drives Purchasing Behavior – Strong Correlation
Source: The Conference Board, MVI analysis

lows, consumer purchasing behavior continues to contract. In fact there is roughly a 60- to 120-day lag time between changes in consumer confidence and retailer comparable store sales performance; i.e., a lag between when consumer confidence changes and when we are able to observe changes in purchasing behavior as measured by comparable store sales performance (Figure 1).

Key takeaway: Until we see a sustained change in consumer sentiment, we will not see a big turnaround in comps performance. Watch for an inflection point in monthly consumer confidence reports – with a 60- to 120-day average lag time. This gives you a window to start planning against a pick-up in comps performance.

The Impact on MVI's Retailer Forecasts

We will be watching consumer confidence and retailer announcements for indications of a turnaround (or a prolonged slowdown, as the case may be). As retailers continue to release new sales and financial information in 2009, we will evaluate their most recent performance versus our expectations. If retailer sales and comps performance begins to deviate significantly from the past few months' performance and our expectations, we will adjust our forecasts accordingly. Keep in mind that while there may be some volatility in our 2009 (and potentially 2010) forecasts during the year, our expectations for the longer term and five-year forecasts should remain relatively consistent (unless there is a major change in retailer strategy or an acquisition/divestiture).

How is this changing consumer confidence impacting sales performance across the retailer landscape? Clearly, not all retailers are impacted equally.

MVI's Five Simple Retail Rules

MVI presents its "Five Simple Retail Rules" for predicting which retailers are best-positioned to capitalize on today's uncertain economic environment. These five rules apply to retailers across the board, but Wal-Mart versus Target serves as a great example:

Needs / Wants	In Target's "Expect More, Pay Less" strategy, the retailer is better known amongst their consumers for the want or "Expect More" part of the equation. However, as consumers cut back on and defer discretionary purchases, need-based purchases win. With over 54% of sales from grocery, Wal-Mart is well positioned to capitalize.
Value / Difference	While Wal-Mart has struggled over the past few years to move its brand positioning from one of price to one that is more inclusive of value, today's economy and the new "Save Money, Live Better" tagline have firmly positioned it as a value retailer in the minds of all consumers – even amongst those who wouldn't have shopped Wal-Mart a year ago. Meanwhile, Target's reputation for differentiation and innovation are weighing heavily on its ability to communicate the "Pay Less" and value messaging to shoppers.
Trip Drivers / Basket Adders	In an environment where shoppers' purchasing behavior is increasingly event-driven, Target's Chairman and CEO Gregg Steinhafel said it best: "Our shoppers don't want to be tempted."
Trip Consolidators / Extra Trip	Wal-Mart is the ultimate "one-stop shopping" destination. While Target has increasingly tried to position itself as more of a one-stop shop, it still struggles to drive conversion to many need-based, replenishment categories (primarily due to out-of-stocks).
Financial Conservatism / Financial Adventure	Mention the words "credit card" and "retailer" in the same sentence and Wall Street gets very nervous. Though Target's credit portfolio is doing better than many credit companies from a delinquency and portfolio strength perspective, investors of today wish they had zero exposure to credit risk.

Wal-Mart beats Target in each one of these rules, which helps explain the financial results for 2008 that each is reporting right now. Wal-Mart has averaged comps of 2.7%, while Target has struggled with an average comps decline of -1.8%. Again, these five rules apply to ALL retailers.

Financial Impact: Short Term vs. Long Term

Financial conservatism is critical, as tighter financial and credit markets continue to drive ongoing changes in investment behavior for businesses across the board. For retailers, concerns about access to debt are paramount and have caused a number of them to significantly cut back on their planned store investment and remodeling plans.

Retailers that have just gone through a period of rapid store expansion will be particularly hit hard. Because it takes several years for a new store to break even, the combination of rapid expansion and weaker sales trends will weigh heavily on their profitability and financial health/flexibility. Walgreens, for example, reduced planned store expansion by USD 500 million in July (from 8% to 5% growth) and again in December by another USD 500 million (slowing to less than 3% growth through 2011).

Not surprisingly, it's not just the retailers in financial distress that are cutting back. In today's delicate balancing act between short-term tactics and long-term strategy, many financially sound retailers are cutting back on planned capital expenditure (capex) so that they can invest in flexibility. They want to ensure they have the flexibility to re-allocate capex from new stores to remodels, capitalize on potential opportunities to enter new markets (or fill-in), or acquire a chain in financial distress (or at least some of its real estate). In today's uncertain market, having excess cash on hand is particularly valuable when access to credit (when available) is increasingly expensive.

Following are a few examples of retailers scaling back to ensure future flexibility:

- Best Buy has recently announced that it will cut its planned capex and store expansion in the US, Canada, and China by half (and reduce headquarter staff by 12.5%).
- Even as Target has cut back its store openings from approximately 90 to 100 stores per year over the past few years to roughly 60 stores this year (and potentially to as few as 35 in 2010), it has committed to preserving cash for flexibility to take advantage of opportunistic deals in key markets. Remember: it was the opportunistic purchase of Kmart's real estate in the early 2000s that allowed Target to gain access to the Northeast.
- Wal-Mart, who has been scaling back its US growth under its capital efficiency model launched in 2005, will actually increase capex in its US division from an estimated USD 5.8 million-USD 6.4 million in 2008 to approximately USD 6.3 million-USD 6.8 million in 2009. However, its 2009 square footage increase of 14 million will be half of what it was in 2008 (23 million), as it devotes more capital to remodels.

Why is that? The inverted yield curve provides some answers (Figure 2).

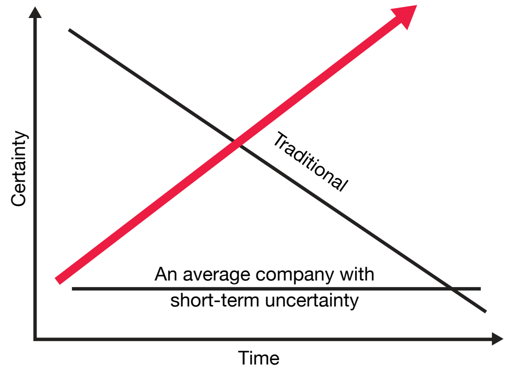


Figure 2: The Inverted Yield Curve – A Crisis Is a Terrible Thing to Waste
Source: MVI analysis

Most companies are very short-term focused because they are comfortable with more certainty. Traditionally, as you go further out in time, things become increasingly uncertain (explaining why yields on long-term investments are typically higher: to make up for increased risk). With an inverted yield curve, there is much more uncertainty about the short term.

What does this mean about investments today? To retain the option to act quickly and take advantage of unique

Many of the good retailers that weather this storm will emerge much stronger than when they went in. After all, **nothing focuses the mind like a crisis.**

opportunities, companies must move beyond the short-term focus on the unknown to be able to invest for the long term today.

Key takeaway: "A Crisis Is a Terrible Thing to Waste!" This was a significant theme of MVI's recent Year-End Forum event. Today's short-term uncertainty creates a unique window of opportunity for companies. While you may be highly uncertain about your 2009 forecasts, probably somewhere close to 70% of what you thought was going to happen in 2012 is still true; this gives our companies permission to invest in new things that will pay out in a couple of years. If we let this window of opportunity pass, it will be that much more difficult for us to capitalize when things do turn around.

Many CPG companies are great examples: Disney and HP were companies founded during the Great Depression. Many already existing CPG companies, such as Kellogg and P&G, invested in advertising and deals during the Great Depression and came out stronger. Similarly, many of the good retailers that weather this storm will emerge much stronger than when they went in. After all, nothing focuses the mind like a crisis.

That said, with many minds focused on the short term, you may see some seemingly strange behaviors from your retail customers. As cash is king in this uncertain environment, you may see your retailers trading future profits for cash today. Specifically, expect retailers to focus on:

- **Profit Certainty vs. Profit Maximization:** Retailers may be willing to trade opportunity for profit certainty.
- **Asset Avoidance vs. Asset Productivity:** Retailers may stop shipments across the board to minimize inventory investment, even if it comes at the expense of potential sales and asset productivity.

Following MVI's Roadmap into 2009

As we continue into 2009, we hope that this roadmap helps you to navigate the uncertainty of the marketplace and understand its impact on retailers' growth prospects.

MVI will continue to closely follow ongoing developments. As new information becomes available, particularly about changes in sales and capex plans by key retailers, we will adjust our forecasts accordingly. For some retailers that are particularly dependent on holiday sales, how these retailers finished the 2008 holiday shopping season will have a big impact on how we view the year-end balance sheets heading into 2009 and their ability to invest for future growth. Expect more detailed information on the key assumptions and changes to our five-year forecasts by channel in upcoming articles.

Upcoming MVI Events - Americas

MVI Retail Insight

Canadian Retailing Forum — Toronto, Canada

Jul 7 General Session
Jul 8 Costco Canada Workshop (AM)
Sobey's Workshop (AM)
Wal-Mart Canada Workshop (AM)
Shoppers Drug Mart Workshop (PM)
Loblaw Workshop (PM)
Jul 9 Strategic Retail Management in a Recession

NEW Retail Success In A Recession — Jersey City, NJ

Jul 14 The New Shopper, Retailer, and Supplier Reality: How to Respond
Jul 15 Retailer Economics: The Art of Shelf Defense (AM)

NEW Retail Success In A Recession — St. Louis, MO

Jul 16 The New Shopper, Retailer, and Supplier Reality: How to Respond
Jul 17 Retailer Economics: The Art of Shelf Defense (AM)

Walgreens Workshop Series — Chicago, IL

Aug 4 Walgreens Workshop
Aug 5 Strategic Retailer Management in a Recession

NEW Future of Food Retailing Forum — Princeton, NJ

Aug 18 General Session
Aug 19 Grocery Store Trends (AM)
Best Practice in Grocery Retailing (PM)
Aug 20 Strategic Retailer Management in a Recession

Target Workshop Series — Minneapolis, MN

Sep 1 Target Workshop
Sep 2 MVI Keys to Vendor Success: What You Need To Know About Project Impact (AM)
Retailer Economics: The Art of Shelf Defense (PM)
Sep 3 Strategic Retailer Management in a Recession

Supervalu Workshop Series — Minneapolis, MN

Sep 1 Supervalu Workshop
Sep 2 MVI Keys to Vendor Success: What Supervalu Will Learn From Wal-Mart (AM)
Retailer Economics: The Art of Shelf Defense (PM)
Sep 3 Strategic Retailer Management in a Recession

NEW Future of Food Retailing Forum — Oakland, CA

Sep 22 General Session
Sep 23 West Coast Offense (AM)
Best Practice in Grocery Retailing (PM)
Sep 24 Strategic Retailer Management in a Recession

Kroger Workshop Series — Cincinnati, OH

Oct 13 Kroger Competitive Landscape (AM)
Seeing Around the Corner: Kroger 2014 (PM)
Oct 14 Strategic Retailer Management in a Recession

Wal-Mart SuperSession — Rogers, AR

Oct 20 Sessions TBD
Oct 21 Sessions TBD
Oct 22 Sessions TBD

Mexican Retailing Forum — Mexico City

Oct 27 Clubs Overview (AM)
Soriana Workshop (AM)
Retailer Economics: The Art of Shelf Defense (PM)
Oct 28 Wal-Mart Mexico Workshop (AM)
Advanced Thinking in Category Management (PM)
Oct 29 Strategic Retailer Management in a Recession

Future of Category Management Forum — Chicago, IL

Nov 4 General Session

Costco Workshop Series — Seattle/Bellevue, WA

Nov 10 Costco: A Foundation
Nov 11 Costco Advanced Workshop

Consumer Electronics Workshop Series — CA

Nov 12 Consumer Electronics Workshop

Year-End Forum — Atlanta, GA

Dec 8 Breakout Sessions (TBD)
Dec 9 General Session
Dec 10 Breakout Sessions (TBD)

For More Information, please contact...

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Wal-Mart's **Project Impact**

PART I: AN OVERVIEW OF ITS SCALE

By Robin Sherk | Originally published on January 16, 2009

This article is the first of a four-part series that will outline the elements of Project Impact and offer insight into the implications that this substantial initiative will have across the industry.

Wal-Mart has begun to roll out a three-year go-to-market strategy in the United States. This plan, called Project Impact, aims to increase Supercenters' sales by improving the stores' shopping experience and use of space as well as its marketing approach. Implementation of this comprehensive strategy reaches across Wal-Mart's functions, impacting merchandising, operations, and marketing. It will significantly transform supplier relations with Wal-Mart, so understanding the retailer's strategy will be essential within manufacturer organizations. The scope of changes will impact a number of functions for suppliers, as we will see in subsequent parts of this series. Three key phrases have come to define Project Impact. The remaining articles in this series will further discuss each of these components, but a brief summary follows.

Project Impact in Brief

Components of Project Impact

Finance

Win, Play, Show A more strategic merchandising approach, called "Win, Play, Show," is being implemented. Not all categories will be treated equally, as Wal-Mart aims to increase its product selection relevancy. The retailer is concentrating on areas that show growth potential, scale advantages, and alignment with Wal-Mart's image. Pricing, assortment, and promotional consideration are all impacted. Part 2 of this series will provide an in-depth discussion on the "Win, Play, Show" component.

Operations

Fast, Clean, Friendly The focus on the in-store experience is designed to encourage loyalty and basket size among shoppers. In-store signage, themes, displays, and layouts will change. Importantly, in-aisle pallets will be eliminated. A sound in-store setting can, as Eduardo Castro-Wright explained in October 2008, enhance Wal-Mart's "credibility" to sell outside its core shopper base, an issue of critical importance to Wal-Mart's long-term growth prospects. Wal-Mart is shifting capital expenditures to remodeling Supercenters. Moreover, newly constructed Supercenters are set to be about 10%-25% smaller than today's typical Supercenter (140,000-170,000 sq. ft. compared to the 185,000 sq. ft. average). Part 3 of this series will provide an in-depth discussion on the "Fast, Clean, Friendly" component.

Brand

Save Money. Live Better Wal-Mart's messaging has shifted to emphasize the value and quality of life that its lower costs provide. Better living is multifaceted: It includes environmental and health & wellness issues in addition to family and community support. This positioning is to enhance resonance and engagement with key consumers, including moms, boomers, and aspirational shoppers. Alignment with both the "Save Money" and "Live Better" components is vital, as Wal-Mart pushes for a clear, consistent message across media. Part 4 of this series will provide an in-depth discussion on the "Save Money. Live Better" component.

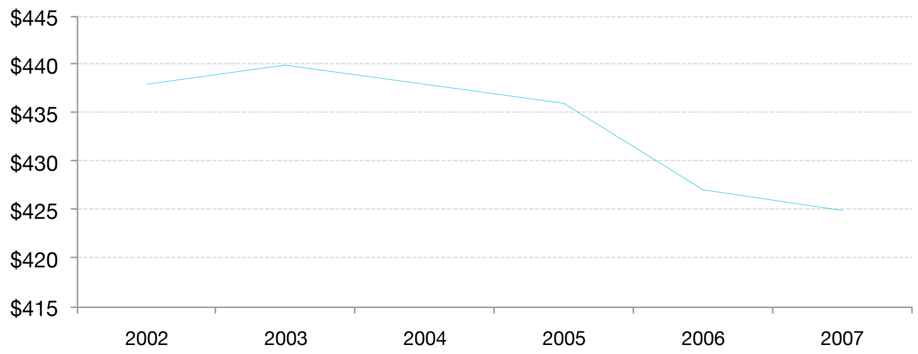


Figure 2: Wal-Mart Supercenter Sales per Square Foot
Source: MVI analysis, company reports

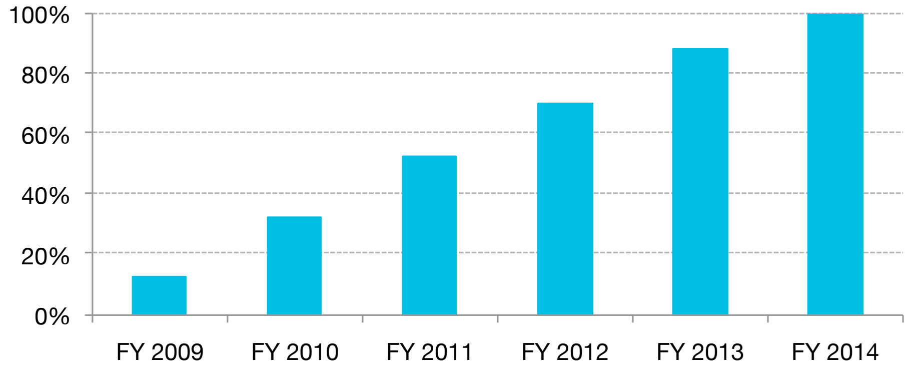


Figure 3: Projected Rollout of Wal-Mart Supercenter Remodels
Source: Company presentations

Project Impact's Underpinnings

Wal-Mart has embarked on this new initiative for three primary reasons:

Declines in Store Productivity – Since 2004, Supercenters' sales per square footage has declined, hampering productivity and return (Figure 2). The assortment has frequently been duplicative and lacked compelling focus across or within categories. The pricing message has seemed insufficient in this merchandising environment, as other retailers have adopted more scientific pricing methods or generated greater excitement via their product offerings.

Poor Shopping Experience – Wal-Mart understands that a more convenient and pleasant shopping environment will help to drive sales performance. Stores have lacked appeal beyond the Price Value shopper in the past, as in-store conditions and the checkout experience have been lacking. These conditions have limited the chain's ability to grow and certainly hampered its efforts to reach out to aspirational shoppers or shoppers across an array of demographic targets.

Need for Marketing Outreach Efforts – Wal-Mart has traditionally lacked a marketing strategy that extended beyond promoting low prices. As the largest retailer in the world, Wal-Mart has often borne the brunt of anti-corporate efforts that have limited its ability to operate as freely as it might like. Wal-Mart's previous marketing endeavors have not been successful, as the retailer has lacked credibility (e.g., advertising in *Vogue*) or has been limited by a missing "emotional" connection to the shopper. Mothers with young children, a critical demographic group, have frequently opted for other retailers (especially Target) with an image that is more resonant with their lifestyles.

Strategy execution is already underway, with Wal-Mart planning to finish remodeling the existing US Supercenter base by the end of January 2014 (Figure 3). As President and CEO Lee Scott recently declared at a recent analyst meeting, "There is no doubt that this is Wal-Mart time."

MVI Interpretation

Project Impact has begun in earnest, and the implications are beginning to be felt across the industry. Wal-Mart is, in effect, placing bets on certain categories, consumers, and vendors. This will surely change the supplier landscape in the years to come. The rollout is occurring at the same time as the economic turmoil, so initial success has to be measured against the impact of the poor economy. Nonetheless, it seems certain that Wal-Mart is committed to an aggressive assertion of its new go-to-market approach.

For suppliers, Project Impact will increase the complexity of selling to Wal-Mart. For example, selling through Wal-Mart was relatively simple in the days when there was a single, national EDLP price. Now, pricing will vary increasingly by zone, proximity to Target, and whether the product is in a "win, play, or show" category. In-store display opportunities will, in many cases, be significantly diminished, as pallets in the racetrack are removed—leaving suppliers to find other ways to meet sales targets. In addition, the increasing importance of the marketing department at Wal-Mart will mean another set of touch-points and contacts for suppliers, complicating the relationship and potentially the cost-to-serve Wal-Mart. This complexity also represents a challenge to Wal-Mart itself, as a retailer of its size requires simplicity to achieve efficiencies of scale. Tensions among buyers, marketing associates, and store operations are also likely to increase, as power is redistributed.

It will be critical for suppliers to recognize the role of their products and categories within Wal-Mart's new agenda. Possible inventory, SKU, and promotion reduction need to be planned against, as category designation does not appear to be negotiable. The internal sell can be the most difficult in this environment, as Wal-Mart will increasingly require adherence to its marketing standards and media. Supplier marketing departments, in particular, are likely to feel as if their roles are diminished, as Wal-Mart demands increased funding for its programs on its terms. Bigger promotions across media vehicles will force suppliers to adjust planning calendars to align with Wal-Mart's calendar. Particularly for manufacturers with iconic brands and their own marketing strategy, the potential for conflict with Wal-Mart's brand is significant. A flexible approach—requiring a single, coordinated approach from each supplier—will be crucial.

Another area for suppliers to consider will be the staffing of their Wal-Mart team. Adaptability and resourcefulness will be crucial traits going forward, as requests from Wal-Mart may vary by department and therefore require creative responses from suppliers. As Wal-Mart enhances its own abilities to generate shopper insights, suppliers will be challenged to provide unique, dynamic insights that Wal-Mart will not already have access to via its own data and systems.

The next three parts of this series, one for each component described here, explores these and other implications of Project Impact—an endeavor whose impact is only beginning to be felt.

View Parts 2, 3, and 4 of MVI's four-part series on Wal-Mart's Project Impact on MVI-Insights. For more information on obtaining a web license to MVI-Insights, contact Global Sales & Services at (617) 588-4100 or by e-mail at CustomerService@mventures.com.

MASS MERCHANDISE

Target's Weekly Circular Redesign: Did the Retailer Execute Its Plan?

By Caroline Doyle | Originally published on May 1, 2009

During its Q4 2008 conference call, Target announced changes to its weekly circular. These adjustments aim to clearly convey the retailer's value proposition and to ultimately increase in-store traffic. Following the announcement, MVI reviews the circular and evaluates whether Target executed this plan.

Conventional shopper wisdom contends that Target is more expensively priced than Walmart. Target's trendy, chic, and fashionable merchandising fuels this image. During its Q4 and fiscal 2008 conference call, Target related that it is well aware of this perception. To combat the notion, Target announced that it would proactively convey that it sells what guests "need" through quality items at competitive prices. The retailer was to complement this message by "surprising" guests with these competitive prices, given that guests seemed unaware of Target's price position.

To effectively communicate this value proposition, Target announced several key initiatives, one of which affected its weekly circular. Effective immediately, Target would redesign its circular with the following adjustments:

- A reduction in the number of subfeatured items, allowing for enlarged photos of featured items
- Increased amount of frequency-driving items
- Bold headlines and savvy value messaging

These changes would allow Target to make a stronger impact with "key items" and prices. Following this announcement, MVI evaluated the subsequent circulars (for the eight weeks ended April 19, 2009) to determine whether Target followed through with its proposed changes.

Ad Blocks and Subfeatured Items

Versus the year-ago period, Target reduced the overall number of promoted items by 3.4% over the course of eight weeks (Figure 1). Most of the reduction took place in the latter weeks, not surprising since it usually takes multiple weeks to plan the circular's layout and content.

As for a reduction in subfeatured items, it appears that Target did in fact rationalize this area (Figures 2 and 3). For pages of March 2008 and April 2009 circulars that feature similar items (dry grocery and other consumables), the March 2008 page promotes seven subfeatured items (out of 14 ad cuts), while the April 2009 page only features four (out of 13 ad cuts). The outcome, of course, varies from page to page, but the overall result is that of fewer subfeatured items. At the same time, this reduction in subfeatured items has not been accompanied by enlarged photos of featured items. Each page has five larger-sized images, balanced with a comparable number of ad blocks. The one difference is that Target seems less likely now to include a second image at the same price point. Excluding the larger-sized images, there are 10 remaining single ad blocks in each year's circular. On the March 2008 page, seven of these blocks have dual items; on the April 2009 page, only three do.

Category Name	# of Ad Blocks - '09 (Mar - Apr)	# of Ad Blocks - '08 (Mar - Apr)	Index
Miscellaneous	1	-	-
Fresh	2	1	200
Toys	159	103	154
Grocery Perishable	32	22	145
Automotive	9	7	129
School & Office Supplies	45	36	125
Personal Care	111	94	118
Cosmetics, Fragrance & Bath	14	12	117
Pet Supplies	28	24	117
Household Products	104	98	106
Apparel	247	256	96
Electronics	246	258	95
Housewares	230	247	93
Dry Grocery	158	177	89
Hardware	57	80	71
Infant Accessories	12	17	71
Sports Equipment	30	46	65
Holidays	8	13	62
Outdoor	44	77	57
Health Care	26	46	57
Home Recreation & Fitness	5	9	56
Total	**1,568**	**1,623**	**97**

Figure 1. Total Ads in Circular – Eight Weeks Ended April 19, 2009
Source: ECRM data, MVI analysis

March 2008

April 2009

Figures 2 and 3: March 2008 and April 2009 Pages
Source: Target circular

April 2008

April 2009

Figures 5 and 6: Bold Messaging Comparison
Source: Target circular

Also worth noting is the surfacing of bolder price points, as seen on the April 2009 page. There are three red circles framing and emphasizing different price points.

Increased Amount of Frequency-Driving Items

MVI classifies "frequency-driving" items using the following category groupings: fresh, grocery perishable, personal care, household products, dry grocery, and health care (Figure 4). While there is variation within each individual category, the sum of the items that fall within these categories comprise 28% of the circulars surveyed during the eight-week period in 2009 – and 27% for the comparable period in 2008. On an item basis, frequency-driving items were actually more prevalent last year (438) versus this year (433). Clearly, the emphasis on consumables has not manifested itself.

Bold Headlines and Savvy Value Messaging

A comparison of the April 2008 and April 2009 circular covers is telling (Figures 5 and 6). The 2009 "red hot savings" message jumps off the page, whereas the 2008 "outdoor fun" header blends in with the rest of the imagery. The new print is larger and bolder, creating a much more punctuated statement.

As for messaging, Target has traditionally accented its circular pages with clever taglines but has recently stepped up the intensity to include more savvy and trendy messaging, in many cases "surprising" the guests with Target's low prices and great value. A typical phrase in 2008 would be something to the tune of:

- "Popular styles at great prices"
- "Spend less to create a cool kids room"
- "Save on beauty & wellness"
- "Grocery store savings and so much more"
- "Merona style for work and weekends"

In March 2009, the messaging intensified to:

- "Remarkable values for surprisingly low prices"
- "Smart solutions, sharp prices"
- "Aren't you smart. You just saved!"
- "Head-turning low prices"
- "Savvy shoppers save at Target"
- "Merona style at unbeatable prices"

Keep in mind that Target started to shift the "Expect More, Pay Less" balance toward the "Pay Less" side beginning in spring 2008. The 2008 listed messages reflect this shift. However, Target took this low-price/value-oriented messaging one step further by enhancing it with catchier phrases and adding an element of surprise, particularly regarding consumable items.

Category Name	# of Ad Blocks - '09 (Mar - Apr)	% of Total	# of Ad Blocks - '08 (Mar - Apr)	% of Total	Index
FRESH	2	0%	1	0%	200
GROCERY PERISHABLE	32	2%	22	1%	145
PERSONAL CARE	111	7%	94	6%	118
HOUSEHOLD PRODUCTS	104	7%	98	6%	106
DRY GROCERY	158	10%	177	11%	89
HEALTH CARE	26	2%	46	3%	57
Miscellaneous	1	0%	-	-	-
Toys	159	10%	103	6%	154
Automotive	9	1%	7	0%	129
School & Office Supplies	45	3%	36	2%	125
Cosmetics, Fragrance & Bath	14	1%	12	1%	117
Pet Supplies	28	2%	24	1%	117
Apparel	247	16%	256	16%	96
Electronics	246	16%	258	16%	95
Housewares	230	15%	247	15%	93
Hardware	57	4%	80	5%	71
Infant Accessories	12	1%	17	1%	71
Sports Equipment	30	2%	46	3%	65
Holidays	8	1%	13	1%	62
Outdoor	44	3%	77	5%	57
Home Recreation & Fitness	5	0%	9	1%	56
Frequency-Driving Categories Total	**433**	**28%**	**438**	**27%**	**99**

Figure 4. Frequency-Driving Categories   Source: ECRM data, MVI analysis

MVI Interpretation

MVI's scrutiny of Target's circular for the last eight weeks reveals that Target has indeed begun to implement the redesign plan that it put forth in February 2009. The retailer has started to promote fewer items overall and fewer subfeatured items, though progress still remains in featuring larger photos. Similarly, the number and share of frequency-driving products still remains comparable versus last year. At the same time, in terms of circular stylistics, MVI has noted a substantial increase in the amount of bolder headlines and savvy value messaging. This is a clear indication that Target has begun to reorganize its circular. It is looking to leverage the circular to make a stronger impact with key items and prices to ultimately drive in-store traffic and improve comp-store sales, especially in comparison to Walmart. It is unclear whether these adjustments will bear fruit in the near-to-long term, but Target appears confident in its plan. The in-store execution of more impactful pricing and messaging around consumables will be the key determinant of its success.

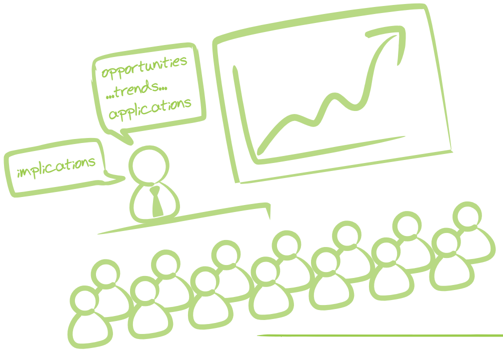
Supplier Implications

Following are key points for suppliers looking to showcase their items in the weekly circular:

- Target has started to rationalize SKUs and is reserving space for key items that drive traffic in store. Suppliers should be prepared to point out the reasons why their item will increase frequency because competition for available space is and will become increasingly fierce.
- By decreasing subpromoted items, Target claims to allow for enlarged photos of featured items. At the same time, in many cases Target appears to be eliminating dual images below one category umbrella in favor of a single image. To optimize their promotion, suppliers must convince Target that their item should be the standalone feature by explaining why it's a "need" item, pointing out its unique attributes, and leveraging price elasticity studies to recommend an optimal price point.
- Target's circular messaging is getting increasingly bold and more cutting edge. Suppliers should try to align their item with this messaging, explaining why their item is a "smart solution at a sharp price" or is perfect for Target's "savvy shoppers." They can even bring half-developed ideas to Target, which will spark a collaborative discussion and allow Target to ultimately take credit for the full expression of the idea. This will not only demonstrate a willingness to comply with Target's strategy but also provide suppliers with an auspicious opportunity to sell in their item.

At a time when Target is starting to become more collaborative, suppliers should capitalize on the opportunity to show Target how their item is a great match for the weekly circular. Target is more willing to listen to their ideas, especially when these ideas align with the direction in which the retailer wants to take its circular. Offering Target items that will increase trips, promote value, and surprise guests are a sure win.

Upcoming MVI Events - EMEA



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Geographic Coverage: Central & Eastern Europe

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Sep 24 Business Planning for Tesco

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Dia% Workshop — Madrid, Spain

Oct 22 Business Planning for Dia%
Geographic Coverage: France, Spain, Portugal

Middle East Retail Forum — Dubai, UAE

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Geographic Coverage: Middle East, GCC

Auchan & Carrefour Workshops — Moscow, Russia

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Wal-Mart's Growth Strategy in Latin America

To Serve the Underserved

By Stephen Mader | Originally published on March 13, 2009

Under the direction of Mike Duke and Craig Herkert, Wal-Mart North America has had a laser-like focus on a growth strategy dubbed "Serving the Underserved." This slogan, chanted continuously by geographic and country leads, will become increasingly important to the retailer's operations, top-line growth, and brand weight.

Background

To start, it is important to define Wal-Mart North America and how it ties into the overall Wal-Mart International and Corporate structure. Wal-Mart at the highest level is broken into three business units: Walmart Stores (US), Sam's Club (US), and Wal-Mart International. Within Wal-Mart International, there are CEOs of both geographic regions and country-specific business units. Wal-Mart North America (NA) is led by Craig Herkert. Although the unit is called North America, it covers Central and South American operations. Wal-Mart NA encompasses Canada, Mexico, Puerto Rico, Chile, Argentina, Brazil, and Central America operations.

Strategic Alignment

One of the most prominent slogans to come out of Wal-Mart as of late is to "Serve the Underserved." Wal-Mart NA has wholly embraced this mantra: Format development, in-store fixtures, operations,

category and SKU mix, real estate, social programs, and marketing completely revolve around it.

In Brazil, the two formats that Wal-Mart has been piloting – Todo Dia and Maxxi – are aimed directly at serving customers who are currently underserved. Maxxi is a small traditional cash and carry, and Todo Dia is a limited assortment discount supermarket. At pilot locations within these two formats, Wal-Mart is also testing a new program called "Store of the Community." This program aims to bring essential services (e.g., medical clinics, computers, banking, and business services) to rural undeveloped parts of the country.

Suppliers must understand the country-specific implications of this strategy. A complete alignment between distribution, product assortment, marketing, and social programs will yield the truest success with Wal-Mart in these markets.

Serving the Underserved through Format Development

The core of the new "Serving the Underserved" strategy is the shift in format portfolio from hypermarket expansion to small box limited assortment discount formats. The base of this format's strength is fairly standard across all countries. Important aspects to Wal-Mart include:

- Comparably cheap to build, thus low risk and easy to open and close
- Low labor requirements – As few as four associates per store are possible
- Capture market share of urban environments that are prohibitive to hypermarkets
- Rural environments – Build a store where there may be no formal retail at all

Country	Banner	Stores		CAGR	Average		Sales in Millions USD		CAGR
		2008	2013E	'08 - '13E	Square Foot	USD/SqFt	2008	2013E	'08 - '13E
Brazil	Todo Dia	37	140	30.5%	29,000	$766	$644	$3,522	40.5%
	Maxxi	22	132	43.1%	25,000	333	145	1,104	50.1%
Chile	Bodega Acuenta	13	76	42.4%	19,000	848	128	1,150	55.1%
	Ekono	63	238	30.5%	4,500	505	66	710	60.8%
Mexico	Bodega Aurrera	279	461	10.6%	47,000	535	6,730	11,440	11.2%
	Mi Bodega	97	252	21.0%	12,600	722	770	2,780	29.3%
	Bodega Express	67	652	57.6%	4,000	966	140	2,650	80.1%
Puerto Rico	Super Ahorros	1	26	91.9%	10,000	884	4	220	122.9%
Totals and Averages		579	1,977	27.8%	18,888	$695	$8,627	$23,576	22.3%

Figure 1: Banners by Country   Source: MVI analysis

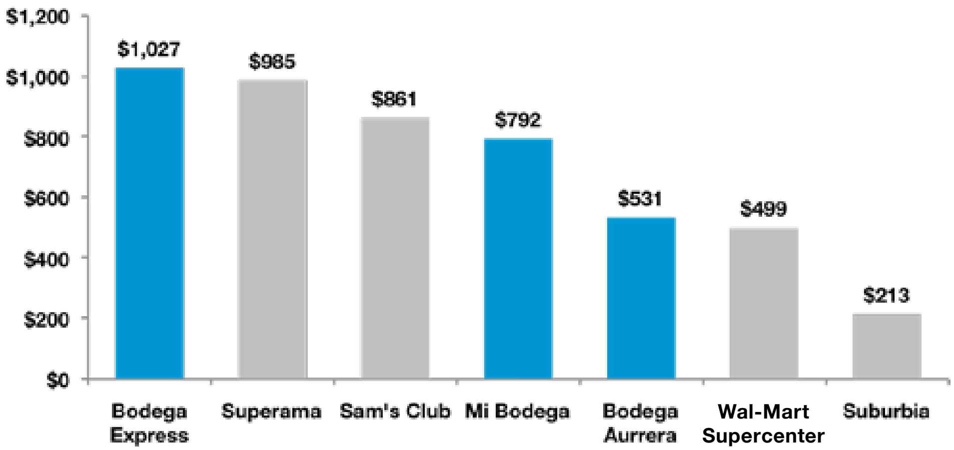


Figure 2: Sales per Square Foot of Walmex Banners   Source: MVI analysis

- Design product assortment around neighboring demographics
- Limited assortment – Very high turns, very high productivity per square foot

Wal-Mart is using this small format as a way to get into tight urban environments, but a variation works equally well in rural environments. A town of 100,000 may support a single hypermarket, but – with the addition of a 3000-5000 sq. ft. format – an entirely new type of trip can be captured.

MVI believes that Wal-Mart will show a complete commitment to these formats in 2009 and 2010, which is reflected in our analysis of the retailer's growth rates (Figure 1).

As shown, a small box limited assortment discounter can be quite productive in developing regions of Latin America. These very small stores are often the only formal retailer in their area; they have an assortment tailored to their neighborhood with a very clear pricing message; and they are often open air and use inexpensive fixtures. All of this adds up to a very high-traffic, high-velocity store.

To further illustrate this point, MVI compares the USD per square foot sales productivity of the portfolio of formats from Wal-Mart Mexico (Figure 2). This is what MVI has been seeing as the new portfolio standard across Latin America where "Serving the Underserved" is in full swing through format diversification.

The next chart gives insight into Wal-Mart's strategy behind format placement for geography as well as income demographics (Figure 3). The traditional Wal-Mart formats (e.g., A complete alignment between distribution, product assortment, marketing, and social programs will yield the truest success with Wal-Mart in these markets.

Sam's and Supercenter) are used as a brand and marketing engine, while the alternative banners (e.g., Bodega) are used as a growth engine for the E, D, and C classes of trade – in both rural and urban environments. One of the paramount messages required to succeed with this income demographic is one of clear value and everyday low cost.

Serving the Underserved through EDLP

Save Money, Live better ties into "Serving the Underserved" at a much deeper and impactful level outside the US market. Walmart in the US usually tries to embed "Live Better" into products with sustainable, green, healthy, and beauty themes. However, when a small box Bodega store eventually goes into Peru or rural Mexico in 2009, consumers will have access to global and local products that are not only priced at a level lower than alternative informal retail but are also trusted to be safe. It is this shift in living standards that Wal-Mart NA is trying to bring to parts of Latin America, which is truly helping consumers "Live Better."

The standard Wal-Mart formats (Supercenter, Mass, Sam's Club, Supermarkets) use pricing structures based on what succeeds traditionally in the local area in which they operate. Wal-Mart focuses on aggressive rollback promotion in Canada, EDLP in Mexico, and a hybrid mix of high-low in Brazil. However, hard EDLP is constant across all small box Bodega-style formats.

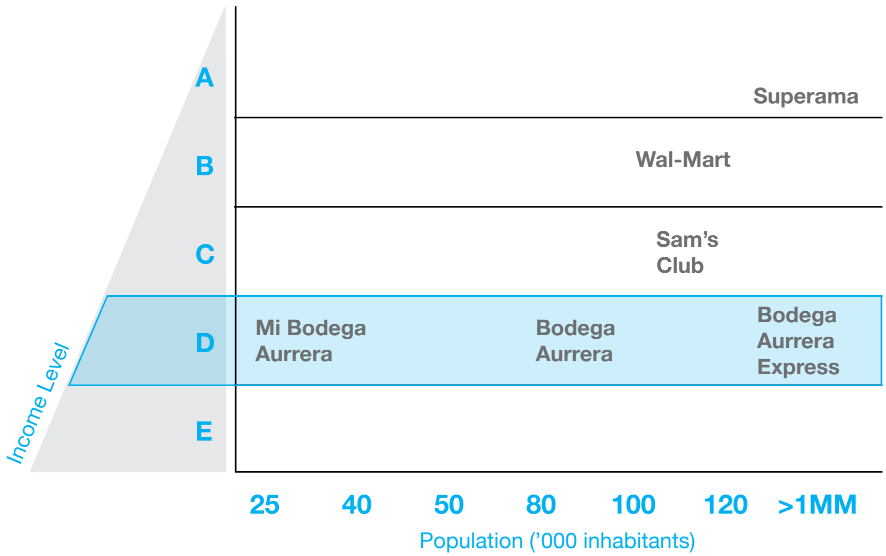


Figure 3: Banners by Region/Income Source: Wal-Mart

Serving the Underserved through Social Responsibility

Though Wal-Mart Corporate has been no stranger to social programs and helping local communities, it was not until the wake of Hurricane Katrina in the southern US that Wal-Mart learned how to communicate this outwardly and leverage its size to blend outward messages (marketing) with true operational impact (Live Better).

Wal-Mart International has had success in tailoring its social responsibility programs to the specific regions in which it operates. In Mexico, Walmex not only markets its relationship with elderly care and child education but also participates in region-wide disaster recovery. In Brazil, Wal-Mart is trialing a program that brings medical clinics, computers, banking, and local business services to the retailer's low income formats. This effort aims to bring increased traffic and recognition to the store and invigorate local communities to succeed.

MVI Interpretation

Wal-Mart International's strategy is becoming increasingly consistent across all global business units. Although each country unit is free to position itself to best address the market in which it operates, corporate messaging and format strategy are clearly becoming more central in nature. It is paramount that vendors understand both the "big picture" of Wal-Mart North America's "Serving the Underserved" campaign and the deeper implications to individual country units.

Social Responsibility

It was not until the wake of Hurricane Katrina in the southern US that Wal-Mart came to understand the power of positioning itself as the socially responsible corporation. That softer image, combined with hard size and process orientation, has made for documented changes recognized by the public. Wal-Mart has focused on individual market social needs such as elderly care, child-centric programs, education, and disaster relief. Suppliers that can partner with one of these types of initiatives will not only see success with Wal-Mart but also improve in-country brand perceptions.

Format

Small box limited assortment discounter stores will be the format Wal-Mart aggressively grows within Latin America. This format is often the only formal retail in town. It focuses on limited assortment tailored to surrounding neighborhood needs at EDLC price points. This results in a very high-traffic and fast inventory velocity store. Suppliers that can understand the merchandising and pricing model of this format, along with the field demands for servicing them, and propose optimal category assortments to the buyer will find success.

Positioning for **Modern Trade Growth** in Developing Markets

How do we effectively serve both traditional and modern trade customers in rapidly developing economies? **Can we predict growth** and proactively manage the product mix in developing markets? **How can we build realistic growth plans and key performance indicators** 5, 10, or 15 years out?

Overview

Recently, MVI completed a groundbreaking study of 30 developing countries around the globe. Following that study, MVI analysts worked with key clients to build a supplier-centric assessment tool, called the Market Evolution Model, which tracks local market conditions and effectively trends retail and format growth for the leading modern trade retailers over a 10-year continuum. Suppliers can use this framework to:

- Conduct current market assessments and gap analyses,
- Track retailer growth rates,
- Predict modern trade format evolution over the coming years, and
- Build sales and marketing capabilities that are appropriate for a market, not a specific customer.

Why a Market Evolution Model?

Leading CPG/FMCG suppliers sought planning tools and advice on resource requirements and capabilities development to jumpstart their business with the modern trade in developing markets. MVI worked to develop a market assessment model, tying Key Performance Indicators (KPIs) to dynamic in-market realities and helping to influence the strategic direction of field teams in developing markets.

3 Key Drivers Influence Market Evolution

Consumer Drivers

Why do consumers shift their spending away from the traditional vendor environment to a chain-based environment?

- Price
- Product Availability
- Trip Aggregation
- Disposable Income
- Other Related Factors

Consolidation Drivers

What conditions facilitate modern trade consolidation/concentration?

- Homogeneous Consumer Base
- Wholesale Structures
- Geography and Population Density
- Access to Capital
- Other Related Factors

Disruptive Drivers

What external factors disrupt the pace/stage of development?

- Taxation and Duties
- Election Cycles
- Organized Interests
- Labor Markets
- Other Related Factors

Consumer, Consolidation, and Disruptive drivers define the velocity of market evolution. These three drivers also help identify the current and future state of market development.

The resulting tool looks at three major drivers of modern trade growth:

- **Consumer attitude changes.** Are shoppers' perceptions of cheaper vs. quality produce important for retailers operating in traditional environments? What will immediately help, influence, or change shopper behaviors?
- **Concentration trends in retail.** How important is the developed infrastructure (modern transportation/roads and reliable electricity) for organized trade to flourish?
- **Government regulation.** Will new legislation such as zoning laws hinder or spur organized trade?

Testing & Market Validation

We validated the model by comparing long-term forecasting and the growth rates of leading modern trade retailers in eight of the fastest-growing markets: India, China, Brazil, Mexico, Russia, Poland, Turkey, and Saudi Arabia. To further validate the model, MVI conducted interviews with suppliers, retailers, and government regulators in Russia, Turkey, China, and Brazil. The goal of in-market testing: confirm that the model incorporates all locally relevant factors and identifies variables necessary to understand the development patterns at work today and over the long term.

Field Applications: Focus on Latin America

One global supplier contracted MVI to apply the Market Evolution Model in Latin America to refresh the supplier's data and provide new insights on its key growth geographies in Latin America. To narrow the project scope, the supplier segmented its business units in Latin America by key growth customers and by primary and secondary growth countries.

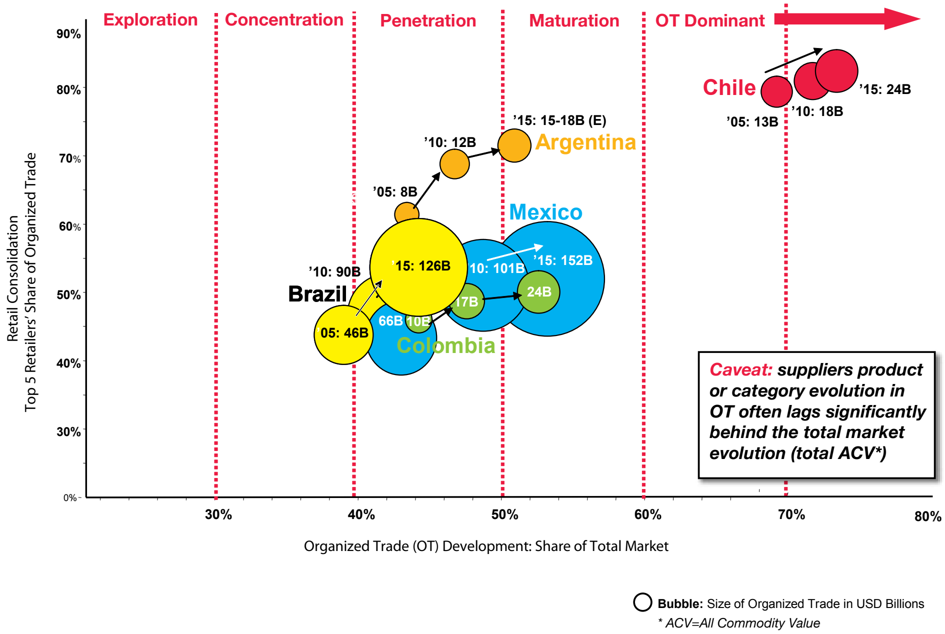
MVI provided several types of foundational information as part of this "Latin America 2015" research project:

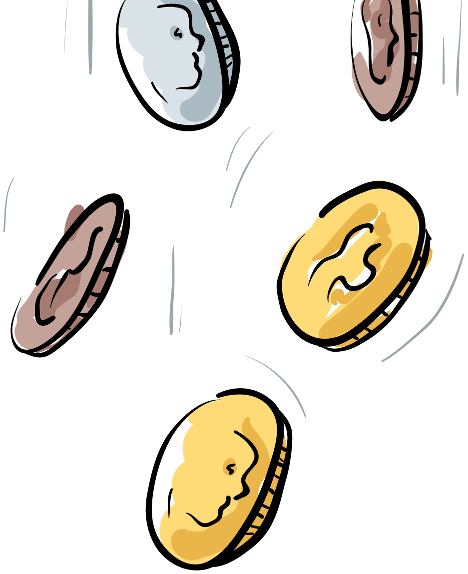
1. Retailer overviews (business models/operations, growth forecasts, etc.) for market leaders;
2. Retailer data (by banner and by format) in all operating countries;
3. Relevant insights on clustering (operating regions) within large geographies such as Brazil and Mexico (e.g., tracking varying evolution in the top urban/metro-markets vs. more rural zones); and
4. Comparative views of market development and retailer growth rates.

Results & Ongoing Progress

Key findings from this study have revealed strategic implications (and sparked some productive internal debate) regarding resource allocations, strategic decision-making, and ongoing alignment with growth customers across the region. Moreover, forecasts for Tier 2 customer growth have raised field-team awareness and interest in improving scenario planning and customer scorecarding to better align with likely market realities and leader retailers over the next decade – and across the top five growth geographies.

To learn more about applying MVI's Market Evolution Model in developing markets, contact Director of Applied Research & Consulting Engagements Jim Leonard at 1.617.588.4105 or by e-mail at JLeonard@mventures.com.





GROCERY

The Price of Change: Strategies in Grocery

By John Rand | Originally published on January 30, 2009

In the last few years, the grocery channel has moved dramatically away from pure high-low pricing. This shift will continue to diminish the availability of promotional opportunity for CPG suppliers, especially in center store categories. It will also force a re-examination of how a supplier can create demand within the channel.

Ever since Wal-Mart emerged as a primary competitor to the entire grocery channel, supermarket retailers have employed many strategies to retain their shoppers and market share. These strategies were successful in direct proportion to the way they addressed one fundamental question: How can a supermarket compete with a competitor that offered lower prices all the time?

It may be hard to remember that in the beginning, the Every Day Low Price (EDLP) approach was a matter of Wal-Mart's strategy rather than an inherently sustainable fact based on any advantage in cost. Wal-Mart simply accepted that their job was to maintain the lowest possible prices even if it meant lesser margins. Most grocery operators generally preferred, then and now, to realize a profit on the trade spending brought to them by suppliers rather than to depend on end-user sales as the sole source of income. Once Wal-Mart combined efficiency with negotiation leverage, however, the gap in pricing became a sustainable advantage.

US Supermarket Price Model

Price Model	2008E	2010E	2011E	2013E	2008E-2013E CAGR
Hybrid	$153,427	$170,882	$180,876	$203,013	5.8%
High-Low	$135,654	$143,597	$148,976	$160,732	3.5%
EDP	$50,470	$57,292	$61,474	$71,012	7.1%
Total	$339,551	$371,771	$391,325	$434,756	5.1%

Figure 1: US Supermarket Price Model Source: MVI analysis

As late as 2001, the channel remained overwhelmingly committed to a high-low pricing and promotional behavior – despite the inescapable fact that once a reliable EDLP reference point existed in the market, no portion of the grocery channel in the US retained its share completely intact.

In 2004 we calculated that more than 80% of the channel remained firmly high-low. At that time MVI pointed out that the two primary alternatives, Every Day Price (EDP) or some sort of hybrid system, both seemed able to deliver comparable sales growth far above what high-low was achieving on average. We predicted even then that, over time, pure high-low pricing would lose its attractiveness as a strategic approach, and it would be supplanted by much more thoughtful hybrid programs and a certain number of EDP retailers.

The speed of the change, however, has been nothing short of remarkable.

Today, we see that 2008 was clearly a turning point (Figure 1). The amount of overall grocery sales done by pure high-low operators is now barely 40% of the overall channel volume and continues to shrink in our projections. Even if no additional retailer changes its approach, we expect that high-low strategies will shrink further to less than 37% of channel sales by 2013.

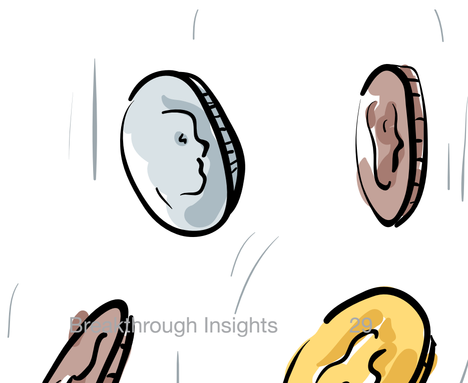
Kroger best exemplifies this dramatic shift in channel behavior. In this same period, it has steadily evolved a hybrid pricing approach that we at MVI called KVI and Draft.

KVI and Draft requires a retailer to identify Known Value Items, or items that are price reference points for the key shopper, and maintain those items at strongly competitive price points on a long-term basis and to “draft” with the remainder of the item mix. This allows the retailer to take higher margins on less important items to the decision about where to shop and where higher prices do not create a negative overall perception. Kroger tries to index its KVIs to within a few percentage points of Wal-Mart’s local pricing, which has depressed Kroger’s average margins but made their top line much more robust.

Other retailers have moved to a simpler and more stable EDP system. It should be noted that we grouped all retailers with long-period stable pricing into the EDP group in Figure 1, but not all retailers with stable pricing – such as Whole Foods – are necessarily low price.

The success of both the EDP and hybrid programs has established this much: consumers no longer see promotional discounting as a reliable expression of value. They are voting with their feet and their wallets – longer term and less volatile pricing strategies are winning in the marketplace.

Most likely, our projections of this shift are overly conservative. The demands of a consumer who is worried about the future and much more budget-conscious than in prior years will probably accelerate the drive for reliable value in everyday purchasing. Retailers as widespread as Publix and Safeway are being compelled to reconsider their promotional behavior in light of the recession. The longer the downturn continues, the more likely many retailers will need to establish a more reliable price image.



MVI Interpretation

The implications of the change in pricing and promotional strategy in the grocery channel are profound. For suppliers, a new approach to trade activity is absolutely imperative. The days when a brand strategy was based on linking a trade TPR (temporary price reduction) to a national coupon drop are clearly numbered. Neither the fragmented media market nor the inconsistent trade response will make this sort of program remotely as effective in the future. A calendar of regular quarterly promotions on many brands and items will find fewer chains as willing partners, and many items at “normal” shelf price will have limited movement without promotional discounting.

Supplier Implication 1

If an item cannot survive without a regular promotional event, much of the trade will eventually move to delist the item. Reductions in promotional opportunity, when combined with the needs for efficiency and value coming out of this recession, are likely to ignite massive SKU optimization efforts at many chains. Item reductions in the double digits are not impossible.

Supplier Implication 2

The transition from the current practice, even for core items with strong movement, will be extremely challenging. It is very difficult for any item—no matter how strong its consumer franchise—to “comp” against a promotional history without continued promotion. Internal metrics based on year-over-year comparisons will be unrealistic in the near term. Forecasting, which is demanding new methodologies, will be considerably less consistent from customer to customer. Standardized channel strategies are rarely effective without a lot of adaptation and becoming even less relevant.

Supplier Implication 3

Rethinking the sources of lift is now mission critical. The challenge for manufacturers will increasingly be this: How can a supplier create expanded takeaway at the shelf without a TPR or circular ad? Both general consumer messaging and in-store merchandising and marketing will be increasingly important to close the gap, and the regular package on the shelf will be more significant than ever in communicating value to the shopper.

Rethinking the sources of lift is now mission critical.

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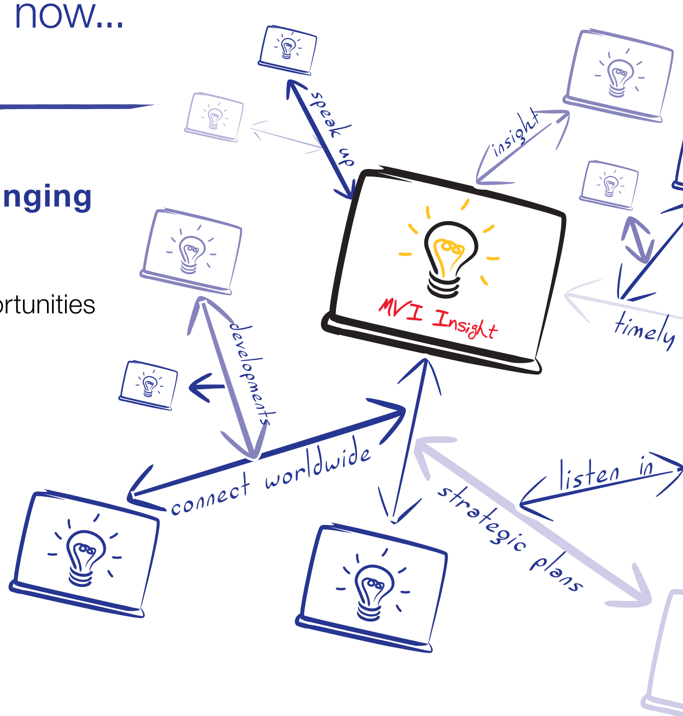

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MVI's Look at Supermarket Competitiveness

By John Rand | Originally published on April 8, 2009

In October 2007, MVI wrote about improvements that were leading supermarkets to greater competitiveness. We outlined some of the trends, both positive and negative, likely to persist for several years that would shape the channel course from that time.

So how well did we do? Well, let's take a look.

Control of Operating Expenses

In MVI's 2007 article, "Regaining Competitiveness: Searching for Supermarket Efficiency," we wrote about and predicted a continued focus on how grocers had somewhat narrowed the gaps in operating expenses between Wal-Mart and themselves, in particular commenting on Safeway's higher expenses. We also noted:

- Continued reductions in head count and employee wages and benefits would not wear well over time.
- Safeway in particular would need to improve its compensation for its worker base if it expected to compete on service rather than price.

Since then, Kroger has almost entirely closed the expense gap with Wal-Mart (Figure 1). In 2007 there was a 2.2% gap in Wal-Mart's favor in operating expenses. It is now a mere 0.6% difference, as Kroger lowered its costs by 1.1% overall. Safeway, on the other hand, has lowered its expenses by only 0.5% in the same period. It spent at least part of the intervening time giving back some of the wage and schedule concessions it had gained after the California grocery strike earlier in the decade.

We also commented, "The challenges for Supervalu are quite clear; the number two retailer will have difficulty becoming truly competitive until it has taken costs out of its system, one way or another." This is just as true today as it was 18 months ago. The recession only adds to the struggle for Supervalu, as it has to contend with a much more price-conscious shopper.

We also noted that "efficiency-oriented retailers will focus more on cost-shifting and will likely be looking for more efficient shelf-ready packaging, more pre-packaged display options, and other ways to reduce handling and labor. Most retailers will, of course, continue to have a relentless interest in shrink of all kinds." This remains true as well – and even more so during a downturn.

Inventory, Turns, and SKU Optimization

Back in 2007, we said: ". . . no amount of supply chain accuracy can protect slow-moving items from becoming a drag on a retailer's working capital, and sooner or later SKU reductions will become appealing for every retailer of scale. The recent reductions at retailers such as Kroger and Safeway are unlikely to be the last word on this. The ability to create more targeted store distribution with more locally appropriate selection will grow, and many items that currently enjoy chainwide authorization may not retain their positions in the future."

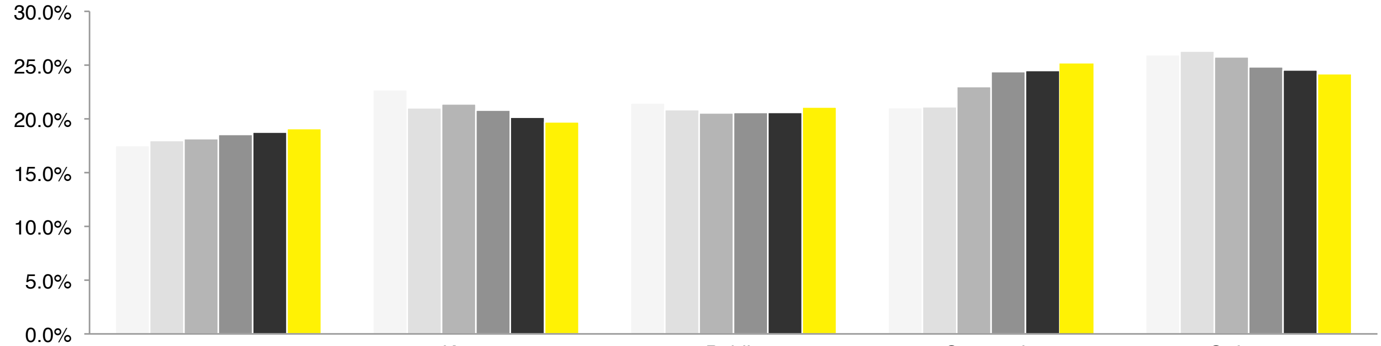
This was, if anything, understating the case. Many retailers—including Kroger, Safeway, Delhaize, and Ahold—have made significant repeated reductions in SKU count both by segmenting their store base to improve accuracy of distribution and by making overall reductions of space and items, especially in traditional center store aisles. Kroger is now even making a further series of dramatic item reductions, although a fair amount of the space will be reassigned to private label products. SKU count reductions and optimizations will undoubtedly continue.

Gross Margin

In our 2007 article, we pointed out that the search for additional margin would lead retailers to adopt three strategies:

1. Move into higher ring offerings, including natural and organic;
2. Increase general merchandise; and
3. Expand private label.

All three of these have come to pass, though not with equal results. Both Kroger and Safeway have increased their commitment to natural and organic products. Safeway even combined the organic and the private label strategies through development of its O Organic



	Wal-Mart	Kroger	Publix	Supervalu	Safeway
2003	17.5%	22.7%	21.5%	21.0%	26.0%
2004	18.0%	21.0%	20.9%	21.1%	26.3%
2005	18.2%	21.4%	20.6%	23.0%	25.8%
2006	18.6%	20.8%	20.6%	24.4%	24.8%
2007	18.8%	20.2%	20.6%	24.5%	24.5%
2008	19.1%	19.7%	21.1%	25.2%	24.2%

Figure 1: Operating Expenses
Source: MVI analysis

and Eating Right lines. Virtually all retailers in the channel are increasing their emphasis on private label brands. Last quarter, Kroger achieved a new high with 35% of their units and 27% of their dollar sales coming from retailer brands.

In the past 18 months, Safeway and Kroger have increased their offering on general merchandise as well. Kroger has devoted considerable resources to perfecting the Marketplace format precisely because it enables more general merchandise in their mix.

As we advised our clients in 2007, opportunity in center store would be reduced. Today, we remind them that the bar continues to be set higher. Supermarket retailers are slowly moving from a “buy side” mindset, selling opportunity to suppliers and accepting a seemingly unending expansion of items, to a “sell side” mentality, becoming more willing to edit assortments with their own data-driven understanding of what their best shoppers want to buy.

GROCERY

ASDA Continues to Support Market Share Growth

By Vincent Verdier | Originally published on March 23, 2009

In this article, MVI assesses how the ASDA business is controlling its profits to finance a price-led brand strategy against Tesco. We also examine the elements of Return On Net Assets (RONA) and consider whether it will be possible for ASDA to improve returns and at the same time maintain aggressive margins.

Since acquiring the ASDA business in 1999, Wal-Mart has been focused on building the company into the UK's leading retailer. This was an ambitious goal at the time of acquisition given that ASDA was the number three grocer in a congested market. Currently, ASDA's success puts it at only a little more than half the size of Tesco. Because of ASDA's relative lack of scale, the company has been allowed to pursue an aggressive financial model that allows it to erode Tesco's market share through the financing of a price leadership model.

ASDA Sacrifices Profit Growth to Remain Competitive

Wal-Mart is in a unique position as a corporation. The scale of its USD 100 billion International division allows the company to invest aggressively in ASDA while still delivering profit margin growth and improving returns to its shareholders.

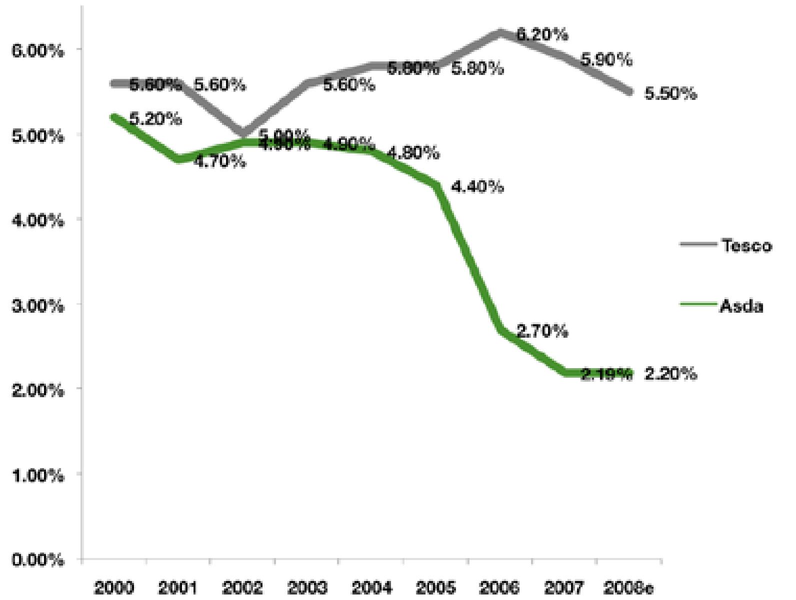


Figure 1: Tesco and ASDA Operating Profit as a Percentage of Sales
Source: Company reports and MVI analysis

During the past few years, ASDA has steadily improved its gross margin; it has continued to invest a good portion of these gains back into its stores. Thus, the company's historically competitive price position has been complemented by dramatically improved fresh food departments and cleaner, more appealing stores. Some of this cost investment has also gone into expanding ASDA into Northern Ireland where the business has seen explosive growth accompanied by rising logistics costs. In total to date, ASDA has been putting more of its margin gains back into the business than any other grocer in the UK. The result has been a much better experience for shoppers supported by a steady erosion of operating margins.

Since 2002, Tesco and ASDA have implemented two different strategies (Figure 1).

- Tesco still generates more than 75% of its profits from the UK. Consequently, the company must balance providing a better shopper experience with developing new channels in the UK, continuing global expansion, and delivering returns to its shareholders. (Unlike Wal-Mart, Tesco does not have a dominant family shareholder.)
- ASDA has chosen a drastically different strategy. It has lowered its operating profit to apply pressure on the competition in the UK. The company hopes that its profits will improve over time, as the group gains scale and competition comes under pressure. Through the end of last year, however, the group's continued market share gains were funded by lower profits.
- Though ASDA cannot continue this strategy indefinitely, clever financial management has been part of the company's superior growth record in the UK in the past few years.

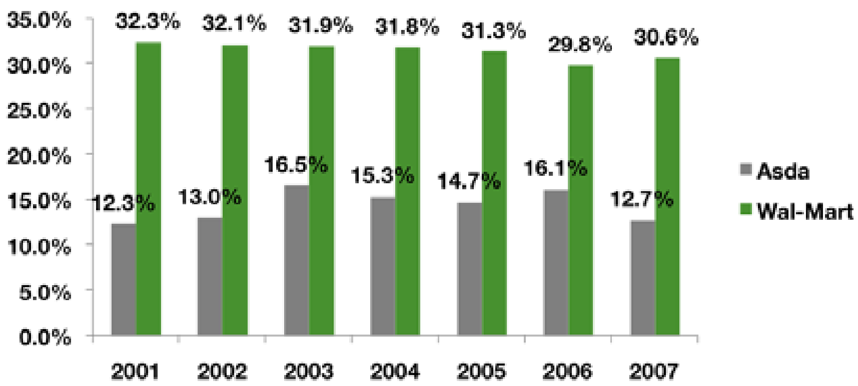


Figure 2: How will ASDA drive RONA growth?
Source: Company reports and MVI analysis

RONA as Wal-Mart Key Performance Indicator

Wal-Mart uses a form of Return On Net Assets (RONA) to assess its performances at a corporate level. Whereas the Gross Margin Return On Invested Inventory (GMROII) is how ASDA measures suppliers at the category level, RONA is used by top management to assess the returns generated by the business (Figure 2).

At the corporate level, Wal-Mart has been able to maintain RONA levels

In total to date, ASDA has been putting more of its margin gains back into the business than any other grocer in the UK.

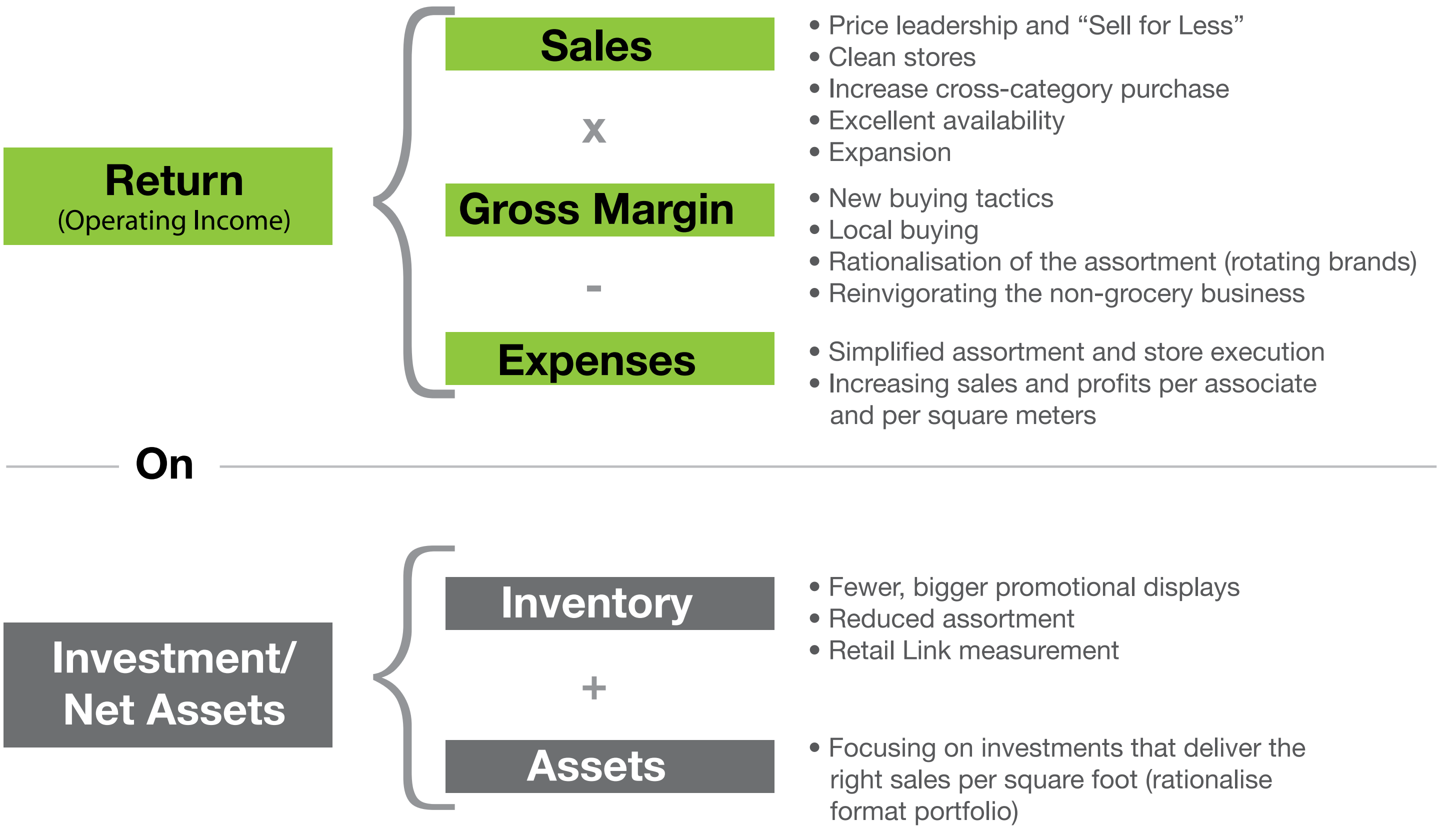


Figure 3: Wal-Mart and ASDA Corporate RONA
Source: Company reports and MVI analysis

over the last years (Figure 3).

When looking at the ASDA RONA figures, two conclusions can be made:

- The enormous asset costs associated with operating a retail business in the UK make it difficult for ASDA to achieve corporate RONA averages.
- While the 2003-2006 period showed a significant improvement in ASDA's RONA, the figure decreased from 2007. A similar trend is forecasted for 2008. This doesn't mean that RONA is less relevant for ASDA; however, it implies that the priority for the retailer has shifted: from RONA only to a combination of RONA and like-for-like (LFL) growth. This LFL expansion must be financed by a more competitive price positioning.

At the same time, ASDA management is pursuing a number of initiatives that will hopefully allow the business to begin improving RONA again and maintain its growth in the UK market. The trick will be to do this without sacrificing the advantages gained to date by pursuing a more costly operation than its largest competitor.

MVI Interpretation

ASDA's business in the UK is about more than simply achieving short-term returns. Wal-Mart management has for the past few years focused on addressing the significant imbalance of power between Tesco and ASDA in the UK market. This has all been accomplished without diluting the targeted growth in shareholder returns.

Looking forward, the challenge for ASDA will be transitioning the business to a more sustainable model whereby it can return to achieving reasonable levels of profit but still provide its shoppers with the excellent prices and experience being put forth by the brand today.

In the meantime, this analysis supports Tesco's aggressive foray into the US market. While still a long way from being relevant to Wal-Mart, the development of a successful large-scale business in the US will be critical to ensuring that Wal-Mart cannot simply drain the profits from the UK market as a means of neutralising the growth of Tesco.

HYPERMARKET

Carrefour at the Crossroads of a New Strategy

By Vincent Verdier | Originally published on March 18, 2009

Carrefour's management has clarified some of the key strategic changes coming to the retailer in 2009 and 2010. In this article, MVI discusses the main cultural and structural changes at stake and what they mean for suppliers.

In recent meetings and at the presentation of 2008 results, Carrefour's management has clarified some of the key strategic changes coming to the retailer in 2009 and 2010. While Carrefour's Key Performance Indicators (KPIs) will remain focused on increasing the Return On Capital Employed (ROCE) for shareholders, new CEO Lars Olofsson will try to implement a new structure and culture to achieve these results. This has major implications for the ways in which Carrefour runs its day-to-day operations and relates to its suppliers.

This article will focus on the main cultural and structural changes at stake, starting with the internal evolution and concluding with implications for suppliers of the retailer.

A New Way of Running the Carrefour Business

At the recent public presentation of shareholder results, Olofsson adopted a markedly different tone from his predecessor. He noted that the 1999 merger with Promodès has not been fully digested and that an "inefficient organisation" with a "poor strategy" was in place. He stated that there was a need to "transform and simplify." These comments were aimed primarily at the French operation, where management structures dividing hypermarkets, supermarkets, and convenience stores have never been fully integrated. (France represented 55% of Carrefour's total sales in 1999 and produced 43% of the group's revenues in 2008.) This is also a message for the Italian business, which has never embraced the idea of a combined brand operating in the marketplace.

A more harmonised and integrated approach will undoubtedly yield much of the EUR 500 million cost savings targets discussed in the past few weeks. Still, there is a desire for a more streamlined business that can better react to market trends. During the past few months, several references have been made to becoming a "lean" business in the mold of Tesco. Tesco is one of the few retailers that has adapted Toyota's automobile industry model into retailing, which links scaled shopper insights into a reactive centralised business model. (For more on moving from mass production to lean production, read *The Machine That Changed the World* by Womack, Jones, and Roos.) Though this is not the first time Carrefour mentions Tesco as a "best-practice" retailer, management is now linking the idea of a more efficient centralised organisation to one that will use more shopper data in shorter periods of time to adapt its business.

To meet its target of reducing operating costs by EUR 500 million, the retailer will look at three areas:

1. Greater interaction between formats
2. Becoming a more centralised business
3. Staff rationalisation

In line with the Carrefour-Promodès integration, most of these changes are expected to take place in the French market.

> Carrefour is trying to become more centralised in its day-to-day management by removing the power from the stores.

Greater Interaction Between Formats

Following successful transfers across its markets, Carrefour has decided in the course of 2008 to transfer its entire Champion supermarket network to the Carrefour Market banner. This transfer has numerous implications; one of the most important is to generate synergies between formats: similar assortment base, similar Carrefour private label ranges, similar promotional activity, and even the integration of a common supply chain platform.

The most obvious changes (private label and some promotions) have already been implemented, but the largest task ahead lies in the definition of a common assortment base and of a more integrated supply chain. Carrefour is now merging the scope of its category buyers to reflect both formats and is even testing to include the online division in their role.

Finally, the move towards new banners for Carrefour's convenience stores (Carrefour Contact and Carrefour City) follows the same logic but will be more difficult to efficiently execute, as almost 100% of the convenience network runs under franchise agreements. The extended role of the buyers also follows Carrefour's intention to become a more centralised retailer.

Becoming a More Centralised Business

Carrefour and its competitors in the French market have been running on a fairly decentralised model. The weight of the "independents" in the market, combined with strong geographical differences in terms of network presence, has reinforced the need for retailers to adjust their offer and prices at a store level.

Carrefour is now trying to change this approach and with a more centralised structure, where decisions could be implemented faster and more consistently across the network. The roles at store level (store manager, but more importantly aisle manager) are currently being re-assessed. The plan is to decrease the time they spend with suppliers' field sales forces in-store, as the planograms and promotions would have been decided and planned at the central category level. In other words, Carrefour is trying to become more centralised in its day-to-day management by removing the power from the stores.

According to French magazine *Linéaires*, a new back office IT system would allow aisle managers to check in the aisles that the planograms, prices, promotions, and trading terms are in line with the HQ decisions. To be successful, this strategy from Carrefour will have to be supported by the field sales of suppliers. The aisle managers and merchandisers will not have the capacity to ensure that marketing and merchandising decisions are correctly implemented. However, it is unclear yet how this relation is now going to evolve at the store level, if aisle managers do not have the responsibilities to interact with suppliers the way they did before.

While this approach from Carrefour makes a lot of sense from a cost savings standpoint, it is unclear if it can be successfully rolled out in the fragmented French market. The back-office implications are major for Carrefour here, and again Tesco can be used as a benchmark. Tesco's main success factor has been to limit the number of planograms it generates to ensure this strategy leads to cost savings. The goal is to balance localisation with as few differences as possible.

Whereas Tesco spent more than a decade implementing such a structure, Carrefour doesn't have as much time at hand to deliver on this.

Staff Rationalisation

While no announcement has been made so far, Carrefour will have to reduce its workforce to reach this cost savings objective of EUR 500 million. The integration of different formats in Carrefour's buying process, along with the difficult economy of the retailer's home market, imply that the management team will have to make difficult decisions. Based on the centralisation approach, MVI expects that both store staff and head office employees will be affected.

MVI Interpretation

The new management team at Carrefour is looking at fresh ideas to continue growth in terms of both profits and sales for the years ahead. The new CEO's assessment and comments have been a significant shift from the previous years; the solutions are at stake now.

Supplier Implications

Since the beginning of the year, Carrefour has also adopted a different tone with its suppliers, emphasising a more collaborative approach. This probably represents the main cultural change: Carrefour has always been very demanding with its suppliers, and this will not – or cannot – change overnight despite the new management drive. Here lies the main challenge: Carrefour is now in greater need of its suppliers to reach its internal objectives. Following are the main evolutions from a supplier point-of-view:

- While this is not the first time that Carrefour has looked to its suppliers for greater collaboration, now seems to be different from the past. The retailer must deliver quickly while implementing a significant set of changes within its day-to-day business. Though the pressure on negotiations will remain, this new context creates some opportunities for suppliers.
- An evolution in the responsibilities of field sales force. As the role of Carrefour's staff in-store is being scrutinised, it will probably imply that field sales will also have to evolve in their point-of-contact role at store level. If the weight of decisions is now balanced towards headquarters in favour of the category buyers, it will have great implications for the suppliers—considering what their respective KPIs are. The main concern for suppliers on this matter is the loss of control regarding the assortment and planograms in-store.
- The role of the loyalty card is expected to take greater importance in the coming months. As Carrefour is looking to rationalise its assortment base, it will use its shopper data to implement the most consistent offer across its network. Using loyalty card data—as has been emphasised by the management team—will also become more important for suppliers in their promotional proposition to Carrefour.

The retailer must deliver quickly while implementing a significant set of changes within its day-to-day business.

MVI Store Visit – Germany:

Real Hypermarket

By Vadim Khetsuriani | Originally published on December 19, 2008

MVI recently visited a Real hypermarket in Regensburg, Germany. The objective of the visit was to evaluate the new private label strategy that Real is implementing in Germany and to evaluate how Real hypermarkets are positioned in the retail marketplace. The following article is the overview and analysis of what we saw in the store.

The Real hypermarket is a division of Metro Group. The division has around 342 stores in Germany, 54 stores in Poland, 19 stores in Romania, 13 stores in Russia, and 12 stores in Turkey at the end of 2008. The division has struggled to reach profitability in a majority of its markets, including Germany. Real hypermarkets took over Wal-Mart operations in Germany but at the same time closed many underperforming stores over the last few years.

In an effort to reach profitability, Real launched a new marketing campaign, refurbished stores, and launched a new private label strategy in Germany. The transformation of Real is led by Joël Saveuse, Director General Europe Carrefour, who is a former Deputy Management Board Chairman. The new private label strategy and the effort to improve price and quality perception are mostly driven by Saveuse, who has two years to turn around Real to make it a profitable division for Metro Group.

MVI Store Report:
Location and the Outside-Store Experience

The Real hypermarket store we visited is located on a busy roundabout with Aldi and Lidl on the other side of the main route. The store had a lot of ancillary services and a DM pharmacy sitting in the same parking lot. The ancillary businesses include a petrol station, a bank, a pharmacy (in addition to a DM), a Christmas bazaar, a mini car dealership in a small shopping mall, a few clothing boutiques, and a couple of cafes. While these additional businesses ensure maximum customer traffic to the Real hypermarket location, the proximity of the discounters puts Real in a tough competitive catchment area where it must fight for shopper attention.

At the store entrance, the messages to shoppers were about the loyalty program, the convenience of one-store shopping, and the new Real positioning in the marketplace (Figure 1).

Right at the mini shopping mall entrance where Real is located, there was promotion of the Real Payback loyalty card scheme (collecting points for specific products purchased or shopping in the store on specific days) and a presentation of Real Quality, a new private label with already 600 SKUs available (Figure 2). The marketing message of Real Quality is focused on everyday low price and the quality of the product. The purpose of this launch was to focus on a "complete range" of products instead of on brands. Real has also launched a new web campaign promoting private labels with extra features – such as a famous chef in Germany cooking with Real Quality products.

The Real marketing campaign to promote the new range of private labels is described in greater length on the company website: Real.de. The range includes Real Selection; Real Quality; Real Bio; and TIP, the open price point private label. Interestingly, there is a great value component (price promise) for all of the private label ranges. The Real Selection price promise is to be cheaper than other premium private labels in Germany; the Real Quality price guarantee is to be cheaper

Figure 1: Real Promise to Shoppers – Parking Lot Posters
Source: MVI store visit, December 2008

Figure 2: Real Advertising Payback Scheme and Private Labels at the Entrance
Source: MVI store visit, December 2008

than national brands; the Real Bio promise is a "healthy" price in the market; and TIP is the open price point, the cheapest product in the marketplace.

MVI Store Report: The In-Store Experience

The store looked very clean and tidy inside, which gave a "premium" feel to the shopping experience. However, the promotion section, located in the centre of the store, was heavy on TIP product promotions. Gondola ends were used for both brand-specific promotions (e.g., a Family Manager theme offering products at promotional prices that at the same time gives money to child care programs and kindergardens) and for TIP products. The branded display was placed on the side of the gondola end next to the TIP products (Figures 3 and 4).

In general, the store did not excessively focus its promotions on private label products. Still, the signs were showing price cuts on private labels. This unmistakably indicates that Real is fighting for a better price image in the marketplace and is willing to sacrifice margins for specific key value items.

Once in the aisles, there was a noticeable segmentation of private labels and brands, and clear shelf signage for the open price point selections (Figure 5). Real has done a good job analyzing price-sensitive categories and adding TIP sections

Figure 3: Gondola End – Brands and Branded Displays
Source: MVI store visit, December 2008

Figure 4: Gondola End – TIP and Central Promotional Placements
Source: MVI store visit, December 2008

Figure 5: Home Space Examples – Positioning of Private Labels and Brands
Source: MVI store visit, December 2008

to them, while other categories that were not very price-sensitive had a good selection of branded merchandise.

Apparent from the photos, TIP was most clearly marked on the shelf. One of the risks that Real is facing in Germany is to oversell TIP products, as the company is building a better price image. Due to bold packaging and big signs, TIP stands out on the shelf a lot more than other private label products. Because of that, the sales of TIP products can grow faster than Real had projected, which in turn will likely drive the margins down and would not help Real profitability.

MVI Interpretation

From the shopping experience, MVI found that Real's messaging is clear and its private label strategy is very well executed. However, the problem for this chain is to balance improving its price image and reaching profitability in Germany. The store had a good selection of branded products: supplier displays and promotions added to the quality image of the chain. Constant reinforcement of price and quality, backed up by a Payback loyalty scheme, is a strong effort by Real to sustain traffic growth that the company experienced during Q2 and Q3 in 2008. Once the seasonal shopping campaign is over, sustaining frequency will be even more important for the company, thus suppliers should build in frequency-driving arguments into proposals for the Real hypermarket.

Despite the overall good execution at the store level and the creation of a pleasant shopping experience (with a balance of price and quality), undoubtedly the current economic environment makes it extra challenging to attract shoppers into the hypermarket and convince them to spend—especially more than they were planning to. Time is running out for Real: 2009 will be a critical year for it to strengthen its performance in Germany, or Metro Group must evaluate other options for its hypermarket chain.

Innovation at Work:

Brendan Langan Thrives on Growth and Learning, Encourages His Clients to Do the Same

By Elizabeth Lee

When Brendan Langan was a history major at Fordham University, his mentor presented him with two career options: become a professor and perhaps write, or go into business and make money. Shortly thereafter, Langan changed his major to marketing. Though Langan pursued a business career, he didn't give up his passion to learn, teach, and write.

"The day I stop learning, I'll choose another profession," he admits.

Langan, who oversees the drug channel research for MVI as a director of retail insights, likely won't see that day during his tenure at MVI. The "collective knowledge and experience of the team" creates an ideal environment for continuous growth and learning.

"At MVI, I'm surrounded by some of the most experienced people in the industry," he says. "Companies view us as thought leaders in retail."

Similar to what Langan views as perks from his workplace are the benefits that clients gain from him and the rest of the MVI research team.

"We actually got started helping people to be successful, to advance their careers," he says. "We've watched many of our longtime clients get to senior levels of their company, in part through the knowledge and perspective they gained from our insight."

Along with his expertise in retail, Langan has a solid background in economics and finance. While pursuing his degree, he got his start working on the consumer side of JPMorgan Chase. Immediately after college, he was selected for a Citibank management program, rotating between roles in areas of credit, finance, marketing,

"The day I stop learning, I'll choose another profession," he admits.

What is happening in the drug channel?

It's a dynamic time right now. Two retailers, CVS and Walgreens, are pulling away. They are transforming their business models to ensure they're successful in the future.

What do you see for it in the future?

The leading retailers will continue to pull away. Consolidation is accelerating. There are some challenges unique to drugstores. Drug retailers can no longer benchmark themselves against just their drug peers. The whole notion of channels is becoming less relevant; it's more and more about the customers. Of the top 100 retailers of the country, 25 operate pharmacies; only four of those are drugstores. There's a lot of competition. In this environment, drug retailers are no longer competing just against CVS, Walgreens, or Rite Aid.

sales, and accounting. He then worked as a relationship manager at CitiCapital, a commercial lending business for Citibank. In this role, he had opportunities to work with and lend to various small to mid-sized companies. He guided manufacturers, distributors, and retailers in growing their business.

"I didn't want to stay in banking, but I liked the analytical side of it: working with companies, understanding their strategies and how company models worked, and helping them understand their business," Langan says.

Then, Langan got direct exposure to the retail industry when he took a job with a private credit rating agency: Global Credit Services. He analyzed wholesalers and retailers across the food, drug, and health care sectors. Through this experience, he not only worked on behalf of the credit and finance organizations but also gained exposure to hundreds of retailers. Finally, Langan returned to his native Massachusetts and, in 2006, began his employment at MVI.

Langan now leads MVI's drug research team in helping clients gain better alignment with their retail partners, exposing them to more than their usual focus "to connect the dots to put together the most complete picture." Clients gain valuable retail insight via workshops, on-site visits, webinars, and online content.

"We help them win business and align the direction of their strategies beyond just our category," Langan says. "We're passionate about it. We're retail geeks. We love what we do. That's reflected in the quality of our work and our brand."

For his part, Langan feels very fortunate for the opportunity to work with each client and claims that they have a shared interest in each other's success.

"They appreciate us; they know we're helping them win. They enrich us with their knowledge, and we bring that back to them."

"We're passionate about it. We're retail geeks. We love what we do. That's reflected in the quality of our work and our brand."

For the retail expert who started out being curious, asking questions, and wanting to learn new things, MVI seems to be an ideal place to thrive. Despite the years-ago advice that he must choose either to teach and write or get paid, Langan has created his own path and proved he could have it all.

Director of Retail Insights Brendan Langan can be contacted at 1.617.588.4116 or by e-mail at BLangan@mventures.com.

How can drug retailers compete?

Retailers must aggressively take control of their future by solidifying their brand messaging. Their key focus should be growth and increasing the sophistication of their private brand programs. They must continue to build upon their capabilities and strengths.

In this economy, what should MVI's clients keep top-of-mind?

In a challenging economic environment, leaders take advantage of being able to pull away. They need to continually be pushing the envelope and remain two steps ahead of their competition; they need to be as informed and aligned with their retail customers as possible. Innovation today is more about the idea than the product. We help our clients be innovative and bring insights to the table, so they increase their value with the retailer and thus increase their business. Information really is power.

Key Retail Indicators for the US

*By The MVI Research Team | Originally published on April 13, 2009**

The state of the US economy has changed considerably within the last several months. The collapse of the banking industry in the fall of 2008 caused corporations to raise their rates and forced consumers to minimize risk and cut debt. **The health of the US consumer is on everyone's mind:** a key way to evaluate this is through revolving credit. A revolving credit arrangement is one that allows a consumer to borrow up to his/her credit limit without having to re-apply every time cash is needed; credit cards operate under this type of arrangement. **Revolving consumer credit in the US dropped 6.7% in Q4 2008,** as credit terms and limits tightened. More Americans opted to pay cash for Christmas goods rather than sink into debt. Non-revolving credit was also down during this period, as more **Americans focused on short-term needs**—such as paying off their credit card debt—rather than making long-term purchases to build up their assets. Both revolving and non-revolving credit rebounded slightly in January 2009, **indicating that the US consumer is not yet out for the count.**

**As part of MVI Country Report: United States, "Economic Indicators."*

Consumers contracted their overall spending, particularly in the latter half of 2008. GDP posted a negative growth rate during Q4 2008, marked by a decline in exports and equipment & software. The grim fact that the rest of the world is also entering into recessions, leaving other nations limited funds to purchase US goods and services, is also compounding the economic pressure in the US. Domestic consumption, particularly in the durable goods category, declined heavily despite the myriad discounts offered and reduced inventory levels in retail. In Q4 2008 the year-over-year growth rate of durable goods plunged 11.4%.

Not only are consumers spending less, but they are also saving more. Personal savings as a percent of disposable income grew 110 basis points (bp) to 5% in January 2009, due in part to the continual contraction of discretionary spending and decreases in usage of credit card debt.

The increased savings activity has had a devastating effect on the US labor force, a phenomenon that John Maynard Keynes referred to as "the paradox of thrift." This school of thought contends that increases in consumer savings begins a vicious cycle: banks that house the money sit on it, resulting in a decrease in wages, increase in unemployment, and eventually lower savings. In February 2009, unemployment levels reached a 25-year high of 8.1%. This figure will likely continue upward at least in the near term, as some analysts predict that US unemployment could reach 9% in 2009.

Job uncertainty has, in part, steered both the Present Situation Index and the Expectations Index downward, reflecting an overall plunge in consumer confidence. This indicator began reaching all-time lows in October 2008 and has continued to post dismal marks through February 2009. MVI has observed a lagging correlation between comparable store sales (comps) and consumer confidence; in other words, overall retailer comps will likely get worse before they get better.

After a jump in inflation, specifically within the food and energy categories, the US started to see price deflation during August 2008 and lasting through February 2009. This deflation has brought down prices in the retailer channels that sell these categories, or at least it has caused retailers to put intense pressure on suppliers to take their own prices down.

Today, supercenters, discounters, and club operators are benefiting from the weakness in confidence and increased cost-saving activities. As a whole, however, retail sales have taken a considerable blow at the hands of the sluggish US economy. To help keep profit afloat, many retailers are proactively managing inventory and expenses, and are aggressively pushing private label as a way to further optimize profit.

Consumer Credit

After dropping 3.2% in Q4 2008, outstanding consumer credit increased 0.8% year-over-year to USD 2.564 trillion in January 2009 (Figure 1).

- Revolving credit rebounded 1.2% to USD 961.3 billion in January 2009.
- Non-revolving credit grew 0.6% to USD 1.6 trillion.

Consumer Credit		**2008**					
(% change, year-over-year)	**Q1**	**Q2**	**Q3**	**Q4**	**Nov '08**	**Dec '08**	**Jan '09***
Total	4.8	3.9	1.5	-3.2	-4.2	-3.5	0.8
Revolving	7.6	3.5	4.5	-6.7	-7.1	-9.5	1.2
Non-Revolving	3.1	4.2	-0.4	-1.1	-2.5	0.1	0.6

**Preliminary*

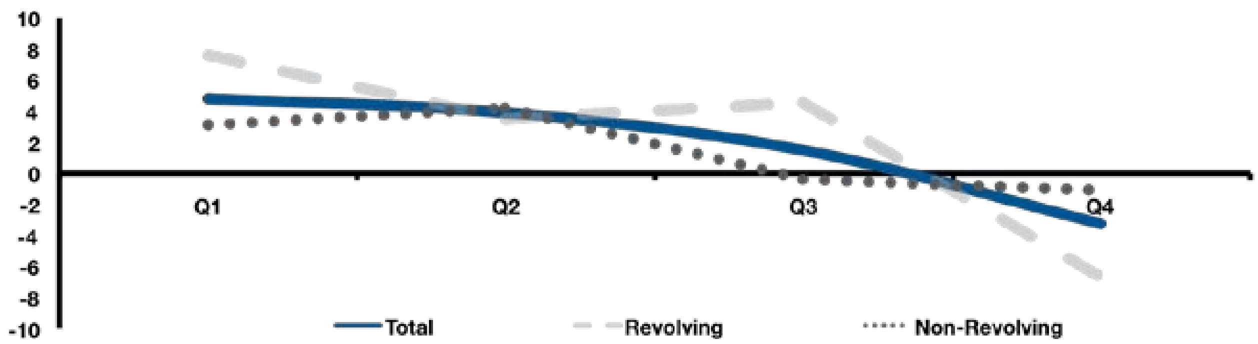


Figure 1: 2008 Year-Over-Year Change in Consumer Credit Source: Federal Reserve Bank

Gross Domestic Product

During Q4 2008:

- Gross Domestic Product (GDP) decreased 0.8%.
- Durable goods expenditures significantly declined 11.4%.
- Nondurable goods expenditures fell 3.4%.

Durable goods are a key driver in US macroeconomic performance. US consumers are more likely than other developed markets to turn extra purchasing power into high-ticket durable goods (Figure 2).

	2006				2007				2008			
	I 06	II 06	III 06	IV 06	I 07	II 07	III 07	IV 07	I 08	II 08	III 08	IV 08
Gross Domestic Product (GDP)	3.7%	2.6%	2.0%	3.1%	1.9%	1.9%	2.8%	2.5%	2.5%	2.1%	0.7%	-0.8%
Personal consumption expenditures	3.3%	2.6%	2.8%	3.6%	3.5%	2.9%	3.0%	2.6%	1.9%	1.3%	-0.2%	-1.5%
Durable goods	4.3%	-0.1%	6.4%	7.4%	4.8%	5.0%	4.7%	4.2%	0.5%	-1.1%	-5.5%	-11.4%
Nondurable goods	4.5%	1.4%	1.5%	3.7%	3.0%	2.5%	2.3%	1.5%	0.4%	1.2%	-0.9%	-3.4%

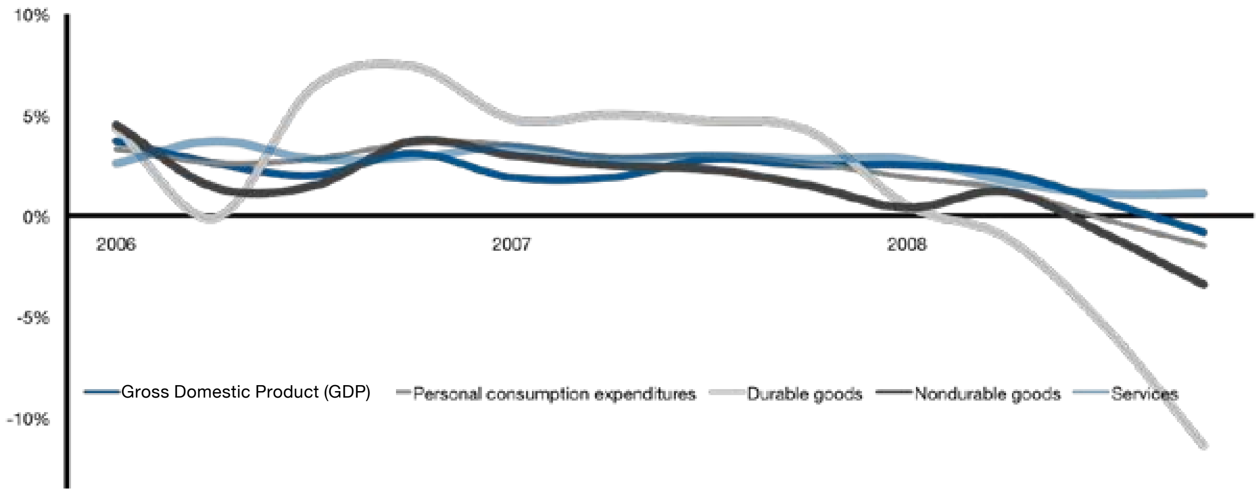


Figure 2: US Real Gross Domestic Product Year-Over-Year Change (2006-2008)   Source: Bureau of Economic Analysis

Personal Income

Personal income increased 0.4% month-over-month to USD 12.157 trillion in January 2009 (Figure 3).

- Personal consumption rose 0.6% to USD 9.886 trillion.
- The personal savings rate grew 110 bp to 5.0% of disposable personal income.

	2008											2009
	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan
Personal Income	0.2%	0.4%	0.3%	1.9%	-0.2%	-0.8%	0.3%	0.1%	0.0%	-0.4%	-0.2%	0.4%
Personal Consumption Expenditure	0.0%	0.6%	0.3%	0.7%	0.5%	-0.1%	-0.2%	-0.4%	-1.2%	-0.8%	-1.0%	0.6%
Personal Savings (in pct. pts.)	0.26%	-0.10%	0.03%	4.78%	-2.52%	-0.80%	-0.90%	0.60%	1.20%	0.50%	0.80%	1.10%

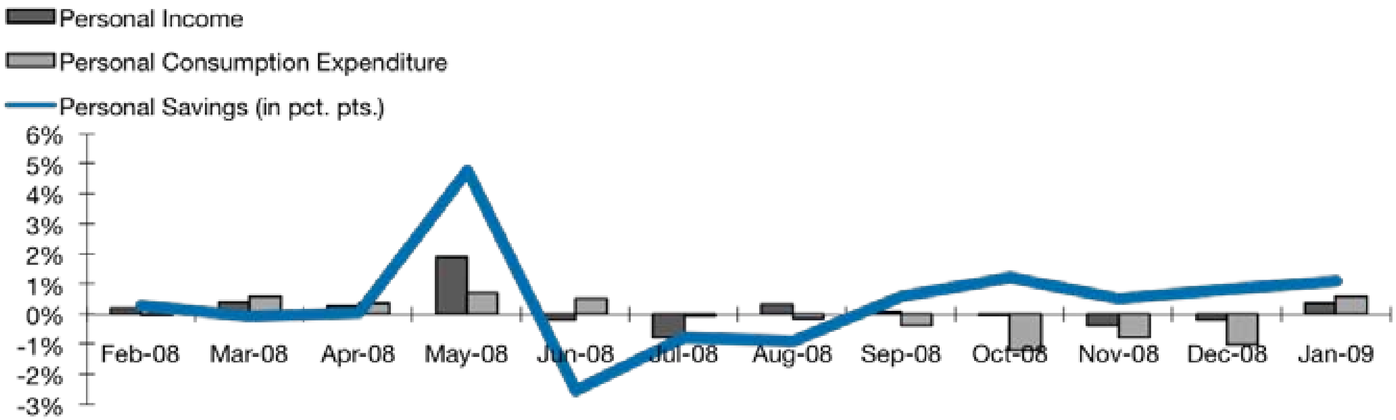
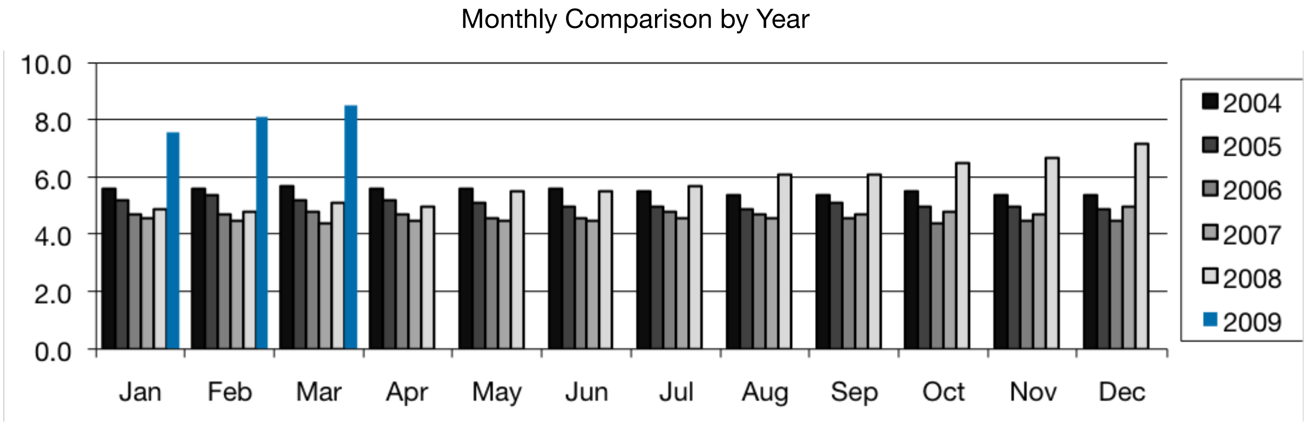


Figure 3: Monthly Changes in Personal Income Source: Bureau of Economic Analysis

Labor Statistics

The unemployment rate grew 50 bp month-to-month in February 2009 to 8.1%, seasonally adjusted (Figure 4). Unemployment in the US is defined as “people out of work who are actively seeking work.” More US workers may be “underemployed,” working part-time but desiring full-time employment.

- Average hourly wages were up USD 0.03 at USD 18.47 per hour.
- Average weekly earnings were up 20 bp to USD 615.05.
- The average work week was 33.3 hours for the third month in a row.



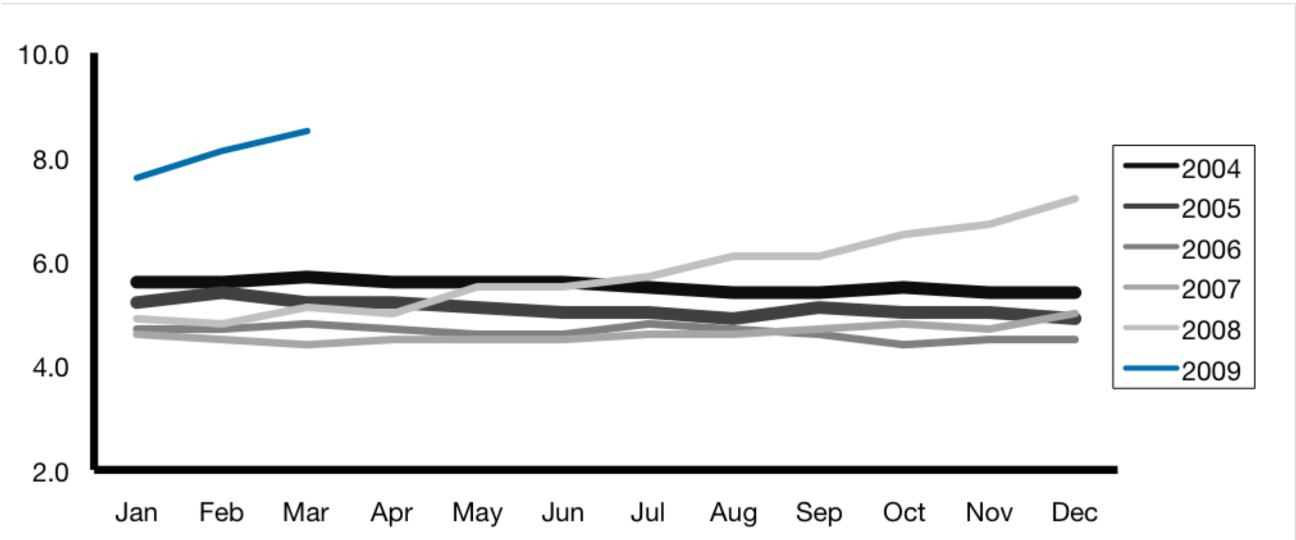


Figure 4: US Civilian Monthly Unemployment Rates 2004-2009   Source: Bureau of Labor Statistics

Consumer Confidence

The Conference Board's Consumer Confidence Index dropped a significant 12.4 points month-over-month to 25 in February 2009 (Figure 5).

- The Present Situation Index also decreased 8.5 points to 21.2.
- The Expectations Index fell 15.0 points to 27.5.

These figures represent the lowest Consumer Confidence marks on record.

Index	Consumer Confidence													
	2008												2009	
	Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb*
Consumer Confidence Index	87.3	76.4	65.9	62.8	58.1	51.0	51.9	58.5	61.4	38.8	44.7	38.6	37.4	25.0
Present Situation Index	114.3	104.0	90.6	81.9	74.2	65.4	65.8	65.0	61.1	43.5	42.3	30.2	29.7	21.2
Expectations Index	69.3	58.0	49.4	50.0	47.3	41.4	42.7	54.1	61.5	35.7	46.2	44.2	42.5	27.5

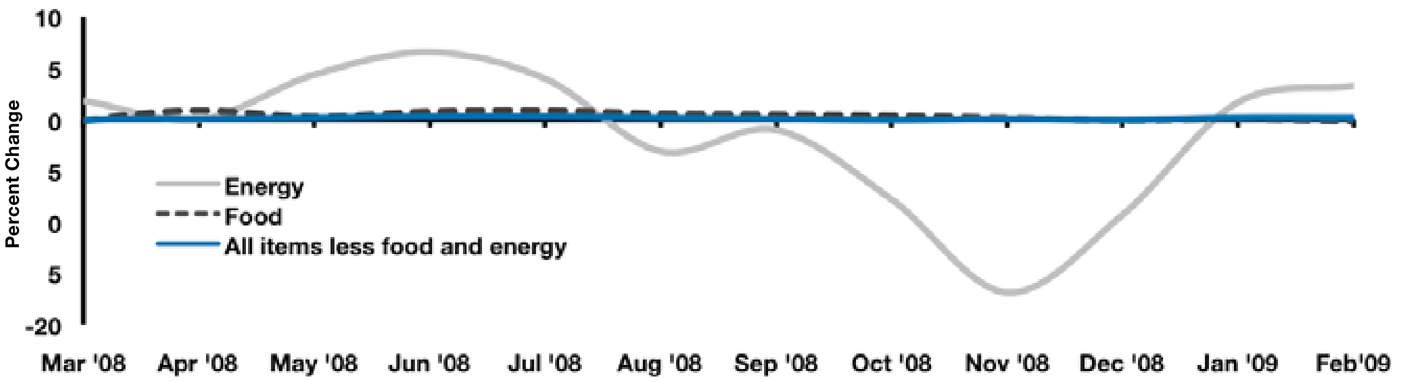
**Preliminary*

Figure 5: Monthly Consumer Confidence
Source: The Conference Board

Consumer Price Index

On a seasonally adjusted basis, the Consumer Price Index (CPI) was up 40 bp in February 2009 (Figure 6).

- Energy costs increased 3.3% for the month of February 2009. Energy costs tend to fluctuate more in the US on a percentage basis since taxation is a much lower percentage of total fuel cost in the US than it is in other developed countries. As a result, changes in retail fuel prices have a more marked effect on the US economy than in most other developed nations.
- Transportation costs increased 1.9% for the month of February 2009.



	% of Change Over Previous Month												Compound Annual Rate for 3 Mos.	Unadjusted for 12 Mos.
Expenditure Category	Mar '08	Apr '08	May '08	Jun '08	Jul '08	Aug '08	Sep '08	Oct '08	Nov '08	Dec '08	Jan '09	Feb '09	Ended Feb '09	Ended Feb '09
All items	0.3	0.2	0.6	1.1	0.8	-0.1	0.0	-0.8	-1.7	-0.8	0.3	0.4	-0.5	0.2
Food and beverages	0.2	0.9	0.3	0.7	0.9	0.6	0.5	0.4	0.2	0.1	0.1	-0.1	0.1	4.7
Housing	0.4	0.3	0.5	0.5	0.6	-0.1	-0.1	0.0	-0.1	0.0	0.0	0.0	0.0	1.9
Apparel	-1.3	0.5	-0.3	0.1	1.2	0.5	-0.3	-0.7	0.1	-0.6	0.3	1.3	3.9	0.8
Transportation	0.7	-0.7	2.0	3.8	1.7	-1.5	-0.1	-4.8	-9.7	-5.0	1.3	1.9	-7.4	-11.0
Medical care	0.1	0.2	0.2	0.2	0.1	0.2	0.3	0.2	0.2	0.3	0.4	0.3	4.3	2.8
Recreation	0.3	-0.1	0.1	0.1	0.4	0.5	0.2	0.2	0.0	-0.2	0.0	0.4	1.0	1.9
Education and communication	0.3	0.4	0.4	0.5	0.5	0.2	0.1	0.2	0.2	0.3	0.3	0.2	3.3	3.6
Other goods and services	0.4	0.5	0.4	0.4	0.4	0.2	0.2	0.3	0.0	0.0	0.3	0.2	2.0	3.2
Special Indexes	Mar '08	Apr '08	May '08	Jun '08	Jul '08	Aug '08	Sep '08	Oct '08	Nov '08	Dec '08	Jan '09	Feb'09		
Energy	1.9	0.0	4.4	6.6	4.0	-3.1	-1.0	-7.8	-16.9	-9.3	1.7	3.3	-17.4	-18.5
Food	0.2	0.9	0.3	0.8	0.9	0.6	0.5	0.4	0.2	0.0	0.1	-0.1	0.0	4.8
All items less food and energy	0.2	0.1	0.2	0.3	0.3	0.2	0.1	0.0	0.1	0.0	0.2	0.2	1.5	1.8

Figure 6: Consumer Price Index Monthly Change *Source: Bureau of Labor Statistics*

Retail Trade/Retail Sales

Unadjusted retail sales fell 13.5% from February 2008 to USD 270.9 billion in February 2009 (Figures 7 and 8).

- General merchandise store sales were down 1.3%.
- No format posted positive sales growth.
- The most notable declines came from gasoline stations, motor vehicle & parts dealers, building material & garden equipment dealers, and furniture & home furnishing stores, which were down 34.9%, 26.7%, 14.9%, and 14.8%, respectively.

	Dec '07	Dec '08	% Change	Jan '08	Jan '09	% Change	Feb '08	Feb '09	% Change
Retail Sales & Food Services Totals	433.3	392.8	-9.3%	348.8	318.2	-8.8%	348.9	305.9	-12.3%
Retail Sales (Excl. Autos)	363.0	338.4	-6.8%	281.6	265.7	-5.7%	278.6	254.4	-8.7%
Retail Sales	394.2	354.5	-10.1%	313.2	281.5	-10.1%	313.2	270.9	-13.5%
Durable Goods									
Building materials & garden equipment dealers	24.7	22.3	-10.0%	23.0	19.0	-17.1%	21.8	18.5	-14.9%
Motor vehicle & parts dealers	70.3	54.5	-22.5%	67.2	52.5	-21.8%	70.2	51.5	-26.7%
Electronics & appliance stores	15.4	13.8	-10.5%	8.9	8.6	-3.3%	8.9	8.4	-4.9%
Furniture & home furnishing stores	11.6	9.9	-15.0%	9.2	7.7	-16.0%	8.8	7.5	-14.8%
Nondurable Goods									
General merchandise stores	71.4	69.7	-2.4%	42.1	43.4	3.1%	44.2	43.6	-1.3%
Food & beverage stores	53.7	52.5	-2.3%	47.9	48.7	1.8%	45.4	44.0	-2.9%
Gasoline stations	37.0	25.0	-32.4%	36.6	24.9	-31.8%	36.8	23.9	-34.9%
Clothing & clothing accessories stores	31.2	27.4	-12.2%	14.4	13.9	-3.8%	16.1	15.1	-6.5%
Food services & drinking places	39.2	38.4	-2.1%	35.7	36.8	3.1%	35.6	35.0	-1.7%
Department stores (excl. leased)	29.6	27.5	-7.1%	13.4	12.7	-5.0%	14.5	13.2	-8.7%
Grocery stores	46.2	45.5	-1.5%	43.5	44.2	1.6%	41.0	39.6	-3.4%

Figure 7: Retail Sales　*Source: US Census Bureau*

Retailer/Division	Monthly Sales in Billions (LCU) Mar '08	Mar '09	% Change	Comparable/Identical Sales Growth Mar '08	Mar '09	2-Year Average	Fiscal Year-to-Date Sales (YOY % Change)	Comps/ IDs	Latest Store Count
Mass Merchants, Clubs, and Discounters*									
Wal-Mart Inc	37	36.2	-1.90%	0.70%	1.40%	1.00%	0.20%	3.10%	7,899
Wal-Mart International	9.5	8.1	-14.80%	-	-	-	-13.10%	-	3,635
Walmart Stores	23.2	23.8	2.60%	0.90%	0.60%	0.80%	5.00%	2.60%	4,264
Walmex	19.8	21	8.30%	6.00%	1.10%	3.60%	10.30%	3.30%	1,217
Target Corporation	5.7	5.5	-2.30%	-4.40%	-6.30%	-5.40%	-1.30%	-5.30%	1,699
Costco	6.6	6.4	-3.00%	7.00%	-5.00%	1.00%	0.30%	-2.00%	524
Costco USA	-	-	-	5.00%	-2.00%	1.50%	-	0.00%	408
Costco International	-	-	-	17.00%	-13.00%	2.00%	-	-10.00%	116
Sam's Club	4.3	4.4	2.20%	-0.70%	6.20%	2.80%	2.60%	6.10%	602
BJ's	0.9	0.9	1.70%	6.00%	-0.10%	3.00%	2.00%	0.20%	180
Family Dollar	0.6	-	-	-4.40%	-	-	-	-	-
Drugstores									
Walgreens	5.1	5.5	6.80%	4.40%	1.50%	3.00%	6.80%	1.50%	6,736
Walgreens Front End	1.8	1.8	0.50%	11.30%	-5.60%	2.80%	-	-	6,736
Walgreens Rx	3.3	3.6	10.20%	0.80%	5.70%	3.20%	-	-	6,736
Rite Aid	2	2	-2.30%	2.60%	-0.70%	1.00%	-2.30%	-0.70%	4,883
Rite Aid Front End	0.7	0.6	-7.50%	5.70%	-6.30%	-0.30%	-	-6.30%	4,883
Rite Aid Rx	1.4	1.4	0.10%	1.00%	2.00%	1.50%	-	2.00%	4,883
Longs	0.5	-	-	2.80%	-	-	-	-	-
Department Stores/Others									
Dillard's	0.6	0.5	-21.00%	-10.00%	-19.00%	-14.50%	-18.00%	-16.00%	315
Gap	1.4	1.3	-6.00%	-18.00%	-8.00%	-13.00%	-9.00%	-10.00%	3,100
JCPenney	1.5	1.5	-5.40%	-12.30%	-7.20%	-9.80%	-6.20%	-7.90%	1,101
Kohl's	1.4	1.4	0.50%	-15.50%	-4.30%	-9.90%	1.80%	-3.20%	1,022
Limited Brands	0.7	0.6	-11.90%	-8.00%	-9.00%	-8.50%	-11.40%	-8.00%	3,011
Nordstrom	0.8	0.7	-10.10%	-9.10%	-13.50%	-11.30%	-10.50%	-14.30%	173
Ross	0.6	0.7	8.00%	-2.00%	3.00%	0.50%	8.00%	2.00%	974
Saks	0.3	0.2	-24.20%	-2.90%	-23.60%	-13.20%	-25.30%	-24.60%	105
TJX	1.7	1.7	0.00%	0.00%	2.00%	1.00%	-1.00%	1.00%	2,671
Macy's	-	1.9	-9.80%	-	-9.20%	-	-9.60%	-8.90%	840

**MVI uses the term "discounter" or "value discounter" to denote dollar stores or single price point operators.*

Figure 8: Retailer Comparable Store Sales

Source: MVI-Insights.com

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