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BUSINESS INSIGHT FOR NATURAL AND ORGANIC BUYERS

Merchandising Organics

By Dan Bolton, Editor, Natural Food Network

Three converging trends are altering the merchandising of organics.

The most significant is SKU rationalization. Whether nip and tuck or a chain-wide clean sweep, retailers are reducing the number of items they stock between 10 and 30 percent. Turns get intense scrutiny under these conditions, even in produce departments where organics are a mainstay. With every linear foot under review, packaged goods organics in center-store aisles often reveal turns that are sub-par.

Second, grocers whose business models were built on continuously adding new products see fewer sellside opportunities. Their focus has shifted to reducing operating expenses. Retailers are now more selective about new oferigns at a time when organic imitations outnumber innovations.

New launches overall were down 30 percent in 2009, the first significant decline in a decade. Mintel International reports that products with an organic claim declined from 12 percent of all launches in 2008, to 10 percent last year. New products with an all-natural claim fell 2 points to 13 percent.

Many categories are over-saturated according to Mintel Chief Consultant and Global New Products Database Expert Lynn Dornblaser who observed, “Natural and organic products, which saw large increases in 2008, took a few steps back in 2009 due to their higher price points.”

Rising ingredient costs and supply shortages complicate manufacturing efficiencies for many organic lines. Dairy farmers supplying national brands like Horizon and Organic Valley, for example, experienced brutal whiplash last year. Priced at $5 or more per gallon in some cities, these brands found themselves displayed next to $3.29 store brand organics and $2.89 conventional. Horizon’s sales fell 22.6 percent to $10 million in the food, drug and mass merchandise channel.

Pricing remains the single biggest obstacle for consumers who are interested but not yet purchasing organics.

Third, and perhaps most damaging to national brands, is the stampede to private label. Due to quality and packaging improvements, private label goods that were once seen as “cheap” are now viewed as “best value.” In 2005 fewer than 13 percent of new product launches were private label. In 2009 that number reached 30 percent. In categories like natural and processed cheese, private label penetration tops 38 percent. Last year’s sales growth of 9.3 percent for private label food products was nearly twice that of national brands, according to Mintel.

SKU Rationalization

Reducing SKUs is now a critical element of every retailer’s cost reduction plan. The Great Recession accelerated the trend as evidenced by mighty Wal-Mart’s decision to slash assortments by 15 to 18 percent. Can you recall a time when brands like Glad and Hefty were evicted from shelves in favor of a program exclusively featuring Ziploc and Wal-Mart’s own private label food bags (manufactured by Hefty). When a retailer with positive growth numbers like Wal-Mart is forced to rebalance its offerings, you can expect that grocers with falling stock values like Safeway and Kroger are doubly anxious and twice as aggressive.

And with good cause, Proctor & Gamble markets 110 SKUs of Tide. Frito Lay sells 46 variations of its Lays potato chips and there are 50 types of Oreo cookies. In 1996 supermarkets stocked 50 percent less than tthe average 47,000 items in today’s stores, according to the Food Marketing Institute. Chain executives say they intend to cut that number by at least 10 percent.

“In the past, reducing assortment was not considered an option,” writes Paul Weitzel in the September 2009 issue of market research firm Willard Bishop’s Competitive Edge. “However, this is a different retail environment and reducing store-level assortment will become an increasingly viable option for retailers.”

“While we expect to see less variety, it’s the complete elimination of brand lines that’s getting everyone’s attention and is unprecedented in the 20+ years that I've been consulting in the grocery industry," says Weitzel.

In addition to cutting cereal selections by 30 percent Kroger moved from a 1.2 case back up on the shelf to 1.5 cases with fewer facings to lower labor costs and reduce the number of trips to the back room.

Other vulnerable categories include organic cookies, crackers and gluten-free baked goods, new age beverages, salad dressings and some ethnic and specialty foods. "The problem is, that no matter what SKU is on that shelf, someone is buying it," says retail consultant Neil Stern of McMillan/Doolittle.

He told the Wall Street Journal that "Eliminating it is going to anger that customer. You have to be really careful. Is that SKU going to be the tipping point that makes them shop elsewhere?"

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Jeff Weidauer, VP of Marketing
Vestcom International

New Product Innovation

SPINS, Inc. the Schaumburg, Ill-based market research and consulting firm for the natural products industry, estimates a monthly average of 1,500 new product introductions in the natural channel with another 400 natural products added monthly that are exclusive to conventional stores. Natural products outsold gourmet in the specialty channel for the first time last year according to SPINSscan Specialty (West). Natural products suppliers launch an average 2,000 specialty-natural items each month, according to SPINS.

But does this onslaught of products actually profit retailers?

There is a huge cost for adding new items that lack real innovation. It affects supply chain efficiencies and reduces consumer/shopper satisfaction. According to Willard Bishop, retailers lose money today on 25 percent of the categories and more than half the SKUs in the center store. "Even well-run stores and strong centralized category management programs have not been able to slow down the insatiable appetite suppliers have for space. In many cases, we simply slice the pie thinner when line extensions and non-value-adding SKUs make their way on to the retail shelf," says Weitzel.

"Thirty years ago, stores turned 12.5 times a year. Today, stores still turn 12.5 times a year. That means we've made no real progress in improving inventory levels in the past 30 years," he says.

Private Label Offerings Accelerate

Although consumers will cautiously return to buying some branded products throughout 2010 as the economy rebounds, a Citigroup analyst expects this to be a "breakout year" for private label growth.

Citigroup's Deborah Weinswig sees rosy prospects. She predicted "another growth spurt in 2010 for private label and exclusive products as retailers cater to the growing demand for these products and better merchandise these products in-store to appeal to the consumer," she wrote in the Private Label Manufacturing Association's e-newsletter. According to Weinswig, food retailers were engaged in a "modern-day price war" last year, but now an "old-time price war" will begin.

Wal-Mart's drastic price cuts are credited for the changing price war. "We view this move as a gamechanger in the food retail industry in 2010," she writes. "As a result, there likely will be further price investments from food retailers and gross margin pressure as they scramble to match Walmart's aggressive pricing in 2010."

Merchandising Recommendations

Based on the trends cited above, merchandisers should:

ONE: Embrace innovation. Expect lesser assortments as grocers strive to lower store inventory to reduce labor and space costs. Reject imitation and reward innovation.

"The recession drained food and beverage manufacturers of their will to innovate in 2009," says Supermarket Guru Phil Lempert.

"The slowdown was especially evident in two places: in the activity of small companies that often differentiate themselves through new products, and in the natural and organic segments.," he says.

TWO: Sell Health. Build loyalty and increase basket size by helping shoppers make healthier decisions. Through shelf and other in-store marketing solutions, retailers who want to move a lot of organics must take time to educate shoppers.

A key finding in research for the Innovation Center for U.S. Dairy is to convince shoppers that "my store cares about the health and wellness of my family." Among best practices cited is making the dairy case "My" store not "your" shelves. The study recommends "building stronger emotional connections by leveraging health & wellness."

"The first rule of merchandising organics is to educate the shopper. Tell her why these products are better, and then give her a compelling reason to try them," says Jeff Weidauer, vice president of marketing for Vestcom International a Little Rock, Ark., firm that specializes in shelf-edge tags and labels that include advertising messages and pricing. While this is standard “awareness and demand” marketing, it requires a greater focus from the retailer to be effective, he explains.

“Make these efforts genuine, as opposed to just another trick to “sell more,” advises Weidauer. “While shoppers understand that their supermarket is a business, they also want to feel valued as part of that business, rather than just another dollar in the till,” he says. “Seek feedback, and more importantly, act on it. Engaging these shoppers at the shelf, as well as other places like online, social media, etc., is a necessary element to a successful organics program,” he says.

“It takes extra effort, but the benefits can be extraordinary. Organics shoppers – and those open to buying organics – are more likely to be highly educated, have higher incomes, and willing to spend a little more to get the products they want. This equals higher margins, and better resilience to economic downturns for retailers who successfully court this desirable demographic,” says Weidauer.

THREE: Showcase organics. More than 80 percent of all supermarkets carry at least some organic product but there is no universal rule for display. The quality of today’s organic produce is equal to and in many cases exceeds the appearance of its conventional counterpart. In produce departments consumers are more apt to look at organic when it is in a separate display. Consider a center island as it helps prevent co-mingling and encourages rotation. Integrate organic in most conventional sets (exceptions include pet food and baby food).

“Integration means the casual shopper is more likely to see the product, but it’s hard to make an impact or educate. Special sections make a statement, but unless a shopper has an interest, she may not visit that section as part of her normal shopping routine,” says Weidauer. In general, label prominently and conform to conventional standards of appearance and (where possible) pricing.

FOUR: Embrace technology. The final few feet of the supply chain are the hardest to manage. Multiply thousands of end points by hundreds of product mixes, times thousands of suppliers and the value of modern distribution quickly becomes apparent. Merchandisers like Acosta, Inc., based in Jacksonville, Fla., one of themost technologically advanced retail sales and marketing agencies. rely on data-driven category management. Acosta’s merchandisers carry GPS enabled smart phones that connect field staff to headquarters enabling “a higher level of execution, with total measured productivity improving by 6 percent in test markets,” reports Brad Smith, Acosta’s Senior Vice President-Retail Operations.

Merchandisers can access product and promotional display images, plan-o-grams, product lists and digitally photograph completed tasks then transmit these images to headquarters. Reportingis in real-time allowing CPG clients to make smarter decisions.

FIVE: Reward loyalty. Loyal shoppers account for 40 percent of sales. The top 10 percent of the average North American retail store’s customers visit the store more than twice a week, spend more than $39 per visit, and represent nearly 40 percent of the store’s total sales, according to an analysis of more than two million grocery shoppers by Concept Shopping.

The study also found that these most valuable shoppers tend to remain very loyal to the store, with 95 percent continuing to shop there throughout the year. Conversely, only 34 percent of the store’s worst shoppers, those who visit the store less than once a month and spend only $9 per visit, remain customers.

“For too long customer data has been synonymous with loyalty marketing, but this is a misconception,” says Gary Hawkins, president of Hawkins Strategic, in Skaneateles, New York.

“A loyalty card is simply a way to barcode the shopper, enabling the shopper to be scanned and made part of the transaction record, just as any product is. While loyalty cards with their attendant marketing programs have been the most prevalent way to identify shoppers, other means of doing so are at hand,” he explains.

Biometrics, RFID cards and tags, mobile telephones with near field communications capability, smart cards and others are all proving to be capable shopper identifiers. These new tools, when combined with digital communication channels, open the door to true individualized retail consumer marketing, a quantum leap beyond loyalty marketing, writes Hawkins.

Merchandising is undergoing a momentous shift in power from retailers toward individual shoppers, says Hawkins. Shopper-identified transaction data is the foundation for this industry movement, he says.

“Without it retailers will be at a significant disadvantage, regularly underperforming their peers,” says Hawkins who calls the shift Retail 3.0.

Hawkins’ view of the future: “Enlightened retailers that communicate with individual shoppers over low cost digital channels (email, web, mobile etc.) while delivering relevant promotions and information will enjoy a steady climb to superior business and financial performance.”