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RABOBANK REPORT HIGHLIGHTS SUCCESS FACTORS FOR FOOD RETAILERS IN CURRENT MARKET

NEW YORK (Aug. 28, 2008) – A new Rabobank report, **"**Food Retail: Sailing Through Turbulent Waters," finds that food retailers must look beyond traditional differentiation strategies to succeed in today's economy.

"Most retailers have been honing their differentiation strategies in recent years. Those that have competed on price have outperformed many of their main competitors, but others with a clear differentiation strategy have also shown good growth," said Rabobank Food & Agribusiness Research and Advisory (FAR) Vice President Stephen Rannekleiv. However, in light of food and fuel inflation and the soft economy, some traditional strategies may not be as effective as they once were."

In order to succeed, the report examines three key elements for effective positioning: customer and competition knowledge; ability to communicate a value message; and cost controls.

Customer and competition knowledge

"While differentiation strategies are becoming increasingly important, changes in competition and in consumer priorities are altering the effectiveness of traditional strategies," said Rannekleiv.

Consumers continue to maintain various priorities when it comes to purchasing food – health, convenience, price, etc. – but they are now focusing on one of these priorities to an extreme, almost abandoning the others completely. This is creating a "trend of barbelling," which creates a more challenging environment for food retailers in the middle. Retailers who have designated a specific consumer priority are seeing more success.

For example, Whole Foods caters to less price-sensitive consumers seeking unique gourmet and organic products, and had some of the highest gross margins and comparable store sales growth of its competitors. Conversely, Kroger has cut prices and continues to outpace its main competitors in same-store sales growth.

Retailers that had positioned themselves to compete by offering consumers healthy options may find that this is becoming less effective as a differentiation strategy. Healthy lifestyle offerings are becoming ubiquitous, and successful competitors are combining healthy lifestyle offerings with other differentiators such as price, gourmet offerings and convenience. Retailers that have healthy lifestyle options, but not another strong differentiator, may be caught in the middle of the barbell. Finding the right balance depends on knowing what the competition is doing and what the customer wants.

Value message

"In the current economic context, value is increasingly important to consumers, but it is ill-defined and subjective," said Rannekleiv. "Reducing prices and offering specials only serves to compromise margins unless consumers perceive the value clearly enough to drive increased traffic."

Successful retailers consistently monitor consumer reactions to pricing and react accordingly. However, retailers must balance their response to current consumer priorities without jeopardizing the long-term value of their brands' identity. To do this, retailers should evaluate the balance of their overall brand portfolio, and focus resources on those that respond to consumer demand – rather than reposition the image of a brand to respond to cyclical conditions.

Cost Controls

"While smaller retailers have faced cost disadvantages for some time relative to their larger competitors, the ongoing challenges in the economy can be expected to create greater price competition," said Rannekleiv. "This will further squeeze margins and create an increasingly challenging environment for smaller chains, and will likely lead to further consolidation."

As retailers seek to control operational costs, health care and distribution costs have become the main targets. According to the Food Marketing Institute, on average health care costs have risen 7-10 percent annually for the past three years. To combat this increase, retailers – both large and small – are finding a middle ground by increasing the deductibles but also promoting wellness and giving incentives to employees for reducing their health risks.

Given current fuel costs, distribution is also an area of concern. Smaller retailers, who don't manage their own distribution, are more limited, but others have made investments in technology to improve inventory forecasting, which can reduce the number of deliveries. Reducing just one delivery per week can save more than $10,000 per store.

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