

THE GAME HAS CHANGED

HOW CONSUMER COMPANIES CAN WIN BACK THE U.S. MARKET

By Nicholas Keuper, Steve Matthesen, Jeff Gell, and Drake Watten

THE BOSTON CONSULTING GROUP and Nielsen collaborated on both the analysis of fast-moving-consumer-goods companies and the resulting recommendations outlined in this article.

The U.S. market has been tough on the biggest fast-moving-consumer-goods (FMCG) companies. Although big players have traditionally fared well, “size and scale” do not provide the same advantage they once did, and these companies have recently been outpaced by retailers and niche brands, The Boston Consulting Group and Nielsen have found in recent analysis. Fortunately, this same analysis and our work with clients also reveal that despite this trend, protecting—and growing—profits is very attainable for large FMCG companies that embrace the right strategies.

By analyzing the top performers, we have found that the consumer is at the crux of the winning strategies. To drive profitable growth in the U.S., FMCGs should return to a fundamental focus on the consumer that acknowledges and taps purchasing behav-

iors and mindsets as they have been transformed by the recession, the proliferation of retail channels, and innovations in technology.

Why the Profit Pool Has Shifted from Large Branded Manufacturers

From 2006 to 2011, our proprietary research shows, annual gross-profit dollars grew by 5 percent at retailers and niche brands, while they grew by only 2 percent, on average, among the 25 largest branded FMCGs. Had the top 25 FMCGs (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. The stalled pace and missed revenue opportunities result from a few major factors:

- *Retailers* claimed roughly 75 percent of the profits shifting away from large FMCGs. Among the factors driving this shift are the lingering recession—which makes private-label products more

attractive to consumers—and the burden placed on manufacturers by rising commodity costs. The most powerful factor fueling the shift, however, is that retailers have more leverage than ever before: They have consolidated the market, gaining power, and they are becoming more sophisticated. Through data mining, their knowledge of the consumer now surpasses that held by many manufacturers, and this is informing all aspects of their business from innovation to person-specific pricing. Retailer consolidation has not only limited the ability of manufacturers to take a tough stance in negotiations with retailers but has also provided retailers with more transparency into manufacturers' costs.

- *Manufacturers of niche brands* accounted for the remaining proportion of the profit shift. Again, several trends are associated with this shift, such as the rise of health and wellness as a consumer focus and the role of digital marketing in enabling small brands to better reach customers. The most prominent driver, however, is the fact that consumers perceive niche brands as delivering a stronger value proposition than ever before. The enhanced quality and positioning of these brands have resulted in a loyal consumer base that is willing to trade up to premium prices.

In this environment, many large FMCGs have turned to counterproductive strategies such as reducing product quality, cutting back on marketing, and relying on price discounts to maintain or increase volume. They have been harvesting the market rather than investing to grow it. Although these moves may help meet short-term financial targets, they don't communicate value to the consumer and will degrade the brand over time.

What the Best Performers Are Doing Differently—and Getting Right

Based on our proprietary research and our work with clients, BCG and Nielsen

evaluated the portfolio mix, go-to-market approach, and performance of the 25 largest public FMCG companies in the U.S. (ranked by sales) to determine what was and wasn't working. We segmented the FMCG companies into the top 10 and bottom 15 performers by growth in gross-profit dollars for the period from 2006 to 2011.

Our analysis has found that traditional sources of industry success—such as long-established brands with accumulated brand equity, sustained marketing through national campaigns, and high relative market share in conventionally defined categories—are eroding. Indeed, many of the largest FMCG companies—those with the most recognizable household names—didn't rank among the top ten performers. And high relative market share did not necessarily lead to stronger performance. Although relative market share, a key proxy for competitive advantage, may generate high profitability, it does not guarantee growth. Many of these established companies are either failing to grow or move beyond saturated categories, or are falling short in other key areas of execution.

By contrast, the top ten FMCG performers operate more like niche brand manufacturers. They have focused relentlessly on providing a great value proposition to their consumers and have reoriented their businesses around how those consumer behaviors are changing in the wake of the recession, a proliferation of retail channels, and innovations in technology. Specifically, they applied at least one of the following five strategies to differentiate themselves from the pack.

- *Focus the portfolio.* The top performers had a high amount of concentration in their portfolios, homing in on the few product ranges that appeal to their target consumers or in which they commanded a competitive advantage, such as the route to market.
- *Partner with winning retailers.* In the midst of retail consolidation and

channel proliferation, the best-performing FMCG companies skewed their investments of people and resources to the retailers and channels that were growing the fastest and drawing in the most targeted consumers.

- *Innovate to grow the category.* Through a combination of organic R&D and M&A, the top performers managed to expand their categories in one of two ways: by making fewer but bigger innovation bets, or by taking share through line extensions that did not cannibalize the existing portfolio of products.
- *Sharpen your marketing.* The top performers actually increased marketing spending during the downturn, but they did so in a smart way—repositioning their brands to cater to the cost-conscious postrecession consumer, self-funding campaigns through trade spend reductions, and being much more targeted in their use of mass media such as television. This approach limited defection of their consumers to cheaper or more premium brands.
- *Master the art of pricing.* The top performers drove higher price realization during the downturn not by making across-the-board hikes (which often get peeled back by trade promotions to preserve volume) but by undertaking surgical price moves—for example, by week, by SKU, or by account—that took advantage of inequities in the marketplace and the areas where consumers were insensitive to price increases.

Applying the Lessons

All FMCG companies can bring these same emerging strategies to bear, just as the top performers in the industry are doing, by heeding five calls to action.

Focus the portfolio. Our research shows that FMCG companies with more concentrated product portfolios performed better than companies with more fragmented portfolios. The top product

category for the ten top-performing FMCGs accounted for 56 percent of sales on average, compared with only 35 percent for the bottom 15 companies. Such a focused approach enables FMCGs to better understand how consumers and customer needs are evolving—and to make more effective use of their resources for competitive advantage.

Danone serves as a great example of how a highly focused company can drive advantage and achieve strong growth in a growing category by quickly responding to trends and investing in promising areas with overwhelming force. Although Danone didn't start the Greek yogurt trend, the company quickly reacted by drawing on its understanding of the consumer and category, gaining a leadership position. By breaking the compromise between “better tasting” and “better for you,” the Greek yogurt trend ultimately enabled Danone to convince many consumers to trade up to a product that is twice the price on average as regular yogurt.

Certainly, companies don't have to be as concentrated as Danone to achieve a high degree of focus. Large, diversified FMCGs can increase their focus in a number of ways, such as by aggressively reorienting their portfolio around specific points of competitive advantage or consumer occasions (such as breakfast), segments (such as moms of school-aged children), or megatrends (such as an emphasis on health and wellness).

Partner with winning retailers. As the retail sector continues to consolidate and new channels begin to take off, FMCG companies that direct the bulk of their attention and resources toward the most successful retailers stand to gain the most.

This approach is not about 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 unique needs, assigning dedicated people to work with a retailer's specific buying structure and planning processes, and

collaborating to create a truly demand-driven supply chain that connects seamlessly to the retailer's operations.

To this end, FMCG companies would do well to communicate more openly about product planning, production schedules, and any ideas related to innovation and cost-saving. The goal is to develop greater trust and a true working partnership. This is often achieved by establishing global teams that are dedicated to working alongside specific retailers.

In this area, Procter & Gamble set the bar during the early 2000s, becoming the supplier of choice to the largest retailers through joint value-creation initiatives around category management, product innovation, and collaborative planning. As a result, P&G sharply increased its market share and gross margin—all while spending less on advertising.

Innovate to grow the category. Our research shows that private labels commanded a lower market share, on average, in categories marked by a relatively higher rate of innovation. We have also observed that large companies can stay on top of consumer trends and reinvent seemingly mature categories both organically and through acquisitions.

An example of success in organic R&D is Reckitt Benckiser, maker of household products such as Lysol and health and well-being products such as Mucinex. It has a proven innovation process fueled by employee ideas, recognition, and promotion. With rapid decision making and minimal bureaucracy, the company brings new products to market quickly. Consequently, even though Reckitt Benckiser spends less on R&D than its competitors do, its new products account for roughly a third of sales—making it a consistent leader in the FMCG industry.

An example of success achieved through acquisitions is Church & Dwight, long known for its household products and Arm & Hammer brand. It has used acquisitions to strengthen its portfolio and reinvent ma-

ture categories such as laundry care. The company is highly disciplined, investing a significant portion of the accretive gross margin of the acquired company back into its brands to spur additional growth. This acquisition strategy has contributed to total shareholder returns that lead the industry.

Sharpen your marketing. The marketing budget is often the first place many companies cut when times get tough. However, our research showed that, over the five-year research period, the top-performing FMCG companies grew their measured marketing expenditures by 9 percent, on average, while the bottom 15 FMCGs grew them at just 2 percent. But the top performers didn't just spend more. They repositioned their brands to cater to the cost-conscious postrecession consumer, self-funded campaigns by reducing trade spending, and were much more targeted in their use of mass media such as television.

A great example of the last point is Old Milwaukee's Will Ferrell ad during the 2012 Super Bowl. Instead of paying for a national spot, the beer maker aired the commercial only in North Platte, Nebraska, a hotbed of loyal consumers. These loyalists spread the news virally, and the ad garnered higher digital ratings in terms of tweets, YouTube views, and similar measurements than some national Super Bowl ads did.

The majority of the FMCGs we researched increased the proportion of their marketing dollars spent online from 2006 to 2011, and we expect that trend to continue. Digital media, online marketplaces, and mobile devices are changing how people interact with brands and shop—and are providing a flood of data that allows FMCG companies to better segment and target potential buyers according to their demographics, interests, past purchases, and buying behaviors. These developments will likely be the catalyst that causes “shopper marketing”—a discipline that influences the consumer's path to purchase—to finally take off. They are also likely to continue leveling the playing field so that

niche brands and private labels can better compete against brands with bigger marketing budgets.

Master the art of pricing. On average, the ten top-performing FMCG companies increased prices faster coming out of the recession than the bottom 15 FMCGs did. Of course, not all of these high-performing companies had breakout innovations that could command price premiums.

Few FMCG companies fully understand how to price their products to maximize profits—or have the in-house capabilities to do so. To achieve higher margins, companies need to rethink their pricing strategies based 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 are creating centers of excellence for managing and adjusting prices on an ongoing basis instead of treating pricing like a one-time event.

Within the pricing realm, FMCG companies also need to ensure that trade spending expenditures—essentially price discounts to retailers—are truly “pay for performance,” promoting 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 fund a range of unprofitable promotion events. These mistakes could be easily avoided by using basic measurement tools, such as return on trade spending.

Looking Forward

Growth is becoming difficult for large multinational FMCGs to attain in the U.S. market, and traditional forms of success to drive growth are eroding. However, the enormity of the U.S. market makes even its slow growth—relative to the fast-paced growth of emerging markets—too large (in terms of growth in absolute dollars) to

ignore. Furthermore, given the large portion of sales that this market represents for most multinational companies, it is critical not to lose out in the U.S. No FMCG can afford to see the U.S. market become a “leaky bucket” that would squander gains made elsewhere in the portfolio.

To drive profitable growth in the U.S. market, large FMCGs must evolve from relying on their large size and scale as an automatic advantage to focusing on doing fewer things better, starting with a renewed focus on their value proposition to consumers. The five strategies outlined in this article can be powerful individually, and FMCG companies that apply all of them in a coordinated manner will achieve a sustainably strong position of market leadership.

About the Authors

Nicholas Keuper is a senior partner and managing director in the Los Angeles office of The Boston Consulting Group and leader of BCG’s U.S. West Coast consumer practice. You may contact him by e-mail at keuper.nicholas@bcg.com.

Steve Matthesen is the executive vice president of professional services at Nielsen; he is responsible for Nielsen’s consumer products companies based in North America. You may contact him by e-mail at steve.matthesen@nielsen.com.

Jeff Gell is a senior partner and managing director in BCG’s Chicago office and leader of the Americas consumer products sector. You may contact him by e-mail at gell.jeff@bcg.com.

Drake Watten is a principal in the firm’s San Francisco office. You may contact him by e-mail at watten.drake@bcg.com.

The Boston Consulting Group (BCG) is a global management consulting firm and the world’s leading advisor on business strategy. We partner with clients from the private, public, and not-for-profit sectors in all regions to identify their highest-value opportunities, address their most critical challenges, and transform their enterprises. Our customized approach combines deep insight into the dynamics of companies and markets with close collaboration at all levels of the client organization. This ensures that our clients achieve sustainable competitive advantage, build more capable organi-

zations, and secure lasting results. Founded in 1963, BCG is a private company with 78 offices in 43 countries. For more information, please visit bcg.com.

Nielsen (NYSE: NLSN) is a global information and measurement company with leading market positions in marketing and consumer information, television and other media measurement, online intelligence, mobile measurement, trade shows, and related properties. Nielsen has a presence in approximately 100 countries, with headquarters in New York and Diemen, the Netherlands. For more information, visit www.nielsen.com.

© The Boston Consulting Group, Inc. 2012.
All rights reserved.
12/12