



## 2012 Consumer Packaged Goods Industry Perspective

We would like to offer our thoughts on the current business environment for consumer packaged goods companies, what 2012 holds, and the capabilities that this industry needs for success right now.

Although merger and acquisition activity has not yet returned to the peak levels of the mid-2000s, the restructuring of assets is still one of the industry's most notable trends. Expansion in emerging markets, of course, remains a major driving force: Witness PepsiCo's acquisition of the Russian dairy product and fruit juice maker Wimm-Bill-Dann; Diageo's purchase of the Turkish spirits group Mey İçki Sanayi ve Ticaret; and H.J. Heinz's deal for an 80 percent stake in the Brazilian tomato sauce and condiment maker Coniexpress.

A less heralded but even more significant trend in this industry is the realignment of portfolios around capabilities. Many companies – including Kraft Foods, Fortune Brands, and Sara Lee – turned in 2011 to splits and spin-offs as tools for focusing their businesses. (We also saw this in other sectors, with companies such as McGraw-Hill, ConocoPhillips, and Hewlett-Packard announcing or contemplating splitting into parts.) This suggests that the days are gone when bigger was better and consolidation was seen as inevitable because it provided the asset and scale base to win in a category. Instead, the leading consumer product manufacturers – whether they explicitly think of it this way or not – are reshaping their portfolios to better build and deploy the systems of capabilities that make them distinctive.

For example, Kraft's recent announcement that it would split itself into two separate companies – a US\$32 billion global snacks business and a \$16 billion North American grocery business – surprised many observers. After all, this came after a run of acquisitions, highlighted by the purchase of Cadbury for \$19.6 billion in 2010. But the acquisitions and the split followed the same competitive logic: making the most of capabilities systems. The new snack business to be spun out of Kraft, focused on chocolate and impulse consumption, will take advantage of go-to-market capabilities such as direct store delivery and execution in immediate consumption channels, deployed across several valuable global brands. The remaining Kraft business will be able to focus on the different capabilities system needed for grocery products.

The Fortune Brands split, separating its spirits business from its home and security products business, was another capabilities move. Similarly, the continued breakup of Sara Lee has restructured the company into smaller units that can develop capabilities systems more tailored to their product categories. Most recently, Sara Lee has divested its international fresh bakery business, mainly to Grupo Bimbo, and sold off its North American food service beverage business to J.M. Smucker. In 2012, it plans to split into two companies: a North American meat business and an international food service beverage company.

On the surface, SABMiller's acquisition of Foster's seemed aimed at scale in the consolidating global beer industry. But SABMiller downplayed the importance of global brands. Instead, the company is focused on applying its capabilities, most notably in marketing, to turn around historically underperforming companies.

The real magic of capabilities – the interconnected people, knowledge, IT, tools, and processes that enable a company to execute better than its competitors – is how they align and integrate to form a mutually reinforcing system. A winning capabilities system, which usually comprises a select handful of capabilities, creates coherence because it links tightly with the company's strategic position: its "way to play" in the market. In a world where products become obsolescent and patents expire, coherence enables a company to endure and prosper.

CPG companies have seen this dynamic firsthand. Whether they are large or small, companies earn a premium when they achieve coherence. Our research shows a correlation between coherence and shareholder returns, with companies that have managed to stay coherent for a sustained period of time, such as Coca-Cola and Church & Dwight, delivering higher returns to shareholders, and other companies, like Procter & Gamble and Sara Lee, gaining profitability as their coherence rises. (For more detail, see "[Consumer Packaged Goods: Escaping the Consolidation Mentality](#)," by Steffen Lauster, Elisabeth Hartley, and Samrat Sharma; *strategy+ business*, June 2011.)

The link between coherence and performance is particularly evident in M&A. As part of a cross-industry study, we recently identified and evaluated the top 40 deals by transaction value in the CPG industry since 2002. Deals aimed at leveraging or enhancing capabilities – whether the acquisition was intended as an adjacent product or geographic move or as a consolidation play – outperformed others by 7 to 8 percent CAGR over two years – a very healthy premium.

Along with investors, leaders in the industry increasingly recognize the value-creating potential of coherence. In PepsiCo's third-quarter analyst call, for example, CEO Indra Nooyi provided an explanation of the company's coherence by pointing out the value of its go-to-market, procurement, and marketing capabilities across its hundreds of brands and multiple product markets. Similarly, Unilever CEO Paul Polman has spoken about the link between the company's performance and its application of capabilities across a variety of markets in both emerging and industrialized economies. The company is aggressively pursuing global investments in such capabilities as customer insight, differentiated innovation, and trade promotion management.

Intensified competition from coherent, capabilities-driven companies will play a major role in persuading more diversified holdouts to restructure – and some major companies will have to define, strengthen, and communicate their capabilities coherence. For this reason, the current restructuring trend is likely to continue until consumer markets settle into a “new normal.” In short, while the macro themes driving industry M&A are growth categories and access to emerging markets, especially the BRIC countries (Brazil, Russia, India, and China), the underlying glue is capabilities. The increasing complexity and customization required to access consumer markets around the world require greater skill, not scale. Scale economics still matter, to be sure, but many companies have attained it. It is excellence and distinction around capabilities rather than assets that will differentiate the winners in CPG during the next few years.

### **Your Capabilities Agenda**

If a select set of mutually reinforcing capabilities is the key to a successful future, which capabilities should your company focus on developing? We think this is the most salient question you can ask this year.

Your answer will be unique to your company. As the wave of portfolio restructurings attests, no single group of capabilities will serve all CPG companies – the sector is too broad and diverse for that. There are

competitive necessities – in effect, “table stakes” – in most CPG sectors. They may not, in themselves, provide the right to win in your category, but they confer the right to play, and they establish a platform on which leading companies build their more distinctive, differentiated capabilities systems. For example, at some level all CPG companies need to be capable of developing and leveraging consumer and shopper insights, bringing new products to market, and executing efficiently and effectively.

From there, however, the specific capabilities vary by subsector. For instance, an over-the-counter healthcare business needs capabilities that enable it to secure advantaged molecules; to support its products with clinical claims; to market these benefits to consumers and influencers, such as pharmacists, regulators, and medical professionals; and to manage a supply chain that meets good manufacturing practice standards for pharmaceuticals. A personal care products company, on the other hand, needs capabilities that enable it to identify unmet consumer needs and shopping trends; to execute rapid innovation cycles with high rates of product turnover; and to manage a high-volume, fast-moving supply chain.

Even within subsectors, the winning capabilities systems will vary by company. If every company develops the same capabilities, they will have little to compete on except price. Only a strong set of things that “we do better than anyone else” can confer competitive differentiation.

In this short letter, we don’t have room to describe all the potential capabilities that CPG companies need, but we must highlight two interconnected areas that will require capability development in most consumer-oriented companies: digital media and shopper marketing. Proficiency in these still-emerging arenas, especially when combined effectively with established brand marketing and trade promotion practices, offers an unusually rich opportunity to create competitive advantage for the companies that get it right.

Digital media represent an exciting new frontier in which CPG manufacturers can engage consumers anywhere on their path to purchase. Leading marketers recognize that with the right mix of content, utility, community, and product, they can attain valuable benefits in terms of branding, relationship building, and repeat purchase. They are using proprietary websites, retailers’ sites, social media, and mobile apps to transform their digital presence into powerful direct media channels. In some areas, such as cooking, fitness, and parenting, CPG manufacturers already generate more traffic than media companies.

The rise of marketers as publishers coincides with increased emphasis on extending shopper marketing investments outside the store, providing manufacturers with new avenues for collaboration with retailers aimed at winning the trip and driving a larger shopping basket. To achieve this heightened level of performance, CPG manufacturers are using shopper solutions. For example, ConAgra Foods developed a menu-based shopper solution program, “Give Every Night New Flavor,” that offered recipes for popular meals, such as a stir-fry and pasta, and all the products needed to prepare them in a single display. The company built shopper awareness outside the store by creating a microsite for the solution, providing digital coupons, and using paid search and digital advertising, as well as gatefold ads in print media. In the store, it used stanchion signs and coupon books that led shoppers to pallets that featured the recipes and their ingredients. The solution delivered double-digit growth in units, dollars, and profit over the prior year, as well as significant market share gains for a leading grocery retailer across participating brands and categories. The latter benefit points to the retail barter value of solutions: By creating wins for retailers, manufacturers can use solutions to gain more valuable opportunities in and out of the store, such as more and better display space, visibility on retailer websites, and access to retailers’ loyalty program members. (For more on the latest developments in shopper marketing, see “[Shopper Marketing 5.0: Creating Value with Shopper Solutions](#)”)

As yet, no consumer company has figured out all the ramifications of digital media and shopper marketing or created the capabilities required to fully exploit them. But many companies are trying hard. For instance, one reason that PepsiCo and Coca-Cola acquired their North American bottler operations (in 2009 and 2010, respectively) was to integrate their capabilities in assortment planning, in-store marketing, and product supply with the more sophisticated and granular view of the consumers that is now available. This kind of integration will prove much easier within one organization than across companies.

As CPG companies recognize and pursue a strategic focus around capabilities, they will reorganize and reallocate resources accordingly. They will explicitly articulate a winning capabilities system; define their core businesses, brands, and markets in line with that system; and allocate people and funds accordingly. They will tune their business processes – from R&D to sales and marketing – to support this focus, and embrace a talent development strategy centered on recruiting, training, and retaining employees skilled in the capabilities that matter most.

In the past, our year-end missives have prompted executives to call or write us with their own thoughts and comments. We hope this one sparks a dialogue with you about the challenges you face, the distinctive capabilities needed to meet those challenges, and how we can help you make your company more prosperous in 2012.

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