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Assortment Optimization Why *now* is the time

How building and prioritizing an assortment strategy built on the idea of *less is more* is a huge opportunity to grow sales, drive shopper loyalty, and build brand credibility on a crucial social cause.

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This past year has placed unprecedented strain on the retail sector with supply chain costs increasing by nearly 50% and e-commerce sales as reported by NielsenIQ growing +73%, now representing 16.6% of all CPG sales. Growth such as this demands rapid change and forces the industry to challenge many of its fundamentals. Today, assortment optimization is under the microscope with a call to action for the industry to take collective responsibility for the future.

The constant widening of product selection and entry of new products has been feeding inefficiency in the CPG industry for far too long. In fact, in a study within Western Europe, over 70% of all sales come from 2% of SKUs and of the 120 new products launched onto the European market every day, only 30% survive past two years.

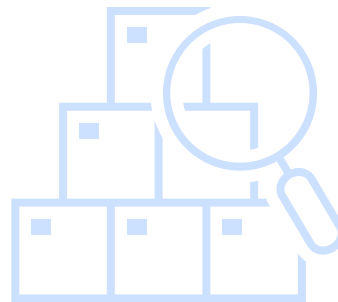
This means that 98% of SKUs and 70% of new products are simply a drain on resources, finances, and brand perception.

Now add to this the peak of “assortment scrambling” that took place during the pandemic as retailers tried to be all things to all people and it is easy to see how we might finally have come to a tipping point.

Indeed, the pandemic has led us to an awakening of sorts. While some retailers and categories scrambled, others were forced by

supply challenges to scale back and work smarter and in doing so came to understand that they could still survive, maybe even thrive with tighter and more efficient assortment. And this is now gaining some momentum.

“Right now, assortment optimization is about less is more. Back in the day, all you could buy was two sizes of milk. Now there are 47 different ways you can serve it up, so this is the time to get to the 80/20 rule.” - North American Retailer



The numbers show that retail assortment is a widespread industry problem, yet the greater the problem the greater the opportunity and for retailers and suppliers who pivot to streamline their efforts, the opportunities for improved efficiency and bolstered profitability await.

Before we address how the challenges may be unlocked, let us first take a deeper look at the problem.

Why is there so much waste in the CPG environment?

“They continue to increase the range but not taking out anything. It ends up being a game with them... There should be category solutions when bringing in new products by taking out others because they do not bring value to the category.”

- Asia Pacific Retailer

Reasons are surely as many and varied as the assortment proliferation itself, but Advantage puts forward three key reasons for reflection:

Reason 1: A legacy of low importance put towards assortment strategy

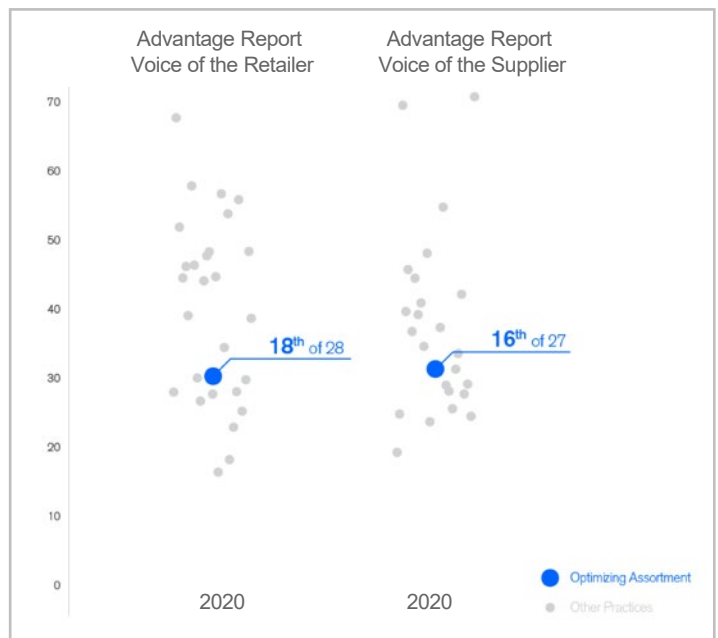
Surveying and supporting retailers and suppliers with their partnership engagement strategies, Advantage Group has found that assortment optimization has consistently

ranked as one of the lowest priorities for both retailers and suppliers around the world for many years. This lack of focus has driven more and more retailers to follow a scrambled assortment strategy to remain competitive with other retailers despite dwindling returns and oftentimes consumer apathy to new products

The lack of importance prescribed to assortment is a global problem on both sides of the relationship.

“Optimizing Assortment” priority rankings are low for both suppliers and retailers.

Source: Advantage Supplier Total Manufacturer Benchmark Sets 2020
Advantage Retailer Core Benchmark Sets 2020



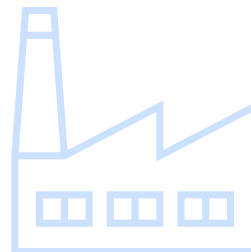
There are many widely recognized assortment strategies such as deep, wide, scrambled, localized, and mass market and each strategy has its own advantages and drawbacks, but finding the right one is crucial for improving profit margin and reducing product waste – particularly in the CPG space with perishable goods. Identifying which strategy works for a specific business takes time, research, and a depth of knowledge, and above all an ability to translate strategy into action but we know that this has not been a top priority across retailers and suppliers in CPG.

When thinking about the shopper, data from Shopper Intelligence shows that product range falls behind only freshness, quality, and price on the priority list for grocery shoppers, suggesting that retailers and suppliers are oftentimes jumping ahead to what they are selling, rather than focusing on why they are selling it. This results in product stock that does not necessarily sell-through and a glut of new products that consumers don't want.

Reason 2: Retailer and supplier KPIs are focused on metrics that simply exacerbate the problem



“If we did not have to negotiate their monies, we would probably get rid of half their range. Our hands are tied as we need the money, but we know we could get a third of their range and bring in something new and different”. – European Retailer



“Rather than working collaboratively to grow the category mutually in partnership, they took a more adversarial position... We have to pay, or they will not do business. It is challenging...”
- North American Supplier

The waste that occurs in 98% of SKUs and 70% of new products must be pegged, at least to some degree, back to the internal processes and culture prevalent in CPG. For example, supplier marketing and sales teams are given KPIs that are tied to a percentage of sales from new products and retail buyers are similarly incentivized to acquire listing fees or space for new products.

These KPIs create a short-term focus with employees on both sides of the aisle equating success with growing the number of SKUs available in store. That worrying figure of 70% failure rate for new products after two years does not factor into the day-to-day discussions because long-term thinking would clash with the necessary pursuit of individual and team targets. If KPIs were instead focused on whether products survived the sought-after two-year mark, how might this change what shoppers saw on shelves, not to mention subsequent profit margins and the volumes of waste?

Reason 3: Me-too products or minor tweaks are often masked as innovation

“In recent years, they have gotten into the habit of trying to launch new products that are not particularly different to existing products. These are not really creating a

point of difference to the other SKUs. They need to make these more differentiated, or not launch them.”

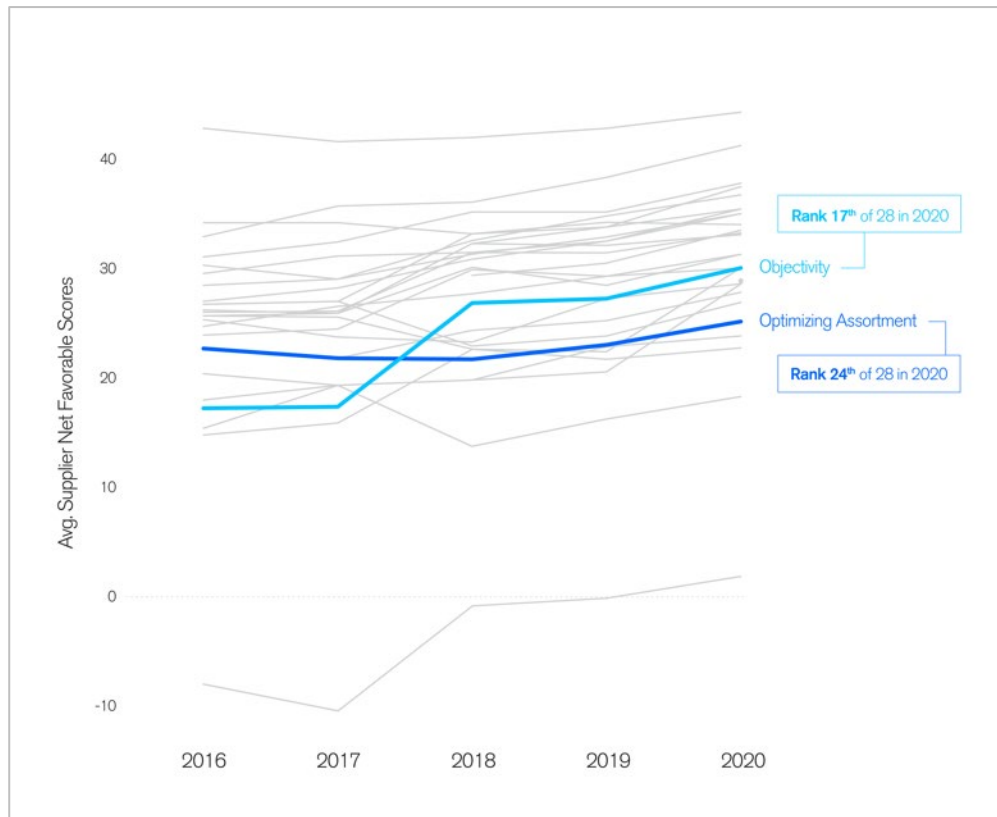
– European Retailer

With retailers and suppliers both focused on new-product or line extension KPIs it is no surprise that retailers are overwhelmed by constant new-product pitches from suppliers. As a result, it can be hard for retailers to discern which new offers are designed around shopper insights and to serve an authentic real consumer want or need.

This is where the importance of meaningful B2B relationships comes into play. It is crucial that retailers can trust their suppliers to provide balanced and category-focused perspectives with sound insights and objective recommendations, but for the most part this is not what they get today. Suppliers have an obligation to reduce the complexity in the assortment puzzle by reducing the numbers of new products, line extensions and product modifications they pitch. Instead, their focus should be on producing products that are truly differentiated from current offerings and rooted in consumer need – good for the category. In fact, this is a point of frustration for many retailers, who in 2020 ranked “Assortment Optimization” 24th and “Objectivity” 17th out of 28 competencies in terms of satisfaction with their supplier community. The constant production of new products, without a clear and genuine rationale, is eroding relationships, profit margins, and consumer trust.

Critical relationship drivers “**Optimizing Assortment**” and “**Objectivity**” are consistently among the lowest performing of 28 competencies within Advantage Voice of the Retailer Programs globally

Source: Advantage Total Manufacturer Benchmark Sets 2016-2020



The opportunity for assortment optimization

Due to the large-scale problem of wastage for both retailers and suppliers, organizations need to move assortment prioritization up on their priority list and now is the ideal time to do so.

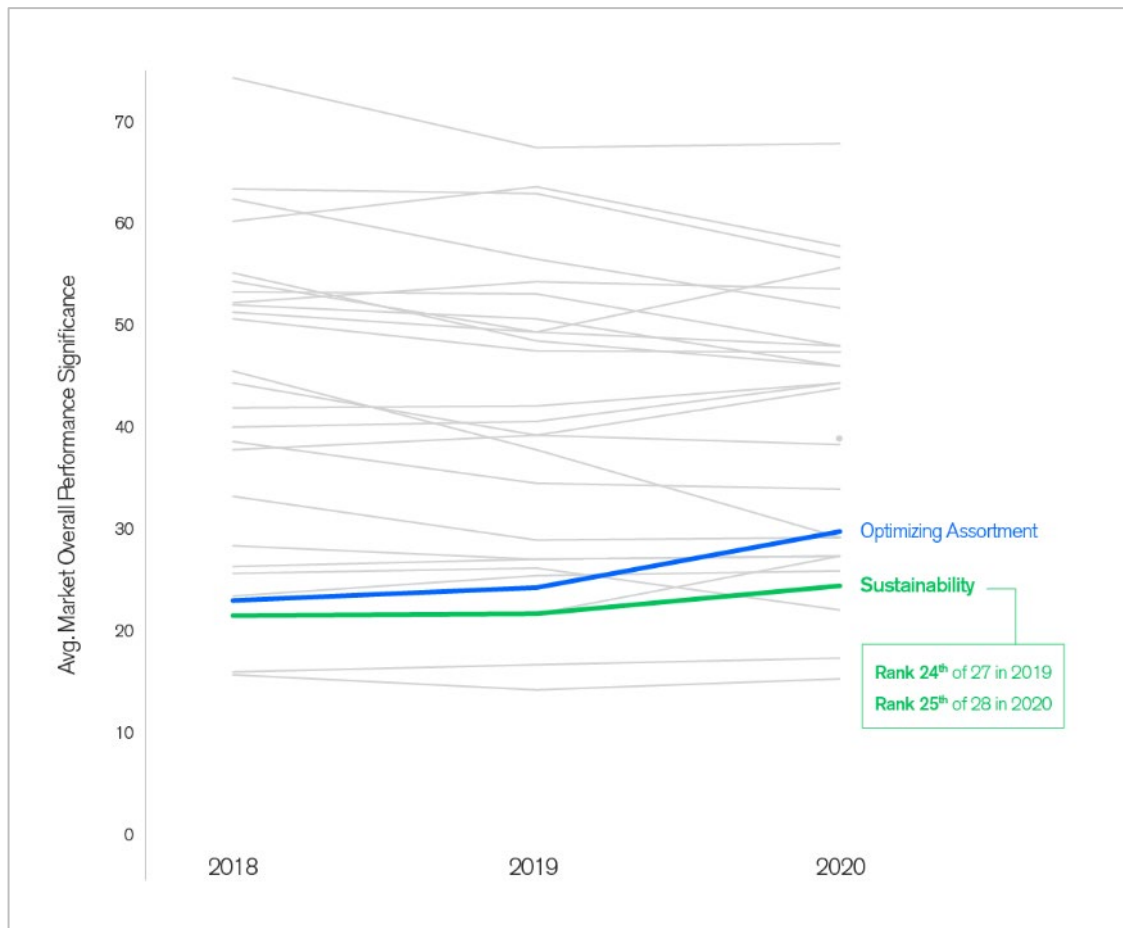
“The change in consumer habits during COVID-19 has really changed the dynamics of products that are selling and not selling. We would like to see them be more proactive in analyzing the new normal and what they can do to accelerate the brands that are working very well.” – North American Retailer

The shift in the types and range of products that shoppers are buying creates an opportunity that perfectly dovetails with assortment prioritization. There is also another critical reason why the time is at hand: sustainability.

Sustainability is gaining momentum, rapidly becoming an expectation of consumers, yet Advantage data shows that of the 27 supplier competencies measured, “sustainability” ranked 24th on the priority list in 2019 and dropped to 25th in 2020.

“Sustainability” is also persistently one of the lowest ranking priorities for commercial roles within CPG across Advantage Voice of the Retailer Programs globally.

Source: Advantage Total Manufacturer Benchmark Sets 2018-2020



For years lip service has been paid to the importance of reducing waste and the environmental damage that waste causes, but we see through the Advantage Report that at the commercial interface between buyer and seller it simply is not on the radar. Yet, it is clearly an agenda item for many shoppers with statistics like these in the United States:

- Market share in sustainable products has grown to 16%.
- Sustainable product sales are growing seven times faster than conventional products.
- Sustainable products account for 55% of all growth in new products.
- On top of this growth, sustainable products have a lower price sensitivity for shoppers, fetching a 39% premium.



Optimizing assortment and reducing the number of SKUs available to shoppers in the name of sustainability provides the opportunity to tell a story of tangible social impact while also being a good business. In a recent report, Bain cited that eliminating 10-

20% of SKUs can yield 5-10% production costs for suppliers and 2-3% COGS for retailers. In addition, reducing SKUs based on emerging consumer insight and shopping trends will help drive deeper brand loyalty.

The move toward bringing sustainability and assortment optimization together is already underway. Bain reports that 50% of grocery retailers are planning a reduction of SKUs over the next year and The Symphony RetailAI and Incisiv study of senior executives of both retailers and suppliers have found that 95% of those surveyed cite inventory optimization as their top priority for the upcoming fiscal year.

How to seize the opportunity

Although the opportunity and logic of sustainable assortment prioritization is clear, seizing that opportunity is no easy feat, especially given the paradoxical intentions vs. consumer behaviors.

After all, today's consumer wants convenient, customized products on the one hand while advocating for sustainability and corporate responsibility on the other. The solution is assortment optimization, and not necessarily assortment reduction. Retailers and suppliers need to scale back by only offering products that consumers really want, first taking the time and investment required to understand consumer and shopper needs and driving responsible value-based strategies to cover dimensions such as sizing, pricing and so forth.

To do this there are several strategies that should be employed:

1. Focus on building a meaningful relationship between retailer and supplier, whereby both parties are motivated by a genuine desire to address the issues and their underlying causal factors in their assortment strategies.

“The challenge for suppliers is how we continue to keep a close eye on the trends and think differently, how we adjust the set if we need to address changing trends, and how we address our business plan to address the changing trends. That is going to be our biggest challenge on which we are going to have to work together as partners.” – North American Retailer

2. Create KPIs on both sides of the supplier and retailer relationship that prioritize win-win solutions, long-term economics, smart ways to cater for range and customization needs, and put a magnifier on sustainability.

“We will be asking for more shopper insights and information for assortment decisions, for what is the right thing for the category, how the shopping of the consumers have changed, and how we can collaborate to meet those needs.” – North American Retailer

3. Build a mandate of trust, objectivity, transparency, and responsibility around portfolio management, promotions, and innovation, a mandate that does not shy away from hard choices and short-term pain for long-term gain.

“The challenge of range rationalization is not going away so we ask suppliers to proactively look at where they have opportunities and duplication to ensure we can go after the greatest opportunities we have in the years to come, and look at what they do in other markets...” – European Retailer

4. Operationalize actions, KPIs, and the mandate across every department in both the supplier’s and retailer’s organization – you will need everyone working in the same direction to be successful.

“...they're all about "me, me, me". They're not saying these brands will help broaden our shopper appeal and grow our business. It is more their brand is what we need, and we don't need anybody else. It's very one-sided.” – European Retailer

5. Limit assortment and new product development by relying on data-backed shopper, category and store-wide insights, enabling that only products that shoppers want are created, supplied, and sold.

“Our expectations will be that there will be a heightened reliance on insights to tell us whether our ranges need to change. Market intelligence will be a big thing in the future.” – European Retailer

6. Prioritize flexibility and speed in your processes to effectively manage supply and meet the rapidly shifting priorities of shoppers.

“We are expecting more than before in two things. One is agility because in the past we could accept several months to change an assortment or a route to market, and now we want it to be done in days. We are expecting our suppliers to have a higher level of entrepreneurship with our company, meaning there are

risks and opportunities coming our way, and there is not always the time to go through the whole hierarchy and model for decision making...” – North American Retailer

7. Design an effective online assortment methodology to increase agility and go where the shoppers are.

“In terms of the retail industry, the shift toward online has been huge. That shift is going to be key. It is not going to replace brick and mortar; that will always be the primary, but ... Online is going to be a much bigger part. They are making sure their ranges are active online.” – Asia Pacific Retailer

For years assortment strategy has been nudged to the side as a secondary consideration in the pursuit of shoppers with proliferation causing a problem for supply chains, profits, shoppers, and the planet. It has become a lose-lose game for everyone. Building and prioritizing an assortment strategy around the idea of less is more is a huge opportunity to grow sales, drive shopper loyalty, and build brand credibility on a crucial social cause.

Advantage Report insights are well placed to support both suppliers and retailers as they understand what it takes to build the kinds of partnerships that can bring sustainability and assortment prioritization together to drive tangible customer impact. Now is the time - your business, your shoppers, and your shareholders will thank you for it.

Sources:

Advantage Total Manufacturer Benchmark Sets 2016-2020

Advantage All Retailer Respondents 2020

Advantage Best in Class Analysis – Advantage Report, 2020

[COVID-19's impact on demand and costs in the CPG industry](#)

[US ecommerce grows 44.0% in 2020](#)

[Growing the Joint Profit Pool of Retailers and Manufacturers in Europe](#)

[Shopper Intelligence](#)

[Latest Research From NYU Stern Center for Sustainable Business and IRI Shows that Sustainability IS Surviving COVID-19](#)

[Webinar: Assortment Optimization](#)

[95% of FMCG retailers say inventory optimization is a top priority today](#)

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