THE PRESS

www.thepress.co.nz

In-store secrets

SATURDAY , 23 JULY 2005

Thursday night is shopping night, but MATT PHILP is looking for something more in his supermarket.

The supermarket keeps its specials at eye-level and its business secrets buried deeper than the Masons. I'd been warned. John Corbett, the editor of Grocers' Review, had sighingly described the industry's attitude to scrutiny as "North Korean".

On a Thursday night at one of Christchurch's busiest supermarkets, I experience the paranoia first-hand.

It begins in the "Aisle of Value", where I have twice tried to crack the grocers' code of silence.

One of the young stackers has scurried off – to try to get permission to talk, he claims, but that last twitchy backwards glance suggests another purpose.

Two aisles on, pushing a still-empty trolley, I glance to the right to confirm that the fundamentals of store layout are being observed – high-margin products slotted towards the more lucrative centre of the aisle and at eye height; house brands below, because bargain hunters will always stoop – and when I look up the store manager is beside me, walking in lock-step.

Brad – for that is what his chest badge says – wants to know if I am enjoying my shopping experience tonight.

Lovely, thanks.

"I understand you've been trying to talk to my people."

Would that be possible?

"Unfortunately, our guys can't talk to you. It's in their contracts."

Ahh. Can he talk?

"No. Well, I can – it's whether I want to or not."

I don't want much. I don't expect Brad to confirm the suggestion that New Zealand supermarkets effectively rent shelf space to suppliers. Or to elaborate the various other stratagems by which they extract "contributions" from those suppliers. Or to demystify the blend of exact market science and crude horsetrading which determines whose product goes where. I don't want to pierce the veil.

I just want to know what's the best deal in here tonight.

No.

As a customer?

"I'm going to have to leave it there," says Brad.

It is, he explains, even as he walks away, "a cut-throat business we are in".

The supermarket turns 75 next month, and it is the crankiest of septuagenarians. In New Zealand, the industry is worth $9 billion and is fought over by just two players – corporate, Australian-owned Progressive, and local co-operatively owned Foodstuffs – with a ruthlessness that belies the candy-striped, family-friendly marketing.

Culturally, they are different beasts, says a source, a former senior servant of Progressive, who is still involved in the industry, so wants to remain anonymous.

"If you talk to a category manager at Progressive – major brands: Foodtown, Woolworths and Countdown – he talks about his or her `stores', as a building with stuff in it that includes people. If you talk to a category manager at Foodstuffs – major brands: Pak'N Save and New World, – he talks about his `members'. And if a Foodstuffs' owner-operator wants something, he gets it."

For Foodstuffs, Pak'N Save is the jewel in the crown, a high-volume, money-making machine that has played to the New Zealand consumer's innate price instinct so successfully it has grabbed one-third of the market. Progressive, which prides itself on a full-service mentality, looks to its new-generation Foodtowns.

Neither hesitates to use the courts, as happened in June when Progressive blocked progress on Foodstuffs' new Pak'N Save at Wairau Road, on Auckland's North Shore, after an 18-year fight and with the store all but built.

Most blood is spilled at the discount end, where Pak'N Save is battling a reanimated Countdown for the title of New Zealand's cheapest. At times, the tactics can descend into ugly farce.

Both Consumer and Grocers' Review have had to yank price surveys after being threatened with legal action. In the case of Consumer, it had to move to a mystery-shopper exercise after it became clear that some supermarkets were trying to rig the results, slashing prices before the surveying team arrived – there were even reports of management delaying them in-store while staff worked the price-gun into a white heat two aisles over – and raising them immediately they had left.

The Consumers Institute's chief executive, David Russell, describes the supermarkets as "manipulative". That incident, "was a good indication of the competitiveness of the chains. They keep a very, very close eye on each other."

Margins are tight. And with the takeover of Progressive by mega-operator Woolworths Australia imminent, the game, until now narrowly dominated by Foodstuffs with 55 per cent of the market, is likely to become even closer.

John Corbett, of Grocers' Review, says the industry is on edge about the new player. "How are they going to deal with local manufacturers and suppliers? How fair-handed are they going to be? Are they going to bring in more house brands and dislodge local people? The fear is that they will treat New Zealand as just another unit."

All this sound and fury over groceries? There is an intimate aspect to what supermarkets do. Food shopping, as someone has put it elsewhere, "is part of the veins that make up a household and the relationships in it". But on the face of it they are the most straightforward of businesses: buy at one price, sell for another, right?

Think again. Behind those shelves festooned with bright specials labels is a world of torturously evolved and closely guarded business arrangements. And in a sense, those arrangements are all about space.

"Many shoppers believe supermarkets make their money from selling products. They do not. Their billions come from the charges they level on their shelves and floor space."

That's Mark Dapin, writing in the Sydney Morning Herald's Good Weekend magazine about the Australian supermarket industry. Asked whether Aussie supermarkets could make a profit without suppliers' subsidies, one retail expert tells Dapin: "Absolutely not. They would not cover their costs."

These so-called "slotting fees" evolved out of advertising arrangements, writes Dapin.

"In the early days, when supermarkets made a profit simply by selling their goods to the public, they used to fund their own catalogues and flyers. After a while, they realised they were paying to advertise another company's product and approached that company for a contribution."

A couple of grand became $50,000, then $100,000. For untried new products, argued the retailers, slotting fees were a fair mechanism for sharing risk.

"There was always a special space associated with the promotions charge, and eventually the charge became simply a space charge."

Across the ditch, space charging tends now to be disguised in the rolled-up terms of trade. But one local source, with experience of the Australian scene, says that space charging can still be startlingly crude.

"The horror stories you hear out of Australia lately from New Zealand suppliers who are in both markets are quite something. At its most outrageous, I've heard of manufacturers being asked $500,000 to stay listed in a chain. `That'll be half-a-million, thanks, otherwise ta-ta'."

Does it happen here? In one respect, there's no reason why it shouldn't. In a New Zealand supermarket, as elsewhere, space is a finely measured and diversely valued commodity.

Some space is more lucrative than other space, and traditionally stores have been built around the idea of steering your wallet through the big-earning areas.

That's why you enter at the "fresh end", where the markup is around 30 per cent, and not among dry goods, where it is considerably less, and why staples such as milk tend to be placed in corners which can only be reached by walking down an aisle.

At the level of the shelf, the considerations have become so fine as to have spawned "planograms", computer programmes with which the retailer may micromanage the arrangement of individual categories, highlighting slow sellers and stock levels, and zeroing in on shifts in consumer behaviour.

With a half-decent planogram, any manager ought to be able to measure his return on investment almost down to the square centimetre.

For the supplier, the prime real estate is the middle of an aisle, at eye level. (The thinking, according to Dapin, is that "at the beginning of an aisle you have not started focusing; by the end you're bored".)

But the ultimate honeypots are the promotional bins at aisle ends – the so-called "gondola ends" – and the checkout shelves. It's no secret that local supermarkets charge suppliers

a premium for the short-term, showcase spots. However, according to Brenda Cutress, of the Food and Grocery Council, "New Zealand suppliers don't pay to get their product onto the shelves".

John Winter, managing editor of food-and-beverage trade publication FMCG magazine, agrees, adding that some are worried that Woolworths Australia will try to introduce slotting fees when it arrives.

"In comparison with Australia, it is a very tight, very efficient game over here, and that's why there is such concern about paying for shelf space. It's not something anyone in the industry wants to see."

But our insider, the former Progressive man, claims that charging for shelf space beyond the honeypots is already well established.

"Being at eye level in a grocery aisle, for example, is a very desirable position and suppliers will find ways and means to get there. In some cases that will mean offering a financial incentive to make sure they get that position over a competitor or the house brand.

"If you as a supplier go into a supermarket, nobody will hand you a menu and say `please choose'. Nobody gets told to open the chequebook. It happens in a roundabout way and is classed as a `promotional package'. Anything you see in a catalogue that is branded, you can bet that it is being sold in terms of space."

It's not just about selling space. "When Progressive was owned by (Australian outfit) Coles, one of the people who came over was euphemistically called the merchandise promotions manager and his job was to teach New Zealand category managers how to negotiate more money out of suppliers.

"There were times while I worked there, when the company was making more money from supplier contributions than from sales margins."

Where supermarkets are able, particularly in the case of highly perishable goods, they will put the cost for stocking their shelves onto the supplier. Overseas, some operators have taken this concept of product support to an extreme, whereby "they are saying that the Coca-Cola in its bottle will continue belonging to Coca-Cola right up until about three nano-seconds before it crosses the checkout scanner".

Random promotions are another revenue generator. "The marketing department will come up with a theme, and if there isn't one it will invent one like International Food Week and the relevant suppliers will be asked, and in some cases `politely encouraged', to participate."

If they don't, he says, "they may eventually find they become a non-supplier".

"At one level, it's all perfectly plausible. As a retailer you can say: `Well those are all costs that someone needs to incur in order to get the product consistently into the supermarket trolley'. But the question is who should incur those costs? Is it the function of the supermarket to determine how the supply chain is structured?"

In the relationship between supermarkets and suppliers, the power is with the shopkeeper, even more so since the merger of Progressive and Woolworths New Zealand a few years ago.

No supplier can afford to get offside with the Big Two. None will talk on the record. Off the record, however, they complain they are in a vice.

"They are always trying to squeeze your margins," says one. "They are very aggressive, but they are also very sensitive about being accused of being bully boys."

When it comes to terms of trade, he adds, most suppliers are conscious of the need to be evenhanded.

"Because if you ever got caught out, you could potentially lose 40% of your sales."

The advent of house brands, or private labels, has tilted the balance of power still further, says our former Progressive man.

"Before, the supermarket could have been described as the place where Coca-Cola reached its customers; now it is the place where Coca-Cola competes with the private label to get to the consumer."

For the supermarket, the private label represents a higher margin, more control and less hassle. And potentially more leverage to push for a discount.

But the degree to which supplier margins have been eroded is arguable.

Tim Morris, of food and fast-moving consumer goods consultants Coriolis Research, points out that in some categories in some locations – fruit and vegetables in Auckland, say – supermarkets account for less than 50% of the market.

"The suppliers who are falling through the cracks are the smaller New Zealand companies. But, then, is there really a need to have a number-four supplier of some minor category at the supermarket?

"If supplier margins are getting squeezed and the retailers are passing that saving on to the consumer, I don't have a problem with it.

"So, where is all the money going? With Foodstuffs, because they're all independent operators, you can only go on anecdotes. And the anecdotes are that owning a Pak'N Save in New Zealand is a licence to print money. Those guys are all multi-millionaires.

"But on the flipside, I've looked at Progressive's accounts and they aren't making excessive amounts."

Are they passing it on? Between June 2002 and June 2004, when the Consumer Price Index rose 3.88%, the Food Price Index rose by less than half of that.

Says Consumer's David Russell: "The consumer is benefiting, especially on commonly bought goods."

* * *

On a miserable night in Christchurch, not long after the shortest day, the distillation of cheerlessness is Countdown on Moorhouse Avenue.

Even though it's Thursday, when supermarkets may be expected to be doing some of their best business, rain sweeps across an almost empty carpark. I have driven past once thinking it must be closed.

Inside, where the staff outnumber customers, a checkout guy drags a rubbish sack mordantly down an aisle. I have walked into what may be the saddest supermarket in the world.

This was once a Big Fresh, a 1980s-store concept based on a farmyard. It's been rebranded, but no-one has bothered to remove the big plastic Grizz Wyllie lookalike or the barn animals, so they remain as artefacts, evidence of a flawed premise: that grocery shopping could be funny.

Where Big Fresh went, today's supermarkets fear they could sink. And for all their power, they have challenges.

The Warehouse is trumpeting the imminent launch of its "hypermarkets" – although plenty of watchers remain sceptical about its chances. There are perennial rumours that German cut-price king Aldi is about to make an entrance.

There are more fundamental challenges. Household expenditure on food is shrinking; people are eating out. New Zealand's population mix is changing and this has fragmented the market.

Specialist independents are staging a comeback, and where they have serious scale, as in the case of the Mad Butcher or the North Island chain Fruit World, they represent a significant competitor, able to offer a specialised service and better range. In Auckland, independents get half of all fruit and vegetable sales.

For all their cumbersomeness, local supermarkets are gearing up for the fight. Pak'N Save has slashed its lines – some local suppliers will testify to the pain – so it can buy in greater volume.

Progressive is rolling out new-generation urban stores painstakingly designed to entice the basket shopper. All are moving into more profitable general merchandise.

But Morris, for one, believes that in the long term they will struggle. "Globally, the supermarket is really losing its way to other competitors, to the general merchandise hypermarkets. It's a format of the past and it is in a long, slow decline. There is," he concludes, "no future in food."

Someone had better tell Brad.

THE PRESS

»RETURN TO PARENT SECTION