Canada's Independent Agri-Food "Think-Tank"

Revitalizing Grocery Categories
SPECIAL REPORT

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Summary Points

- Grocery stores are full of under performing food and consumer product categories.
- Grocery distributor category managers are continually reviewing their categories seeking ways to improve sales and profits.
- Food manufacturers need to be aware of the questions and analysis that grocers are undertaking with regard to these slower lines.
- Grocers and manufacturers can revitalize a weaker category by re-thinking the product itself and how it is merchandised to consumers.
- Revitalized categories bring large rewards to both manufacturers and grocers.
- Even when categories cannot be revitalized, manufacturers need to work with grocers to ensure that their share and sales are not lost due to de-listing.

Introduction

Unfortunately for both food manufacturers and distributors, grocery stores are full of under performing or weak categories. They are characterized by below average margins and flat sales. These are mature products that are in the flat or declining sales phase of the classic "product life-cycle" curve. That is, the fast paced growth of the earlier years has given way to the slow predictable sales from a core of steady consumers.

Most of the slower categories can be found in the grocery aisles (as opposed to the store perimeter). Examples of static categories or sub-categories over the years have been varied. They have included niche lines like luxury canned cat food or lines that were once high flyers like rice and corn cakes. These lines can also include household standbys such as soda crackers, paper towels, margarine and ice cream. Their only common feature: sales have slowed and in many cases margins are below average.

Unlike a warehouse club or mass merchandiser that has a choice of whether to carry these lines or not, a grocer generally has no choice. Grocers cannot abandon these lines because they still serve a consumer demand, sometimes a large consumer demand. These categories also typically make up an important part of the consumer's

pantry. Eliminating these categories would harm the grocer's merchandising mix and positioning.

Admittedly there is little hope for rehabilitating many of the "challenged" categories lining the shelves today. If there were a magic bullet someone would have thought of it by now and of course every competitor would have copied it. This does not mean, however, that grocery category managers and food manufacturer brand managers are not interested in working at the task. There are examples in which stagnant lines have been turned around. PepsiCo/Frito Lay's invigoration of the pretzel market during the mid-1990's is a prime example. The fact that it takes a great deal of effort and expense does not mean that revitalization of a weak category is not worth the risk (Pretzels are still generating huge sales gains). In fact even if nothing can be done to spark the category, food manufacturers need to understand the grocer's perspective and need to be prepared to fight to retain what share and sales they currently enjoy.

Recognizing the Problems and the Trends

The need to revitalize a "challenged" or "rehab" under-performing category can be the result of a single issue such as profitability or declining sales. The need might also be driven by a more complex set of opportunities as perceived by the category manager. These more complex opportunities could include:

- Consumer purchase trends
- Consumer requests
- Studying the category performance in other retailers and other geographical locations.

The above noted points lead to a series of questions that are analyzed by category managers before deciding on a plan to revitalize or not. These questions include the following:

1. Can anything be done to modify the product within the rehab category to complement or capitalize on over-riding consumer trends?
2. Can anything be done to better position or merchandise the category to complement or capitalize on over-riding consumer trends?
3. Is the plan-o-gram and store positioning right given the overall banner merchandising thrust? Is the space justified given the role and volume?
4. Have the worst category performers been culled yet?
5. If there is a seasonal element to sales or margins, can the positive aspects be expanded upon through the rest of the year?
6. Are there other regions or countries in which the category is more successful? If so, why is it more successful and can those reasons be duplicated?
7. Can it be cross-merchandised more effectively?
8. Can another substitute category effectively cannibalize the sales and therefore, put it out of its misery with little loss to overall sales?
9. What is the elasticity of demand? Can prices be increased without hurting sales?
10. Can prices be increased without hurting store positioning?

11. Is there room for private label? Is there room for a low and a high-end private label?

In addition, noting variances in sub category and/or item performance can also serve to raise the question of opportunity to the category manager. In other words, are there items within the category that are doing better than average, and if so can that be built upon?

While both manufacturers and category managers can often see the trends and determine the opportunity, the retailer's perspective can be very different from the manufacturer's view. These differences in agendas can often slow down the timetable for product development, launches and resulting availability.

The retail category manager usually determines that there is a need for an in depth category review as a result of poor performance in the area of sales and/or profitability. The resulting analysis often brings forth subtle trends in that retailer's environment. That renewed awareness can highlight opportunities to confront or dispute costing models, listings, discontinuations or new product development. These usually spark discussions with the trade and the retailer's product development groups.

When category managers want to deal with "challenged" or "rehab" categories, they sometimes confront national brand manufacturers who are hesitant to move forward. One reason for hesitancy is a concern that an in-depth review of options might in fact lead to a de-listing of the manufacturer's product. In addition category managers are often faced with a national brand manager that is more regional or geographically driven than the category manager himself. This narrower focus is based on product logistics such as plant locations. The brand manager's motivation is to maximize the return on existing manufacturing equipment before considering further investment in new equipment or facilities. That is of course no concern to the category manger.

The grocer's product development group is often equally hesitant to participate in a new strategy. The reluctance will stem not only from a resource allocation perspective but also because the category manager does not have enough evidence to justify the effort and expense. The opportunity then boils down to the level of commitment that the category manger will make to initiate change in a category.

Taking the Challenge (the Orange Juice Example)

Creativity is a key ingredient of a successful category manger. This will often drive them to source outside the usual supply chains in a category and look at sourcing a product globally to test the hypothesis they may have. This is usually very difficult because it is clouded with logistical issues and a lack of marketing monies to drive the needed change in a category.

There have been cases where the retailer driven tactics have been very successful. The most vibrant one was the refrigerated orange juice category. Several years ago this category was loosing out to the frozen juice category and many retailers carried only one sku of a "pure" orange juice and a number of blends or "from concentrate" mixes.

The leading sku was retail priced virtually at cost and no number of reconfigurations solved the issues of declining profitability, declining sales and very low average transaction behavior by consumers.

The challenge fell back to the retailer as the immediate manufacturing community did not see or was incapable of responding to the opportunity and risk. The key question was: would consumers pay the price for a pure orange juice, a price considerably higher than the per unit retail in the frozen category? This was in addition to the question of whether consumers would pay more than the products offered by the dominant price driven players in the refrigerated category. There were huge challenges but comfort was found in studying a trend in the US market place and the success story of a premium pure orange juice there. In addition there was a macro trend evident of a growing acceptance by consumers to pay for quality.

Discussions with the US supplier initiated by the retailer quickly highlighted the logistical challenges of managing a short shelf life. This was the barrier or roadblock that prevented others from participating. Nevertheless, by working together it was evident that change could be made. In a matter of a month or two “testing” was initiated, criteria for product handling established, and product launching was under way.

In a matter of a few months the category moved up in sales, profit, and average transaction size as consumers quickly moved from the economy brands and to some degree from the frozen category. Listings became national and without a doubt the category was both revolutionized and revitalized. Today the category is still growing and the number of listings has increased 30 fold from the first launch. The category now includes premium retailer brand listings and flavour extensions.

Dealing With Stagnant Lines

Of course this approach may not work or even be possible for all categories requiring attention. For many categories that are in need of revitalization, there is no choice but to turn to the more traditional shelf management and pricing strategies.

These rehab categories, however, usually do not provide much room to maneuver even with the traditional strategies. These categories are usually under margin pressure because retailers and manufacturers must price them aggressively in order to attract consumers. The fact is that some products and categories just do not maintain consumer acceptance when these aggressive pricing thresholds are increased. Furthermore, competitive markets usually prevent any retailer from increasing prices to effect market change.

Another way retailers seek to revitalize a category, or at least their returns from a category, is to employ store brands. A multi-tier private label strategy can add life to a previously stale merchandising mix. At the very least, the better profit retailer brands or second label can shield consumers from the lower margin national brand. An impediment to this tactic, however, is that in many “challenged” categories, the national brand pricing and cost structure is so lean that there is no room for equivalent quality retailer brands. In these categories the private label cannot be developed and

launched, as the cost differential needed at retail is not possible or economical. This same costing model prevents importing other global brands due to the high costs layered on to manage logistics.

A good example of this was canned milk approximately five years ago. Due to the competitive costing model of the national brand there was insufficient margin room to develop a retailer brand. This was because by the time the retailer brand would have been sourced, delivered and priced, there was not enough of a price differential to penetrate the sales or improve the profit. This was all due to insufficient cost advantages.

When all else fails, these challenged categories are then put on a "maximum retail, minimum sales" set of strategies, while carefully watching share of category and consumer trends. Prices are set as high as possible, which of course is not very high, while at the same time some minimum sales target is put in place. In other words, this is an acknowledgement that while that category must stay in the store, it is effectively written off in terms of merchandising support. The category has become "commoditized."

Message for Manufacturers

The message for manufacturers is four-fold:

1. Anticipate the questions and processes that the category manager is considering and develop a revitalization plan in advance.
2. Give consideration to strategic alliances with companies in other countries or regions that have been successful in the category.
3. When asked to participate in a rehab project for a struggling category, active participation might not only prevent de-listing, it could result in a revival of the category.
4. As long as the product in question is not a flagship or main line brand for the firm, serious consideration should be given to the development of private label for the category. It could result in price improvements for the brand and its quite likely that if you do not do it, another manufacturer will.

If all else fails and there is no hope of revitalization, then the manufacturer must ensure that the category becomes as in-hospitable as possible for the competing brands and private label. That means spending dollars to become the exclusive supplier or keeping costs and prices as low as possible to keep new or old competitors out. In situations in which there is no hope of progress, manufacturers need to acknowledge that grocers are also going to be doing their best to milk as much out of these categories as possible. Trade spending by manufacturers is not going to be passed-through to consumers and promotional depth and frequency will be greatly curtailed. Displays and space will be minimal and assortment will be culled harshly.

The fact is that static lines largely dominate the food industry. In many ways that is the nature of the food industry: slow but steady performers. There is nothing particularly unique or flawed about marketing slow moving lines. Nevertheless, it is a precarious

position for a food manufacturer and it requires constant vigilance to stay ahead of the game.

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