WHAT'S
NEXT

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RESPONDING TO NEW CHALLENGES IN THE US CONSUMER PACKAGED GOODS MARKET

BY STEVE MATTHESEN AND DENNIS MOORE

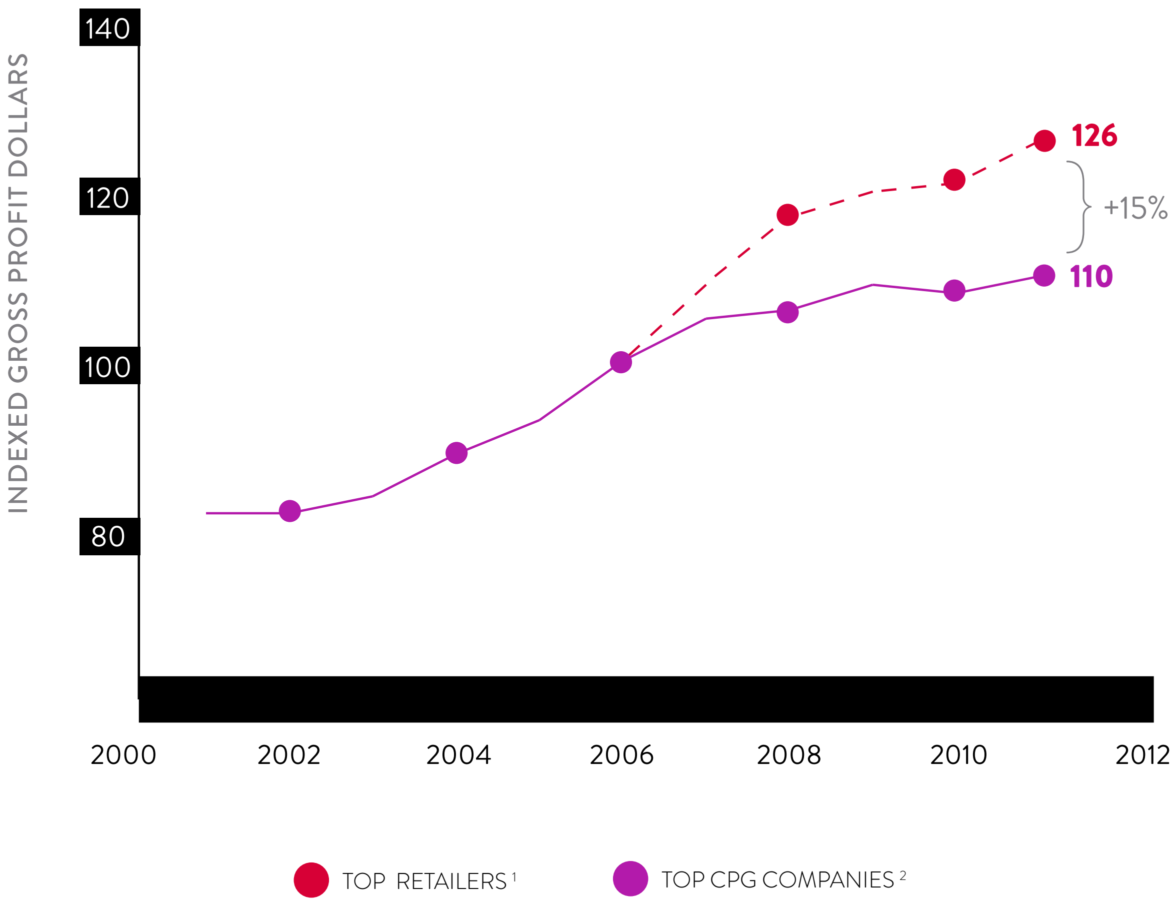
To drive profitable growth in the U.S. market, leading consumer packaged goods companies must evolve from relying on large scale and broad scope as automatic advantages to concentrating on doing fewer things better - starting with a renewed focus on their value proposition to consumers.

The U.S. market has been tough on the biggest consumer packaged goods (CPG) companies. Although the leading players have traditionally fared well in this industry, scale and scope do not provide the advantage they once did, and growth at these companies as a group has recently lagged that of the leading retailers. Analysis jointly undertaken by Nielsen and The Boston Consulting Group has shown that for the five year period from 2006 to 2011, annual gross-profit dollars grew by 5 percent at retailers, while they grew by only 2 percent, on average, among the 25 largest branded CPG companies. Had the top 25 companies (ranked by sales) maintained the same growth rate of 5 percent, their annual gross-profit dollars on average would have been 15 percent higher in 2011 than they in fact were (Exhibit 1).

This article is adapted and developed from "The Game has Changed: How Consumer Companies Can Win Back the U.S. Market," by Steve Matthesen, Nicholas Keuper, Jeff Gell and Drake Watten, bcg.perspectives, 2012. Nielsen and The Boston Consulting Group collaborated on both the analysis of consumer packaged goods companies and the recommendations outlined in the article.

STARTING IN 2006, GROSS PROFIT GROWTH OF CPG MANUFACTURERS LAGGED RETAILERS

EXHIBIT 1



Source: Nielsen, company financial statements, BCG Value Science, BCG analysis

1 If the largest CPG companies had grown gross profit dollars at same rate as top 10 public retailers. Adjusted for acquisitions / divestitures above $2 billion. Used global gross margin %s when United States was not available.

2 Largest 25 public CPG companies excluding alcohol and tobacco.

This multi-year differential produced a total "lost growth" gap for these companies amounting to $18 billion of gross profit – a differential that is likely to persist unless they find a way to regain momentum in the US market.

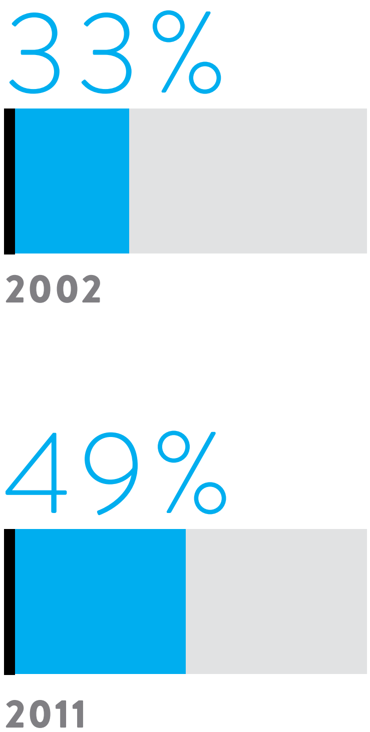
While such a challenge would be significant at any time, for these companies right now it is a particularly important and urgent issue. First, the U.S. continues to account for a very substantial part of the sales of the large CPG companies. This means that none can afford to see the U.S. market become a "leaky bucket" that would quickly drain away any gains made elsewhere in the world. Second, the demographic and macroeconomic trends for at least the next three to five years in the US will not provide a rising tide that lifts all boats. There is simply no indication that overall market growth can be relied upon as a driver of individual company performance. Growth will have to come from category expansion and share gains.

As is often the case, there are number of companies among the top 25 that have bucked the trend. Our research into the performance of the winners and the also-rans revealed five go-to-market strategies that are at the heart of how the winners have been able to compete and grow in this market environment:

- **Build a proprietary understanding of your consumer.** Know more than your competitors about your most profitable consumers: how and where they shop, how and where you can best communicate with them, their motivations, and their unmet needs. Then align all your marketing activities against this vision.
- **Make your marketing more precise.** The winners are spending more, but are also spending in smarter ways to sustain the equity of their brands and attract and retain consumers even when times are tough.
- **Master the science of pricing.** Greater analytic precision, based on a close understanding of the consumer, will allow you to execute surgical price moves and allocate trade dollars to the most productive uses.
- **Innovate based on identified unmet demand.** Use a highly disciplined system to find unfulfilled consumer needs and wants, and then closely align all product development and go-to-market execution with that demand-driven insight.
- **Partner with winning retailers.** Skew your investment of time and resources toward the higher growth retailers that are drawing in consumers with a differentiating value proposition. Retailers are also under pressure, and need to work with the manufacturers who can best help them with their own challenges.

EXHIBIT 2
RETAIL CONCENTRATION INCREASED IN THE LAST DECADE

Percentage of total sales from top 10 retailers



Source: Company 10-Ks. Total sales from Datamonitor; includes the total US market for the following categories: Food, Alcoholic and Non-alcoholic Beverages, Tobacco, Personal Care, Pet Care, News and Magazine, and Household Products.

In what follows we discuss briefly how the largest CPG companies collectively found themselves falling behind, and how a subset of this group has been able to apply these strategies and significantly outperform the rest. We then examine the five winning strategies in detail.

HOW WE GOT HERE

The success of retailers compared to manufacturers is the result of several factors.

The retailing sector has become more concentrated during the last decade, with the largest operators leading the sector's growth and gaining greater potential operating leverage and bargaining power in negotiating with manufacturers than they have ever had before (Exhibit 2). Retailers have used this leverage to gain more visibility into manufacturers' costs and take a tougher stance in pricing and promotion negotiations. Because manufacturers also faced rising commodity costs during this period, their more limited pricing flexibility forced them to cut costs in other areas – including in some cases marketing support.

Perhaps even more significantly, retailers have been investing more in their own private label brands and in the equity their franchises have with consumers. As a result, they have been more successful in dealing with the 'hourglass' economy that has emerged during the lingering recession – where the wealthy are continuing to do well, the lower income folks are not doing well but are growing in number and as a market segment, and the middle – which is the traditional core for the large-scale CPG companies – is both being squeezed and shrinking in number. Competition for this middle ground has intensified among manufacturers and retailers alike, hurting the growth and profitability for all serving this segment. But through their investment, retailers have been able to secure a greater share of profitable growth at either end of the market, both from the attractiveness of private label in specialized formats for the higher end and the credibility of their value-driven offerings for consumers at the lower end (Exhibit 3). It is noteworthy that the fastest growth of private label consumption in this time frame was among higher income consumers (those with annual earnings above $100,000), who increased the share of their spending allocated to private label by 31% between 2005 and 2011.[3]

Finally, advances in data mining technology have transformed shopper loyalty programs into powerful tools that allow retailers to know as much (or more) about their consumers as many manufacturers do, with the potential to inform all aspects of their business from innovation to store level pricing and promotion.

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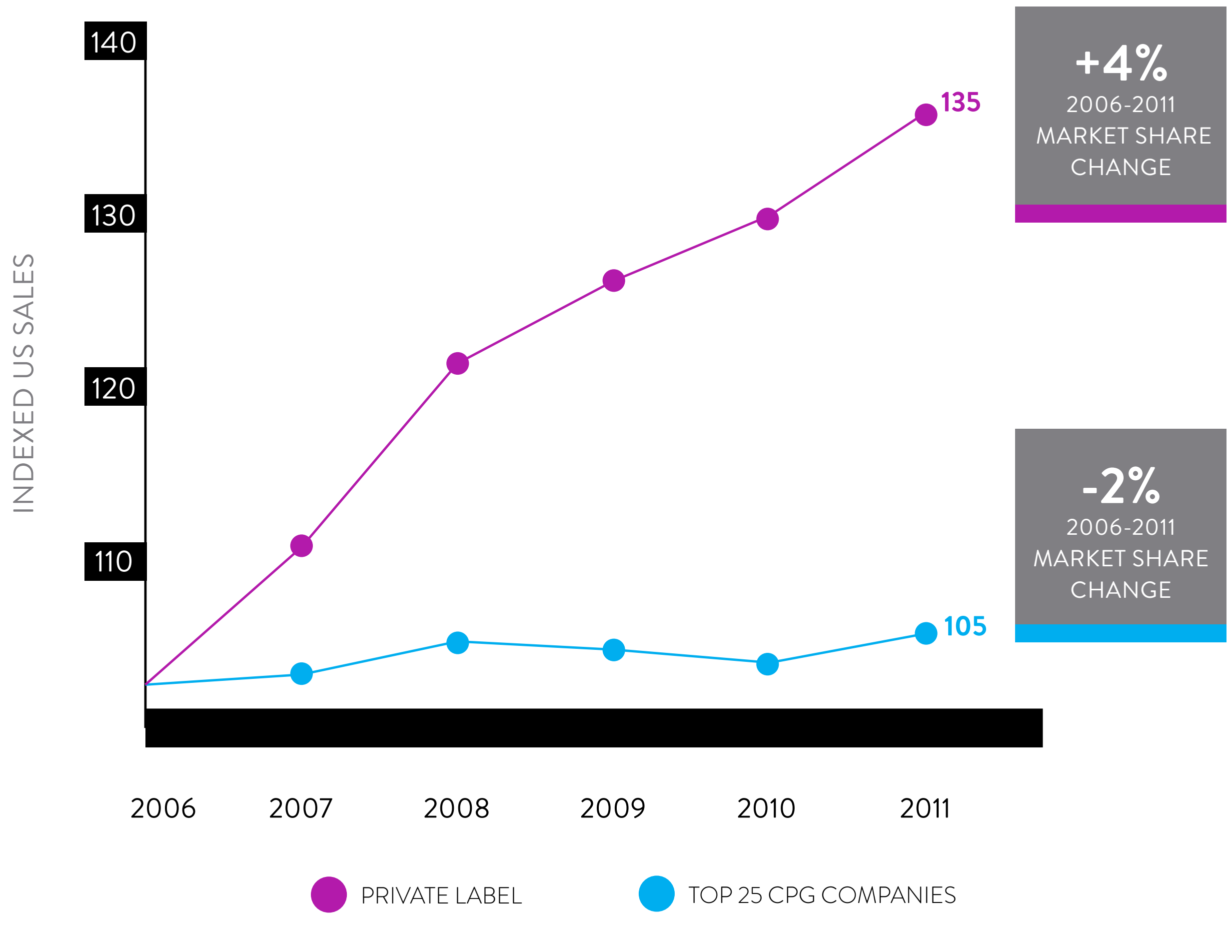
3 Nielsen analysis.

PRIVATE LABEL GROWTH

EXHIBIT 3



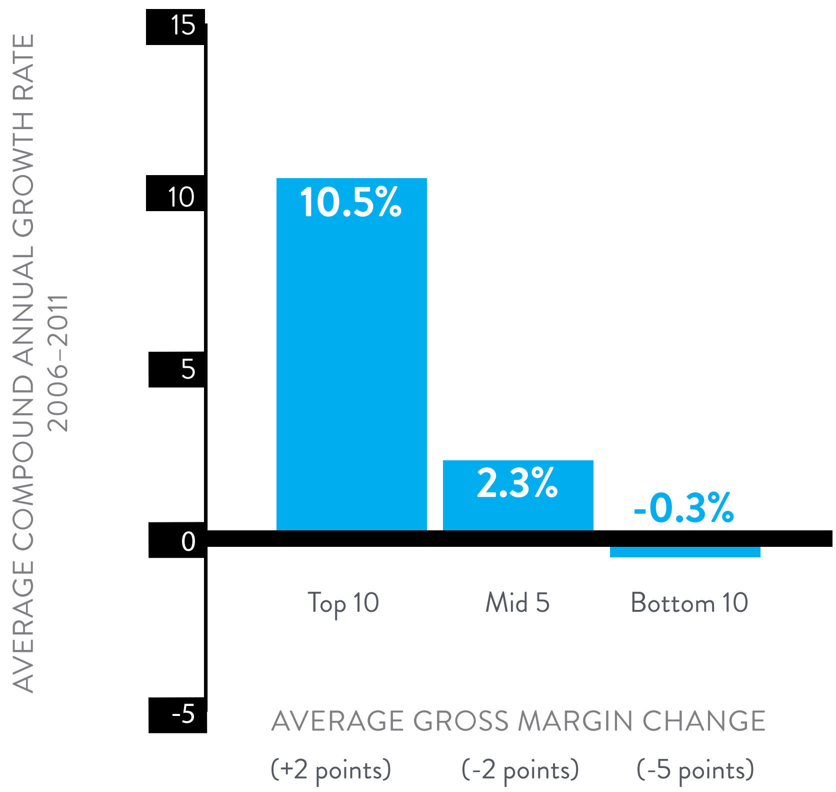
Source: Nielsen

DIFFERENCES AMONG TOP CPG COMPANY STRATEGIES

While the average performance for the largest CPG companies highlights a key growth issue for the group, it is instructive to see how varied the performance of the individual companies has been. We separated out the top 10 performers by growth in gross profit dollars for the period from 2006 to 2011, which revealed a substantial difference from the rest of the group (Exhibit 4).

GROSS PROFIT GROWTH RATES AMONG THE 25 LARGEST US CPG COMPANIES

EXHIBIT 4



Note: Gross Margin data is either Global or US.

Source: Company financials, BCG Value Science

We then analyzed the portfolio mix, go-to-market approach, and performance of all 25 companies to determine what was behind these results. Notably, many of the largest CPG companies with the broadest portfolios, biggest marketing budgets, longest-established brands, and most recognizable household names didn't rank among the top ten performers. High relative market share, which typically speaks to competitive strength, was no guarantee of growth.

FIVE STRATEGIES FOR GROWTH

In analyzing what drove success at the top performers, we found that they differentiated themselves from the pack through the use of five go-to-market strategies: build a proprietary understanding of your consumer, make your marketing more precise, master the science of pricing, innovate based on identified unmet demand, and partner with winning retailers.

This made it possible for the winners to reorient their businesses around the transformation in consumers' purchasing behaviors, mindsets and shopping patterns that has occurred in response to the recession, the proliferation of retail channels, and innovations in technology.

The result was a sustained ability to achieve profitable growth in a sluggish, intensely competitive market. As such, the five strategies represent the main avenues on a roadmap for how large CPG companies can protect – and grow – profits in the years ahead.

THE FIVE STRATEGIES REPRESENT THE MAIN AVENUES ON A ROADMAP FOR HOW LARGE CPG COMPANIES CAN PROTECT –AND GROW – PROFITS IN THE YEARS AHEAD.

BUILD A PROPRIETARY UNDERSTANDING OF YOUR CONSUMER

The notable feature of the top ten CPG performers is that they brought a laser-like focus to their markets. They moved from mass marketing to segmenting by groups of consumers, and they developed more precise strategies for product innovation, marketing, pricing, and assortment to serve their most valued consumer segments.

THE NOTABLE FEATURE OF THE TOP TEN CPG PERFORMERS IS THAT THEY BROUGHT A LASER-LIKE FOCUS ON THEIR MARKETS.

In many cases, this was made easier by the fact that they operated businesses spanning fewer categories, providing them with more of the kind of category concentration you expect to see in smaller niche-brand manufacturers. Scale and scope in this market can actually hurt because having a broad business mix means you can have problems everywhere. With macroeconomic winds blowing in the face of most categories, companies managing large broad-based businesses find that all or most of their business lines are facing challenges. For those operating with a narrower portfolio, making just one or two key moves within the categories where they compete can make all the difference.

But even for those companies that did compete across many categories, the winners were those that brought the mindset and management discipline of a focused brand. Larger companies need to ensure they are able to act like a focused company and not rely on scale and scope to win. Each brand team needs to have a deeper level of knowledge about their consumers' behavior, wants and needs than ever before – winning now requires a proprietary understanding of your consumer.

MAKE YOUR MARKETING MORE PRECISE

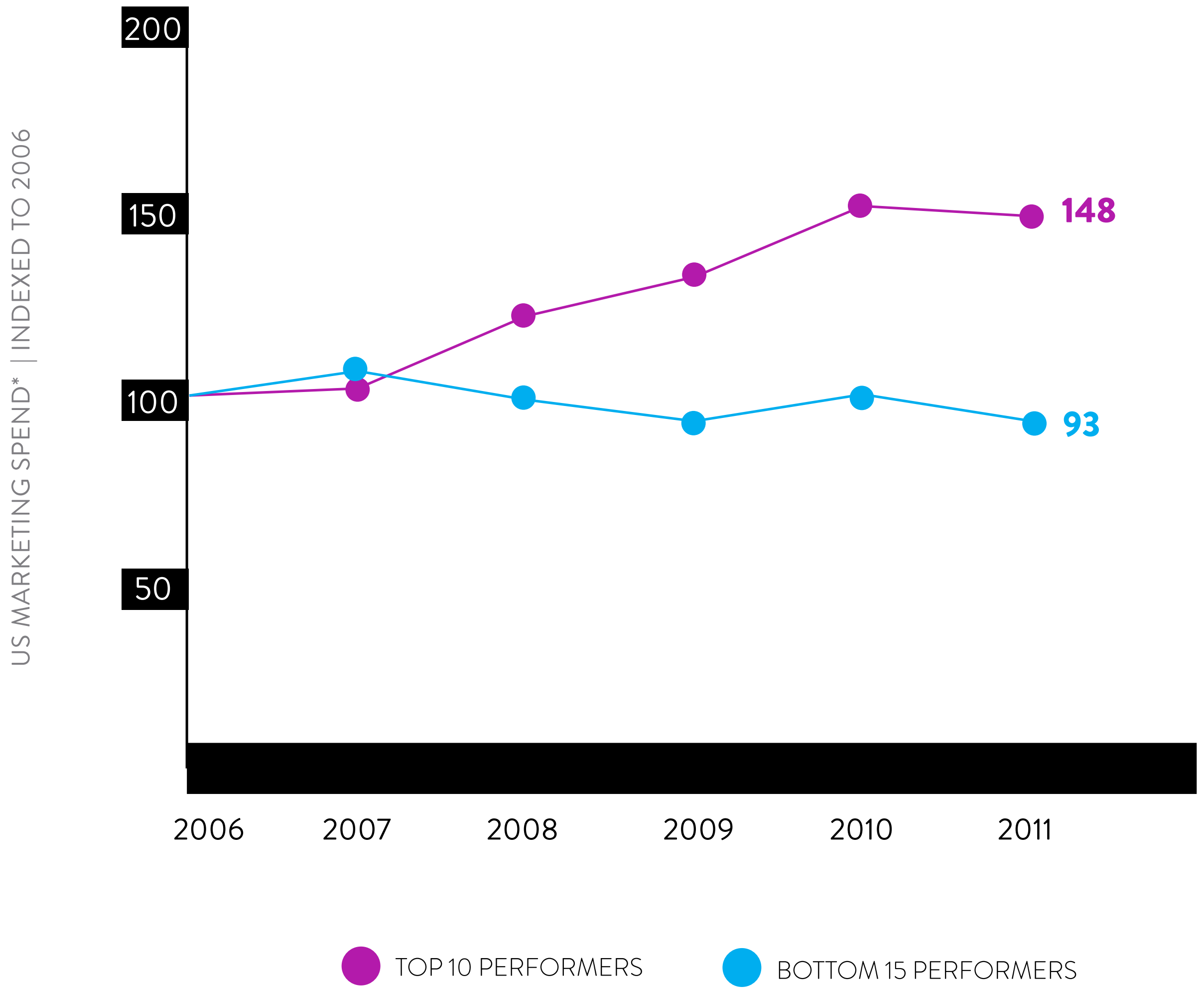
The marketing budget is often the first place a company cuts when times get tough, and many companies in our study did just that. But over the five-year research period, the top-performers actually spent more heavily on marketing than the others (Exhibit 5).

Importantly, for the top performers it wasn't just about spending more, but also spending with greater precision. They adjusted their marketing programs to cater to the more cost-conscious, post-recession consumer; they self-funded campaigns by reducing trade spending; and they were much more selective in their use of media. In doing so, they were able to limit defection of their consumers to cheaper or more premium brands.

What must be recognized is that these factors now can be measured more accurately and dynamically by all CPG companies. The ability to direct one's marketing efforts more precisely, is a function of strategy and organizational discipline – not the scale or scope of the business.

THE TOP PERFORMING CPG COMPANIES INCREASED THEIR MARKETING SPEND DURING THE RECESSION

EXHIBIT 5



** Average CPG US measured marketing spend divided by US factory sales.*

Source: AdSpender, company financial statements, BCG analysis

Continued technological advances and innovations in measurement and analysis are likely to level the playing field even further so that niche brands and private labels can compete yet more effectively against brands with bigger marketing budgets.

The basic equation for marketing has not changed. The capacity and confidence needed for a company to invest more heavily in marketing comes from being convinced it will earn a return on that investment. The decision on making an investment in an advertising campaign, for example, still comes down to how effectively it will drive "the 3 Rs": the more of your ideal audience you can *reach*, and the more intensely your advertising *resonates* with them, the stronger the brand lift or sales lift *reaction* will be. What has changed is that the digital revolution is providing a flood of data to CPG companies and retailers of any size. This enables all of them to segment potential buyers more effectively according to the consumers' interests, needs, past purchases, and buying behaviors, and market to them much more precisely than has been possible using the traditional approach built around broad demographics and retail formats.

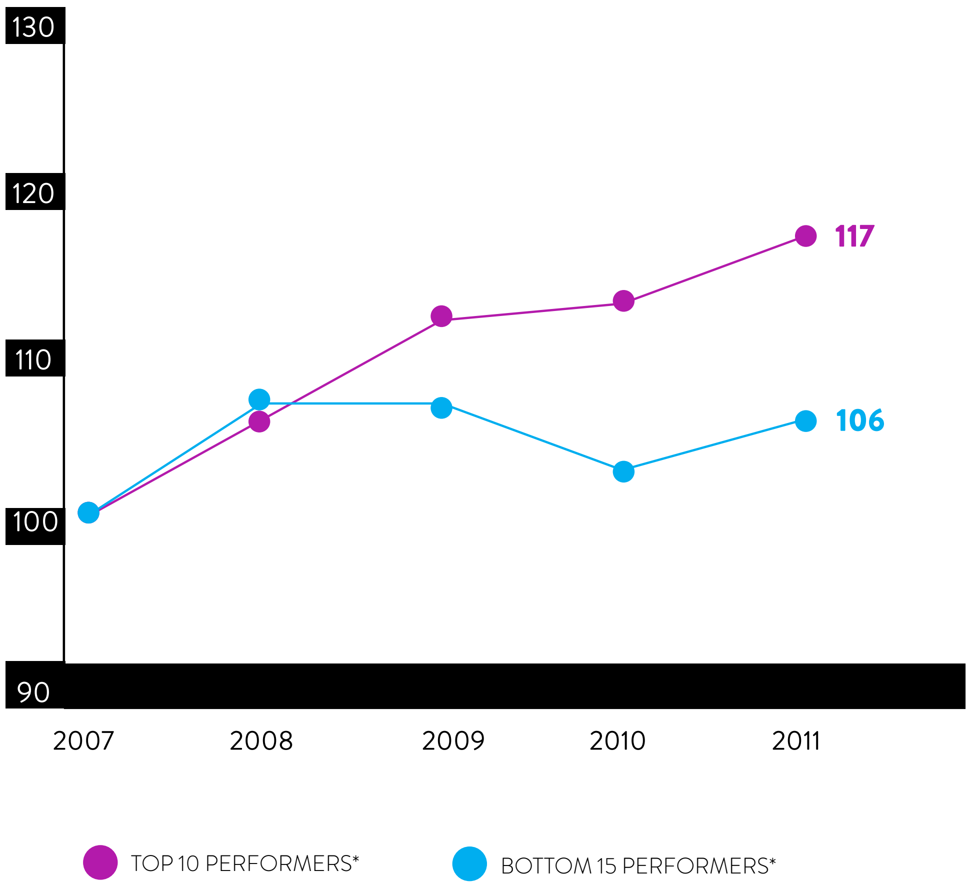
MASTER THE SCIENCE OF PRICING

The top performers drove higher price realization during the downturn and increased prices faster coming out of the recession. They did this mostly through surgical price moves – for example, by week, by SKU, or by account – that took advantage of inconsistencies in the marketplace and areas where consumers were insensitive to price increases (Exhibit 6). Of course, a few high-performing companies had breakthrough innovations that could command price premiums. But most did not, and most were also unable to make across-the-board hikes (which often just get peeled back by trade promotions to preserve volume anyway).

To achieve higher margins, companies need to approach their pricing strategies with greater analytic rigor based on a close understanding of the consumer on a range of factors – such as regional differences, product segments, ingredient mix/quality, seasonality, competitive dynamics, packaging options, retail outlets, and consumers' willingness to pay – instead of using a one-size-fits-all approach. Best-in-class players have created centers of excellence for managing and adjusting prices on an ongoing basis instead of treating pricing as a one-time event.

CPG AVERAGE RETAIL PRICE INDEX TO 2007

EXHIBIT 6



**Performance measured by gross profit dollar CAGR in US '06-'11.*

Source: Nielsen, BCG analysis

CPG companies also need to ensure that trade expenditures are truly "pay for performance," delivering the right retailer behavior (such as improving shelf placement or offering point-of-purchase displays). Too often, companies allocate too many budget dollars to the most unprofitable retailers or to unprofitable promotion events – or both. These mistakes could be easily avoided through more rigorous use of basic measurement tools, such as return on trade spending.

INNOVATE BASED ON IDENTIFIED UNMET DEMAND

Innovation that matters expands categories and broadens franchises. It sets the basis for how everyone will compete, keeps the consumer focused on the added value of products, and sustains brands. Not surprisingly, our research shows that private label has commanded a lower market share, on average, in categories marked by a relatively higher rate of innovation.

THE KEY TO SUCCESSFUL INNOVATION IS APPROACHING IT AS A SYSTEM BUILT AROUND SATISFYING UNMET DEMAND

In our years of work on innovation and new product development in the consumer packaged goods industry, and in line with the analysis on which this article is based, we have learned that the key to successful innovation is approaching it as a system built around satisfying unmet demand. This was brought to life in an analysis we recently completed of the largest and most successful CPG breakthrough innovations over the past several years. This work offered a compelling illustration of the three core disciplines that make the difference between incremental or unsuccessful efforts and true breakthrough winners:

- **Demand-driven insight.** Uncovering latent demand – lurking in the unmet needs and poorly performed jobs in consumers' lives – lies at the core of breakthrough innovation.
- **Demand-driven development.** From beginning to end, the innovation team must pursue the demand-driven insight faithfully and fully. The concept, product, and go-to-market execution all must align – free from the constraints of established processes, existing resources, or conventional assumptions – in order to realize a breakthrough proposition.
- **Pervasive leadership.** Driving the innovation process with rigor and passion over the countless hurdles that must be cleared from the idea, to the spending at launch, to ongoing in-market support, requires top-down and bottom-up leadership throughout the organization.

In combination, these disciplines amount to an innovation system. Embracing them requires investment and considerable management discipline, but delivers growth and outsized rewards in return.

PARTNER WITH WINNING RETAILERS

The pressure on retailers to differentiate is as great if not even greater than it is for manufacturers. The US is already densely stored and there is no sign that this will lessen soon. If you add in e-commerce and consider a “square footage equivalent” for the growing business they do, that density is even greater.

This intense and growing competition within the retail sector will be won by those who create clearly differentiated value propositions that well-informed and ever more discerning consumers will respond to, just as they do to the value propositions of their favorite brands. The best-performing CPG companies recognize this and have skewed their investments of people and resources to the retailers that are growing the fastest and drawing in consumers with a particularly compelling offering.

Importantly, this strategy is not about simply allocating more money to retailers to promote sales. Rather, it’s about gaining a better understanding of a retailer’s consumers, developing products and marketing activities that meet those consumers’ unique needs, assigning dedicated people to work with a retailer’s specific buying structure and planning processes, integrating with their loyalty programs, and collaborating to create a truly demand-driven supply chain that connects seamlessly to the retailer’s operations. These all serve to strengthen the manufacturer’s business with the best retailers, enhance total category performance for those retailers, and strengthen their franchises in their retail markets.

The emergence of shopper loyalty analytics has helped leading retailers optimize their stores and improve performance, but at the risk of a more inward-looking focus. To win, they need to be thinking about the total market – and manufacturers are well positioned to help them do this.

Most CPG companies long ago moved from a single uniform approach to a set of standard alternatives or a menu of options for working with retailers. Given the evolution of the industry, success will now require another progression in the precision with which these programs are designed and executed.

* * * *

This is what's next. It is a new game for large multinational CPG companies in the U.S. and it calls for a fresh approach to growth. Focus is trumping scale and scope. Those companies that can build a proprietary understanding of their consumers, precisely attune their marketing, pricing, innovation, and retail partnering strategies to that understanding, and then tightly align their operating systems in line with that strategic direction are the ones that will find success – at the expense of those who do not.

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