

SAVING AND SHRINKING THE CENTER STORE: FIGHT OR FLIGHT?

HOW TO KEEP AN EMBATTLED GROCERY SEGMENT PROFITABLE



The center store – the area of a supermarket piled high with packaged food, detergent, and tissue paper – has long been, and will continue to be, a creator of value for grocers. Though shoppers tend to visit supermarkets for fresh food, once there they also stop by the center store for household essentials. These basic items typically wind up in 80 percent of all shopping baskets – and the categories often have better margins than fresh food, not least because their ease of handling and storage means less waste. The products are also a major source of supplier funding, such as fees for promotions, which attract shoppers who will go on to buy other products, too.

However, this part of the supermarket faces several risks. Customers no longer show the same level of brand loyalty they once did. Center-store categories are under attack, as shoppers' interest shifts to fresh and refrigerated food and as online commerce takes business away from supermarkets. The store share of product categories such as hygiene and homecare has been declining at more than 1 percent a year in the United States, as consumers increasingly shop for basics online.

A variety of innovations can make center stores more attractive and profitable. The space can be restructured. Products can be organized around eye-catching themes – think international wines or Japanese food. And



private-brand products can be added that are not widely available online. At the same time, grocers can repurpose some of their center-store space to boost the supermarket as a venue for socializing and discovery, thus increasing perimeter sales.

A historically important part of the supermarket, retailers need to pose a fundamental question regarding the center store: How can innovative products and use of space continue to generate the returns of the past – or even improve on these? While many grocers have been inclined to choose either a fight or a flight response to the challenges facing the center store, the right strategy includes elements of both. Below are some of the responses being tried out.

FIGHT



FLIGHT



FIGHT: REVIVE THE CENTER STORE

A major problem facing retailers is that customers have grown fatigued with center store displays and offerings. “Retailers have spent years trying to convince their consumers that name-brand soft drink tastes better than [those of their] competitors,” one executive said recently. Some stores have found ways to spice up the area.

USE THEMES TO GENERATE EXCITEMENT

Despite its overall decline, the center store contains clusters of potential growth, if developed correctly. While rows of ordinary, everyday beer brands are not likely to spark much enthusiasm among customers, a craft beer garden could generate greater interest through exhibits and tastings. Some supermarkets have developed sections for ethnic food, products from different countries, and local specialties. Cooking classes can encourage interest in these exotic ingredients and give shoppers ideas for how to use them. Health- and sports-related offerings, from gluten-free bread to bodybuilding supplements, are other potential attractions. To liven up the shopping experience, fun or exclusive center-store products can be dotted around the store premises to provide a kind of treasure hunt.

ADD – OR AUGMENT – PRIVATE BRANDS

Private brands, which typically sell at higher margins than established brands, have great potential in North America, where they currently account for only 18 percent of supermarket sales. In Europe, where private label makes up 31 percent of sales on average, many supermarkets have developed comprehensive price architectures, encompassing consumers’ demands for “good,” “better,” and “best” products. One UK grocer goes from a “basics” tea at £0.50 per unit, via a middle product at £1.10, up to its “taste the difference” range, which includes Kenyan Fairtrade Fine Tea at £2.75. Discounters tend to focus on price, advertising that their private-label soda tastes just as good as the more famous brand – at half the price.



North American supermarkets could benefit from expanding own-label offerings. Doing this correctly requires a specific skill set, sufficient scale, and a companywide strategy. Increasingly, grocers in diverse geographies are finding they can join forces to achieve the necessary scale and capabilities through group purchasing organizations and sourcing alliances. But the bar is high. High quality, keeping up with the latest trends, and attractive branding are all needed to move a private-brand program beyond the basics.

FLIGHT: MAKE BETTER USE OF STORE SPACE

Nevertheless, some decline in the traditional center-store product categories is inevitable. Sales have started to move online in a pattern seen before in electronics and apparel. The products on which consumers are spending more tend to be fresh food options (see Exhibit 1). While the fruit category expanded at an average annual rate of 2.7 percent between 2011 and 2017 and seafood at 3.7 percent, packaged food averaged just 1.8 percent a year and homecare products 1.3 percent. Here are three ways grocers can preserve value as the center store shrinks.

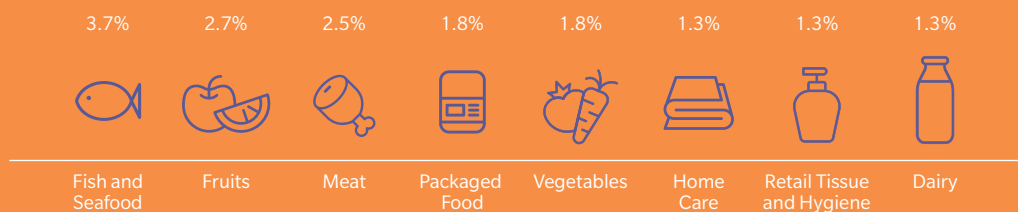
SELL-PACKAGED GOODS VIA ONLINE-TO-OFFLINE (O2O)

Supermarkets can try to capture some of the growing online sales by setting up their own dark stores – distribution centers that cater exclusively to online shopping. Or they can set up virtual center stores, where customers select items using images and barcodes and the products are held for them at the warehouse exit. Shoppers can then either collect their purchases on the spot or have them delivered. This approach is particularly suited to urban and suburban areas with dense populations.

The O2O – online-to-offline – approach offers customers in stores some of the benefits of e-commerce: one-click ordering via QR matrix barcodes, free delivery above a certain basket size, instant payment, and lower prices. The combination has proved especially successful in China, where some highly innovative O2O stores have achieved sales per unit of floor area that exceed their traditional rivals once delivery sales are taken into account. Similarly, some European hypermarkets are reducing floor space and are developing and publicizing their own online channels instead.

Exhibit 1: With sales growth in the perimeter exceeding that of other departments, the center store is becoming less and less “central”

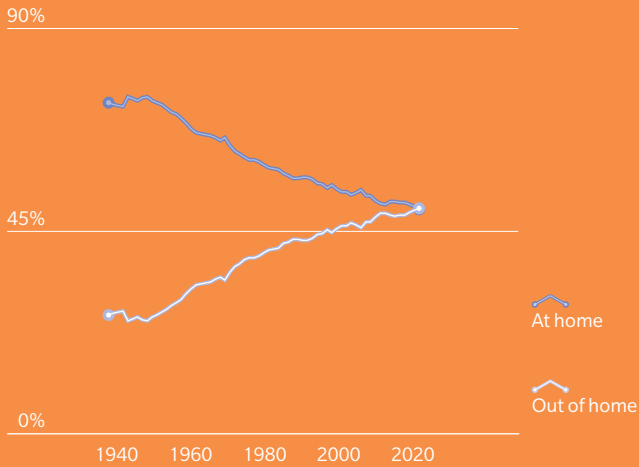
US MARKET SIZE GROWTH BY DEPARTMENT
2011 TO 2017 (% CAGR IN RETAIL VALUE)



Source: Passport Euromonitor International 2017, 2018, Oliver Wyman analysis

Exhibit 2: "Out-of-home" food expenditure has surpassed that of "at-home", and alternative channels are emerging for at-home preparation

US AT-HOME AND OUT-OF-HOME SHARE OF TOTAL FOOD EXPENDITURES



Source: Oliver Wyman analysis based on GIRA data; NPJ Group



EMPHASIZE FRESH AND SEMI-PREPARED FOOD

Stores in the best locations can build the retailer's brand by showcasing new products and staging demonstrations. Traditional food stores still have a decisive advantage in fresh food, which they can emphasize by optimizing range, quality, and presentation. Some grocers are blurring the lines between the center store and the perimeter to explore combinations of products that complement and reinforce one another. Mustard can be embedded in the meat section, for example.

The past half-century has seen a steady shift away from spending on at-home food – that is, food that needs additional preparation and ingredients, some of which are often found in the center-store aisle. Instead, people are demanding more service and convenience, and are spending on out-of-home food, such as ready-made meals from stores or food prepared at local eateries for eating out or eating in. Meal-kit companies are further driving this trend toward convenience, with the US market for meal kits expected to jump to \$11.6 billion in 2022, from \$1.5 billion in 2016 (see Exhibit 2). To attract this spending and become a more desirable destination, supermarkets can offer meal kits of their own. They can also expand and upgrade the store perimeter, with a focus on local products and delicatessen.

COMBINE GROCERIES WITH OTHER ATTRACTIONS

Grocers with enough free space can offer an expanded range of services, such as setting up a food court or renting out store space to complementary businesses. Some bookstores, for example, fought back against online competition with attractions beyond their core product, such as coffee shops and sections devoted to toys and board games. Supermarkets can also team up with retailers likely to interest grocery shoppers, such as clothing and home-decorating stores.

TOWARDS A LEANER CENTER STORE

These initiatives will require technology investment, which needs to be supported by lower costs. Typically, the center store takes up between 35 and 40 percent of a supermarket's total labor hours. But information tools – such as electronic shelf labels and real-time out-of-stock alerts – can make staff more productive. Stores and warehouses can be redesigned for quicker picking of products.

The grocery business is changing rapidly. Trips to the center store by supermarket shoppers slipped 2 percent in 2017 from 2016, and online sales of many center-store products are starting to take off. Even a small further percentage shift downwards could break some marginal supermarkets and threaten a broader move to online grocery shopping, particularly as obstacles to selling fresh food online are removed, making it easier to complete a basket. Passive cooling is reducing the need for refrigerated trucks, helping to make fresh food delivery cheaper and faster; and better interfaces are making selection easier.

The center store is the crucible of the disruption that is hitting groceries. Finding the right formula for defending against the turmoil will go a long way toward creating the supermarket of the future.



Oliver Wyman is a global leader in management consulting that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, and organization transformation.

In the Retail & Consumer Goods Practice, we draw on unrivalled customer and strategic insight and state-of-the-art analytical techniques to deliver better results for our clients. We understand what it takes to win in retail: an obsession with serving the customer, constant dedication to better execution, and a relentless drive to improve capabilities. We believe our hands-on approach to making change happen is truly unique – and over the last 20 years, we've built our business by helping retailers build theirs.

For more information please visit www.oliverwyman.com

AMERICAS

+1 212 541 8100

EMEA

+44 20 7333 8333

ASIA PACIFIC

+65 6510 9700

www.oliverwyman.com

Copyright © 2019 Oliver Wyman

All rights reserved. This report may not be reproduced or redistributed, in whole or in part, without the written permission of Oliver Wyman and Oliver Wyman accepts no liability whatsoever for the actions of third parties in this respect.

The information and opinions in this report were prepared by Oliver Wyman. This report is not investment advice and should not be relied on for such advice or as a substitute for consultation with professional accountants, tax, legal or financial advisors. Oliver Wyman has made every effort to use reliable, up-to-date and comprehensive information and analysis, but all information is provided without warranty of any kind, express or implied. Oliver Wyman disclaims any responsibility to update the information or conclusions in this report. Oliver Wyman accepts no liability for any loss arising from any action taken or refrained from as a result of information contained in this report or any reports or sources of information referred to herein, or for any consequential, special or similar damages even if advised of the possibility of such damages. The report is not an offer to buy or sell securities or a solicitation of an offer to buy or sell securities. This report may not be sold without the written consent of Oliver Wyman.