

RETAIL PRESENTATION: THE M&S APPROACH TO INNOVATION

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Thank you very much Miles, good afternoon everybody. As Miles has said, Guy Farrant can't be with us today. He would love to be but isn't and so you're stuck with me I'm afraid, not the best of starts really for me, I'm a substitute speaker and I have well and truly the graveyard slot so I'll make the best of it and hope that you'll bear with me. The fact of it being that slot really reminds me of this statistic and I only really have one statistic in my entire presentation so if you are turned on by statistics pay attention now, is this: that apparently during any speech, after three minutes of the speaker being underway, approximately one third of the audience are still paying attention and with the speaker, one third of the audience have already gone to sleep and the final third of the audience have already embarked on some kind of fantasy, sexual or otherwise. [Laughter] I just want you to know that all of those are fine by me, catch up on some well earned rest if that's what you need and I won't speak about the rest of it.

So for the few of you who are still with me, I want to give an outline today of the M&S approach to innovation in food. The reason I have chosen that as a subject, and I hope that it does give an overview of our entire food business, but the reason I have chosen that subject is that really food innovation lies at the heart of everything that we do and really is our raison d'être in the UK food marketplace. If we are not innovating then we will be dead because quality can be replicated and price is something that we will never be able to compete on so unless we have got that flow of new ideas coming through, we are not going to have much future within the UK food industry, so that is why I am going to concentrate on it. I am going to talk briefly about three main areas: product, service and environment. First of all a word though about our food products, we want to have the same approach to all of the food that we make, we want to make it the best possible eating quality that we can and it is all Marks and Spencer food, all subject to the same standards. I should start off with perhaps by giving a bit of context to that statement and here's a chart which really shows what we are all about. So first and foremost we are a 100% own label food retailer with an emphasis on quality, innovation as I've spoken of, convenience is a big part of our offer and I will come onto that not only in product but also in terms of the way that we serve our customers, freshness is hugely important to us and value. It may seem a little bit strange for me to have value when I've just talked about price but actually the value that a product represents for the money that you pay is intrinsic to the way that we look at the products that we launch. Then an edited range, we only sell 5000 products compared with 25,000 that you will find in one of our competitor's supermarkets.

So innovation is what we are talking about today but underpinning that innovation are two extremely important aspects of our business that I'd like to draw on which are on that chart, those of the edited range and the fact that we are 100% Marks and Spencer branded, because these two things mean that with a more restricted range we are not trying to be all things to all men. We set out our stall unashamedly on the basis of high quality, differentiated, innovative food sold at prices that represent good value for the quality and which we hope will delight customers when they eat them. So our edited range gives us choice rather than proliferation. Secondly, being 100% Marks and Spencer branded means that we've got full control of our supply chain and so we can effect changes across our entire range of products with speed and with a wide stroke and again I'll refer to that a bit later in my presentation. In some respects it is this kind of focus of these two aspects which enable us to be clearer about our innovation programme.

Where does product innovation start? Well as a good retailer, I should say that it all starts with the customer and what he or she wants. The question for us is, do we really know what they want all of the time and perhaps as importantly, do they really know what they want all of the time? Now if the answer to those questions was yes, all we need to do is have a few focus groups and every product launch would be right on the button and a raging success. I don't know about your world but unfortunately in our experience life just isn't like that. Some fantastic innovations can bomb because they didn't chime with customers. Our chief executive, Stuart Rose, has got a very telling phrase around that subject and that is simply that you need to be half a step ahead of the customer. If you are a whole step ahead then he or she may not get it and if you are a whole step behind the customer, make no mistake you are dead in the water. A good example of that I would say through the 90s was our range of Thai food in our ready meals range. Now we tried to launch Thai food I think about four times in the space of ten years and each time we failed. We thought that it was the right moment, the products were of excellent quality but actually it wasn't the right moment. We did it again because we were convinced it was the right thing two or three years ago and finally it has taken its rightful place within our catalogue but for those few years or so, unfortunately our feeling was that we were one whole step ahead of the customer and they really didn't want it so we try to be half a step ahead.

Now one of the ways we try to achieve this within our organisational structure is by having a highly integrated team within the category so each product area has a team of product developer, buyer and technologist. I think this is now fairly widespread throughout the industry, the classic category structure but I think that we were the first organisation to start this kind of structure and I believe that still, to a large extent, we have these roles more integrated than perhaps other people within the food retail industry. The other point about it is that since we have no branded products coming towards us from the industry, this team has to interpret the market and create that stream of product innovation that ensures sustainable and profitable sales growth. Clearly

because we don't manufacture anything, that has to be done in close conjunction with our suppliers and we would say – and we would say that wouldn't we? – we would say that it is the M&S team which is the driving force behind it. The key here really is good teamwork, clarity of purpose and communication because although each team member has a role and if I summarise it broadly, the product developer is saying what is it, how do we make it and what can we do to make it taste fantastic? The buyer is saying how much does it cost, how much of it do I want and the technologist is asking can we make it in volume and a fairly fundamental question, is it going to kill you when you eat it?

They have all got their roles but in fact they are all participating in the overall decision making process and so as I said, in the absence of branded new products they must really work together to turn new ideas into compelling new products which deliver either new tastes and flavours, new levels of convenience, new standards of freshness, new healthy properties to name just a few of the kinds of innovation that we look for to excite and entice customers to buy. I think it is an important point that innovation can take many different forms. It shouldn't be limited to simply flavour or ingredient or something like that, a surprising number of attributes of a product can actually add to its innovative appeal.

In order to arrive at that, that kind of approach needs an understanding and an adherence to the core values of the business that I outlined at the start. No compromise on quality, a determination to differentiate and go a step further than what has been achieved so far and once they are working together as a team, each member can contribute and often a quality breakthrough can result from a technical advance which enables a whole new class of products to emerge. A good example of this I would say is our melt in the middle pudding, a bakery product. This product was a breakthrough in mass producing the melting sauce which comes out of the middle in the pudding, a technical innovation in fact which enabled us to deliver a great product in big volumes. Now I don't know if you have tasted it, it was launched a couple of years ago but from the sales after this product went on to our TV adverts, I'd be surprised if you haven't. Can we just show as a reminder the advert now please? [Shows advert] Thank you. It's a good job it's after lunch I would say. That product actually became our Product of the Year for 2006 and I think the other thing which is probably just worth alluding to if we are talking about innovation again is that style of advertising which now I think arguably is clichéd, much copied and imitated but at that point was quite ground breaking in the way that food was depicted on television adverts. So it has taken us a long way and fantastic that it was a bakery product.

So I think that's a good example of a product based innovation at a category level and for many years this kind of approach of the category team getting their ideas together and turning them into products on the shelf has stood us in really good stead. But a second and parallel approach is beginning to

approach now and I suppose what that can be termed as is the Big Idea approach. It goes back to the point that I made at the start about 100% owned brand enabling us to control the supply chain and effect innovative changes across all of our product ranges. Some examples of this Big Idea approach was the move that we made to remove genetically modified ingredients from all of our food, our move to use only free range eggs, our move last year to get rid of hydrogenated vegetable oils and then again a year or so ago, the declaration that all of our tea and coffee will come from free trade sources. Now we can do this and then we can make some fairly bold statements about them because we don't have a plethora of manufacturers branded items on our fixtures which may or may not have these values and attributes so we can make a statement that all of the products that you see under our roof have got this or that attribute about them. Now we believe this is really important today because in our assessment this is where the consumers mind is focusing, so last year we launched an advertising campaign called "Look Behind the Label", it's been very well received and you can see that some of those activities that I talked about earlier figure prominently and we believe they are playing a bigger and bigger part in consumers perception of what differentiates higher from lower quality and also figures in their perception of the extent to which retailers are being innovative. These products aren't being produced at a category level, they are coming from a strategic view of where the customer is heading and the kind of steps that we need to take to remain that magic half a step ahead. Then we get cracking, we mobilise quickly across the whole food business to deliver the step change and then we use, as you can see, the power of marketing to communicate it to our customers.

The most recent example of that I guess is our commitment to what we are calling Plan A which is our commitment to corporate social responsibility. I could do a two hour presentation on this, there are over a hundred points in it so I'm not proposing to do that this afternoon but what I will do is give you a quick whiz through of what some of the main tenets are of what we are trying to get across.

So really this is a Marks and Spencer commitment, it is within our company and it turns around these five commitments that you can see: climate, waste, raw materials, being a fair partner and a commitment to health. Just taking them quickly in order, first of all on climate, a number of commitments here, the first of these is the move which we are taking to signify where product has been air freighted so that customers can make a choice about the production of greenhouse gases and how they can be restricted or reduced. We are moving down the route of regional sourcing so in other words selling the product made in that particular region, again reducing the number of food miles and the use of biofuel in our food delivery fleet. If you can understand this slide then I'd like you to explain it to me afterwards please but this is called anaerobic digestion – what apparently it does, my technical colleagues tell me, is that it enables us to take our food waste which is unsold at the end of the period in stores and which hasn't been used for other purposes and we are

able, apparently, to convert it into a form of energy which can then be converted into electricity and thereby fuel our stores and is therefore, I understand, extremely carbon friendly. This is at an early stage but it is something we are serious about and apparently this technology does exist so watch this space. Finally a clothing one which is our initiative to get people to wash clothes at 30 degrees centigrade rather than the majority being at 40 thereby again saving energy.

Moving on to waste. I suppose the first thing to say is, there's a lot of it isn't there? We have made a commitment that we will not send any waste to landfill from our operations in our stores, our warehouses and our offices, by 2012 we won't be sending any waste to landfill so that's what we are doing if you like internally within our organisation. We are then looking to reduce packaging where we can and I think M&S, along indeed with the baking industry, have been pioneers in this with the use of the plastic returnable tray and therefore eliminating cardboard to a large extent, it is very nearly eliminated from the majority of our food products and I know in the bakery industry as well that's taking place so we are already doing quite a lot there, there is more still for us to do. We are saving on packaging itself, getting rid of unnecessary sleeves which if you like are gilding the lily of the product.

This is an innovation, this is film which is made from a substance called PLA which is a form of corn starch which is compostable and gets us away from the use of PVC so it is at an early stage, we don't have it across our entire business but we will be developing this to use with more and more of our product ranges. Then getting rid of things like plastic trays, polystyrene trays and using more sustainable, biodegradable materials.

Quickly on to raw materials. You saw earlier on with the slide about what we're doing with regard to sustainable fishing, really we are trying to take that across the piece so with agriculture, restricting the use of pesticides and our use of free range eggs and extending the use of free range farming rather than intensive farming wherever we can.

Fair Partner is not only about fair trade. We are interested and very supportive of fair trade initiatives really across the world not only on farms but also the conditions in which people work in factories and then not only abroad but also at home where actually links with the farming community in Britain are very important to us. We have a farmers milk pledge and very good relationships with the farming community on milk, we go to the agricultural shows to meet with farmers and in fact our series starts tomorrow at the Balmoral Show in Belfast. I think just to make a point here which I think is relevant to this industry, if I look across the various areas of agriculture which we are involved with be it meat, be it agriculture in terms of fruit, the dairy industry, I would say that we within M&S have a good knowledge of and a connection with the farming community. I don't believe that does exist within the grain and arable farming community and that sense of the chain being completely linked up so

that the consumer and indeed the retailer has got a contact with, a flow of communication with, the grower in the first place. I believe that that is an opportunity that would benefit the baking industry as we go forward and I think you are starting to see it a little bit in one or two areas but to me, from where I stand, that is something that is missing at the moment.

The Fair Partner works right across our industry, not just in foods. This is fair trade cotton so where it says 22 million singles, what it means is T-shirts where our basic ladies T-shirts this season are all made from fair trade cotton and you can imagine how much cotton goes in to 22 million T-shirts and that really is making a difference to the growers.

Then the final part of it is health where we have been on this for quite a while, it is very important for us and growing all the time we believe in the mind of the consumer so that involves the reduction of ingredients, getting rid of things like hydrogenated fats and then our adoption of both front of pack guidelines and greater nutritional information on the back. Finally we have embarked on a training programme for our sales advisors where around 1500 of our sales advisors are given a half day's training on basic nutrition and healthy eating. Now they don't turn into experts overnight I have to say but they do have some grounding in it and are able therefore to advise customers who are even less educated than they are, but who know that it is something important and they can give reassurance to them so we are underway on that as well.

Now that is a very, very brief summary of some of the main tenets of what we are trying to do but I hope it gets over to you how important Plan A is to my organisation and I believe we are not alone in this and you have seen the declarations by other retailers as well but it is here and it is here to stay and it exemplifies that Big Idea approach. In order to do these things we can't rely on just the individual category teams, we are going to have to get together to make it happen.

Now the way that I described the Big Idea approach so far has been about really ethical considerations such as free range, fair trade, the sort of stuff I've just been talking about, but the launch of our speciality range in 2006 is a good example of a more broad based approach based on product and eating quality rather than those other things I've just been talking about. Now everyone is aware of the emergence of the premium tiers across the major food retailers and they have been a rich source of growth for them, and indeed I think the bakery industry has been at the forefront of that trend with the success and growth of your own premium tiers. Now our food has traditionally been recognised as being of the highest quality but because we didn't have a tiering within our ranges, we started to think that it may be possible to think that Finest for example was as good as Marks and Spencer products in the eyes of the consumer so we felt we needed to really reinforce our credentials as being right at the top of the quality tree. So we tasked our category teams to put together a range of food which really was truly speciality, using artisan

methods and small suppliers from authentic production areas where appropriate. Then I think as you can see, as we flick through these slides, we established an overarching style of packaging which looked both alternative from our mainstream product and also quite dramatic with the use of black and gold and really emphasising the food credentials of the range. Now we have had these out for just over a year, we have got over 200 products across now virtually all of our categories and they have been really very well received by our customers. Although it may seem strange to think of artisan and craft manufacture as being innovation, in fact so far as the feel and look of our food halls have gone, it actually has really changed the customer perception of the kind of food we have been selling. I guess that slide there is probably the best example of showing how it does go across the range of both longer life items, chilled, protein and fresh produce. So I hope you will agree that that is an innovative approach to products, slightly different to some of the things I have been speaking about and from those individual ideas.

I would like to move on for a minute and leave product for a moment to try to illustrate some of the things we are doing to innovate in the fields of service and environment. Now it's no secret that for a number of years our stores were under invested and we are currently in the process of modernising our whole estate. I am going to show some pictures in a moment that I think will speak far louder than my words but really our intention is to move away from a traditional supermarket feel with long aisles and a lot of cardboard, really creating what you might call a noisy environment so we're trying to use black flooring, more subdued lighting and a cooler and more subtle signage system which creates a look and feel which supports our credentials as a quality food retailer rather than a supermarket. Now when we do these modernisations, very often a video is made to show what the transformation is like and I am going to ask you to look at one now. It actually goes right across the store because these aspects that I'm talking about actually don't apply only to food but they also apply to our general merchandise offer so I think this is probably Bromley store that you are going to see, the before and after so can we play the video please. [Plays video]

Thank you very much. Hopefully you could tell the difference between the before and the after, otherwise we haven't done a particularly good job and the other thing I should say is that the store was closed when those pictures were taken otherwise commercially it might not have been the best thing that we've ever done. Finally, these videos are produced or the mastermind behind them is our marketing director who is a creative genius, believe me, but has a lousy music sense so I apologise for inflicting that on you.

Now that approach, that look and feel, has now been transferred to our newest stores in the Simply Food chain of convenience stores of which we now have about 225. We are delighted with the success of these stores, they offer again harking back to something I said right at the beginning, they offer a very, very edited range, often only around 1000 skews within the whole store but they are

appealing to a younger customer who is looking for something delicious to eat now or eat later with lots of convenience but at the same time great quality. Now again convenience stores have been with us for a long time, there is nothing new about convenience stores but I hope you would agree that that approach of appearance and arranging does represent a real innovation in approach and from the feedback we get from our customers they recognise it as something really quite different from what is being offered elsewhere.

A bit about product, a little bit about the environment but I also wanted to touch on the service which we give to our customers and it is linked to the point about environment. Basically people consider food shopping to be a chore rather than a pleasure and so we feel that our task within Marks and Spencer foods is to turn that around and make food shopping with us an exciting and pleasurable experience. We start by trying to have the best products and turning you on with the products themselves and you can see we are trying to transform the appearance of our food halls. Now we are experimenting with offering services which we hope will exceed your expectations of what food shopping can mean so these pictures illustrate what we mean. This is a serve over deli bar which is right in the middle of the food hall. You can have a sandwich, a salad and a glass of wine while you are taking a well earned rest from shopping and obviously by staying within the food hall to have that rest and refreshment we hope you will carry on shopping once you decide you are going to start again, but really give quite a different feel to our larger food sections.

This is a hot food to go counter. We have built a very strong business in cold sandwiches and salads in what we call our food to go category, this idea is really to complement that with a full range of hot meals cooked freshly to order and representing again a quality step up from that which you may be able to get elsewhere. 400 of our stores now have in store bakeries but we now have a new design which is incorporating fresh cream patisserie and a range of truly crusty bread baked through the day. This is really important to us, and I guess really important to you, but we feel that bakery will lie at the very heart of our food offer in the future and again we really want to get away from what can look like a commoditised, fairly industrial approach to the manufacturer and indeed the selling of bread and we feel we are starting to get there. There is still a lot of work to do there but we are starting to achieve that in some of the newest bakeries that we have in store. Then we have already had success with our in store coffee bars but we are now expanding that idea into a number of formats including as you can see some more lounge style coffee shops and we have opened a full scale restaurant with waiter service in our store in Newcastle and we have introduced in Canterbury a coffee bar concept called the M&S Kitchen with coffee bar and some basic food which actually sits outside of our main store, it's a stand alone operation and that is in Canterbury. So all of these initiatives for us are designed to improve that experience of shopping but also they serve as a great introduction to tasting and eating our food.

Now the attitude to all of these initiatives is exactly the same as our attitude to innovating product so in these cases teams of designers and architects and indeed the category teams themselves, get together and ask how can we make this different, how can we make it better than what anyone else is doing and how can we create something that will really delight our customers? I said that they are experiments and I think that too is a really important point. If I go back to product for a minute, we launch about 1000 products a year and after one year less than half of them have survived on our shelves. Now you might say you must be mad to waste all that time and money on products which are simply going to fail and we say that to ourselves a lot of the time as well, but remember that if you get left behind the customer then you are dead in the water so some of these initiatives are going to fail and that's okay because it's the price that you pay for that culture of relentless innovation and therefore you have to be sure at the same time that blame doesn't stick to the teams of people who are creating these because if you do then you will just absolutely stymie the level of innovation that you want to keep coming through. So if it was a good idea well executed but didn't work, then that's okay but stop it quickly and move on to the next thing.

These service initiatives which I've just shown you are all in store and starting to move just outside the store with the Kitchen concept but I should also mention how we are moving outside of the store environment totally to offer our food to consumers. This is an example of that and you can see at the bottom left there and from this picture that Marks and Spencer has gone rock and roll. This is a stand that was selling food at the Isle of Wight rock festival or pop concert or whatever you young people call it these days but this was last summer, it went down incredibly well and actually got us a whole page of publicity in the Evening Standard, again appealing to younger customers than would be traditional with us. I understand that there is more to come although they haven't really shared much of that with me. But that's a big future we feel in hospitality and then I should also mention the development of a growing and strong direct to home business across flowers, wine and event food, using the internet but also using in store ordering. I should say now that we sell at Christmas where the traditional purchase is obviously the turkey, I think the ration now is about four to one the number of turkeys that we sell pre-ordered through our customer ordering service versus actually picked up on the day from the fixture in the normal way of shopping, so I think that is an illustration of the strength of how popular ordering can become to ensure you get the product exactly as you want it when you want it.

I hope you feel in that talk I have illustrated the things that we are doing in order to keep innovation right at the heart of everything that we do across the company and to summarise what that means for us, first and foremost it needs to be driven by our commercial needs. If we don't have that flow we will die. It has got to be really in the blood and at the heart of the organisation. You've got to live it and everybody has got to share it and you can never be satisfied. There is always something that you can be doing and it is the question we are

constantly asking ourselves about how can we make this better, good as it may be. And you have got to be prepared to fail I'm afraid, in order to be sure that ultimately hopefully you will succeed. Thanks very much for your attention.

[Applause]

MILES WARNICK:

Ian thank you very much for such a thought provoking and stimulating presentation. Looking round the room when you were giving the presentation it was clear that you had the audience's full attention rather than your anticipated 30%. On a personal level I would say that is remarkable because I know a number of my competitors in the audience today have a tendency to drift into that fantasy world! [Laughter]

45 mins