Giant Pursues Ukrop's

Introduction

Rick Herring grimaced at the irony. For all his years in the retailing business, Herring had longed to take charge of repositioning another company. But he now realized the wry truth to the old adage "be careful what you wish for." Herring was the president of Giant Food Stores, a division of the multinational Dutch retailer Royal Ahold, and had been a key part of the team charged with making a recommendation to the parent company on the potential acquisition of Ukrop's, a chain of high-end supermarkets in Richmond, Va.

Ukrop's was a family owned company that, for generations, had been regarded by consumers as an integral part of the Richmond community. It boasted one of the strongest levels of consumer brand image of any supermarket company in the United States and was particularly regarded for its high level of customer service and the quality of its fresh foods. But sales and profit performance had recently weakened, and industry speculation suggested that a sale was possible. After an unprecedented amount of due diligence and exhausting negotiations, Herring's team turned in a positive recommendation to make an offer.

On December 17, 2009, Herring was present to witness the signing over of Ukrop's to Royal Ahold as the newest group of stores to join Giant Foods. However, he was barely able to savor the moment. A large question loomed in front of him: Could Ukrop's, a high-touch, high-quality company, actually fit into Giant, whose business model was based on the supply chain efficiencies and low prices associated with a global chain store operation? He knew he faced the challenge of his career. How would he deliver on Ahold's promise to turn the troubled Ukrop's stores around and bring them into the Giant family?

Royal Ahold

Royal Ahold, one of the world's largest retailers, was the direct descendant of the company founded in 1887 by Albert Heijn with one small grocery shop in The Netherlands. Over the years, many stores were added, and the supermarkets in Holland still operate under the trade

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name “Albert Heijn.” During the 1970s, the firm began to diversify into other retailing formats, such as liquor stores (Gall & Gall) and drugstore/beauty shops (Etos), as well as several other non-retailing activities — restaurants (AC Restaurants), vacation parks (Ostara) and specialized “border” food stores (Ter Huurne). By 2009, after numerous rounds of acquisitions and divestitures, Ahold controlled nearly 1,900 stores in The Netherlands and was a source of great national pride to the Dutch.

However, beginning in the late-1960s, growth in Holland, and Europe in general, became difficult for retailers. Real estate was expensive and, bowing to consumer pressure, governments were reluctant to grant access to large lots for commercial development.

Thus, in the late 1970s, Ahold began to launch what was to become one of the most aggressive international expansions of any retailer anywhere, beginning first in the United States. Between 1977 and 2001, Ahold acquired six U.S. food retail companies (Giant Carlisle, BI-LO, Tops, Stop and Shop, Giant Landover and Bruno’s), as well as U.S. Foodservice (USF), the second-largest foodservice distribution company in the United States.

By 2002, U.S. retail stores numbered more than 1,600 and employed in excess of 80,000 people. Ahold had not only become the leading food retailer on the East Coast, but was among the top five U.S. grocery companies. Moreover, starting in the early 1990s, Ahold acquired retail companies in South America, Asia and Europe. By 2001, Ahold operated retail stores in 32 countries and held the No. 1 or No. 2 share in most of their markets. This growth story had established Ahold as one of the world’s leading retailers, its own self-proclaimed goal.

Ahold’s financial success paralleled its meteoric rise in store numbers. During the late 1990s, all key performance metrics were not only up, but many had increased by double digits year after year. From 1998 to 2000, annual earnings before income tax (EBIT) had grown from slightly more than 500 million euros to about 1 billion euros, a 100 percent increase. Net earnings had grown over the same period by a like proportion, approximately doubling. These were phenomenal increases for a traditional, normally stable industry.

However, the euphoric growth was about to end. Ahold failed to harvest the synergies it once believed existed between its foodservice and retail companies, and among its various retail companies in far-flung countries. Trying to juggle differences across five continents in cultures, languages, time zones, currencies, technologies and consumer tastes was overwhelming. The “stable of thoroughbreds,” a phrase then-CEO Cees van der Hoeven often invoked to describe his vision, proved too difficult to manage. Stock price told the story: the company lost half its value as stock price tumbled from $24 in January 2000 just before the USF acquisition to less than $12 by January 2003. But matters were to worsen.

On February 23, 2003, major “irregularities” were discovered at Ahold’s USF operations. Top management had perpetrated a fraud whereby income had been incorrectly reported over five years amounting to accounting irregularities of $1 billion. Ahold’s stock plummeted further to less than $3 a share in April 2003. A number of senior executives were immediately suspended, and the CEO of USF resigned. More than a dozen USF vendors and three senior USF executives,

including the CFO, pled guilty to fraud, conspiracy and other criminal charges. The parent company was reeling, and international banks were making demands for which the company was financially unprepared. Dramatic measures were called for. New management at Ahold set forth an aggressive, two-pronged and multi-year recovery plan: resolution of the fraud issues and divestiture of all non-strategic business units, including holdings in Asia, Latin America and eventually (2007), USF.

These recovery efforts were bold and hugely successful. After several years of rebuilding morale and the balance sheet, a leaner Ahold emerged. At the end of 2009, both net sales revenue and operating income had been growing steadily since the "recovery years" (Exhibit 1 and 2). What's more, after shedding many of the underperforming international assets, the U.S. market had become dominant, responsible for 57.5 percent of Ahold's corporate sales (Exhibit 3). Finally, but significantly, through a deft combination of productivity increases and debt reduction, Ahold had produced an excess of nearly 3 billion euros in cash (Exhibit 4), thereby brandishing one of the strongest balance sheets of any retailer worldwide.

Although, in the aftermath of the fraud, Ahold had managed to re-establish itself as a recognized global player, the divestiture of more than 14 retail companies in a dozen countries remained a poorly repressed embarrassment for Ahold. In some investment circles, Ahold had become known, indeed, for its ability to buy companies, but had not demonstrated the ability to add value to them. Furthermore, senior management remained under intense pressure from major shareholders to return its stock price to levels enjoyed in the 1990s. Ahold was at last ready for — indeed, desperately needed — an expansion strategy. As early as 2006, Anders Moberg, then Ahold CEO, stated, "We have rebuilt our foundations and now can confidently look ahead… to growth."

The same year, Ahold began by aligning organizations on both sides of the Atlantic to prepare for growth. In March 2009, CEO John Rishton reinforced the growth theme: "I am confident that our strong position will allow us to further grow Ahold…" Under the leadership of Rishton and the Ahold corporate executive board, a single leadership group of 50 senior executives was composed to develop and share common vision and values. This group commenced a journey together that included custom-designed leadership programs at Oxford University's Said Business School and the Harvard Business School.

At the end of 2009, Ahold announced a reorganization to further simplify business processes and structures in both Europe and the United States as it embarked on its announced growth era. A new dual-continental platform was designed to more easily integrate the new acquisitions that Ahold envisaged. In the United States, the reorganization created four geographic divisions — Stop and Shop New England, Stop and Shop New York Metro, Giant Carlisle and Giant Landover — all, for the first time, under one retail executive leadership team. Many at Ahold regarded this reorganization as long overdue and were upbeat about Ahold's future prospects once the new structures were in place. However, no one was naïve about the challenges embedded in making the transition from the former organization to the one proposed: integrating all hardware, software, systems and policies from multiple companies into one unified platform was bewilderingly complex. Unprecedented investments of financial and human resources would be required.

Giant Food Stores

Giant was established in 1923 when budding entrepreneur David Javitch opened a small meat market in Carlisle, Pa. What subsequently became a chain of 29 supermarkets, Giant Food Stores was acquired by Royal Dutch Ahold in 1981. Ahold often assisted in Giant's expansion over the decades, first in 1968 as it facilitated the purchase of Martins, a small chain based in Hagerstown, Md., that Giant would operate. While most of these outlets were converted to Giant Stores, the name Martins was retained for some stores operating in adjacent market areas to avoid confusion with Giant-Landover to its south (a chain eventually purchased by Ahold) and with Giant Eagle based in Pittsburgh (to the west).

In 1997, Ahold merged Giant with the Ahold-owned Edwards Super Food Stores and, again in 2006, Ahold acquired 14 stores from Clemen's Family Markets in suburban Philadelphia, 13 of which were immediately rebranded Giant Food Stores. Significantly, between 2004 and 2007, Giant-Carlisle faced the challenge of attempting to manage the operations of Tops Markets, then an operating company of Ahold, headquartered at a considerable distance from Carlisle, in Buffalo, N.Y. As a result of continued disappointing performance, Tops was subsequently divested in December 2007.

Giant-Carlisle had established an enviable track record. Over recent years, in particular, Giant had managed to grow impressively through a combination of acquisitions, new store openings, innovative format development and creative merchandising. By the end of 2009, Giant-Carlisle operated in four Mid-Atlantic states (Pennsylvania, Virginia, Maryland and West Virginia) under both the Giant banner (126 stores) and the Martins banner (26 stores, including all nine Virginia stores) (Exhibit 5).

During the mid-2000s, Giant consistently posted same-store sales growth far above industry averages and above most of Ahold's other divisions. Between 2006 and 2009, Giant grew its total sales from $3.8 billion to $5.0 billion. In part because of this uncommonly strong performance, Ahold expected still more from Giant. Ahold had determined the growth opportunities at its other U.S. operating companies to be quite limited. Consequently, Ahold turned to Giant to spearhead its ambitious corporate growth objectives.

It was amidst this climate and pressure for growth that Rick Herring, a 25-year retailing veteran, assumed the office of president at Giant-Carlisle in January 2010.

Ukrop's: "The Face of Richmond"

Like Giant-Carlisle, Ukrop's grew from the single store opened in 1937 by its founder, Joseph Ukrop. By 2009, Ukrop's operated 25 stores, nearly all of which were in the Richmond, Va., market. Ukrop's had achieved a special place in the hearts and minds of Richmond shoppers for its high-touch approach to retailing. Ukrop's had developed a genteel type of clientele, reminiscent of Virginia's "Old South." Their customers had refined tastes, drove fashionable, late-model cars ("Volvos but not Mercedes," as noted by subsequent market research) and did not seem particularly troubled by high grocery prices. Their stores provided convenient locations and offered almost mythical quality fresh foods, particularly prepared deli foods and bakery products

created in Ukrop's own proprietary central kitchen. Indeed, in the late 1970s and early 1980s, Ukrop's had practically invented the new category of "fresh prepared foods," elevating their own operations ("Homestyle Foods") to a national pedestal of best practices. Retailers from around the world flocked to study their execution.

The Ukrop's family operated their stores in much the same highly ethical way they led their Southern Baptist life. Unlike the great majority of the retail food industry, they chose not to open on Sundays and refused to sell beer or wine in their stores. Further, Ukrop's took family like care of their employees, paying them above-market wages, providing fringe benefits and vacation allowances far exceeding industry norms, and not enforcing the rigorous and often stressful productivity standards common at their competitors. Ukrop's donated a minimum of 10 percent of its pre-tax profits to the community each year — to churches, schools and a variety of non-profit organizations. Not surprisingly, such largesse made Ukrop's very popular with employees and community alike. In 2004, for the fifth consecutive year, Fortune magazine named Ukrop's one of the top 100 companies to work for in the United States.

It was, at the same time, a powerful consumer proposition. So powerful indeed, that in the consumer research later conducted as part of Giant's due diligence, some shoppers who indicated that Ukrop's was NOT their everyday store admitted to feeling guilty because they had chosen not to patronize one of Richmond's finest families. Such shopper admiration provoked one Giant executive to remark, "I have never seen customer satisfaction ratings this high at any supermarket company in the United States, bar none! How can we possibly improve on the performance of a legend?"

Yet despite the proud history Ukrop's enjoyed, by the mid-2000s, numerous cracks in the veneer were appearing. The two Ukrop brothers, Bobby and Jim, had been running the company for more than 40 years and, lately, some believed them to be less attentive to the company's day-to-day operations. The two did not always see eye to eye and had recently made several costly real estate errors resulting in three store closings. And, as is often true with family companies, the next generation did not seem inclined to take over. Additional pressure came in the form of new, stiffer competition. The Richmond retail grocery landscape had become densely populated in recent years, giving shoppers a diverse set of alternatives, each with distinctive positioning (Exhibit 6). Food Lion represented the convenient option at the value end of the retailing continuum and had in the past few years been joined there by Walmart. Kroger was well positioned in the middle of the Richmond market, while the top tier was crowded with Harris Teeter, Trader Joes, Fresh Market and Whole Foods. Although in 2009, Walmart enjoyed the largest market share of Richmond retailers, Ukrop's shared roughly equally with the other largest players, Kroger and Food Lion (Exhibit 7).

Previous recessions had barely been noticed at the upmarket retailer, but the economic downturn of 2008 hit Ukrop's hard. After several years of barely acceptable results in the mid-2000s, sales growth came to a virtual halt in 2008 despite the opening of two new stores the year before. In 2009, both sales and profits declined markedly (Exhibit 8). In the last half of 2009, same-store sales — perhaps the single most watched retail benchmark — fell by double digits each quarter. Even Ukrops' once loyal shoppers were apparently abandoning their long-time preferred store

for lower-price retail alternatives. Jeff Martin, Giant's executive vice president of merchandising, summed up the irony this way: "Customer satisfaction is nowhere higher, but the customers don't shop there anymore!"

It was an open industry secret that Ukrop's was on the sales block. In July 2009, a trade magazine reported that Ukrop's was courting SuperValu and Harris Teeter as potential buyers. But by that time, quietly, Ahold had already constituted its acquisition team.

The Acquisition Outlines Challenges

The acquisition team appointed to assess the feasibility of the Ukrop's purchase was deep with experience from the entire spectrum of retailing functions. Ahold had asked directors and vice presidents from both Giant and Ahold USA for their assessments of a broad array of marketing/merchandising, pricing, human resource, real estate, operational and consumer issues at Ukrop's. Although Ahold had trod acquisition paths many times before, results had not always been positive. Senior management was determined not to repeat past mistakes this time.

The acquisition team's voluminous reports had satisfied Ahold that Ukrop's represented a high-potential investment. The deal was consummated on December 21, 2009, for $140 million. Now, it was Rick Herring's job to quickly restore Ukrop's financial health and grow the business. Assessment reports from the acquisition team were stacked high on his desk, all with multiple "opportunities and risks."

Consumer Insights Key

Since the Richmond market was new territory to Herring and to Giant, he first turned for help from Erik Keptner, Ahold USA senior vice president of marketing and consumer insights. The year before, as part of Giant's due diligence, Keptner's team had conducted extensive research with Richmond shoppers. Keptner suggested getting started by seeing what shoppers thought were Ukrop's key strengths and weaknesses.

Herring studied the eye-opening findings. Shopper perception of Ukrop's service levels was almost cult-like; ratings more than 90 percent were almost never observed in food retailing anywhere (Exhibit 9) and, consequently, the lead over competitors was substantial (Exhibit 10).

Shoppers raved over the knowledgeable and friendly associates who frequently greeted them by name, carried purchases to the car and even allowed them to take groceries home when they had forgotten their wallet with payment due later! Shopper ratings of Ukrop's perishable foods were also improbably strong: higher not just than the average U.S. supermarket, but higher than Giant had been able to produce in its own stores elsewhere (Exhibit 11). The consumer insights report put it this way: "There is a powerful element to the Ukrop's family brand; it is an emotional aura that is felt by all, even those who don't prefer the store." Keptner warned, "…With image ratings this high, I am concerned about the probability that they could fall."

Improving on these image ratings seemed impossible to Herring. Even maintaining them would present considerable challenges for Giant since, as a publicly owned chain, its business model did not allow for the generous labor levels generally associated with producing such ratings.

Yet, letting the images slip to the levels more customary at Giant risked alienating Ukrop's core shoppers, further accelerating the recent sales decline. By contrast, another key dimension in the same quantitative research buoyed Herring's spirits: Ukrop's suffered from a poor price/value image. This was an area where Giant could make inroads.

To deepen the understanding of Ukrop's shoppers' emotional attachment, Keptner arranged five focus groups in Richmond. Participants were female heads of households primarily responsible for shopping, with a mix of ages, incomes and employment status. They were asked to discuss their expectations for a new store and what their hopes and fears for that new concept might be. As Herring reviewed the results (Exhibit 12), he concluded that lower prices and better value would be welcome surprises to Richmond shoppers and benefits that Giant could deliver.

Real Estate and Operations

Once a growth objective was declared within Ahold USA, it was up to the real estate team(s) to determine the feasible set of physical expansion possibilities. Giant-Carlisle, for its part, was able to dismiss in-market growth as nothing more than occasional fill-in business. In fact, despite aggressive market-by-market assessment, Giant had increasingly struggled to find new store locations over the past six to eight years (Exhibit 13). Thus, naturally, the team was enthusiastic about the new Richmond market that would allow expansion into virgin territory and provide 25 new stores, all high-traffic "A" locations that, if successful, promised to establish a foothold for further penetration in a south and southwest direction.

Store age, however, was a concern. Giant's business success depended heavily on operating up-to-date, attractive stores. The majority of its operational efficiencies relied on the latest technologies in refrigeration, electrical, heating, design and sustainable building materials. Giant's average store in 2009 was 6.1 years old, but the due diligence showed that many of Ukrop's stores had not been remodeled in more than a dozen years. Particularly, over the past five years, Ukrop's had cancelled or postponed nearly all capital investment in store maintenance and improvement. After surveying the deteriorating physical condition of Ukrop's stores, one Giant engineer observed, "These stores are being held together with baling wire." Bringing these stores up to current standards would require an investment much larger than anticipated. And, so much needed to be upgraded, it was hard to know where to begin.

A few team members believed that in a few cases store conditions had so deteriorated that it would be best to simply close certain stores and rebuild from scratch. Others disagreed. They pointed to inevitable time delays, lack of resources for new construction and the certain business loss as customers were diverted elsewhere to shop during the closings. What's worse, they knew that once shoppers became accustomed to a new shopping pattern, temporary diversion could become permanent. Customer loss had already been growing. To be sure, further loss would be ruinous.

Supply Chain

Giant had never acquired this many stores at one time before. Integrating several dozen new stores into the current supply chain would be an ominous challenge, especially given the considerable distance of the Ukrop's stores from Carlisle, Pa. In several past instances — e.g., Tops Markets, Edwards Stores, Giant Landover — Ahold had not been particularly successful in attempting to manage one market area from a headquarters in a distant area.

The distance to Richmond from the heart of Giant's market area and sole distribution center (DC) in south-central Pennsylvania would stretch the supply competencies to their fullest. Transportation costs were projected to spike. The average truck in Giant's core market traveled less than two hours between the DC and stores, but Richmond was almost five hours from Carlisle, Pa., so the time in transit more than doubled. Moreover, Federal Motor Carrier Safety Administration guidelines dictated that drivers could only be on the road 11 hours in a 24-hour period. Thus, if the truck hit any heavy traffic — a commonplace occurrence on the Washington, DC, Beltway (Interstate 495) — it would be entirely possible that the truck could not make the round-trip replenishment journey in a single day. Even more constraining, Ahold's DC for health/ beauty care and general merchandise was located at its subsidiary, the American Sales Company, in Buffalo, N.Y., a costly, 10-hour trip to Richmond.

Furthermore, central Pennsylvania was home to many of the largest manufacturer supply depots in the United States, making expense-reducing cross-docking and backhaul possibilities relatively easy. Very few such opportunities existed in Virginia. This new geography and greater distances would markedly increase the delivered costs to stores in ways that could compromise Giant's ability to offer low prices, arguably its strongest competitive tool. The fact that for much of the trip, trucks would pass through the territory of Ahold sister company, Giant Landover, appeared to offer some largely unexplored synergy opportunities.

Before the acquisition, Ukrop's had long-term, multi-million dollar contracts with SuperValu, the nation's largest food wholesaler, for its grocery products and with Vantage Meats, a family owned food company with a state-of-the-art distribution facility in neighboring North Carolina, for its case-ready meats (Ukrop's had no in-store meat cutting). Retaining these vital relationships would have the benefit of continuity in an already challenging supply situation, but having Giant operate through these third parties with whom they had not previously conducted business could be risky. Of course, one option would be for Giant to simply buy out these contracts but that would be expensive for Giant, a company accustomed to controlling most of its own distribution from wholesale level to stores.

One of Ukrop's most valuable assets was certainly the strong reputation it enjoyed for its prepared foods, particularly the high-quality deli and bakery products. Most of these products were prepared from generations-old, family recipes in their own proprietary central kitchen. Although, in most markets, Ahold USA generally received better scores from consumers in the perishable foods areas than low-price rivals, this was often not the case when compared to stronger, premium competitors. Giant acknowledged that much progress was needed in their own prepared foods. Thus, while Giant surely hoped to capitalize on Ukrop's reputation for high-quality prepared foods, some saw even greater potential in actually incorporating these prepared foods into the other Giant-Carlisle stores, and even in the rest of Ahold USA.

Maintaining and creating new supplier relationships for the Richmond-based stores would pose challenges for Giant. First, the Ukrop family had elected not to include its central processing kitchen in the Ahold acquisition package, preferring instead to launch a new company, Ukrop's Homestyle Foods (UHF), to allow them, in their words, "to continue the tradition of producing fresh and delicious foods that have become staples in homes throughout Richmond and beyond."

UHF would continue to supply its traditional product line exclusively to the 25 acquired stores in Richmond, but would also retain the right to supply competitors outside of Richmond. How to best gain access to these products in Giant markets beyond Richmond was unclear to Herring's team. A number of options had been suggested, all of them with important supply chain consequences. Simply ordering from UHF like any other supplier was straightforward, but some on the supply chain team questioned their ability to maintain the quality of such fragile and highly perishable products through a distribution network that must reach stores across the Northeastern United States. Moreover, most were skeptical that UHF could scale up to satisfy the demand of Ahold's nearly 800 stores.

An alternative might be for Giant to simply duplicate the UHF business model and build its own state-of-the-art kitchen in a location more central to Ahold's four U.S. geographic divisions. But questions here were legion: In the wake of a major acquisition, would resources be available for capital-intensive plant construction? With no processing experience, would Giant/Ahold be able to recreate the high-quality products of UHF at the scale it needed? Would recipe copyright and licensing infringements become hurdles?

Marketing and Merchandising

If supply chain assessment underscored risks, marketing and merchandising assessment shouted opportunities. Before the acquisition team ever stepped foot in Richmond, they had already identified what appeared to be "low-hanging fruit" — Sunday openings and sale of beer and wine. Sunday was the No. 1 or No. 2 biggest shopping day at U.S. supermarkets, and the combined categories of beer and wine could account for as much as 6 to 10 percent of a store's sales. Together, just these two modifications to Ukrop's operations would go a long way, the team surmised, toward the overall goal of improving sales. One of the team members quipped, "… These changes are no-brainers, no downsides."

Perhaps Herring's most vexing marketing conundrum was fundamental branding: what to call these stores? The Ukrop's banner had demonstrated incredible equity with Richmond consumers for its strong community role and legendary quality bakery and prepared foods. So continuing to employ the Ukrop's name was logical: why depart from such a rich tradition? Keeping the same name simplified what would undoubtedly prove to be a long list of related communication, design and positioning challenges for a new owner who is unknown locally. But Herring realized that retaining that name had its risks: how long would the goodwill last once consumers realized that the Ukrop family was no longer involved? Indeed, what if consumers believed that Giant was attempting to deliberately mislead them into thinking that family ownership had not changed? What's more, perhaps brand strength had already peaked. Some pointed out that brand erosion would be dramatic soon enough if sales continued recent downward trends. They argued that a new store name would mark a fresh departure for Richmond consumers, signaling a new era of quality and value made possible through the scale efficiencies of a now much larger parent company.

The branding decision was further complicated by what the team evaluated as Ukrop's "lackluster" private-label (PL) program — the products were commonplace, did not carry the Ukrop's name and appeared to contribute little to differentiate the stores. Ukrop's PL products had been sourced from Topco, a Chicago-based, member-owned distributor offering PL procurement, quality assurance and packaging services to retailers across the United States and Canada. Furthermore,

Ukrop's PL program was quite underdeveloped, comprising about 10 percent of store sales, far below industry averages and only half as much as Giant Carlisle and its other Ahold affiliates, and less than a third of Kroger's. Remedying these problems would not be straightforward. Even choosing the PL name would be problematic: the "Giant" PL logo had no name recognition in Richmond. But choosing a new, "neutral" name would limit flexibility, synergies and the cost savings involved with a PL brand common to both companies. Indeed, it was partly for this reason that Giant's own PL program was already undergoing a major overhaul in coordination with Ahold's other banners.

Herring pondered the nearly overwhelming list of potential changes he must communicate: company name, colors, logo, signage, architectural design, promotion layouts, pricing and product mix, operations and more. Such an overhaul was sure to be confusing to associates, not to mention shoppers. Even worse, Herring was perplexed about how to undertake all the construction and remodeling changes that his team believed imperative immediately. He knew that closing stores, even temporarily, risked diverting shopping patterns permanently. And this, he could not afford. His transition communication strategy needed to enlist the support and patience of both consumers and associates.

Herring's colleagues had agreed that Ukrop's product assortment was not correct — too much fresh, not enough grocery; or, at least, not enough of the "right groceries." It appeared that the popularity of Ukrop's perimeter departments had led management to expand those areas at the expense of the proper assortment of center-store groceries. Ukrop's had apparently given up certain "price-impact" grocery categories (e.g., paper items and cleaning products) to value players like Walmart and other discounters. Instead, they stocked a scatter-shot array of gourmet and specialty foods. The result was that the price-value perception of the Ukrop's shopping experience was the weakest in the Richmond market. However, ironically, subsequent examination of actual market prices revealed that Ukrop's was actually not higher priced in center store products; they only were perceived this way due to the unbalanced, high-end product assortment and over emphasis in both space allocation and communication strategies of fresh foods.

Competition

Space was a serious constraint at Ukrop's vis-à-vis its two principal competitors. The average Ukrop's store, at 50,000 sq. ft., was only a quarter the size of Walmart's supercenters and barely larger than half the size of Kroger's stores. Larger stores permitted competitors to carry much more inventory and a wider variety of the products consumers wanted. Of course, operating the largest stores by far, Walmart had the capacity to carry the most goods. However, Walmart's product mix skewed heavily to apparel and general merchandise. Giant realized that most consumers considered Walmart a discount, mass merchandiser, not a conventional grocery store.

Kroger was a very different matter. Kroger competed "in the middle" for traditional grocery shoppers. It recently launched an 80,000 sq. ft. prototype and devoted 75 percent of its space to center-store groceries compared to only 50 percent in Ukrop's stores. These differences resulted in a formidable advantage in total base lineal feet that Kroger could use to carry grocery lines for which Ukrop's had no room. What's more, if Herring were to follow the "no-brainer" advice of his many colleagues to immediately add beer and wine, even less space would be available to expand

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into a broader selection of dry groceries. Yet, he recognized that wide grocery assortment drew traffic, created price impression, built basket size and, importantly, supported margins in perishables.

Herring was unwilling to cede such space advantage to Kroger. Kroger represented a rival mostly unknown to Ahold, and he could not predict their likely competitive reaction to his plans. Although it was true that Giant competed against Kroger, it was in one or two outlying locations only, and the stores were not the best of either company. Richmond, on the other hand, was a very lucrative market and Kroger, anticipating Ukrop's new owners' likely plans, was already rumored to be defending their turf with considerable investments into their Richmond stores.

Kroger's strengths were formidable. As the largest traditional supermarket company in the United States, they had the resources for sustained battle. They boasted high-quality perishables; a store base of almost 3,300 units, including 740 convenience stores; an aggressive gas points program that drove traffic into the stores; and the leading position in nearly every major market where they competed, even against Walmart (Exhibit 14). Moreover, Kroger possessed one unique competitive advantage over virtually all others — an exclusive U.S. joint venture with dunnhumby, a London-based data management firm.

dunnhumby analysts operated at Kroger's Cincinnati, Ohio, headquarters delivering shopper insights gleaned from Kroger's industry-leading loyalty card program. Such insights enabled Kroger to segment its customer database, customize product selection and target promotions to specific individual households. While most food retailers, including Giant, utilized various forms of customer analytics, few had the depth of analysis and application competencies that dunnhumby's program(s) offered. Such capability was, in part, what had allowed Kroger to maintain and, in some markets, grow consumer spending per shopping trip even during the recent economic downturn.

Labor

Herring's team realized that the myriad human resource issues they faced would make or break a successful Ukrop's "conversion." The Ukrop family paid higher than average wages, provided much more generous fringe benefits than its competitors, tolerated lower work productivity standards and gave generously to community causes. Indeed, although the family openly avowed that they "shared" 10 percent of profits (before tax) with workers and the community, examination of recent tax records revealed that the actual figure was more than 15 percent. One former Ukrop's executive observed, "…When someone asked for help, their hearts were so big, they couldn't say no." However noble such behavior might have been and however much associate loyalty it may have engendered, Herring sensed that the next wave of business success would be based on a higher level of investment and execution focus.

Giant had concluded that Ukrop's had far more employees than sales justified. Moreover, the mix was wrong. For reasons of scheduling flexibility and cost minimization, most retail companies employed the majority of their store-level workforce only part time (e.g., fringe benefits were limited for part timers). This was not the case at Ukrop's, where the full- to part-time ratio was almost the reverse of industry norms. Giant had learned that for maximum efficiency and performance, its stores could rarely afford to devote more than 10 to 12 percent of sales to cover

labor costs, which, at Giant, were about $12 per hour (full time and part time blended). Thus, a store generating sales of $500,000 per week would be restricted to utilizing about 104 associates at 40 hours per week.

Because of higher-paid managers and more full-time associates, the labor rate at Ukrop's averaged nearly $16 per hour. The same number of labor hours would cost 13.3 percent of sales, as much as 1 to 3 percent higher than at Giant. That calculation relies on the unlikely assumption that the same number of Ukrop's associates would be able to accomplish what the Giant associates did within those labor hour constraints. This gap was staggering in an industry that, on average, produced only 1.5 percent of its sales as profit.

Herring came to believe that such stark labor cost differentials were unacceptable to the point that Giant's standard business model simply could not be successful. He knew that labor costs had to be taken out of the business, but he also knew that eliminating high-cost, full-time labor would be sticky, perhaps even impossible. For one thing, labor unions posed hurdles. Retailers operating under union contracts faced important constraints in associate work rules and pay rates. Working conditions at Giant had always been such that associates felt no need for union representation. Commonly, unions were openly antagonistic about the prospect of non-union companies entering their markets and could be counted on to be aggressive in attempting to bring any new entrant into their collective bargaining agreement. Kroger, the market leader in Richmond, already operated under a contract with the United Food and Commercial Workers Union and, as a result, was believed to have significantly higher labor costs than non-union Giant. Herring realized he must be price competitive in Richmond.

Devoted, some would say "pampered," associates were the backbone of Ukrop's legacy, and their support, Herring knew, would be instrumental in the transition to Giant. Associates would be the front line in communicating the new company's proposition, whatever shape it ultimately took, to shoppers. But how would he position Giant's new expectations of work standards, wage/benefit packages, uniform requirements, Sunday openings and less time for the customer service and pleasant conversations that had made them famous? Moreover, he realized he must implement changes in such a way as to not make the work environment less attractive from the perspective of Ukrop's long-time associates.

Herring's Next Steps

Herring had spent the past 12 months as a member of the Ukrop's acquisition team and knew better than anyone the challenges that must be overcome to make the purchase successful. He harbored no illusions about his assignment. He had to turn around an ailing business, stop the exodus of the high-end Ukrop's shoppers who mistrusted the new owners and do all this under the watchful eye of the world's investment community that is skeptical of Ahold's ability to add genuine value to acquisitions. And he must, at the very same time, meet the aggressive goals set by Royal Ahold to realign the four new U.S. divisions into one seamless operating company.

It was time to lay out his conversion plan. Two questions were paramount in his mind: Where would he get the new business he needed, and how?

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Discussion Questions

1. Royal Ahold is an international retailer with the key efficiency strengths that come with a century of experience in mass retailing. Can it be successful in operating a closely held, family company whose strengths are a mix of high-touch service, high-end merchandising and community involvement?

2. Was growth the only alternative for Ahold to send the positive signals sought by the financial community?

3. The Ahold/Giant due diligence team developed an extensive "shopping list" of challenges to be dealt with to make the acquisition successful. Which were the most important? Given limited resources and time, where should Herring focus his efforts first?

4. How should the Ukrop's brand be positioned, or re-positioned? Can Ahold introduce its private-label brand used at Giant Foods into Ukrop's when shoppers in Richmond have never heard of Ahold or Giant Foods?

5. The Richmond market is limited in size and not growing its population (consumer base). If Herring is to expand Ukrop's sales, where will the new business come from? Which competitors are most worrisome?

6. How can suppliers assist Ahold/Giant in making the acquisition successful?

Exhibit 1

Ahold Net Sales (€ million)

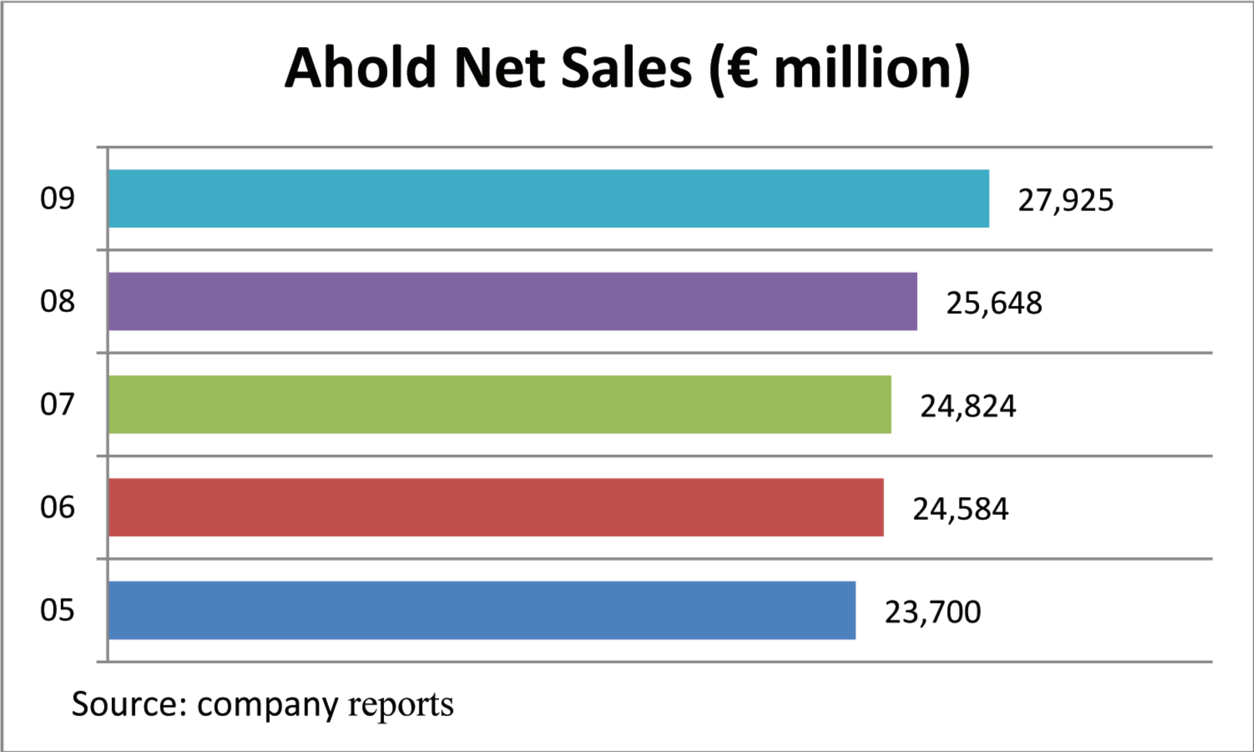

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Exhibit 2

Ahold Operating Income (€ million)

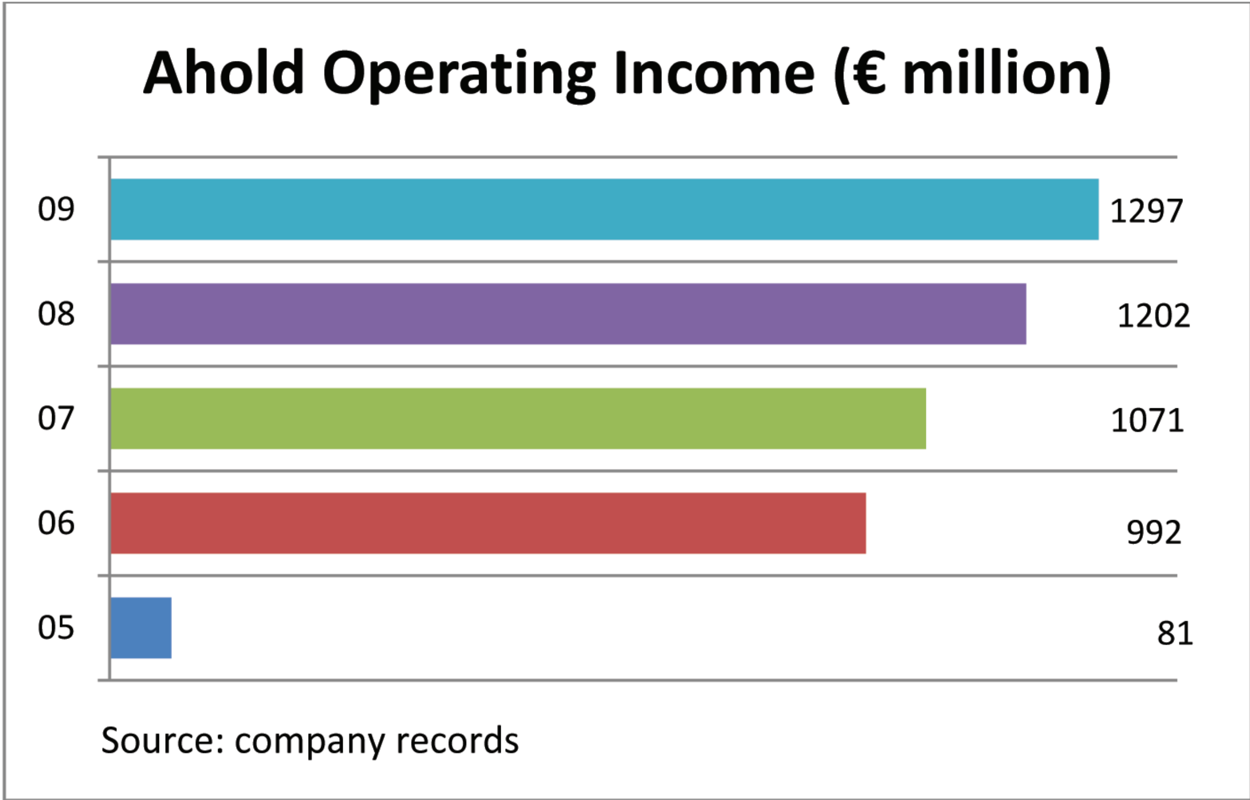

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Exhibit 3

Ahold Retail Operating Income (€ million), % of group total[1]

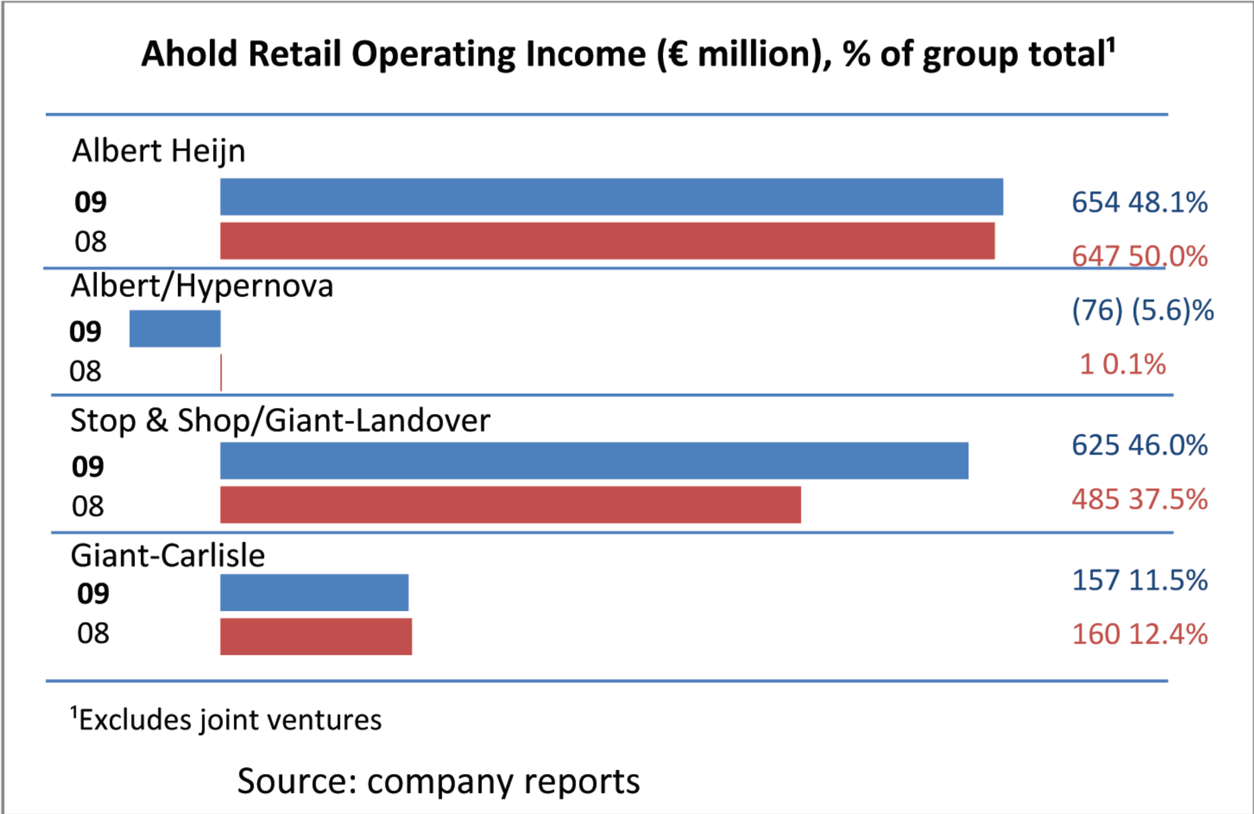

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Exhibit 4

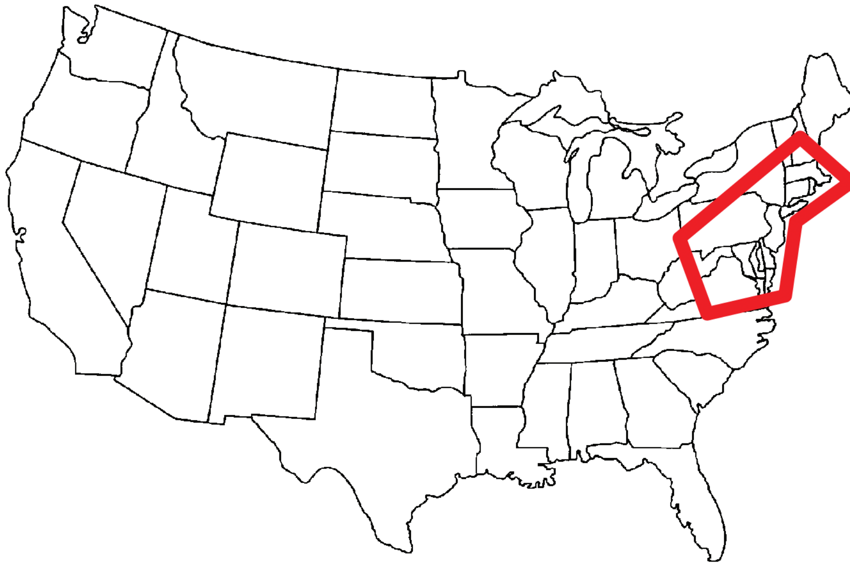
Ahold's Consolidated Balance Sheet: 2010 and 2008

	Jan. 3, 2010		Dec. 28, 2008	
	€ million	%	€ million	%
Property. Plant and equipment	**5,407**	**38.8%**	5,526	40.6%
Other non-current assets	**3,421**	**24.6**	2,940	21.6
Cash, cash equivalents and short-term deposits	**2,983**	**21.4**	2,863	21.1
Other current assets	**2,122**	**15.2**	2,274	16.7
Total assets	**13,933**	**100%**	13,603	100.0%
Equity	**5,440**	**39.0%**	4,687	34.5%
Non-current portion of long-term debt	**3,242**	**23.3**	3,782	27.8
Other non-current liabilities	**1,226**	**8.8**	996	7.3
Short-term borrowings and current portion of long term debt	**458**	**3.3**	459	3.4
Other current liabilities	**3,567**	**25.6**	3,679	27.0
Total equity and liabilities	**13,933**	**100%**	(13,603)	100.0%

Source: Company reports

Exhibit 5

Ahold USA: 2008-2009; Giant-Carlisle: 2008-2009



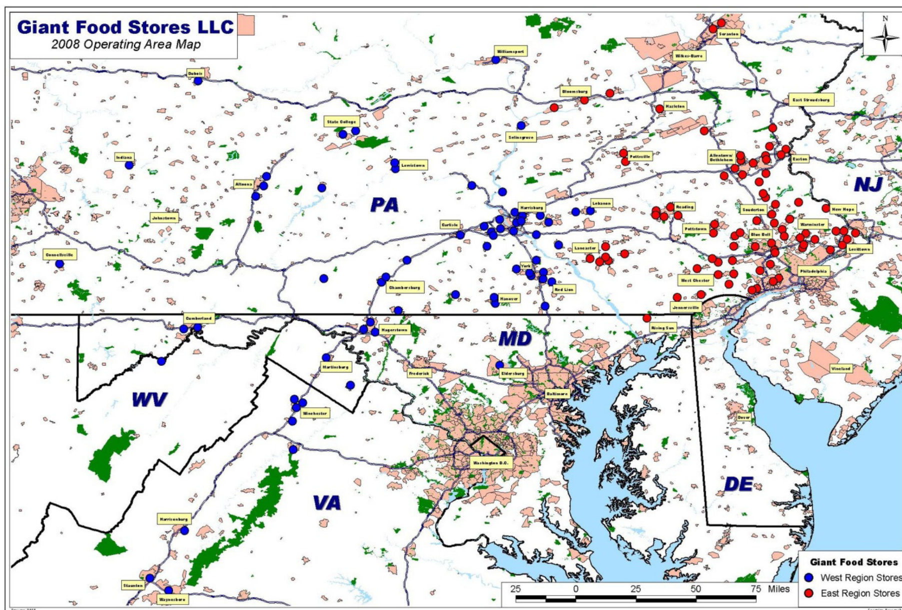


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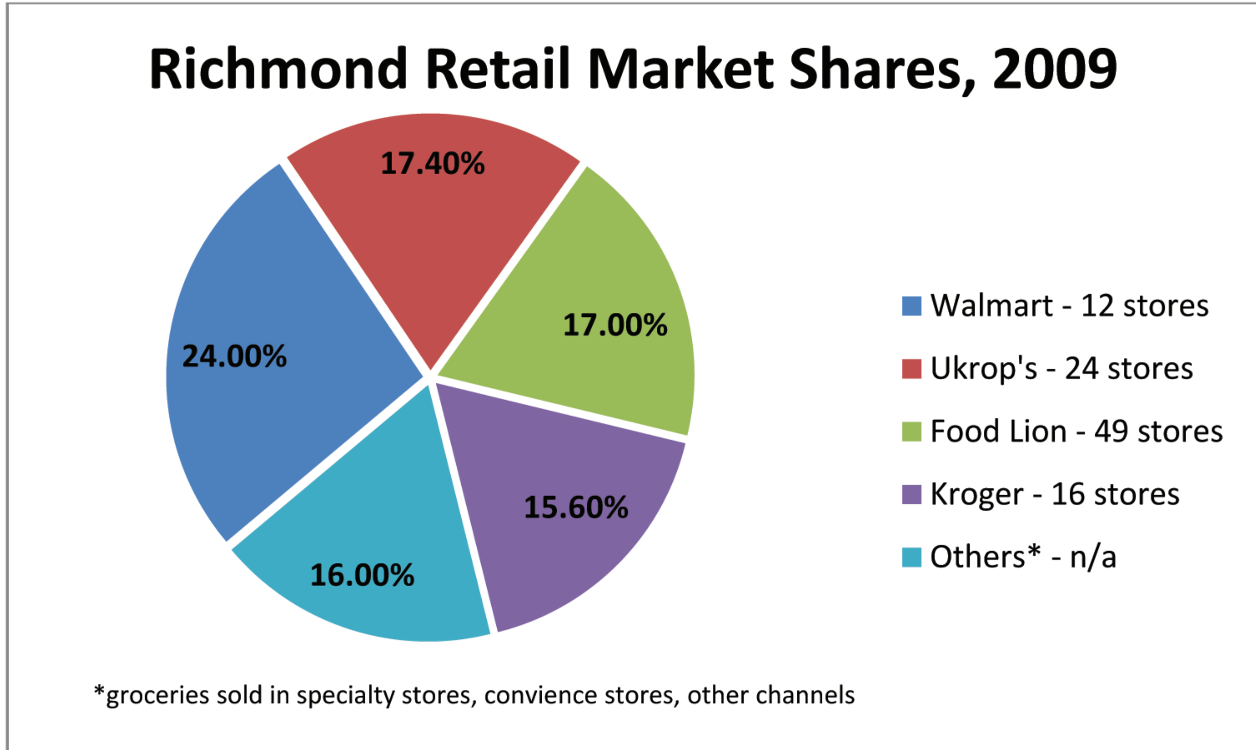
Exhibit 6

Richmond Competitive Landscape, 2009

	Upper Tier	Middle Tier	Lower Tier
Stores	Ukrop's, Trader Joes, Whole Foods, Fresh Market	Kroger	Walmart, Food Lion
Comparable store to Giant	Wegmans	Giant	Weis
Offer	-Focus on gourmet/ specialty and quality, generally at higher cost -"High touch" -Emphasize the total shopping experience and at least one of : meats, seafood, produce, prepared, natural/ organic	-Focus on basics, with emphasis on price side of value equation -Some specialty -"Moderate to low touch" -Emphasis on being solid throughout store -Comfortable atmosphere but not strong point of emphasis	-Focus on low price, even at the expense of quality/ atmosphere -Only basics -"No touch" -Unpleasant atmosphere; no emphasis – often cited as dirty, disorganized
Imagery	Classy, proper southern woman, mannered but still down to earth, hosting dinner party	Family reunion with large BBQ spread	Unemployed, homeless
"To me, shopping is…"	"Fun, exciting, creative, enjoyable" More emotional	"Something I have to do" More rational	"too expensive, a pain" Strong budget constraints dominate process

Exhibit 7

Richmond Retail Market Shares, 2009



Source: Company records

Exhibit 8

Ukrop's Sales and Profits

	2007 - 52 weeks ($ in 000s)	2008 - 52 weeks ($ in 000s)	2009 - 53 weeks ($ in 000s)
Total Sales	$ 585,793.00	$ 589,916.00	$ 553,171.00
EBIT*	$ 19,997.00	$ 20,002.00	$ 12,611.00
% sales	3.40%	3.39%	2.23%

*Earnings Before Income Tax

Source: Company records

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Exhibit 9

Ukrop's Shopper Image Ratings

Ukrop's Shopper Image Ratings 2009

Category	Attribute	Rating
	Overall rating	84%
	Value for the money	61%
Price	Prices of everyday items	54%
Price	Weakly specials	74%
Quality	Meat & poultry quality	88%
Quality	Produce quality	93%
Quality	Deli quality	91%
Quality	Quality of prepared foods	92%
Service	Grocery selection & variety	87%
Service	Speed of checkout	87%
Service	cashier friendliness	95%
Service	Helpful & friendly assoc.	95%
Service	Store cleanliness	97%
Service	Healthy choices	93%
Service	Ease of finding help	91%
Service	Ease of shopping	87%
Emotional Drivers	Welfare of family	76%
Emotional Drivers	Fun & enjoyable place to shop	78%
Emotional Drivers	Feel comfortable	91%
Emotional Drivers	Values & beliefs	80%
Emotional Drivers	Store you trust	94%
Emotional Drivers	Store for someone like me	84%
Other	Convenient location	87%
Other	Local community support	92%

0% 50% 100%

BASE SIZE = (380) UKROPS

Source: Company Records

Exhibit 10

Ukrop's vs. All Richmond Competition

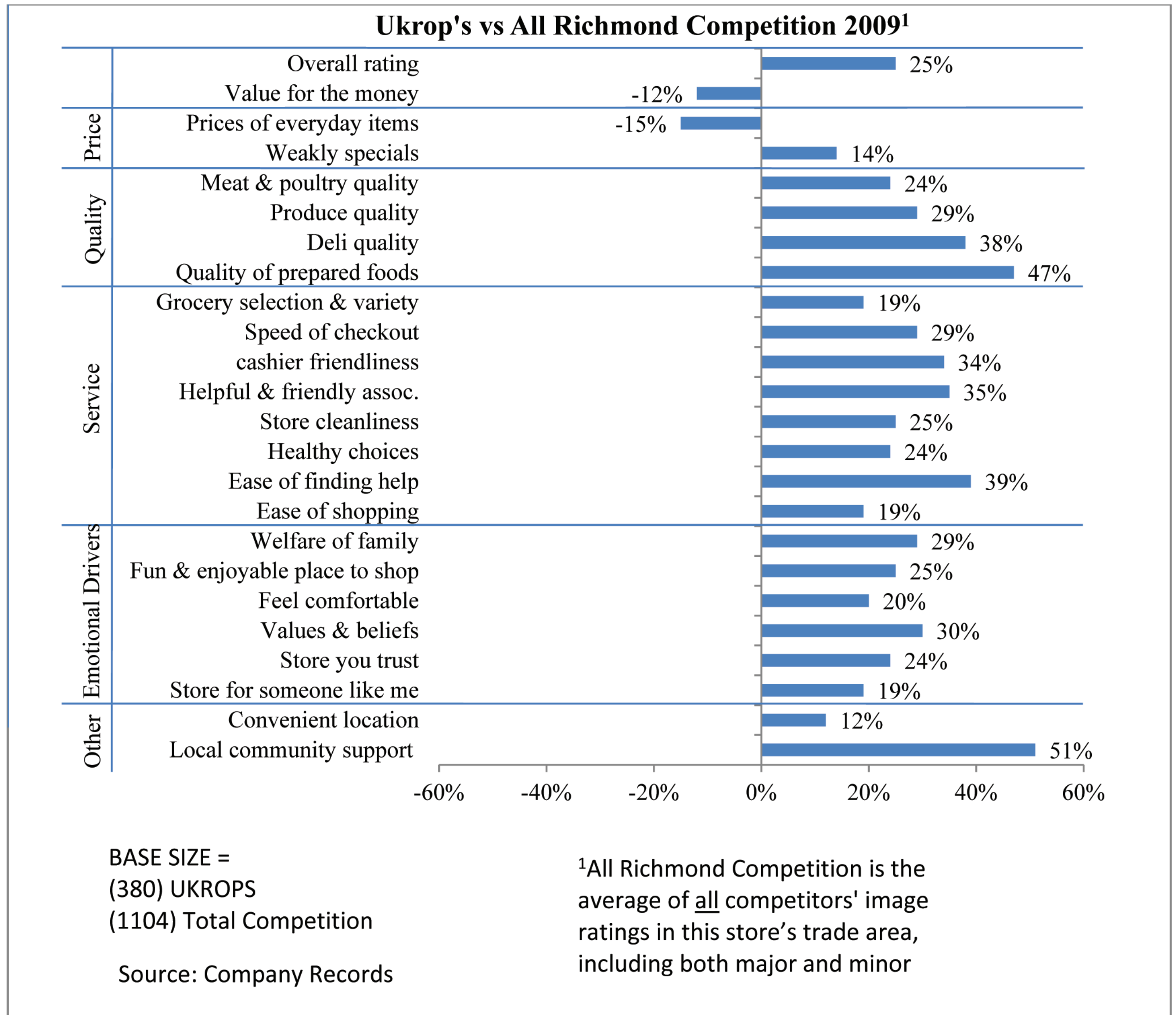

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Exhibit 11

Perishable Department Loyalty[1] Ratings

Dept	U.S.	Giant	Ukrop's
Meat	68%	69%	80%
Produce	70%	84%	85%
Deli/Kitchen	67%	79%	95%
Bakery	61%	78%	95%

[1]Shopper Loyalty is the percent of a merchant's primary shoppers that purchase most of their specific department needs at their shop-most food store

Source: Company records

Exhibit 12

Ukrop's Shopper Focus Group Results, December 2009

Hopes

- **Stay as active in the community**
- A clean/attractive store
- Variety improves
- Open Sundays
- Alcohol
- Similar or better prepared food
- Prices not higher than Ukrops (lower would be better but not necessary)
- More selection/variety

Fears

- Customer service declines/ carryout service ends
- Less a part of the community
- Becomes just another store
- **Employees lose out/bring in new employees**
- **Store will "change too much"**

Expect

- A clean/attractive store
- Community involvement declines
- Customer Service to decline/ carryout service ends
- Employees lose out/bring in new employees
- **"Change too much" becomes "just another grocery store"**
- Prices to at least stay same or go down
- Prepared foods to decline
- **Quality/freshness to improve**
- **Bakery to stay same**
- Alcohol/Open Sundays
- Pharmacy to stay

Source: Company records

Exhibit 13

Giant Carlisle, New Stores, 2003-2009*

2003	2004	2005	2006	2007	2008	2009
8	7	6	6	6	4	2

***Organic growth only**

Source: Company records

Exhibit 14

Market Share, Kroger vs. Walmart, Selected Major Markets, 2003-2008

	Kroger Market Share %		Walmart Market Share %	
Market	2003	2008	2003	2008
Los Angeles, CA	27.7%	24.7%	0.0%	2.6%
Atlanta, GA	30.8	31.4	14.9	26.3
Houston, TX	24.5	26.0	15.7	27.4
Seattle, WA	29.3	29.1	0.0	4.9
Phoenix, AZ	29.1	24.9	12.9	23.7
Detroit, MI	22.2	27.6	1.1	12.3
Cincinnati, OH	44.6	54.7	3.2	17.4
Denver, CO	48.4	37.3	6.8	18.5
Columbus, OH	45.7	41.3	7.4	19.1
Riverside, CA	19.2	15.4	0.0	6.6
Average	**30.6%**	**29.9%**	**12.4%**	**20.5%**

Source: Nielsen Market Scope

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