



Wilson Perumal & Company's
Vantage Point

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▶ ***Grocery Retail In Flux:***

Harnessing Five Key Trends Currently Shaping
The Industry



Even by industry standards, grocers are currently experiencing high levels of change, and at an increasing pace. The market has evolved over the last decade, creating opportunity but also introducing new layers of complexity and challenge. Competition has increased as grocery boundaries have blurred, allowing online and non-traditional players to expand into grocery products. In an effort to engage with new consumer segments, grocery stores are not only expanding their inventory ranges but also entering the new wave of mobile commerce. Additionally, supply chains are increasingly global, heightening the interplay of cost, risk, and speed/flexibility in supply chain operations.

Consumer behaviors are changing as well. For instance, baby boomers are the age group that buys the most groceries online, accounting for nearly a quarter of total online purchases¹. And, as social media increasingly weaves itself into the everyday fabric of consumers' lives, so does its influence on purchase decisions and brand awareness.

As new trends arise in this ever-changing segment, grocery retailers must navigate the obstacles complexity can create, such as a misaligned customer offering, declining operating margin, increasing capital expenditure, and a failure to achieve the benefits of scale.

Here we reveal the five key trends grocers must understand in order to handle both the positive and negative impacts of this changing landscape.

- Mandatory Localization
- Omni-Channel Integration
- Promotional Effectiveness and Efficiency
- Big Data “Arms Race”
- Contraction and Consolidation

TREND 1

MANDATORY LOCALIZATION

The often-cited concept of localization has turned into a mandatory skill retailers must master in today's grocery retail industry. Yet many retailers still struggle with the question of how far to go: what is the appropriate scope of localization that should be applied in order to expand and best-manage each geographic location.

The challenge retailers face arises from upcoming demographic shifts favoring various racial and ethnic groups, as well as changing age cohorts. By the year 2035, the nation's Hispanic population will rise to 23% from about 17% presently. This particular population subset will account for about 20% of the

¹ Source: IBISWorld

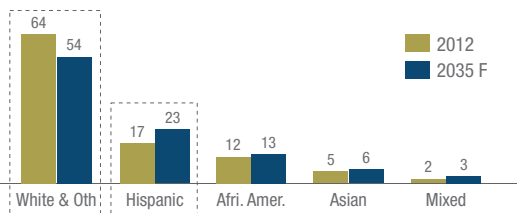
The challenge arises from upcoming demographic shifts, which is not equally geographically distributed. By the year 2035, the nation's Hispanic population will rise to 23% from about 17% presently.

money spent on food within the next two decades, as shown on the graph on the right. At the same time, the percentage of Caucasian ethnicity in the United States will drop to 54%, about a 10% decrease over the projected 23-year period.

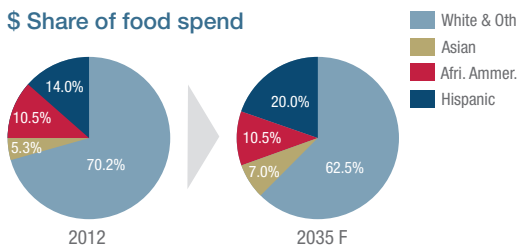
This suggests that grocers should engage in extensive localization, selectively expand their product range, and re-assess their footprint and format. Grocers should not only offer products to meet local demand but also possess deep understanding of consumer segments and local behavior to develop differential product pricing and carefully adjust the planned customer journey.

Race/ethnicity and age mix changes rapidly, and it is not equally geographically distributed*

Population by race and ethnicity (2012, 2035F)
Percent of total population



\$ Share of food spend



*Source: Nielsen consumer reports; US Census Bureau; Euromonitor report; WP&C Analysis

- Economies of scale
- Simple supply chain
- Easier to manage
- No additional CapEx required

Increasing Complexity and Cost



- Few economies of scale
- Complex supply chain
- Hard to manage
- Large CapEx requirements



Retailers should choose the most appropriate level of localization to balance economies of scale with the benefits of a tailored offering. Decisions on degree of localization will be based on your strategy, size of your supply chain, timeline, available data and analytical capability, execution resources (capital and human), and the flexibility of your operations and organization.

TREND 2

OMNI-CHANNEL INTEGRATION

Another of today's key growth engines is omni-channel integration. Constructing a coherent omni-channel framework is crucial when facing challenges posed by the online channel's rapid growth. Online grocery sales in the United States generated about \$6.5 billion in revenues in 2013 alone. This revenue is expected to grow 9.2% year over year until 2018².

An omni-channel presence brings with it many opportunities, including extended product range, early product launches, improved cross-selling, focused marketing efforts, and lower operating costs. Realizing the full potential of an omni-channel framework, however, requires overcoming certain obstacles, most importantly cutting through the sheer complexity of operating across online and brick & mortar channels.

Contributing to this complexity is a myriad of execution issues. For example, the online and offline operating models must be closely aligned to limit cannibalization across channels. They should also be agile enough to respond to an imbalance across stock availability, holding costs, and waste. If not executed properly, omni-channel integration may lead to self-cannibalization across channels, under-performing category management, and increased headquarter costs.

Our experience shows that the two key aspects of winning online competition in a profitable manner are to develop the right operating model and ensure alignment of internal processes. Grocers who prioritize operational coherence and integration across all channels can thrive in today's increasingly complex marketplace.

Key Online Grocery Statistics*

Online grocery sales continue to grow rapidly, driving leading grocers to invest in the sector

\$6.5 billion

Revenue generated by online US. grocery sales in 2013

9.2%

Predicted annual growth rate from 2013 to 2018 to eclipse the \$10 billion mark

18%

of U.S. households went online in the past three months to buy food, beverages or groceries

Of these:

75%

purchased 5% or more of their groceries online, and

20%

purchased at least half online



*Source: IBISWorld; Statista 2014; The Online Grocery Shopper report 2013, The Hartman Group, Inc.

TREND 3

PROMOTIONAL EFFECTIVENESS AND EFFICIENCY

Traditional promotional levers are no longer driving the same lift previously achieved. Consider how the number of marketing channels has increased over the years. Consumers are now faced with a variety of promotional options, across multiple channels, at a wider variety of store types and formats. As a result of this saturation, price

² Source: IBISWorld

competition has intensified, marketing spend is fragmented, and overall lift has declined. For example, despite an overall increase in CPG coupons distributed (+3.3% in 2013 over the previous year) and an increase of new products introduced through free-standing insert (+18.3% in 2013), the total volume of CPG coupons redeemed in the US declined (-3.4% in 2013)³.

In our grocery client examples, this erosion has led retailers to expend substantial time and resources on further promotion initiatives, only to achieve ineffective and costly promotions that deliver low-impact results. Many times, inaccurate forecasting derails the supply chain, leading to unforeseen overstocks and out-of-stocks. Corporate planning can become overly detailed, leading to multiple handoffs that, in turn, call for frequent rework. Store labor is also impeded, increasing the labor required to stock shelves, assemble displays and provide customer service.

Nonetheless promotions remain critical to driving traffic, influencing basket composition, and increasing brand awareness. To get a promotions program on track, retailers can begin with a promotional diagnostic to understand true performance. How well do promotions meet their objectives? What is the real cost of managing these promotions?

These issues must be examined from both a top-down and a bottom-up approach. The former illuminates how promotions meet strategic business goals and customer needs. The latter evaluates individual promotion performance against expectations in terms of effectiveness and efficiency. Properly executed, promotions can continue to be a key lever to drive lift while being more flexible, dependable, and less expensive.

TREND 4

BIG DATA “ARMS RACE”

The days when personalized and value-added services were considered “extras” are long gone. Now these new forms of convenience and overall value are expected by consumers. Grocers are prompted to provide more personalized customer experiences as part of a comprehensive shopping package. They must pay particular attention to this expectation to combat intense price competition.

As this personalization trend evolves, customers have become increasingly accustomed to direct communication on the part of grocers. Approximately 55% of shoppers expect retailers to offer promotions based on their prior purchase choices, and 43% expect grocers to recommend new products based on their purchase histories. Hyper-local advertising and the ability to attract customers within smaller geographic locations are becoming crucial tools in today's grocery industry.

The online and offline operating models must be closely aligned to limit cannibalization across channels. They should also be agile enough to respond to an imbalance across stock availability, holding costs, and waste.

³ Source: NCH Marketing Services, Inc., Coupon Facts Report, 2014

Personalization Trends and Implications

Trend

Grocery retailers are providing more personalized customer experiences to combat intense price competition



The 'Just for U' program gives shoppers digital coupons and deals on items they regularly buy



Amazon enhances one-on-one interaction with specific product recommendations



Ahold is leading the way with consumer choice for online orders, in-store pickup or delivery



Hyper-local advertising, the ability to target customers by location, is on the doorstep

As more companies employ these services, they will become expected rather than value added extras

Implications

Consumers are becoming increasingly accustomed to direct communication¹

55%

Use my prior purchasing to offer me promotions

43%

Use my prior purchasing to recommend new products

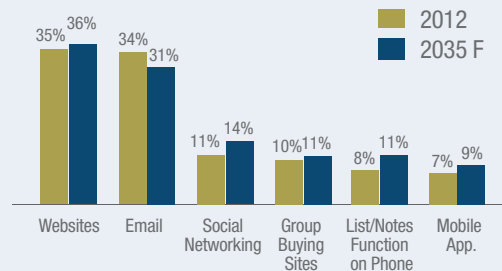
43%

Invite me to events

36%

Involve me in new product ideas

Grocery retailers have more access to consumer info than ever before²



¹Source: IBV Retail 2013 From Transactions to Relationships: Connecting with a Transitioning Shopper Study

²Question: What online or interactive tools/sites do you use regularly for planning your grocery shopping trip and/or which specific products you eventually decide to buy? The Why Behind the Buy, Spring 2013, Acosta Sales and Marketing Source: WP&C research and analysis.

Such trends allow retailers access to never-before encountered amounts of data directly from their target audiences. In the past year, 14% of grocers have used social networking to gather consumer information, a 3% uptick in the utilization of this method. In the meantime, direct e-mail campaigns have decreased from 34% in 2012 to 31% in 2013.

The availability of consumer data has grown exponentially thanks to grocer-shopper

interactions in the social media sphere, elsewhere online, and through loyalty and rewards programs. Improved access to multi-channel interactions and data vendors provides a multi-faceted view of the consumer, allowing for tailored promotions and customer experiences. Initiatives at the individual level maximize sales and customer satisfaction.

Access to this data, however, is just the beginning. Retailers must then be able to

utilize this data to better shape predictive analytics, including more effective advertising and service delivery tactics. Deeper data mining stemming from these analytical tools and reduced storage/processing costs can permit further cross-selling and up-selling if leveraged correctly. Of vital importance is simple experimentation that provides retailers with easier testing of customer responses, resulting in more accurate future value estimates. This aids the long-term goal of customer acquisition and retention.

TREND 5

CONTRACTION AND CONSOLIDATION OF TRADITIONAL FORMAT

Contraction and consolidation continues in the traditional grocery retail industry. In fact, the market share of traditional grocery formats is shrinking each year, albeit at a slowing pace. Traditional supermarkets are expected to decrease in market share from about 40% to about 36.5% by 2017. In the meantime, non-traditional supercenters and convenience stores now account for about 32% of the \$1.11 trillion industry. But in about four years they will make up close to 35% of the \$1.25 trillion market.⁴

The consolidation brings implications, not only on the physical stores, but also on the operating model. Grocers frequently see value in rationalizing branches. Asset/footprint consolidation, the speed of migration, and post-merger integration are additional concerns. Subsequently the supply chain, inventory stocking, pricing, and branding are all impacted. Consequently, contracting the footprint without the rationalization of these aspects will not deliver the expected impact on the business.

Traditional formats are struggling as a viable option. Grocers now must incorporate other growth levers, including a smaller format and new product categories.

Implementing these combined levers in the course of migrating or integrating back-end processes can quickly escalate into an overly complex business, unless carefully managed. The more products and services a grocer offers, the greater the chance of customer confusion and poor service. The higher the number of processes, steps and handoffs, the more likely duplication and reworking will occur. Rethinking the operating model in the face of a new footprint, and the rightsizing of operational requirements, is a key competitive advantage retailers must master in the race for hidden profits.

CONCLUSION

We've discussed several of the emerging trends in the retail grocery industry, but the excitement about grocery retail, and the challenge, is the pace of change. New challenges emerge overnight. What is crucial to remember is that overcoming increasing complexity requires a holistic and integrated approach across all channels, silos, and strategies. Another key point to keep in mind is that long-term adjustments are necessary to address a changing consumer population, a growing customer demand for personalization, and blurred lines of traditional and non-traditional formats. Evaluating all these factors in tandem will lead to more streamlined business models and larger profit, both in the short and long terms.

⁴ Source: Neilson What's In Store 2016; Willard Bishop, Includes both grocery and consumables; WP&C analysis.

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About Wilson Perumal & Company:

Wilson Perumal & Company is a premier management consulting firm and the leading advisor on how to manage and capitalize upon the complexity of today's world. To learn more, visit www.wilsonperumal.com.

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