# Case

# Hi-Value Supermarkets

## Everyday Low Pricing

In early April 2006, James Ellis was reviewing the first-quarter financial results for Hi-Value Supermarkets. As senior vice president at Hall Consolidated and president of Hi-value Supermarkets, he was about to meet with the district manager responsible for three Superior stores in Centralia, Missouri. Others in attendance would be Hall Consolidated's vice president of retail operations and the controller for Hi-Value Supermarkets. The agenda for the first of four quarterly meetings scheduled for 2006 was to discuss the district's progress toward achieving planned goals and address any issues related to the district manager's supermarkets.

In anticipation of the quarterly review, Randall Johnson, District III manager for Hi-value Supermarkets, had proposed that everyday low pricing be reconsidered for his three stores in Centralia.[1] He cited company research documenting Hi-Value's relatively higher prices in Centralia and the growing price consciousness among Centralia shoppers. He also noted that Hi-value Supermarkets could lose market share in Centralia since store sales were below budgeted levels in this first quarter of 2006. He added that 2005 fourth-quarter sales revenue, which was normally a heavy sales period due to the Thanksgiving and Christmas holidays, was also lower than sales for the same period in 2004.

The everyday low pricing strategy option for Centralia had been discussed briefly in August 2005 as part of the annual planning process. However, a decision was made to continue Hi-Value's current pricing strategy pending further study. James Ellis believed that the time had come to formally address the question in detail.

## THE COMPANY

Hi-Value Supermarkets is a division of Hall Consolidated, a privately owned wholesale and retail food distributor. Hall Consolidated was formed in 1959 and initially included a number of wholesale food operations and produce companies. The company's first retail grocery store chain was purchased in 1970. The Hi-Value

[1] With an everyday low price policy, a retailer charges a constant, lower everyday price for merchandise with few, if any, price discounts. This practice differs from a "Hi-Lo" price policy whereby a retailer charges higher prices on an everyday basis but then runs frequent promotions, sales, or specials in which selected merchandise prices are deeply discounted.

Supermarket chain was acquired in 1975. By 2002, Hall Consolidated distributed food and related products to some 150 company-owned supermarket units operating under three supermarket chain names through 12 wholesale distribution centers. These distribution centers also supplied about 1,100 independent grocery stores in the United States. Hall Consolidated sales in 2002 were $2.3 billion.

Hi-Value is the smallest of the three supermarket chains owned by Hall Consolidated with sales of $192.2 million in 2002. Hi-Value operates conventional supermarkets in trade areas that served small cities and towns in the South Central United States. The median size of a Hi-Value Supermarket was 20,730 square feet, which is considered small by industry standards (the median size of a supermarket in the United States is about 44,000 square feet). Nevertheless, Hi-Value was the number one or number two ranked supermarket chain in each of its trade markets as measured by market share.

## COMPETITIVE ENVIRONMENT IN CENTRALIA, MISSOURI

Centralia is the primary trade area in Scott County, which is located in central Missouri. The Centralia trade area had total retail sales of $725 million in 2002. Food and beverage retail store sales were $62.3 million in 2002, which represented a 4.6 percent increase over 2001. There are 20 establishments in Centralia that sell food and beverages.

According to the U.S. Census 2000, Centralia has a total population of 41,000, including 13,500 households. The median age of the Centralia population was 35 years; the median household income was $36,000; and 80 percent of residents had a high school education or more. Slightly over one-half (51.5 percent) of Centralia's residents were employed by manufacturing, retail trade, and education, health, and social services establishments. Exhibit 1 shows the age and household income distribution of Centralia residents.

**EXHIBIT 1** **Centralia Population Profile: Age and Household Income Distribution**

| *Age Distribution* | | *Household Income Distribution* | |
|---|---|---|---|
| *Category* | *Percent* | *Category* | *Percent* |
| 19 years and under | 29.6 | Less than $10,000 | 10.4 |
| 20 to 24 years | 6.8 | $10,000 to $14,999 | 7.5 |
| 25 to 34 years | 13.8 | $15,000 to $24,999 | 16.1 |
| 35 to 44 years | 14.9 | $25,000 to $34,999 | 14.5 |
| 45 to 54 years | 12.9 | $35,000 to $49,999 | 19.8 |
| 55 to 59 years | 4.4 | $50,000 to $74,999 | 19.8 |
| 60 to 64 years | 3.5 | $75,000 to $99,999 | 6.3 |
| 65 to 74 years | 6.9 | $100,000 to $149,999 | 3.8 |
| 75 years and over | 7.3 | $150,000 or more | 1.9 |
| | 100.0 | | 100.0 |

*Source*: U.S. Census 2000.

### Major Competitors

Four grocery chain stores accounted for 85 percent of all food sales in Centralia in 2002 (see Exhibit 2). The remainder of the retail food business was shared primarily by two small independent grocery stores, several convenience stores, specialty food stores (bakeries, butcher shops) and a seasonal Farmers' Market. Three of the chains—Harrison's, Grand American, and Missouri Mart—operated one store in Centralia. Hall operated three Hi-Value Supermarkets in Centralia. Each of the three Hi-Value stores was smaller than the other chains' stores. Grand American, Harrison's, and Missouri Mart drew their customers from larger geographic areas than did Hi-Value, including business from outside Centralia. Missouri Mart, in particular, enjoyed a sizable trade from outside Centralia. Store locations are shown in Exhibit 3.

**Harrison's** Harrison's supermarket on West Main Street was built in 1976, expanded in 1990, and remodeled in 1999. About 15 percent of the store's 50,000 square feet is devoted to an extensive assortment of general merchandise and a small pharmacy. Hall officials believe that Harrison's has captured most of the business of the middle and upper-income groups in Centralia with annual household incomes in excess of $40,000. Harrison's supermarket has the second highest sales of all the major chain stores. Its store in Centralia is one of the company's 65 supermarkets located throughout Missouri and Illinois.

Harrison's is well managed, clean, orderly, and attractive. The decor is warm, the staff friendly, and the physical layout easy to shop. Its merchandising strength is a balanced variety of groceries, quality meats, and produce. The store is conveniently located, with excellent parking facilities. The store's principal promotion theme is everyday low prices, as evidenced by its advertising slogan, "Save on the Total." According to Hall executives, Harrison's has an extremely favorable customer image.

**Grand American** The Grand American store, measuring 39,800 square feet, opened in mid-2001 and is located at the corner of Fairview and West Main. This store replaced an older, smaller facility located several blocks northeast of the new site. The Centralia store is one of 148 supermarkets operated by Grand American, a large regional food distributor and retailer. The Grand American store is the most modern store in Centralia and has the finest fixtures and decor. It has wide aisles and is relatively easy to shop.

Hall officials consider the Grand American store a secondary competitor. According to Hall executives, the store is highly regimented and lacks any

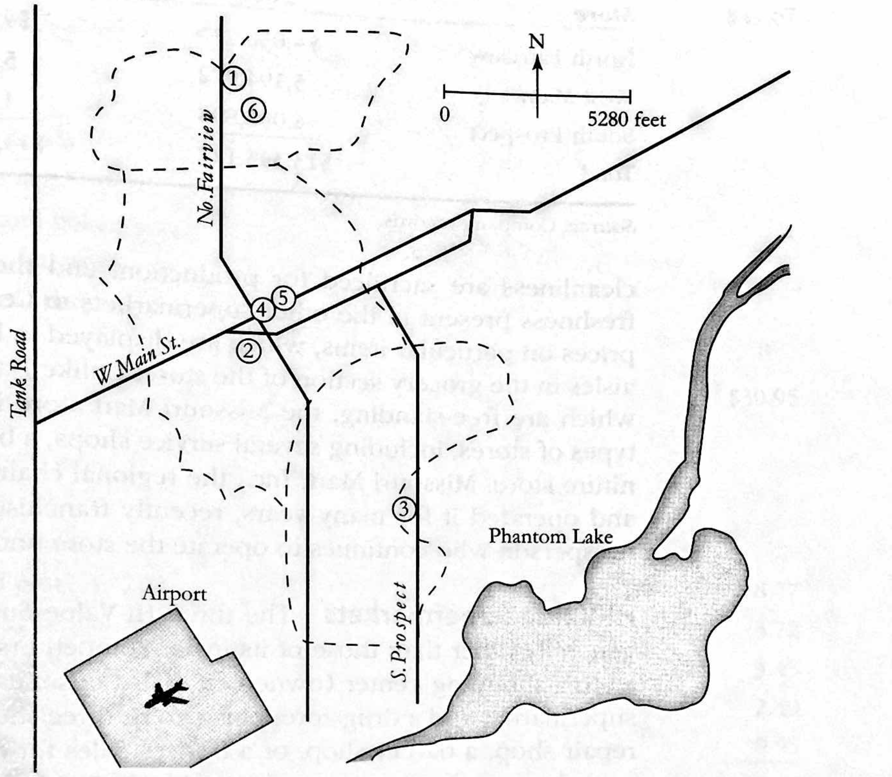
**EXHIBIT 2** **Estimated Share of Market for Supermarkets in Centralia**

| | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 | 2001 | 2002 |
|---|---|---|---|---|---|---|---|---|
| Hi-Value | 24% | 29% | 27% | 30% | 31% | 22% | 23% | 23% |
| Grand American | 22 | 11 | 7 | 6 | 6 | 6 | 6 | 13 |
| Missouri Mart | 25 | 25 | 26 | 28 | 30 | 34 | 34 | 27 |
| Harrison's | 9 | 14 | 19 | 16 | 14 | 20 | 20 | 22 |
| Others | 20 | 21 | 21 | 20 | 19 | 18 | 17 | 15 |

*Note*: Share-of-market estimates were made by Hall Consolidated executives on the basis of information they considered reliable. The total market (100%) represents all food sales made in Centralia.

*Source*: Company records.

**EXHIBIT 3** **Location of Stores, Major Traffic Arteries, and Principal In-City Trade Areas of Major Supermarket Chain Stores in Centralia**




*Key:*

1. Hi-value (N. Faireview)
2. Hi-value (W. Main St.)
3. Hi-value (S. Prospect)
4. Grand American
5. Harrison's
6. Missouri Mart

*Note:* Trade area boundaries were drawn on the basis of personal interviews with customers in each Hi-value store. The address of each interviewee was then plotted on the map and boundaries drawn.

innovative merchandising appeal. It has modest variety in meats, produce, and groceries, but its dairy department is highly regarded by Centralia shoppers. The store carries a skeleton variety of general merchandise and houses a small pharmacy. Grand American's weekly advertising emphasizes high-volume items and also attempts to create a low-price image by highlighting competitive prices on items listed in each ad. The store also offers double coupons and in-store "Manager's Specials." The store's customers come from residential areas similar to those of Harrison's customers; however, the annual household income of Grand American customers ranges from $20,000 to $35,000.

**Missouri Mart** According to Hall officials, Missouri Mart is the food sales volume leader in Centralia and is the principal competitor of Superior supermarkets. Approximately 32 percent of Hi-Value customers shop Missouri Mart regularly. Most of Missouri Mart's customers are middle-aged and older families whose annual household incomes exceed $30,000. Sixty percent of the store's 120,000 square feet is allotted to general merchandise; 40 percent is devoted to food items. The store was remodeled in 2001. Managers of the three Hi-Value stores maintain that "Missouri Mart's primary merchandising strength is in groceries and special purchase displays." One manager stated that "orderliness and

**EXHIBIT 4 Hi-Value Supermarket Sales in Centralia: 2000–2002**

| *Store* | *2000* | *2001* | *2002* |
|---|---|---|---|
| North Fairview | $4,050,277 | $4,287,686 | $4,437,632 |
| West Main | 5,194,972 | 5,174,051 | 5,374,517 |
| South Prospect | 4,098,898 | 4,227,304 | 4,514,551 |
| Total | $13,345,147 | $13,689,041 | $14,326,700 |

*Source*: Company records.

cleanliness are sacrificed for production, and the store lacks the quality and freshness present in the other supermarkets in Centralia." Ads feature very low prices on particular items, which are displayed in large quantities at the ends of aisles in the grocery section of the store. Unlike Harrison's and Grand American, which are free-standing, the Missouri Mart store is part of a complex of other types of stores, including several service shops, a bakery, a drug store, and a furniture store. Missouri Mart, Inc., the regional chain that built the Centralia store and operated it for many years, recently franchised it to an independent businessperson who continues to operate the store under the Missouri Mart banner.

**Hi-Value Supermarkets** The three Hi-Value Supermarkets in Centralia were generally older than those of its major competitors. Each of the stores anchored a strip shopping center (owned by Hall Consolidated) consisting of a Hi-Value supermarket and a drugstore, plus two or three shops (e.g., a dry cleaner, a shoe repair shop, a barber shop, or a florist). Sales for the three stores had increased over the past three years reaching $14,326,700 in 2002 (see Exhibit 4). The overall gross profit margin for the three stores was 28.8 percent in 2002. By comparison, the median U.S. supermarket industry gross profit margin was 26.4 percent.

Sales of the three Hi-Value stores were divided as follows: grocery (including dairy), 50 percent; fresh meat, poultry and seafood, 20 percent; produce, 18 percent; seasonal and general merchandise (including health and beauty care items), 7 percent; and bakery (including bread and baked goods) and deli (including self-serve and service deli), 5 percent. Gross profit margins in each of these departments were grocery (including dairy), 30 percent; fresh meat, poultry, and seafood, 18 percent; produce, 30 percent; general merchandise (including health and beauty items), 33 percent; and bakery and deli, 50 percent.

Company officials believed that Hi-Value stores offered a more limited variety of merchandise than the major competitors but that Superior carried high-quality merchandise, particularly in grocery items and fresh produce. Officials recognized that the fresh meat, poultry, and seafood departments of the three stores varied in consumer acceptance.

Hi-Value follows both Missouri Mart and Harrison's in terms of overall advertising exposure, measured in terms of newspaper advertising space, circulars, and newspaper inserts, radio spots, and outdoor. Grand American's advertising exposure is considerably less than Hi-Value in these media. Hi-Value features a value positioning in its advertising: Hi-Value Supermarkets = Superior Value. In 2002, Superior spent $127,500 for advertising or .89 percent of its sales. Missouri Mart and Harrison's were spending the equivalent of about 1 percent of their sales on advertising, Hall officials believed. None of the food stores in Centralia advertise on television.

Hi-Value supermarkets are the highest-priced food stores in the Centralia area, based on comparison market-basket studies of supermarket competitors. (Exhibit 5 shows the dollar breakdown of products sold in Centralia

**EXHIBIT 5 How $100 Is Spent in a Typical Centralia Supermarket**

| | | |
|---|---|---|
| Perishables | | $49.67 |
| Fresh meat, poultry, and seafood | $14.32 | |
| Produce | 9.70 | |
| Dairy | 9.08 | |
| Frozen foods | 6.95 | |
| Service deli | 3.38 | |
| Bread and baked goods | 3.15 | |
| In-store bakery | 2.14 | |
| Self-serve deli | 0.77 | |
| Floral | 0.18 | |
| Food grocery | | $30.95 |
| Beverages | 10.71 | |
| Main meal items | 8.44 | |
| Snack food | 6.39 | |
| Miscellaneous | 5.41 | |
| Non-food grocery | | $8.77 |
| Health and beauty care | | 3.72 |
| General merchandise | | 3.45 |
| Pharmacy | | 2.49 |
| Unclassified | | 0.95 |
| | | $100.00 |

*Source*: Company records.

supermarkets.) Nevertheless, it advertises high-volume items at deeply discounted prices and features "loss leaders"—items sold to the customer at or near their cost to the seller. Soft drinks, bread, eggs, and flour are popular loss leaders in the Centralia market.

**North Fairview** Built in 1975, the North Fairview store is the oldest of the three Hi-Value stores in Centralia. Improvements were made to the store in 1990 and 1995, including new checkstands and new freezers. The store is located less than two blocks from the shopping complex that houses Missouri Mart. About 20 percent of the North Fairview store's customers come from outside Centralia. Most of these customers live approximately three to four miles from the store.

**West Main Street** The Hi-Value store on West Main Street was opened in 1977. Substantial improvements to the store were made in 1992, including an expansion of the frozen food and dairy departments and the addition of new checkstands. A "mini-deli" was added in 2000 as part of a modest renovation. The deli prepares items for sale on the premises and for delivery to and sale at the North Fairview and South Prospect stores.

Two competitors, Harrison's and Grand American, are situated across the street. Although both are strong competitors, Hall executives believe that the West Main Street store draws most of its customers from the area south of the store, and that Harrison's and Grand American draw fewer customers than Hi-Value does from that area. Approximately 22 percent of the West Main store's sales come from people living beyond the city limits.

**South Prospect** The South Prospect store was built in 1982 and substantially remodeled in 2000. No major competitors presently exist in the immediate vicinity of the store. The South Prospect store has the only on-premise "scratch" bakery among the three Hi-Value stores. Deliveries are made to the other stores daily. Company executives believe that the bakery offers high-quality items but less variety than the typical retail bakery shop in Centralia. About 23 percent of the store's sales are to people who live outside Centralia.

## CONSUMER RESEARCH INITIATIVES

In mid-2002, Hall commissioned an independent marketing research firm to conduct a series of studies for the three Hi-Value stores in Centralia. Two objectives were outlined for these studies. First, Hall executives sought (1) to develop an updated profile of Hi-Value shoppers and (2) to determine the shopping behavior of these customers. This information was to be used in making store merchandising and renovation decisions. Second, executives hoped that questioning shoppers about what they liked and disliked about the Hi-Value stores would reveal what kind of retail image the stores projected. The question of store image had been a subject of discussion among corporate officials since 2000, when a retailing consultant to the company had concluded that the stores in Centralia failed to reach their full sales and profit potential because of the lack of a strong consumer image.

The first study consisted of a telephone survey of 400 Centralia residents, who were asked to comment on the principal strengths of the Hi-Value stores, Missouri Mart, Grand American, and Harrison's. More than 30 percent of the interviewees considered Hi-Value's prices "above average." In contrast, some 20 percent of the respondents thought the prices at Missouri Mart and at Grand American were below average. Harrison's was thought to have the lowest everyday prices. Additional results from this study appear in Exhibit 6.

**EXHIBIT 6 Association of Store Characteristics with Major Food Stores in Centralia**

| *Characteristic* | *Grand American* | *Harrison's* | *Hi-Value* | *Missouri Mart* | *Don't Know* | *Total* |
|---|---|---|---|---|---|---|
| Most reasonable prices | 11% | 36% | 7% | 34% | 12% | 100% |
| Most convenient | 18 | 21 | 35 | 25 | 1 | 100 |
| Best-quality meat | 20 | 27 | 18 | 11 | 24 | 100 |
| Widest variety of meats | 22 | 25 | 20 | 18 | 15 | 100 |
| Best-quality produce | 24 | 35 | 21 | 11 | 9 | 100 |
| Widest variety of produce | 24 | 30 | 14 | 18 | 14 | 100 |
| Best store service | 12 | 30 | 28 | 13 | 17 | 100 |
| Quality of canned goods | 12 | 24 | 14 | 14 | 26 | 100 |
| Best overall variety | 6 | 8 | 2 | 74 | 10 | 100 |
| Best store layout | 27 | 24 | 14 | 9 | 26 | 100 |
| Best bakery | 5 | 20 | 25 | 5 | 45 | 100 |
| Best deli | 5 | 9 | 9 | 2 | 75 | 100 |

*Source*: Company records.

A second study consisted of two focus groups recruited to discuss various aspects of food store choice and patronage in Centralia. A summary of their comments follows:

***Price.*** Price is the most important store choice determinant. Focus group participants believe that for grocery items, in particular, Centralia stores carry the same national brands and the stores' private labels have similar quality. Harrison's is perceived as having the best overall prices.

***Meat.*** Twenty of the 24 focus group participants stated that the quality of meat is the second-most important determinant of store choice and patronage. They like to see cleanliness in the meat department and bargains that are not simply poor cuts of meat. Meat display is also an important consideration. Harrison's was judged to have the best quality and variety of meat. Missouri Mart received the lowest marks on meat.

***Produce.*** Produce quality, variety, and display follows meat as a major store choice and patronage determinant. Focus group participants tended to equate produce quality (and meat quality) with a quality store image. Harrison's is the "produce store" in Centralia. Missouri Mart rates lowest in produce quality, variety, and display.

***Shopping Convenience.*** Focus group participants tended to lump together a host of factors that seem to represent a fourth major consideration in store choice and patronage. These factors tend to represent shopping convenience. Convenience includes ease of getting into and out of store parking lots, quick checkout, carry-out service, well-stocked and orderly shelves, and helpful store personnel. Closeness to home or work also seems important, particularly for last-minute shopping trips.

***Stores in General.*** Focus group participants are generally pleased with their food shopping options. They shop for food twice a week on average. One trip is for major food purchases; the second trip is for fill-in items. They usually shop more than one store on a regular basis.

***Missouri Mart.*** The typical comment made by focus group participants in reference to Missouri Mart was that "you can't stick to your budget if you shop at Missouri Mart because there are so many things to buy." However, they don't like the service at Missouri Mart, nor do they care for the quality of meat.

***Grand American.*** Most remarks about Grand American were in a neutral or negative vein. Focus group participants stated that the store is often out of stock and that it usually overadvertises. Grand American-advertised specials are not in fact specials at all, according to some focus group participants.

***Harrison's.*** Harrison's is winning the price competition with Missouri Mart in Centralia. Harrison's is recognized as having the best in price, courtesy, quality of merchandise, and service. Focus group participants believe Harrison's "Save on the Total" advertising.

***Hi-Value (combined stores).*** Hi-Value appears to be the winner on shopping convenience. Focus group participants from all parts of Centralia considered Hi-Value to be a good neighborhood store. The "Hi-Value Supermarkets 5 Hi-Value Value" advertising was questioned given the perceived higher grocery, meat, and produce prices.

A third study involved personal interviews with 587 Hi-Value customers at the three store sites. Customers were asked to respond to questions asked by the interviewer and to comment on the store. Responses to questions are tabulated in Exhibit 7 on page 508 for each store and for all three stores combined.

In commenting on Hi-Value stores, shoppers emphasized that lower prices and greater variety were needed. Shoppers suggested that the dairy section be cleaner, the prices of meats be lower, the variety of goods in the bakery be greater, the out-of-stock situation in private labels be improved, and the quality and freshness of produce be enhanced. Questions concerning features of the Hi-Value stores liked by shoppers generated a variety of responses. Appearance and cleanliness, friendliness, service, and convenient to home or work were liked most by shoppers.

## EXHIBIT 7 Hi-Value Supermarket Shopper Interview Results

| | S. Prospect | W. Main | N. Fairview | Hi-Value, Combined |
|---|---|---|---|---|
| **Age of customer (years):** | | | | |
| Over 65 | 7.5% | 16.8% | 9.7% | 10.7% |
| 64–50 | 13.7 | 25.5 | 28.0 | 21.6 |
| 49–35 | 33.0 | 35.8 | 33.1 | 33.8 |
| 34–25 | 18.9 | 15.3 | 24.0 | 19.7 |
| 24–18 | 21.2 | 6.6 | 4.0 | 11.6 |
| Under 18 and no response | 5.7 | 0 | 1.2 | 2.6 |
| **Average persons per household** | 2.6 | 1.9 | 1.9 | 2.1 |
| **Frequency of store visits:** | | | | |
| 4 times a week | 18.1% | 11.7% | 9.7% | 13.4% |
| 3 times a week | 19.9 | 21.2 | 22.7 | 21.2 |
| 2 times a week | 28.2 | 38.0 | 40.0 | 35.0 |
| Once a week | 10.6 | 11.2 | 9.2 | 10.3 |
| 3 times a month | 0.9 | 1.7 | 5.4 | 2.6 |
| 2 times a month | 6.0 | 4.5 | 7.0 | 5.9 |
| Once a month | 9.7 | 8.9 | 5.4 | 8.1 |
| Other | 6.5 | 2.8 | 0.5 | 3.5 |
| **Length of patronage:** | | | | |
| Less than 1 year | 11.4% | 10.0% | 7.1% | 7.6% |
| 1–3 years | 19.3 | 8.8 | 8.0 | 12.5 |
| 3 or more years | 69.3 | 81.2 | 84.9 | 77.9 |
| **Proportion of total food needs purchased:** | | | | |
| Almost all | 13.0% | 12.4% | 24.4% | 17.0% |
| About ¾ | 18.8 | 14.1 | 13.3 | 15.0 |
| About ½ | 50.0 | 58.2 | 47.2 | 51.7 |
| About ¼ to ½ | 6.7 | 7.9 | 7.2 | 7.1 |
| Less than ¼ | 11.5 | 7.3 | 7.8 | 9.2 |
| **Departments shopped:** | | | | |
| Grocery, meat, produce | 22.5% | 17.4% | 30.2% | 23.4% |
| Grocery, meat | 10.7 | 10.4 | 13.6 | 11.5 |
| Grocery, produce | 11.2 | 7.3 | 5.4 | 8.2 |
| Meat, produce | 6.5 | 3.7 | 2.2 | 4.3 |
| Grocery only | 33.5 | 45.1 | 32.2 | 36.9 |
| Meat only | 1.4 | 2.4 | 4.3 | 2.7 |
| Produce only | 0.9 | 3.7 | 2.7 | 2.3 |
| **General Merchandise, including:** | | | | |
| Health/beauty items | 15.2 | 9.2 | 7.5 | 10.9 |
| Frozen foods | 22.4 | 20.8 | 28.5 | 23.9 |
| Dairy | 39.6 | 37.6 | 49.7 | 42.3 |
| Bakery and/or Deli | 23.3 | 22.4 | 29.1 | 24.9 |

**EXHIBIT 7 (Continued)**

| | S. Prospect | W. Main | N. Fairview | Hi-Value, Combined |
|---|---|---|---|---|
| Other stores shopped most regularly: | | | | |
| Grand American | 7.6% | 7.8% | 4.9% | 6.8% |
| Harrison's | 30.8 | 40.8 | 16.8 | 29.5 |
| Missouri Mart | 29.0 | 22.1 | 43.8 | 31.6 |
| Superior | 0.6 | 0.6 | – | 0.4 |
| Independent 1 | 5.8 | – | 0.6 | 2.2 |
| Independent 2 | 4.7 | 0.6 | 3.7 | 1.8 |
| Other | 3.5 | 3.0 | 0.1 | 3.4 |
| None | 18.0 | 15.0 | 30.1 | 14.3 |
| Liked best about other regular store: | | | | |
| Prices | 33.8% | 29.5% | 19.5% | 27.0% |
| Meat | 8.8 | 22.7 | 7.8 | 11.6 |
| Produce | 10.3 | 9.1 | 6.5 | 8.5 |
| Location | 10.3 | 9.1 | 5.2 | 7.9 |
| Other responses | 36.8 | 29.6 | 61.0 | 45.0 |
| (No one category accounted for more than 7% of the total.) | | | | |

*Source*: Company records.

## THE QUARTERLY REVIEW MEETING

James Ellis convened the quarterly review meeting soon after pleasantries were exchanged among the participants. The performance of the 15 stores in Randall Johnson's District III were reviewed. Except for the three Hi-Value Supermarkets in Centralia, Missouri, all met planned quarterly sales, gross profit margin, expense, and profit goals. The three stores in Centralia had posted a 1 percent negative variance on sales. Inspection of the stores' sales mix, which evidenced an increase in the percentage sales among higher gross margin categories (grocery, general merchandise, and bakery/deli), had boosted the stores' gross profit margin percent. The slightly higher gross margin percent, coupled with lower operating expenses, resulted in the stores' net profit margin being slightly under 1 percent—just shy of the budgeted 1 percent net profit margin for the first quarter of 2003. In addition, customer counts at all three stores were higher than the first quarter of 2002. Over all, District III was performing according to plan.

### Everyday Low Pricing Discussion

Following the District III quarterly performance review, the discussion turned to Randall Johnson's proposal to implement everyday low pricing in Centralia, Missouri. He reiterated the points made in an earlier memo to James Ellis: (1) Superior's prices were higher than the competition at a time of growing price consciousness among Centralia shoppers and (2) Hi-Value could lose market share in Centralia due to the price differential. Sales in Centralia were already down 3 percent in the first quarter of 2003 compared with budgeted sales goals. This decline, following a slower than expected fourth quarter of 2002, "could indicate the beginning of a trend," Johnson said. He added, "We are running the risk of losing our hold as the second largest supermarket (based on market share) in Centralia."

Hall Consolidated had selectively employed everyday low pricing in well-defined market areas served by each of its three supermarket chains. According to Hall's vice president of retail operations,

> Our success with everyday low pricing has been a mixed bag. We've learned that this pricing strategy tends to work better when it is part of a broader store positioning strategy and supported with advertising. We've also learned that for everyday low pricing to work, we don't have to be the lowest priced supermarket in the trade area.

Ellis agreed with these observations and added:

> Everyday low pricing has to be used by all stores in a trade area, otherwise we'll only confuse our store image or positioning. In short, I think we need to take a hard look at our recent consumer research to see how we are positioned in Centralia and how everyday low pricing will change our image.

The controller for Hi-Value Supermarkets pointed out that everyday low pricing had the potential to reduce operating costs. He said:

> Everyday low pricing can lower our operating costs in two ways. It can reduce our inventory and handling costs due to more steady and predictable demand. It can also reduce our labor costs related to less frequent temporary price reductions. Our experience indicates that we can get an additional 50 basis points (.5 percent of sales) due to lower inventory and handling costs. The need to remark merchandise and shelf tags, including labor expense, costs us 60 basis points (0.6 percent of sales), which could be eliminated with everyday low pricing. Both savings could be added to our gross profit margin.

Johnson injected, "Or we use the savings to bolster our advertising budget featuring our new everyday low pricing strategy." Everyone agreed that such an option existed.

## Everyday Low Pricing Implementation Considerations

"Let's not rush to a conclusion on everyday low pricing yet," said James Ellis. "We still have a few things to consider, not the least of which are the knotty implementation questions."

All of the Hall executives acknowledged that Hi-Value Supermarkets were "rightly perceived by supermarket shoppers as having the highest prices in Centralia." However, everyone agreed that few shoppers had specific product or brand price knowledge upon which to compare stores. To the extent that price knowledge existed, it tended to be category dependent. Prior company consumer research indicated that shoppers tended to have a relatively good idea of prices for products they purchased frequently. For example, new parents have a better price knowledge of baby foods and diapers. These price-knowledgeable shoppers also tended to recognize attractive (lower) and unattractive (higher) prices and were proficient at detecting a "good deal" when they saw it either in an ad or in the store.

"When we consider everyday low pricing, we have to consider whether or not we adopt this pricing strategy across-the-board for all our products or just certain categories," Ellis said. Randall Johnson was in favor of the across-the-board approach, noting that the impact on shopper perceptions would be greater. The vice president of retail operations favored limiting everyday low pricing to grocery (including dairy items) and seasonal and general merchandise (including health and beauty care items) from an operational standpoint. The controller agreed: "We are more likely to see cost savings due to everyday low pricing in these categories than in the others. These categories represent 57 percent of Hi-Value's sales in Centralia and everyday low pricing there should convey the image we want to project."

Ellis continued, "Another consideration is the pricing itself. How much should we lower our prices?" The market-basket studies of supermarket competitors consistently showed that Hi-Value's everyday (nonpromotional) prices were about 10 percent higher than Harrison's prices and about 7 percent higher than Grand American and Missouri Mart. "That is, if there is such a thing as an everyday price at Grand American or Missouri Mart given their frantic discounting," said Johnson. All of the Hall executives agreed that Hi-Value could not "outprice" Harrison's and any suggestion that Hi-Value intended to do that in Centralia would be unwise. "We are not about to start a price war in a market that has been profitable for us," said Ellis. "Besides," said the vice president for retail operations, "we offer greater convenience of shopping with our three stores and that is worth something."

At that moment, the telephone rang and James Ellis was told his scheduled meeting with the District II manager was running late. "Randy, I promised you that we would get closure on the everyday low pricing proposal while you are in town," said Ellis. He concluded the meeting saying, "We've made some progress this morning, but I think the matter requires further attention. Let's all meet again tomorrow morning. In the meantime, all of us need to look hard at the Centralia situation, consider our present competitive position in the market, and agree on how we might proceed."