



## 2010 Consumer Packaged Goods (CPG) Industry Perspective

Most of you are probably more than happy to put a period on 2009. The past year was characterized by economic uncertainty and extremely difficult operating conditions. While the CPG industry fared better than most other sectors of the global economy, it was hardly immune to the effects of the financial crisis that began in September 2008: a substantial loss of wealth worldwide, very tight consumer and corporate credit conditions, delayed private investments, and a pullback by consumers in discretionary spending and big-ticket purchases.

This year might have been even more challenging if not for the emergence of a number of indicators pointing to an economic recovery. Global stock markets stopped their swoon in March, with many indexes rebounding significantly. Consumer demand has rebounded in key markets, bringing inventories more in line with sales. Central banks around the world have started phasing out emergency monetary measures as lending is picking up. And home price and sales declines in many housing markets are showing signs of stabilizing.

With regions and countries recovering at varying rates, the upturn will be uneven at best. More autonomous emerging markets such as China and India are leading the way, while the majority of industrialized nations and the smaller developing nations that depend on them are taking a slower path.

Still, growth is growth. Improvement in the economic environment is finally allowing companies to redirect their attention back to deep-seated structural and demographic changes that will have far reaching implications on their businesses for years to come. For example, in mature economies, people aged 55 and over are becoming the largest population segment – with considerable spending power. And a growing segment of consumers are seeking products that promote health and wellness, such as “organic” or “earth-friendly” goods. Meanwhile, improved standards of living in emerging economies are swelling the ranks of the middle class. To better serve them, modern stores armed with the latest technological advances are sprouting up next to mom-and-pop shops.

The retail landscape is experiencing dramatic shifts as well. Retailers are simplifying product assortments to boost their margins and to make shopping more convenient for consumers who prefer limited assortment formats such as dollar stores. Retailers are also investing in private label, gaining greater insight into point-of-sale data, and coming to grips with how best to integrate online channels to build closer consumer connections.

In light of these trends, it's no longer sufficient for CPG companies to play the game by the old rules. Today's times call for more thoughtful strategies underpinned – and made actionable – by a core set of organizational capabilities. Leading companies have demonstrated that capability-based strategies are a powerful tool for navigating a rapidly evolving marketplace and creating essential advantage for better performance today and tomorrow.

### **The Capabilities Imperative**

The problem is that few CPG companies have mastered the capabilities they will need to make these adjustments. Most organizations aren't properly structured to respond quickly to changes in demand. They don't have the right touch points to reach consumers and glean valuable information about their shopping behavior. Their distribution networks aren't set up to reach an increasingly fragmented customer base. And they have not yet formed the partnerships with media marketing companies, suppliers, and others they will need to backfill gaps in their own capabilities.

As the page turns on 2009, CPG companies need to address their capability gaps, particularly in three broad areas: empowering their organizations, building the supply chains of the future, and modernizing marketing programs.

#### *Empowering the Organization*

In today's increasingly complex organizations, work is typically spread across three operating entities: the corporate center, individual business units, and a shared services center.

Yet the corporate center is still looked on as the ultimate arbiter of day-to-day operations; divisions frequently call on headquarters to make decisions both big and small. Because of this, the organization has become a slow-moving bureaucracy. Even worse, C-suite leaders have less time to spend on setting strategy, understanding key drivers within their business, and putting the right people in critical positions.

This was the situation Kraft Foods Chairman and Chief Executive Officer Irene Rosenfeld found herself in when she assumed command of the company in June 2006. Known essentially as a collection of businesses acquired over 25 years, Kraft had moved in the early 2000s to a centralized organizational model in which decisions were taken out of the hands of individual business units.

Rosenfeld established an “Organizing for Growth” initiative that dismantled the existing organizational framework. She replaced it with a decentralized structure that gave the company’s newly reorganized business units more direct lines of responsibility, with clear-cut decision rights and the responsibility to share information across the organization. The program also established new measurements for performance and aligned compensation incentives with them. While the company’s transformation is still a work in progress, the reorganization has already begun to create a more nimble and flexible organization with well-defined lines of responsibility.

Large companies tend to believe that everything else follows when they make structural changes first. But as Kraft’s example shows, the success of a transformation on this scale depends equally on a solid foundation of people, knowledge, and organizational coherence.

To that end, CPG companies should spend part of their focus in the coming year addressing the four levers of organizational effectiveness: aligning decision rights; designing an integrated and strategy-aligned structure; defining new performance measurements; and aligning incentives and rewards to these new performance measures. Capturing the full opportunity requires a company to build a sustainable capability based on all four. Falling short on any of these dimensions jeopardizes a company’s ability to build a high performing organization model that will facilitate, not constrain, growth.

### *The Supply Chain of the Future*

As consumer behavior shifts across markets, reengineering the supply chain will be critical to stay abreast of these changes and reach an increasingly fragmented customer base. Supply chains are already under increased pressure to deliver lower costs and offset generally rising costs for raw materials and energy.

That pressure may be dialed up even further as governments around the world put a price on carbon emissions and establish new regulations on waste by-products. Large swings in exchange rates are contributing as well

by driving shifts in demand and changing the economics of production. At the same time, as CPG companies emerge from the recession, they need to stay ahead of the curve on longer-term changes in demographics and consumer behavior to ensure their own future success.

Today's supply chains were built on yesterday's blueprints, in a world where low energy and transportation costs, cheap labor, relatively inexpensive raw materials, and scarce environmental regulations were fixed assumptions. The supply chain of the future, by contrast, will require different capabilities to make it leaner, greener, and more tailored to manage increasingly complexity.

Due to public demands for environmentally sustainable business practices, companies will also need to rethink their choices in product design and process technology. This is particularly true in the case of the ingredients they use, the packaging that is required, and the amount of materials and energy consumed by manufacturing processes. They will also need to realign their supply networks to build more flexibility and adaptability into their processes while reducing their carbon footprint.

Finally, CPG leaders will need to engage in larger collaborative networks to better understand sourcing decisions and share information on new production processes and technologies. As Anheuser-Busch Companies can attest, even small changes can have a meaningful impact on the bottom line: The company worked with key suppliers to help it reduce the lid diameter for four types of cans, saving 17.5 million pounds of aluminum in one year alone.

### *Marketing 2.0*

Across the globe, consumers are migrating away from traditional paid advertising toward "below the line" media and marketing programs that put them in direct contact with consumers. This shift is giving rise to a new generation of customized marketing platforms, transforming the way in which consumers experience advertising and establish relationships with brands.

Digital marketing platforms are a big part of this strategic shift; they are redefining what it takes to succeed in building brands and reaching customers. Companies will need to use emerging technology in new assets such as databases, websites, and branded content. They will need to develop new analytical models to measure the effectiveness of media spending. And they will need to manage the integration of advertising planning, media

buying, promotions management, and other tasks currently handled by multiple agencies.

CPG leaders are distinguishing themselves in the consumer marketplace not by the success of single campaigns but by achieving greater sophistication in the development of such marketing capabilities.

General Mills, for instance, is shifting more advertising in support of its Betty Crocker brand to digital platforms after concluding that its customers were spending more time online looking for recipes and other baking ideas. This year, more than half of Betty Crocker's total ad spending will move online with its own branded content, including sneak previews of new products, online games, and even children's books tied to the Cheerios brand.

Companies that build these capabilities will find their marketers can play a more strategic business role. Yesterday's marketing organizations stuck to tactical functions to support strategic decisions that had already been made. Tomorrow's marketing leaders will help set the strategy for major advertising, promotions, and public relations campaigns, and serve as growth champions in the development of a company's brands, products, and new businesses.

In the coming months, CPG marketers should look to shift their creative and media strategies to fully capitalize on the online opportunity and make digital media a bigger priority in their brand strategies. Mass marketing will continue to play a role in driving increased awareness, but marketers will need to develop their presence in channels that not only drive greater brand awareness but also open up new insights into consumers.

### **Establishing the "Right to Win"**

The marketplace has repeatedly shown us that successful companies with a few distinct, best-in-class capabilities earn superior returns. For example, Wrigley outperformed its competitors by continuously innovating and owning the front of the store through superior merchandising. Pfizer successfully leveraged its capabilities in research and development and drug delivery technologies to create competitive advantage in the consumer healthcare space, and then monetized the investment when it sold its consumer healthcare division to Johnson & Johnson for more than US\$16 billion – an unprecedented industry multiple of 21 times EBIDTA.

Even within industries, there is more than one way to succeed. Both Dell and Apple earned the right to win in the consumer electronics space, each with a very different and differentiated set of key capabilities.

There is only one Wrigley or one Apple, but that's precisely the point – every company has the ability to create or fortify its own differentiating capabilities. With signs increasingly pointing to economic recovery, now is the ideal time to identify those capabilities and align a growth strategy around them. The economic downturn created a new set of issues for CPG companies to address, but the recovery will not remove the deep-seated changes that are transforming the industry and will continue to do so for years and decades to come.

From the partners of the Consumer, Media and Digital Practice