



Retailing

NEWSLETTER



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PROGRAM SUMMARY

Strategic Planning and Management in Retailing Program Makes 46th Run

The open enrollment version of the Strategic Planning and Management in Retailing Program ran for the 46th time in North America in May 2007. It was conducted at Williamsburg, Virginia, at the Mason School of Business of the College of William and Mary. In late May, the program also was offered for the 22nd time in Australia at the Cape Schanck Resort outside of Melbourne, and sponsored by the Australian Centre for Retail Studies of Monash University. This program is offered twice in North America (at Babson and at William and Mary), and once in Australia and in Singapore (both sponsored by Monash University in Australia). The program next will be offered September 15–21, 2007, at Babson College. Those interested are encouraged to apply early. To register, contact Susan Hartshorn at shartshorn@babson.edu, or at 781-239-4395.

The programs were kicked off with "The Eight Ways to Win in Retailing," and, with slight differences from program to program, featured a brand new case on Target Stores in 2006, as well as cases on Tesco, Best Buy and Best Buy in 2005, Home Depot, Zara, Kohl's, and Meijer. In addition, the faculty delivered lectures and exercises on financial and productivity analysis, strategic thinking and planning, category scorecards, customer relationship management, and supply chain management, which included a simulation.

On Wednesday afternoon during the Williamsburg program, the group participated in a store tour with visits to a new Wal-Mart Supercenter, Target Greatlands, Costco, Lowe's, World Market, Ukrop's, Best Buy, Circuit City, PETsMART, Toys "R" Us, T.J.Maxx, and others. In addition, they were given a guided tour of Colonial Williamsburg, followed by dinner at the King's Arms Tavern in the restored colonial area.

Australia program participants enjoyed the Cape's spectacular coastal environment and views of Southern Ocean and Port Phillip Bay. The Cape Schanck Resort is ideally located between the traditional resort areas and the burgeoning wine, food, and golf district of the Mornington Peninsula.

Participants in the programs represented 13 countries and included companies in the drug, food, apparel, footwear, home improvement, consumer electronics, convenience, health appliance, and consulting sectors. Senior executives from buying and merchandising, marketing, store operations, strategic planning, human resources, logistics, finance and control, and business development attended the class. Channel management executives represented several manufacturers. Professors Larry Ring and John Strong were the primary faculty on each of the programs.

Wal-Mart's Second Coming to Canada

Stories and strategic lessons from north of the 49th

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Four years ago, in a glowing review of one of the most innovative food retailers in North America, we had profiled the Loblaw Companies in the Newsletter and noted that:

"Though people always have to eat, the prospect of feeding an aging and barely growing population generally might not be considered a fun line of retail trade to be in! But Loblaw Companies appear to be having a grand old time in Canada, while some of its investors, in fact, can't control their laughter all the way to the bank.

During the last five years, Loblaw Companies Ltd. has consistently enjoyed a P/E ratio of 25-30x, and has returned more than \$400 for every \$100 investors might have put into this company since 1996. That is an astounding rate of return for any company in any industry, but especially so for an enterprise which essentially operates in a zero growth market in its core business."¹

WELL ... HOW TIMES CHANGE!

As many of you must surely know, from the date of that article to midyear 2007, the high flying Loblaw Companies has come crashing down—its stock also significantly lower from an all-time high of C\$76 in April 2005 to just under C\$45 in late 2006—on a stunning 40 percent reduction in market capitalization in less than two years (See Figure-1). Some analysts on Bay Street now rate Loblaw a "Sector Underperformer" with a target share price of C\$40, and a paltry P/E multiple at 15x.

Unfortunately, the unsavory news of late for Loblaw Companies was not limited to its stock valuation, but also included a major shake-up in its senior management ranks; a sudden announcement of huge write-offs in its Quebec operations; an ill-timed and badly executed restructuring in its merchandising group, followed by significant supply-chain disruptions in the field and deep staff cuts at the new home office—all of which have culminated in the company's first annual loss in 19 years.

WHAT HAPPENED?

Though some of the "cuts" Loblaw Companies is suffering from are substantially self-inflicted, there is little doubt that many of the problems this organization now faces are directly attributable to the presence and future momentum of Wal-Mart in Canada today. In his most recent meeting with the investor community in Toronto in February of this year, the newly installed CEO, Galen Weston Jr., summarized the current state of the company, and its challenges, as follows:

"We need to improve virtually every key driver of our business:

- We have not been focused on our core strength of being the best food retailer in Canada.
- Our organization is too complex, with ambiguous accountabilities, and is ineffective and too slow as a result.
- We have insufficiently distinctive formats, poor availability and are relatively overpriced."

Though some observers have considered the current management's assessment of Loblaw's issues to be "a little too dark"—intended perhaps to lower the expectations externally and/or raise the bar for performance expectations internally—there is little doubt that Loblaw Companies is in a very serious fight with Wal-Mart and other established food retailers in Canada.

Loblaw's current problems surfaced innocently enough about two years ago when a long-planned transition into a new head office in Brampton, Ontario, and a streamlining of some of the supply-chain nodes ran into major trouble. First a core group of merchants, who were arguably the heart and brains of the general merchandise group in Loblaw's, decided not to follow their colleagues in a cross country exodus out of Calgary into Toronto. This was followed by a series of serious disruptions in both general merchandise and food supply chains of Loblaw Companies—which suddenly, but simultaneously, either choked its supply chain or flooded the stores and ware-

LOBLAW COMPANIES DAILY STOCK PRICE CLOSING

Figure 1.



Source: TSX

houses with too much, but of the wrong kind of merchandise. Suddenly, during the height of the Christmas rush, there were frozen turkeys, but no stuffing; or fresh tomatoes, but no cucumbers in the stores—all the while when some stores were desperately trying to clear out summer chairs, hats, or sandals! It was not a pretty sight, but perhaps more importantly, Loblaw Companies, for the first time in a very long time, was no longer a “reliable” food merchant to millions of its loyal shoppers.²

For close followers, there were actually other troubling signs of emerging issues at Loblaw for some time, but given the company’s strong and sustained standing in the Canadian marketplace, none seemed particularly insurmountable. These included, among others, such things as:

- a series of new store formats that appeared to age and tire more rapidly than before, leading to a large stock of prematurely dated physical plant;
- a string of new, but wholly uninspiring President’s Choice products which seemed to have suddenly lost all their sizzle; and perhaps most disturbingly,

- a high and rising price umbrella on the shelves that simply did not seem to be quite in line with the level of service or ambiance found in the Loblaw stores in the past.

All of this was taking place in a competitive space, where other Canadian food store competitors, such as Sobeys and Metro, were also accumulating significant heft—and with it, some exciting stores and controlled products of their own. This was certainly not helpful, as increasingly, the best Loblaw could do was to claim that they were “no better or worse than anybody else!” All of which, of course, could easily have made for a “perfect storm” all on their own, except that an even bigger one finally arrived on the Canadian shores in November 2006 with the opening of Wal-Mart’s four new Supercenters!

It was clearly not a coincidence, (but perhaps the first salvo in what is shaping out to be an epic battle), that Wal-Mart not only opened its first seven stores in Ontario—the bastion of Loblaw’s core strength in the country—but also announced in a highly publicized investors meeting

a few months later that they would follow these with 21 others in 2007, and perhaps an equal number after that, for the foreseeable future!

ELEPHANTS DANCE—TAKE II

In a preview of this impending confrontation between Wal-Mart and Loblaw Companies, we had recently asked *What Happens When the Elephants Dance?* in another Newsletter.³ But despite all the emerging issues at Loblaw's, our short answer at the time was that "a host of 'others' would ultimately get hurt" in this melee. In other words, though we were cognizant of some of the "missteps," we frankly did not anticipate the mighty Canadian elephant to stumble or fall at this dance! In fact, quite on the contrary, we noted that:

"What Loblaw Companies has been doing in Canada is perhaps the most complete "battle plan" for food retailers (and others) who happen (or plan) to take on Wal-Mart in their backyard: Respect your enemy and never let your guard down in rationalizing your cost structure on a continuous and sustained basis, but perhaps most importantly, never, ever stop differentiating and innovating your market offer in the market space you intend to share with Wal-Mart."

Today, as we reflect on the events of the ensuing two years since these initial observations, it is clear that Loblaw was not only unable to improve its cost structure, but in fact may have made it far worse. But perhaps more importantly, with all the fires now raging in the home office and still empty store shelves in the field, it would appear that there is very little discretionary time, energy, or resources left in this enterprise for "innovation" in the near term—which has always been (and remains to be) the fundamental source of Loblaw's competitive advantage.

Though this may be a distressing situation for Loblaw's as an organization, it should reinforce an important and a familiar lesson to the students and managers of (retailing) strategy. Just as a brilliant execution of a flawed strategy gets one nowhere, poor execution of a good strategy also takes us no further. However, having learned whatever lessons from the recent past, Loblaw's senior management seems to realize that the most important thing today is to look into the future, and chart a new course.

STRATEGIC CHOICES OF LOBLAW COMPANIES

Initial battle plans for both Loblaw Companies and Wal-Mart Canada were introduced in what were surprisingly two very public meetings that took place a few weeks apart early this year. First up was Loblaw's, where in an extensive Investors Day Conference on February 21, the new management team introduced its three- (or was it perhaps a five-?) year strategic plan entitled "Making Loblaw's the Best Again."

Though it appears to be still evolving, the Loblaw game plan essentially calls for the organization to "Simplify, Innovate, and Grow" the current business by concentrating on its core strengths in "Food, Fresh, and Controlled Brands," as it redefines the meaning of "general merchandise," re-engineer its supply chain, and find a new equilibrium in its "price/value" equation as a retail organization. According to a "thematic ideogram" that summarizes this battle plan, there is virtually no corner of the "Pentagon and the Triangle" that will be untouched or unaltered in some significant way during the next three to five years (See Figure-2).

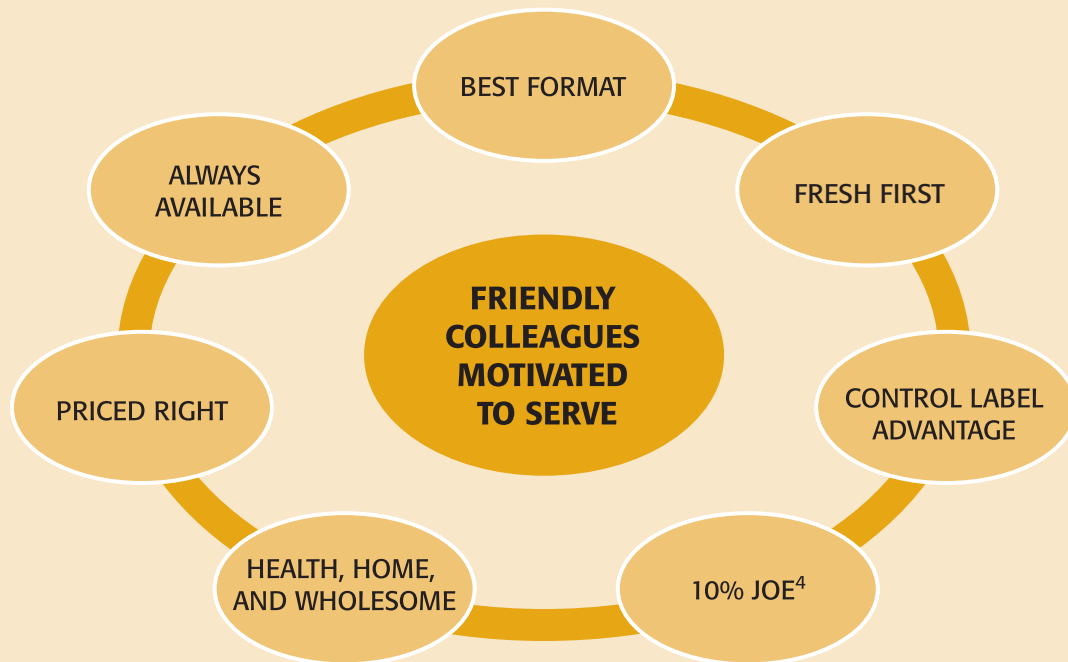
That, on its own, is worrisome to many—especially given that these changes will have to be undertaken by a new and young management team that is already depleted of some of its key knowledge workers and engineers. Other parts of the emerging Loblaw's battle plan—especially certain things that the management announced that it will not (or won't be able to) do in the midterm—are even more troubling, and we think may put this organization in peril in the months and years ahead.

First among these, is a significant retrenchment in its general merchandise offer, whereby Loblaw will seek to redefine what is relevant to its customers, and is doable profitably, by Loblaw in the future.

It is difficult to accurately "read" what this really means strategically—an acceptance of defeat or powerlessness in the face of Wal-Mart's dominance? Or an orderly retreat to a more defensible set of borders?—but it is clear that a highly edited GM offering will not help Loblaw's claim any supremacy on the "one-stop-shop" front. Some might argue that this is all for the better, as Loblaw's historical and renewed focus on "food and fresh" was never likely to make it a very strong "destination" for the consumers in general merchandise in the first place. However, that rationalization brings into sharper focus the rationality of

LOBLAW COMPANIES STRATEGIC THRUSTS

Figure 2.



Source: Loblaw Companies

the recent significant investments in Real Canadian Superstores in Ontario, and what exactly the management was thinking when it embarked on an ambitious, billion-dollar building spree with large surface stores, that are now either too big for food, or too empty (and inefficient) to generate an acceptable rate of sales per square foot! Though one can envision Loblaw's rediscovering its magic in innovation, and evolving its general merchandise offering where new products and services are integrated around what it describes as "health, home, and wholesome"—and where, perhaps, the concept of "healthy eating" is seamlessly extended into a new concept of "healthy living"—this is likely to be a long and costly process, with perhaps modest consumer appeal.

A second important element in Loblaw's strategic plan calls for a simplification of not only the human side of the organization—where a number of different cultures has now been brought together under one roof—but also the multiplicity of the banners that consumers see and shop in every day.

No doubt, part of this effort is motivated for Loblaw to rationalize the likely banner confusion across the country, and to improve its supply chain and operational control. But in no small part, this is also an issue thrust on the company today as it is forced to address emerging "imbalances" (in inventory vs. space investments) that are created due to its evolving general merchandise strategy. This is always a painfully grinding process, and with all the other issues it faces in making its supply chain work, it will take time to accomplish. However, we find Loblaw's strategic decision to virtually stop all new store programs for the duration of this rationalization program to be fraught with peril—especially given Wal-Mart's aggressive expansion plans in Canada for the very same planning horizon—which we will explore in the next section.

Finally, setting aside what we consider to be quite significant issues on the "Place and Product Corners in the Pentagon," we consider perhaps the greatest threat for Loblaw is its "value proposition" in the Canadian marketplace.

Though it is an important part of their strategic plan, we think that there is a much larger price/value gap especially between the Loblaw's "traditional" food stores and Wal-Mart than most observers realize. Perhaps more worrisome is the fact that—despite these differences now being made even more glaring under the brighter lights of the new supercenters—these gaps do not appear to be materially or rapidly closing—at least in the Toronto market with which we are most familiar.

Some of these price differentials, of course, were always known, and in fact meticulously planned for in Canada by all the key players—in the form of deep discount retail food formats, such as No Frills (Loblaw's), Price Chopper (Sobeys), and Food Basics (Metro). For a long time, the pricing disparities found between these stores and the conventional supermarkets also could be easily "explained" away by the wider/better/higher assortments/ambience/service found in the conventional formats. Today, however, Wal-Mart has rudely thrust itself into the middle of this convenient explanation, (and the huge price disparities), with great determination and bravado in their gleaming new supercenters—that provide for the prices of a deep discount food store, but in an assortment and ambience that easily meet and beat any conventional supermarket!

As the Loblaw organization now also is busily doing, we, too, did some shopping around the traditional Loblaw stores, its No Frills units, as well as the new Real Canadian Superstores—comparing prices among them and the new Wal-Mart Supercenters in Ontario. As Table-1 clearly indicates, on the price dimension, all formats in the Loblaw Companies arsenal today are challenged rather significantly. During the months of April-May 2007, we found the traditional Loblaw supermarkets, on a large basket of goods of identical or near identical products, to be more than 20 percent; and the new RCSS units to be 6 percent overpriced compared to Wal-Mart SCs. Though Loblaw's franchised No Frills units appear to meet Wal-Mart's food prices at par, these stores, as their names aptly imply, neither have the requisite ambience nor the assortments consumers normally expect and will now find at the Supercenters. Hence, whatever "parity" these stores may have found on price, they give it all away on every other key store attribute that is important to a typical food shopper.

For a merchant that provides nearly half of all of what Canadians consume in supermarket food, we think it will be increasingly untenable for Loblaw's to be underpriced

on such basics as eggs, milk, and bread, or tea, bacon, and chips—where we found prices to be 15 to 30 percent higher in most traditional Loblaw stores compared to both Wal-Mart and No Frills (see Table-1). With such large price disparities, and a very large market share, we think Loblaw's will be running a huge risk of alienating the average food shopper in Canada—as price becomes an important wedge issue that no matter how good you are, or may become in other store choice dimensions, your patronage will be severely curtailed.

WAL-MART'S STRATEGIC THRUST IN CANADA

As Loblaw Companies try its best to gather its armada of stores and people together, Wal-Mart also appears to be getting into a (renewed) fighting spirit in Canada. In a recent Investors Day conference of its own on March 20 that was hosted for the first time by the local management team in Toronto, Wal-Mart also introduced some of the key elements of its strategy, in an eerie reminder of its first coming to Canada!

In uncharacteristic candor—and at times in an air of open but perhaps earned bravado—the Wal-Mart senior management noted that it will be spending about C\$500 million in 2007 to open 21 Supercenters, and hinted strongly that it may do the same for a number of years to come. For a very reserved division of a reticent U.S. company that has consistently shied away from any major public announcements, or sharing of any domestic figures for Canada, this was indeed a groundbreaking admission of some serious future ambitions. Though admittedly, no longer a very big number for an estimated C\$15 billion company, nevertheless C\$500 million capex for 2007 was a significant figure, as it roughly equaled the initial price of market entry for Wal-Mart when it acquired 122 Woolco stores in 1994!

During the investors' conference, when Canadian President and CEO Mario Pilozzi was asked if he thought "... in 10 years' time ... the number of Supercenters in Canada would be equivalent to the number of discount

IN UNCHARACTERISTIC CANDOR, THE WAL-MART SENIOR MANAGEMENT NOTED THAT IT WILL BE SPENDING ABOUT C\$500 MILLION IN 2007 TO OPEN 21 SUPERCENTERS.

Table 1.

SELECTED ITEMS FROM PRICE BASKETS CONDUCTED IN TORONTO, ONTARIO, APRIL-MAY 2007								
Selected Items	Quantity	Loblaws	RCSS	No Frills	WMT-SC	L:SC	RCSS:SC	LNF:SC
Granny Smith Apples	1 Kg	\$3.29	\$2.15	\$2.18	\$2.14	154	100	102
Bananas	1 Kg	\$1.30	\$1.08	\$1.04	\$1.04	125	104	100
Wonder White Bread (Sliced)	1 Bag	\$1.99	\$1.99	\$1.99	\$1.77	112	112	112
Wonder WW Bread (Sliced)	1 Bag	\$2.09	\$1.89	\$1.99	\$1.66	126	114	120
Boneless Skinless Chicken Breast (Chilled)	1 Kg	\$18.72	\$17.61	\$17.61	\$17.37	108	101	101
Lean Ground Beef (Packaged)	1 Kg	\$8.11	\$7.03	\$6.54	\$7.21	112	97	91
Unsalted Butter	454 gr	\$4.99	\$4.99	\$4.79	\$4.97	100	100	96
Kraft Cheese (Mozzarella)	200 gr	\$4.79	\$4.19	\$3.77	\$3.67	131	114	103
Milk – 2%	2 L Carton	\$4.29	\$4.29	\$4.19	\$3.93	109	109	107
Milk – Skim	4 L Bags	\$4.49	\$4.49	\$4.19	\$4.67	96	96	90
Europe's Best Frozen (Mixed) Fruit	500 gr	\$5.99	\$4.99	\$4.97	\$4.96	121	101	100
McCain Frozen Super Fries	900 gr	\$2.95	\$2.45	\$2.43	\$2.48	119	99	98
Minute Maid Frozen Orange Juice (Low Acid)	355 ml. Can	\$1.79	\$1.75	\$1.73	\$1.58	113	111	109
Fancy Feast Cat Food	85 gr	\$0.55	\$0.49	\$0.47	\$0.42	131	117	112
Pedigree Real Beef Dog Food	630 gr	\$1.89	\$1.49	\$1.59	\$1.43	132	104	111
Miracle Whip - Easy Squeeze	532 ml	\$3.99	\$3.49	\$2.97	\$3.27	122	107	91
Miss Vickers Potato Chips	1 Bag	\$3.59	\$1.99	\$2.99	\$2.50	144	80	120
Pringles Potato Chips	1 Can	\$2.35	\$1.49	\$1.93	\$1.77	133	84	109
7-Up	12 Pack	\$4.99	\$4.49	\$4.47	\$3.97	126	113	113
Allens Apple Juice	1 L	\$1.49	\$0.88	\$0.99	\$0.82	182	107	121
Gatorade	710 ml	\$1.69	\$1.39	\$1.37	\$1.37	123	101	100
Chunks Ahoy Christies	350 gr	\$3.69	\$3.25	\$1.97	\$1.97	187	165	100
Nestle Tasters Choice Coffee	150 gr	\$9.19	\$5.99	\$7.97	\$8.47	109	71	94
Tetley Tea	72 Bags	\$4.39	\$3.69	\$3.67	\$3.27	134	113	112
Aunt Jemima Light Maple Syrup	750 ml. Bottle	\$3.69	\$1.99	\$2.25	\$1.97	187	101	114
Billybee Honey	375 gr	\$3.99	\$3.49	\$3.49	\$3.47	115	101	101
Kraft Smooth Peanut butter	1 Kg	\$4.79	\$3.99	\$3.97	\$3.96	121	101	100
Kraft Ranch Dressing	475 ml. Bottle	\$2.99	\$2.69	\$2.67	\$2.54	118	106	105
Unico Long Grain Rice	250 gr	\$1.49	\$1.49	\$1.33	\$1.27	117	117	105
Cinnamon Toast Cereal	400 gr	\$4.79	\$4.59	\$4.47	\$3.97	121	116	113
General Mills Fiber 1 Cereal	450 gr	\$3.99	\$4.27	\$3.93	\$3.97	101	108	99
Kellogg's Frosted Flakes Cereal	525 gr	\$5.49	\$4.59	\$4.47	\$4.29	128	107	104
Kellogg's Mini Wheats Cereal	1.3 Kg	\$9.25	\$7.69	\$7.69	\$7.47	124	103	103
All Purpose Flour (Five Roses)	2.5 Kg	\$4.99	\$4.29	\$3.77	\$3.17	157	135	119
Iodized Salt	1 Kg	\$1.19	\$0.79	\$0.77	\$0.97	123	81	79
Red Path Sugar	2 Kg	\$1.89	\$1.89	\$1.78	\$1.78	106	106	100
French Mustard	400 ml	\$2.29	\$1.99	\$1.93	\$1.67	137	119	116
Packaged Pasta (Rotini)	500 gr	\$1.79	\$1.19	\$1.63	\$1.07	167	111	152
Campbell's Chicken Rice	1 Can	\$1.79	\$1.49	\$1.49	\$1.57	114	95	95
Bounty Paper Towels	6 Rolls	\$8.99	\$6.99	\$6.97	\$6.97	129	100	100
Dove Soap	2 Pack	\$2.82	\$2.82	\$3.57	\$2.78	101	101	128
Head & Shoulders Shampoo (Refresh)	420 ml	\$5.96	\$5.96	\$5.88	\$5.93	101	101	99
Huggies – No.2 Diapers	72 Pack	\$17.97	\$17.97	\$17.97	\$17.97	100	100	100
Kleenex	3 Pack	\$7.49	\$6.99	\$6.99	\$5.97	125	117	117
OB – Regular	40 Pack	\$7.79	\$7.33	\$7.33	\$7.33	106	100	100
Palmolive Dish Washer	625 ml	\$2.19	\$1.99	\$1.49	\$1.84	119	108	81
Tide	26 Uses	\$9.99	\$8.79	\$8.77	\$8.77	114	100	100
Average Unweighted Index						122	106	101

Source: Retailing Research & Strategy Group.

stores." Pilozzi's response, amid nervous laughter from both sides of the aisle at Wal-Mart Canada's spartan meeting hall, was: "We are taking one step at a time, but that's a very good guess!" Pilozzi's answer to a related question, where he noted that "[they] will build discount stores wherever they are appropriate, [but] Supercenters wherever possible" also left no doubt as to where their strategic priorities lie in Canada. These pronouncements, especially coming at a time when Wal-Mart Stores in the U.S. are in the midst of a rather significant retrenchment from its growth goals, showed not only the intensity of Wal-Mart Canada's strategic intent, but also the speed with which it intends to execute it over the next several years.

In order to appreciate the implications of Wal-Mart's future plans on Canadian retailers, one need not do any extensive analysis, but simply consider the following:

If indeed Wal-Mart Canada were to achieve its goal of having nearly 300 SCs in Canada by 2016, that would roughly translate into 40 to 50 million new square feet of retail space (in food, drug, and general merchandise lines of trade), which would mean incremental sales of about C\$15–\$20 billion to Wal-Mart Canada by 2016. Clearly, there is room for some of this new volume to come from natural expansion and the normal growth in consumer consumption—currently at about 5 to 6 percent per annum. But in order to accommodate the balance of this ambitious rate of growth, a nearly equal number will have to be generated through market share gains. Therefore, if Wal-Mart indeed follows through with its plans, and succeeds, we will inevitably see a period of major upheaval in Canadian retailing for a number of years to come.

Given the scale of the supermarket industry in Canada, (at about C\$65 billion and growing at 4 percent per annum), this is clearly a very significant development for all food merchants; and given the (negative) growth profile of the GM merchants, truly bad news for both Sears and the HBC. However, given some of their current strategic choices and operational difficulties, we think perhaps

IF WAL-MART INDEED FOLLOWS THROUGH WITH ITS PLANS, AND SUCCEEDS, WE WILL INEVITABLY SEE A PERIOD OF MAJOR UPHEAVAL IN CANADIAN RETAILING FOR A NUMBER OF YEARS TO COME.

the most vulnerable retailer in Canada these days may well be the Loblaw Companies.

The major strategic weapon Wal-Mart intends to use in its battle with Loblaw's (and others) in Canada is well-known, and can be seen in all Wal-Mart discount stores and Supercenters in the country where six-foot banners declare they've "checked it out ... (and) are lowing ... prices again!" This, of course, can be both good and bad news for Loblaw's and many of the local players:

The good news is that they all know precisely what lever(s) Wal-Mart will press in its quest for retailing supremacy in Canada. Unfortunately, the bad news is that Wal-Mart also knows that these lever(s) also happen to fit rather well with the expectations of many Canadian families today.

In summary, the Wal-Mart's strategic game plan for Canada for the foreseeable future is exceedingly simple, and contains substantially two key elements:

1. open more Supercenters, and
2. rollback prices

Interestingly, this strategic thrust is substantially not very different from what Wal-Mart used very effectively in Canada, nearly 10 years ago, during its initial market entry!

FOOD FOR THOUGHT FOR THOSE STILL ON GUARD FOR THEE IN CANADA

As most observers would agree, the effect of Wal-Mart's initial entry on the Canadian retail scene has been both breathtaking in its speed, and relentless in its ever-widening scope.⁵ Now that Wal-Mart's "second coming" is well under way, there is reason to believe that equally dramatic changes may be afoot in this country for the next decade.

For anyone who was paying close attention, it was not difficult to predict that a major confrontation among Loblaw Companies and Wal-Mart was not only likely, but perhaps inevitable. Wal-Mart, in fact, had publicly announced its strategic intentions quite early-on—in its 1997 Annual Report to shareholders—where senior management had noted that "[Their] first international goal [was] to be the dominant retailer in each country in North America."⁶ However, the second part of what Wal-Mart management also had to say in the same report, namely that "[They]

accomplished that goal this year [as] Canada had an outstanding year," may have lulled many to think that Wal-Mart's job in Canada was done.

For many Wal-Mart observers who have been closely following the early success of their experience in food retailing in the U.S., and their accelerating reliance on international expansion since 2000, it was of course only a matter of time before Wal-Mart would seek to increase its footprint in Canada. The scale and scope of this desire in fact first found expression in its "Grocery Shelf" concept, where a floating island of a dry grocery store was established in the middle of its existing discount stores in the late 1990s, followed by the introduction of the first four of its six Sam's Clubs in 2003.

Watching these events unfold for many years, we had likened Loblaw Companies and Wal-Mart to "two very fast cars on a fairly narrow track, each racing to get to the finish line first," and noted that:

"Wal-Mart is determined to be a player in the retail food industry which Loblaw's 'owns'... and Loblaws Companies is heavily committed to becoming a significant force in the general merchandise retailing that Wal-Mart recently 'acquired' in Canada. So, our interest here is akin to that all-too-human fascination of watching a crash that is just about to happen: We know almost certainly that somebody is going to get hurt, but we don't know who—and we are equally fascinated to find out who else will be sucked into the melee!"

Though it now appears that Wal-Mart clearly has the faster start and the early momentum in this race, we don't believe that Loblaw Companies is yet to concede an appreciable inch. But the time is well at hand for Loblaw and all Canadian retailers to examine the battleground one more time, and to take more decisive action. As the Noah principle states "Predicting rain really doesn't count anymore, but building the right ark does!"

VALUE ORIENTATION — A KSF IN CANADA

In their future plans, we suggest all Canadian retailers to first revisit their understanding of that unique character of the Canadian consumer—their value orientation—as a defining element in most everything they do, and decide how they intend to position themselves on this key dimension.

To help in this effort, we have provided in Figure-3, a plot of the disposable income for an average Canadian

(adjusted for the Purchasing Power Parity or PPP)—as a percent of their American cousin's for the last 25 years.⁷ (On this chart, 100 percent means that both consumers, on average, are enjoying the same purchasing power on all the goods and services they consume in their respective markets). As the level and momentum of this chart clearly indicate, for the average Canadian consumer, seeking value in all that they do in the marketplace is not simply a national trait, but an economic necessity.

During the last 25 years, despite some modest gains in household incomes, the consumers north of the 49th parallel have consistently been strained in maintaining their lifestyle vis-à-vis their neighbors to the south, but more recently, have really and substantially lost this battle to keep up. The current run-up on the Canadian dollar certainly does help those shoppers who are crossing the border to the south, but it does nothing for the residents who are left behind—whose jobs are becoming perilous in many sectors as their companies struggle to sell to the United States. Therefore, it is no surprise that when one examines the list of both the old and new retailers that have enjoyed the most rapid rates of growth in Canada, one will always and consistently find such retailers as Wal-Mart, Winners, Best Buy, Staples, and Home Depot at the very top of the list.

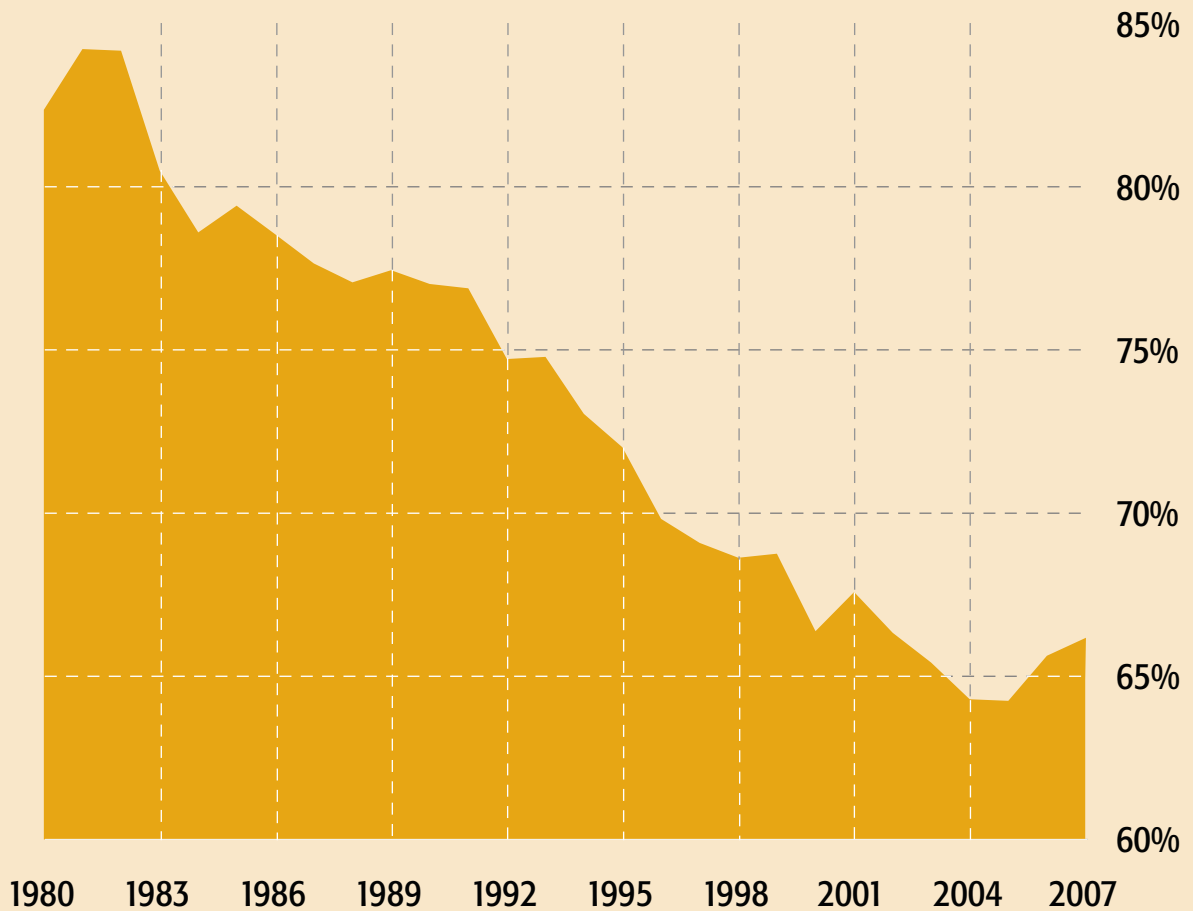
Perhaps some of the most salient strategic takeaways from this chart are the following:

Canadians, as a group, like a very strong "value proposition" in all they do, from food to drugs to home to fashion. And when they find it, or believe that they have, there is no limit to their patronage and loyalty to a retail brand. Therefore, future success in retailing in Canada for nearly all players, in nearly all lines of trade, will importantly depend on presenting and delivering a compelling "value proposition."

Even if the general strategic thrust of a retailer is "differentiation," that proposition will not be sustainable in the long term or in critical mass, unless there is a value component that is readily recognized, and clearly understood by the Canadian consumer; and honestly delivered by the merchant. Therefore, the ability of the key players to rapidly position themselves in this market reality and to communicate their position well will be among the most significant success factors in the coming battle for retail supremacy in Canada.

CANADIAN DPI PER CAPITA AS A PERCENT OF U.S. PDI (ADJUSTED FOR PPP)

Figure 3.



Source: Statistics Canada, US BEA, OECD, and R2SG Computations

We think this is why we have been unable to support but one stump of a high-end department store—Holt Renfrew; one high-end men’s wear retailer—Harry Rosen; and only a handful of Abercrombie & Fitches, Hollisters, and Banana Republics; and even fewer Restoration Hardware, Williams-Sonoma or Pottery Barn stores in this country.⁸ Thus, if there is one bitter truth about Canada for any large-scale or mass-market retailer, it is this: If you stray too far from a strong value proposition in your market offer, you cannot and will not be successful in this country.

There are lessons in this proposition for all retailers, but especially for Loblaw’s and others in food retailing. Now that Wal-Mart Supercenters are here—and will be multiplying at a frenetic pace—this fact will need to become

a central strategic imperative for them as they jockey for more defensible positions.

NEED FOR A NEW SYNTHESIS

Though they are strained for both money and time, Canadians also value style, fashion—and convenience—due in part to their closer European heritage, and in part, to the sheer amount of time they have to spend at work to pay their taxes and all their bills. Today, Wal-Mart and Loblaw Companies collectively account for about 22 percent of consumers’ total retail spending at general merchandise, food and drug stores in Canada—a footprint that is second only to the government of Canada’s take from their incomes! Sadly, however, neither of these retailers really fully satisfies the needs and expectations of the Canadian consumer:

Loblaw fails them on providing a strong value proposition in their food shopping—which has been even more distressing to watch as they also failed spectacularly in core product availability during an extended period of time. We think Wal-Mart fails them in not offering innovative and unique or higher-quality products for their money—and in providing a more pleasant shopping environment or experience in their stores and in their market offer.

We believe a pathway to success in Canada—as it is in many other markets—will increasingly require merchants to find a new synthesis where they are able to offer something from both of these worlds in a new business model.

Wal-Mart is beginning to do this in the U.S., but so far has been unable to convince both its internal public and the public in general that it can really deliver on it on a credible and sustainable basis. Loblaw in Canada also is on the right track to do the same with its new Superstores, but issues remain and questions persist as to whether they will have the “time” to see the light of day—and engineer a business model that will be credible to their investors and acceptable to Canadian consumers.

Having said all of this, we must admit that, we don't know whether an efficiency orientation or the operational disciplines that are prerequisites for a better value proposition in retailing can ever be compatible with a culture tuned for newness or innovation. In other words, while “cost leadership” nearly always demands excellence in operational controls, precision, consistency, and repetition in most tasks; “differentiation” in organizations nearly always calls for trial and error, endless variations in processes, or very simply, serendipity.

Today, in an ironic twist, both Wal-Mart in the U.S., and Loblaw's in Canada are trying these role reversals, and in due time, will each provide us immense learning whether any of this is possible.

There are some hopeful signs that, with the increasing sophistication in the deployment and use of technology, some of these syntheses are not only possible, but, in

fact, will be required for future success. For example, one of the key growth areas in food retailing today—the ready-to-heat or eat products, organics, and other “fresh” products, all require faster throughput, and far more accurate demand forecasting for such offerings to work profitably for the food merchant. Hence, “differentiation” in this area is only possible if it's married with the disciplines and processes of a cost leader in logistics and operations. Similarly, higher service levels at a differentiator can only be profitably employed, if the retailer is better than the competitors in labor and fleet scheduling—just as a low-cost leader has to be.

In this regard, the organizations that are able to create a “new DNA” in their inner workings and among their associates—where they blend every corner of the “Pentagon and the Triangle” seamlessly and for collective impact—will have a distinct advantage. In this pursuit, however, we believe “only the lead dog will enjoy the change in scenery!”

CONCLUSIONS

About 12 years ago, when Wal-Mart entered Canada, few could have imagined that a C\$1.7 billion operation, with a strange cheer in the mornings, would turn into a C\$15 billion retailer—second only in size to the market leader in 2006. We think it will be foolish again to discount the possibility that Wal-Mart Canada could displace Loblaw Companies as the largest retailer by 2015.

However, we do not believe that it is ordained or inevitable that this will or has to happen. Unquestionably, the footprint Wal-Mart has established in Canada for the last 10 years has been large, and its effect on many players, rather painful. Yet, we also believe that the future progress in retailing in this country ultimately will benefit from Wal-Mart's footprint and footsteps.

If, in 2015, we indeed find Wal-Mart to be the supreme purveyor of goods and services in Canada—with no improvements in its market offer—we submit to you that it will not be because of Wal-Mart's larger footprint, but because of the collective inability of our local managers to find defensible competitive advantages, or to execute well on those they already possess.

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SADLY, HOWEVER, NEITHER OF THESE RETAILERS REALLY FULLY SATISFIES THE NEEDS AND EXPECTATIONS OF THE CANADIAN CONSUMER.

Endnotes

- ¹Retailing Newsletter (Winter 2003), "Some Food for Thought for Food Retailers Everywhere—How Loblaw Companies Is Standing on Guard for Thee in Canada," 1-7.
- ²Needless to say, there was also a significant "hit" to the bottom line as Loblaw Companies had to clear out more than C\$250 million of "dated" merchandise for the year.
- ³Retailing Newsletter (Winter 2006), "What Happens When The Elephants Dance? It is happening in Canada and the grass is already awfully trampled!" 2-6, and also in the same issue, "The Elephants Dance—Update," 10-11.
- ⁴JOE refers to Joe Fresh Style, a new apparel brand and a department located in selected Loblaw Superstores designed by Joseph Mimran—formerly of Club Monaco fame. Loosely, it is to Loblaw Companies what George is to Wal-Mart, but perhaps with bolder lines, and a higher sense of fashion and style. Loblaw Companies hope Joe departments will contribute 10 percent of shop sales in general merchandise, and ultimately to become a billion-dollar business.
- ⁵Serpken, Ray (2007), "The Barbarians Are Not at The Gate: They Are Already Inside! The story—and lessons—from the battle for retail supremacy north of the 49th," Retailing Research & Strategy Group, Working Paper, (July)
- ⁶See Wal-Mart Annual Report, 1997, p.5. Incidentally, in the same annual report, Wal-Mart went on to say that "Our second goal was to penetrate South America, and our start-up operations in Argentina and Brazil are progressing as planned." All of these goals, as many of you know, also have been accomplished.
- ⁷It is always difficult to make a pure, apples-to-apples comparison between Canada and the U.S., given the treatment of mortgage interest payments, and the different accounting of health benefits/costs in the two countries. However, even when these factors are taken into account, the fact remains that Canadian consumers are disadvantaged compared to their neighbors, in part due to a higher rate of real growth in personal incomes in the U.S. (and higher relative rate of taxation in Canada). According to a recent Fraser Institute Report on The Canadian Consumer Tax Index for 2007, "the average Canadian family now spends more of its income on taxes than it does on the basic necessities such as food, shelter, and clothing combined."
- ⁸Truth be told, it is another sad Canadian fact, but a very instructive story, that in a G-7 country with more than 30 million people and a strong middle-class, we even seem unable to support two poorly run department stores!

2008 PROGRAM DATES

- William and Mary, April 26–May 2
- Monash, May 25–30
- Singapore, June 22–27
- Babson, September 13–19

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