Perspective

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Three Steps for Building a Consumer Products Powerhouse

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OPPORTUNITIES IN THE CRISIS

Three Steps for Building A Consumer Products Powerhouse

As consumer companies struggle to respond to the deepening economic downturn, some companies are in a better position than they may realize to use the crisis to build for the future. We see three opportunities that many companies have not yet recognized. One is to rapidly capture insight into the changing profile of consumers, which companies can use to tailor their offer at multiple and lower price points—a combination that will continue to offer a winning consumer proposition that is based on operational marketing execution and a more effective use of the full brand and package portfolio. A second opportunity is to use the pressures from the crisis to involve the entire company in supporting the pricing strategy and value proposition by increasing efficiency, minimizing risks, and cutting costs in key areas. Finally—and importantly—the new economic environment is affording opportunities for companies with strong balance sheets to make strategic acquisitions that can reposition their brands and business portfolios for continued success in the eventual recovery.

Brand Strategy and Consumer Anxiety

The first element of this strategy is to devise an effective response to the changing consumer profile. Consumer anxiety has been building for more than a year, but only recently has this anxiety showed up in day-to-day buying habits. Perhaps this is because the chill first bit consumers fairly high up the spending pyramid, such as bankers fearful of losing their jobs, or homeowners unsure they would be able to refinance their mortgages, rather than being felt in mass layoffs similar to those we have seen in previous recessions. But all that is likely to change, as loss of access to credit is reinforced by rising unemployment.

In the U.S., a view of changing consumer behavior was evident in an in-depth survey conducted during September by Booz & Company and covering 1,000 households. This study, "Consumer Spending in the Economic Downturn," suggests that, contrary to their behavior in many previous downturns, a large proportion of consumers have already begun to cut back in anticipation of income declines. They are shopping more frugally, driving less, and spending less on restaurants and entertainment outside the home. Consumers expect to make deeper cuts, given their gloomy outlook for the economy. But they have not switched brand loyalties or expectations: As they spend more time at home, they may even grow more attached to brands that provide the most perceived value at the lowest cost.

Managers must adapt the brand portfolio to stay one step ahead of the rapidly changing consumer in a time of uncertainty. Companies that have successfully built up a distinctive combination of brand value, customer loyalty, and savvy pricing can now use it as a launching pad for further growth. Consider what Tesco has already done, for example: In September, it rolled out a range called Discount Brands—high quality you can afford—products that are much more expensive than its Value brand. Now is the time for those "second brands"—provided they can offer genuine quality and value for money without the frothy advertising and aspirational pricing of their top-of-the-line brothers.

Marketers can also thrive by providing alternative reasons—non-economic excuses, if you prefer—to help consumers trade down to less expensive products. These might include environmentalism, health, and simplicity. Auto dealers can sell the Toyota Prius instead of the Lexus as a way for customers to "do their part to stop climate change," even though it's the price and fuel-cost savings that ultimately drive the decision to switch. Similarly, consumer concerns for health and wellness have inspired much product innovation during the past five years; now, as the growth of organic food falters, some wonder if the pendulum is swinging back. But is this the end of organics and the death of consumer wellness? We don't think so. Economic stress or not, consumers age each year. They will still want the benefits of premiumization around health and wellness. But now they will reinforce pressure on manufacturers and retailers to deliver those benefits at mainstream prices. This tension will stimulate innovation that should lead to a new synthesis between environmental and health concerns and pricing, made possible as minority concerns spread to the majority.

For luxury goods, the challenge is different. It's commonly said that spending by the superrich is immune from economic crisis, and that may be true for this downturn as well. But luxury brand owners will still face losses at the level of the merely well-to-do, which is the market segment in which many of the most prestigious brands achieve enough volume to remain profitable. In other words, while Savile Row carries on, the premium-branded factory "made to measure" clothiers will suffer. They, too, will need to find ways to become palatable to more cost-conscious consumers while maintaining their image of high value and status.

The key to building a portfolio for the economic crisis is pricing. Manufacturers and retailers alike should feature just a few different price points, clearly indicated, so that consumers know how to control and manage their spending. That fits the in-store behavior already observed in the U.S. and Europe—where retailers report seeing more planning, more lists, and more conscious management of price and value. The long economic summer let many marketers cloud brand portfolio fundamentals; now they need to send crystal-clear signals showing which brands are premium and why, and which brands represent the bottom of the pricing ladder. Weak, undifferentiated brands that have muddled along in price promotion will not survive.

Clever pricing strategies will be dramatically more effective. They will steal share from competitors and reward consumer loyalty. Marketers need pricing that fits like a wetsuit, following the nooks and crannies of customer preference and spending constraints, stretching and bending as the economy shifts up and down, and as consumer demand zigzags in response. Tailored in-store price promotions will catch more and more eyes, but they must be competitively sensitive and dynamic. One of our clients has already been caught off guard by a rapid shift in consumer interest from premium convenience packages to larger, better-value packages; the client discovered in the process that the larger packages were not profitable. This kind of pricing surprise needs to be prevented, so that profit realization is robust despite rapid changes in the consumer purchasing mix.

Driving Efficiency, Controlling Risk, and Cutting Costs

Executing this brand portfolio strategy and controlling price premiums is a job not just for marketing, but for the whole company and its value chain partners—including suppliers, distributors, and retailers. As commodity prices fall, supply chains must be lean and agile to keep prices in line and keep delivering value to the consumer. Manufacturers and retailers will have to work together more closely than ever, minimizing the friction that raises prices and inefficiency. The closer the integration of retailer data and manufacturing response, the better the tailoring of pricing and promotion, the faster the feedback loops, and the more productive the operation. Retailers will need this close interaction too; popular brands remain a draw, and the right promotions, pricing, products, and deals will be vital to their success. But most retailers will limit close cooperation with manufacturers to one or two companies in each category. Dealing with more will be too complicated and time-consuming. The largest, strongest brand owners will reap the advantage. Smaller competitors will be squeezed.

Consumer companies will also have to dodge new risks in this downturn-driven business environment. Supply chains may include companies reliant on bank debt and private equity, which is drying up. Major manufacturers thus need to understand the financial exposure built into their supply chains and must look at trading patterns and partners through the lens of risk. Where there are potential problems, companies need options: alternative suppliers, efforts to finance suppliers directly, extended trading terms, and direct investment. And they must have supply chains and contracts that deal well with rapid fluctuations in commodity prices.

For some large consumer products companies, innovation strategies pose another sort of risk. While some companies have developed effective innovation networks to source ideas widely and develop them effectively, others have, in practice, depended on small, entrepreneurial companies to find and develop product and brand innovations. The bigger companies then use their financial muscle to lasso successful pioneers once the business proposition is proven. That trick will no longer work in a world where private equity power has withered. Companies will no longer be able to float their way out of the innovation desert by buying established companies with demonstrated consumer demand. Instead, they must find, plant, and water the seeds of innovation in-house or nurture their own innovation networks.

Consumer companies will also need to cut costs to support their pricing strategy—for example, by accelerating the established trend away from old media to new media. This should force the adoption of the lower-cost, better-tailored, more cost-effective consumer communications technologies that are now available. Marketing spend may catch up with the shift in consumer media habits that has already taken place. This would be a major advance compared to the standard "recession marketing" tactic of reducing marketing expenditures and relying more on promotions.

Emerging markets have stepped forward to save the results for many of these companies, but although they may appear as saviors today, they were the very devil in the financial crisis of 1997. We think that crisis will not be repeated and that places like China and Brazil are still good economic bets, but we could be wrong. Markets and consumer spending in these markets are already slowing down. The capabilities that are needed are resiliency and an ability to respond rapidly—an alertness to the potential risks as well as to the opportunities. For this recession, it is too late to create capabilities for companies that do not already have them, but those companies that do will use them to the full.

An Opportunistic Acquisition Strategy

Successful companies will need operational focus, but they must also realize that this is the time to act in mergers and acquisitions: to use discrepancies between price and value to vault their strategic boundaries. The downturn will provide good hunting grounds for major corporate giants looking for established businesses to help reshape their portfolios. Many consumer products companies have balance sheets that are in excellent shape—better than those of banks. Coca-Cola, Nestlé, Johnson & Johnson, and Procter & Gamble each have, on average, more than US$5 billion available in cash alone. When bank lending dries up, cash is king. As the credit markets start to recover, these companies (and others) will start to apply that firepower. More and more targets will be available, including private equity–funded companies that need exits or expansion finance and public companies whose balance sheets are stretched because company leaders were over-influenced by bankers to do share buybacks. Perhaps the larger acquisitions will be out of reach until debt finance returns, but distressed midsized companies will be affordable; and the giant companies in this category will be poised to act on even the larger acquisitions when credit returns.

Well-capitalized companies will also be able both to buy previously unaffordable positions in adjacent markets and to execute needed changes to product, brand, and geographic portfolios through acquisition, even at some cost to the balance sheet. This sounds easy, but it takes courage—courage to act and invest when the world is in a funk. The best basis for courage is confidence, built on comprehensive knowledge, solid analysis of value rather than price, and clear strategic intent. If a company is equipped for this, now is the time to look outward for new opportunities. Courage can become the root of successful repositioning. In the downturn of the early 1990s, for example, Tesco's commitment to build its land bank helped power its subsequent ascendancy. Combine that strategic opportunism with operational intensity and you have a powerful weapon.

For many large and strongly capitalized consumer-oriented businesses, the availability and pricing of acquisitions has been transformed. Consider Gap Inc.: Though it is affected by falling sales like everyone else, it has seized the opportunity to make some key acquisitions. In September, it spent $150 million buying Athleta, an online and catalog retailer of women's active apparel. Similarly, though Foot Locker Inc.'s annual revenue has fallen 5 percent, in September it bought the CCS skateboarding brand from Delia's Inc. for $102 million, extending its appeal to teenage males, who are CCS's target customers. The vendor was willing to sell; it had seen its share price fall by almost half in the preceding 12 months and was suffering consistent losses. But Foot Locker was in a position to invest, and is now moving to build this brand. One luxury company that has also found a way to do this is Coach Inc.—which, despite setbacks in its established stores, has bought 24 Coach stores in China, Hong Kong, and Macao from ImagineX, the Hong Kong–based distributor that had previously operated them as a franchise.

Acting with Confidence

The most successful approaches will be both operationally intense and strategically active no matter what direction the current downturn takes and no matter how long it lasts. The companies that best vault their strategic boundaries will look at their markets as Marshal Ferdinand Foch saw the battlefield of the Marne in his legendary dispatch: "My center is giving way and my right is in retreat. Situation excellent. I shall attack."

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