
Supplement to Ellickson, Misra and Nair (2011), "Repositioning Dynamics and Pricing Strategy".

In this supplement, we discuss a brief sampling from the trade-press that discusses how supermarkets have reacted to Wal-Mart’s entry in ways that impinge on our model. These reports helps adds some more industry context to our analysis.

Our models and analysis focuses on pricing format as a key differentiation amongst stores, and emphasizes competition as a key driver of format choice. Merrefield (1997) reports that pricing format is a key source of differentiation amongst supermarkets, and that significant price substitution exists within EDLP operators, who are perceived as strong substitutes by consumers:

"Moreover, if there is more than one EDLP supermarket in a market, they tend to start looking alike with their similar prices and bare-bones approach to store decor, as is mandated by cost cutting. [...] Maybe there’s a lesson here that could be used since what supermarket EDLP needs is a nonprice means by which different EDLP chains can differentiate from each other, and from high-low chains."

Slezak (1994) reports on the trend to EDLP in the 1990-s. Interestingly, he points out the example of Valu Foods’ switch to EDLP in 1994, which however reduced profitability, and its subsequent decision to go back to a PRcMO (or HiLo) strategy to improve margins. This is consistent with our analysis.

"Valu Food’s change to high-low pricing takes place in the aftermath of a nationwide trend toward EDLP strategies that had been implemented to challenge mass merchandisers. While many retailers said EDLP increased their sales and stopped customers from switching to other classes of trade, the resulting low margins often resulted in decreased net profits."

Slezak (1994) also points to advertising as the repositioning costs required to implement the change in pricing strategy:

"[Allan] Karpe [director of pharmacy and Health and Beauty products at Valu Foods] said the aggressive advertising campaign that will accompany the pricing switch is an essential part of the store’s new attitude toward HBC."

Zwiebach (2002) reports on Wegman’s decision to shift to EDLP, and how it is explicitly driven by a desire to compete with Wal-Mart’s entry:

"Wegmans Food Markets here converted more than 4,000 grocery items to an everyday low-pricing program last week –– a move apparently designed to blunt the impact of Wal-Mart Supercenters that are beginning to proliferate in its upstate New York marketing area, industry observers told SN."

Zwiebach also notes how Wegman’s incurred significant repositioning costs to communicate its new price positioning to consumers, by posting physical
videotapes to over 1M consumers with the new price positig explained in detail by Danny Wegman, the company's president (see http://youtu.be/AKNiNKm-k_8 to see an online version of this video).

Quoting Zwiebach (2002),

Billing the price change as "a simpler way to shop, a simpler way to save," Wegmans sought to explain the new approach to shoppers in videotapes that were sent to approximately 1 million consumers' homes, featuring Danny Wegman, president. In the tape, Wegman says the new pricing was instituted "to simplify the shopping experience," and make lower prices available to Wegmans shoppers every day. He also pointed out that tests showed the company was able to increase sales when prices were lowered.

Zwiebach (2002) also notes that the idea is to educate consumer's about price image:

"Wegmans is trying to put out the perception that it has low prices," he explained. "It's been perceived as an upscale chain, and this is a way to speak to the masses to tell them it cares about them while maintaining its edge on quality, service and value. And second, it's a direct slap at Wal-Mart -- to let them know it's going to go after them on price, which is Wal-Mart's edge."

Similar issues involved with educating consumers faced the Ahold chain when it transitioned its U.S. supermarket Stop & Shop and Giant-Landover to EDLP. Quoting Springer (2006),

"Introducing the pricing programs to shoppers used to a high-low approach is "a bit of dilemma," Moberg admitted, adding that even a faster rollout will take some time to catch on with shoppers. "You can change [pricing strategy] overnight, but that is not how the customers will get this," Moberg said. "It will take awhile before we're through this phase."

Springer (2006) also reports that Ahold will need to invest in advertising to make its Value Improvement Program (associated with the move to EDLP) successful,

"Richard Withagen, analyst for SRS Securities, Amsterdam, said he felt Ahold also needs to differentiate its banners to make the VIP program truly successful."

Saxton (1994) provides a cogent summary about similar fixed investments made by Winn-Dixie stores to communicate its new EDLP positioning:

"Winn-Dixie Stores here created a 16-page, in-store flier that celebrated Valentine's Day and showed off the chain's everyday low pricing on brand name grocery products.

All the chain's divisions participated in the promotion, said Mickey Clerc, Winn-Dixie's director of advertising. He said this was part of an ongoing emphasis on the chain's grocery EDLP strategy. "We periodically put out these fliers filled with in-store promotional items, coupons and things of that nature for our customers," explained Clerc. "The main thing is, we're trying to communicate with our customers about our lower prices. "We're an everyday-low-price operator. So, generally speaking, our prices are good for a long period of time; we don't have the specials like some stores do," he added. Thus, the in-store flier serves as a way to place coupons made available by manufacturers, as well as a chance to reinforce the chain's image of a wide variety of lower grocery prices in its consumers' minds, he said."
Our analysis shows that inspite of the prospect that EDLP may be an effective way to compete against Wal-Mart, choosing EDLP conditional on Wal-Mart entry is on average associated with a loss in revenues, and that many incumbent EDLP supermarkets actually switch the other way to respond to entry. Consistent with this finding, we find that skepticism that choosing EDLP is an effective way to compete with Wal-Mart had also been expressed at that time in some sections of the trade. Quoting Zwiebach (2002):

“Another New York-based analyst, who asked not to be quoted by name, offered a contrasting opinion. "It’s been proven that EDLP is a tough way to go in the face of competition from Wal-Mart," he told SN. "With targeted promotions, a retailer can surprise the consumer on different items from time to time. But by simply dropping 4,000 prices, Wal-Mart can price itself 15% lower on those items, and there’s no way Wegmans or anyone else can match those prices. So EDLP is a very tough strategy to use going up against Wal-Mart."

Similar revenue implications are assessed in Springer (2005):

“Retailers who go to EDLP should be prepared for bumps in the road, experts said. Drawbacks include a potential loss of revenues, diminished drawing power and challenges in communicating the new price message.”

He also points to these revenue impacts using the example of Delhaize America's decision to switch Victory Markets to EDLP:

“Delhaize America, the Salisbury, N.C.-based retailer, is switching the Victory Markets chain of stores it purchased last year to align with the EDLP strategy of Delhaize's Hannaford Bros. chain. "It's going to take a year of bleeding comparable sales until they get it," noted Mark Husson, an analyst with HSBC World Markets, New York.”

Springer (2005) points out how Wal-Mart is a key reason to shift to EDLP, and how the decision to switch to EDLP has long-term implications.

“To effectively do EDLP, you have to bring everyday pricing much closer to Wal-Mart, and I don't know if publicly traded supermarket operators have the cost structure to do that," John Heinbockel, analyst for Goldman Sachs, New York, told SN. "They would [also] take a huge hit for the first 12 months in comps."

Our analysis emphasizes both revenue and cost side arguments for changing pricing strategy. In spite of the revenue hit, Angrisani (2007) points out one cost-side reason to shift to EDLP, viz. lower fixed costs of operation:

“EDLP retailers benefit in terms of the reduced costs associated with running weekly ads and making frequent changes to their in-store signage and price files.”

Springer (2005) also emphasizes the importance of educating consumers and communicating the positioning:

“Other risks of EDLP, Hauptman [Jon Hauptman, vice president at Willard Bishop, Barrington, Il] said, are in communicating the price message effectively and in providing reasons beyond price for drawing shoppers to the store.”
To emphasize the difficulty in changing perceptions, he reports the following quote from Larry Johnston, Albertsons’ chief executive officer:

“This program of everyday fair price on our highest velocity and highest basket penetration items is already beginning to build new trust levels with customers, assuring them we’ll be priced right on the items they need every day,” he said. "While we know that price perception is the toughest consumer dimension to change, we believe that this program ... is already beginning to change customer perception on our price competitiveness and most importantly, can be sustained long-term in our business model.”

Angrisani (2007) reports on additional fixed, re-positioning costs of EDLP associated with in-store displays, and signage:

“A variety of other efforts should also supplement EDLP, Hauptman [Jon Hauptman, vice president at Willard Bishop, Barrington, Il] said. Among them are ensuring that endcaps truly offer values; in-store signage that defines how shoppers can save; and shelf tags that highlight either EDLP or promotions so that the store gets full credit for what it’s doing.”

There are also many suggestions in the press that this is a competitive game amongst supermarkets, with Wegman’s anticipating Wal-Mart’s competitive reaction, and Wal-Mart actually responding in pricing to Wegman’s actions:

“[] He doubts Wegmans will succeed on the second count, noting Wal-Mart has already lowered prices below Wegmans’ level on some of the 4,000 items. "But Wegmans is not trying to match Wal-Mart price-for-price -- it’s determined its own comfort level and the necessary level of profitability, and it’s staying there,” the observer explained.” Zwiebach (2002).

And Angrisani (2007) notes the role of competitors in influencing Green Hills Farms:

“Green Hills Farms, Syracuse, N.Y., has enhanced its circular in response to its new EDLP program. [...] Green Hills switched to hybrid EDLP last year because much of its competition went the same way.[]

Further, some note that supermarkets respond to each other’s expected actions like in our model,

“Giblen said the switch to EDLP is "definitely a defensive move -- I don't think Wegmans is going for increased market share, but rather it's trying to prevent a loss of market share." Zwiebach (2002).

Zwiebach (2002) also notes Kroger Foods lowed pricing based on expectations of Wal-Mart entry:

“A discount store analyst, who asked not to be identified, said it's doubtful Wegmans' move will have much impact on Wal-Mart...["When Kroger lowered prices on all items, that was a preemptive strike. But lowering 10% of your SKUs [stockkeeping units] is a weak attempt to shore up your traffic patterns. But perhaps Wegmans is simply putting its toe in the water to see what effect its move will have."
In an interest volte face, in the late 2000-s Wal-Mart went back on its EDLP strategy implementing a quasi-PROMO regime with selective roll-backs. Quoting Bustillio (2011):

“As growth slowed and Wal-Mart began running out of room to build new supercenters, the chain began touting more discounts on select products—Wal-Mart calls them "rollbacks”—while raising prices on other items, according to interviews with more than a dozen current and former executives and vendors.

That "high-low" tactic, as it is known in retailing, is the opposite of what was preached by the firm’s founder, widely known as "Mr. Sam." Rollbacks reached a climax last spring, spurring healthy sales on products that were discounted, such as Coca-Cola, but failing to lift overall revenue."

In hindsight, this is now seen by many as a mistake. Quoting Bustillio (2011):

"Wal-Mart's struggles are the result of a misstep: To jump-start lethargic growth and counter the rise of competitors such as cheap-chic rival Target Corp., executives veered away from the winning formula of late founder Sam Walton to provide "every day low prices" to the American working class. Wal-Mart, the world's biggest retailer by sales, instead raised prices on some items while promoting deals on others."

"Company executives acknowledge having miscalculated and are adjusting their strategy again. The big question is how quickly the mammoth chain can turn itself around."

And, as Associated Press (2011) also notes, pricing was the key to the entire fiasco,

"Wal-Mart's next mistake was pricing. Over the past year, it had strayed from its "everyday low prices" slogan, the bedrock philosophy of founder and namesake Sam Walton. Wal-Mart was less aggressive about being the low-price leader. Instead, the company slashed prices only on select products, and the deals were temporary. The idea was to draw customers into stores for the bargains and hope they would also pick up other, more profitable items.

But the strategy failed.

The economy was still weak. Customers were scrutinizing prices as many had never before. They discovered that Wal-Mart couldn’t be counted on to have the lowest price on some items, if it stocked them at all."

In response to recent losses and flat “same-store” sales Wal-Mart, is now going back to its EDLP roots. But, as Bustillio (2011) notes, the key challenge now facing Wal-Mart is indeed that of re-positioning itself to convince disenfranchised consumers that they are truly an EDLP operation:

"The whole rollback thing spread like a cancer, and it is systemic," said Scott Edwards, a former regional vice president of operations at Wal-Mart who left the company in 2005. "Now Target doesn’t have to lower prices, because we have raised ours. I think we have alienated a lot of blue-collar shoppers," he said. Wal-Mart now is de-emphasizing rollbacks, returning to its claim of daily low prices.
References