



# Captain America!

## Kroger CEO Rodney McMullen's plan to become "America's Grocer."

speaking, the entire supermarket channel is threatened by the loss of customer traffic as consumer purchases of center store categories migrate online.

The list of challenges Kroger faces is long, but that's nothing new in the food retailing world where the mindset of Kroger Chairman and CEO Rodney McMullen is to always expect the next year to be more competitive than the last and for change to happen quicker. That will be the case for Kroger in 2018, McMullen's fourth year as CEO, as it looks to execute components of the Restock Kroger plan that include:

- ▶ Leveraging data even more aggressively and accurately than in the past to achieve shopper personalization strategies.
- ▶ Increasing re-modeling activity and the optimization of assortments so that an unprecedented 20% to 30% of stores are touched in 2018.
- ▶ Investing in smart, targeted pricing and promotional activity and continued growth of Kroger owned brands.
- ▶ Expanding omnichannel programs such as Click List beyond the current 1,000 locations.
- ▶ Teaming with Google on cloud computing to accelerate digital and e-commerce services.
- ▶ Executing a sweeping corporate responsibility and reputation initiative called, "Zero Hunger, Zero Waste."

"We understand that today's marketplace is shifting rapidly. Kroger's success has always depended on our ability to proactively address changes by focusing relentlessly on our customers," McMullen said. "We have the scale, the data, physical assets and human connection to win. Combining our food expertise and data analytics uniquely positions Kroger to create new and

Nothing gets the attention of the board of directors and C-suite like seeing a third of their company's market capitalization evaporate in a single day. That's what happened in mid-June when The Kroger Co. learned the meaning of the Amazon effect first hand. Kroger wasn't having a great year to begin with when Amazon's acquisition of Whole Foods was announced in mid-June, but the deal put Kroger shares in free fall from which they have not recovered. The \$115 billion operator of 2,800 stores has been in high gear ever since, moving aggressively on physical and digital initiatives to grow sales and win back investors. The effort is code named Restock Kroger and details of the multifaceted plan shared with investors on Oct. 11 could help the company live up to its self-proclaimed status as America's grocer — if successfully executed.

It's a big "if" because even though Kroger has considerable assets and industry leading capabilities, the challenges it faces are numerous and extend beyond the uncertain impact of the Amazon Whole Foods combination. Kroger is coping with the continuing impact of a resurgent Walmart and expansion minded hard discounters Aldi and Lidl. Broadly



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highly relevant customer experiences, delivered both digitally and in stores.”

Restock Kroger is meant to build on the company historical strengths but really accelerate efforts to grow in a food retailing marketplace the company now defines as a \$1.5 trillion

opportunity. That’s a lot bigger number than the roughly \$600 to \$800 billion figure most food retailers use to describe the food at home universe. Kroger is including food away from home, basically restaurants, to get to the \$1.5 trillion.

“The market is incredibly fragmented, which creates all kinds of opportunities. In the past, you would have heard us talk about food in terms of \$800 billion industry. Now you will hear us talk about it in terms of \$1.5 trillion business opportunity. Because if you’re eating, we want to serve you, and unless it’s a white tablecloth restaurant, we view that as a meal that we should be able to provide to you,” McMullen said.

His expanded view of Kroger’s share of stomach opportunity isn’t just about convincing analysts to think differently about Kroger’s growth prospects. The changing nature of competition for share of stomach is real and the line between supermarkets and restaurants has forever blurred thanks to improved meal offerings at supermarkets, meal kits and home delivery from restaurants. Kroger recently opened its own restaurant called Kitchen 1883 in Cincinnati.

#### BEEN THERE, DONE THAT

Information shared at investor conferences can often serve as catalyst to move a company’s stock price. That wasn’t the case with Kroger’s event which failed to impress investors judging from Kroger shares which remain near their 52-week low. The aversion to Kroger’s stock stems from a gloom and doom outlook on the part of investors convinced food retailing is about to go through a phase of disruption unlike anything seen before.

While acknowledging the dynamism unfolding daily, McMullen also views the tremendous change happening in the current climate as part of the normal strategic repositioning that goes on in food retailing industry. As a 37-year Kroger veteran, McMullen has been through a few cycles, the most notable of which involved Walmart’s ascension to become the

nation’s largest food retailer. He has seen major disruption before.

“Looking back in retail, we find every 12 to 15 years you really have to reposition the company and that usually takes three to four years for that to happen. We’re in the middle of that process,” McMullen said. “We feel really good about where we are. We’ve done it before, and we are doing it again.”

There is a general feeling though that this time it’s different, with dire warnings for food retail being sounded from the industry’s leading trade association. Food Marketing Institute Senior Vice President and Chief Collaboration Officer Mark Baum doesn’t pull punches when describing the scenario facing food retailers.

“There is no doubt that the industry is at a tipping point. More shoppers are buying more of their food and related products across more channels than ever before. Center store categories are already making their way online and it is expected to continue,” Baum said. “We think the industry will reach digital maturity and saturation more quickly than other industries that went online earlier.”

FMI and Nielsen in January 2017 projected that online food sales would hit \$100 billion by 2025, or roughly equivalent to the sales volume of about 4,000 grocery stores. Baum thinks the \$100 billion figure is already too low.

“The digital growth curve will rapidly accelerate over the next five years,” Baum said. “Food retailers need to develop deep competencies and digital capabilities that can scale while enhancing physical assets. World class in store experiences coupled with digital capabilities will win the day.”

Kroger is doing many of the things Baum describes. Already a leader in leveraging data and analytics, Kroger is taking those capabilities to new heights to drive personalization, while upgrading stores and providing ever more seamless experiences. One of the most significant involves a massive store assortment optimization effort that, once again, involves leveraging data to drive sales growth.

“The other key with space optimization is how many operating efficiencies we’re building into the space



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optimization thought process, where we may not have always done that on our historical remodel program,” said Mike Donnelly, Kroger’s Executive Vice President and COO responsible for merchandising and operations. “Almost every one of the (stores we touch) starts with how can we do this and make it more efficient to run and operate the store?”

That means making products grab and go instead of placed behind a counter, adding self checkout to more locations, rationalizing offerings in categories where shopper insights confirm it is more important to have depth than breadth and providing unique assortments specific communities.

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## WINNING WITH DATA

Kroger is a data driven technology company operating a network of retail food stores integrated with a digital user interface to offer customers a seamless way to engage with rich experiences and content. Framing the supermarket company in terms of the technology industry is one way to appreciate Kroger’s data advantage. Analysts agree the company’s capabilities are impressive and routinely cited data insights an analytics as the secret sauce behind how Kroger produced a decade long run of uninterrupted identical store sales growth. The impressive streak came to an end in the third quarter of 2016 and stayed negative until the second quarter this year when Kroger posted a 0.7% gain. Now, company executives want investors to believe it has turned the corner and unsurpassed data capabilities are key to future growth.

“We can see 96% of every transaction that goes through our store. I don’t care if that transaction is a card transaction, debit or credit, or a cash transaction. I can tie that back to a household,” said Stuart Aitken, CEO of 84.51°, Kroger’s wholly-owned insights and analytics subsidiary. “We also have clickstream data, feedback data, rest of market data, demographic data. Across this entire data spectrum, we create what we call our data DNA layer. That data DNA layer has 2,700 attributes today and is growing all the time.”

Within those attributes, Aitken said Kroger knows things about household’s competitive geo-densities of competing retailers and restaurants, household size, hobbies, spending across various categories of travel and entertainment that offer a view of lifestyle, social media data digital device type.

“Data is critical in order to truly personalize. It creates a rich picture of our customers,” Aitken said.

From that rich picture, Kroger is able to develop strategies that grow sales and in turn create more data in a sort of virtuous cycle. But to do so means Kroger has to stay ahead of the pack in how shoppers interact with stores and interact with customer facing technology. For example, the order online pick up at store

## KROGER’S STORE COUNT BY STATE

State	Banners	Store Count 1/31/16
<b>California</b>	Food 4 Less, Foods Co., Ralphs	309
<b>Ohio</b>	Kroger, Kroger Marketplace, Ruler Foods	212
<b>Texas</b>	Kroger, Kroger Marketplace	211
<b>Georgia</b>	Kroger, Kroger Marketplace, Harris Teeter	174
<b>North Carolina</b>	Kroger, Harris Teeter	162
<b>Indiana</b>	Jay C, Kroger, Kroger Marketplace, Owen’s, Pay Less Super Markets, Ruler Foods	152
<b>Colorado</b>	City Market, King Soopers, King Soopers Marketplace	146
<b>Michigan</b>	Kroger, Kroger Marketplace	128
<b>Arizona</b>	Fry’s Food & Drug, Fry’s Marketplace, Smith’s	127
<b>Tennessee</b>	Kroger, Kroger Marketplace	123
<b>Washington</b>	Fred Meyer, QFC	119
<b>Wisconsin</b>	Pick ‘n Save, Copps, Metro Market	115
<b>Kentucky</b>	Kroger, Kroger Marketplace, Ruler Foods	112
<b>Virginia</b>	Kroger, Kroger Marketplace, Harris Teeter	111
<b>Illinois</b>	Food 4 Less, Kroger, Mariano’s, Ruler Foods	103
<b>Kansas</b>	Dillons Food Stores, Dillons Marketplace	62
<b>Oregon</b>	Fred Meyer, QFC	57
<b>Utah</b>	City Market, Smith’s, Smith’s Marketplace	54
<b>Nevada</b>	Smith’s	44
<b>West Virginia</b>	Kroger	42
<b>South Carolina</b>	Kroger, Harris Teeter	36
<b>Arkansas</b>	Kroger, Kroger Marketplace	32
<b>Mississippi</b>	Kroger	31
<b>New Mexico</b>	City Market, Price Rite, Smith’s, Smith’s Marketplace	25
<b>Missouri</b>	Gerbes Super Markets, Kroger, Ruler Foods	17
<b>Idaho</b>	Fred Meyer, Smith’s	15
<b>Maryland</b>	Harris Teeter	15
<b>Alaska</b>	Fred Meyer	11
<b>Nebraska</b>	Baker’s	11
<b>Alabama</b>	Kroger	11
<b>Wyoming</b>	City Market, King Soopers, Smith’s	9
<b>Louisiana</b>	Kroger	9
<b>Montana</b>	Smith’s	4
<b>Washington, D.C.</b>	Harris Teeter	4
<b>Delaware</b>	Harris Teeter	2
<b>Florida</b>	Harris Teeter	1
<b>TOTAL</b>		<b>2,796</b>



Roughly half of Kroger's nearly 2,800 stores operate under the corporate banner, leaving huge sections of the country more familiar with regional names such as City Market, above.



service known as Click List is now available at 1,000 locations and customers love it, according to Yael Cosset, Kroger's Chief Digital Officer.

"Adoption of the service has been tremendous. It's a huge endorsement of both the quality of the service and the quality of the experience, but also the readiness of our customer telling us this is the experience they want to have," Cosset said. "Putting up a sign and handing out bags with the groceries a customer may have ordered online is one thing, managing their entire end-to-end experience in a personalized way is the differentiated part."

To further differentiate on the experience front Cosset said Kroger is working aggressively to position itself for where the market is headed at an accelerating rate with mobile and eventually voice.

"Our customers historically have been heavy on the web engagement, somewhat light on the mobile and very, very light on voice. That is shifting today and we expect that based on industry trends to continue to shift on an accelerated pace," Cosset said.

Loyal customers interacting with Kroger with greater frequency via digital devices will simply add to

Kroger's already vast data warehouse and lead to new opportunities. Cosset refers to the phenomenon as a constantly changing data ecosystem that is welcoming new partners.

"We're bringing new partners onboard to leverage either technology capability that they've built or technology capabilities we can build together or just linking together to enable more services that are more personalized and more differentiated than you can find in the rest of the industry.

One of the company's newest partners is Google. Kroger in early November announced plans to partner with the Google Cloud Platform and create a cloud enablement team. The adoption of Google signals the company's commitment to position Kroger as the industry leader for ship-to-home and home delivery, according to Kroger CIO Chris Hjelm.

"The expansion of our cloud computing portfolio will be a foundational cornerstone to current and future initiatives that will drive measurable business value by advancing Kroger's ability to offer the digital and e-commerce services our customers want most," according to Hjelm.

## SOURCING LOCAL SUPPLIERS

Kroger plans to host Natural Foods Innovation Summit events several times a year following a successful inaugural event held Oct. 12, 2017. The event, in partnership with 84.51°, the retailer's insights and analytics group, was held in Cincinnati and involved more than 40 brands, according to the company.

"(The natural and organic products) category was a \$16 billion business for us in 2016," Kroger's Vice President of Natural Food, Jill McIntosh said, adding that the event served as an, "innovation platform that allows us to continue to expand our natural foods product portfolio by partnering with emerging brands on micro and macro levels."

Kroger said its team of buyers continuously look for opportunities to purchase regionally that allow the company to expand its product portfolio for customers, stimulate the local economy and enhance product freshness. Sourcing locally also supports the company's sustainability commitments, including and recently announced program called, "Zero Hunger – Zero Waste." (See page 32.) To be even more effective in that regard, the company has essentially issued an open call to suppliers of local and natural food brands and encourages those interested to visit [Kroger.Com/WeAreLocal](http://Kroger.Com/WeAreLocal).



## AMERICA'S GROCER?

"We are proud to be America's grocer," is how McMullen referred to Kroger in his letter to shareholders in early 2017. Since then the phrase has appeared selectively in press releases and it is also how McMullen began his remarks at the October investor conference. "As you know, we are America's grocer," told the analysts in New York.

Actually, aside from Kroger and those paying close attention to the company's public comments, the America's grocer claim is lost on, well, most Americans. Kroger has a large footprint with 2,800 stores but it has some huge voids. There are no Kroger stores in New York and only one location in Florida. Even in states where it does operate, only about half of its stores fly the Kroger banner. Residents of California, for example, only know the company by its Ralph's and Food 4 Less brands.

If any company wanted to lay claim to being America's grocer it would be Kroger's arch rival Walmart. Its U.S. division operates more than 3,500 supercenters and 735 small format stores in all 50 states under the Walmart and roughly half its annual sales of \$307 billion come from food.

Kroger's not going to match Walmart's presence anytime soon, but it could close some holes in its physical footprint that would give the company more of a national presence. One way to do that would be through acquisitions, something Kroger could be in a better position to do in 2018 following a decision to sell its 784-unit convenience store business. Kroger hired Goldman Sachs & Co. in October to find a buyer and extract maximum value

for the \$4 billion business, the proceeds of which could be used to make an acquisition of its own. Kroger's last deal of any significance from a physical footprint standpoint came in January 2014 when it purchased 227 Harris Teeter stores for \$2.5 billion. More recently, Kroger purchased ModernHEALTH for \$407 million in September 2016, Roundy's supermarkets for \$866 million in December 2015 and Vitacost.com for \$287 million in August 2014.

Kroger doesn't need to do a deal or sell more food than Walmart to make the America's grocer moniker work for it because store count and sales aren't the only metrics that matter. Kroger seems to have embraced the notion of America's grocer as a sort of rallying cry for its 450,000 employees. It is also consistent with the sense of idealism captured by Kroger's other aspirational vision to, "feed the human spirit." Even the way the company described the Restock Kroger plan, "to redefine the food and grocery customer experience in America," has a lofty idealism to it.

"We know that when we serve America through food inspiration and uplift, we create value for our shareholders, customers and associates," McMullen said before reeling off a list of competitive strengths. "Kroger has more data than any of our competitors, which leads to deep customer knowledge and unparalleled personalization. We have incredibly convenient locations and platforms for pickup and delivery within one-to-two miles of our customers. We have a leadership team that combines deep experience with creative new talent. We have the scale to win with more than 60 million households shopping with us annually."

Kroger isn't just selling food, the company is uplifting and improving lives, according to McMullen. Who would expect any less from a company claiming to be America's grocer. **RL**

**Any company that's going to call itself America's grocer needs to be on trend with robust offerings of organics, quality prepared foods to capture diverse meal occasions and specialty products such as gourmet cheeses.**

