# GOING AGAINST THE GRAIN

## HOW TO CREATE A SUCCESSFUL ASSORTMENT STRATEGY

At Nielsen, data drives everything we do—even art. That's why we used real data to create this image.

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## THERE IS AN AVERAGE OF ABOUT 39,000 ITEMS IN A TYPICAL GROCERY STORE.

With so many products on the shelf, how do you build an assortment strategy that captures consumer attention and contributes growth to the category?

# INTRODUCTION

You're in the midst of planning for next fiscal year and want to come up with an assortment strategy that's going to support growth across the category. To start, you might consider adding a new product to your lineup based on what your competitors are doing, or what current trends are cropping up in the market. However, while these factors are good indicators of whether you should add more or less variety, they shouldn't be considered in isolation. That's because there are a number of other conditions that also dictate a successful assortment.

In this white paper we'll look at two main hurdles affecting assortment-related revenue:

1. **The sheer number of products on the shelf is cluttering the consumer experience.** There are about 39,000 items in a typical grocery store. With so many products and such limited space within stores, it can be difficult to build an assortment strategy that captures consumer attention and contributes to category growth.
2. **Many new products are chasing the same benefit.** A hot new product is introduced and consumer demand for it goes up. Suddenly, manufacturers flock to capitalize on this pocket of innovation and opportunity, causing the benefits of the new product to saturate or, even worse, over serve the market. As a result, the benefit loses value for the number of companies that are seeking to leverage it with related new products.

So, in today's crowded and over served market, what's the first step that you should take to determine what products make the cut? To find the answer to this question, let's take a look at some of the issues at play.

# EXPANDING ON THE NOTION OF EXPANDABILITY

## IDENTIFYING THE EXPANDABLE QUALITIES OF A PRODUCT

Typically, when fast-moving consumer goods (FMCG) companies pursue innovations, they're in search of what is called "incrementality" or "expandability," a process that requires quite a bit of research. Ultimately, they want to know how much new demand will be created if they introduce a new product to the market, pinpoint SKUs that are expandable enough to grow the category and avoid those that will contribute to oversaturation and result in no extra sales.

Unfortunately, the pace of the marketplace doesn't always allow for in-depth research, forcing companies to make quick bets on innovation using levels of analysis that are less than ideal. Here are a few road bumps that companies run into when evaluating potential for a product.

## CONFIRMATION BIAS

Many companies experience confirmation bias during the research process, where they find themselves seeking out evidence to support a particular point of view and discounting data that does not. For example:

- A beverage company has a concept for a new product that its testing. Early in its research, the concept tests well in a qualitative session, with rave reviews from one or two people in the test group who say that the product has the perfect amount of sweetness.

- So the product team runs with the concept, but accidentally overlooks the data points that don't support the assumptions derived from the qualitative session.
- Next, they test the same concept in another qualitative session only later to find that that a different test group feels that the product is too sweet.
- In response, the development team works to make the product less sweet, but then they do not test the level of sweetness again.

A perceptual shortcut like this one is often what leads innovation teams to err.

## HALO EFFECT

Companies can also experience halo effect, a situation where teams take the positive (or negative) aspects that they've learned about a product and start to believe that the product has other, objectively unrelated, positive (or negative) attributes. As an example, a company believes that gluten-free products are trending well and therefore they perceive all gluten-free products to be more expandable.

This is a common occurrence for a lot of manufacturers. But often the thrall of the halo effect dissolves the promise of expandability, and quickly leads to an overserved and saturated market because so many companies are chasing the same new benefit. Halo effect can also work in the reverse order, causing companies to miss an expandable opportunity because they believe, for example, that gluten-free is a dying fad.

In a fast-paced industry, it's no surprise that these assumptions have gained currency in shaping decisions. So what happens when missteps like confirmation bias and halo effect take place? And, as a marketer, how do you know that your competitors didn't rely on the same flawed evidence of expandability to lead you down this road in the first place?

The answer is unfortunately in the results. Let's take a look at what happens when manufacturers add a new SKU that has not undergone the ideal, in-depth research process.

# SKU-ED ECONOMICS

## HOW ADDING A NEW SKU CAN AFFECT SALES

There are three possible responses to adding a new SKU. Category sales might:

### INCREASE

Increase, in which case the benefit or value proposition is said to be "expandable."

### HOLD STEADY

Hold steady, or change minimally, in which case the benefit is considered "saturated."

### DECREASE

Decrease, in which case the new SKU carries greater opportunity cost than incremental value and will result in "decrementality."

One thing that FMCG companies need to keep in mind is that it's important to measure the expandability and benefits of a product both during the development process and at launch time. In a lot of cases these initial decisions don't end up panning out because either:

- The competitive edge that once existed during the development period no longer exists at the time of the product launch.
- Too many companies try to capitalize on the same trend and overserve the market.
- The initial development turns out to be based on incomplete and rushed research.

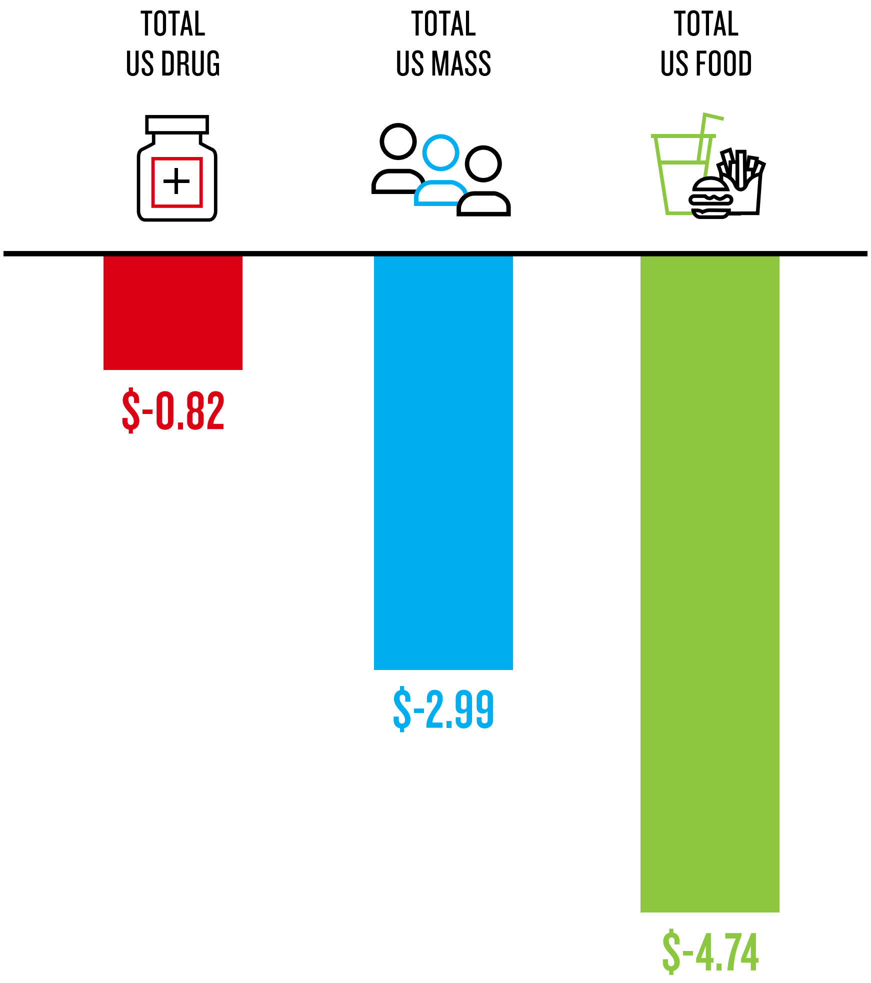
No matter the reason, the fact remains that the new product no longer can provide sufficient incremental growth. As a result the product launch flatlines or, even worse, leads to "decrementality," a situation where adding a new SKU negatively impacts the category.

We know that five out of six new SKUs fail, and for a variety of reasons. A product may lack of differentiation in the category. An uncompelling consumer proposition. A lack of marketing support. No matter the reason, oftentimes companies replace SKUs that have been viable for quite some time, but appear to be at the end of their lifecycle. However, that doesn't mean they have maxed out their value. They are simply selling less than they used to.

## ADDING SKUs CAN RESULT IN CATEGORY VOLUME LOSS

To get to the bottom of this phenomenon, we conducted a total store assortment study. Here we show the actual outcome where adding a SKU, whether it was in the drug, mass merchandise or food channel, ended up lowering category sales. So while the struggling SKU drove some incrementality, replacing it with the new, weaker SKU actually caused the reverse effect and took away from the incremental growth that previously existed.

### $ IMPACT OF +1 ITEM



# THE ASSORTMENT PENDULUM OF SUPPLY AND DEMAND

## ... AND HOW NOT TO GET SUCKED INTO IT

Another chain reaction that manufacturers need to avoid getting sucked into is what we call the "assortment pendulum," where the movement of supply and demand (the pendulum) dictates where marketers focus their energies. Here's a play-by-play of how it happens:

Marketers rush to innovate and capture growth within the categories that are on-trend or growing fast.

With so many manufacturers focusing on the same type of innovation, the variety gets saturated and no new benefits are driven through assortment.

The category continues to grow, but it is not being driven by the proliferation of assortment.

Then the same process happens in reverse. A soft or declining category will get rationalized, but at some point the rationalization goes too far and the lack of variety starts to exacerbate the negative trend.

And so the pendulum continues to swing back and forth, leaving pockets of opportunity in between the shifting demand and the fluctuating supply.

What we've found from our research is that, while trends can sometimes be a predictor of expandability, they often are not the primary indicator. To identify the expandability potential of certain categories, we created four buckets: surfers, mirage, sleepers and renovation. Here's a breakdown:

## 1. SURFERS

Surfers include masked categories, such as healthy snacks, ready-to-drink beverages or alcoholic beverages, that are trending well. We recommend investing here, whether it is in new products, assortment, pricing, etc.

## 2. MIRAGES

Mirages typically include categories that are growing, such as energy, dessert and paper. The important point for assortment practitioners to note is that it's best to not try to add more SKUs to the shelf as it is successful in its current state.

## 3. SLEEPERS

Sleepers tend to encompass categories that have seen declines but are expandable, sometimes just because retailers cut too many SKUs. There is latent opportunity that's waiting to be realized in these categories even though it seems counterintuitive to invest in a declining category.

## 4. RENOVATION

These are the categories that are in dire straights. We recommend either taking drastic action to reinvigorate these categories or, if they are unlikely to be profitable, perhaps investment in these categories should be reduced.

For the purpose of this whitepaper, we're going to hone in on "sleepers."

# GOING AGAINST THE GRAIN

## CREATING ASSORTMENT STRATEGIES THAT WORK

Sleepers are a contradictory bunch because they tend to be in decline but have the potential to be expandable. Here's a look at some sleeper categories:

| SIDE DISH CATEGORY | FROZEN CATEGORY | BAKING CATEGORY |
| --- | --- | --- |
| -0.9% Base $ Vol % Chg | -1.7% Base $ Vol % Chg | -1.7% Base $ Vol % Chg |
| -0.3% Total Distribution Points | -1.6% Total Distribution Points | -1.7% Total Distribution Points |
| EXPANDABLE | EXPANDABLE | EXPANDABLE |

Since the two key implications of sleepers are antithetical, managing these categories can be risky and an off-the-mark investment could be costly. For example, these categories could be the result of retailers cutting too many SKUs. However, there is a latent opportunity that's waiting to be realized in these categories. So even though items considered to be in a sleeper category can be a bit of a wild card, the good news is that organizations like Nielsen can measure the impact of such cuts to help companies determine whether it's an investment worth making.

Referring back to the example above, it's commonplace for retailers to excessively delist off-trend SKUs. In response, manufacturers often avoid those negative trends. But what if one or two manufacturers went against the grain and invested in the negatively trending spaces? We think they would find that many of the products in these negative spaces could be surprisingly expandable because their supply is not meeting the demand, even though demand is declining.

## HOW RETAILERS CAN FIND SUCCESS IN GOING AGAINST THE GRAIN

- Despite weak trends, there is evidence that increasing SKUs will drive sales
- Make sure other in-store levers are optimized, as they may be impeding growth

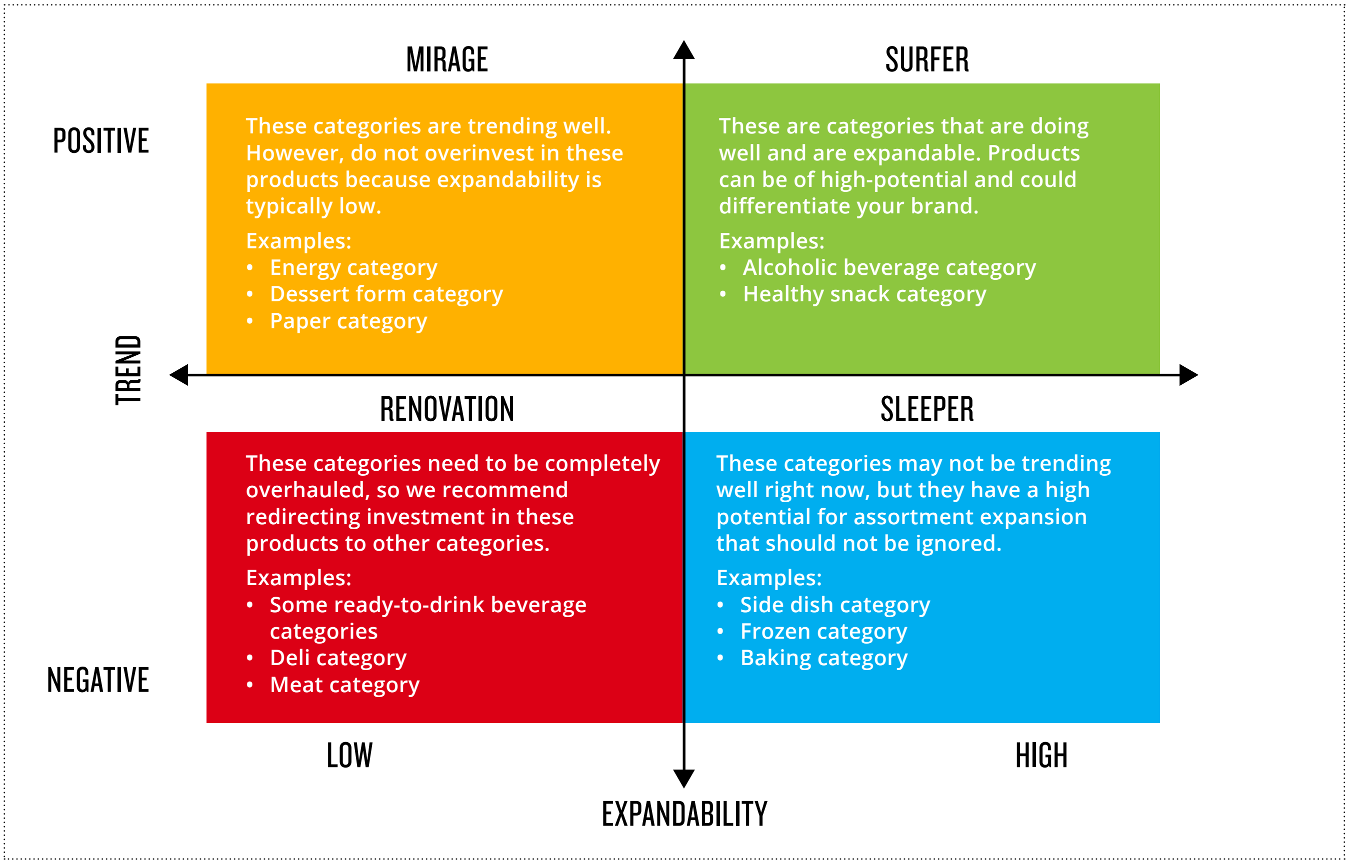
## HOW MANUFACTURERS CAN FIND SUCCESS IN GOING AGAINST THE GRAIN

- Test seasonal items and new benefits
- Add new flavors and sizes as needed to appeal to changing consumer interests
- Test whether consumer investment can turnaround soft trends

In the chart below we take a look at some real-life examples by showing actual trends in a few different broader categories. Take the "dessert form" category for example, which includes everything from frozen dough to baking powder to prepackaged treats. We're saying that one of the categories (but not all) within the broader "dessert form" category is trending well but has low expandability. So the examples in the chart illustrate that levels of expandability are not highly related—meaning that categories showing strong trends may have low expandability, while categories showing weak trends may have high expandability. Again, we're not suggesting where to invest, per say. We're simply suggesting that FMCG manufacturers take the counterintuitive strategy—to target the opportunities that marketers tend avoid, those in declining or "Sleeper" spaces.

# IDENTIFYING GROWTH POTENTIAL

This chart compares how a product is trending (either positively or negatively) to its potential for expandability (positive or negative). From this exercise, we can identify which bucket a product falls into—mirage, surfer, sleeper or renovation—to determine whether it has expandable qualities.




Source: 1) Nielsen, Assortman, Total Store, Total US Food, L52 ending July 9, 2016; 2) Nielsen, Answers on Demand, Total US Food, L52 ending July 16, 2016

The key here is to deliver a benefit that the category does not offer. This means that expandability does not always require from-the-ground-up innovation because, in many cases, existing products and their benefits have untapped expandability too.

# A STRATEGIC LENS

## HOW TO INNOVATE IN UNDERSERVED CATEGORIES

There are three critical determinants in deciding which benefits and products to invest in. Specifically, we recommend considering a product's:

1. Level of expandability
2. Growth
3. Size

Let's take a look at this through a strategic lens. In the right quadrant in the chart above, we've combined these metrics—expandability and trends—to show how the different combinations of each can lead to different action steps. For instance, a company may want to focus on a product that is both expandable and trending well. However, if a product is trending well but is not expandable a company may want to invest in other in-store levers such as price or promotion.

Our research has shown, it isn't enough to pursue growing trends in isolation. You have to look at the benefits of the product too, as they have a level of elasticity that can also contribute to growth. A few examples of this include:

### VALUE

This is a benefit that receives very little attention in the marketplace because margins are lower, making this an area of expandability.

### ALTERNATIVE SIZES AND PACKAGING

Another product improvement, alternative sizes and packaging are often expandable because supply tends not to be excessive.

One of the primary reasons new products fail is because assortment practitioners miss the important role that product benefits play in expandability. Successful assortment is all about matching consumer demand with supply, and then considering whether the product and its benefits are over or underserving the demand for it. And by putting these assortment opportunities into a broader strategic context, companies can create a strategic classification that manages all in-store levelers—not just assortment.

Leveraging assortment can be challenging, but it doesn't have to be. When manufacturers start considering trends, category size and benefit expandability together, they will see a more holistic view of the marketplace and be able to develop products that better resonate with consumers.

**For more information contact your Nielsen representative at 866-864-1244 or visit www.nielsen.com**

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