EXECUTIVE INSIGHTS

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Conventional Wisdom: Successfully Transitioning From the Specialty Grocer Channel

Specialty grocery retailers such as Whole Foods and Trader Joe's have a knack for offering customers a wide range of unique, hard-to-find products, many of which they source from smaller, regionally based specialty-brand manufacturers. Specialty grocery stores provide these micro businesses a number of key benefits, including a healthy level of distribution and the ability to build consumer trial and "trust" in their brands.

This formula is often so successful that a specialty brand must ultimately transition into the retail mainstream to maintain its growth trajectory. (Specialty retailers are by definition a niche industry estimated at $40 billion of the approximately $800 billion retail grocery landscape). But this move can be tricky. L.E.K. Consulting advises these high-growth companies to follow a series of carefully timed steps to ensure a seamless transition, maximize distribution and sustain success by keeping both specialty and conventional retailers satisfied over the long haul.

> ***The market is flush with thousands of flash-in-the-pan specialty brands so only those brands that have a differentiated, uniquely packaged and great-tasting product will gain shelf space...***

Building Brand Momentum

Specialty brands cannot make the leap to the conventional retail channel without first establishing a high degree of momentum and a solid proof of concept within the specialty channel. The market is flush with thousands of flash-in-the-pan specialty brands so only those brands that have a differentiated, uniquely packaged and great-tasting product will gain shelf space and establish trust among retailers and consumers alike.

To build momentum, specialty brands can pursue a number of techniques to generate excitement about and "buzz" around their brands. Successful strategies include investing in trials to drive first-time purchases, strategically using social media, and attending food trade shows to connect face-to-face with prospective retail buyers.

Crossing Over at the Right Time

Specialty brands that achieve critical mass may think they're ready to enter the retail mainstream, but it is imperative that they maintain their standing within the specialty channel to ensure the smoothest transition possible to the conventional channel. By first riding the wave of momentum leading up

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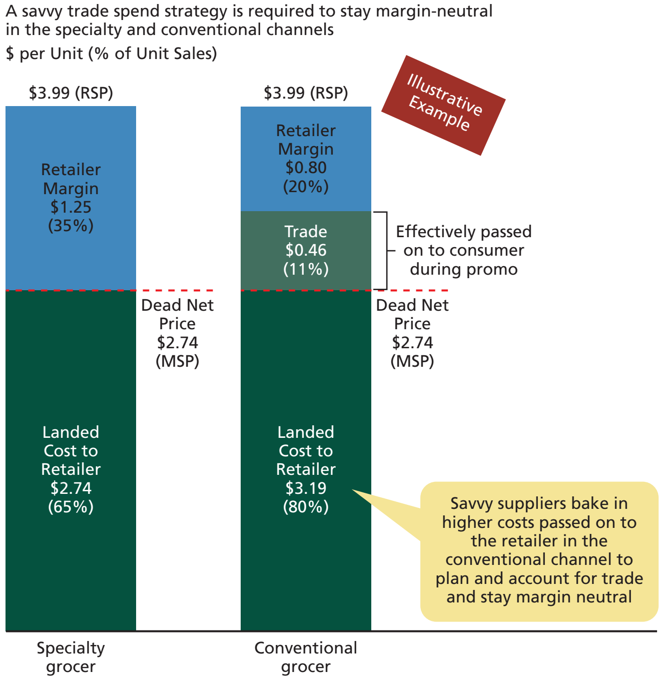
Figure 1
Trade and Retail Margin Examples



to the point of transition, specialty brands can create a halo effect of trust and convey to conventional retailers that their products are cutting-edge and differentiated, which is critical to gaining shelf share. Brands should time their entry into the broader channel just as momentum is peaking in order to give the brand "must-have" appeal among mainstream retailers. They should also be selective in their choice of key retailers from the outset (e.g., partner with retailers such as Costco to reinforce trust) and ensure they can meet capacity requirements in the larger conventional channel.

Finding Key Partners

Brokers and third-party distributors can help specialty players optimize their conventional channel growth potential once these companies have established a foothold in large national anchor retailers. Brokers and distributors help new suppliers build credibility and navigate the specific needs of retailers. And because store-owned distribution centers typically carry about half of the roughly 40,000 conventional retailer SKUs, many specialty retailers often choose instead to work with specialty distributors (e.g., KeHe and UNFI) to get their products on the shelves.

Anticipating Conventional Price/Margin Differences

Some specialty firms initially make the mistake of selling to conventional retailers at the same price as to specialty retailers without factoring in the required trade spend in the channel. To avoid margin erosion upon entry into conventional retail, specialty brands should adopt a savvy trade-spend strategy – including planning ahead for required trade funds/slotting fees, and then pricing products accordingly so they can remain margin neutral upon their entry into the conventional channel (see Figure 1).

Understanding how to navigate the "high/low" pricing dynamic in conventional retail grocery is key. This involves targeting the same dead-net price to conventional retailers, which specialty brands can do by offering higher gross prices that net out when factoring in the trade spend required for promotions. The result is typically a lower per-unit margin for conventional retailers compared with specialty retailers (which pass most of the trade dollars to consumers), but at generally higher turns per unit.

After a specialty brand's transition, conventional retailers expect heavy trade and promotion to drive trials. Accordingly, specialty players must be disciplined in their roll out of promotions in order to provide the right amount of conventional support without over-promoting to their specialty base. Specialty manufacturers that establish momentum and have key partners should evaluate their options to limit the amount of annual promotions, (e.g., targeting only a select number of SKUs to promote).

Sustaining Brand Appeal and Differentiation

Even as they gain scale, specialty brands must strive to maintain their appeal and invest in their roots: the core specialty channel. Brands need to roll out innovative new products frequently in order to distinguish themselves from the pack of existing alternatives and up-and-coming copycats. Brands should debut product releases in the specialty channel and include a wide SKU selection to keep specialty retailers invested in their products (see Figure 2). While extending the brand into newer categories can often fuel growth, players must take care to avoid any segment that might not be a good strategic fit.

The Proof Is in the (Gluten Free) Pudding

By making the leap into the conventional world, a number of specialty brands have gained mainstream appeal: KIND Bar, Annie's and Chobani (the latter becoming so popular that it was ultimately delisted by Whole Foods in late 2013), among others. One of the more notable crossover success stories is gluten-free food maker Udi's (please see our Insights@Work), which made its conventional debut in 2010 yet continued to maintain its strength in the specialty channel; in the process, Udi's became the fastest-growing packaged-food brand since 2009*, with 2012 sales achieving a run rate of approximately $73 million, compared with $4 million in 2009. Smart Balance Inc. purchased Udi's for $125 million in 2012.

Figure 2
Sustaining Brand Appeal

Specialty channel | Conventional channel

"Wall of Annie's": 21 facings | 7 Annie's facings mixed with other brands

*Source: Nielson; Udi's 2014 Analyst Day Presentation

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