Three Trends Changing the FMCG Ecosystem

Best Practice White Paper

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Why read this paper?

This paper addresses at a high level three important trends that are permanently changing the FMCG competitive ecosystem. These changes affect all the industry participants: retailers, manufacturers and the diverse community of solution providers. The three trends and their implications are:

- **The Growing Power of the Retailer.** The traditional weapons of FMCG mass marketing (TV and magazines) have lost effectiveness and especially efficiency thereby debilitating brand equity building. At the same time retailers have consolidated and now dominate the moment of truth at the shelf aided by new tools such as loyalty cards. The balance of power has permanently shifted towards the retailer.
- **The Digitally Empowered Shopper.** Today's shopper can rapidly compare price and quality. This creates new shopping behaviors especially the cherry picking of formats to satisfy specific shopper need states.
- **The Big Data Big Bang.** Digitally driven shopping behavior creates billions of variegated data points. This tsunami of data comprises 'big data'. Applying new predictive analytics to this expanding data universe enables marketers to better understand and influence shopper behavior.

Actions to consider

If you are a retailer:

1) Immediately begin building a 'big data' capability primarily by identifying a small test situation where you may explore your capability to combine data sets to create competitive advantage.
2) Recognize the imperative to create customized stores by neighborhood by varying category space and assortment to optimize the shopping experience and total store profitability.
3) Address the shopper leakage problem caused by shopper's fulfilling specific need state requirements at other formats. Recognize that internal organizational silos and inadequate processes frustrate your ability to build volume through superior need state marketing. Reach out to the CMA for help in overcoming your problems.

If you are a manufacturer:

1) Understand how total store optimization will affect your company.
2) Begin mastering multi-category need state marketing by partnering with a retailer's efforts.
3) Ensure that your company is organized to exploit 'big data' primarily by identifying what you wish you knew and then identifying combinations of data that can yield the answer.
4) Recognize you must collaborate more effectively with retail trading partners and move up the Category Management maturity curve.

The digitization of the shopping experience changes everything, both empowering the shopper to cherry pick retail formats for superior deals but also enabling the retailer to respond across the demand and supply continuum in a more efficient manner. Local store customization is the logical outcome.

Brand equity declines while retailer power grows. The balance of power between trading partners has changed probably permanently!

Brand Power Declines, Retailer Power Increases

Traditional brand building weapons are declining in efficiency and effectiveness

The 20th century saw the development of mass communication. First the great newspapers, then the hugely popular mass magazines like Good Housekeeping and McCall's, then the all-pervasive radio networks like NBC, Mutual and CBS, each with mass audiences for popular programs like Jack Benny, Burns and Allen and Fibber Magee and Molly. Finally in mid- century came the mass medium of all mass media, TV. With its dynamic combination of sight, sound and motion, TV captivated America as no medium had previously done. With only three national network viewing choices available to most homes for the last 50 years of the century, every family in America gathered around the electronic alter to watch its favorite weekly show. Reaching large loyal audiences was easy and relatively cheap especially during the day time. Marketers like P&G built large brands on the strength of highly efficient daytime commercials on shows like Guiding Light and Days of Our Lives. At night, large audiences often exceeding 20 million homes per episode watched iconic shows like I Love Lucy, MASH and All in the Family.

Low cost, high reach TV enabled the building of mass brands through commercials that were memorable and persuasive. Then in the late 20th century, media began to fragment. Audience size declined for Individual shows but costs kept escalating so that cost/thousand target Households sky rocketed. By the early 21st century, CPM's had increased 4X in 25 years. Equally ominous was the effect that fragmentation and channel surfing had on viewer attentiveness, recall and persuasion. These scores dropped by ½ in the same period. This meant that persuasion or brand equity building was nearly 8 times more expensive. Some of this cost was offset by price inflation but cost per usage and profit per usage for FMCG brands was dramatically less than the increase in the cost of persuasion. The net result was a drop in brand equity scores over the past 25 years as consumers perceived less difference among brands and shifted their purchases among brands based on price driving profits down.

Retailer Power Increases

As brand building power waned, the power of the retailer began to increase. The first cause was retail chain consolidation. In 1960, the largest food retailer in America was A&P with a total US share of 3%. By the mid 1990's 4 grocery retailers had a total US market share of approximately 10%. During that same period an even more formidable retail format, the supercenter was introduced and taken nationally by an obscure retailer out of northwest Arkansas. From nothing in 1960, Walmart built a 30% share of the grocery business by the early 21st century.

In virtually every major market one of these large 'national' grocery chains or Walmart had a share of over 33%. In most markets, two chains, Walmart plus a Kroger or Safeway had nearly 60% of the FMCG

The power in the shopping process is now shifting away from retailers towards the shopper armed with the Excalibur of information, the ubiquitous smartphone!

market. A similar consolidation had taken place in the Drug channel with the result that on a national basis, seven buying points accounted for over 70% of national volume in virtually every FMCG category. This meant that retailers were much more effective at reaching a huge share of shoppers than television. Moreover, these retailers were touching shoppers at the ‘Moment of Truth’ while the shopper was in the act of buying at the store shelf.

Many of these retailers augmented their sheer market dominance with the introduction of shopper loyalty cards giving them new power to understand shopper behavior and to influence their buying decisions. After a slow start in the early 1990’s, the food chains especially grew more and more adept in using the loyalty card to grow share of wallet and their own retail profit margins. It is no coincidence that some large chains became so adept at using loyalty card data that they grew share in their markets even in the face of Walmart’s expansion into these markets.

The power of the retailer and their capability to attract huge ‘audiences’ to their shelves at least once a week made their aisles an ever more importance locus of brand marketing. FMCG marketers began shifting their budgets from conventional advertising vehicles to ‘shopper marketing’ options. This shift reflected both the weakness of traditional brand building vehicles and the increasing importance of the retail store as ground zero for marketing dominance.

But this shift of power from conventional marketers to conventional retailers began to be threatened by the development of new retail formats with distinctive market place positioning. Whole Foods began to leverage the growing interest in healthier eating while the Dollar stores and deep discounters such as Aldi’s and Save-a-Lot offered branded and off brand merchandise at very attractive prices in easy to shop, easy to park neighborhood locations.

But the largest threat to the dominance of conventional retailers of all types and stripes was yet another new development, the rise of the digitally empowered shopper.

All Hail the Digitally Empowered Shopper

Digitization changes everything for retailers, manufacturers and shoppers

It seemed to burst upon us so suddenly that most did not realize the digital era had been over 40 years in development. It began in 1980 with the development of the IBM PC. By 1990 the device had become ubiquitous in most businesses and was penetrating the millions of U.S. homes. By 2000 the development of the internet was bringing information by the megabyte to businesses and individuals. As the power of the microchip doubled every 18 months, consumers began to buy telephones with more computing power than the original IBM Univac. With astonishing rapidity came search engine optimization from Google followed by even more powerful smartphones which brought even more data to the shopper.

By the second decade of the 21st century, shoppers began to use the smartphone as a shopping aid. For many shoppers what began as a complement to the shopping experience rapidly became a valuable tool and to some an obsession. Early adopters began to realize that the smartphone enabled price comparison and the ability to find exactly the right product from obscure locations previously unknown. By 2013, Amazon, who began as a book seller, had developed a 20% share of disposable diapers, an astonishing achievement in such a short time, thereby proving the power and speed of the trend from bricks to clicks in some categories.

As smartphone penetration soared past 50% of U.S. households, even more shoppers experimented with digitally enhanced shopping. What was once an infrequent adventure on to the internet to find a better price for a considered purchase such as household furniture, an appliance or an automobile went rapidly upstream to the weekly shopping trip. By early 2013, 52% of shoppers were regularly using the PC or cell as an integral part of their shopping process. Over 30%of shoppers reported using digital coupons. More than 20% of shoppers reported using two or more sites to plan their shopping experience. Comparison shopping among various channel options became a normal occurrence.

Some shoppers began choosing specific retail formats for specific need states. Many consumers chose category killers like pet stores while others chose Walmart, Costco or CVS for specific needs and need states. In almost every case where shoppers chose these channels the loser was the conventional grocery channel. The phenomenon of 'leakage' defined as a regular shopper of one channel going to another for a product available to her in her normal food channel, was becoming an epidemic. The most extreme and oft cited example is new mothers buying their disposable diapers from Amazon while purchasing baby food at the neighborhood supermarket.

Everyone correctly believes the internet and the smartphone have changed the shopping experience permanently so now marketers, both manufacturers and retailers, are in a frenzied search for ways to leverage the new digital tools to intervene in the path to purchase in more creative and effective ways.

Everyone recognizes the key to the future is leveraging the torrent of new digital data, 'big data', to target shoppers using new predictive analytic software to recapture the shopper's affection.

Understanding and leveraging 'big data' is now the key to regaining the affection of the digitally empowered shopper!

Big Data Comes to the Rescue (Maybe)

> *'Big Data' is the torrent of structured and unstructured data available to understand and influence shoppers*

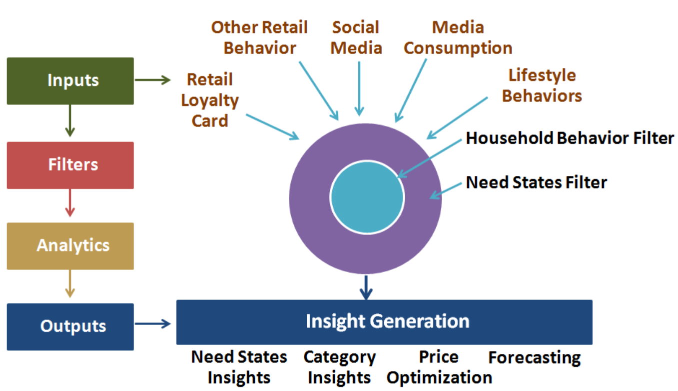
The digital revolution started it all. It enabled the creation of cable and satellite TV which started the fragmentation of media that weakened the brands. It enabled the development of loyalty cards that empowered the retailer and now it is handing the power to the shopper sitting before her computer or standing in the store aisle, smartphone in hand. In the struggle for primacy between the FMCG brand owner, the retailer and the shopper, it appears the shopper will be the real winner in the long term

But as the shopper searches for answers, buys product and even subscribes to a magazine or gives to a charity, she is giving back part of the power to brand owners and retailers who can analyze these behavioral patterns to understand shopper attitudes, needs and values better than ever before.

The FMCG ecosystem is creating data an incredible rate. Every day more than 2.5 quintillion bits of new data are created AND stored. Examples abound regarding the incredible speed and amount of data being created. In the two weeks after the Hubble telescope began sending back pictures of deep space, astronomers learned more about the solar system that in the previous 200 years. As the data multiplies so does the capability to analyze it using new predictive analytics software driven by more powerful computer hardware. But the picture is not all that easy to discern because the power lies in combining data sets that sometimes resist easy combination. Some data sets are structured like loyalty card data while other data is unstructured like that from social media. Linking that data in meaningful ways can be daunting. Finding meaningful actionable insights can be next to impossible.

Developing analytical protocols producing actionable insights is the single largest challenge for marketers today and into the foreseeable future. The table at the right describes one approach to how data could be organized and processed to bring insights from the incredible scope, variety and type of data being generated. This approach advocates organizing and sorting data by household and need state (baby needs, diabetic needs, etc.)

Organizing Big Data for Insights



Even though big data is empowering the shopper at the expense of manufacturers and retailers, BD does help both of these parties in major ways. In the case of manufacturers, Big Data helps by:

- Improving understanding of shopper needs
- Enhancing targeting capability
- Building a direct relationship with the shopper
- Uncovering unarticulated shopper needs
- Improving allocation of marketing $'s

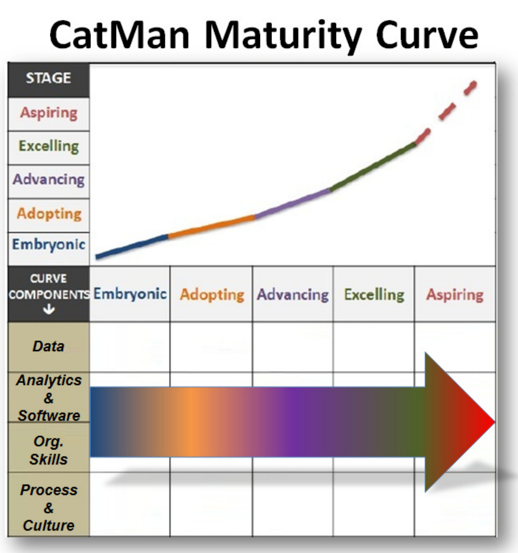
In the case of the retailer, big data helps by

- Facilitating household level offer customization
- Enabling localized/customized pricing
- Personalizing communication
- Converting shoppers to private label
- Strengthening shopper loyalty via personalized offers
- Permitting marketing to specific shopper need states (e.g. baby needs)
- Enabling true shopper management

But one of the major advantages of Big Data is its ability to facilitate Total Store Optimization (TSO), the customizing of category space and assortment for each neighborhood store. This means more satisfied shoppers, fewer out of stocks , higher sales and profits.TSO has become an obsession with retailers once they realized how greatly shoppers varied by neighborhood in their tastes and buying habits. Until now however, retailers have been frustrated in their ability to understand demand by neighborhood and their ability to manage the supply chain. Big data helps both issues assuming retailers and manufacturers have the tools and trained personnel to use the data properly.

Mastering Category Management

For both trading partners and especially the retailer, the key to responding to the three trends is mastering the discipline of category management. Based on the extensive work of the Category Management Association, practitioners can orient themselves along a CatMan maturity curve which pinpoints progress on four performance characteristics: Data availability, software and analytics, organizational skills, process and culture. The table at the right captures progress in these areas from the initial stage called 'embryonic 'to the ideal end state of 'aspiring'.



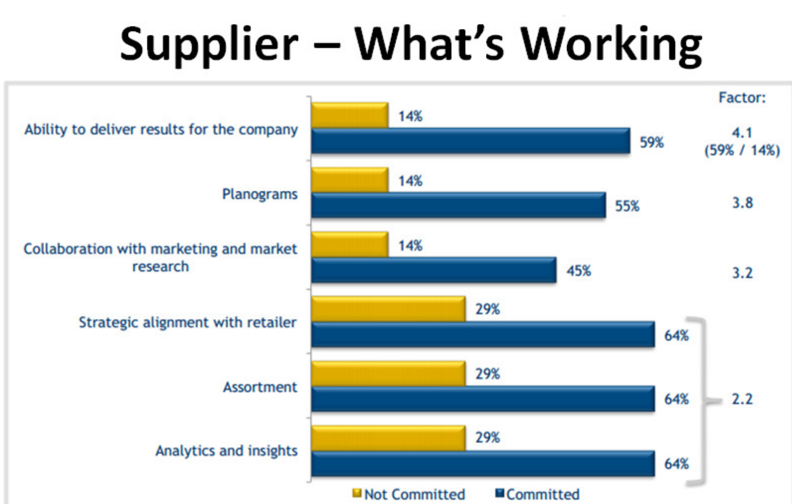
The detailed specifics of the maturity curve model are available from the CMA by going to our website (cpgcatnet .org) and downloading the free white paper, ***Category Management Mastery: The Key to Growth'*** Below is shown one example from the 'excelling' stage along the maturity curve for the software and analytics characteristic:

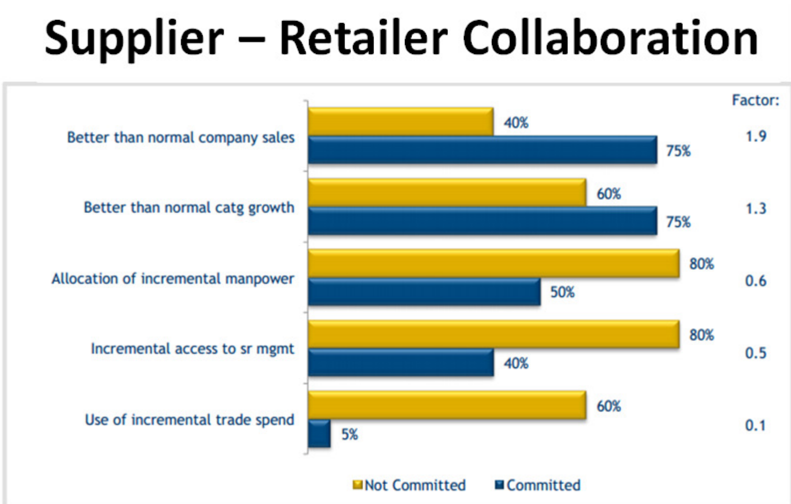
The Excelling stage

- **Analytics and software**
  - Advanced assortment analytics by total store, aisle and allocated category space linked to predictive analytics on to supply chain.
  - Three-dimensional shelf and aisle modeling capability.
  - Activity based costing for category, brand and items
  - Advanced loyalty card analytics capability by shopper behavior and groups
  - Individual store level supply chain analytics to reduce out of stocks
  - Advanced basket and shopper purchase analytics by category and broader need state
  - Shopper card analytics by store and category most valuable shoppers.
  - Success models for assortment, shelf merchandising, pricing and promotion by format.

The Importance of Collaboration

The mastery of Category Management by retailers and manufacturers is clearly critical to thriving in the emerging FMCG ecosystem. But another lesson has also emerged. Neither trading partner can deliver superior results for its common shopper- customer without collaborating aggressively with the other. Both trading partners have multiple assets and capabilities to contribute to the value stream. A recent survey on the state of Category Management conducted by The CMA in collaboration with The Partnering Group, demonstrated how collaborating trading partners were getting superior results. Those trading partners who are collaborating are experiencing improved business results and growing category volumes as is shown in the tables below.





Summary

The FMCG ecosystem is changing rapidly driven primarily by underlying changes in digital information delivery that is simultaneously weakening brands, strengthening retailers and empowering the shopper while creating an unprecedented tsunami of data.

From this data, both manufacturers and retailers are learning more about their common shopper and understanding the importance of household level customization of marketing efforts. This data in turn is enabling retailers to customize their store layouts and category assortments to the store level. Perhaps most importantly, the improvements in instantaneous interactive communication enabled by the cell phone is empowering shoppers to meet their needs in ever more personalize fashion creating a new shopper paradigm characterized by cherry picking among retail formats to meet differing need states at different retailers more attuned to each shopper's unique needs.

Acknowledgements

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The Category Management Association is solely responsible for the findings and conclusions herein.

For more information please contact the author:
Gordon Wade
Managing Partner and Director of Best Practices
gwade@cpgcatnet.org
859-360-2828 direct line USA Eastern Time
513-608-9461 cell phone USA Eastern Time

Gordon Wade is one of the founders of the category management discipline. In 1991, along with Dr. Brian Harris and Bill Burns, Gordon started the Partnering Group to improve collaboration between retailers and manufacturers. They were asked by the CPG industry co-coordinating committee called Efficient Consumer Response (ECR) to lead development of the category management process.

Gordon's personal contributions to CatMan include the development of the Efficient Item Assortment process for the ECR committee along with virtually all the consumer focused analytical templates subsequently committed to software by Nielsen and IRI. Gordon has served scores of manufacturer clients around the globe in the development of their CatMan platforms and has facilitated category management projects with retailers and manufacturers on every continent.

In 2005, he was asked by the Association of National Advertisers, the world's largest Marketing Trade organization, to develop best practice in marketing accountability, the measurement of marketing's ROI. He has published two white papers on accountability that focus on the interrelationships of process, metrics and systems. He has founded six marketing related companies and currently serves as an advisor, board member or major investor in three leading edge marketing services companies.

Gordon is an alumnus of P&G's marketing department and a graduate of Harvard. He resides in Kentucky with his wife, Jill and noble dog, Grace.