WestRock On-Site Insight
Retail Merchandising Trend Update

March 2015

# SITUATION: *FRAGMENTATION* FORECAST: *OPPORTUNITY RISING*

**Rapidly changing demographics and social trends have altered - seemingly overnight - the way people shop for and consume products, and the way retailers and manufacturers market and deliver them.** The situation is primed for early movers, although visionaries are not necessarily always appreciated. Consider this:



When Josh Hix and Nick Taranto pleaded the case for their home delivery meal kits on Shark Tank last year, they were met with a chorus of pessimism from Shark's Kevin O'Leary and Robert Herjavec.

businessinsider.com


Then Mark Cuban stepped forward with $500,000 for 6% of their company, Plated, which charges a $10 membership fee and a $48 monthly minimum to deliver ingredients and recipes for four entrees. A year later, Plated is established in 80% of the country and regularly sells out its inventory. It has received more than $20 million in Series A funding to ramp up production and fulfill demand. Meal solutions meet the Digital Age!

Change has come fast and promises to come even faster in the years straight ahead. Just for starters:

- **The population is aging out!** Every 50 seconds in America, someone turns 50, a pace of 12,500 people a day. A quarter of the U.S. is comprised of people 55 or older.

- **The population is getting younger!** This year, the number of Millennials will swell to 75.3 million, overtaking Baby Boomers as the dominant generation.

- **The population is getting urban!** More than 60% of Millennials prefer to live in urban centers. They also earn less than Boomers and work longer hours. They have less time to shop and less space to store goods.

“Immigration, too, has a huge impact on consumer products retailing,” says Dan O’Connor, CEO of RetailNet Group, a research and analytics firm. “There are eight different types of Mexican food - the point is that all roads are leading to a very fragmented marketplace. This puts a lot of pressure on consumer products marketers and retailers: “What do I carry? How do I merchandise it?”

WestRock recently met with O’Connor, a busy speaker and industry thought leader who, prior to founding RNG, was the national director of consumer products and retail consulting at Touche Ross (Now Deloitte Touche). Dan laid out some of the big marketing and merchandising challenges that will need to be confronted in a fragmenting and modulating marketplace.

**BIG BOX TOO BIG.** One effect the Digital Age has had on supermarkets is a notable migration of nonfoods sales to online sellers. “This will reduce the content needs of hypermarket stores by 20 to 40 percent over the coming years,” O’Connor predicts. “If the typical super center was 50-50 food/nonfood, and if 25 percent of nonfoods went online, then more than 10 percent of the store is empty. But suppose we forecast that number at 50 percent, not 25 percent? Then you've got to reduce a quarter of the store content. Ultimately, this will lead to smaller store formats, which will impact packaging and promotion enormously. Maybe case-packs go to 12s instead of 24s."

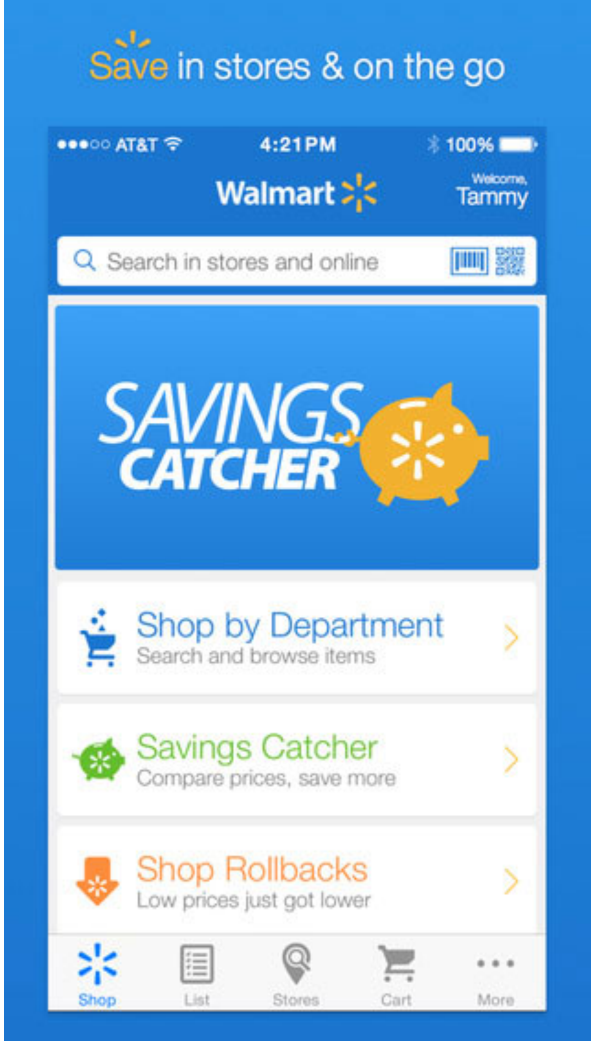
In the meantime, O'Connor contends: "This situation could hand CPG merchandisers a huge opportunity, since seasonal and promotional aisles in existing stores could increase from between one and one-and-a-half aisles to two or two-and-a-half. National brands looking to own large sections in stores may find the real estate available and reasonable."

**PERMANENT DISPLAYS.** Customization has become the norm in merchandising displays. For example, the average production run size at WestRock has decreased by 40% over the last decade, despite remarkable growth in overall business. A marketplace modification of this magnitude brings with it higher costs tracing to more plate changes, set-ups, and re-starts. As a result, major manufacturers are gravitating toward the option of permanent displays. It's a trend that happens to dovetail with concurrent trends toward shoppers looking for more service and large stores with extra space for rent.

"Solution centers are going to become more important," O'Connor says. "Retailer apps will continue to integrate all sorts of in-store features. Home Depot uses videos to show you how to fix your sink, with an expert on screen telling you what stuff you need. If you're Moen, you can help Home Depot create the content - which is incredibly tough- in and of itself - and then be there in-store to provide the stuff."

**HIGH SWITCHING COSTS.** One paradox of technological enablement is that, while it intensifies price and product transparency and leads to fragmented consumer demand, it also plays into the hands of huge mass merchandisers who can afford whizz-bang mobile apps loaded with incredible content. "Walmart and Amazon get the consumer engaged with an app that has 17 feature sets - recipe finders, product information, pricing options. The product search begins more often on Amazon than it does on Google, and so the switching costs go up for other retailers," O'Connor says, making the point that a consumer locked into one retailer's app is going to be expensive to lure to another store.

“We’re moving toward this world of apps. [Walmart’s] Savings Catcher is just in its early stages, but it allows consumers to keep digital records of all they’ve bought, to take a picture of their receipts and get credits if a product at a competing retailer offers a lower price. You can envision a world in which retailers have near perfect information on a shopper. It’s going to really change what’s put in front of consumers in store.”




**PROMOTIONAL PRICING PRESSURES.** One other aspect of the business models of Walmart and Amazon that may need to be emulated by all retailers is national pricing. Though the debate is in its early stages, Congress is looking long and hard at technology’s ability to allow personalized pricing to consumer segments and intervals. Senator Jay Rockefeller (D-WV) has been on a witch hunt of “data brokers,” arguing that they unfairly use consumer data to enable preferential pricing for certain individuals. In a hearing of his Commerce Committee, Sen. Ed Markey (D-MA) said that pricing and promotion segmentation was a harmful and questionable practice. “It’s not redlining but ‘weblining,’” he said. “It’s telling people, you’re in the wrong financial group, the wrong racial group, the wrong sex.”

Should the tune play out badly in Washington for business, zone pricing could be endangered, thinks O’Connor. “More than 50% of super marketers’ profitability can be attributed to zone pricing. If you put different ZIP codes into a retail search and come up with different prices, I don’t think that’s sustainable. And we have to wonder whether the government is going to let us offer a box of Cheerios at different price points to different people.”

**RETAILER-MANUFACTURER INTEGRATION.** All this leads to the primary imperative facing retailers and suppliers in the years ahead - working together to attract and retain customers with products that meet their unique needs. The retail shift to smaller stores will demand SKU rationalization to tailor and reduce the number of items carried. Perhaps most importantly, they are going to need to train their sales and marketing teams to come together to address changing retail requirements. Manufacturers may begin to deploy more regionally based sales and marketing personnel to tackle regional fragmentation in closer concert with retailers.

Ultimately, several forces are converging to foster fragmentation, chief among them highly empowered consumers who know what's available at what price and who want what they want. "Most say it's all about technology. I say it's one third technological change and two thirds societal change," O'Connor avers. "I think that if I'm on the board of a major retailer, I would expect management to be updating their strategy once or twice a year. They're going to need a faster cycle of store updates to remain relevant in the years ahead."

***For information on how WestRock is developing innovative in-store solutions to turn shoppers into stoppers and browsers into buyers, call your WestRock representative.***