The Struggle For a Place on the Shelf

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I. THE BATTLEFIELD

In March of 1977, approximately 85 new products (including line extensions, new packages, and new formulations) were introduced in the U.S. grocery and drug industry. In all of 1977 there were about one thousand new product introductions.

In 1987 – 1988, new product introductions were running at the rate of one thousand per month, twelve thousand per year – more than ten times the rate of the ‘70’s!

Think of it. One thousand new products are going into your supermarket every single month. Where would you put them if you were a retailer? Say you had three hundred new pastas and sauces, two hundred new juices and soft drinks, two hundred fifty frozen foods, fifty new yogurts and cheeses, fifty new cold remedies, and one hundred new magazines and general merchandise items.

Slotting Allowances

Now you can see why retailers have started charging manufacturers "slotting allowances."

Slotting allowances are fees that retailers charge manufacturers for each space or slot on the shelf or in the warehouse that a new product will occupy. For example, if a manufacturer introduces a new yogurt brand with 14 items in the line (flavors and sizes) the manufacturer of that brand will have to pay for 14 slots.

A major retailer in Los Angles will charge a slotting fee of $4000 for the chain, per slot. Fourteen slots times $4000 would cost $56,000 for distribution in that one chain. Distribution in five major chains in the Los Angeles market would cost $280,000.

Presumably this brand will roll out nationally to all major markets. Allowing for lower costs outside of L.A., the yogurt manufacturer is looking at millions of dollars just to get the product on the shelf. Those costs are on top of case allowances, co-op advertising allowances, end-aisle display allowances. To paraphrase the late Senator Dirksen, an allowance here, an allowance there, pretty soon you’re talking real money.

Retailer Leverage

During the last ten years, marketplace economics, demographic and lifestyle changes, corporate consolidations, and technology have become levers of power for retailers. It is important to
understand how these four factors have permanently changed the structure of the marketplace; they explain why retailers now have control of the marketplace with respect to marketing, pricing, and distribution.

**Marketplace economics:**

Slotting allowances are just one of the reasons why trade spending as a percentage of total marketing dollars has been growing at the expense of advertising and consumer "pull" spending. The other reasons go back to the inflationary period of the early ‘70s.

When Nixon lifted price controls in 1974, which were instituted to slow down inflation, manufacturers’ prices were caught at a low point. When the controls were lifted, prices immediately went up.

Manufacturers created a margin to protect against the potentiality of future price controls. While this was supposed to be temporary, the method of establishing high list prices while heavily promoting discounts to accelerate volume has become part of the economics of packaged goods marketing.

This vicious circle of high list, high deal activity, has put the emphasis for manufacturers on short term promotion. For retailers it has become a financial way of life. Manufacturers now spend roughly $18 billion on trade promotion to get their brands promoted at the deal price necessary to attain volume goals. Retailers now receive over ten thousand deal offers per year. As the price for promotion increased, again based on supply and demand, retailers began to manage trade dollars as a profit center.

Most of the large supermarket chains now make a substantial portion of their profits from the $18 billion. Only one third of those dollars reach the consumer in the form of price discounts.

You can imagine why many manufacturers think that slotting allowances and trade promotion funds are onerous. Slotting allowances did not even exist ten years ago. Yet look at it from the retailer’s perspective. He is the one with the one percent margin.

If I’m a retailer, long before you come to me with your new yogurt, or any new product, my shelves are already bursting with line extensions and new packages. The same goes for my warehouse. Scanner data has given me the information to know pretty close to the penny how much money I make on each of the products on the shelf today. I have no evidence that your new product will sell even half as much as the product I have to remove from the shelf to make room for it.

In addition, as a retailer I have generally been thinking about reducing the amount of space devoted to all traditional packaged items to make room for faster growth – higher margin categories such as health and beauty aids and general merchandise items like housewares, greeting cards, and flowers. (The Kroger Chain is now the largest florist in the United States.)

In the same contrasting period of the ‘80s versus the ‘70s, when the number of new products increased tenfold, store space devoted to traditional packaged goods items remained virtually flat. Total square footage of grocery stores has increased by only eight percent, all of it going to the new growth areas on the perimeter of the store. The packaged goods section – lying more or less fallow in the middle of the store – has become what could well be called the "demarkeing zone."

Viewpoint
That is why the race for space is the new frontier of marketing. It is also why retailers charge slotting allowances. Retailers have a fixed amount of real estate. Laws of supply, demand, and leverage begin to prevail.

A retailer is taking a risk with all new products that their turnover, or price value relationship, will not deliver the level of profitability he is getting from the brand now renting the same space. Remember also, the retailer has to reallocate slots in the warehouse the same way.

These basic supply and demand principles led Forbes, in August of 1985, to say, "No longer are retailers a faucet at the end of the distribution channel that food companies can turn on and off. Slowly, the balance of economic power has shifted away from the food companies to supermarkets."

Demographic and lifestyle changes:

As is always the case, the consumer has been the change-maker. Once upon a time, the target audience was described as the consumer, singular.

There were segments, of course: urban vs. rural, upscale vs. downscale, old vs. young. Yet, with the exception of the extreme ends of these demographic groups – the very rich and the very poor – the vast majority shared similar lifestyle characteristics: they drove Chevys and Fords, they watched Ed Sullivan and Bonanza on Sunday nights, they ate meat and potatoes, and in most households a female homemaker did the shopping, cooking, and cleaning.

All of that has faded into the sunset along with Little Joe. The homogeneous structure of the consumer marketplace was shattered by the baby boom’s size, education, and affluence – in short, by its clout. Relative to previous generations the baby boom is much larger, representing one-third of all households, and accounts for 70 percent of total household growth. Baby boomers are three times more likely to have a college education, and, in terms of dollar power, between now and the end of the century the real personal income of the baby boom will grow at a rate roughly double the rate for the whole population.

Money and knowledge have given the baby boomers courage to make highly personal choices about career and lifestyle: what to buy, when to buy, where to buy, when to buy another. Here is a poem from The New York Times:

Instead of canned goods, meats and cheese,
They smother us with expertise;
Floppy disk and salad bars,
Computer papers, caviars,
Adidas sneakers, in some states wines.
Yuppies stand in checkout lines
With mung beans, video tapes and gouda.
What next? Pickled barracuda?
Items French, Italian, Greek –
The General Store has gone boutique,
And markets once called super
Have been upgraded to super-duper.

Viewpoint
The economy is now driven by the mercurial and fluid lifestyles of these consumers, characterized as craving variety, value, but lacking predictability – or "health conscious but high in butter fat."

One example of this deluge of diversity is the number of new product categories that have developed which did not exist (as more than ideas) ten years ago: MTV, microwave products, frozen yogurt, cable home shopping, money market funds, IRA's (which have come and gone), frequent flyer clubs, desktop publishing, wine-coolers, caffeine-free colas, lite beers, and artificial-but-natural sweeteners. For the most part these are now industries that have made their way into the vernacular of our daily life in less time than it took for us to accept rock-and-roll.

Another example is the explosion in media choices. Twenty years ago it was possible to reach 95 percent of the population with advertising on the three major networks, and in Life and Look. Now many markets have 50 cable channels. It is worth noting that cable television has been around since 1949. The explosion in cable is a result of the demand for choice. No better example of variety and choice exists than the newsstand where there are entire magazines about subjects that did not exist ten years ago. Personal computers is just one example. The vast middle class of homogeneous stability has given way to an unpredictable assortment of consumers whose purchasing habits are predicated on the lifestyle factor most important to them at that moment. The diversity factor has played havoc with product development and the marketing and sales strategies of manufacturers and retailers in every consumer goods industry. While it is often a mistake to characterize times past as the good old days, in this case they were. Marketing was easier before the ‘80s.

Consolidation in manufacturing:

Revolution, meaning permanent change, is difficult too distinguish from mere trends when you are at the beginning of the revolution (at least that was what Marie Antoinette was heard to say). One useful barometer is the financial markets.

Mergers and acquisitions in the food, drug, and retailing sectors have been among the most active of any business sector: Phillip Morris bought General Foods; Beatrice and Esmark have been bought and sold so many times that their last corporate name was E-II, (who said C3PO was just a robot?); Seagram's bought Tropicana, P&G bought Richardson-Vicks, Unilever bought Cheesebrough-Ponds, and R.J. Reynolds bought Nabisco. And there are hundreds of smaller mergers and acquisitions along similar lines.

Consolidation in retailing:

In 1967, when Dustin Hoffman "Graduated," he was advised to go into plastics. If they do the sequel soon, the advice would be retailing. There have been 352 mergers and acquisitions in retailing since 1981, totaling $52 billion. Campeau bought Federated, letting Macy's then buy part of it; A&P bought Waldbaums and Shopwell; Safeway, the largest supermarket chain in the country, has been disassembled; Pathmark was acquired in a leveraged buyout, as was Stop & Shop; Allied Stores – consisting of Jordan Marsh, Ann Taylor, and Brooks Brothers among others – was bought; K-Mart bought B. Dalton, and on and on.
In the last three years alone, the four largest chains in California have either been merged or acquired: The Los Angeles division of Safeway was purchased by Vons; Vons had just a year earlier bought itself from Household International; Ralph’s, which is part of Federated, will be bought and sold by the Campeau/Macy’s group; and American Stores is about to buy the Lucky chain.

The next best-selling book of lists may well be "Who Owns Whom" or "Who Owns What" or "What Owns Whom."

**Technology and information:**

Technology has changed the face of the world in many ways. In retail banking, automated teller machines are now used 90,000 times per day. On Wall Street, volume of 200 million shares is becoming routine; in the ‘60s, 10 million shares almost shut down the markets.

In consumer goods, the application of technology is just beginning; the impact will be as significant as it has been in the financial markets. Scanners at the check-out reading the universal product codes – which describe the brand item, manufacturer, and pricing – are now in grocery stores representing over 50 percent of total U.S. grocery volume.

TOYS ‘R’ US has recently completed installation of scanners in all of their stores. Bullocks, one of the Federated Department Stores, has begun scanning apparel items; and Wal-Mart, Sears, and K-Mart have begun to install scanners in their stores.

Scanning information has already changed the grocery business, reducing labor costs through faster checkout lines and fewer clerks, improving accuracy of pricing and shelf inventory control, simplifying ordering and warehouse inventory management.

Scanner information has also fueled the promotion spending machine. While the economics of the times created a promotion-driven marketplace, scanner information has given manufacturers and retailers courage to sustain their promotional drive. Where brand-building advertising is for the most part difficult to measure, except over long periods, promotions by nature are short-term, and definable, and scanner information can be isolated by item, time, and location. Manufacturers and retailers receive measurable results for each dollar invested in a display or price discount. Manufacturers and retailers have demonstrated that knowing what the return on a promotion will be, even if the return is less than they would like, gives them greater comfort from their investment than they get from the same dollar invested in the unquantifiable, longer-term purposes of advertising.

**II. A Powerful New Weapon**

Although the power of scanner information has been revealed for measuring promotions and improving operating efficiency, so far retailers have been playing with it, like a cat with a ball of yarn. More significant impact remains in the future. A good example of the next wave of change is the use of a cost accounting model called DPP, for Direct Product Profitability.

DPP is simply a financial model which allocates all the retailer’s costs, item by item, to every item on the shelf, to determine the net profit of each. The model takes into account product acquisition costs, transportation costs, warehousing costs, labor costs to stock the warehouse, put the product on the shelf, and check the product out of the store, shelf inventory costs,
marketing costs, the general overhead of store lights, phones, rent, etc.

Until DPP was developed, retailers used a system of accounting which stopped at the gross profit level. To compare the old and the new:

THE OLD WAY

Total Sales

minus

acquisition costs…

= Gross Profit Per Item

THE NEW WAY (DPP*)

Total Sales

minus

acquisition costs

…and

transportation, labor, marketing, shelf inventory, overhead

= Net Profit Per Item

* Direct Product Profitability

The impact of looking at real profitability for the first time can best be understood by looking at some examples from one major grocery chain. A standard measure of performance – productivity per foot of shelf space.

<table>
<thead>
<tr>
<th>Category Item</th>
<th>Gross Profit Per Foot of Space</th>
<th>Net Profit Per Foot of Space (DPP)*</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sugar</td>
<td>$ 6.84</td>
<td>$-3.44</td>
</tr>
<tr>
<td>Sugar Substitute</td>
<td>11.02</td>
<td>+9.72</td>
</tr>
<tr>
<td>Cold Remedies</td>
<td>6.66</td>
<td>+2.44</td>
</tr>
</tbody>
</table>

Viewpoint
Just looking at these comparisons can send shivers down the backs of the sales forces of some manufacturers, while others might feel as though they’d won the lottery.

On a gross profit basis, sugar looks like an important and profitable category to promote and stock. On a net profit basis, it loses money for the retailer. By using DPP the retailer learns that because sugar is a big, bulky package, heavy and easily damaged, the space it takes in the warehouse and on the shelf, and the labor costs in stocking it on the shelf, cost more than the return he is getting based on price and sales turnover. Now obviously retailers are not going to pull sugar from the shelves. All retailers know that product selection and variety is important in securing customer loyalty. However, it seems reasonable to assume that retailers will take a close look at how much space is devoted to sugar, at which brands perform better than others, and at which sizes perform better than others.

On the other hand, manufacturers of sugar substitutes are in an enviable position. Because their packages are small and their prices high relative to turnover, their DPP is among the highest in the store. Retailers will look closely at finding more space for sugar substitutes, perhaps putting them in two locations: one in the sugar aisle and another in the coffee and tea aisle. They will look for opportunities to promote and display the category.

The ramifications of this exercise in basic cost accounting affect the behavior of manufacturers as well as retailers. Manufacturers must take a hard look at their packaging, weighing the brand elements which drive their customer franchise, against the efficiency of the space it occupies on the shelf and in the warehouse.

Stating the obvious, which perhaps was always known but never truly understood, pricing and marketing become critical factors.

Let’s take mouthwash as an example. Mouthwash comes in packages bigger than analgesics or cold remedies and therefore costs more in space occupancy. While the average
sales turnover of mouthwash items is higher than it is for either cold remedy or analgesic products, the price of mouthwash is about 40 percent lower. The result is that mouthwash barely breaks even for the retailer.

Accordingly, mouthwash manufacturers must find a marketing lever, or an enhancement in product quality, to justify a higher price and mark-up – or expect to get less space in the store. At the same time, as retailers look at these numbers they will start weeding out package sizes, formulations, even entire brands that do not perform up to the category average of 30 cents profit.

While the mouthwash folks are working on advertising which can generate a premium price, the analgesic and cold remedy marketers are ready to do battle. One of our clients, Miles, Inc., asked SAGE to analyze the cold remedy category and brand within the category. Below, and in the charts on the following pages, is what we found:

First, reviewing the category:
- Cold remedies are a $1.1 billion category, surprisingly large and not realized by most retailers.
- Cold remedies grew 68 percent during the last five years, faster than ice cream, frozen vegetables, shampoo, and many other major categories.
- While cold remedies account for a high percentage of store sales, they rank only 46th in the share of trade advertising.

Conclusion:
Cold remedies have been undervalued by retailers; their growth and lack of trade support is a missed opportunity.

Second, analyzing scanner data for the category as compared with some others:
- Sales per foot for cold remedies are not as high as for analgesics, yet cold remedy item sales are two and one-half times larger than deodorants and three times larger than mouthwash, per foot of shelf space.
- Applying direct product costs, cold remedies are 50 percent more profitable on a net profit basis than mouthwash and twice as profitable as deodorants.

Conclusion:
- The cold remedy and analgesic categories deserve more space at the expense of the deodorant and mouthwash sections.
- Based on size and profitability, cold remedies should be getting a higher proportion of trade advertising, promotion, and display support.
- Pricing needs to be increased or space decreased for mouthwash and deodorant sections.

Third, reviewing scanner data for the brand:
- Mile’s Alka-Seltzer Plus has four times the gross profit per foot of space of the number one and two brands.
• On a DPP, net profit basis, Alka-Seltzer Plus is the number one brand in the category.
• Alka-Seltzer Plus turns over twice as fast as all other items while occupying less space.

**Conclusion:**
While Alka-Seltzer Plus is the number five brand in the category with a five percent share of market, it is the most profitable brand to the retailer and has a very strong brand franchise...

This is not the end of the story. Our objective for Alka-Seltzer Plus was to increase its space and generate more merchandising support from retailers. We have demonstrated that it is the most profitable brand in the category, that it deserves more space and more advertising and promotional support because of the consumer’s vote that it is a strong price-and-value brand.

Therefore the final step in this process, which is the most difficult step to execute, is to convince the retailer that by increasing shelf space and support for Alka-Seltzer Plus, through eliminating certain other brand items, profits from the cold remedy category as a whole will be increased.

The return on investment for the category is $1.72 – that is, for every dollar invested by the retailer in a cold remedy item, he gets back an average of $1.72. The return on investment for Alka-Seltzer Plus is about $3.50 – high for the very reason that the retailer invests less in Alka-Seltzer Plus, relative to its price and its sales, than in other brands. Thus, as a retailer increases its investment in Alka-Seltzer Plus – by increasing shelf space and other support – return on investment will go down. But it will still be higher than the category average of $1.72. Since the extra space for Alka-Seltzer Plus would come from items which are performing below the $1.72 average, the return on that space will go up sharply. So the average return on investment for the whole category will rise above $1.72.

The net result will be a higher category profit for the retailer; the retailer will have eliminated items that perform below average; and Alka-Seltzer Plus will get more space and support.

**SUMMARY**
Although Alka-Seltzer Plus spends $12 million on advertising and has an established brand franchise, the lack of retailer support was undermining the brand’s share and delivering lower category profits to the retailer.

**RESULTS**
Due to marvelous execution of this program on the part of Mile’s sales force, and to continued advertising support, Mile’s share of market has increased by 19 percent. Sales volume is 69 percent ahead of plans and retailers’ inventories of Mile’s Alka-Seltzer Plus and Alka-Seltzer Plus Night-Time have increased by 40 percent.

In the case of Miles, the impact of scanner data, space management, and DPP have immediate application to how the sales force approached retailers. However, the information also generated important long-term marketing considerations. For example, the big blue box turns out to be a measurable disadvantage for Alka-Seltzer Plus, as other brands in the category – like
Actifed and Contac – come in a form that allows thin packages and more inventory per square foot of shelf. Although Miles has decided that the high recognition and strong brand identity of its big blue box warrant sticking with it, at least for the time begin, such a decision can now be made with precise knowledge of its liabilities.

Information also supported Miles’s investments in advertising by demonstrating the strength of the brand and the need to continue to build it in the face of the many new product introductions and line extensions in the cold remedy category.

The value of this information is that it represents the vote of the consumer and value to the retailer. For example, traditional market share information was useful when success was predicated on a mass marketing. But now, as retailers identify market niches based on consumer segmentation, total market share becomes less important: Miles’ five percent share would have given it little power to persuade retailers to give Alka-Seltzer Plus more support in the old days, but today the figure has even less relevance in the face of the specific and powerful measures of profitability that are now available.

**Measuring Brand Strength**

The ability to measure what happens on the shelf is the equivalent of measuring all of the marketing factors involved. The strength of the brand franchise, and the importance of brand-building through advertising, can now be demonstrated at the store level by the ability of the brand to achieve consistent sales at a price that delivers profits both to the retailer and the manufacturer.

The interdependency between brand image building, local marketing, and sales activities becomes evident when you look at the measures like DPP. For example, without attention to execution at the store level, a strong brand image might result in something like the icing without the cake, as was formerly the case for Alka-Seltzer Plus.

Decisions about packaging and pricing are marketing elements which have typically been developed along follow-the-leader lines. For both manufacturers and retailers, pricing was an insoluble mystery. Profitability-by-item-by-store can now give both manufacturers and retailers the ability to determine the price elasticity of brands, items, sizes – and of whole product categories.

Packaging, for the most part, has been driven by artistic and manufacturing considerations. Now the costs of handling, of space on the shelf, and of case packing, become factors that can be taken into account.

A marketing revolution is truly in progress. We must recognize that we are operating in a totally new marketing environment with new rules.

**Rule #1:** Marketplace leverage is at the local level. As consumers’ tastes, needs and wants continue to multiply and fragment, leverage can only be achieved by delivering relevant products, services, messages, and promotions to consumers as individuals.

**Rule #2:** Building brand equity among retailers should be as important as building brands among consumers.

**Viewpoint**
As stated earlier, the retailer is exercising more and more control of the marketplace in terms of pricing, distribution, and marketing.

**Rule #3:** Marketing decisions must shift to the local level, with greater involvement of sales people leading to a new organizational structure headed by a combination sales/brand manager. Campbells, General Foods, Proctor & Gamble, and others have already begun this process.

**Rule #4:** Technology must be used as the driving force of execution. The only way to execute on a local level quickly and efficiently is to use low-cost resources like technology in place of arms and legs.

**Rule #5** (and most important): Winning the battle will depend on managing information and recognizing it as the most valuable asset.