Is Small The New Big? Challenges In The Retailing Industry

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Abstract

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In the last decade the Industry of Grocery retail has seen its biggest changes since distribution became organized. From the empowerment of private label products and the introduction of sophisticated loyalty programs, retailers have been able to shape the market and the preferences of their consumers. But what happens when these preferences change due to factors that fall outside retailers capabilities?

This study describes the changes in an industry that seemed to reach its maturity due to a change in consumer purchasing habits for smaller store formats. Players in the grocery retail industry in Portugal that have been focusing on Hyper and Super formats are facing new challenges. Consumers start to demonstrate preference for a commerce based on proximity at the same time as they are threaten by new entrants in smaller formats and cheaper business models. We focus on the example of Meu Super, the new proximity chain of small grocery stores launched by Sonae MC in order to respond to the introduction of Amanhecer, a similar concept created by its main competitor Grupo Jeronimo Martins and adaptation of already existing brands like Dia's group Minipreço or Spar. The problem is that for a company that holds a heavy-weight brand in the grocery retail in Portugal like Sonae may be a bigger than expected challenge to penetrate in segment with many different features that the ones where Sonae is competing in.

We present a Case Study based on Meu Super strategy by Sonae to point out the main challenges and threats of this strategy and promote the discussion of whether Sonae should leverage its already successful brand Continente in order to beneficiate from its synergies, or if the choice of creating a new separate brand was the right one, taking in consideration the company's resources and limitations.

Resumo

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Na última década a Indústria do Retalho Alimentar assistiu às maiores mudanças desde que a distribuição se tornou organizada. Desde o fortalecimento das marcas de distribuidor e da introdução de programas de lealdade mais sofisticados, os retalhistas tem sido capazes de moldar o mercado e os hábitos de compra dos seus consumidores. Mas o que será que acontece quando estes hábitos de consumo mudam devido a fatores que caem fora do controlo e das capacidades dos retalhistas?

Este estudo descreve as mudanças numa indústria que parece estar a atingir a sua maturidade graças a uma mudança dos hábitos de compra dos consumidores para formatos de lojas mais pequenos. As empresas na indústria de retalho alimentar em Portugal que até agora tem focado em formatos "Hyper" e "Super" enfrentam um novo desafio. Os consumidores começam a demonstrar preferências por um comércio baseado na proximidade, ao mesmo tempo que são ameaçados pela entrada de novos concorrentes em formatos mais pequenos e com modelos de negócio mais baratos. Focámo-nos no exemplo do Meu Super, a nova cadeia de pequenas lojas de proximidade lançada pela Sonae MC de forma a responder à introdução do Amanhecer, conceito semelhante lançado pelo seu maior concorrente, o Grupo Jerónimo Martins, e pela adaptação das insígnias já existentes como o Minipreço do grupo Dia ou a Spar. O problema é que para uma empresa que detém o peso pesado Continente, o desafio pode ser maior do que o esperado em penetrar num segmento com características muito diferentes daquelas que definem o segmento onde se insere o Continente.

Apresentamos um Case Study baseado na estratégia adotada pela Sonae em lançar o Meu Super com o objetivo de salientar os maiores desafios e ameaças desta estratégia e promover a discussão se a Sonae deveria ter aproveitado as marcas de sucesso já existentes como o Continente e assim beneficiar de sinergias, ou se a decisão de lançar uma nova marca de lojas separada daquelas já existentes foi acertada, tendo em conta as capacidades e limitações da empresa.

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1. Introduction

Over the last few years the Grocery Retail Industry suffered several changes. It has evolved from small non-organized local commerce with low differentiation offering in the beginning of the XX century to big hypermarket chains offering over 30.000 references.

In the last decade the industry went through an unforeseen change that many sector analysts refer as the "back to basics" tendency in grocery shopping. A lower consumers' purchasing power and the increase of demand for fresh products brought the millennial generation to prefer to shop faster, for less items and with more frequency. As a result, many consumers start shifting their purchases to local grocery shops instead of driving to the outskirts of their town to go to a hypermarket.

The decrease of the purchasing power of the typical Portuguese consumer can be considered as a benefit for grocery retailers. With less money to spend, consumers prefer to eat more at home instead of spending money out-of-home. However the decrease in purchasing power is can also reflects in less "out-of-pocket" money to spend which is the instant availability of money that consumers have in a given moment.

In addition to having less money to spend at once, customers also started to have less time to spend shopping and an increase in preferences for proximity, convenience and smaller formats in terms of grocery shopping started to be observed. However, most grocery retailers in Portugal have applied their efforts to compete in the Hyper and Super formats during the 90's and were not expecting such a drastic change in the consumers' purchasing habits.

Among these retailers is Sonae MC. With its brand Continente, Sonae is the leader in volume in the Portuguese market and was the first company to open an Hypermarket in Portugal in 1985. After the success of its first store, the company continued to explore this format reaching 152 stores in the Hyper and Super format in 2012.

For the last decades, big formats have sustained the company's growth. In 2012 the sales reached 3.31 M€. However with the new "back to basics" consumer, Sonae is facing a big challenge: will Sonae MC be able to adapt to the new market conditions?

1.1. Managerial Relevance

This dissertation is of particular interest for any retail oriented study. Although it may not be the first time that the changes in the grocery retail industry in Portugal are documented, it is the first time that such changes are connected with the strategy taken by a leading company in this industry. It is very interesting to watch a giant company like Sonae MC taking measures to tackle the shift in consumer preferences. Related to this, this thesis is also relevant for consumer behavior observation in the sense that it introduces some of the factors that led consumers to prefer smaller formats of grocery retail stores.

In terms of managerial relevance, this dissertation describes the options that a company like Sonae has considered, leveraging its resources and taking in consideration its limitations in order to successfully penetrate in a different segment that it was operating. A segment based on proximity and stores with smaller formats.

Managers will also find interesting the solution found by Sonae to create a new smaller store format at a very low financial risk. In terms of managerial relevance the main contribution of this dissertation is to point out the biggest threats and benefits of the decision taken by Sonae in penetrate this new segment.

1.2. Problem Statement

The main problem that this research aims to answer is how a leading grocery retail company that has focused mostly in the Hyper and Super formats can tackle the change in consumer purchasing habits, namely the preference for proximity stores and lower value shopping baskets? In order to address this issue, five main research questions need to be answered.

Research Question 1: What are the most noticeable changes in the consumer shopping habits?

Research Question 2: What are the growth strategies followed by different players in the market?

Research Question 3: What are the different strategies that a company in grocery retail may use in order to tackle the changes in consumption habits?

Research Question 4: Who are the current players in proximity retail and what is their growth penetration strategy?

Research Question 5: What are the risks related to use Franchising as a growth strategy?

The aim of this thesis is to provide a broad vision of the grocery retail market in Portugal and the changes that it is facing. The objective is to present the main challenges that companies that are operating in this market are facing with special focus in Sonae MC and its brand Continente.

In the following sections a Case Study about the strategy adopted by Sonae MC to face the changes in the grocery retail industry will be presented followed by a Literature Review, Teaching Notes and finally a Conclusion section.

A Case Study of the strategy chosen by Sonae to respond to the market threats is presented aiming to identify what have been the major challenges faced by the retailers' industry in Portugal, describing in detail the new distribution strategy followed by Sonae with "Meu Super" brand.

In the Literature Review section, a contextual analysis based on the most relevant academic material was made. It is important to introduce the topics that are approached in the strategy chosen by Sonae and relate them with the available theoretical context. The main topics that the Literature Review focuses are Growth Strategies, the Importance of a Brand and Private Label impact.

In order to aid in the Case Discussion, we propose in chapter 4 a Teaching Note that serves as a conducting element of that discussion, identifying the most relevant issues to be addressed as well as all the subjects that are related with those issues. Two exercises are proposed in the Teaching Note, one that is based on class discussion and the other that gives students the opportunity to increase their knowledge on the subjects covered in the Case Study by writing a report and present it in class. Both of these exercises are supported with the main topics that should be covered in order to aid the instructor to conduct the discussion or evaluate the outputs.

The last chapter of these theses is a conclusion chapter where a small synopsis of the dissertation is presented as well as a quick overview of the grocery retail market in

Portugal. The main conclusions are stated and fundamented based on the findings generated by the research for this dissertation.

2. Case Study

In this chapter a Case Study is introduced. The objective of this Case Study is to present Sonae as a holding company of the leading brand in grocery retail in Portugal, as well as its strategy to tackle the changes in that Industry. We address the creation of Meu Super, a brand of proximity grocery stores that Sonae launched and we promote a discussion of the main threats and advantages of this strategy.

Meu Super: Thinking Small To Stay Big

2.1. Introduction

At 7h45 a.m. in a cloudy September morning, the whole team of Meu Super store in Restelo was gathered by the front door as well as some elements of SWF team. After several days and nights in a row preparing for this opening, Mr. Carlos, the owner of the store and his staff of 8 were making part of an important mark in Meu Super's history: the opening of the 50th store of the chain. Meu Super was the latest response of Sonae MC to the changes in consumer preferences in the grocery retail industry.

Since the beginning of the century, the traditional concept of grocery shops has suffered several changes. From organized retail, to size and layout of the retail store, the grocery retail industry has seen its biggest changes in the last 100 years. Starting in non-organized small commerce, the industry evolved to a market dominated by several big players with control over almost the entire value chain. But it seemed that this industry was about to face a new loop.

In 1985 Sonae opened the first hypermarket in the north of Portugal. It was the first time that such big selling space was opened in the country and the concept was a huge success. Since then, customers started to value a large selling space where they could park their cars, take their families and most important, buy the entire household supplies for a whole month. All the big retailing players in the country followed Sonae's strategy and the grocery retail industry started to develop towards modernization.

By the end of the 90's, the Portuguese biggest retailers flooded the market through the outskirts of the biggest cities in Portugal, changing the way people shopped. At that time

the market was divided among five different retailers (Continente, Feira Nova, Carrefour, Jumbo and Pingo Doce) with Sonae (with its brand Continente) and Jerónimo Martins (company that owned Pingo Doce) disputing the leadership in share of the grocery retail industry. Nielsen data in 2013 revealed that the concentration index is 46,2%, indicating a moderately concentrated industry, with these two players representing approximately 48,1% of the market.

However, like any other trend, by the end of 2000's the habits of the consumer started to change. From filling a shopping cart once a month in a hypermarket with supplies for four weeks, the typical consumer started to adopt different purchasing habits. The financial crisis over Europe brought a decrease in the consumers' purchasing power that led to a change in the consumers' purchasing habits. Consumer started to have less money to spend in large-value shopping baskets and started to value more frequent visits to a store, where it was possible to dilute the spending in grocery throughout the month. Since consumers increased the number of monthly visits to the store, convenience and proximity started to be important attributes when choosing where to shop.

Ultimately this change in the consumer's habits led to a necessity of retailers to rethink their strategy in order to fulfill the needs of this new type of consumers where convenience and proximity were valued.

Following the tendency of some big grocery retailers in the world, Sonae MC decides to launch in 2011 a new brand named "Meu Super" which embraced the proximity format. The company decides to penetrate in the "neighborhood store" market with a franchise-based business model, which hopefully aimed to suffice the new consumer needs observed in the market

2.2. Grocery Retail Industry

When the retail industry for consumer goods is analyzed through times, significant changes in its distribution strategy are observed, especially by the end of the 20th century. In an initial stage there was a decentralization of the product offering by nature of it and the consumer had to buy its groceries directly in the source. If the consumer wanted to buy milk, some fruit and meat he/she would have to go directly to the milkman, the farmer and the butcher. Although all of these products could be gathered in a same commercial place like a market or a town fair, the producers were almost always

the sellers and they would work independently and most of the times they would work locally.

By the end of the 19th century, grocery shops had proliferated. Customers could go to a single store and buy different types of products. Products were kept behind a counter where the customer would wait for its order to be packed by the store owner or by one of its employees. Interaction between the customer and the store employees was often seen as a social gathering. However, this model of grocery shops involved high costs due to its personalized service. In 1916 Clerance Saunders filed the first patent for a self-service store and opened its first Piggly Wiggly store in Memphis, Tennessee in the U.S., where customers could pick themselves the products and pay in the end at a check-out point positioned at the exit of the store **(Exhibit 1).** Although it would not be possible to buy some perishable products in this type of store, this was considered to be the birth of the supermarkets. This concept evolved during the XX century from the appearance of networks or chains of supermarkets until the new and innovative efforts by these retailer chains to focus in creating customer loyalty.

The evolution of the supermarkets was much related with evolution in size. In 1963 Carrefour opened its first hypermarket in Sainte-Geneviève-des-Bois, France. This was the first store of its kind in Europe with 2,500 m2, 12 checkout points and over 400 parking spaces[1.] By the end of 1980 several chains of Hypermarkets were established both in Europe and in the U.S..

The Hypermarket concept **(Exhibit 2)** arrived in Portugal in 1985 as a result of a partnership between the French retail group Promodès and the Portuguese multi-business group Sonae. Based in the already existing Continent stores in France and Spain, the new Continente store opened in Matosinhos, in the north of Portugal.

Before the opening of this first Continente Store in 1985, there was very little organization in the retail market in Portugal with only a few chains operating in this business, mostly in the supermarket segment. Sonae group detained the supermarket chain Modelo and Invictus and Jerónimo Martins operated Pingo Doce, an established

[1] Source: Carrefour Corporate – Company's History

brand of supermarkets[2]. The opening of the new hypermarket Continente marked the beginning of a new stage for retail commerce in Portugal.

2.2.1. Trend in the Grocery Retail Industry: "From the Hyper and Super to the Mini and Friendly"

In the beginning of the 90's there was a proliferation of the Super and Hyper concept with all major retailers applying their efforts to compete in these segments for market share. Bigger shopping spaces meant higher range of categories with higher amount of SKU's in each one. Typically a hypermarket was located in the outskirts of urban areas, with big parking lots, high rates of visits and big spending per visit **(Exhibit 2).** Going to the hypermarket usually involved a lot of time per visit and big intervals between visits. Portuguese families had the habit of going to a hypermarket to do their monthly grocery purchases.

However, since the 90's to nowadays, the consumer shopping habits changed significantly. Some of these factors can be explained by a (1) decrease in purchasing power, as a consequence of the economic crisis, that ultimately reflects in a less availability for big "out-of-pocket" spending, (2) less time to go to a hypermarket and to spend a couple of hours shopping or (3) increase of proximity chains, are just some factors that are starting to play a significant role in consumers' decisions about where to shop. In the beginning of the 2000's the consumer would go to a hypermarket once or twice a month and fill a shopping cart with the monthly amount of supplies, but with society changes, the typical consumer started to prefer to go two or three times a week to the nearest store and buy daily fresh products. Retailers started to face the challenge of having to adapt to this new reality and move away from the previously ideal strategy of big formats and work towards smaller and closer to customer stores.

Part of this economic shift can be explained by the effort applied by the main (proximity) brands to motivate daily visits from customer: Increase in perishable products offer, increasing investment in their private label lines, and development of loyalty and CRM programs are some of the strategies that grocery retailers started adopting to attract consumers who seem to have started to value proximity, trying to become the "neighborhood stores". While in Portugal this was the strategy followed by

[2] Source: Jeronimo Martins website – Company's History

several players in the market like Pingo Doce and Intermarché Group, the trend was also visible in other European markets. For example in the U.K., Tesco that initially invested in superstore formats with a wide range of category offers, started to experiment new and smaller store formats during the 90's and 2000's. Tesco Express and Tesco Metro are mostly convenience formats that were designed for small spaces in the city center. A smaller range of category offer and relevance in perishable products are some of the main characteristics featured by these formats, either under its flagship brand or by acquiring other proximity chains. In France, Carrefour Group (in 1999) invested in the convenience chain 8-À-Huit[3] that was "inherited" from its acquisition of Promodès Group and in 2000 Carrefour acquired the Spanish hard-discount chain Dia that operated mostly as a proximity retailer[4]. After its Spin-off from the Carrefour Group in 2011, Grupo Dia turned its attention to a wider range of proximity and convenience formats. In 2012 Grupo Dia launched its new brand Dia Fresh, a proximity store focusing on perishable products, a brand that added to the already existing Dia Market (less than 700 m2) and Dia Maxi (less than 1000 m2).

In 2012, the main competitor for Sonae was Jerónimo Martins retailing chain that although did not impose a big threat in the hyper format, was one of the strongest players in proximity grocery retail with its Pingo Doce brand. Pingo Doce developed a quality and convenience strategy over the years, while investing in a wide private label offering, decreasing the average shopping-basket value.

2.3. Sonae SGPS: From Industry to Retail

In August 1959 Sonae – Sociedade Nacional de Estratificados (National Society of Stratified conglomerate structures) was founded. Until the 70's the main focus of the business was the production of decorative laminates. In 1975 Sonae diversified into the Chemical Industry and in 1983 Sonae Investimentos SGPS, SA was founded as a holding company. In the same year Sonae opened to the capital markets and celebrated a joint venture with the French retailer Promodès. As a product of the Joint Venture between Sonae and Promodès, (in 1984) Modelo Continente, SARL started its activity in the retail sector and in 1985 the group opened the first hypermarket.

[3] Source: Concept "8 à Huit" : Carrefour Franchising website
[4] Source: "About us: DIA Group". *Dia*. Retrieved 18 February 2013.

While entering in the distribution and retail sector, Sonae did not set its other business areas aside and kept a growing strategy in its operating areas as well as a diversification strategy. In 1986 Sonae opened the Porto Sheraton Hotel (nowadays Porto Palácio Hotel) and acquired Orbitur a small tourism services provider, entering in the tourism sector. In 1988 Sonae Tecnologias de Informação was created with the objective of operating in the IT and Media sectors. In 1989 the group initiated activity in the Real Estate business with the creation of Sonae Imobiliária and in the same year inaugurated the first two malls to be operated by the company: Portimão Shopping Center and Albufeira Shopping Center. Still in 1989, the group acquired the travel agency Star and created Ibersol – Restauração e Gestão Hoteleira, to manage several Horeca units. Ibersol had the Portuguese representation of big international food chains like Pizza Hut and Burger King.

In 1990 Sonae Tecnologias de Informação launched Público, SA, the first newspaper with national distribution in Portugal. In 1992 the company bought a participation in the BPA – Banco Português do Atlântico's capital entering in the financial sector. In 1995 and 1996 the company tackled the specialized retail through the creation of several non-alimentary brands like Modalfa (Clothes), SportZone (Sportsware) or Worten (Technology) while launching its first chain of health clubs: Solinca. Two years later in, 1998, Sonae entered in the mobile phone's sector with Optimus that soon became the third largest telecommunication company. By the end of the decade Sonae Tecnologias de Informação is renamed to Sonaecom.

In 2005 Sonae Imobiliario was renamed to Sonae Sierra and the main business focus is the development and management of Shopping Centers. In 2007 Belmiro de Azevedo **(Exhibit 3)** became chairman of the group while his son Paulo de Azevedo became Chief Executive Officer. Still in 2007 the company acquired the Portuguese operation of Carrefour Groupe. By the end of this decade there was a restructuration of the group's business areas and a new corporate image is presented. The decision to include all the sub-holdings of Sonae Group under the same umbrella Sonae brand was to create a more recognizable and homogeneous image of the group as a whole **(Exhibit 4).**

In the beginning of 2010, Sonae SGPS was organized into six different business areas and was composed by Sonae MC in the distribution and food-retail segments, Sonae SR in non-food retail, Sonae Sierra for development and management of shopping centers,

Sonaecom in the Telecom and media sectors, Sonae RP for retail properties and finally Sonae Investment Management[5.] In 2012 the group detained over 70 brands spread across its different business areas and generated aggregate revenues of 33 M€.

Despite the apparent capability of replicating abroad their formula of success, Sonae has opted from the beginning of its growth to focus mostly in Portugal. The company has developed some internationalization but not at a very fast pace. Although Portugal is the main investment country for Sonae, the company has been internationalizing itself over the years. In a first stage the internationalization process was mainly through acquisition or partnerships in the Industry Sector, however in the last few years the company gained presence in foreign markets through development of shopping centers and specialized retail. The brands Zippy, Worten and SportZone are already present in foreign countries, like Spain, U.A.E. or the U.S., but mostly through franchised stores.

Regarding financial strategies, Sonae pursuits a capital light strategy that spreads across all of its business areas. In 2012, and after reducing 147 M€ its debt, the company still holds 1.816 M€ in net debt, representing a debt-to-EBITDA of 2,8[6]**(Exhibit 5).** This reflects that even though Sonae is a multi-business corporation with a drive for change and diversification, its leverage level is very high which ultimately may represent a limited autonomy to invest in new businesses.

2.4. Sonae MC: Overview of the Leader in Grocery Retail in Portugal

Two years after celebrating a Joint Venture with the French retail group Promodès and the creation of Modelo Continente SARL (later renowned as Sonae Modelo Continente Hipermercados, S.A. – Sonae MC), Sonae entered in the grocery retail sector with the objective of renovating the distribution and retail business in Portugal, opening the first large surface store for grocery products operating in the country.

Despite the turbulent process of development of the first Hypermarket in the north of Portugal due to several complaints from local small commerce representatives and the internal concern that a brutally large store at the time would not have sufficient demand, Continente Matosinhos was a success. The Grocery Section Chief of Continente

[5] Source: Sonae Business Areas – www.sonae.pt
[6] Source: Sonae Results Presentation 2012

Matosinhos at the time, João de Melo, told in an interview[7] that "in the first day of operations the store in Matosinhos was invaded". The lines reached the 200 meters before opening and the store were forced to an early closing due to lack of stock and empty shelves. Even the local traffic in Matosinhos was affected with an artificial rush hour that lasted almost the entire day.

Even though Sonae MC had launched previously Modelo stores in Lisbon and Invictus stores in Oporto in Supermarket formats prior to the Continente store, the know-how provided by the French partners from Promodès was essential in the development and management of this new Hypermarket.

Sonae MC played a decisive role in the modernization of the retail sector in Portugal with the launch of the new format. In 1989 Sonae was followed by the Pão de Açucar Group (later acquired by Auchan Group) with the opening of its first Hypermarket: Jumbo Amadora. A few months later Sonae MC opens Continente Amadora, close to Lisbon, aiming to stop the growth of Pão de Açucar Group while safeguarding a position in the Hyper format in the region of Lisbon, the highest populated region in Portugal. Since then, all grocery retailer stores from Sonae MC were named under the flagship brand Continente. In 2012 Sonae holds 184 Continente stores: 39 Continente Hypermarkets, 113 Continente Modelo and 32 Continente Bom Dia (Exhibit 6), reaching a market share of approximately 25.5% of the total market.

The innovation culture of Sonae MC is not only limited to the modernity of the stores and diversity of formats. In 2007 Continente launched Cartão Continente. Although the company benchmarked some of the most sophisticated loyalty cards in retail in the world, like Tesco Loyalty Card, Cartão Continente is one of its kind and it is itself a benchmark for other companies in the world in the process of launching and developing their own loyalty cards.

Cartão Continente is one of the most sophisticated loyalty cards in the industry. Some of its most important features include the easiness to become a member, focused marketing and diversity of benefits for the user. In general terms this card combines off-the-shelf discounts with accumulation of credit based on store discounts. For instance, the card accumulates in credit 1% of the value purchased in all Continente stores, which is the

[7] Source:"Primeira Catedral do Consumo Nasceu Há 25 Anos em Terrenos da Igreja" in Público archives, 10/12/2010

same as say that for every 500€ spent in a Continente store, the card accumulates 5€ in credit that can be directly used in many stores of group Sonae.

In June 2013, there were 3,3 Million of active users of Cartão Continente in Portugal and approximately 90% of all purchases in Continente stores are accompanied with Cartão Continente. Additionally this card is already eligible not only in Continente stores but also in another non-food retail stores of the group like Well's, a healthcare chain of stores and the apparel chain Modalfa , as well as in Galp gas stations and Solinca Gyms.

2.5. When The Market Is Challenged By Change

In 2008 Portugal entered in one of the deepest financial crisis that there is memory of. The effects of this crises spread almost across all sectors of the Portuguese Economic and Social Life. An increase of the unemployment rate and a decrease of available income reflected in a decrease of the GDP growth acompaigned by a decrease in private consumption **(Exhibit 7).** The impairment of purchase power affected the behavior of the consumer towards his usual purchases. Most of the companies in the Portuguese economic landscape had to adapt themselves to a shift in the consumption trend from the consumers.

While some companies were deeply and negatively affected by the financial crisis, new opportunities grew in the market. The Horeca sector was specially affected by the Portuguese Crisis with consumers dramatically dropping the demand for restaurants and hotels. However, having less money to spend in restaurants was translated in an increase in the "in-home" consumption. In general grocery retailers benefited from the fact that people were less willing to spend money out of home and preferred to consume in their houses. From 2006-2011 there was an increase of 11% in spending in grocery retail while the spending in the Horeca Channel decreased 30% (revealing a drop of 13% the spending in Cash&Carry's)[8.]

Although this may seem like good news for grocery retailers, this shift in the purchasing habit of the consumer does not come alone. In fact, it was not just a shift from out-of-home to the in-home segment that was verified in the consumer's behavior. The buyers became much more price sensitive and less willing to spend in non-essential goods as

[8] Source: Nielsen Recenseamento 2006-2011

well as the available out-of-pocket amount of money decreased. Although there is an increase in demand for in-home purchase, in 2012 the volume of FMCG purchased in Portugal decreased 3,6% (Exhibit 8) The decrease in available income is also due to an increase in taxes by the Portuguese Government. A general increase in the VAT reflected in an increase in prices. In Exhibit 9 we can see that a decrease in volume of FMCG in 2012 did not reflect a decrease in value, quite the contrary actually. This means that the consumer is spending more but buying less. Again, this does not only change the amount of goods purchased, as it intrinsically changes the consumers purchasing behavior.

As a result of a decrease in net income, related with an increase in taxes and the economic recessions, consumers started to be much more concerned about the best prices and promotions. According to the 2013 Shopper Trend report by Nielsen, consumers became less loyal to a specific store or brand of product as they increasingly seek for the available promotions (Exhibit 10). Another study by Nielsen shows that proximity to the store is a critical attribute for the "new consumer" and that the number of visits to a store per week increased, as the number of items purchased by visit decreased (**Exhibit 11**).

With all these changes in the consumer habits, the grocery retail landscape in Portugal is rapidly changing. Consumers now value proximity stores with targeted product offering as well as less expensive shopping baskets and increasing concern for freshness of the products. There are new convenience brands replacing the traditional non-organized grocery shops and the small proximity format is generating an increasing loyalty by its customers.

Also, an increase in the online shopping for groceries is verified. Consumers are not only less available to spend more money, but they have also less time to shop and the online platforms developed by all major players are proving to be a very useful tool to combat the effects of the crisis.

Although Portugal was specially affected by the financial crisis, this trend verified in the grocery retail industry was observed in most European countries. Some of the biggest players in Europe are already adopting strategies to tackle the small proximity strategy. Carrefour, pioneer in the Hyper format developed several proximity ensigns, and Tesco

increased its investment in innovative ways to sell that in most cases involves an efficient online platform and a targeted CRM program. In Portugal, Jeronimo Martins Group, Sonae's competitor, launched Amanhecer, a convenience format to penetrate in the "neighborhood store" segment and Minipreço, the brand from Dia Group increased its presence in the small sized stores format **(Exhibit 12).**

With this change in the Grocery Retail Industry, a big player like Continente that based is growth through the super and hyper formats is now facing new threats that may challenge its leadership position. The market share growth of Continente is flattening, indicating that innovation needs to take place.

Due to all the market changes in the grocery industry, Sonae MC faced a new challenge: How can the leader in grocery retail in hyper formats keep growing in an industry where consumers are not only less available to spend big amounts of money at a time, but are also less available to spend much time shopping as they start to value more smaller proximity formats?

2.6. Options to Grow

In order to continue with its growth, Sonae MC had to adapt to the new market tendencies. Following its national competitors and international benchmarks, the company launched its new proximity chain of grocery stores: Meu Super.

To penetrate in the proximity retail Sonae had two main initial options: either acquire or partner with an already existing brand of grocery stores, or to grow organically and develop a new chain from the very beginning.

In the beginning of 2012, GCT group, the operator of Ponto Frescos grocery stores in Portugal was pointed as a valuable candidate to establish a partnership. With more than 500 grocery stores under the Frescos brand and 19 Cash&Carry stores, the company was a big leverage for Sonae to enter in the proximity segment and in the Wholesale channel. Although GCT was pointed as a valuable potential partner, its financial situation was volatile which led to stop the interest from Sonae. In fact, a few weeks after stopping negotiations with Sonae, the company went bankrupt, supporting the adequacy of Sonae's decision.

On the other hand, the company could develop its own chain of proximity stores: either by developing a new brand from the beginning, or to expand an already existing brand of the group. Continente Bom Dia is the smallest store format of the Continente family and could be a valid alternative for growth in the proximity segment, taking advantage of the Continente flagship synergies. However, the company decided to develop a new brand of grocery stores, the first food retail chain outside of the Continente flagship family: Meu Super.

To develop a new chain of stores, several issues have to be considered: Should it be 100% company's capital or should it be developed some kind of investment share between the company and a third party? Who will manage the stores: should the stores be managed internally or should they be granted license to a third party to manage? How about supply and distribution of merchandise? Should Sonae MC use the already existing Continente supports or should it be created a new distribution system just for Meu Super?

To enter in the proximity segment with 100% company owned stores would involve a high investment which is ultimately related to high risk. Even if the option is to adapt an already existing brand of the group like Continente Bom Dia, the costs of expanding it to an optimal scale that would be able to compete with the other already established players in the proximity grocery retail segment would be high. However, by completely owning the stores, Sonae would have total control over them, enabling the company to impose its culture and its strategy while being able to fully use the resources created by the leader in grocery retail in Portugal.

There was, however, another option to develop a new chain of stores that substantially decreases the level of initial investment and the risk of the project: franchising. This strategy follows the line of capital light strategy typically preferred by Sonae. In fact, franchising is being used for decades by some of the most dominant players in the world and by some of Sonae's competitors in Portugal. Dia group argues that through franchising it is possible to reduce the operational cost of the stores for the group by transferring some of these costs for the franchisee (for example Personnel Expanses) and therefore increase the EBIT for the group **(Exhibit 13).**

2.7. *Meu Super*: a "Small" Strategy to Grow

To develop Meu Super, Sonae MC benchmarked some of the biggest franchising operators in grocery retail in Europe, like Eroski, Dia or Carrefour and combined different aspects of each to create Meu Super franchising Business Model. The result was a full-franchised model with no fees or royalties for the franchisee and where the only return for Sonae is the revenue for supply the stores in the Wholesale channel.

Table 1: Franchising Business Models in grocery retail in Portugal

	Meu Super	Minipreço	Amanhecer	Spar
Deliveries (Mechandise)	2-3 times per week plus direct supplies	2-3 times per week (only to non perishable merchandising)	2-3 times per week, plus direct suppliers and access to Cash&Carry	2-3 times per week plus direct suppliers
Investment Level	Medium with no subsidization	Medium, with subsidization (until 50% of total cost)	High with subsidization (Untill 25.000€)	Low with no sibsidization
Supply Agreement	100% of volume (with exceptions)	100% of non-perishable volume	70%-80% of volume	100% in Private Label
Payment Conditions	In front or with bank guarantee	In front	In front or with credit card	Differed with pre-date check
Support and Services	General Information	General Information	Agreements with banks and energy suppliers	General Information

Under the Foods Division is the recently renamed Sonae MC Wholesale & Franchise (SWF). SWF is responsible for Sonae's wholesale channel and for the development of Sonae's new brand of franchised grocery stores.

Meu Super's objective was from the beginning to penetrate in the residential areas and become the new "neighborhood store". Ideally the sales area of a Meu Super store is between 100 m2 and 700 m2, the initial investment for each new Meu Super store is expected to be in the range between 150.000€ to 400.000€ and the expected annual value of sales may vary from 400.000€ up to 2M€.

Meu Super store concept is based in proximity, with stores conveniently located in residential areas with modern and appealing image. Meu Super focuses on client service, low and stable prices and dynamic promotions.

To assemble a new Meu Super store the franchisee, either with own capital or with debt, gathers almost all the initial investment. In some cases SWF may play a liaison role between the franchisee and the bank in order to get better loan conditions to the client.

To identify potential franchisees, SWF assembled a team of canvass managers that are divided by geographic areas in the country. The job of these managers is to identify and

approach possible candidates to be a potential Meu Super franchisee, based on criteria defined by SWF, like previous experience, age or even familiar aggregate.

Several steps are needed from the moment a potential franchisee is identified until the moment that the new store is opened and that for the franchisee there are three main investment areas when opening a new store: The civil construction work of the store; the equipment of the store; and the Filling of the store (stocking the shelves). Depending on the size of the store the values can vary but the average investment for a new Meu Super store is about 160.000 € **(Exhibit14).**

SWF supports the franchisee throughout the entire process of assembling the store. For instance, in the space procurement phase SWF may help a potential franchisee to find a better-suited space for the new store. In the implemental phase, SWF supervises the work in order to make sure that deadlines are respected and that requirements are being fulfilled and the franchisee will receive formation on the daily functioning of a Meu Super store. All the processes around the functioning of the store are integrated in the process of Continente. In other words, the software that the franchisees use to order new merchandise is integrated in Sonae MC software that also services Continente, and in SWF there is a team that is constant monitoring the provisioning of the stores in order to make sure that no out-of-normal orders are made by the franchisees and that there is no shortage of stock in the stores. Off course that the stocking of the store ultimately will depend in the franchisee's willing to buy new merchandise, however SWF may advise him to do so. Also, the franchisee may benefit from synergies inside Sonae MC's structure. For instance, there is a whole division for Space layout of Continente stores (isles position and dimensions, check-out points, products positioning inside the store, etc) and for every new Meu Super store, the layout is specifically designed according to the same criteria used in Continente stores. SWF also provides with marketing support to the stores in order for the clients to be able to attract more customers.

Other advantage that the store owners benefit when franchising a Meu Super store is the fact that they are able to buy Continente private label products. Continente developed several different lines of PL products, from a basic line to a gourmet line **(Exhibit 15)** and franchisees can order any of these products to sell in their stores, leveraging on Continente's PL's established reputation.

For the first time in Portugal PL products from a Portuguese retailer are being sold in the same country by a different retailer brand. Although Meu Super belongs to Sonae, customers are used to see PL products with the brand of the store as the brand of the product. Now, Continente's products are being sold outside of Continente stores. This may have great implication both to the development of PL's itself, as well as for the success of Meu Super. Besides the operational synergies that the new franchising chain may take advantage from Continente, it can also benefit from a range of PL products that reach almost 3000 SKU's in 6 different categories. Another advantage that Meu Super has in benefit from the Continente's PL products is to be able to benefit from the already existing loyalty to Continente's PL, which ultimately may reflect in store loyalty.

On the other hand, this may also represent a threat in the sense that Continente's PL products market value is not assured in the entire value chain (from the producer until the final customer) as it is with Continente Stores. However, with Continente products being sold in Meu Super stores the outcome for the final customers is, among other, the sense of trust in Meu Super as it is trusted by the leader in retail in Portugal with one of the most recognizable brands.

SWF's vision towards Meu Super is to become the biggest and better franchise network in grocery retail in Portugal and the division expects to have 300 Meu Super stores open in 2018, increasing the business volume in 88% when compared with 2013. In the beginning of September 2013 there are 50 stores open and the company expects to reach 80 stores by the end of the year, maintaining and average rate of one opening per week.

2.8. The Future: Is *Meu Super* a Sustainable Strategy to Keep Sonae MC's Growth?

While Mr. Carlos and its Meu Super store in Restelo were busy attending their new customers, the team at SWF offices was celebrating the 50th store opening. The opening of Meu Super Restelo marked a stepping stone for the company and represented an objective that was accomplished sooner than expected. The team at SWF was more motivated than ever to achieve the objective established for the year of 2013: To open 80 stores until the end of December.

Having presented both the grocery retail industry tendency as well as the strategy adopted by Sonae MC to adapt to these changes, there are several questions that arise.

First of all, is proximity approach like Meu Super Initiative enough or should it be complemented by an effort to develop the online platforms as well as create an effective CRM?

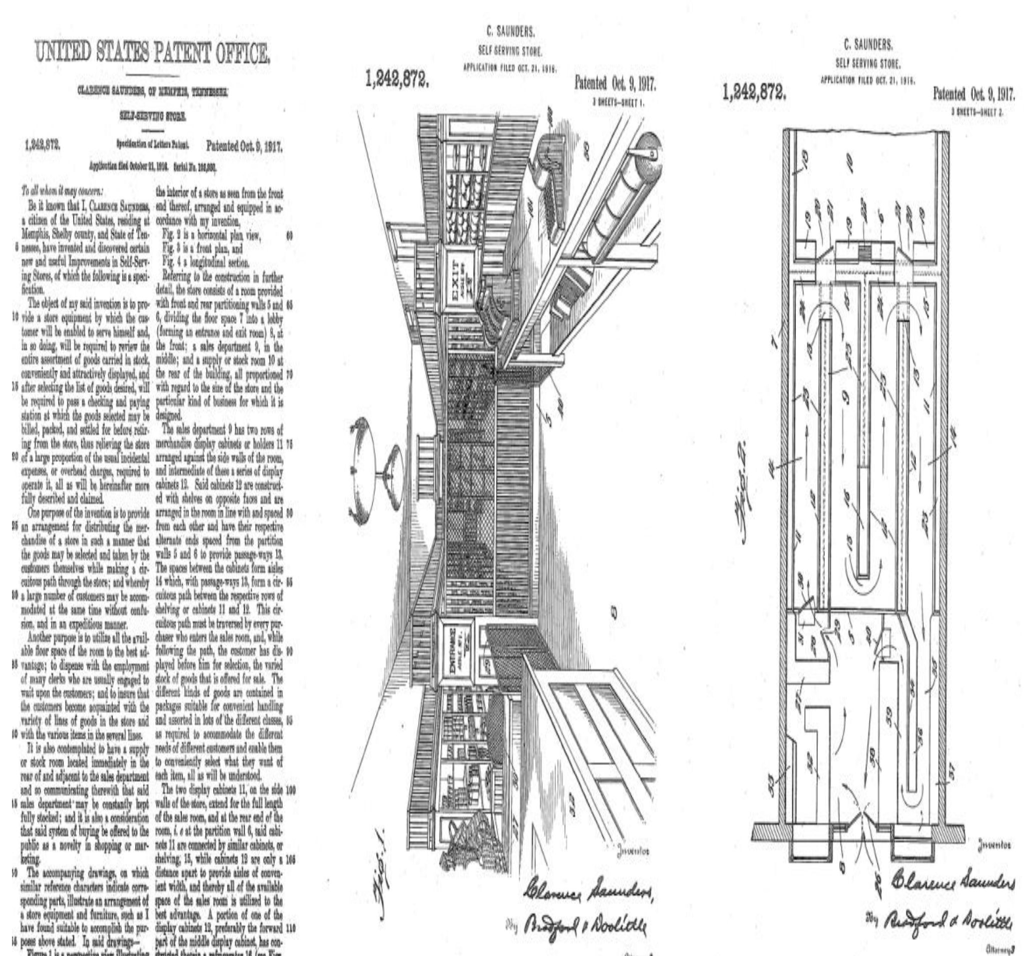
In a full-franchised model, how can Sonae manage an efficient CRM system when the connection between the final consumer and the company itself, is the franchisee that is independent of Sonae?

Regarding the management of the new stores, there are several options that could be explored. Should the stores be owned and operated by a third party or can the stores be owned by Sonae, but operated by an independent entity? Dia group developed the FOFO/COFO/COCO **(Exhibit 17)** framework which is a model that combines both full operated and owned by the group stores, full owned by the group stores but operated by a franchisee, and full-franchised stores (owned and operated). Will Sonae be able to sustain its full-franchised model, or should the company develop shared ownership of the stores like Dia Group?

Finally, regarding the logistic operations of the new stores, Sonae can use the already existing structures of distributions to all Continente stores benefiting from possible synergies, or create a new distribution structure for its new stores. Continente has two main hubs in Portugal, located in Maia (close to Oporto) and other in Azambuja (center of Portugal) and one of the most sophisticated distribution systems in Portugal. However, logistics are set to supply Continente stores in their already existing formats and to insert a new chain of small sized stores operated by an independent party can mean new adapting costs. On the other hand, in order to assemble a new distribution system specifically to the new brand can mean an even higher investment and a greater dependency on the amount of stores of the chain (in order to compensate).

With the variables shown, decisions have to be made. In one case or the other, Meu Super is already the most recent response to the changes in grocery retail in Portugal.

Exhibit 1 – First patent for a self service grocery retail store



UNITED STATES PATENT OFFICE.

CLARENCE SAUNDERS, OF MEMPHIS, TENNESSEE.

SELF-SERVING STORE.

1,242,872. Specification of Letters Patent. Patented Oct. 9, 1917.

Application filed October 21, 1916. Serial No. [illegible]

To all whom it may concern:

Be it known that I, CLARENCE SAUNDERS, a citizen of the United States, residing at Memphis, Shelby county, and State of Tennessee, have invented and discovered certain new and useful Improvements in Self-Serving Stores, of which the following is a specification.

The object of my said invention is to provide a store equipment by which the customer will be enabled to serve himself and, in so doing, will be required to review the entire assortment of goods carried in stock, conveniently and attractively displayed, and after selecting the list of goods desired, will be required to pass a checking and paying station at which the goods selected may be billed, packed, and settled for before retiring from the store, thus relieving the store of a large proportion of the usual incidental expenses, or overhead charges, required to operate it, all as will be hereinafter more fully described and claimed.

One purpose of the invention is to provide an arrangement for distributing the merchandise of a store in such a manner that the goods may be selected and taken by the customers themselves while making a circuitous path through the store; and whereby a large number of customers may be accommodated at the same time without confusion, and in an expeditious manner.

Another purpose is to utilize all the available floor space of the room to the best advantage; to dispense with the employment of many clerks who are usually engaged to wait upon the customers; and to insure that the customers become acquainted with the variety of lines of goods in the store and with the various items in the several lines.

It is also contemplated to have a supply or stock room located immediately in the rear of and adjacent to the sales department and so communicating therewith that said sales department may be constantly kept fully stocked; and it is also a consideration that said system of buying be offered to the public as a novelty in shopping or marketing.

The accompanying drawings, on which similar reference characters indicate corresponding parts, illustrate an arrangement of a store equipment and furniture, such as I have found suitable to accomplish the purpose above stated. In said drawings—

Figure 1 is a perspective view illustrating the interior of a store as seen from the front end thereof, arranged and equipped in accordance with my invention,

Fig. 2 is a horizontal plan view,

Fig. 3 is a front plan, and

Fig. 4 a longitudinal section.

Referring to the construction in further detail, the store consists of a room provided with front and rear partitioning walls 5 and 6, dividing the floor space 7 into a lobby (forming an entrance and exit room) 8, at the front; a sales department 9, in the middle; and a supply or stock room 10 at the rear of the building, all proportioned with regard to the size of the store and the particular kind of business for which it is designed.

The sales department 9 has two rows of merchandise display cabinets or holders 11 arranged against the side walls of the room, and intermediate of these a series of display cabinets 12. Said cabinets 12 are constructed with shelves on opposite faces and are arranged in the room in line with and spaced from each other and have their respective alternate ends spaced from the partition walls 5 and 6 to provide passage-ways 13. The spaces between the cabinets form aisles 14 which, with passage-ways 13, form a circuitous path between the respective rows of shelving or cabinets 11 and 12. This circuitous path must be traversed by every purchaser who enters the sales room, and, while following the path, the customer has displayed before him for selection, the varied stock of goods that is offered for sale. The different kinds of goods are contained in packages suitable for convenient handling and assorted in lots of the different classes, as required to accommodate the different needs of different customers and enable them to conveniently select what they want of each item, all as will be understood.

The two display cabinets 11, on the side walls of the store, extend for the full length of the sales room, and at the rear end of the room, *i. e* at the partition wall 6, said cabinets 11 are connected by similar cabinets, or shelving, 15, while cabinets 12 are only a distance apart to provide aisles of convenient width, and thereby all of the available space of the sales room is utilized to the best advantage. A portion of one of the display cabinets 12, preferably the forward part of the middle display cabinet, has constructed therein a refrigerator 16 (see Fig.

Exhibit 2 – Definition: Hyper, Super and Mini formats

Hypermarket: With business models focusing typically in high volumes and low margins, a Hypermarket typically covers a space between 14,000m2 and 25,000m2 and its supports almost 9.000 SKU's. Usually hypermarkets are often located in suburban areas due to their large footprints.

Supermarket: Slightly smellers than Hypermarkets, supermarkets are actually the most common grocery retail stores. With an area typically from the 150m2 to 600m2, supermarkets have less SKU's than hypermarkets and due to its area they may be located in more residential areas and city centers. However like Hypermarkets, Supermarkets are also characterized by having their own parking lot spaces and are prepared to supply to their customers almost every category

Mini Formats: Smaller formats of grocery stores are in general stores with areas no bigger than 200m2 and are usually located in residential areas. With a smaller range of SKU's offer, mini formats' concept are often designated as convenience stores as it offers products for the everyday use. The main focus of product offering in these formats is usually in the food-segment with special importance for perishable products.

Exhibit 3 – Belmiro de Azevedo's short Bio

Birth: February 17, 1938 in Marco de Canavesses, Portugal

Son of a carpenter father and a seamstress mother, Belmiro de Azevedo is the oldest of 8 brothers.

In 1964 graduates in Chemical Engineering from Porto University and in 1965 is hired to Sonae by Afonso Pinto de Magalhães to integrate the company. After taking the leadership in Sonae, Belmiro de Azevedo goes to the U.S. to get an MBA from Harvard in 1975. In 2007 Azevedo becomes the chairman of Sonae and his son Paulo Azevedo becomes executive president.

Friend and admirer of Jack Welch, former CEO and chairman of GE group, Azevedo's vision for Sonae is much inspired in the multi-business strategy taken by Welch with GE.

Source: "O Homem Sonae – A Gestão segundo Belmiro de Azevedo" by Felipe Fernandes

Exhibit 4 – Sonae's Composition

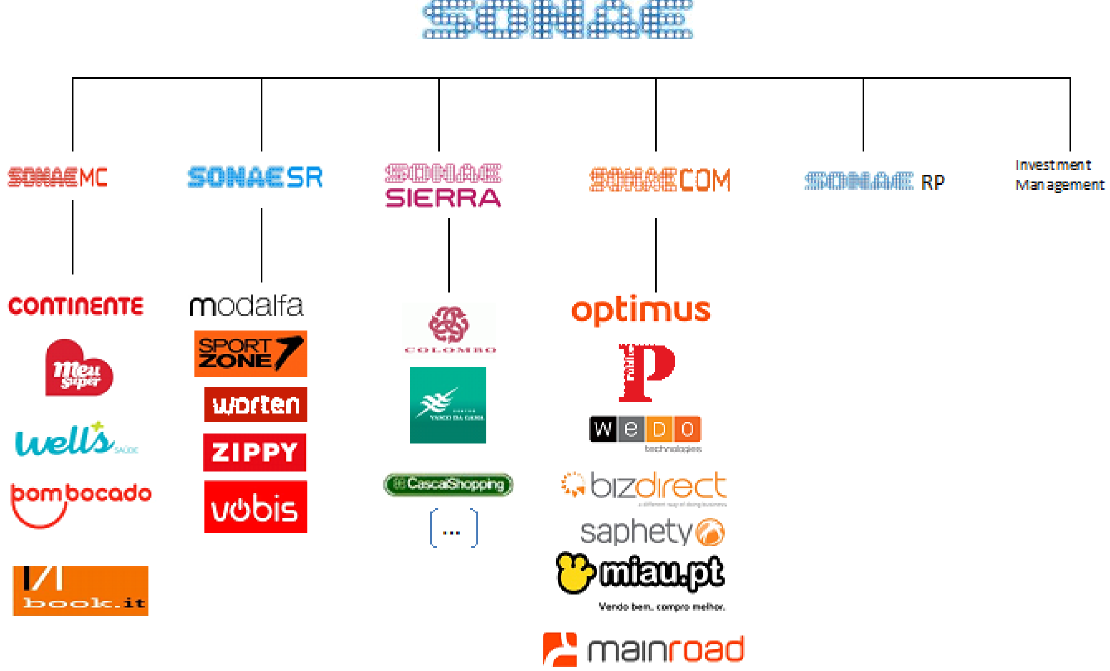
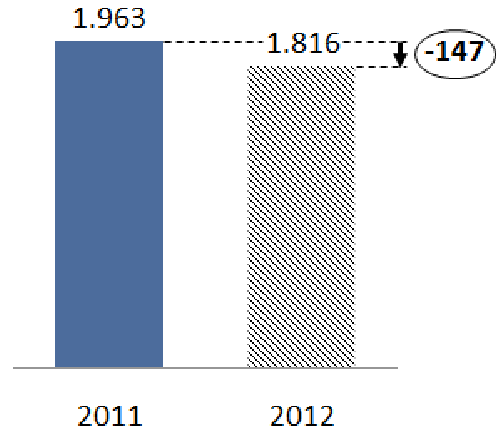
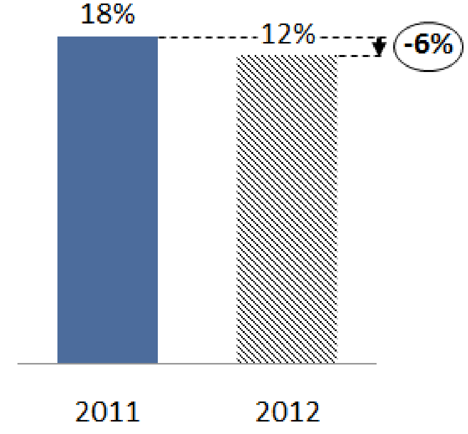


Exhibit 5 – Sonae's Debt Level 2012





Source: Sonae 2012 Financial Results

Exhibit 6 – Continente Formats

CONTINENTE

- Traditional Hypermarket
- Average surface of 9.000 m2
- More than 70.000 references
- 39 stores in Portugal

- Supermarket Ensign
- Average surface of 2.000 m2
- 113 stores in Portugal

CONTINENTE
bom dia

- Proximity Supermarkets
- Average surface of 800 m2
- 32 stores in Portugal

Exhibit 7 – GDP Growth Rate, Private Consumption Growth Rate and Unemployment Rate in Portugal, 2008-2013 (estimate)

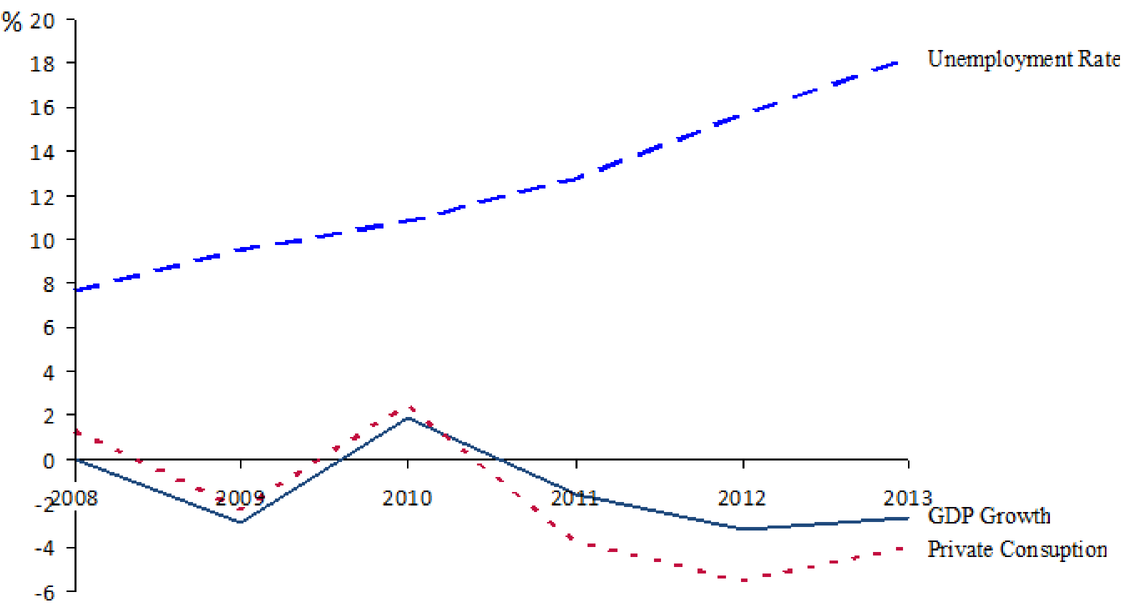


Exhibit 8 – Decrease in Volume of FMGC Consumption

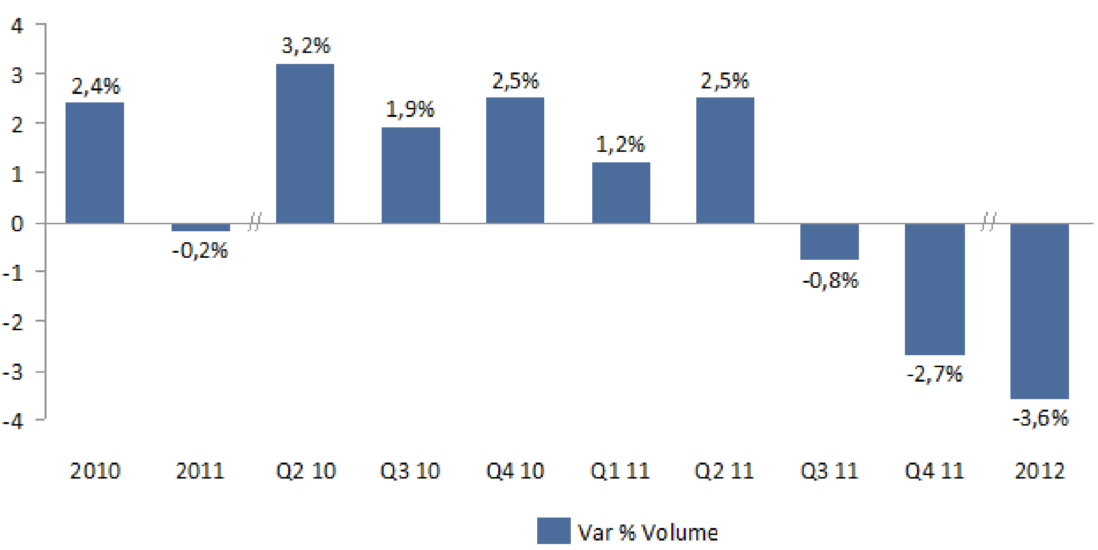


Exhibit 9 – Value vs. Volume in FMCG Consumption 2012

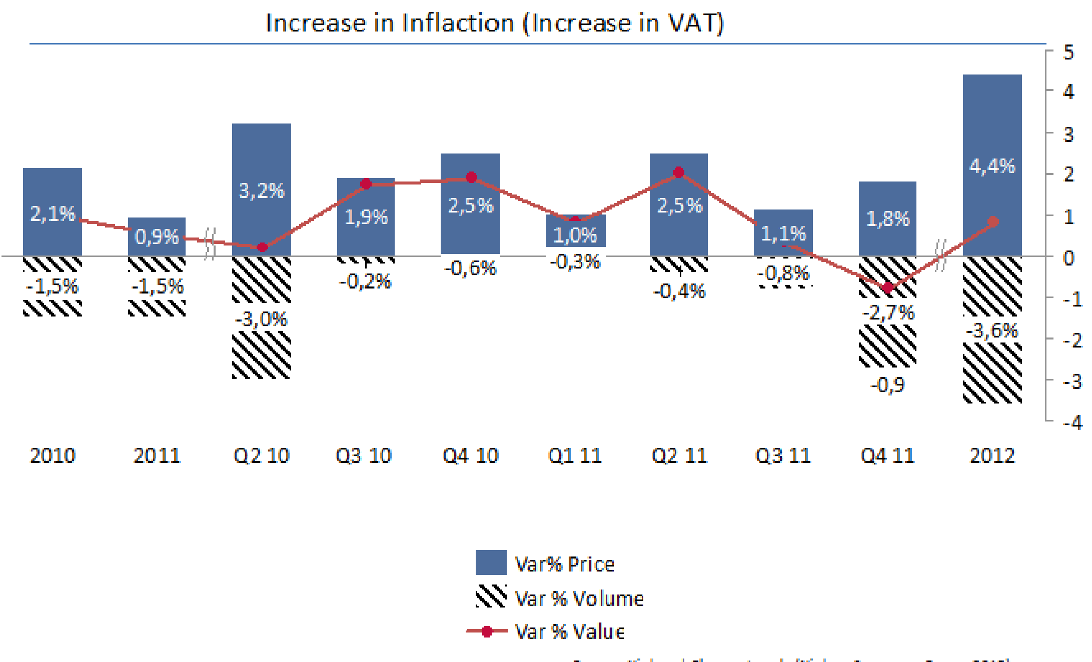


Exhibit 10 – The Promotion Effect on the Shopper

Promotions rarely influence the choice for a brand
Only shop in promotion when like the brand
Usualy buy different brands due to promotions
Rarely change store brand, but always look for promotions
Change store according to the store with better promotion

Source: Nielsen | Shoppertrends (Nielsen Consumer Forum 2013)

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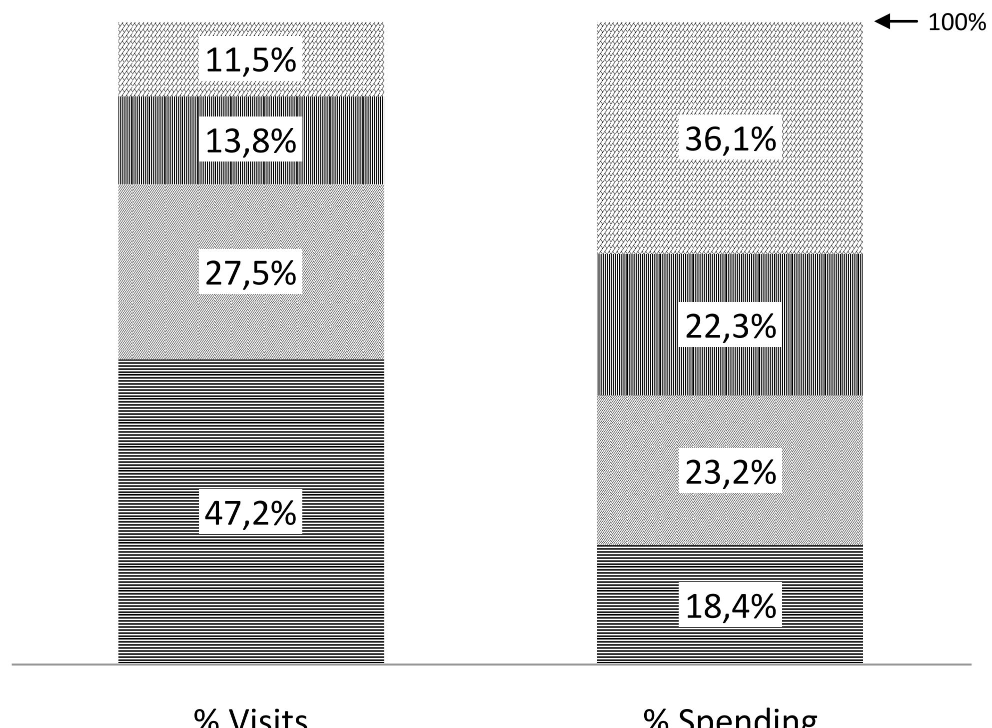
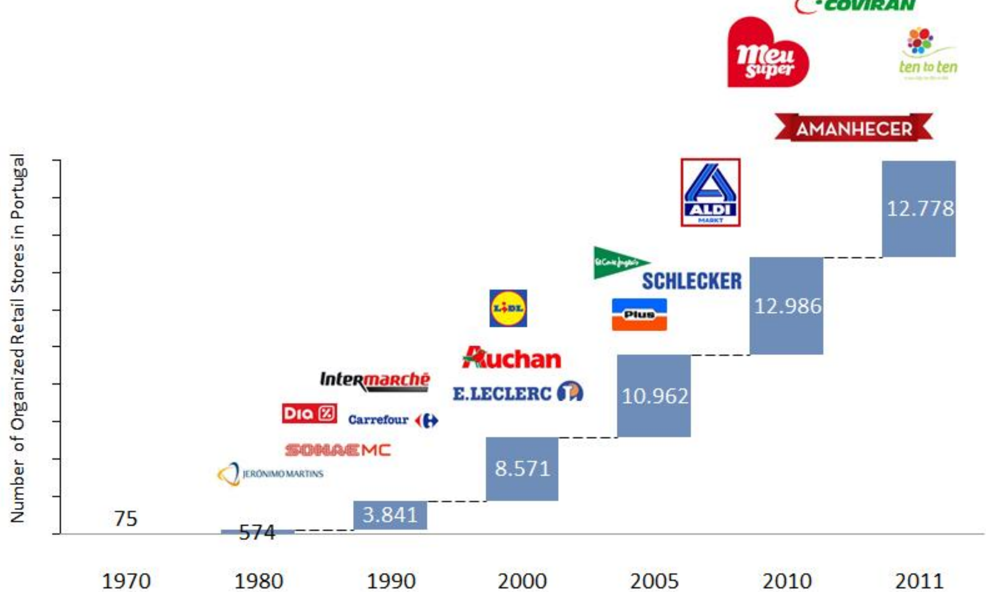
Exhibit 11 – Variation of number of Visits and Variation of Spending per Visit



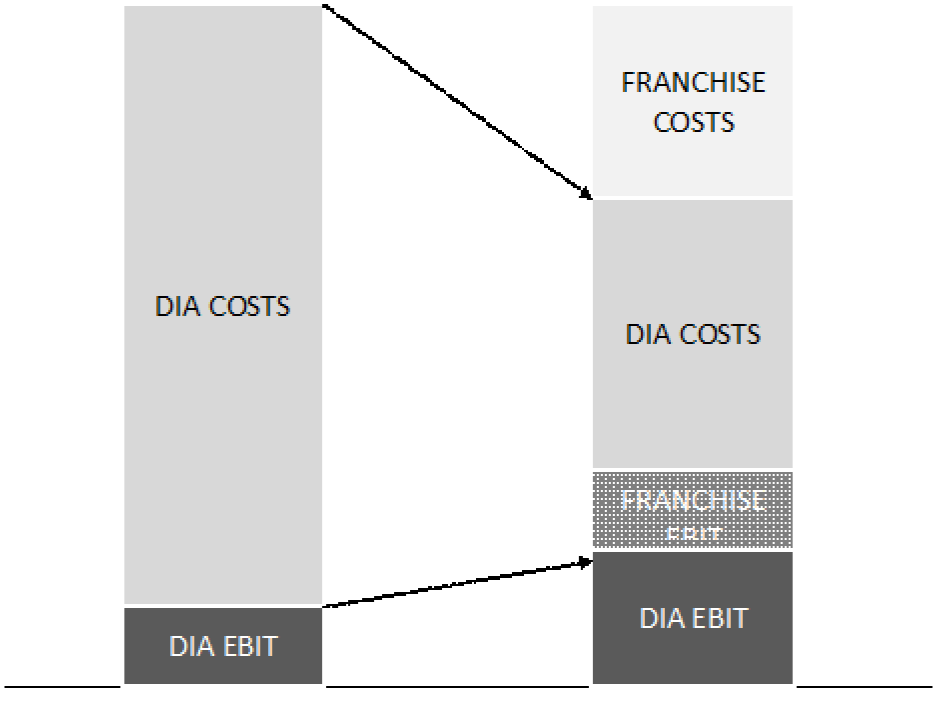
Source: Nielsen | Shoppertrends (Nielsen Consumer Forum 2013)

Exhibit 12 – New Players in the Market



Source: Nielsen | Recenseamento (Nielsen Consumer Forum 2013)

Exhibit 13 – Dia Group’s EBIT with fully-owned and franchised stores



Source: Dia Group Company Presentation, 2012

Exhibit 14 – Discriminated Values of Investment in a new Mew Super store sorted by categories (approximated values)

Investment Areas	Expected Investment (simulation for 200m2)	% of Total Investment (simulation for 200m2)
Cívil Construction	20.000 €	13%
Equipment	50.000 €	31%
Filling	45.000 €	28%
Warranty	45.000 €	28%
Total	**160.000 €**	**100%**

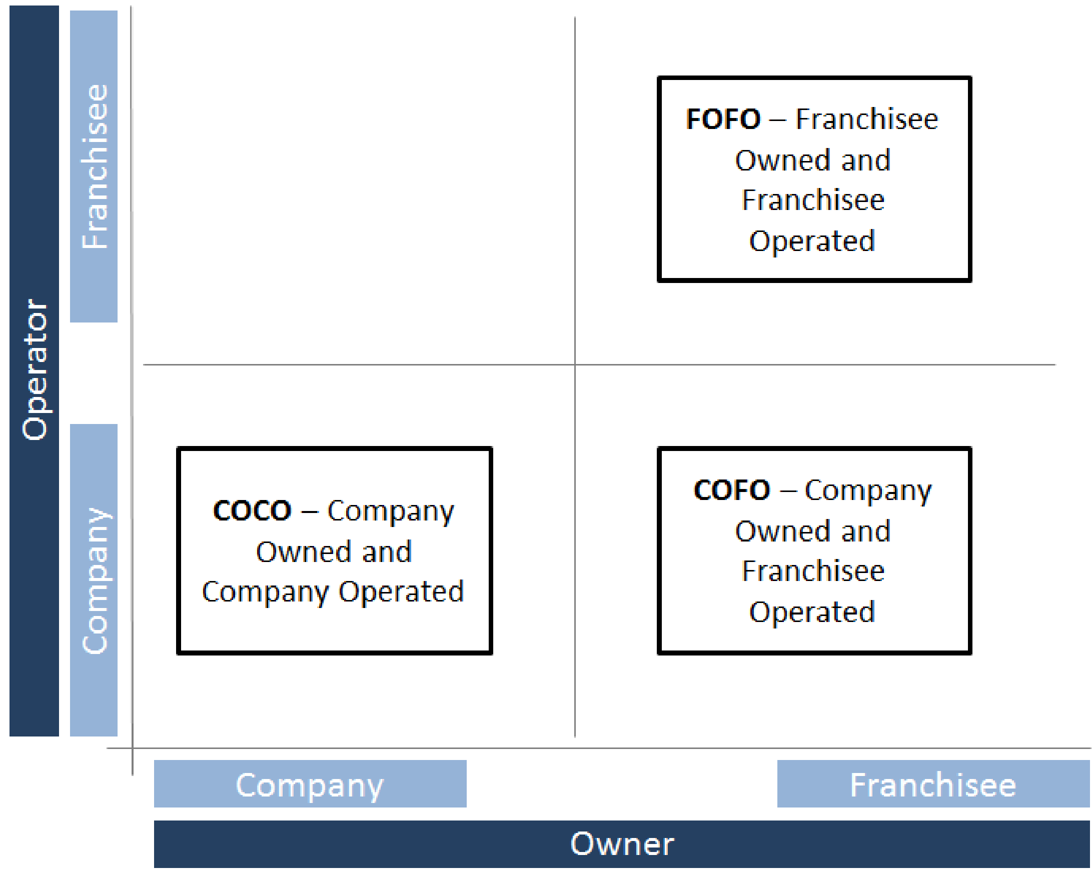
Exhibit 15 – Continente Private Label Lines

PL Brand	Description
CONTINENTE	-The most basic line of products -Aim to the lowest price-tear -Low product innovation -Value-for-money
	-The most diversificated line of PL products from Sonae -Aim to medium-low price tears -Medium product Innovation - Products in 9 different segments:
áreaviva CONTINENTE	-Range dedicated to specialized alimantary needs -High price-tear -High Product Innovation -Products in 9 different segments
CONTINENTE GOURMET	-Most differentiated line of products -Offering only in foods segment -High product innovation -High price-tear
SELECÇÃO CONTINENTE	- High differentiated line of perishable products -Selected products from the best suppliers -High price-tear

Exhibit 16 – Carrefour Franchised Models

	- **Área: 300m2 a 900m2** -**Turnover**: 2M€ a 8M€ -**Turnover/m2**: 4500€ a 8000€ -**Average Basket:** 15€ a 28€ -**Nº Clients p/ day**: 300 a 800 -**Nº Employees**: 6 a 20 -**Initial Investment**: >150K€		-**Área: 400m2 a 900m2** -**Turnover**: 2M€ A 4M€ -**Turnover/m2**: 5000€ -**Average Basket:** 11.50€ A 20€ -**Nº Clients p/ day**: N.D. -**Nº Employees**: 5 A 20 -**Initial Investment**: >100K€
	-**Área: 200m2 a 900m2** -**Turnover**: 2M€ A 10 M€ -**Turnover/m2**: 6000€ A 18000€ -**Average Basket: 7€ A 15€** -**Nº Clients p/ day**: 700 A 1200 -**Nº Employees**: 6 A 25 -**Initial Investment**: >150K		-**Área: 70m2 a 400m2** -**Turnover**: 0,6M€ A 1,8M€ -**Turnover/m2**: 4200€ -**Average Basket:** 6€ A 15€ -**Nº Clients p/ day**: N.D. -**NºEemployees**: 2 A 7 -**Initial Investment**: > 50K€
	-**Área: 90m2 a 300m2** -**Turnover**: > 900K€ -**Turnover/m2**: >4500€ -**Average Basket: 7€ A 15€** -**Nº Clients p/ day**: 300 A 800 -**Nº Employees**: 3 A 6 -**Initial Investment**: (>100K€ a confirmar)		-**Área: 200m2 a 400m2** -**Turnover**: 1,5M€ A 3,8M€ -**Turnover/m2**:6900€ -**Average Basket:** >8.5€ -**Nº Clients p/ day**: N.D -**Nº Employees**: 5 A 12 -**Initial Investment**: >100K
	-**Área: 200m2 a 450m2** -**Turnover**: 1,5 M€ A 4,5M€ (aberto de 7 a 12 meses) -**Turnover/m2**: 6000€ A 14000€ -**Average Basket**: 15€ A 20€ -**Nº Clients p/ day**: 600 A 1200 -**Nº Employees**: 6 A 15 -**Initial Investment**: (>100K€ a confirmar)		-**Área: 60m2 a 250m2** -**Turnover**: 250K€ A 750K€ -**Turnover/m2**:3225 € -**Average Basket: N.D.** -**Nº Clients p/ day**: N.D. -**Nº Employees**: N.D. -**Initial Investment**: >50K€ (a confirmar)

Exhibit 17 – Dia Group's Franchise Models



Source: DIA Group Corporate Presentation

Exhibit 18 – Proximity Grocery Stores: Examples of Meu Super, Minipreço and Amanhecer stores

Meu Super

Minipreço

Amanhecer

3. Literature Review

The purpose of the next section is a theoretical contextualization of the topics covered by the new proximity business of Sonae that is described in the previous chapters.

This section is divided into three sub-sections that represent the three main subjects of interest related to a franchising business such as Meu Super. The first subject regards Growth strategies that companies can adopt to expand. On this topic we focus on Organic or internal growth and external growth, displaying the different types of each that are relevant. At the end of this sub-section, a small discussion over the best way of a company to expand is presented. The second subsection is related to Branding and the most relevant topics regarding this subject for the purpose of this thesis. Finally we end the section of the Literature Review with the introduction of some Private Label related concepts.

This section is based on evidence shown in previous literature that is considered relevant for the purpose of this study.

3.1. Growth Strategies

There are two main routes for a company to grow:

Organic Growth or Internal Growth - a strategy or combination of strategies that leverage the company internal resources and capabilities to grow in a autonomous and independent way and; External Growth - a set of different ways for a company to grow that demand the interaction with other companies or agents in the market (Matos and Rodrigues, 2000).

In this section we will describe in more detail each of these strategies, offering at the end an overview of the conflicts that arise among these two strategies.

3.1.1. Organic growth

First it is important to present a clear definition of organic or internal growth: A firm may grow internally from its own resources, and whether it is because it is doing better than its own competitors or whether it is because the market is growing, it is considered organic growth (Kourdi, 2003). In addition, companies may decide to organically grow vertically in the value chain and use internal resources for instance to expand their

production capacity by building a new factory and therefore secure the standards of their production outputs instead of outsource these services (Fesser and Willard, 1990).

Organic growth can be vital for an organization but it can also be very difficult to achieve, especially in mature industries where the annual growth rate of companies is confined to a single digit growth (Meer, 2005). According to David Meer (2005) organic growth among firms can be a difficult task due to lack of understanding of what is the driver that connects "customer value" with the price paid. However, firms that are able to achieve organic growth faster than their competitors understand that in order to achieve a healthy internal growth, they have to shape the organization from the inside out, create a supportive culture for growth, enhance their internal capabilities and approach growth in a very disciplined way (Irvin, Pedro and Gennaro, 2003; Meer, 2005).

However, internal capabilities that could boost organic growth might slowly fade in the course of a company's operation, as a result of a constant search for cheaper ways to develop the same capability often resulting in the extinction of it (Dawson, 2005). On the other hand, internal growth itself in the form of new business development, like a new product release or a new brand development with a difficult-to-imitate strategy may represent a turning point to companies that are failing to meet the market expectations (Morrow, Sirmon, Hitt and Holcomb, 2007).

Generating new revenue flows to the company using already existing resources should have a positive impact in the profits of the firm since it can avoid the costs of acquiring new resources (Alchaim and Demstez, 1972).

3.1.2. External Growth

Alternatively a strategy of Organic Growth, a company may choose to grow externally. There are three main routes for external growth of a company that are analyzed: Growth through Mergers and Acquisitions, growth through Joint Ventures and Strategic Alliances and growth through Franchising. Each of these strategies is presented next.

3.1.2.1. Mergers and Acquisitions

The concept of M&A (Merger and Acquisition) is applied to the cases where two companies of relatively the same size, that before were working separately, are now

merged in a single company or in cases where a company acquires the majority of other company's ownership (Matos and Rodrigues, 2000; Hagedoorn Duysters, 2002). Mergers and Acquisitions can be a set of market activities in which two or more independently operating companies, come under the same leadership structure (Scherer and Ross, 1990).

Previous literature show that there is a set of main goals for managers to engage in M&A activities, such as obtaining market power (Ellert, 1976), dominance over competitors with for instance operating synergies (Mandelker 1974) or efficiency (Eckbo, 1986). Walker and Barney (1990) break down these goals, supported by previous research (e.g. Kitching, 1967; Howel, 1970; Steiner, 1975) into a list of 20 common objectives for managers to engage in M&A and group them by relevance according to the following types of M&A activities (Walker and Barney, 1990; Matos and Rodrigues 2000): (1)Vertical mergers, which occurs when a buyer-seller relationship exists; (2)Horizontal mergers, which are mergers between firms with similar dimensions that can operate in the same or different markets; (3)Concentric mergers, which are mergers with very similar production or distributed technologies and; (4)Conglomerate mergers, which are mergers between firms with no buyer-seller relationship, no similarities in terms of production and no relationship in terms of markets.

In a cultural and managerial point of view, Mergers and Acquisitions may represent a complex process for companies to integrate among each other (Nahavandi and Malekzadeh, 1988). Shirvastava (1986) developed a framework that combines three main focus points - Procedural, Physical and Managerial, with three types of activities - Coordination, Control and Conflict resolution that managers should have in consideration in the post merger period. However, according to Larsson and Finkelstein (1999) a successful M&A operation can be measured not only by the results generated by the new incumbent form, but mostly by the synergy realization originated by the merger.

In previous literature were identified five main drivers for acquisitions (Damodaran, 2001):

1. The motivation to acquire a firm that is undervalued in the financial markets;

2. Diversification and reduction of risk-exposure by the investor to a firm specific risk;
3. The creation of synergies that can result in increase of operating income, growth of the acquiring company or even both;
4. Willing to acquire a high potential firm that is showing signals of poor management;
5. Managerial self-interest, and in this case there are many different kinds of reasoning that may be considered like simply to reduce competition or to show company's power.

3.1.2.2. Joint Ventures / Strategic Alliances

An alliance or partnership is often defined as a relationship between more than one entity that pursues common goals while all parts of the partnership remain independent (Kumar, 2012). Although Kumar considers a Joint Venture as a type of alliance, Harrigan (1996) goes further and defines a Joint Venture as a strategic alliance that generate a separate entity as an independent organization and excludes partnerships where a minority investment is made that does not create a separate entity from the participant firms.

Joint Ventures and Alliances in general are an increasing trend in international businesses as customers are growing their concern for maximizing the value for their money and therefore decreasing their nationalist preferences (Kenichi, 1989). Additionally, through Joint Ventures firms can complement weaknesses, maximize strengths and fill a gap in their value chain, as well as take advantage of new opportunities for them to penetrate in new markets (Kumar, 2012). David and Tammy (2005) found that using alliances to leverage a company's strength instead of hiding a weakness might create a successful alliance and a more efficient strategy.

Kumar (2012) develops a framework where it is exposed that collaborative strategy is a synergy between the strategy of a business and the strategy of its partners to achieve the objectives of an alliance through collaboration. Kumar highlights Trust in the partnership as the main factor for the success of the relationship and Values, Vision,

Competency and Quantification of Benefits as interdependent variables for a healthy maintenance of the alliance between the participant firms.

Although an alliance or a joint venture may generate opportunities for organizations, an Accenture study (Roussel and Kalmbach, 1999) shows that approximately 80% of alliances fail. Changes in the market structure, inexperience of a partner and flaw on the evaluation by the other partner, poor trust and lower than expected competency for executing a task by one of the partners are some of the reasons pointed as responsible for failure of alliances and joint ventures (Kumar, 2012).

3.1.2.3. Franchising

A franchising relationship is seen as a partnership where the franchisor sells to a franchisee the rights of using its trade name, operating systems and product specification in a specific agreed period of time or region (Justis and Judd, 1998).

Franchising poses as an attractive way for companies to grow without putting at risk a big amount of financial resources (Combs and Ketchen, 2003). Additionally, franchising strategies create opportunities for several entrepreneurs to start business in a shared-risk model where they can adopt an already existing (and more often than not) known trade-mark and benefit from its brand equity while becoming an important source of innovation and local engagement and penetration for master franchisors (Kaufmann and Eroglu, 1998).

However, when conducting in a franchise partnership, a firm is allowing small entrepreneurs to represent the company as if they organically belong at the eyes of the final consumer, and the trade-off is usually a small percentage of the outlet revenues (Combs and Ketchen, 2003). This imposes a considerable risk for the franchisor and the interest of firms that embark in franchising has been often subject of investigation in previous research (e.g. Fong, 1987; Eisnenhart, 1989). However little consensus has been gathered by authors weather franchising is preferable for big or small firms (Roh, 2001; Alon 2001) and the reasons that lead companies to embark on franchising (Combs and Ketchen, 1999a). It is true that franchising reduces the monitoring efforts by the franchisor in the sense that it is assumed that in most cases it is of the interest of the franchisee to make substantial investments in the outlet (Norton, 1988), however it is also true that there is a decreased power over the outlet by the firm and an increased

power by the franchisee which in some cases may turn against the franchisor (Eisenhardt, 1989). Brikley and Dark (1987) refer that specially in the retail industry, the risk of the franchisee over-emphasize cost reduction in its own outlet may jeopardize the quality of the service or product offered which ultimately will reflect on the chain, brand and firm’s reputation.

While some authors suggest that franchising can be a tool for firms who have scarcity of resources, others support that there is little evidence for this fact and that the use of franchising by firms is more (positively) related with the maturity of the company, than with the scarcity of its resources (Kombs and Ketchen, 2003). Nonetheless, it is consensual that capital scarcity may constitute one of the main motivations for companies to initiate a franchising strategy (Thomas, 1991; Dant, 1995) and some authors agree that the growth of the franchised firm trough this partnership model is directly related to shortage of resources (Kombs and Ketchen, 2003).

3.1.3. Conflicts Between Internal and External Growth Strategies

A firm’s growth is often constrained by the speed at which it can expand its managerial capacity” (Penrose, 1959). However, an interesting question that has led to some debate is if in comparison with organic growth, external growth trough contractual agreements allow the firm to overcome its managerial limits and support a healthy growth (Shane, 1996).

In previous literature there were appointed several arguments in favor of internal growth, like the enhancement and maximization of internal capabilities and therefore saving in costs (Meer, 2005), maintenance of total control over the new expanded structure (Combs and Ketchen, 2003) and autonomy from agents outside the company’s scope are among them (Matos and Rodrigues, 2000). However, for companies with scarcity in resources or that are operating in mature markets, organic growth may represent a difficult challenge to achieve (Meer, 2005).

On the other hand, there are several advantages for companies who face growth using external strategies. Mergers and Acquisitions reduce competition and increase concentration in the market, which in the perspective of a firm can be an advantage to increase control over prices (Matos and Rodrigues, 2000). Joint ventures or Strategic Alliances may generate synergies between two independent companies (Kumar 2012),

however there is a very low rate of success for such agreements due to structural and idealistic differences between the parts of the agreement (Roussel and Kalmbach, 1999). Franchising is especially interesting for companies operating in a retail business as it allows a firm to grow and expand its outlet network with little financial efforts (Combs and Ketchen, 2003). However according to agency theory, the decreased power over the outlets by the firm and increased power for the franchisee may jeopardize the company's reputation and brand image (Birkley and Dark, 1987).

Therefore it is critical to understand the different characteristics of each firm in order to evaluate which is the better option for growth. Complementing an evaluation of the firms attributes, resources and competencies, it is also important to look at the market and search for opportunities, market growth rate and market expectations (Matos and Rodrigues, 2000; Morrow, Sirmon, Hitt and Holcomb, 2007).

3.2. The Importance of Branding

A brand's name is one of the most important characteristics of a product since it is the first message of the company to reach the market as it signals the often intangible aspects of the product (according to Park, Jun and Shocker, 1996). Without the brand, consumers would have to learn the different features of the brand only through experience with the product itself. A brand of a product works as the first opportunity that a company has to impress its final customers and firms are making several efforts to leverage this opportunity.

In the next section we will focus on some of the most relevant brand related topics and with the value that a brand adds to a product or service. Starting with Brand Equity a display of previous literature on ways to evaluate a brand is presented. We also introduce the concept of Brand Extensions and the Concept of Umbrella Branding. Finally a brief introduction of Co-Branding is presented.

3.2.1. Brand Equity

Keller (1992) explains that Brand Equity is, in a general overview, the marketing effects on a product that occur due to its brand and that would not occur in the same product or service if it had another label. In the same study Keller (1992) refers that there are two main reasons to explore brand equity: to understand the brand valuation, which is a more

financial approach to find a more accurate accounting value, and to improve the marketing productivity of a brand (Keller, 1992; Ailawdi, Lehmann and Neslin, 2003).

Accordingly, Ailawadi, Lehmann and Neslin (2003) add that there are two levels for measuring the effects that a brand may have: consumer-level, which is traduced in consumers' attitudes towards the brand, awareness, image and knowledge and firm-level which is explained by price, market-share, revenues and cash-flow.

From a financial point of view, strong brand equity may revert in a positive valuation for the company. This may be explained by the intangibility of the brand, being one of the most important assets for the company, the brand is ultimately the asset that customers will have more contact with (Rego, Billet and Morgan, 2009).

Branding can be especially important in the retail industry, as sorting reference of consumer preference and driver of store loyalty (Ailawadi and Keller, 2004). Most retailers offer private label products, which is to say that they take advantage of their already existing brand to place consumer products in the market under that label (Hoch and Banerji, 1993). Therefore it is safe to say that in the context of retailing, a private-label product may contribute to increase or decrease the retailer's brand, which ultimately leads to a variation in the retailer's brand equity (Steenkamp and Dekimpe, 1997).

Besides being sorting references among other brands, a successful brand can also leverage a new product in the market that is using an extension of the already existing brand. The synergies associated with brand extensions are explained in the next section.

3.2.2. Brand Extensions

As discussed before, brands are the most real and valuable intangible assets for a company and in most cases they are the primary factor of consumer's choice for a specific product (Rego, Billet and Morgan, 2009) therefore to leverage the equity of a successful brand in order to penetrate new markets or segments can be a very attractive strategy (Aaker, 2012). One possible strategy is to follow a brand extension strategy. In this case the same brand will be used different products or categories. Continente uses its brand to very different types of products, and created sub-brands for specific lines, like Continente Gourmet for high-end products or Continente Área Viva for health related

food products. Zara leveraged the already known Zara brand for its household products which it named Zara Home.

Although Riel and colleagues (2000) argued that consumers react differently to brand extensions for service and non-service brands, Hem, Chernatony and Iversen (2003) demonstrated that it does not have to be strictly the case and that brand extensions for a successful brand can leverage the new brand of product or service. However the authors concluded that for service brands, perceive similarities between the services of the same brand are a crucial factor for success, however the reputation of the parent brand is one of the most important variables for the success of the new brand introduction. If positive it can leverage the new brand, but if negative it can have a negative impact in the new product or service introduction (Hem, Chernatony and Iversen, 2003).

There is also another way for new products in the market to benefit from success of the already existing and successful brands of the company. Even if a company is intending to launch a product that is from a different segment of the already existing lines, it can take advantage of the perceived reliability of the existing brand to led consumer to perceive the new product under the same umbrella brand as equally reliable.

3.2.3. Umbrella Branding

When a multi-product firm with an already established brand and high brand equity launches new products or services, it can release them under the same umbrella brand, as a form of brand extension and thus reducing customer uncertainty about the quality of the new introduction: if the already existing umbrella brand is perceived as a reliable brand, the brands under it will benefit from its “spill-over” effect (Wernerfelt 1988; Montgomery and Wernefelt 1993).

Wernerfelt (1988) developed a signaling theory for brand extensions where it pointed two main premises of consumer behavior towards new products: (1) there is always consumer uncertainty about the new product or service and (2) the extension of a high-quality brand will generate a high-quality product or service as well (resulting from variations of the customer uncertainty). Erdem (1999) builds on this theory and argues that although consumers expect a matching quality of the brand extension to the quality of the already known products of the parent brand, they will also update their expectations according to their experience in the category. Therefore, if the quality of

the brand extension does not match consumer expectations and may even affect the parent brand. A strong parent brand is not enough to ensure the success of the new product.

There are however several studies that point multiple positive effects generated by umbrella branding. For instance, the advertising of an umbrella brand may increase the awareness of all the brands under it (Aaker 1991), and may strengthen both the umbrella brand images, as well as the sub-brand image (Keller 1993). Also, Erdem and Sun (2002) conclude that umbrella branding may generate savings in marketing costs and brand development as there is a spillover effect from the parent brand investments to its associated sub-brands. The authors suggest integrated marketing communications across products that share the same brand name.

3.2.4. Co-Branding

Co-Branding can be defined as a strategy often used to launch new products in the market that consists in pairing two products (or services) from different and independent brands, into one unique product that creates a composite brand (co-brand) (Park, Jun and Shocker, 1996).

Washburn, Till and Priluck (2000) identify four main types of co-branding: (1) Joint Promotions, which can be explained by the motivation by one or more companies involved in improve their market positions (e.g. McDonald's and Disney); (2) joint advertising, which as the name says is a technique where two or more companies advertise together or display features of products of other companies in their advertisement initiatives (Grossman, 1997); (3) promotion of complementarities, which may happen when for instance two companies display the complementarity between the two products (e.g. Bacardi Rum and Coca-cola) (Rao and Reukert, 1994); (4) Physical product integration, which happens when two or more branded products are intrinsically connected with others (e.g. Audi and Harmann Kardon sound systems).

In the same study, the authors (Washburn Till and Priluck, 2000) discovered that co-branding can have a positive impact on the brand value of all constituent brands. Unlike the expected, even brands with high brand equity do not suffer from depreciation when paired with brands with low brand equity: both brands increase in positive perception by the final consumer. However, it was proven that low-equity brands benefit more from

the co-branding in any partnership that high equity brands, as they are taking advantage of a synergy between the partner brand. Nonetheless the authors argue that co-branding can be a “win-win” deal from the constituent brands.

3.3. Private Label

In the context of this study, a section of Private Label (PL) products is considered relevant due to two main factors:

1. One of the competitive advantages of the new Meu Super Chain is the fact that it will sell Continente PL products and therefore it can benefit from the already established success of this products

2. For the first time in Portugal, a PL product is being sold out of its parent store. In this case we find Continente’s products being sold in non-Continente stores, and being Continente a retailer instead a wholesaler, this is in fact a first-of-its kind action in Portugal

Therefore, in the next sections a short introduction on PL concept and impact will be presented in order to contextualize the strategy of Sonae in leveraging its already existing PL line to use it in non-Continente stores.

3.3.1. Concept

A PL product is a product that is sold under the retailer brand. By other words, a retailer may sell products with its brand (e.g. Continente products) or develop a new brand (e.g. Duchy by Waitrose). Traditionally in both cases the products are sold inside the retailer’s own stores, however that may not always be exclusive (PLMA International, 2013; Kumar and Steenkamp, 2007).

Private Label products are now competing with Manufacturer Brands in almost every segment of their positioning. According to Ailawadi and Keller (2004) the PL consumer is a price sensitive customer with a mid-level income and usually educated. Although it is a price sensitive customer, it is not image sensitive. Therefore, and because price sensitiveness is not the only factor that attracts customers to buy PL’s, Geiskens, Gielens and Gijsbrechts (2010) clustered the PL offering by today’s retailers into three segments: Economy PL’s, Standard PL’s and Premium PL’s where they argue that in the Premium

category, PL are very often perceived to have as much quality as the direct MB competitor and still being sold at a slightly lower price. Kumar and Steenkamp (2007) advance forward on this subject saying that premium PL products are the latest trend on retailer's brand development.

3.3.2. Impact of Private Label Products in the Market

Private Label products are the ultimate challenge for Manufacturer Brands (MB). An increase in market share for the first represents a direct trade-off in market share for the latter. In 2011 some retailers defend that PL market share in Europe amounted almost 40% (The Nielsen Company, 2011). In Portugal, the penetration level of PL products is estimated to be 44% (PLMA International, 2013).

As quality of PL products increase, disposable income decrease and spending awareness increase (in some European countries), manufacturers are left with very little arguments to fight back PL penetration. Resources such as product innovation, advertising or customer loyalty are the main arguments that manufacturers can use to retain the growth of PL products (Kumar and Steenkamp, 2007).

The first official PL product was introduced in the 1970's. The package communicated a no-thrills product and the strategy of its owner aimed to target the value-for-money category (Szymanowski, 2013). Today, PL evolved to directly compete with MB's in various price-tears, in a multitude of categories and targeting very different customers.

3.3.3. Impact of Private Labels on Store Concept

Before specifying if PL consumption is able to be a driver itself of the Store Concept, it is important to first analyze the impact that PL's have in store loyalty. Richardson and colleagues (1996) argue that PL products are able to help retailers to boost store traffic by offering products that customers cannot find in any other store. In fact, several authors share the opinion that there is a positive correlation between the use of store brand products and the loyalty of that store an argument that is supported by other authors (Corstjens and Lal's, 2000; Ailawadi, Neslin and Gedenk, 2001; Kumar and Steenkamp, 2007). However other authors indicate that even if consumers are loyal to PL products, they may not specifically be loyal to a store, as they are loyal to store branded products in general (Richardson, 1997).

Although Ailawadi, Pauwells and Steenkamp (2008) found that there are a positive correlation between the consumption of PL products and the customers' loyalty to their parent store, they also identified the risk of taking it too far. In other words, in the same sense that PL may contribute to increase store traffic, if retailers increase their PL offer up to a certain point, the outcome may be the opposite. This argument may be supported by Sainsbury, one of U.K.'s main retailers, example: Sainsbury had a PL share in its offer of PL that exceeded 60% which resulted in a perception by customers that a higher presence o PL in the shelves restricted customers' choice and ultimately reflected in a decrease of store traffic, as well as revenues and profitability. This phenomenon is also observed in the U.S. in big chains like Sears and A&P where PL programs were pushed too far.

The authors than conclude that regardless of the store concept, a the share of store branded products in the total offering of the store has to be weighted in order for the store itself become competitive and attractive to customers' choice (Ailawadi, Pauwells and Steenkamp, 2008).

3.4. Discussion

Althogh authors like Morrow and colleagues (2007) argue that internal or organic growth may be an essential part for a declining company's strategy for success, other authors argue that while difficult, external growth through one of its different forms may be a cheaper way for a company to achieve its managerial objectives (Matos and Rodrigues, 2000, Kumar 2012). In Sonae's strategy with Meu Super the company decided to expan through Franchising and while this form of growth may represent an attractive way for companies to expand with smaller risk (Combs and Ketchen, 2003) it does not avoid the possibility of high agency costs, which ultimately may negatively affect the parent company (Norton, 1988).

One of the main ways that franchising may affect the parent company is in its image, represented by its brand. Rego and colleagues (2009) argue that it is very important to keep a high brand valuation which can lead to high financial returns. Therefore, the use of the brand by the franchisee should deserve a special attention by the parent company.

The same principle is applied to the sale of PL products outside of the owner store. As PL's are able to create a good perception of the owner store by customers, they are also

able affect it negatively (Kumar and Steenkamp, 2007). While franchising may be a way for a company to expand at low risk, there are several threats that parent companies have to consider in order not to damage their brand.

4. Teaching Note

"Meu Super: Thinking Small to Stay Big"

4.1. Case Synopsis

The grocery retail industry has seen many changes in its history, especially regarding the consumer preferences for grocery store formats. Not only this industry has been changing but also changing fast: In the beginning of the 80's, hypermarkets were a fashionable concept and consumers valued a place where they could go in family and spend the whole afternoon purchasing monthly supplies for their households, however by the end of the last decade consumers start preferring smaller proximity formats with fewer SKU's and focus on fresh products where customers could go more than once per week and make smaller purchases.

"Meu Super – Thinking Small to Stay Big" Case Study discusses the strategy adopted by Sonae MC to tackle the changes in consumer preferences regarding the choice for grocery store formats. As the leader in grocery retail in Portugal with more 26,9% of market share with its Continente brand in different Hypermarket and Supermarket formats, the company is now facing a challenge: How can it grow more in an industry that apparently reached its maturity and where bigger formats are no longer capturing the preferences of their customers?

This case shortly describes the History of the grocery retail industry and points out its main happenings over the last century, introducing the latest trend in the Industry: the increasing preferences for proximity formats. The case also describes an overview of Sonae SGPS's history, the holding company of Sonae MC and introduces Sonae MC with its Continente brand.

The case focuses on the shift in the Industry for proximity grocery retail as it introduces the latest brand of proximity supermarkets: Meu Super. Within Meu Super section, several points of discussion are introduced. As a Franchising network, Meu Super is the strategy adopted by Sonae MC to meet customers' new demand for grocery retail at a low risk and low investment.

The case introduces the discussion between the strategy adopted by Sonae MC to face industry changes, but also explains other options that the company could explore to grow. The case balances organic or internal growth and external growth, displaying the options that the company would have in each. For instance the company could chose to use its already existing chain Continente Bom Dia and adapted it to proximity retail benefiting from synergies created by Continente brand instead of creating a new brand unknown to the public. Another option would be to acquire an already existing chain of proximity stores and an example of a possible candidate is shown in the case.

In this case there is also a benchmark analysis between the major competitors for Meu Super in the Portuguese market: Minipreço, Amanhecer and Spar. These competitors were chosen by its similarities to Meu Super Business Model and for its proliferation in the Portuguese market.

Finally the case introduces the challenges for Meu Super in the future as well as a discussion of whether or not Meu Super was the most suitable and sustainable strategy for a company like Sonae MC to keep growing in the Portuguese market.

Key Words: *Proximity, Grocery Retail, Franchising, Internal/Organic Growth, External Growth*

4.2. Topical Areas

This case is suitable for an undergraduate class, as well as for a Master or MBA and it can be used in Business Strategy and Corporate Strategy courses as well as Brand Management, Marketing and Consumer Behavior. This case is also suitable for any retail related courses and although it describes a specific situation in the Portuguese market, it can be used in an international Management course due to the low risk strategy used by Sonae to tackle a new segment. This strategy can be reported to situations where a company wants to target a new market at a low risk and with low initial investment.

The main focus of the case is to find the best amount of investment (both financial and non-financial) for a new brand of supermarkets without putting at risk the already existing and successful leader brand.

4.3. Teaching Objectives

The Teaching Objectives for this case are:

1. To identify possible strategies that can be used by companies according to the stage of the grocery retail industry.

2. Ability to understand the factors that drive the change in consumer preferences and consumer preference habits in the grocery retail industry.

3. Identify different types of growth strategies in a company (internal and external) and balance the risks that are associated with each one.

4. Evaluate the risk of a leading company in a very competitive industry to enter in a new segment in that industry with a different format but with the same brand instead of creating a new brand.

5. To understand the risk of decreasing brand equity by associating a successful brand to a process that the company that has the ownership of the brand does not fully control.

6. Analyze implications of selling Private Labels outside of the own-branded stores

4.4. Assignment Questions

This case may be used as in class discussion or as a presentation exercise. For a regular class discussion, the instructor may consider the following questions to guide the discussion:

1. Sonae is the leader in grocery retail in Portugal and its Continente brand is one of the most recognizable brands in the country. What are the risks of such company to enter in a new unfamiliar format?

2. Describe the benefits and the disadvantages of Meu Super franchising business model.

3. Comparing Meu Super Franchising Business Model with its competitors, should Sonae increase or decrease its financial and non-financial participation in the stores?

4. In order to grow the network of Meu Super stores, should Sonae MC acquire an already existing chain of stores like GCT group, or should the company focus only in organic growth?

5. Should Sonae fully own some Meu Super stores like its competitor Minipreço? If you think it should, what is your opinion regarding the optimal combination of fully-owned stores and franchised stores?

This case can also be used for a presentation exercise. There are two exercises that can be used in this model:

Exercise A

1. Imagine that you are head of the team responsible for developing the new Franchising network of small grocery stores from Sonae. After carefully analyzing the changes in the grocery retail industry as well as a deep benchmark analysis of your potential competitors, you have to present a draft of the business model to the board of Sonae MC. In this draft you should include:

- A contextual analysis that support the decision of betting in small grocery retail stores (you can use one or more theoretical frameworks like a PEST analysis);
- One argument that support the decision of developing the new network using Franchising based on your benchmark analysis;
- A decision of whether Sonae should own any of the new stores or if all the stores should be full-franchised;
- Decide whether use the flagship brand Continente or to use a new different brand for the stores and support your decision with a list of pros and cons.

The output of this Exercise A can be a written document supported by a PowerPoint presentation. The written document should follow the structure of a standard business model project. The presentation should highlight the main conclusions stated in the written document and should follow its same structure. This document should be prepared in group and each group should have a week to prepare the document and to present it in the delivery class. Groups for this exercise should be from 3 to 5 students. The written document should not have more than 10 pages plus appendixes. Students

must be able to perform a thorough analysis. Group presentation of the case should be only explanatory of the group reports and should not have more than 10 minutes. In these presentations, students should overview the current context of the industry and point out the main conclusions of their report.

Exercise B

Another exercise for this subject can be a class discussion based on group presentation. The class can be divided in two groups. One group will support the decision of using Continente's brand for the new network while the other group will support the decision of using a new name and separate the new business from the already existing brands of the groups. This exercise is to be designed for a 90 minutes class where students are expected to have pre-prepared the case for class. Students should have 25 minutes to prepare the case. Both groups should have 10 minutes to present their arguments and there should be a 20 minutes debate.

In both exercises (A and B) there are several key issues that should be addressed:

1. **Industry Context and Consumer Behavioral Changes**

Students should analyze the differences in purchasing habits of the consumers comparing to the 90's. In this part the groups should introduce the trade-off between big retail store formats and proximity and the factors that have influenced this trade-off.

The topics that should be overviewed include:

- Decrease in Personal Income;
- Decrease in time to spend shopping;
- Increase of demand for freshness in the products – more demand for perishable products;
- Proximity with increased value for the customer.

Other factors that students may point out include the social factor of going to a nearby grocery store where the owner knows the name and preference of its customers, which gives a "vintage" and comfort sense.

2. The fact that Sonae is the leader in grocery retail in Portugal with its Continente brand

Students should be able to identify the main strengths of Sonae MC and Continente and its main competitive advantages.

At this point students should be able to separate Sonae MC and Continente as both have different attributes.

Regarding the advantages of Sonae MC it is important to identify the experience and know-how in the industry, since this company was the first to innovate with hypermarket concept, however it is also important to highlight the reluctance of Sonae MC to venture in high risk business that is reflected in the "capital-light" strategy followed by the company. Students should be able to indentify this risk aversion as a threat to the success of a new proximity chain.

Regarding Continente, students should relate this brand with the concept of brand equity and indentify the competitive advantages of this brand. Some of these advantages include:

- A very high brand equity;
- Maturity as a sign of safety and quality of Continente's products;
- Scale as a sign of strength of the brand.

3. The main limitations of Continente and opportunities in the Portuguese market

In this section, groups should be able to identify the main disadvantages of Continente regarding its main competitors. Students can use the Case study appendixes to compare Continente with its competitors and their shares and formats. The conclusion is that while Continente is the leader in grocery retail in Portugal, the number of smaller formats created by its competitors is growing, and combined with the changes in the grocery retail industry, that can represent a threat for Continente's market share.

4. Strategy development to tackle the changes in grocery retail Industry with chain of proximity stores

At this point students should indentify the best strategy to tackle the growing interest of proximity stores by the public and point out some advantages and disadvantages. Groups should leverage the strategy of entering with an already existing brand of the group and adapt the format (for example Continente Bom Dia which already has a closer format to Meu Super) or to create a new brand from the beginning. Besides this decision, the discussion should involve what type of business model should the new chain be. In this discussion, several points should be covered:

- Entering with an already existing brand and the risk it represents for the umbrella brand;
- Entering with a new brand and the risk that consumers will not connect with Continente already reliable brand;
- Total ownership by Sonae MC of the new chain, versus partial ownership or none (partnership model or franchising);
- In case of a partnership model or franchising model, the requirements for a partner to be able to open a new store.

5. Positioning of the new chain

Here the groups should clearly define the concept of the new chain. The key issues that should be addressed here are:

- Business model of the stores (fully-owned, franchised, mixed model);
- Preferred location of the stores;
- Connection to Continente's stores;
- Name.

6. (Only for the Exercise B) The advantages and disadvantages of using Continente's brand in the franchising business model of the new brand

In this point students should be able to identify the handicaps of the solution that they are arguing in favor of (use or not of the Continente brand name) and base that solution in its benefits for Sonae and for the individual stores. For the group that

defend the use of Continente as the name of the new store and as an extension of the already existing brand, the points that should be discussed include:

- Synergies between an already reliable brand with a new extension in the market;
- Savings in advertising of the new brand as it can free-ride on the expanses of Continente Brand;
- Trust and quality that are already perceived by the customer in Continente's brand, that could be transferred for the new chain;
- Loyalty to Continente stores by the new customer that could also be transferrable for the new chain.

For the group that defends the strategy of creating a new brand, the following points should be approached:

- Decrease the risk of contaminating and already existing and successful brand like Continente, in case the new project is unsuccessful;
- Since this is a franchising business model and the stores will not be operated by Sonae MC it is important that customers are able to separate it;
- Since the company will not control the management of the store, by having a different name it safeguards its image in case a store goes bankrupt;
- The fact that there will be already Continente's Private Label products is a linkage to Continente and consumers would perceive the new chain as related but not completely owned.

4.5. Teaching Strategy Suggestions

This case was designed for class discussion, however it can also be used as an instrument for a home group work. In any situation, the case should be used in class. The best time length for class discussion for this case is a class of 90 minutes, however students should have the case prepared previously to the class in order to use the full class time for the discussion.

The instructor can either promote a class dynamics as proposed in Exercise B or analyze the case in the normal course of the class. In either way, the instructor should be able to conduct the discussion from the industry overview of the grocery retail industry in Portugal until the decision of Sonae MC to launch a new brand of proximity supermarkets.

The instructor should emphasize the decision of launching the new brand of supermarkets in a full-franchised business model and both benefits and disadvantages should be discussed. At this point theoretical concepts such as Organic Growth and External growth should be introduced and discussed under the context of the business and the industry.

After analyzing Meu Super business model, the instructor should proceed to the discussion of the decision of Sonae in launching a new brand separated from the Continente brand for this new chain. Both advantages and disadvantages of this decision should be discussed. At this point the concepts of brand extensions, umbrella branding and brand equity can be introduced and discussed in the context of the case.

Finally, based on the class discussion of the case, the instructor should finish the class with a perspective future of Meu Super considering two main issues: Will it stay a full-franchised business model or will the company decide to increase its participation in the stores? Will Meu Super remain an individual brand or will eventually Sonae transform Meu Super stores in another format of the leader Continente?

5. Conclusion

5.1. Thesis Synopsis

This thesis presents the most recent developments in the grocery retail industry in Portugal. The objective of this document is to display the consumer tendencies regarding grocery purchases and the way these tendencies have been changing over the last few years. We focus in particular on the shift in preferences by big store formats like hypermarkets that once were so "fashionable" to smaller and "cozy" formats where consumers buy less but more frequently. We use the strategy chosen by Sonae MC to penetrate in this new smaller segment as an example of the challenges that such companies may face.

A Case Study is presented that simultaneously helps to understand this change in consumer habits, but also shows in a very clear way the challenge that is imposed to companies like Sonae MC that are leaders in a matured market and whose leadership is supported by hyper and super formats that are increasingly becoming obsolete.

The Case Study presents the alternatives that Sonae had to consider to tackle this shift in the industry and the strategy that the company actually followed: creating a new chain of proximity stores in a franchised business model. The objective is to promote the discussion of the pros and cons of different strategies that were available as well as the associated risk that the company faces in each.

The Case Study describes the recently launched Meu Super which is Sonae's response to the market demand for smaller and convenience demands. Meu Super is a full-franchised business model where the franchisee makes all the initial investment while Sonae MC Wholesale and Franchise, the department in Sonae MC that is responsible for developing Meu Super chain, supports in technical details. These stores are typically located in residential areas and are not only small in size but also in SKU offering. Meu Super product offering focus on food, personal care and household products and as a competitive advantage, it offers Continente private label products in addition to manufacturer brands.

In order to understand better the challenges that grocery retail companies face these days, it is very important to understand the concepts that these challenges and

consequent strategies approach. In the Literature Review Section of this study we focus on three main topics as the most relevant in the context of deciding the best strategy for companies to adopt. In each, a theoretical contextualization was made based on previous research of the topics.

Since the underlined question of the Case Study is how a company like Sonae MC can grow when facing changes in the industry that it operates, in the Literature Review section we started to focus on Growth Strategies and in the different ways that companies have to grow, like organic growth versus external growth, strategic alliances or joint ventures, mergers and acquisitions and finally franchising.

Also very important in the context of this Case Study is the importance of the Brand. Sonae MC has very strong brand in the grocery retail landscape in Portugal – Continente, and it is important to understand how can this brand be leveraged or threatened when embarking in a new project. Therefore the concepts of brand equity, brand extensions, umbrella branding and co-branding are introduced.

Finally we end the Literature Review with an overview of the Private Label concept. The objective in include this subject is to understand the impact of selling Continente's Private Labels outside Continente stores.

Since the objective of the Case Study is to promote class discussion we propose a Teaching Note with the main subjects that should be addressed regarding this issue as well as two exercises that the instructors may use in order to dynamite the discussion.

5.2. Portuguese Grocery Retail Industry Overview

In Portugal, the Grocery Retail landscape is dominated by two main Groups: Sonae MC with its Continente Brand and Grupo Jeronimo Martins with its Pingo Doce Brand. Both chains share 48,1% of the market with Continente leading it with 26,9% of market share. The other relevant players in the market include Intermarché (11%), Dia's group Minipreço (7,3%), Lidl (6,3%) and Auchan (5,6%).

Regarding the type of store formats, there are four main formats in the Portuguese grocery retail market: Hypermarkets, Discounter, Supermarkets and Self-Service stores. According to Nielsen data Hypermarket segment is continuously losing share for Supermarkets. Nielsen estimates that in September 2013 the Hypermarket share is

23,4% versus 62,1% of Supermarkets and other Self Service stores sustaining the argument of shift in demand for smaller store formats.

In terms of brand distributions across formats, Continente is focused on Hypermarkets and Supermarkets while for instance Minipreço and Pingo Doce have betted in smaller formats. While there is a growing interest in smaller formats there is an increasing introduction of new chains in these formats and an adaptation of already existing ones. Pingo Doce for instance that started to compete with Continente in Hyper formats, started to decrease its stores in size and amount of SKU's offers and Grupo Jeronimo Martins introduced Amanhecer, a small proximity concept of grocery stores. At the same time Minipreço started to compete in the proximity segment as well focusing on residential areas and smaller stores. In order to respond to its competitors, Sonae decided to launch Meu Super, a chain of proximity grocery stores.

5.3. Main Conclusions

In several sections of this thesis it was presented a change in consumer preferences. It is important to understand that a change in consumer preferences is able to change the competitive context of an entire industry and that companies that were previously leaders in a growing industry may now enter in a maturity stage of the market simply due to lack of demand. It was exactly what happened to Sonae MC. The leading company in grocery retail in Portugal was faced with a situation where it would be possible to maintain the leadership position, however it would be in a market with continuous lower rates of growth.

Therefore Sonae MC had to adapt to this change. The discussion proposed in the Case Study is weather the decision of creating a new network of stores with little connection with the already existing brands of the group was appropriate and the possible outcomes of this strategy. Regarding Sonae MC's example, there are three factors that are worth to be detailed: Adaptability Strength, Risk Strategy and Innovation Culture.

5.3.1. Adaptability Strength

A company has to be able to adapt to a change in the industry that it operates in. This may seem like an obvious common sense statement but the truth is that not all

companies are dynamic enough to be able to respond to market changes according to its volatility.

Sonae MC is a multi-million company in Portugal and it would be safe to assume that such company would be able to respond to almost any challenge faced. However this may not always be the case. Since the beginning of its existence and after the opening of the first Continente Matosinhos, Sonae MC has been focused on mainly two things: big formats of distribution and in the internal competition (Portuguese market).

In order to develop hyper and super formats there are several systems that have to be created and several issues that have to be adapted. For example, the company created the most sophisticated distribution system in Portugal and one of the most sophisticated in Europe. This has provided the firm with great value in the sense that Continente stores are able to easily respond to demand fluctuations for the products due to two innovative distributions hubs and a fast distribution network. However this system was designed to supply Continente big formats stores, both in quantity and in SKU's ranges. The company faces a logistical problem when it has to supply small stores, located in city centers with a variable frequency, in low quantities and outside of its network of distribution, geographically speaking. To supply a new Meu Super store evolves a great logistical effort in order to adapt a whole system that was designed for much bigger formats. This represents a threat to the adaptability of the company.

Regarding internal competition, Sonae MC was very successful in taking over the Portuguese market of grocery retail and become the leader in this market. However, while Continente become the hypermarket of choice in Portugal, its main competitor, Grupo Jeronimo Martins (JM), was busy trying to establish itself in foreign markets. Eventually JM was able to successfully establish itself in the Polish market with the brand Biedronka and in the first trimester of 2013 Biedronka represented 65,4% of the group total sales. This provides the group with enough leverage to venture in new projects in the Portuguese market while Sonae MC has to safeguard its position with fewer margins of error. This will be traduced in a lower capacity of adaptability and as we will see in the next section a higher aversion to taking risks.

5.3.2. Risk Strategy

In order to venture in new projects there are always risks that companies incur. The aversion to risk varies in every company and the reasons that measure this aversion may be related to a company's culture, autonomy from financial institutions or even its leadership.

Sonae MC is a company with a relatively high risk aversion that is traduced by its capital-light strategy. To venture in a new project at a low risk may seem like an ambitious task. Regarding the launch of Meu Super, Sonae MC opted for a Franchising Business Model as the solution with the lowest financial risk. As presented in the Case Study, the level of investment in each Meu Super store is residual, thus enabling the company to expand a new network of grocery stores with a very low level of investment and therefore with a very reduced risk exposure.

However this strategy may represent a low level of financial risk but it raises a different kind of risk for Sonae MC. With a full-franchised business model of Meu Super stores the company is transferring power over the franchisee from a brand that it still owns. The trade-off is off course a lower control over the stores and the quality of the service at Meu Super stores. The risk here is the contamination of potential bad experiences of customers in Meu Super stores to Continente stores and the company itself.

By not controlling the whole value chain in a Meu Super store as it controls in Continente stores the company may be exposed to a risk that is not considered directly financial, but that ultimately can be traduced in bad perception of Continente brand and its stores.

5.3.3. Innovation Culture

One of the most important concerns for a company when adapting to a change in the market context is the ability to innovate regarding that change. This is applicable to any company operating in a competitive market, however it is especially relevant for a company that as we saw has a limited capability to rapidly adapt and a high risk aversion.

Sonae MC with Continente was the first to introduce in the Portuguese market several important innovations like the introduction of Private Labels, a sophisticated distribution system or later Cartão Continente, the first of its kind loyalty card in Portugal.

This reflects a great competency and willingness to innovate. When launching the new Meu Super network of stores the company has to try to transfer this competency to innovate to the stores itselves. However, as discussed previously this may be limited by a low willingness to take risks or venture in big financial investments.

Nevertheless, Meu Super was the first of its kind chain to sell Private Label products that are not labeled according to the store brand. Meu Super is the only chain that sells Continente's private label products other than Continente. This may represent a great innovation in the sense that for the first time Private Labels "come out of their homes" and are sold as any other brand in a non own-branded store. The benefit for Sonae MC and for Meu Super stores can be described as a win-win situation and can be translated in a vicious cycle. Sonae MC wins in the sense that it sells its products to more customers and ultimately it may represent higher loyalty to the brand and new customers for Continente stores. Meu Super stores benefit from having in their shelves a very well-known brand and leverage from the loyalty caused by Continente PL products. This loyalty may grow as the demand for Continente PL products grow both in Meu Super stores and in Continente stores. Once again the trade-off for Sonae MC to have its PL products being sold in Meu Super stores is a lower control over the quality and sell-out of these products. However there is the risk of confusion. When selling PL's, consumers are likely to consider Meu Super stores as belonging to Continente, expecting simultaneously the same level of service, which Sonae cannot guarantee. So, PL's in last instance can contribute to Continente's brand erosion.

Regarding Cartão Continente, since Meu Super stores are not actually owned by the company, the card cannot be used in Meu Super stores. To adapt the card for it to be used in these stores could present a great challenge to the company, however if succeeded the benefits could be compensating. There are approximately 3,3 million users of Cartão Continente in Portugal and over 90% of Continente purchases are accompanied with this card. If the company could adapt the card to Meu Super stores, the synergies it would create could not only boost sales of the stores but also generate more loyalty facing competition.

Finally, Meu Super full-franchised business model is an innovation itself. Comparing to its competitors, Meu Super is the only franchising business that does not demand for

royalties or fees which can provide a greater sense of autonomy to its franchisees and ultimately promote new store openings.

These three main issues are inter-connected with each other in the sense that to adapt to a new tendency of the market, the company has to increase the risk exposure both in the new business as in the already existing ones. At the same time, in order to create an ambitious innovative strategy there are several risks that arise, most of them financially related.

The conclusion is that in order to adapt to a shift in new market tendencies a company has to be dynamic enough to adapt to a new business and innovative enough to be successful in this business. The risk, weather it is financial or non-financial will always increase, however the benefit may compensate this risk.

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