Supermarkets: How to Compete Against Walmart and Amazon Using Price

by Hubert Paul, Shikha Jain and Ricardo Rubi

How can supermarkets compete against online retail giants Walmart and Amazon who are aggressively entering their markets via online grocery ordering, curbside pickup and home delivery? In this article, the authors explore how supermarkets can use pricing strategy to actively compete and improve their price image with consumers without giving away their bottom line. Hubert Paul is a Director, Shikha Jain is a Senior Director, and Ricardo Rubi is a Partner in the Simon-Kucher & Partners Consumer and Retail Practice. They can all be reached via www.simon-kucher.com.

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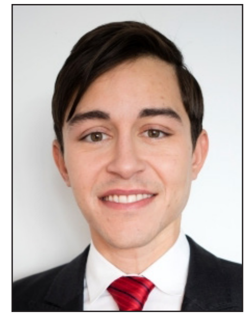

Ricardo Rubi

While the shift to ecommerce and innovations in the digital experience will continue to dominate the press, reality shows that shopping at physical supermarkets is still a great American pastime. This doesn't diminish the fact that threats vying for the same basket continue to put pressure on brick and mortar stores.

Already the world's largest retailer, Walmart posted its best sales in more than a decade by fueling their grocery business, particularly by improving their fresh offerings at those established everyday low price points. The other elephant in the room, Amazon, has been using its Whole Foods physical presence to roll out Prime loyalty promotions and discounts in an effort to make quality food affordable. European discounters like Aldi and Lidl are learning from their early missteps to better understand how Americans shop. The threat these two discounters pose once they crack the code is so large, that even Walmart has had to slash prices for the past three years.

What's the common thread here? The current ecommerce arms race is based on the foundation that Walmart, Amazon, and European discounters are very price competitive from the viewpoint of the consumer. For example, Walmart now continues to brickwall its 25% share of an $800B addressable market by investing further in online grocery, adding curbside pickup at more than 1,800 stores and piloting same-day delivery this Fall. This will directly compete with Amazon's existing Prime Now and Amazon Fresh delivery services. Supermarkets can (and should) join in to improve their digital capabilities but if they aren't first getting the credit that Walmart and others are getting for value, the American grocery shopper will continue to shift away.

With more options than ever over the past decade, households are spending more and more on groceries every week. Food prices have stayed flat during that same time period, which means Americans are buying and consuming more. However, supermarkets aren't getting those dollars like they used to. Whereas supermarkets used to be the primary store, households are now using as many as 3-4 channels to meet their grocery needs. **With more places to buy that exact same box of cereal from, price remains king and will most likely be the tiebreaker at checkout.**

The urgency for supermarkets to best compete by first focusing on improving their price image could not be greater. However, experience has shown common pitfalls supermarkets make in an effort to take the right steps toward pricing excellence:

Building the foundation: Organize the assortment

Supermarkets cannot beat Walmart and Amazon simply by matching their prices across the board. Supermarkets first need to know what role (i.e. price image driver vs

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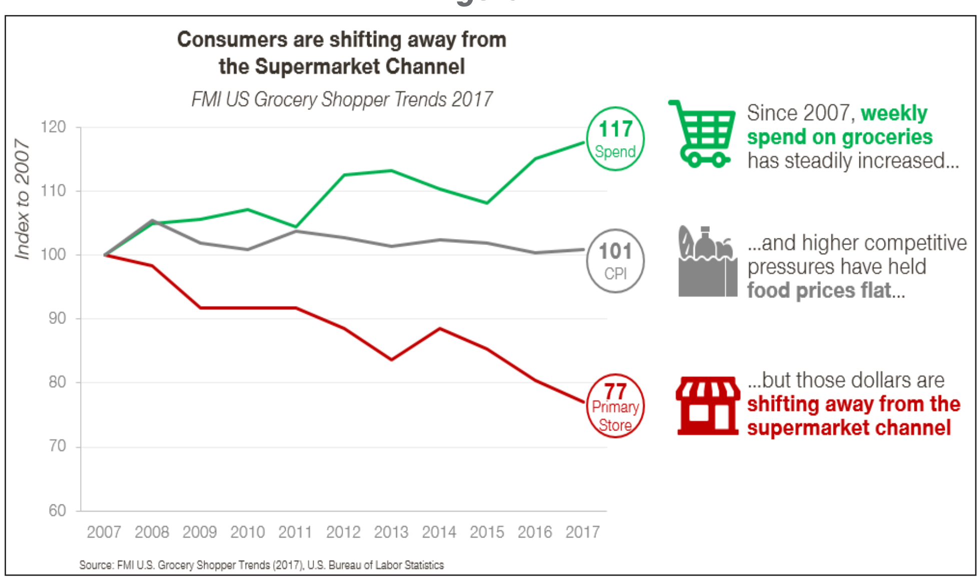
Figure 1



margin builder) each of their SKUs plays within the assortment from the perspective of the consumer. It's easy to fall into certain pitfalls where prices are set using only the first two out of the three crucial Cs – cost, competition and you guessed it, consumer.

Pitfall 1: Guiding pricing decisions solely based on margin targets and/or competition

Most businesses have minimum margin mandates. To that end, supermarkets typically look at cost and competitor prices to guide their pricing strategy. Both of these inputs are highly tangible and should be factored into the final decision. However, since consumer reactions and price sensitivity across categories are not as transparent and harder to quantify, supermarkets more often than not end up ignoring the consumer. In reality, consumers are the ones who establish the supermarket's price image.

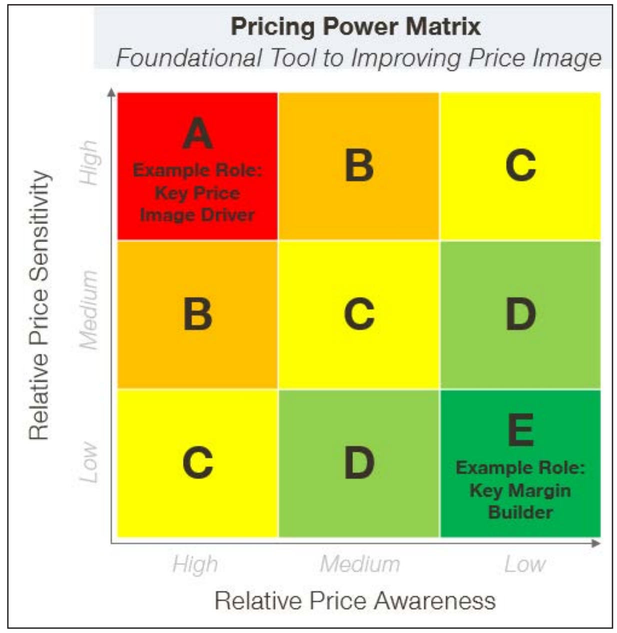
Pitfall 2: Relying on gut-feel or general shopper insights

Even when supermarkets claim that consumers have been incorporated into pricing strategy, it's usually based on gut-feel or general shopper insights. In the worst case, it's based on personal biases that put themselves in the shoes of the consumer (because let's face it, almost everyone buys groceries). As a starting point, supermarkets can use historical data to analyze consumer behavior as it relates to price, and then build on it through targeted primary pricing research.

Pitfall 3: Treating all SKUs equally

Organizing the assortment means not all categories are created equal. However, we typically see supermarkets operating at the category level either because they structure their P&Ls at this level, or because it is easier to break down the complexity of the entire assortment into manageable chunks. As a result, overall store performance is not fully optimized. Understanding the roles categories play compared to each other is crucial to shaping your overall price image objectives.

Figure 2



Where supermarkets strive to be: Competitive only where supermarkets need to be.

We recommend utilizing a pricing tool, such as the Pricing Power Matrix shown in Figure 2, as a foundation that can organize the assortment and assign roles for all SKUs. From here, supermarkets can create a differentiated and surgical pricing strategy. It is crucial to getting price image right on the 3-5% of SKUs across the assortment that are the primary price image driving, or "A" role. Not only should the pricing on these SKUs be competitive to drive overall price image, but they should also be promoted on the front page of your circular to drive traffic to the stores. Supermarkets can then use the opposite end of the spectrum, or the "E" SKUs, that can withstand higher prices with volume drop-offs to help build margin.

In conclusion, a one-size-fits-all cost-plus pricing approach to the assortment poses significant revenue (and as a result market share) risk to the business.

Be proactive especially in this challenging and evolving retail environment. ❖