

November 2011

2012 New Year's Resolutions Every Consumer Package Goods Company Should Make

By Craig Rosenblum

The Benefit

As the song goes, "It's the most wonderful time of the year!" It begins with stuffing ourselves at Thanksgiving, sharing gifts at Christmas, and ends with making all those resolutions at New Years. It also starts the holiday shopping season with Black Friday and Cyber-Monday in order to get the best deals for those on your holiday shopping list and ends with the resolution (and bills) that I am going to stay within budget next year. If you think about it, this really isn't too different if you are a manufacturer or in the consumer goods retail business planning for the holidays (Thanksgiving and Christmas), making on the fly adjustments to enhance or modify accordingly, and ending with resolutions to do things more efficiently, effectively, and profitably next year.

As we look forward to 2012, this issue of *Competitive Edge* will provide insight into several New Year's resolutions that every consumer package goods (CPG) company should make to improve sales effectiveness, financial efficiency, shopper satisfaction, and enhance collaboration.

Evolution

The evolution of retail and where it is heading has never been more apparent than today. Over the last 50 years retail has continued to evolve from:

- ▶ Retail 1.0 – The age of **national brands** and a manufacturer controlled supply chain.
- ▶ Retail 2.0 – The age of **retailing**. Retail consolidation creating fewer more sophisticated retailers, who reclaimed control of the supply chain and cost control.
- ▶ Retail 3.0 – The age of the **shopper**. Customer data is now essential and interwoven into the strategic and tactical decisions being made.



Evolution (Cont.)

Understanding that the new norm is truly all about the shopper, future success must become a true collaborative effort between retailers and CPG companies in order to meet the shopper's needs. Recognizing that CPG resources (human, financial, and technological) are not endless, it is imperative that you make the following New Year's resolutions to make sure that you are maximizing the utilization of your resources and ensure retailers are focused on your company and your brands to drive sales, profits, shopper satisfaction, and competitive differentiation.

Seven New Year's Resolutions

Recognizing that each facet of a CPG company (IT, manufacturing, supply chain, marketing, finance, category management, etc.) is going to have their own unique list of resolutions, the following are focused on supporting the retailer facing sales efforts to improve business performance.

1. **Ensure you have the right retailer priorities** – Most CPG companies prioritize resources based upon volume. While historically this may have been the right way to go and profits usually followed, given today's economic and competitive pressures, it is not quite that simple. It is imperative that CPG companies truly understand and evaluate which channels and retailers are growing (or not) and the cost-to-serve or true profitability of each. Some of the benefits from this type of approach are:

- › Focusing upon the most important retailers and priorities.
- › Deploying resources (human, intellectual, and financial) towards the efforts that are most important.
- › Driving greater return-on-investment from your selling organization and efforts.

Understanding how imperative it is to follow such an approach is exemplified by the following:

- › Kraft's recent announcement of separating the high-growth global snacks business and a high-margin North American grocery business.
- › Walmart's transition from the largest in volume and profits for most CPG companies to just the largest in volume due to their demand for lowest cost-of-goods to enable lowest opening retail price points and new hi/lo promotion strategy.
- › The on-going trend of grocery losing share to non-traditional and alternate channels (e.g., Dollar, Club, Limited Assortment, etc.). Traditional supermarket's share has gone from an 89.6% to a 40.2% over the past 25 years according to Willard Bishop's 2011 Future of Food Retailing study.

2. **Increase your organization's understanding of how retailers make money** – Many CPG companies do not understand where and how retailers make their money. We have all heard about what razor-thin margins retailers make. According to FMI's Annual Financial Review reports, over the last 10 years the industry's after-tax net profit has been 1.22%. But do you truly understand why? A retailer's overall

Seven New Year's Resolutions (Cont.)

costs change by store part, department, aisle, category, and SKU. Hence, as you look at the table below you can see that store ABC's weigh heavily on a retailer's ability to be profitable. The two components which have the greatest erosion of in-store profitability are store labor and occupancy/rent. This is evident in the store Perimeter's ABCs. ABCs as a percentage of sales is almost twice as much as the Center due to the nature of handling produce and meat, deli, fish, and bakery service components.

Location	Margin Performance		Activity-Based Costs (ABCs)				
	Adjusted Gross Margin	True Margin	Store ABCs as % of Sales	Transport ABCs as % of Sales	Warehouse ABCs as % of Sales	Total ABCs as % of Sales	Total ABCs Per-Unit Sold
Center	30.16%	13.20%	15.08%	0.67%	1.22%	16.97%	\$0.55
Perimeter	39.27%	9.72%	27.68%	0.60%	1.27%	29.55%	\$0.90

Source: Willard Bishop Total Store *SuperStudy*™, November 2011

Note: Adjusted Gross Margin Percent includes vendor allowance dollars and True Margin Percent nets out ABCs

Focusing on this type of approach and understanding will open up new and more strategic customer relationships. The following are some ways to impact these costs:

- Minimize stocking and rotation time at the shelf by providing cut- and/or case-ready cases.
- Gravity-feed fixtures (e.g., Campbell's Soup Racks) which enable product to feed forward and stay front-faced.
- Optimize case-pack size and configuration to minimize inventory on the shelf and increase turn.

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3. **Provide pricing insights on how your brands/categories impact the retailer's overall price image** – Retailers today are more cognizant than ever of their price image and doing everything they can to enhance it. CPG companies need to be aware of a retailer's overall pricing strategy and their processes to enhance price image. Getting private label price gaps right will help retailers better manage category profitability, and help you protect your own case volume and margins. Willard Bishop has helped over three dozen retailers develop their pricing strategies and enhance their price image, and has identified several components you should be taking into consideration. Do you know the following about your retail customers:

- Their overall pricing strategy (EDLP, hi/lo, or hybrid)?
- Who their primary and/or secondary competitor is in the market?

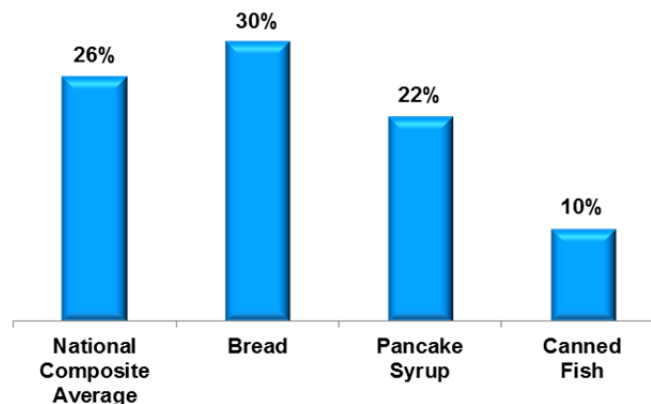
Seven New Year's Resolutions (Cont.)

- › The category role(s) and marketing intent(s) of your categories?
- › If your SKU's are known value items (KVI's)? If so, do you know which ones and why?
- › The tipping points for your category, brands, and SKUs? What are these indexes? Are you in the imperceptible range (1% – 4%), perceptible range (5% – 8%), or pass the tipping point (9+%)?
- › The relationship of everyday and promotion pricing and how it impacts your location in the spectrum of tipping points?

Improving your understanding of how retailers' price image is created can help you design better pricing and promotion plans, and lessen the pressure for you to "give back" price increases in some categories.

4. **Identify the right price gaps between your brands and private label and develop a strategy to hit them –**
 Every shopper today is trying to stretch their shopping budget to bring home as many bags of groceries as possible and save some money. This, combined with the improved quality of product, has enabled private label to continue to grow and gain share. However, commodity inflation has continued to pressure CPG companies to pass on cost increases and retailers to pass these on to the shopper by raising shelf prices. Unfortunately, the gaps between private label and their national brand competitors continue to rise. Average gaps should be dependent on many factors including the retailers' overall strategy, the category strategy, the breadth of private label at their disposal, how many tiers of private label they carry, pricing on national brands, etc. Below is one illustrative example of how gaps change by category.

Discount Gap to National Brand Equivalent



Source: National Composite Average is based upon Willard Bishop retailer database.

Seven New Year's Resolutions (Cont.)

5. **Proactively optimize your own assortment** – Traditionally speaking, 20% of the SKUs in any category account for 80% of the volume. This is why so many retailers, starting with Walmart in 2009, began the 10% – 15% SKU reduction process. As we all now know, they went too far, alienated shoppers, which in turn caused sales, profit, and share loss. While product innovation is still essential, the leading CPG companies have taken the opportunity to control their own destinies and optimize their own portfolio versus waiting for the retailer or a competitor to do so. Those who have conducted this exercise have found success due to:
 - › Enhancing brand equity by focusing on strategic fit and growth opportunities for current and new SKUs.
 - › Increasing sales due to optimizing shelf space, pack-out, and minimizing out-of-stocks.
 - › Limiting their exposure as private label expansion continues.
 - › Improving cost efficiencies in packaging, product, and transportation.
 - › Driving greater promotional effectiveness with existing trade funds.

6. **Utilize Shopper data across all of your merchandising decisions** – It would appear that category management and shopper insights are heading on a collision course to become shopper-based category management. For those who are already incorporating the retailer shopper or loyalty card data into insight across price, promotion, space, and assortment and selling accordingly, you are already there. For those of you who are still “Panning for Gold” in the ocean of shopper data, the following are some thoughts on how to increase your odds of success or value.
 - › Drive your merchandising insights and tactical decisions to focus on the retailer’s top-tier of shoppers (diamonds, platinum, or top-20%).
 - › Develop hypotheses and utilize the shopper data to validate and execute upon them.
 - › Utilize the retailer’s shopper stratification, understand the volume gaps by segment, and derive programs to close the gap.

7. **Identify promotions that work for your categories in a market and maximize your trade fund effectiveness by going after them** – The more things change, the more they stay the same. Retailers today, for the most part, still conduct promotion and ad planning the same as they always have. It is week 23, looking at what they did week 23 a year ago and repeating. Unfortunately, due to the flattening of trade-spend dollars by most CPG companies, this is causing the necessity to ensure you drive the greatest incrementality possible from your

Seven New Year's Resolutions (Cont.)

investment. In order to convince the retailer to change this process, CPG companies today must:

- ▶ Track and measure performance/effectiveness of trade promotion spending.
- ▶ Determine the most appropriate amount and allocation of trade and consumer promotion spending.
- ▶ Identify what works uniquely for a retailer in their competitive market and why. Many times retailers are unaware of other successful programs in the market, because they are too focused on what has historically been the case.

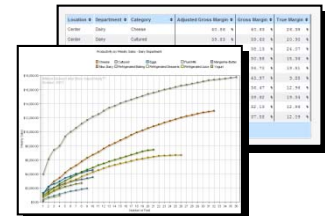
Next Steps

Willard Bishop has been working with CPG companies and retailers for almost 40 years. Our experience and insight has enabled us to help CPG companies succeed at the shelf. Our understanding of retail/retailing, approach, and processes in any of the above areas can help any CPG company become a "winner" at retail.

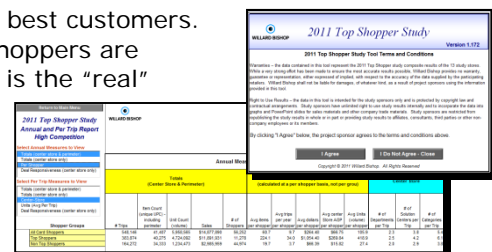
If you have any questions regarding this month's *Competitive Edge*, please contact Craig Rosenblum at 847-756-3726 or craig.rosenblum@willardbishop.com.

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