



As 2008 draws to a close, we at Booz & Company wanted to provide our perspective on how the watershed events of 2008 will reshape the executive agendas of consumer products manufacturers and retailers in 2009 and beyond.

### **The New Economic Environment**

The only certainty in today's global economy is that nothing is as it was. The seemingly immutable conditions underpinning consumer products manufacturers' and retailers' decision to build longer and more complex supply chains over the past decade came under significant strain in 2008. Commodity prices shot up, then settled back as the economic downturn took hold. The formerly safe assumptions of low costs for energy and transportation, cheap labor and little environmental regulation in developing nations, and advantageous currency exchange rates now require reevaluation.

What is clear is that we are staring into the jaws of a global economic recession, so 2009 plans that were predicated on soaring oil, packaging, and commodity prices need to be readjusted to reflect greater volatility and potential deflationary pressures. Consumer spending fueled by easy credit drove the economic boom. Now, consumer products manufacturers and retailers are reeling from the impact of the current credit crunch on consumer spending and brand choices during a challenging holiday shopping season. It's a back-to-basics environment.

Even before November 4, the trend toward tighter government regulation was already gathering momentum around the world. We anticipate that an Obama administration and a strong Democratic majority in Congress will only accelerate that trend as it applies to the consumer products industry. For example, we will likely see more legislation encouraging "green" sourcing and manufacturing in the coming year. Product safety legislation, in the wake of the Chinese milk scare and other highly publicized incidents, will likely get the go-ahead. In general, performance claims in food, beverage, healthcare, and beauty products will be subject to greater scrutiny.

### **Calls to Action in 2009**

As recessionary pressures squeeze consumer spending, manufacturers and retailers are undoubtedly taking numerous measures to handle the crisis, especially in the realm of cost cutting. The danger of a downturn, however, is that a focus on costs will preclude positive action in other arenas. The industry's leaders will be those that are smart about pricing, promotion, and assortment — both to improve efficiency and to enhance the overall shopping experience. Moreover, for both environmental and economic reasons, companies should focus

on implementing a green strategy sooner rather than later, using it as a catalyst to make significant improvements in their cost structure.

Specifically, consumer products manufacturers and retailers need to focus on three pressing priorities in 2009:

1. Price and promote to capitalize on consumer spending and switching trends
2. Be smart about assortment
3. Recognize that green is the new lean

### **Price and Promote to Capitalize on Consumer Spending and Switching Trends**

In September 2008, Booz & Company surveyed nearly 1,000 U.S. households to assess how consumers have altered their spending behavior and how they expect to alter it further in response to the current economic crisis. Responding to the triple hit of sharply higher oil prices in mid-2008, significantly lower housing values, and the sudden credit crunch, the vast majority of consumers have already made substantial cuts in their spending and expect to make even deeper cuts over the next six months as the economy worsens.

The spending areas that are hardest hit are high-cost, less-structural expenditures such as dining out, impulse shopping, and non-essential driving, even though consumers value many of these activities highly. Over the next six months, survey respondents anticipate reducing expenditures on personal durables (clothing), indulgences (coffeehouse purchases, alcohol), household durables (electronics), and services (salon treatments, housecleaning). Structural durables are just beginning to feel the impact, with more than 20 percent of consumers deferring the purchase of automobiles and a further 15 percent trading down to cheaper or more fuel-efficient cars.

Although consumers are shopping more frugally in general, they continue to be relatively brand loyal in categories of high value to them such as personal care and liquor. What we're starting to see, however, is a willingness to shop for these brands at less-expensive retail outlets or even to try private-label or value brands. Moreover, our research suggests that if consumers are satisfied with these new choices, they may well stick with them when the economy bounces back.

Although longstanding preferences for convenience and premium products may eventually reverse some of this frugality, what is particularly interesting about the study is the number of consumers who say they do not believe they will substantially reverse their new, cost-conscious spending patterns when the economy rebounds. The truth probably lies somewhere in the middle, as some consumers stick with new thriftier choices and others revert to premium preferences. Meanwhile, consumer products manufacturers and retailers must work hard to provide value-brand alternatives and solutions that best suit consumers' new shopping preferences.

Interestingly, certain premium brands are the beneficiaries of consumers' quest for value. One example illustrates why consumer products companies should *not* blindly lower prices to regain volume in a recessionary environment: The Scotts Miracle-Gro Company produces three tiers of gardening products – entry, medium, and premium price points. In the current downturn, the company reported growth not just in its entry-priced lines, as you might expect, but in its premium-priced line, which more than compensated for the decline in its middle tier. It seems that many of those who once engaged landscapers are now doing their own gardening, but they still want a premium garden or lawn, so they are “trading down” to Scotts's top-of-the-line products.

Other high-end products could also benefit from consumer substitution. In this environment, consumer products companies and retailers need to upgrade their strategic pricing and promotion capabilities to fully capitalize on the fine distinctions in consumers' brand preferences and switching behaviors. Across-the-board price cutting may lower the perceived value of their products and hence damage the brand over the long term.

Consumer products companies should take a fresh look at the way they communicate value to consumers and ensure the best category strategy across various price points. That effort might be as simple as refocusing the marketing message of appropriate brands to emphasize their relative value: For example, Kraft Foods Inc.'s DiGiorno brand of frozen pizza has responded to consumers who are trading down from casual dining and food delivery by marketing the fact that it costs half the price of pizza delivered from a restaurant. More sophisticated strategies should also be part of the mix. Companies need to consider a broader competitive context that includes not only products in the store, but other “out of the box” options available to consumers. To build on the Scotts example, for instance, the company might offer education modules for the consumers who are taking over from their gardeners for the first time, or even landscaping services.

Another consequence of the sharp economic downturn is an increased emphasis on the billions of dollars spent on trade promotion programs each year. Manufacturers and retailers have a shared need to focus this investment on those activities that drive the highest return, and they are working closely to gain a better, earlier, and more comprehensive understanding of what is happening at the retail shelf. The advent of mobile computing solutions that enable sales reps, brokers, and merchandisers to communicate real-time data back to headquarters has jump-started this intelligence-gathering process. It has shed a great deal of light on the execution and productivity of these trade promotion programs, which is very valuable to those making shelf-management decisions.

Advances in technology enable these capabilities: functionally rich mobility platforms, intelligent predictive ordering solutions, and cheap, wireless WAN connections that offer broad, reliable coverage. These technology advances, combined with the stockpiles of underutilized point-of-sale data that retailers can

provide to consumer products manufacturers, are the technical building blocks for true insight at the shelf. More effective use of data can help consumer products companies and retailers reduce out of stocks, improve the success rates of new products, better execute promotions, and accurately measure promotion effectiveness. Several of the largest and most progressive consumer products companies are piloting or implementing these new capabilities. They will be in an enviable position if they get it right.

### **Be Smart about Assortment**

The retail market in the U.S. has become inordinately complex, as consumer products companies push the envelope on product proliferation. Between 1980 and 2007, the average supermarket assortment tripled, from just under 15,000 items to 45,000, despite the fact that the typical household still purchases only about 650 of these items on an annual basis. In fact, recent studies indicate that consumers are less likely to make a purchase as assortment increases and they are torn between equally attractive choices. The total number of consumer product SKUs available today is nearing 1 million and continues to grow, even though 90 percent of new products fail.

Newly focused on maximizing working capital and the profitability of every inch of shelf space, retailers are pushing back. They are curating their inventory and pressuring manufacturers to redirect their attention from gaining space to increasing product turns. Manufacturers are responding to this challenge with a smart approach to assortment, balancing the cost of complexity with the value of simplification.

A recent Booz & Company study on store shelf complexity, conducted on behalf of a grocery chain, found that 25 percent of stocked items accounted for nearly 100 percent of the profits in the six categories examined. The slowest-moving 25 percent of items all lost money, and we determined that removing these items would grow category profitability by more than one-third. The balance of the SKUs – the middle 50 percent – required further analysis (e.g., segmenting shoppers by their attitudes and behaviors, understanding which stores serve each of these segments) to help us identify the smart mix of items that would effectively – and profitably – meet the needs of store, shopper, and category.

As an example, take Alpen cereal, manufactured by Weetabix Ltd. of the United Kingdom. At first glance, it is revealed as a rather slow-moving item and hence a candidate for delisting. However, further analysis shows that Alpen buyers tend to purchase natural and organic items at a far higher rate than most shoppers, and with significantly larger basket sizes. Delisting Alpen could effectively turn away these highly valued shoppers. Smart assortment takes into account these related variables.

## **Recognize That Green Is the New Lean**

For years, supply chains have emphasized lean initiatives focused on continuous improvement in manufacturing and distribution. Although initially successful at identifying and eliminating waste – be it in materials or labor time – these initiatives rarely won the hearts and minds of the workforce, as they were viewed as thinly veiled attempts to reduce head count in the plants.

Efforts to lessen negative environmental impacts along the entire value chain, on the other hand, are more encompassing and engaging. Such green initiatives not only involve manufacturing and distribution, but they extend back to product design and forward to sales as well. Green initiatives take root at corporate headquarters as well as on the shop floor. More important, they have achieved what most lean programs could not; they have broadly eliminated waste and increased efficiency throughout the enterprise, without incurring the resentment of employees. What began as an exercise in corporate social responsibility is now a major source of cost savings.

In ways big and small, consumer products companies are reconfiguring their supply chain networks and processes to adjust to the costs of fuel, maximize asset efficiency, and reduce waste and carbon emissions. Household goods company S.C. Johnson & Son Inc., for example, recently shifted to plastic pallets across its supply chain. According to the company, these pallets are 20 pounds lighter and 10 times as durable as the wood equivalent, and they are 100 percent recyclable. As a result, S.C. Johnson projects that it will need 900 fewer trucks and burn 80,000 fewer gallons of diesel fuel per year.

General Electric Company has found a way to successfully merge the benefits of lean and green manufacturing. Utilizing lean methods at its jet engine facility in Peebles, Ohio, GE has managed to reduce its greenhouse gas emissions and produce significant cost savings in the process. The company reduced fuel consumption for GE90 engine testing from 20,000 gallons to 10,000 gallons between 2006 and 2007, reducing greenhouse gas emissions by 5,000 metric tons and saving US\$1 million in fuel costs. Because of the success of this and similar programs, the Environmental Protection Agency and U.S. Department of Commerce have formed the Green Suppliers Network, which advises manufacturers and their suppliers on how to be “lean and green.”

Beyond the cost and environmental benefits, the shift to greener operations attracts customers, motivates employees, and anticipates stricter regulation not only in the United States and Europe, but in many of the emerging economies around the world. It is the quality movement of the late 1980s adapted to the exigencies of the late 2000s.

## Looking Ahead

Consumer products companies and retailers, like their counterparts in most industries, find themselves in a welter of uncertainty as they wait to see how changes in credit availability, commodity prices, and consumer demand will pan out. The one thing that is clear, however, is that waiting is the last thing they should do. It is only by taking decisive action now that companies will emerge in a stronger financial position and be better positioned for future growth opportunities when the economy eventually rebounds.

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