

UNIVERSIDADE CATÓLICA PORTUGUESA

Recheio: Growing through a declining channel

A case on wholesale food Private Labels and its competitiveness

João Pedro de Almeida Azevedo Ferreira Clemente

Supervisor:
Prof. Paulo Marcos

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Abstract

The Portuguese wholesale food market is in a mature phase where the space to grow seems to be limited. In the end of 2008 economic and business environment were expected to deteriorate intensely making this growth even more difficult wholesale food companies. Recheio, the market leader in this sector, had been growing sustainably and regardless the situation they wanted to keep their pace. As so Mr. Antunes challenged the Marketing Director Rita Silva, to develop a strategy to boost the Traditional Retail channel sales since it was the one with the one decreasing the most. Due to its lack of capacity to compete with Modern Retail chains Mrs. Silva and her team worked to understand the gap between these two channels in order to build the necessary management tools to increase traditional retailers' competitiveness and Recheio sales. These management tools could be as simple as more competitive prices or as complex as developing a Private Label but one thing was clear, waiting to see the exact evolution without any of these actions was not an option.

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CASE

Recheio: Growing through a declining channel

In February 2009, Rita Silva, the Marketing Director of Recheio, was on her way back to Lisbon listening to the radio news about the crisis that Portugal was going through. While the rain was falling heavily, Rita Silva was thinking about what she heard during the interview with an important client from the Traditional Retail channel, in Northern Portugal. José Manuel, the owner of several small grocery stores, seemed very frustrated when he said “with this economic crisis my customers are disappearing”. Rita Silva replied to this “indeed, we will need to work harder than ever” but she knew that, although this was true, the main reason behind Manuel’s problem was not really the crisis.

When Rita Silva was elaborating on this, her phone started to ring. It was the Recheio’s General Manager Francisco Antunes, asking her to meet him as soon as she arrived at the office. Being a curious person, Rita Silva did not stop thinking on this call during the rest of the trip, trying to figure out what could be so urgent. By the end of the day she arrived at Jeronimo Martins’ building and went straight to Francisco Antunes’ office where she found Rui Saraiva, who was responsible for the Recheio’s Commercial activities.

During the meeting, Francisco Antunes focused on the Traditional Retail SOS project. Traditional Retail was a crucial channel for Recheio’s business and it had been losing market value in the past years. “The gap between what traditional retailers offer and what consumers want is getting bigger and bigger every year” he said. Finally he concluded the meeting, “The strategy Recheio followed 12 years ago was good but not sufficient, we need to make a decision on how we will address this issue quickly since the next trimestral board meeting is getting closer”.

Rita Silva, the person responsible for this project, always liked to put things from a broader perspective in order to be able to see the big picture, as so while she was leaving the building with Rui Saraiva, she reformulated the challenge:

“The Traditional Retail is contracting more than ever due to the fact that they are not competitive enough for what the market demands.”

Since Jerónimo Martins growth objectives for Recheio were very ambitious and the impact of every investment had to be measurable, Rita Silva knew from the work developed in the past months that the solution to close the gap would be changing the price strategy (for a more aggressive one) or developing a Private Label strategy. Both of them had the potential to increase average basket sales, goal set by Francisco Antunes in the beginning of this project. From her perspective, the price impact would be much easier to measure than the PL's because of the fact that the consumer's reaction is quicker and stronger regarding price reductions as such the results will be more noticeable particularly in the short term.

Company history

Jerónimo Martins is an industrial and distribution Portuguese group, founded in 1792. It started its business with one small store in an exquisite neighborhood in central Lisbon city. It had its ups and downs until 1938, when they started manufacturing margarine, which was then a scarce staple thanks to World War II. This was a critical point to the group's history because it led to a joint venture with the multinational Unilever, in 1949.

Alexandre Soares dos Santos, presently Jerónimo Martins' Chairman, took charge of the company in 1968 and became responsible for the retail chain Pingo Doce (1978) and for the Cash & Carry Recheio (1988). Growth and sustainability were the key objectives to run the business in this company and therefore, only ten years later, he decided to expand its business across borders, and bought a retail chain in Poland, called Biedronka. As time passed, the group consolidated its position in all its sectors, particularly in food distribution, and it is now leader in the food wholesale portuguese market through Recheio.

Recheio started operating exclusively in the Traditional Retail channel until 1997, when the management noticed that this channel was losing market value and it was too risky to be fully dependent on it. Since then, Recheio started to invest also in Horeca (Hotels, restaurants and Coffee-shops) and developed and improved a Private Label (PL) called MasterChef, earning the clients' trust and loyalty. By the end of 2008 Recheio had a more diversified business and a more extensive national coverage, which

became one of its main competitive advantages, according to the Operations Manager, José Ferreira. The company is characterized by its sustainable growth and in the past 3 years its market share went from 28,5% to 33,1%, and sales increased from 602 to 654 million euros (Exhibit 1). One of the main drivers for this success and growth was the channel diversification and the promotion of the Masterchef brand.

The PL was created in 1997 for the Horeca channel, to provide products with a similar quality than National Labels (NLs) of the Recheio portfolio but at much more competitive prices. According to the Jerónimo Martins' annual report of 2008, Masterchef was a success among Horeca customers, representing 13,2% of the Recheio sales (excluding perishable products).

Thanks to the decision made in 1997, the business became more diversified and the sales volume relies on two channels instead of just one (traditional retailers and HoReCa) with an increasing relevance of the Horeca channel (Exhibit 2). The strategy proved to be the right one since it allowed Recheio to have the number one position in the food wholesale market.

Portuguese wholesale food market

The Portuguese wholesale food market is in a mature phase with the two main channels showing opposite trends. On one hand there is the Traditional Retail channel which is very fragmented due to the fact that there are only some small familiar networks that operate by region with no national coverage (e.g. Manuel Nunes e Ferreira, BarcelCash and António Teixeira Lopes) but mostly the channel is comprised of one shop only companies. Recheio found here an opportunity and it has been the main player in this channel with widest coverage in the wholesale market.

As the time passed this channel has not evolved enough (low innovation rate) and the wholesalers' clients, traditional retailers, were getting older (50 to 60 years old, on average) and their establishments have become completely outdated. As a consequence of this scenario, the Traditional Retail has suffered a reduction in the number of stores and sales, as shown in the exhibits 3 and 4, respectively. Furthermore the fact that modern retailers, such as supermarkets, were adapting their business, by improving the

service provided inside the stores and also outside, through home delivery service, for instance, has worsen this situation (4% decline of Traditional Retail value JM annual report of 2008).

On the other hand, Horeca (Hotels, restaurants and coffee-shops) has been increasing immensely and it verified an increase above the inflation at the end of 2008 (JM annual report of 2008) even though in the second semester was already showing signs of the crisis. This channel has been the main responsible for the food wholesale companies' growth with a lot of potential but, according to Nielsen, the consumption in this sector will decrease dramatically in the next years leading to a recession in the HoReCa economic value (JM annual report of 2008).

Until 1997 Makro and Elos were the two big wholesale companies in this channel despite the clear dominance of Makro. This cash & carry company belongs to a German multinational company known as the Metro Group, which is the third largest distribution group in the world. Makro entered the Portuguese market in 1990 with one store; by 2008, it had 10 stores and, according to its executive Hugo Geest, the annual revenues exceeded 400 million. Since Recheio entrance in Horeca (1997) Makro has been losing market share (-1,5% percentage points in the past 3 years) and currently it possesses 22,4% of the total market. In order to reverse this trend, the Metro Group announced its intention to invest more in the Portuguese market.

Even though the competition was active, Rita Silva and her team had Recheio mission (Exhibit 5) very present in their minds and decided to give a closer look at the deteriorating traditional retailers' conditions. For this, further research needed to be done, in order to identify the main drivers of their current market situation, so that Recheio could tackle this issue in the best possible way.

Understanding the problem: Brainstorming

In January 2009, just after Francisco Antunes announced the Traditional Retail SOS project, he organized a meeting with the Recheio managers to debate the main possible concerns regarding the Traditional Retail channel current situation. After an exhaustive discussion there were three reasons that were consensual for everyone.

The first reason was the differences in the purchasing power between Traditional and Modern Retail. The traditional retailers were very small compared to modern retail chains which have a large number of stores; as such, independent retailers' sales volumes were much lower and consequently they had less bargaining power, resulting in less competitive prices for the consumers (Exhibit 6). Secondly, and partially due to the larger scale, since modern retailers have a very wide coverage in Portugal and much more customers than traditional retailers, they are able to provide several services and products that traditional retailers usually do not, such as online shopping and home delivery service at reasonable prices. The fact that small Grocery stores' owners have a low education level, explains part of their inability to find solutions to overcome these disadvantages. Ferreira added "Also, the majority of them depend largely on their family to keep the business active and, most of the times their sons tend to follow a different career path which compromises the business sustainability, and therefore the ability to develop and implement medium and long-term strategies". Thirdly, there was a fierce competition between the two biggest Modern Retail chains in Portugal, Pingo Doce and Continente, which reached its peak with the economic crisis. These two well-known retail chains were competing with each other mainly by lowering prices and creating Private Labels with a good quality level that were penetrating the market at very fast pace and attracting consumers from the Traditional Retail. It is because of all these reasons that traditional retailers were not able to keep up with the market changes and were falling behind the competition.

Moreover, as Antunes asked, they confirmed that the problem was not on the Retail market in general because according to the numbers presented by Rui Saraiva, sales were clearly positive despite the decline in number of stores (Exhibit 7) the issue was confined to the Traditional Retail channel. Silva therefore left the meeting very satisfied and with the conviction they were looking in the right direction; however, there was still a lot of work to do, so she went to her office to wrap-up everything before planning the next steps.

Understanding the problem: Traditional retailers know their difficulties

In a sunny day, while Rita Silva was having lunch with Francisco Antunes, they started talking about some of the problem drivers and although he recognized the great

job done, he thought out loud: “I feel that we are missing a piece of the puzzle and...”, “Clients! We need to talk to our clients!”, she interrupted. After that spontaneous reaction she elaborated the idea explaining that they could interview several clients in order to know what difficulties they had, and this could bring a lot of interesting ideas to the table. “Of course, who knows better the traditional retailers’ difficulties than themselves?”, he answered.

During the next week Rita Silva, Rui Saraiva and Francisco Antunes spent most of their time with the operations’ team visiting around 60 clients from all parts of the country. By the end of that week, this tough journey was over and it was time to gather all the information, see the results achieved, and prepare the course of action.

-“The less time I spend out of the store, the better”

-“I do not have the products and prices to compete with Modern Retail stores”

-“I buy my inventory based on my customers’ likes and dislikes”

-“I cannot sell part of my oldest inventory for a lower price because I will lose money”

These were the comments they received repeatedly during the interviews, which have led, directly or indirectly, to the following conclusions. First, it seemed that the fact that they had to go to the Cash & Carry stores was an issue for them, because it was time they spent outside the store without controlling their business. Secondly, traditional retailers said explicitly that it was very hard for them to compete with bigger retail chains, given the current products’ portfolio and prices that Recheio and other suppliers were offering. Furthermore, they noted that most of their clients had way too much inventory in terms of quantity and assortment. The quantity had to do with the fact that there were always suppliers with “great opportunities”, such as quantity discounts, that retailers did not like to miss regardless the demand they had. Regarding the assortment, the issue arises from their will to please every single customer that suggests a certain product or brand - “There was a client who had enough shampoo to wash every single head in Alentejo”, said Francisco Antunes to describe the situation. There was another important reason for these high inventory levels which was implicit in the statement “I cannot sell part of my oldest inventory for a lower price because I will lose money”. The retailers did not understand that if they maintained the prices, these products would

never be sold and at the same time they were occupying shelf space where new and fresh products could be placed and sold more effectively (opportunity cost). Moreover, they had margins too high for some categories (e.g. milk with 30% margin) and, according to Ferreira, it was very difficult to explain them the benefits of lowering their margins in some categories. These inventory and price management issues were a clear result of the lack of training and expertise that had already been mentioned in the brainstorm meeting. As Rita Silva had suspected, the crisis, mentioned by José Manuel, was not part of these conclusions.

Recheio's challenge was much more complex but also clearer now that they understood the main reasons behind it. Still "It is not possible to solve all this issues...", she thought - they needed to choose carefully and define the criteria to tackle them.

How can Recheio tackle this problem?

The goal of this project was to help traditional retailers, but Recheio had to find a win-win situation so that they could increase their average basket sales, besides solving the problem itself. The drivers were divided into three groups: the ones that could not be solved by Recheio; the ones that could be solved, but the return for them was not worth it; and finally the ones that had more potential to create a win-win situation.

The only issue which had no apparent solution was the fact that traditional retailers are old, in general, and have difficulties sustaining their business and developing long-term strategies, since they depend on their family to continue their work.

On the other hand there were several drivers that could be solved but their expected return was not high enough and Francisco Antunes made it very clear in various situations: "Be aware that this is not a social responsibility project". For instance, the lack of expertise in management and the low education level could be overcome through training provided by the Recheio's team, and this would certainly improve the traditional retailers' practices and increase their loyalty but, according to Rui Saraiva, the increase in average basket sales was not there. Another issue included in this group was the time spent outside the store to go shopping in Recheio's stores. To solve this, they had to create a store-delivery service which would create loyalty and attract new clients, but the costs were too high and going through with this solution would change

the business model. Developing a new logistic system from scratch implied tremendous costs because of the transportation network that needed to be built and the management processes that had to be adjusted. Regarding the business model, as the name suggests, the clients pay (cash) and carry the products to their own store, and Recheio was just not prepared for such a change.

The third and last group was the most interesting one for Rita Silva and worth of her attention. Regarding the low purchasing power and prices competitiveness, Recheio could certainly help by lowering its prices and thereby enabling its clients to lower their prices as well. If Rui Saraiva agreed to adopt a more aggressive pricing strategy permanently, this would gain the clients loyalty, attract new ones and increase the average basket sales (forecasts); however, it would also decrease their margins. Alternatively, considering that some retailers mentioned that they did not have the right products to compete with modern retailers, Recheio could certainly solve this issue by producing its own products and develop a PL for the Traditional Retail channel and follow a strategy similar to the one they had for the Horeca channel. The benefits seemed to be highly related to the aggressive pricing strategy, which was good, but the costs had to be carefully evaluated.

Rita Silva wanted everyone to spend more time digging into these two alternatives, in order to analyze in detail the implications for both Recheio and the traditional retailers and make the best possible decision.

Private Labels

Ferreira has been in the company for 26 years and he knew very well many clients because of the close contact his position required. As a consequence he was very skeptical regarding PLs:

“We, as a company, can be impulsive reacting to market changes. That can put us ahead of the competition or force some mistakes. For instance, we already had a brand of our own for the Traditional Retail channel called Amanhecer and it was clearly a mistake. Since then Recheio’s credibility in that regard became damaged which increases the risk of following the same strategy.”

Recheio had launched a new brand 9 years before, with 10 products which were discontinued after less than one year. According to management, the acceptance rate was low and, since there were other projects more relevant to the company, they decided to cancel it and reallocate the budget. Although it seemed to be the right decision at that time, the fact was that clients from the Traditional Retail channel did not trust Recheio as a manufacturer. According to Rita Silva's Marketing experience, in order to develop a successful PL, quality is a key factor and she believed that their current know-how was much more trustworthy than 9 years before. Nevertheless, she was aware that the investment required for this solution was very high and that Ferreira was right when he said that it was a risky alternative.

Pingo Doce had 1.994 billion euros sales in 2008 and 41% of them came from their PLs, which was an intriguing number, but definitely a positive one. Rita Silva therefore decided to talk with Luis Santos, Pingo Doce's general manager, and ask him about the critical success factors and the benefits that achieved with the adopted strategy, so that she could find evidences to clarify some of her ideas. After she explained her thoughts, he said very surprised: "Your perception is quite accurate, unlike many managers'. Usually people think that PLs are all about price, which is not true... Quality is crucial!". He continued, saying that price was a relevant factor, but without quality they would sell perhaps the first time, but consumers would not re-purchase their products. As the conversation progressed, he mentioned three other important success factors which were: the brand image (trust); the economic crisis (need for cheaper products); and the experimentation (test product quality).

"Pingo Doce has a very strong image in the Portuguese retail market so when consumers see new products branded Pingo Doce for very competitive prices they have less uncertainty than usual. This, together with the deteriorating economic environment, makes the perfect incubator for experimentation."

Santos admitted that it had been a very time consuming project with a huge financial effort, but that it was worth it. Pingo Doce PL was one of the main reasons why their client' base increased (higher market share), not only in sales volume (8% increase in the average basket) but also in customers' loyalty (customers went to their stores more often). Although Recheio and the Traditional Retail market did not work

exactly in the same way as Pingo Doce and the Modern Retail market, these insights were incredibly valuable for the decision that had to be made.

From Rita Silva's perspective, the core issue to extrapolate these impacts to Recheio was the company size. The large business dimension of Pingo Doce had leveraged its position during the negotiations with PL manufacturers, but Recheio did not have the same bargaining power or sales volume, to support the costs of investing in a PL with such a good quality level and sell it for a very competitive price. Furthermore, there was also the brand image problem. Their previous attempt of launching a PL for the Traditional Retail channel could jeopardize the whole project. Once Rita Silva told Rui Saraiva her concerns about this solution, he was very pragmatic and said: "If we create synergies with the Pingo Doce commercial department, our value proposition will be such that the brand image issue will be easily overcome". After all these insights, the conclusion was simple: without synergies, Recheio did not have the resources to develop a very competitive PL and even with this synergy the return on investment (ROI) had to be above 5% for investments.

Aggressive pricing

Price was generally a variable that Rita Silva did not like to rely on; she believed that the problem was too complex to be solved with just more aggressive prices. Moreover, reducing their margins was an even higher investment and it could be not viable in a medium to long-term perspective. On the other hand, Ferreira insisted that this was a very simple and effective alternative, with much less risks involved since they had very reasonable margins (Exhibit 8) that could be studied. According to his calculations (1 year length) traditional retailers would definitely buy more products (1,5% increase in the average basket volume for each 1% investment in price) and the market share would increase significantly (1% percentage point for each 2% investment in price), since there was no one in the market with such price levels. The forecasts were reasonable but there were three crucial variables that were not appropriately addressed. Rita Silva argued that the price reduction had to be more relevant, both in terms of value (3% increase in the average basket volume for each 2% investment in price, at the least) and broader (All the categories and not the top 20 used), to achieve these results.

Besides that, the market share gain for each 3% investment would not be as good in the 2nd and 3th year of investment which would make this solution very difficult to sustain in the long-term and emphasized that “Our clients may think that we have very big margins and feel that we have been deceiving them for all these years”, leading to a very vulnerable position, very difficult to revert.

Ferreira agreed that this was an important issue to be considered, but he also proposed a solution: “We can be very clear and explain directly to the clients what is the goal behind this strategy”; he was the right person to do this because of the trust that clients had on him. Afterwards, Rui Saraiva pointed out the fact that at the least they had numbers to analyze this alternative that could be adjusted one way or the other, which was incredibly important to create different scenarios and reduce the uncertainty of the results. In the end of this conversation, Rita Silva had much more to think about because Rui Saraiva had a deep knowledge in pricing and Ferreira had proven many times the value of his experience; these were highly relevant factors to consider, despite her beliefs towards the aggressive price strategy.

Impact on traditional retailers

“We want a real win-win situation where both sides win, instead of having one side (us) winning twice”, Francisco Antunes

The center of this project were the traditional retailers and the goal was that the strategy developed would help them to compete with Modern Retail, while creating value for Jerónimo Martins’ shareholders; both alternatives had the potential to do that.

If Recheio was able to successfully develop a PL for the Traditional Retailer channel, its clients would benefit in several aspects. On one hand, the products should fit specific needs of this channel, making it more consistent to the consumers, without removing completely their “personalized” assortment. On the other hand, it would enable these small businessmen to provide their customers with a good and reliable value for money proposition (similar quality for lower prices), leading to a higher loyalty. All these factors would certainly improve their results and their capacity to compete more evenly with big retail chains, such as Pingo Doce and Continente.

Secondly, if the company decided to follow an aggressive pricing strategy, traditional retailers would be better off, but in a more limited perspective. This option would enable Recheio's clients to lower their prices, which would once again please the shopper, but would not have any effect on quality standards or whatsoever. Moreover, as in the previous alternative, the customers' loyalty should also increase, at least in the short-term. The reason for this is that it is harder to respond to a good value for money proposition than to a price cut, particularly in the situation in which one side (Modern Retail) has a very significant cost advantage over the other (Traditional Retail). As such, from the Recheio clients' perspective, a PL would have a broader and more sustainable impact when compared to an aggressive price strategy.

These would be the impacts on Traditional Retail if both strategies were executed successfully, but there is a trade-off, as always. In order to put PL products in the stores, retailers would have to give up shelf-space where other well-known brands were, and this would represent a considerable investment. Furthermore, retailers like to please their customers; buying products that their customers do not know, thus do not trust, had many risks. Because of this, the task of making them accept and believe in a Recheio PL is a really tough one.

“It is very hard to convince an independent retailer to do a risky investment on a business when they do not understand the majority of the benefits it brings and the money is scarce”, Francisco Antunes

As concerns the new price strategy, things were simpler and quicker. Firstly, retailers did not need to do any investment because the price reductions would be significant and the products would remain the same. In addition, Rita Silva could show the increasing sales volume that would result from the prices decrease, since just saying that prices will go down is usually very well received by clients and consumers, with no further arguments. Regardless of all the obstacles, traditional retailers really needed a little hand to improve their business; otherwise, most of them would not survive, which would have an incredible negative impact on Recheio results.

Key Performance Indicators

In order to evaluate and improve Recheio's results, managers monitored closely several KPI's that would have to be considered during the decision making process namely sales per client, market share and total sales value. The number of independent retailers as been decreasing over the years as their number of clients in 2008, as such, sales per client became a critical variable for Recheio growth. Regarding the other KPI's there was no particular reasoning behind them since they were transversal to all the business units from JM's. In order to show the board to comparable alternatives, Rita Silva did a 3 years' forecast for both strategies (Exhibit 9) to demonstrate the impact of the shareholders' investment in the short and medium/long term.

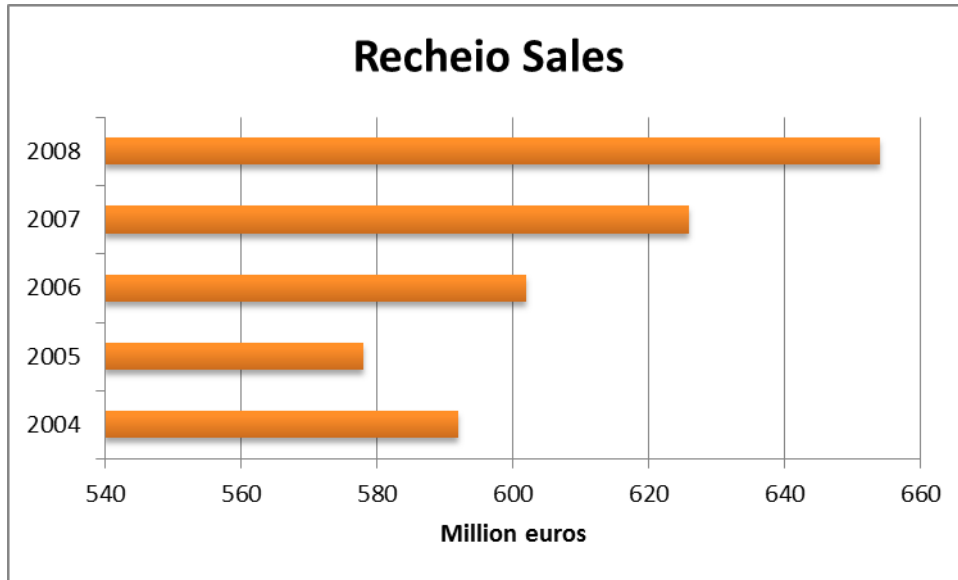
The spring is coming

The board trimestral meeting was getting closer and, with it, a decision had to be made. Both alternatives presented serious obstacles to be successful: one because of the required investment, and the other because of the risk of not being sustainable in the medium and long-term. The most difficult part was that these issues could not be solved before the meeting. While PLs needed the synergies which could only be approved or not by the board, the aggressive price strategy sustainability had to be tested, meaning execute first and adjust later.

Despite all the information available, the decision still had to be made regarding the two alternative strategies.

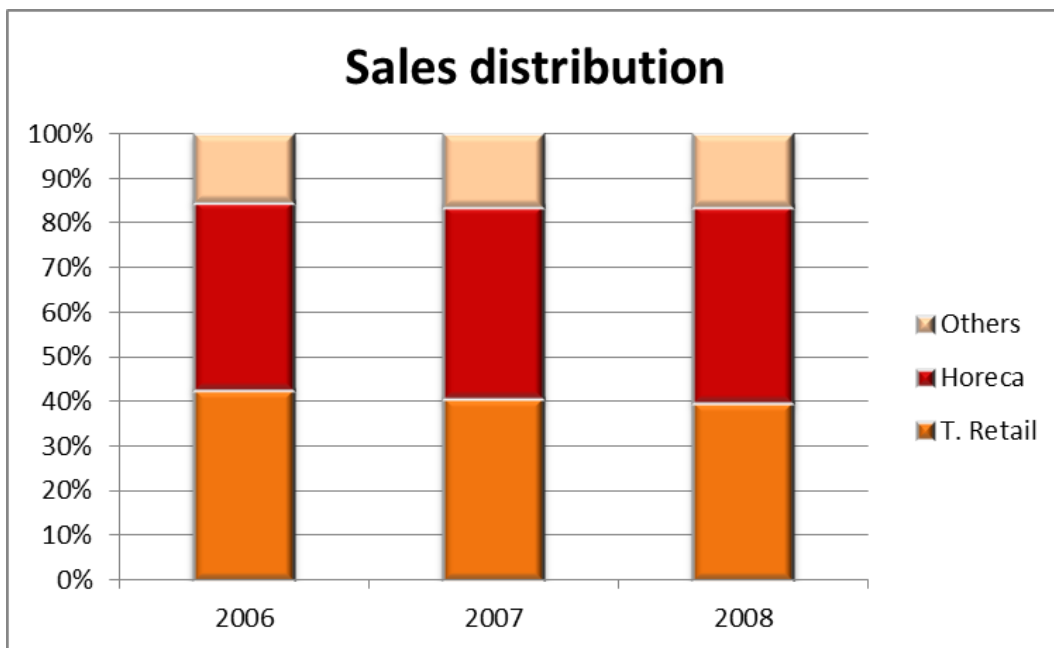
EXHIBITS SUPPLEMENT TO CASE STUDY

Exhibit 1 – Recheio total sales evolution



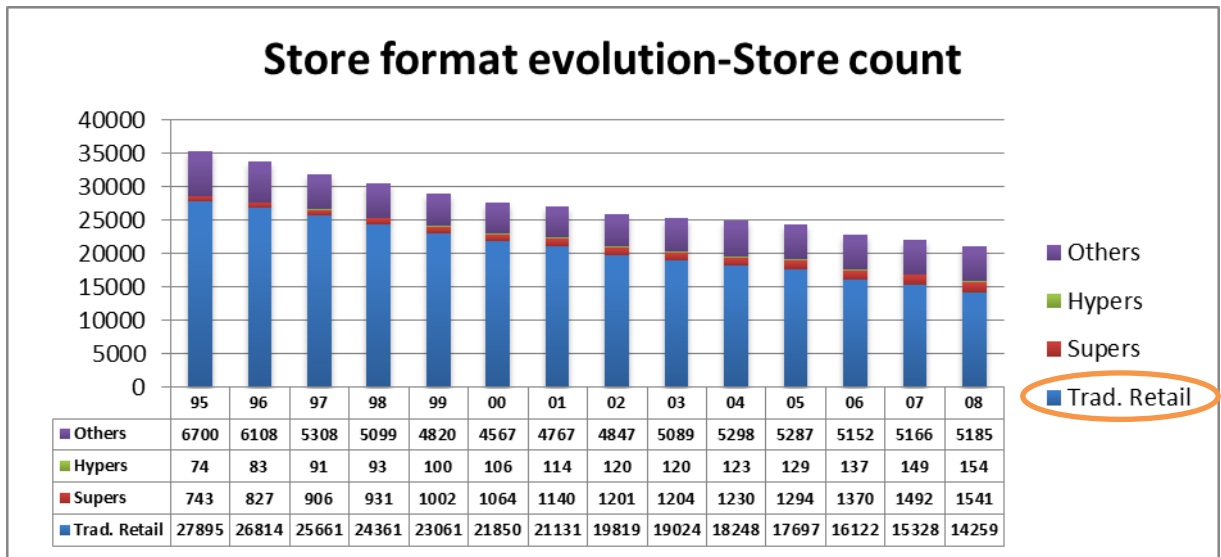
Source: JM's annual report 2008

Exhibit 2 – Sales distribution by channel



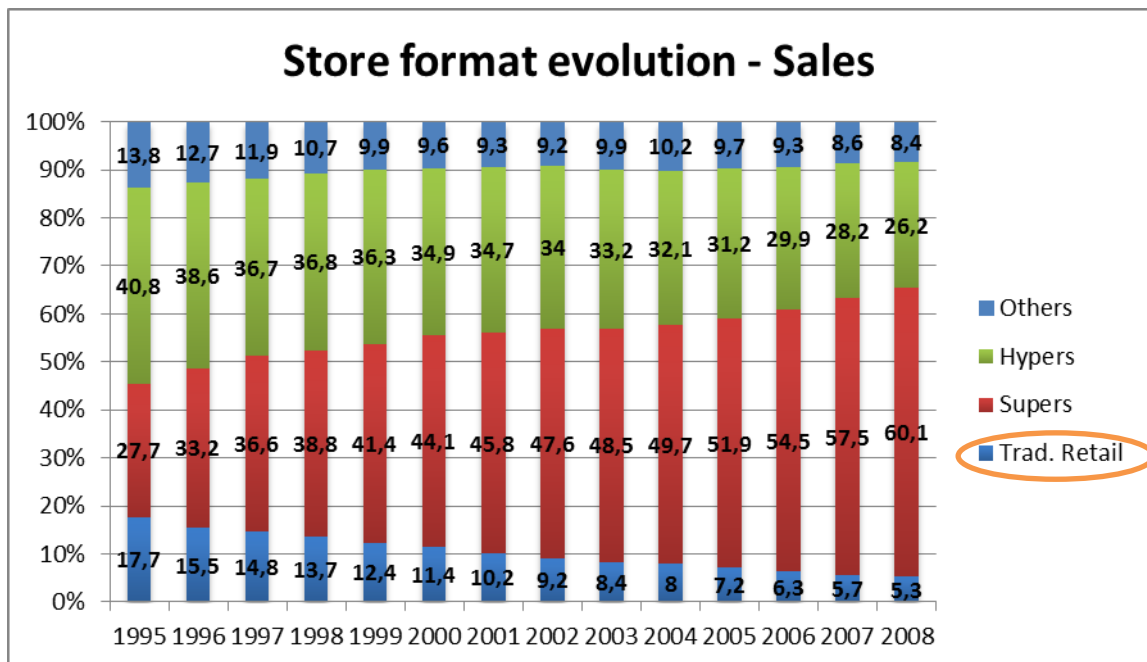
Source: JM's annual report 2009

Exhibit 3 – Number of stores' format evolution



Source: Diamond report 2009

Exhibit 4 – Total sales distribution by store format



Source: Diamond report 2009

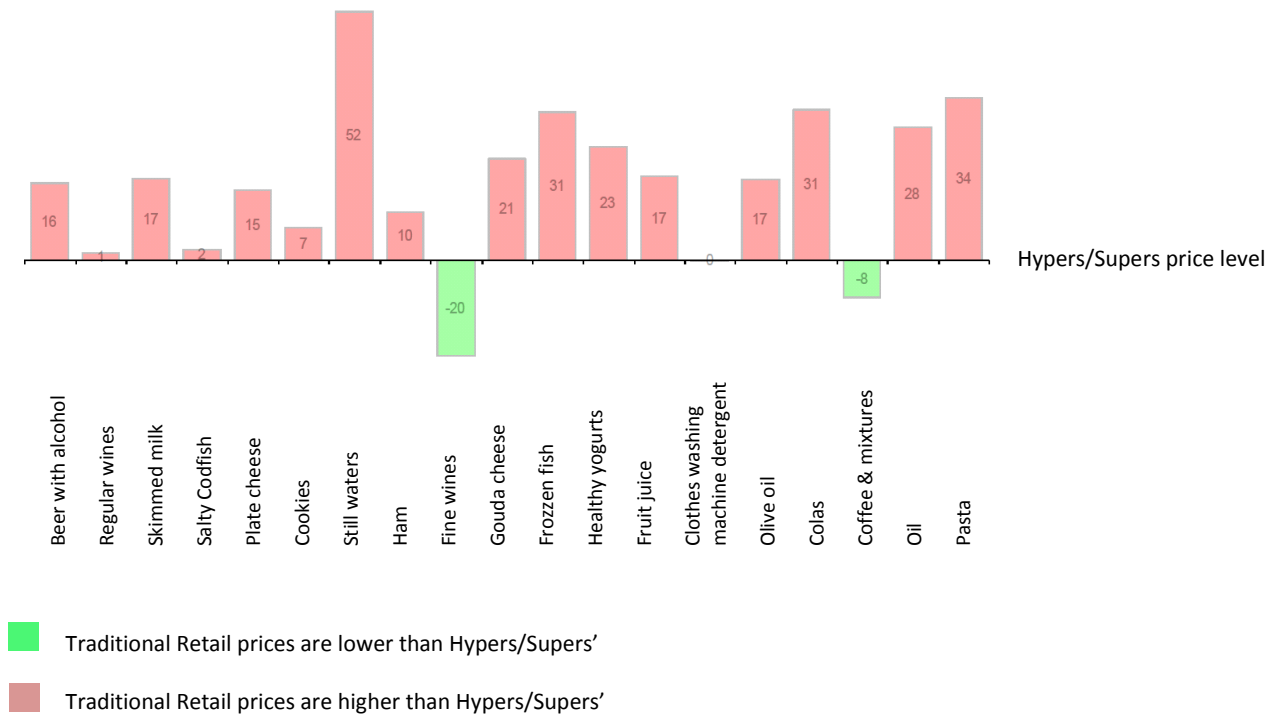
Exhibit 5 – Recheio’s mission

“Recheio's mission is to contribute to the growth and sustainability of its customers. It thus seeks to be its Customers' main business partner, offering them products that meet their everyday needs, with high quality and at low prices and maintaining a relationship of trust with them.”

Source: www.jeronimomartins.pt

Exhibit 6 - Percentage difference between Traditional Retail prices and Hypers/Supers’

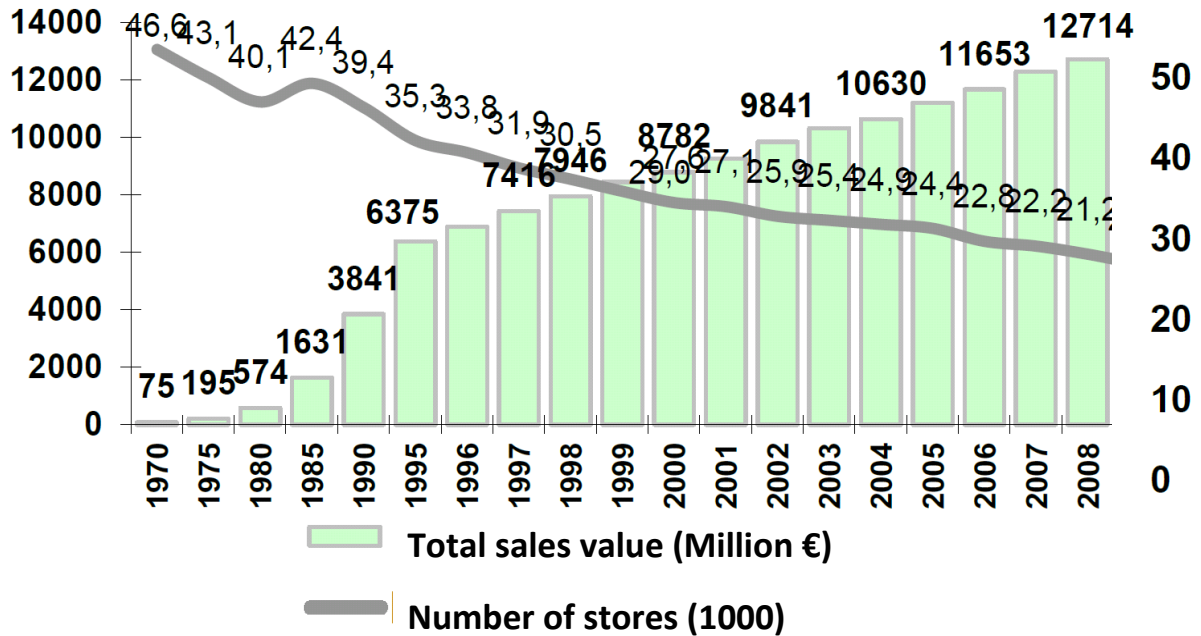
Top 20 Categories in Traditional Stores: Price differences with Hypers/Supers



Source: *Diamond report 2009*

Exhibit 7 – Number of stores and sales evolution in the Portuguese retail market

The Portuguese retail market development



Source: Diamond report 2009

Exhibit 8 – These tables show data regarding Recheio costs, sales and number of clients as Hypers|Supers prices

Category	Recheio Costs (Purchasing price)*	Hypers/Supers Avg prices**
OIL (1L)	1,43 €	2,19 €
OLIVE OIL (75cl)	2,12 €	3,69 €
COOKIES	0,61 €	1,29 €
HAM	1,37 €	2,59 €
HEALTHY YOGURTS	1,15 €	2,59 €
GOUDA CHEESE	3,75 €	5,99 €
PLATE CHEESE	2,27 €	3,99 €
SKIMMED MILK	0,94 €	1,39 €
FROZEN FISH	2,62 €	4,49 €
STILL WATERS	0,33 €	0,46 €
BEER WITH ALCOHOL (33cl)	0,96 €	1,69 €
REGULAR WINES	1,00 €	1,89 €
COLAS	0,82 €	1,19 €
FINE WINES	1,54 €	3,99 €
PASTA	0,64 €	0,86 €
SALTY CODFISH	4,63 €	8,49 €
CLOTHES WASHING MACHINE DETERGENT	3,45 €	7,59 €
COFFEE AND MIXTURES	1,01 €	2,17 €
FRUIT JUICE	1,02 €	1,68 €

*→ This is the price that Recheio pays to its' suppliers

**→ This is the price that Hypers|Supers sell their products

Note: These two price columns are independent data

Source: Author illustration

Year	2006	2007	2008
Number of Clientes	81.998	84.270	76.860
Sales	603.000.000 €	625.000.000 €	657.000.000 €
MasterChef sales	64.335.920 €	72.573.345 €	84.696.975 €
Sales p/ client	7.354 €	7.417 €	8.548 €

Source: Recheio internal report 2009

Exhibit 9 – These tables show the impact forecasted for each strategy and assumptions to consider

FORECAST

	2009		2010		2011	
	Price	PL	Price	PL	Price	PL
Market value variation	-2%		-3%		0%	
Salesp/customer increase	-	0,25%	-	0,50%	-	1,25%
Market share increase	?	-	1,50%	-	1,00%	0,50%
Investment*	4,00%	10.000.000,00 €	4,00%	1,00%	4,00%	0,50%

Assumptions	Number of customers will stay the same in the next 3 years in the PL scenario
	Sales volume increase will impact sales per client 0%**
	Discount rate (r): 4%

*→ Price – This represents the percentage of price reduction in all categories each year

PL – This represents a percentage of total sales except for the 1st year

**→ This means that the gain in volume regarding the average basket is neutralized by the loss in value due to the price reduction

Source: Author illustration

TEACHING NOTES

Introduction

Recheio case was prepared as a basis for class discussion and not an endorsement, a source of primary data, or an illustration of effective or ineffective management. Proprietary data has been disguised but all essential relationships have been preserved. All the necessary data is within the case or in the exhibits that can be made available to the students.

Synopsis

Recheio, the biggest food wholesale company in Portugal with annual sales of 654 million euros, was expecting a sales reduction especially in the Traditional Retail channel that is responsible for 40% of their total sales. Although Traditional Retail value has been deteriorating in the past few years, the other main channel called Horeca (44% of total sales) has been compensating with an outstanding performance until the end of 2008.

Rita Silva, an experienced marketing director, was challenged to change this trend and increase sales per customer in the Traditional Retail channel while boosting the channel competitiveness. The case aims to describe the different stages Rita went through to find the best possible strategy to solve achieve these goals.

These steps include identifying market threats and analyzing them through specific techniques to understand clients' weaknesses and needs; using the learning from research to develop a client centered strategy to increase loyalty as their capacity to compete against Modern Retail chains; leading to a discussion within different departments about price, product or even business model changes that would benefit this loyalty program. Finally, choosing between two alternative paths: new price strategy or PL strategy that apparently are equally valid. The case is based on actual experiences of a marketing manager within a large food wholesale company. Key details including company data are disguised to preserve confidentiality.

Suggested assignment questions

1. Please identify Recheio main competitive advantages and their respective benefits? 10 min
2. What are the threats that food wholesale companies are facing? 10min
3. What are the challenges that can be found in each strategy and possible solutions mentioned in the case if any? How will traditional retailers benefit from them? 20min
4. Is there any evidence of the bargaining power gap mentioned in the case? If yes, considering that Rui Saraiva is advices to reduce prices only in categories with an average margin above 10%, in which categories can they make more competitive prices? Please show the computations to support your answers (Suggestion: Use exhibits 6 and 8) 15min
5. Regarding the two alternative solutions found and considering the forecast that Rita Silva prepared (Exhibit 9), what strategy best performs in each KPI in a 3 years' scenario? Please show the computations to support your answer (Suggestion: Use exhibits 8 and 9) 15min
6. KPI's were crucial to evaluate a project but Rita Silva knew from her experience that the board would focus on the return on investment (ROI) present value and company key objectives. Considering these insights, what strategy would you recommend to the board? Please show the computations to support your answer assuming that there will be 4% price reduction in all categories (Suggestion: Consider the values of your previous answer) 20min

Teaching objectives

- To highlight some of the obstacles to the growth of a company that operates in a mature industry
- To enroll students in a real management decision making process of cross-departmental project
- To help students to better recognize the responsibilities of several positions within a FMCG company such as, Marketing Director, Commercial Director and Operations Manager

- To illustrate students the dynamics between a wholesale company and its customers as the importance of building a healthy with them
- To help students to understand the impacts of changing the price strategy regarding the company competitors, customers and final consumer
- To have students digging into the challenges and benefits PLs bring both to manufacturers and retailers

Use of the case

Recheio case was developed for academic purpose and it is appropriate to be discussed in undergraduate and graduate classes.

Relevant Theory

This case focuses mainly on price and Private Labels (which have been gaining consumers trust and also are being used as a differentiation strategy by many Modern Retail chains) and the opportunities and threats they can represent for retailers and wholesale companies. Six academic articles are suggested to obtain a deeper knowledge on these subjects:

1. Horwitz, I., 2000. "[An Option-Pricing Look at the Introduction of Private Labels](#)" *The Journal of the Operational Research Society*, pp. 221-230
2. Ray, Sourav et al., 2006. "Asymmetric Wholesale Pricing: Theory and Evidence" *Marketing Science*, pp. 131-154
3. Batra, Rajeev & Sinha, Indrajit, 2000. "Consumer-Level Factors Moderating The Success Of Private Label Brands" *Journal of Retailing*, pp. 175–191
4. Myers, John, 1967. "[Determinants of Private Brand Attitude](#)" *Journal of Marketing Research*, pp. 73-81
5. [Ward, Michael et al. 2002.](#) "Effects of the Private-Label Invasion in Food Industries" *American Journal of Agricultural Economics*, pp. 961-973
6. Dhar, Sanjay & Hoch, Stephen, 1997. "[Why Store Brand Penetration Varies by Retailer](#)" *Marketing Science*, pp. 208-22

Analysis and discussion

Q1 - What are Recheio main competitive advantages?

Recheio expanded its activity for the Horeca channel 12 years ago in order to diversify their business. This strategy reduced tremendously their business risk because if one channel was performing badly, managers could try to compensate in the other one. This ended up to be a very important advantage since during the crisis Recheio was much less exposed to the market variations than its competitors who play exclusively in one of the two channels, which allowed them to have more time to think and build a sustainable strategy to overcome the economic environment without any losses.

Many of Recheio competitors in the traditional retail channel were divided by regions, in other words, there was no other player doing business at a national level. Such a wide distribution enabled Recheio to be closer to more clients which was very important considering the fact that one of the traditional retailers' main problems was the time spent outside their store to buy the necessary products. Also, this proximity was very important to earn their clients' trust and loyalty.

Q2 - What are the threats that food wholesale companies are facing and will face in a near future?

Wholesale companies were going through a difficult time, especially the ones that operated exclusively in the Traditional Retail channel. In general, the small retail stores' owners were aging and had a low education level. Thanks to these factors and to the lack of revival in the stores managers this channel became progressively outdated leading to a low innovation rate. On the other hand, some Modern Retail chains namely Pingo Doce and Continente were focusing on innovation with the advantage that their volumes enabled the establishment of new services such as delivery service for reasonable prices. All these elements made many customers switch from Traditional Retail for Modern Retail which explains the increasing number of stores and sales for the Modern Retail chains as the decreasing number of stores and sales for the Traditional Retail stores (Exhibits 3 and 4).

Although the Horeca channel was currently growing above inflation the predictions were not good. More important than this was the experience and knowledge Recheio management had, according to them in periods of crisis, like the one that was

approaching the consumption outside home usually starts to decline significantly which is also what the data given by Nielsen showed. This was a challenge particularly difficult to overcome because consumers tend to spend less money and time outside home during economic crisis which affect directly this channel and leaves little alternatives for wholesale companies.

Q3 - What are the challenges that can be found in each strategy and possible solutions mentioned in the case if any? How will traditional retailers benefit from them?

Challenges	
Private Labels	Aggressive pricing
<p>1-Traditional retailers did not trust Recheio as a manufacturer because of its previous attempt to develop a PL strategy that had no follow up</p> <p>2-The required investment for the first year was to develop a PL with good quality level was very high</p> <p>3-Recheio did not the same volumes as Pingo Doce to to develop a PL with good quality level and for very competitive prices</p>	<p>1-The required investment in price to get a significant impact on the market is very high</p> <p>2-The investment is such that it will be difficult to sustain in the medium and long-term</p> <p>3- Recheio clients may feel they have been deceived in the past years since Recheio had very high margins and only decided to reduce them now that the results were not so good</p>
Possible solutions	
<p>1-Create a very good value proposition</p> <p>2-ROI as to be above 5%</p> <p>3-Create synergies with Pingo Doce to take advantage of their large business scale</p>	<p>1-ROI as to be above 5%</p> <p>2-No solution is mentioned</p> <p>3-Recheio could send Ferreira and his team to talk with their clients and explain them directly the reason why they were going to do this aggressive price strategy</p>

Traditional retailers' benefits	
Private Labels	Aggressive pricing
1-Traditional retailers will gain assortment consistency and product tailor made for their channel needs	1-Traditional retailers will be able to offer products with more competitive prices to their customers
2-Traditional retailers will be able to offer a better and more reliable value proposition to their customers	2-Traditional retailers will also benefit regarding their results and will be able to compete more squarely with Modern Retail chains
3-Traditional retailers will also benefit regarding their results and will be able to compete more squarely with Modern Retail chains	3-Traditional retailers do not need to do any investment and the market is supposed to react quickly to this price reductions

Q4 - Is there any evidence of the bargaining power difference mentioned in the case?

(Suggestion: Use exhibit 6 and 8)

1st step:

Compute traditional retailers average prices for every category

$$= H|S \text{ average price} * (1 + \text{price difference})$$

E.g.(OIL) $2,19 * (1 + 28\%) = 2,80€$

2nd step:

Hypers/Supers' purchasing prices

$$= H|S \text{ average price} * (1 - H|S \text{ margin})$$

E.g.(OIL) $2,19 * (1 - 45\%) = 1,20€$

Traditional retailers' purchasing prices for every category

$$= TR \text{ average price} * (1 - TR \text{ margin}) = \text{Recheio prices}$$

E.g.(OIL) $2,80 * (1 - 45\%) = 1,54€$

3rd step:

Hypers|Supers and traditional retailers' purchasing prices' differences, both in € and % of every category

$$\text{Dif. €} = \text{Traditional retailers' purchasing prices} - \text{Hypers|Supers' purchasing prices}$$

E.g.(OIL) $1,54 - 1,20 = 0,34€$

$$\text{Dif. \%} = \text{Dif. €} / \text{H|S purchasing prices}$$

E.g.(OIL) $0,34 / 1,20 = 28\%$

Answer → Purchasing price differences % = Price differences (Exhibit 6)

As so yes there is evidence of the bargaining power gap between Modern Retail chains and Traditional Retail stores.

(All the computations are in the excel file TN Q4)

Q4 - If yes, considering that Rui Saraiva is advised to reduce prices only in categories with an average margin above 10%, in which categories can they make more competitive prices? Please show the computations to support your answers (Suggestion: Use exhibit 6 and 8)

Compute Recheio margin, both in € and percentage for every category

Margin (€) = Recheio prices (TR purchasing prices) – Recheio purchasing prices

Margin (%) = Recheio Margin (€) / Recheio price

Answer → Recheio margin (%) is > 10% in the following categories:

Olive oil, Cookies, Ham, Healthy yogurts, Plate cheese, Frozen fish, Still waters, Beer with alcohol, Fine wines and Coffee & mixtures

As so these are the categories where they can make more competitive prices.

(All the computations and results are in the excel file TN Q4)

Q5 - Regarding the two alternative solutions found and considering the forecast that Rita Silva prepared (Exhibit 9), what strategy best performs in each KPI in a 3 years' scenario?

1ST Step:

Market share increase (%) = $2 * 1\%$

(2% investment in price returns 1% of market share)

2nd Step:

Sales per customer increase

- **Aggressive price:**
0% for the 3 years

- **Private Label:**
Sales p|client year(n-1) * sales p|client year n

3rd Step:

Market Value (MV)

Market value 08 = Recheio total sales 08 / Recheio market share 08

Market value for the next years:

Market value y_n = Market Value y(n-1)*(1+MV variation y_n)

4th Step:

Market share increase (€)

- **Aggressive price:**
Market share increase (%) y_n * Market value y_n
- **Private Label:**
Market share increase (%) y_n * Market value y_n

5th Step:

Total sales increase (€)

- **Aggressive price:**
Total sales increase y_n = market share increase y_n + Sales p|customer increase y_n * number of customers y₀₈
- **Private Label:**
Total sales increase y_n = market share increase y_n + Sales p|customer increase y_n * number of customers y₀₈

Answer→ According to the three KPI's, the aggressive price seems to be the best strategy since it performs better in two out three KPI's, market share and total sales regardless the year. On the other hand, the PL strategy only has superior results in sales per customer although it starts to get even in total sales during the year 3.

(All the computations and results are in the excel file TN Q5 & 6)

Q6 - KPI's were crucial to evaluate a project but Rita Silva knew from her experience that the board would focus on the return on investment (ROI) present value and company key objectives. Considering these insights, what strategy would you recommend to the board?

1ST Step:

Investment (€)

- **Aggressive price:**
Investment (%) y_n * (market share y_n * market value y_n)
- **Private Label:**
 $y_1 = 10M€$

 y_2 and y_3 :
Investment (%) y_n * Total sales $y_{(n-1)}$

2nd Step:

Cash flow (€)

- **Aggressive price:**
Total sales increase y_n – investment (€) y_n
- **Private Label:**
Total sales increase y_n – investment (€) y_n

3rd Step:

Total investment (PV)

- **Aggressive price:**
 $\text{Invest. } y_n / (1+r)^n + \text{Invest. } y_{(n+1)} / (1+r)^{(n+1)} + \text{Invest. } y_{(n+2)} / (1+r)^{(n+2)}$
- **Private Label:**
 $\text{Invest. } y_n / (1+r)^n + \text{Invest. } y_{(n+1)} / (1+r)^{(n+1)} + \text{Invest. } y_{(n+2)} / (1+r)^{(n+2)}$

4th Step:

ROI both in € and % (PV)

- **Aggressive price:**
 $\text{ROI (€)} = \text{CF } y_n / (1+r)^n + \text{CF } y_{(n+1)} / (1+r)^{(n+1)} + \text{CF } y_{(n+2)} / (1+r)^{(n+2)}$
 $\text{ROI (\%)} = \text{ROI €} / \text{Total investment (PV)}$
- **Private Label:**
 $\text{ROI (€)} = \text{CF } y_n / (1+r)^n + \text{CF } y_{(n+1)} / (1+r)^{(n+1)} + \text{CF } y_{(n+2)} / (1+r)^{(n+2)}$
 $\text{ROI (\%)} = \text{ROI €} / \text{Total investment (PV)}$

Answer→ Although PL's ROI is higher than Aggressive price's, both strategies fulfill the requirement of having ROI > 5%. As so we need to look at the company key objectives to make decide on which strategy should go forward. In the first 2 years following the aggressive price strategy has clearly a superior return but in the third year this trend starts to overturn in favor of the PL strategy. Taking into consideration the fact that the aggressive price strategy results are getting worse over the years contrarily to the PL's, the recommendation to help Traditional retailers while contributing for JM's growth and sustainability is to develop a PL strategy.

(All the computations and results are in the excel file TN Q5 & 6)

What has happened?

In 2009 Recheio management decided to go for the PL strategy and present the solution to the executive board. The board approved the project as the synergy between Pingo Doce and Recheio although they would be indirectly competing. This strategy consisted in re-launch of the brand Amanhecer with an improved image and a much wider range of products. They started by producing 30 products within the categories where traditional retailers were less competitive and some other top categories.

This brand had good and consistent quality standards, same as Pingo Doce's, and very low prices thanks to the synergies that created economies of scale. These new products were massively acquired by many traditional retailers and final consumers as soon as they were in the market. It happened that the Recheio PLs' credibility was not that damaged in terms of quality, the only concern retailers expressed was "Is this brand going to last?". In order to fight this issue Recheio operational team was asked to assure in person to every client that this was a project with sustainability.

Additionally, Recheio decided to give training to their clients regarding price strategies including margins, sales volume and so on in order for them to make the most of the low prices Amanhecer products had. Two years later, after increasing the number of products Amanhecer immensely and its sales, Recheio decided to go further and develop Amanhecer stores. This was an innovative and completely new concept in the Traditional Retail channel. These stores were the traditional retailers' stores fully restored and reworked by Recheio team. Recheio compromised to do this initial investment applying all its know-how in re-building the stores and to do a joint

management regarding price and inventory as well as a 20.000€ annual investment. In return, besides naming the store Amanhecer, traditional retailers had to provide all their sales data and also had to buy 60 to 70% of their stores' assortment.

Nowadays Recheio has 12.000 clients that buy Amanhecer products, 26 Amanhecer stores and expects to double this number until the end of the year. Finally, according to Recheio general manager, sales per customer are higher than ever and their leadership in this market continues to grow every year.

LITERATURE REVIEW

Private Labels (PLs) have been a center topic of discussion in literature. This can be explained by the relevance they gained since they are one of the top 3 brands in 70% of the supermarkets (Sayman, 2002) and by their increasing awareness and usage (Ward et al., 2002). The approach usually focus in understanding to what extent PL improve retailers and manufacturers business but I will try to compare pricing impacts with the so debated PLs.

As the years passed PLs' quality has been improving (Ward et al., 2002) and according to Corstjen and Lal (2000) a PL with quality can be used as a differentiation strategy in order to gain consumers loyalty. On the other hand, Horowitz (2000) highlights the fact that PLs change the consumer perception towards the retailer which can go either way, as so it becomes a critical decision to have PLs or not. Moreover, the cost for both retailer and manufacturer vary immensely depending on the PLs introduction timing. For instance, if any of both parts takes too long to decide less is the likelihood of consumers to switch brands and higher will be the costs to convince them to switch (Horowitz, 2000). Besides the costs mentioned, producing PL has its risks for the manufacturer such as the fact they depend on the retailer who can decide to foreclose shelf-space (Horowitz, 2000).

In what concerns to determinants of consumers attitudes towards PLs, Myers (1967) developed a study from which he verified that if the quality perceived is similar to National Brands' (NBs) and the price is lower, a significant part of the sample (51%) would use PLs regularly. Furthermore, the results showed that unemployed women are more likely to buy PLs than employed women mainly because they had more time to compare brands and prices since the income level was not significant. But times change and approximately thirty years later there was already literature confirming the significant relation between PLs and income level (Hoch, 1996; Richardson, Jain and Dick, 1996). This is supported by the fact that price consciousness increases as the income level decreases (Gabor and Granger, 1979) and that PLs purchases increase when price consciousness is higher (Batra and Sinha, 2000). Although price importance for PLs success has been proven, the quality is more relevant (Hoch and Banerj, 1993; Sethuraman, 1992) which is a powerful insight for PLs strategic development.

Implementing a PLs strategy has impact for many parts in the food distribution business which leads to changes in the food industry itself. Considering that PLs bring higher profits than NBs for the retailers and more loyalty, NBs adapted their strategy since PLs entered the market (Ward et al., 2002) in order to recover part of the market share they have been losing for them. For instance, many NBs are increasing their prices and quality to increase the differentiation from PLs, and it was interesting to verify that on average NBs' prices and innovation rate are higher where PLs exist (Ward et al., 2002).

Price strategy is many times analyzed within PLs but few against it. Wholesale price adjustments have costs for the retailer because of a phenomenon known as price asymmetry (Ray et al., 2006). According to their study with upstream prices, small price increases by the wholesale company will not be followed by the retailers which results in a margin decrease but if they do a large adjustment the retailer will change its prices and the profits increase compensate the costs associated with it. On the other side, Poltzman (2000) did the same study with downstream prices reaching the opposite result, price asymmetry does not exist.

Gathering the ideas above, I propose that the food wholesale companies should consider and compare the impact of implementing a PLs strategy vis-a-vis the impact of changing the price strategy when thinking about increasing retailers' loyalty.