The Tipping Point for Center Store

HOT TOPIC REPORT

March 2013

The 1930s marked the advent of the traditional grocery store format most familiar to us today. Designed for self-serve access and complete with perishable and packaged goods, categorized aisles and spacious parking lots, it was the epitome of convenience. The center of the grocery store was traditionally the heartbeat of the supermarket. Most everyday household items consumers needed to replenish were found there - ketchup, mayonnaise, soft drinks, laundry products, etc.

Surprisingly, relatively little has changed in the center store formula in over eight decades; yet, much has changed about the shopper and channel landscapes. Channel options have expanded, shopper demographics have changed and, with that, U.S. shopper behavior has fundamentally changed. Shoppers now have more choices than ever. Most shoppers today shop in five or more channels.

Center store "leakage" to other formats has become a key issue for the entire grocery industry, in part because channel lines are blurring. Mass stores offer an increasingly robust assortment of key center-of-store options; drug stores and dollar stores continue to add center store food and beverage items; club stores are offering more affordable meal solutions.

Summary

Once the "center" of the grocery shopping experience, center store has lost its zing. Center store traffic and revenue are declining. Understanding the variety of reasons for center store leakage are key to developing strategies to win shoppers back. While some retailers and manufacturers are beginning to address center store leakage, the majority of the industry is not responding swiftly enough and losing revenue as a result. The time has come for a sea change in center store.

Center Store is generally defined as: Packaged Food, Beverages, Health & Beauty Care, General Merchandise, and Home Care

Many traditional retailers have attempted to reinvent themselves and stay relevant to shoppers by revamping their perimeters – creating a much more dynamic shopping experience and capitalizing on the natural and health and wellness trends. But while this fascination with the perimeter has been rewarded by increased traffic and consumer relevancy, it also has eaten into center-of-store categories and diluted overall store profitability.

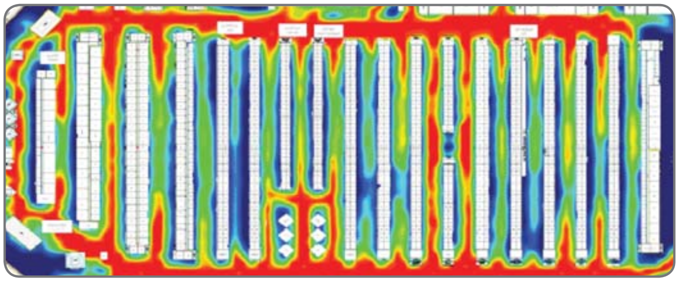
Lost Trips & Lost Sales

Market indicators point to continued pressure on center store categories, and center store sales continue their decline. According to Nielsen estimates, grocery retailer center store unit sales are down 3.4% since 2008. The grocery channel has lost trips that translate to $23 billion in lost sales and nearly $8 billion in lost gross profit dollar sales over the last five years. Supermarket space for dry grocery and HBC products has declined by 2% over the past two years while perimeter departments like meat and produce have increased.

Several retailers are getting serious about developing new strategies to revitalize center store traffic, sales and profit. Some have converted to every day low pricing while others have implemented major overhauls to enhance and differentiate the shopping experience and protect margins. Wegman's, for example, now uses the center store as an area to sell upscale non-food items; Trader Joe's moved to an all store brand format while limiting assortment; Whole Foods has focused on "owning" the organic/natural consumer; and Target has capitalized on the store-within-a- store concept.

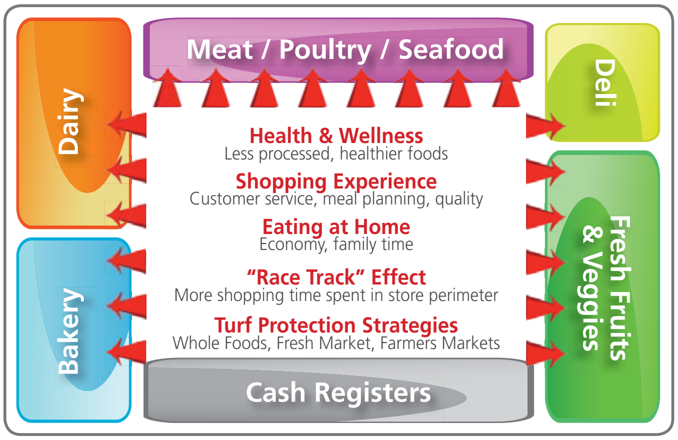
With center store contributing upward of 70% to 80% to the bottom line profit for grocery retailers, there is a strong incentive for retailers and manufacturers to invest time and resources to address center store shrinkage.

Most traffic occurs in the perimeter of the store



Red = Highest traffic areas

Factors driving perimeter growth



Key Trends Influencing Center Store Performance

Fundamental Changes in Shopper Behavior

Shoppers spend most of their actual shopping time in the perimeter of the store. According to a Video Mining™ study of over two million shopping trips, the average shopping trip is just under 13 minutes, with 39% of the trip spent shopping in the perimeter and only 18% occurring in center store. The remaining 44% of shopper time is spent navigating the store and waiting in checkout lines. This suggests a couple of key questions: How can retailers convert navigation time to shopping time, and how can they balance the perimeter and center store shopping time?

Generational Shifts

Millennials (ages 18-29) are the key shopper segment to consider when it comes to center store reinvention. According to Acosta's Fall 2012 *The Why? Behind The*

Buy report, 21% of Millennials indicated an increase in total household income over the past year. Millennials are becoming a bigger part of the spending picture, and they have major life events like buying homes and starting families still ahead of them.

So what motivates the Millennial shopper? They live fast-paced lives and prefer ready-to-eat meal solutions. Younger shoppers are shopping the perimeter fresh departments for "what's for dinner tonight" solutions. They are not stockpiling inventory. Millennials are environmentally conscious, health conscious and concerned about where their food comes from. Product transparency is important to them, and they consider product features and benefits – not just low price – when defining value.

Millennials are heavily influenced by word-of-mouth suggestions and endorsements, and they enthusiastically embrace technology and social media. To be successful, the CPG industry will need to embrace this new breed of shopper and create a two-way conversation with them, looking to them for new offering inspiration and early adoption.

Millennial attitudes are largely about the experience in store:

It's fun to see what is new and out there and to see the deals and sales.

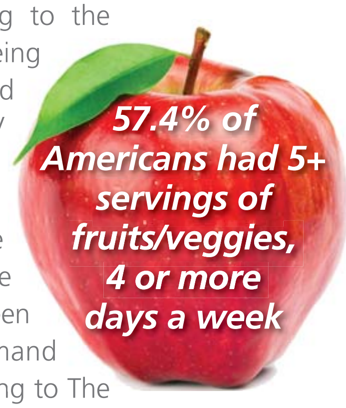
I love exploring new products and ideas ... the alone time.

I enjoy comparison shopping as well as discovering new, healthy items for purchase.

I learned from my mother how to do shopping well. I like to go when it isn't crowded so I can take my time and de-stress from work.

Health & Wellness Focus

Despite frugal shopping behaviors that linger from the recession, shoppers are willing to spend more on healthier products. According to the January 2012 Gallup Well Being Index, 57.4% of Americans had five or more servings of fruits/vegetables four or more days a week, increasing from 55.3% in 2009. Additionally, the rise of dietary-focused products like gluten free and low salt has been a response to shopper demand for healthier options. According to The Hartman Group's *Ideas In Food 2013*, the coming year will be focused on cleaner, fresher and unprocessed meals. Manufacturers are expected to take gluten free to the next level, even convenience stores like 7-Eleven stores are aiming for 20% of sales to be generated from fresh foods by 2015.



Cultural Influences

The U.S. Hispanic market is the fastest growing ethnic group in the U.S. and the group with the greatest buying power. Hispanics spend more on food than the general U.S. population, with a higher average monthly food budget and bigger spends on both routine and stock-up trips. Their buying power was $1 trillion in 2010 and is estimated to grow to $1.5 trillion by 2015.

We studied the top 20 supermarket categories and uncovered a key fact – the majority of household penetration growth across 17 of the top 20 categories was driven by new Hispanic households entering the category. In some categories as much as 70% of household penetration growth was from Hispanic households.

So what drives the Hispanic shopper? In a word: family. Meal times are important social interactions and U.S. Hispanics cook more frequently at home than the general population. What makes the Hispanic shopper different? They make an effort to eat healthy foods, including organic. Hispanics are social shoppers who tend to shop as a group, with family members and even friends. They shop more often and their use of technology rivals, even in some cases surpasses, that of Millennials. Another important insight for CPG manufacturers and retailers is that U.S. Hispanics relate to two identities – American culture and their Hispanic roots – and Spanish language helps keep them connected to their traditions.

Download Acosta's The Why? Behind The Buy HISPANIC report at www.acosta.com/hispanic-why.

Channel Blur

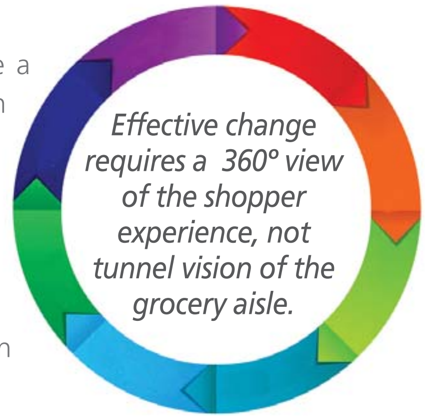
As reported in our Fall 2012 *The Why? Behind The Buy*, one-third of shoppers indicate they buy most of their food categories, most of the time, in channels other than grocery. The proliferation of channel options, from super centers to dollar stores, has significantly impacted the grocery store, especially the center aisles. This trend was exacerbated by a prolonged recession that led shoppers on a hunt for better deals. Dollar stores saw the greatest increase in store visits – attracting 5% more U.S. shoppers and a whopping 10% more Millennials.

Fresh Approach

Consider the rise of fresh format stores such as Whole Foods and Fresh Market. Their typically smaller footprints make them easier to navigate, and they often have no real center. Scaled down refrigeration displays featuring aged romano cheese and fresh tomato sauce tucked right beside dried pasta in an "Italian Foods" section answer the "What's for dinner?" question. Extensive labeling appeals to Millennials, health conscious shoppers and foodies who want transparency in the products they buy. Health and beauty products are merchandised in boutique style. These retailers do a lot of sampling, a lot of labeling and signage, all in an effort to create a sense of transparency and demonstrate the freshness and healthiness of what they're selling.

Roadmap for Center Store Growth

The road to center store reinvention is likely more of a journey that will take a variety of tactics, rather than a quick and easy straight path. There are often organizational or logistical challenges to address. In some cases, there are financial barriers to making changes. A key question in reinventing the center store is: If I were building a store from scratch based on how a shopper shops, what would that store look like?



Center store reinvigoration does not need to be an all or nothing proposition. The process can start with a review of category adjacencies, progress to aisle reinvention in priority aisles, and later to larger reconfigurations and marketing strategies.

1. Understand the Economics of Center Store

For a typical grocery retailer, the center store contributes around 70% to 80% of the store's economic profit. The perimeter departments drive traffic into the store and often set the tone for the shopping experience, but many perimeter departments are labor intensive and are burdened with higher levels of shrink. When a true economic profit analysis is calculated by category, many of the center store categories are much more profitable than the perimeter departments. Finding the right balance between the perimeter and center store is a key for success.

2. Take a Holistic Approach to Understanding Shopper's Evolving Behavior

A holistic approach to understanding the growth of the perimeter and ultimately the resurrection of center store requires an understanding of the key mega-trends that are impacting shopper behavior. This includes the economic, multicultural, generational, competitive landscape and other trends that are molding consumer/shopper behavior even before the shopper can articulate the changes in his or her own preferences and behavior.

It is critically important that retailers assess their categories and departments through the lens of a shopper – gaining an understanding of the shopper's selection and de-selection processes. This includes understanding how and why shoppers select their shopping destination, the departments they shop within the store, the categories they choose to purchase, and ultimately, the brands they select.

3. Shopper Insights

The ultimate goal of aisle reinvention is to create a stronger connection with the consumer by changing the shopping experience. Understanding shopper behavior and attitudes should be the foundation to develop a strategy.

In addition to primary research, loyalty card data can be used to identify which brands and products drive linkage between center store and the perimeter. This is a key way that retailers can develop strategies and tactics to draw shoppers from the perimeter into center store.

Shopper insights will also point to categories where loyal shoppers are leaking to other channels. In some cases a retailer's most loyal shoppers are purchasing 75% or more of some categories in other outlets. It is critical for a retailer to understand the barriers to traditional grocery store purchasing and to use this insight to develop strategies to capture these shoppers while they are still shopping in their stores. For example, seven out of 10 households in the U.S. purchased pet food last year, yet most pet food purchases were done outside the grocery channel. Understanding how shoppers think about pet care needs and learning the channel preference drivers can provide actionable insights into how to reinvent the center store pet food category.

7 out of 10 households purchased pet food last year

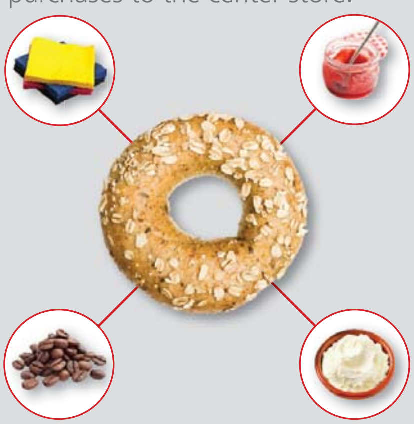
4. Merchandising Innovation and Aisle Reinvention

Why are sugar substitutes in the baking aisle when they are primarily used with hot beverages? Why aren't peanut butter and jelly near the bread? These are the types of questions retailers should ask in their effort to make shopping easier for shoppers and build shopper loyalty. Likewise, manufacturers can do their part by reimagining aisle displays and shelving focused on today's shoppers' behaviors. It is important for retailers to create holistic shopping solutions such as:

- Barbeque destination with one-stop-shop for all barbeque needs
- Store within a store concepts: Pet food, Baby, Gluten Free
- Household cleaners: Shop by "room" (kitchen, bathroom, etc.) concept
- Selling marinades in meat department
- Merchandising cereal and milk together

Spotlight: Affinity Behaviors

Acosta recently reviewed loyalty card data for a major U.S. retailer to identify affinity behaviors. We found that shoppers buying fresh bagels from the bakery have a high affinity for premium coffee, jams and jellies, and cereal, which were preferences we expected and anticipated. But we also found those same shoppers have a high affinity for napkins. Armed with this kind of knowledge, retailers can create promotions that link perimeter purchases to the center store.



5. Meal Solutions

Focusing on meal solutions and convenience is a win for both retailers and manufacturers. Here is a hypothetical example: Alisha, a working mom, arrives at the grocery store thinking about lunch box meals and Sunday dinner. She navigates aisles in search of bread, peanut butter, jelly, healthy snacks, beverages, and the makings of a lasagna meal for Sunday dinner. This takes considerable time. Meanwhile opportunities to present meal ideas to her are lost because she's shopping departments and categories – not meal solutions.

In an AMG shopper survey it was reported that nearly 1/3 of shoppers would likely buy an item that was not on their shopping list if it was part of a relevant meal solution promotion.

6. Product Innovation

Manufacturers have a real opportunity for shopper-driven product innovation based on the changing landscape. Examples include: Millennials' more adventurous food palates, Hispanics' interest in healthy family options, and the nearly universal demand for ready-to-eat meal solutions.

Some iconic brands in the industry are innovating new products that are relevant to new shoppers while not losing sight of the core brand that still appeals to the boomer generation.

Some retailers are dedicating space to feature "new items." This new item center provides excellent visibility with shoppers and also serves as incremental display space.

Retailer circulars are typically organized by department which is often a barrier to offering shoppers solutions. What if the circular presented meal solutions that cross departments from center store, frozen, produce, and beverages?

7. Mission-based Shopper Marketing Promotions

Develop broad, collaborative promotions that stretch across manufacturers and focus on shopper demand and trip drivers like holidays/events, mealtimes, dietary needs, etc.

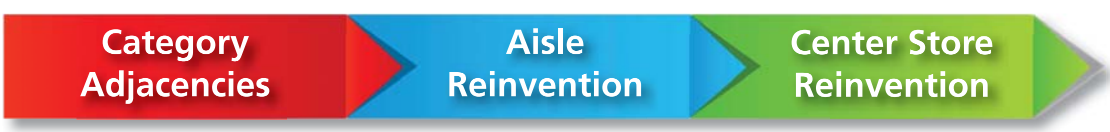
According to the Path 2 Purchase Institute's *2013 Shopper Marketing Trends* report, most CPG marketing executives said that retailers were very/somewhat likely to collaborate on aisle/category reinventions and more strategic merchandising solutions.

Cross department promotions that link perimeter categories to center store categories like "Buy this, Get this Free" using items from the perimeter as the driver or "Center of the Plate" items that link to center store items. In-ad recipes along with a meal deal can give consumers meal ideas.

Displaying center store categories in the perimeter is also effective. For example, placing a gravy mix display next to potatoes in the produce department. Likewise, consider pulling shoppers into the aisles with what has traditionally been end-aisle displays. For example, meal solutions or a display of new items featured in a destination in the middle of the aisle.

Finding effective stopgaps for center store leakage calls for an evolution in focus, from category management to shopper management. At AMG Strategic Advisors, we've helped both retailers and CPG manufacturers develop and execute leading edge integrated programs that turn the tables on center store leakage. From category adjacencies to aisle reinvention to center store reinvention, change can come from incremental strategies or a full-scale transformation.

For more information about AMG Strategic Advisors and our center store strategies, contact Colin Stewart at cstewart@acosta.com.



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