Insight from industry

From commodity marketing to category management: insights from the Waitrose category leadership program in fresh produce

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Abstract

Looks at how Waitrose deals with commodity marketing and category management by examining its category leadership strategy, which aims to reduce costs and align its network to the needs of the consumer. Seeks to shed light on how this was achieved and the key lessons to be learned from this procurement strategy. Concludes that the category leadership strategy requires a fundamental shift in the role of the retailer and supplier as well as a redesign of the performance measurement systems, but once these are achieved there are significant and guaranteed rewards.

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Introduction

Over the past decade the produce industry has been evolving from a horizontal to a vertical alignment. Vertically aligned networks servicing the major retail chains are replacing horizontal layers of growers, agents and retailers. Different countries are at different stages of this evolution. It is fair to suggest that the UK is at the leading edge of these developments, and Waitrose, under category leadership, has pushed further than any other retailer.

Reducing costs is typically the first task addressed by these supply chains. Rather than simply purchasing product on the open market the retailer works with a reduced number of suppliers to ensure consistency of supply and remove costs. The focus of collaboration is internal on the supply chain. But the system remains supply-driven.

The next big challenge in this evolution is to align the whole network to the needs of the final consumer: to create a system that is flexible and responsive to changes in consumer demands. The aim is to put value in, and not just pull costs out. This is the essence of category leadership, where the big gains in the future will come from creating value in the retail store – and not from reducing supply chain costs.

Over the past four years, under the direction of John Foley, Head of Buying – Fruit, Vegetables and Horticulture, Richard Hind and his buying team at Waitrose have been implementing a "category leadership" program in the Waitrose fruit business.

During this time the number of fruit suppliers has been reduced from over 100 to around 15, with one key supplier for each major category. The whole objective – and key challenge – over this period has been to work closely with these key suppliers to reduce costs and to grow the category.

In the year 2000/2001 Waitrose increased average pack prices by 7 per cent when the industry average was down 2 per cent, yet sold 20 per cent more fruit by volume compared with an industry average increase of 2 per cent and increased revenue by over 20 per cent compared with an industry average of 6 per cent. This article seeks to shed some light on how this was achieved and the key lessons that can be learned from such a dramatic change in procurement strategy.

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The UK fresh produce industry

The UK fresh produce industry accounts for 12 per cent of total expenditure on food with a retail selling value of over £7 billion. Overall, per capita consumption is flat in volume terms but is showing growth in value terms as shoppers increasingly seek value-added convenience items. Moreover, there are distinct differences between and within product categories (e.g. per capita consumption is increasing for fruit but decreasing for vegetables, increasing for seedless grapes but falling for seeded grapes) creating considerable opportunities for product differentiation and market segmentation.

The UK is about 80 per cent self-sufficient in vegetables but below 20 per cent self-sufficient in fruit. By European standards, UK consumers have a relatively low consumption of fruit – historically fruit was not an integral part of the diet simply because it was not available for most of the year.

Three items – potatoes, apples and bananas – account for almost half of total fresh produce consumption, but the category is growing week by week in terms of the range of products available and the formats offered – quality and choice are the key drivers in this "destination" category.

The 1990s witnessed an astonishing rise in importance of the major supermarket chains. In 1990 supermarkets accounted for less than half of all produce sold at retail, and this had increased to over 80 per cent by the end of the decade.

During this time fresh produce became a "destination" category for which shoppers will choose and switch stores. The produce department moved from the back to the front of the store and shelf area doubled. It is virtually totally supermarket own label.

This trend has revolutionized the produce supply industry and has led to a terminal decline in the role and importance of the wholesale markets. The number of marketing agents has been decimated: those who remain have transformed themselves into pre-packers acting as the key link between the supermarket and grower. They take responsibility for building global supply networks and sourcing supply for year-round delivery.

The Food Safety Act of 1990 had a significant impact on the evolution of the industry over this period. This Act requires supermarket buyers to take all "reasonable steps" to ensure that the food they receive from suppliers is safe. The growth of own label produce increased the need for improved due diligence and tighter supply chain control. The process of vertical co-ordination was thus driven by the retailer backwards, and not from the grower/processor as is typically the case.

Quality control and traceability became critical. Retailers developed and issued to suppliers codes of practice covering all aspects of crop management. In-house supermarket technical teams were developed to ensure compliance. Supply chain issues continued to evolve and environmental and worker welfare issues were developing as the next threshold.

UK supermarket industry structure

In the relatively static food market in the UK there is intense competition between the major supermarket chains, of which the top four – Tesco, Sainsbury, Asda, and Safeway – account for almost half of total grocery sales, worth just under £100 billion (see Table I). The growth strategies of the previous decade, based on new out-of-town store openings, has been replaced with strategies based on differentiation and price.

The Wal-Mart purchase of the Asda chain in 1999 in particular initiated a new wave of price-based competition. The Wal-Mart-Asda link also generated a new level of sensitivity between retailers and their fresh produce suppliers. Tesco and Sainsbury, for example, were loath to develop relationships with any supplier to Asda. Thus, the market continues

Table I UK retail grocery sales and market share, 2000/2001

Retailer	Sales £billion	Market share (%)
Tesco	16.16	16.2
J. Sainsbury	11.47	11.5
Asda	9.48	9.5
Safeway	7.48	7.5
Co-op	5.48	5.5
Somerfield	4.99	5
William Morrison	3.29	3.3
Marks & Spencer	2.79	2.8
Waitrose	2.09	2.1
Total	99.8	59.6

Note: Source: IGD

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its evolution towards vertically aligned chains servicing the major supermarkets.

In this environment Waitrose tends to compete against Marks & Spencer for affluent shoppers and with J. Sainsbury, whose "taste the difference" strategy is designed to attract would-be Waitrose shoppers.

The success of the category leadership strategy in fruit is reflected in the fact that Waitrose has achieved over 5 per cent market share in fruit retailing compared with 3.5 per cent market share in grocery products. In some products, such as exotics, the market share of Waitrose is as high as 12 per cent.

Waitrose

Waitrose is the food business of the John Lewis Partnership, which operates department stores in the UK. The key feature of the John Lewis business is the partnership structure. All employees are partners, which has two key benefits:

(1) *A longer-term strategy horizon.* Waitrose is not the "victim" of a daily share price, which tends to focus management attention on the next quarterly results. Management can focus on initiatives that may take some time to generate rewards.
(2) *Staff stability.* Employees are more likely to spend four to five years in their position and thus are able to plan and implement new strategies. Richard Hind was aware from discussions with suppliers that one of their key frustrations with the major chains was the rate of staff movement – buyers were typically not in their position long enough to develop a deep understanding of the fresh produce industry and produce retailing. Typically buyers spend two years in fresh produce as part of career progression across a range of categories including grocery, bakery, meat and fresh produce.

Waitrose operates 137 stores primarily in the south of England. Turnover in 2000/2001 was £2.1 billion.

Waitrose's vision is to be the authority on food and to anticipate future consumer needs. The focus is on genuine innovation and not just gimmicks. The success of this strategy on quality and "food authority" is reflected in the fact that Waitrose gained market share during the recent food scares in the UK with respect to salmonella, BSE and *E-coli*.

Waitrose's food authority position is assisted by a range of quality food publications such as the quarterly *Food Illustrated*, the quarterly *Seasons* (which promotes seasonal fruits and vegetables) and the monthly *Selections*.

Waitrose is a relatively early adopter of technology. For example, trials of a new space-planning software product, MarketMax, are currently in progress. This software optimizes space planning and generates planograms for each individual store. The system takes facings, service levels, space and adjacencies into account. Richard and his team have been actively involved in the trials as it can also handle seasonal products.

Category leadership

John Foley and Richard were always clear in their minds that "category leadership" in fresh produce was not simply another "category management" initiative taken from grocery and applied to produce. The dynamics in produce retailing are different from grocery and the new initiative had to be built from the ground up. The key features of category leadership that Richard had tried hard to impress on his buyers and their suppliers were:

- *A whole chain view.* Many retailers and suppliers have a relatively narrow view of "category management" by limiting the approach to the buyer-supplier relationship. Waitrose, on the other hand, have always had a whole chain view of category leadership by encompassing the retail store back to the grower. This has meant that the buying team has had to develop not only a more detailed understanding of the grower, but also stronger links internally with retail operations and promotions/marketing teams.
- *Maintaining responsibility.* Rather than abdicating responsibility for the category, Waitrose is playing an expanded role in managing the supply base. The aim is for growers to consider themselves Waitrose growers – with an excellent understanding of the needs of Waitrose and the Waitrose shopper.

- *The dual focus has to be on continually driving out costs and growing the category.* But rather than lower costs through price negotiation with suppliers, Richard and his team were convinced that the best way to lower costs was to work with suppliers and growers to work smarter.
- *Innovation is critical.* The fruit buying team has identified and implemented a number of initiatives and will extend this strategy in the future. A market research program has commenced and a full-time marketing manager, Ian Durrant, now supports the fruit buying team. Ian's primary role is to prepare marketing programs stretching out two years and to represent the fruit, vegetable and horticulture team in editorial negotiations with the different publications to ensure high visibility of the various products.

The aim of category management is to shift the goalposts from the distribution centre (DC) – where quality control is the test – to the retail store where the consumer is the judge. This sounds easy, but it involves the design of a totally new performance measurement system.

The foundation for category management in the fresh produce industry is all about providing the incentive structures to support this transition from the DC to the store – to provide the incentive in a non-branded environment to encourage innovation. Allocating a significant proportion of the business to a supplier so that it benefits if the category grows creates the incentive. Waitrose has achieved this by nominating a single supplier for each major category. Therefore, category leadership is not just about collaboration. It is about collaboration where the aim is to grow the business and not just reduce costs.

Once the incentive structures are in place, the second key task is to develop marketing capabilities in the system. Under category leadership, retailers recognize that they cannot develop all the marketing skills to cover the full range of products from luxury items (such as strawberries) to staples (potatoes), snack foods (apples) and niche products (mangoes). The retailer aims to unleash the expertise in their supply base and work together to grow the category.

The level of competition does not decrease with category management. The race is to develop marketing capabilities and to manage information. The competition is more intense and sophisticated and the stakes are higher. The role of the supplier changes to that of marketer and information manager. The role of the buyer changes to that of supplier developer and relationship manager. Thus, the buyer is not simply an assessor of the supplier's performance but an active partner in assisting suppliers to expand their role.

Relationship assets and category management

Category leadership is fundamentally different in fresh produce compared with category management in grocery products. In grocery, the value of understanding consumers and managing information is captured in the brand. The brand is the promise and provides the link between the product and the consumer. As the manufacturer invests in marketing capabilities, the value of the brand – as an intangible asset – increases.

There are now sophisticated ways of measuring and managing the value of the brand asset, and a number of companies now include this value in their financial statements. But in produce there is no brand to capture and reflect the investment in consumer understanding.

In the produce industry the set of relationships is more complex and includes consumers, retailers and suppliers. The brand as promise is between the retail chain and consumers. The supplier, rather than investing in a direct brand relationship with consumers, invests in the relationship with the retailer.

But it is still useful to think of this relationship as an intangible asset. It is the relationship between the supermarket and the supplier that is the asset in the fresh produce industry. Both the supermarket and the supplier invest in this relationship, and the relationship grows in value as an asset.

The relationship asset – like all assets – has cash flow implications. The asset can be assessed on how it enhances the performance of the business, such as:

- *Increasing cash flows.* For example, increasing operating margins through better managing price and promotions.

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- *Earlier cash flows*. For example, the more rapid introduction of new packaging and products.

So category leadership in produce is very much about managing the web of relationships between the product and the consumer and between retailers and suppliers. Once the relationship asset issues have been addressed, then the business of managing information and growing the category can be addressed.

Clearly, investing in the relationship with the supermarket is a more risky – but less expensive – investment than the brand relationship directly with consumers. The secret for retailers is to create an environment where suppliers are willing to make this investment. There is no doubt that Waitrose has been extremely successful in patiently developing the relationship with key suppliers – to the stage where these suppliers willingly invest for the Waitrose business.

The whole culture of the retail buying organization at Waitrose has fundamentally changed. Encouraging suppliers to be comfortable investing in the retailer's business is a world away from playing suppliers off against one another and buying on price. Somewhat counter-intuitively, the big difference in the size and power of the retailer and supplier make it even more difficult to design a system where both sides are willing to invest in the relationship. The retailer has so much power compared with the supplier, and such unbalanced relationships are not easy to manage. The trick is to ensure that the supplier is not simply becoming more dependent on the retailer. For example, by having a single supplier for each category, Waitrose has placed itself in a position of mutual dependency with its suppliers.

Designing and implementing systems to support relationship investment and the growth game is the foundation for category management in produce. The next step is to increase the value of information embedded in produce products.

The performance reference point

The essence of category management in produce is to shift the goalposts from the distribution centre to the retail store. In order to achieve this the right incentive systems have to be built and marketing capabilities developed. This section proposes that the use of scanning data is the secret to both these challenges.

Over the past five or so years the major gains have come from removing costs from the supply chain. Shifting the performance reference point closer to the end consumer recognizes that the big gains in the future will come from putting value into the supply chain – and not just ripping costs out. The challenge now is to better manage value. Putting value in is the heart of category management.

In other words, the question we are trying to address expands from "Are we efficient?" to "Are we effective and efficient?". As well as managing efficiency measures such as shrinkage, quality and labour utilization, the produce department embraces performance measures such as managing price, promotions, price perceptions and overall category profit.

Scanning data are the basic data source for managing value. Every time a shopper purchases a produce item this value decision is recorded via the scanning data. Why did he/she choose this tomato and not that one, why did he/she buy the peach at this price but not that price? Retailers collect a veritable gold-mine of information from the decisions made by their consumers. It is no accident that the term data mining is used to describe the quest for capturing insights from such data.

This does not imply that retailers should neglect those who do not currently shop at their stores, as this is one source of future growth. But there is so much information locked into the mine of scanning data that this is a logical point to start.

Furthermore, supermarket chains typically have a large number of stores so that internal benchmarking can be used to highlight critical success factors, craft strategies and monitor progress. Together, it is the ability of retailers and suppliers to embed consumer information into the product. The overall value of the actual commodity decreases and the value of embedded information increases. New products, packaging, promotions, merchandising and pricing are basically information embedded in the product.

Promotions provide the secret to better understanding consumers. The different types of promotions provide the stimulus for gauging consumer response to changes in price, packaging, and merchandising. The

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consumer response to promotions provides the insight into addressing issues such as:

- How volume sold responds to changes in the price of the product? In produce there is a complex relationship between quality, price and promotion. There are not many products where the price can be lowest when the quality is at its peak such as in the middle of the peach season. But, just to confuse the shopper, at other times the price is low when the quality is poor.
- The impact on substitute products. For example, if white-fleshed peaches are on special offer, what other stone-fruit varieties suffer a sales drop?
- The impact on complementary products. For example, if iceberg lettuce is on special offer, does this increase the sale of peppers if consumers are prompted to make more salads?
- How does the volume sold vary with changes in the type of promotions and merchandising?

Scanning data gold mining can also be used to tease out issues such as which products are sensitive to competitor pricing and when the retailer should respond to competitor activity – and when not.

In addition, the perishable nature of the product is a bonus for this type of analysis. With grocery products, promotions may simply stimulate pantry-stocking behavior, with no overall increase in consumption. But shoppers do not stock up when peaches are on promotion. There is a direct link between purchases and consumption.

Category information and scanning data also provide the reference point for retail buyers to manage themselves and assess their performance. Category management treats the buyers and suppliers as knowledge workers, who basically manage their own performance. Traditional command-and-control management systems will not work with this new business.

Conclusions

One of the key themes in this case study is that the transition from cost leadership to category leadership does not happen naturally. There is no natural evolution from an internal supply chain orientation to a focus on the consumer. The Waitrose category leadership strategy shows that this approach requires a fundamental shift in the role of the retailer and supplier as well as a redesign of the performance measurement systems and incentive structures.

Our assessment – and the Waitrose experience – are that the rewards are guaranteed and significant. There is no doubt that price is becoming less dominant in the produce purchase decision of most consumers. However, the traditional fresh produce industry is built on price as the major differentiator. There is virtually no emphasis on the consumer.

In summary, category management in fresh produce is built on two foundations. The first is the incentive structures and the second is the (joint) marketing capabilities of retailer and their supply network. The ability to manage and invest in relationships is the core capability that underpins both these foundations.

In building relationships as assets, the most important point to remember is that business relationships are all about two games being played simultaneously. The first is the win-lose game where the pie is shared – the money is either in your pocket or in mine at the end of the day. Most of us are pretty good at playing this game.

The second game is the win-win game where we work together to make a bigger pie. Many commodity firms have never seriously played this game. They are not good at it and do not really understand the rules or the dynamics. But it is this second game that encourages innovation and builds the relationship asset. And of course the win-lose game never goes away – the bigger pie still has to be shared (fairly). Category management involves learning to play the win-win growth game. This does not happen naturally.

The first key role of the retailer under category management is to ensure that both games are played efficiently and that both sides are investing in the relationship so that the asset grows. This ability to partner and develop relationships as assets is so difficult that it is a core capability that can support the competitive position of the firm.