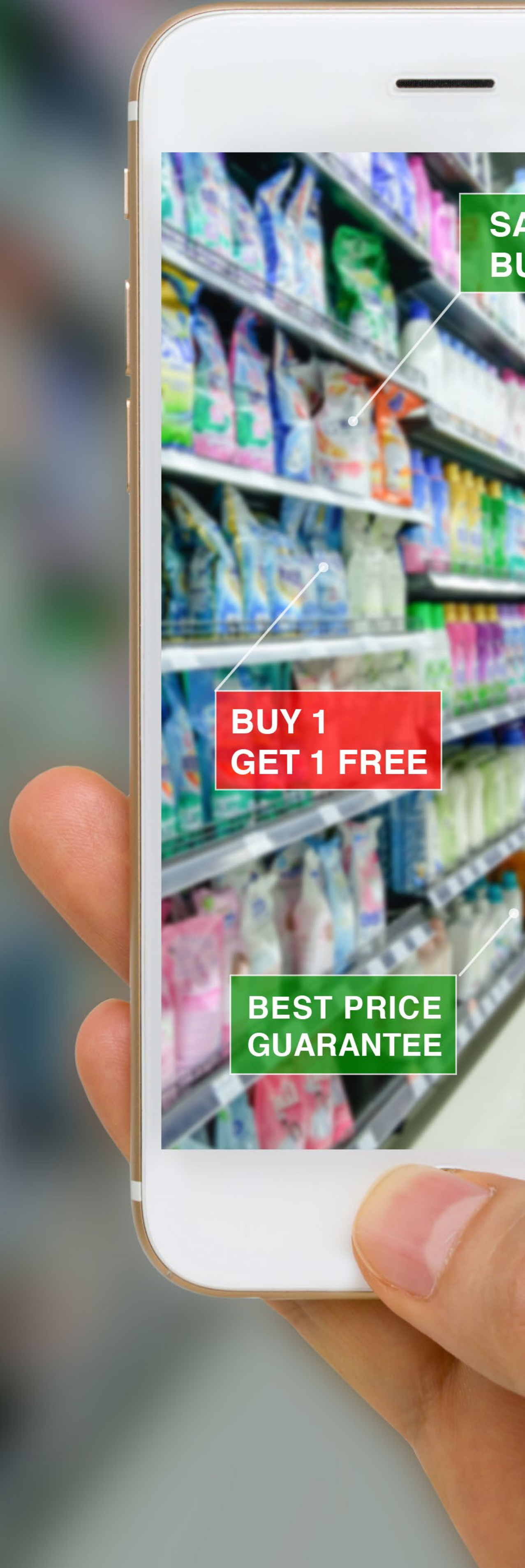
Is there a new recipe for CPG success?

Three tactics CPG executives can take amid retail grocery disruption



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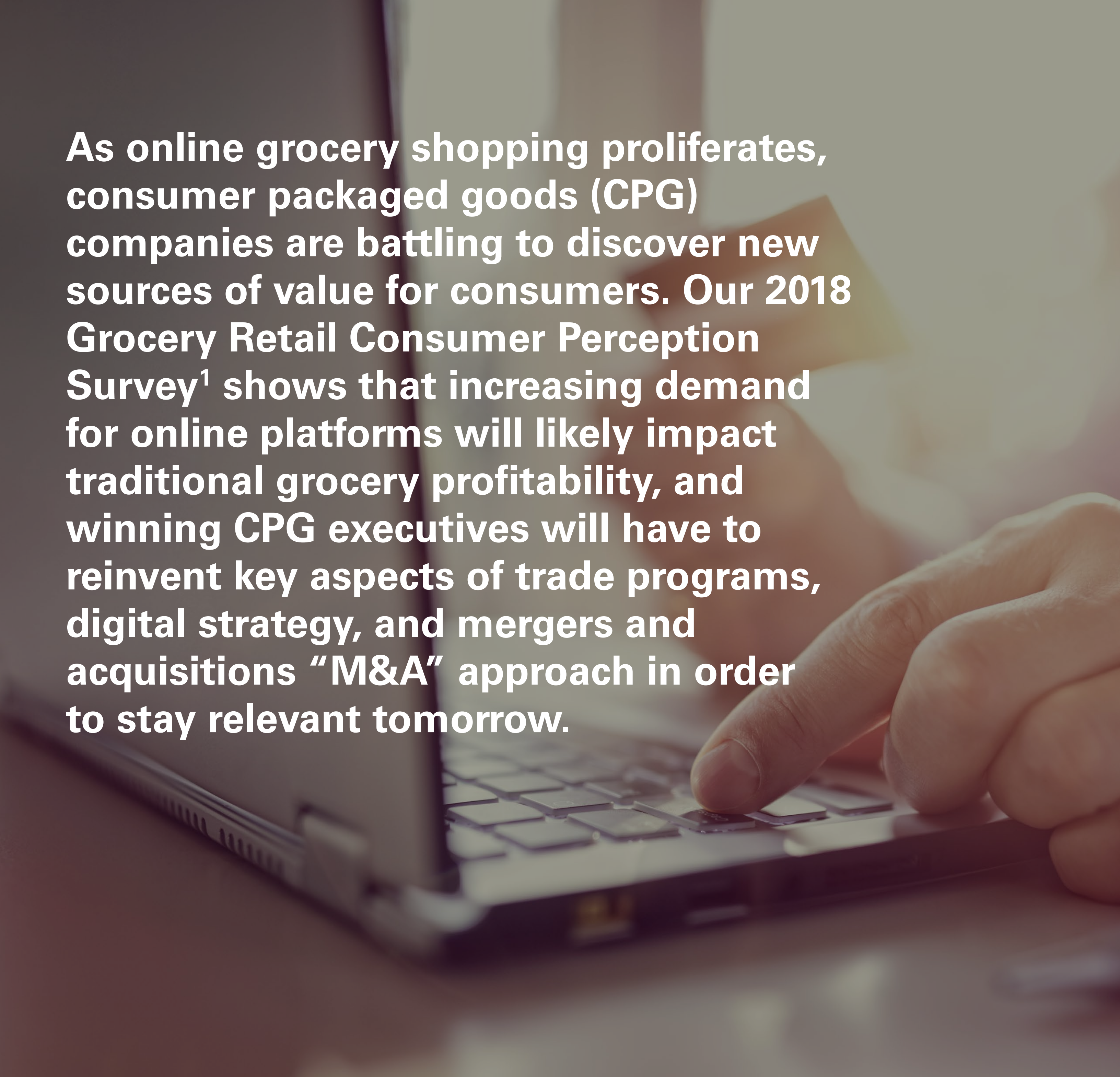


As online grocery shopping proliferates, consumer packaged goods (CPG) companies are battling to discover new sources of value for consumers. Our 2018 Grocery Retail Consumer Perception Survey[1] shows that increasing demand for online platforms will likely impact traditional grocery profitability, and winning CPG executives will have to reinvent key aspects of trade programs, digital strategy, and mergers and acquisitions "M&A" approach in order to stay relevant tomorrow.

Methodology

[1]KPMG's 2018 Grocery Retail Consumer Perception Survey is an annual survey of grocery shoppers across the United States to understand their shopping behavior. In 2018, the survey was rolled out to more than 2,000 grocery shoppers, who were selected to represent the U.S. population fairly in terms of age, household income, and location, among other demographic identifiers, and had shopped at multiple retailers. They were then asked questions to assess the relative performance of the retailers along with the emerging trends in the grocery industry.

Browsing new territory

"Out of milk? Need peanut butter? Craving your favorite candy bar? A few clicks or taps… and the groceries are on their way to your doorstep."

This is how online grocery shopping is making consumer lives better in today's world. But this burgeoning trend also means that CPG companies need to revisit their strategy, requiring executives to adopt innovative digital approaches to increase or sometimes even defend market share.

Driven by retail industry disruption, CPGs continue to face tougher and tougher challenges, some of which include experiencing slow growth, increasing operating costs, and declining profit margins. They need to invest in new digital capabilities while developing new products and channels. CPGs are finding it difficult to find the best path forward due to a low margin landscape, underpinned by a new sense of urgency.

Why now?

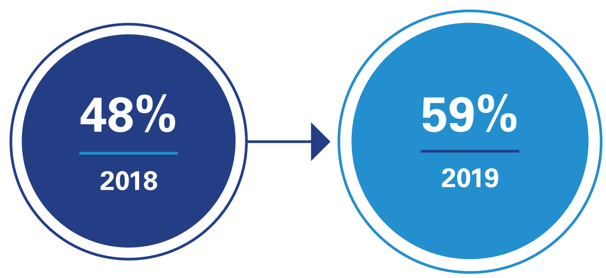
Online grocery shopping is not really new. Home delivery has been pervasive in European countries for over two decades and continues to skyrocket in Asia. Although less practical for most Americans until recently, home delivery of groceries in the United States has been available in select markets since 1997. However, with Amazon's acquisition of Whole Foods last year, Walmart's teaming with Google to offer Google Express, and new, nimble digital newcomers springing up all over the place, it's not surprising to see increased momentum and renewed interest within the U.S. market.

Grocery retailers have been quick to respond. Many of them have added a click and collect option, a home delivery service, or a combination of the two. As more consumers take notice, so must CPG companies. Falling out of lock step with changing consumer buying habits can create significant share loss, and in many cases, simply being on shelf is not enough to stay in sync.

To win in today's market, CPGs need to apply the same level of insight and discipline toward their distribution offer as they have historically put into their packaging and product features. In some cases, that may mean winning with a leading online player, such as Amazon. In other cases, it may mean adapting entirely new approaches that continue to emerge for CPGs, such as subscription, direct-to-consumer models or hybrid programs.

In the last year alone, consumer interest and adoption in online shopping for groceries has made a sizable jump. In fact, according to KPMG's 2018 Grocery Retail Consumer Perception Survey, 48 percent of consumers currently do some or all of the grocery shopping online and 59 percent plan to do so in the future.

Number of respondents shopping online



Source: KPMG 2018 Grocery Retail Consumer Perception Survey, n=2,019

Facing such a pivotal point in the U.S. market, what's a CPG company's next move? Is a wait-and-see approach even a viable option? As the retail landscape continues to evolve, how will CPG companies transform the models that have served them so well for decades? How can they achieve profitable growth online in an already low-margin market? How can they win with digital?

Adapting to the new reality

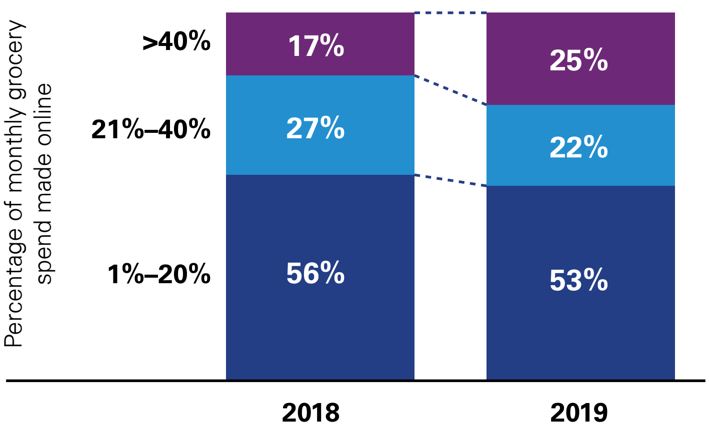
While CPGs are making changes to address such questions, we believe they can benefit from new thinking in three areas, including:

1 Evolving trade planning approaches

While the number of consumers who are planning to shift more than 40 percent of their shopping online is the fastest-growing group, the majority of consumers will do less than 20 percent of their shopping online.

Thus, we anticipate a barbell effect where there is an increasing number of consumers shifting significant spend online while there is also a large group that will remain in store.

Change in online spend by online grocery shoppers

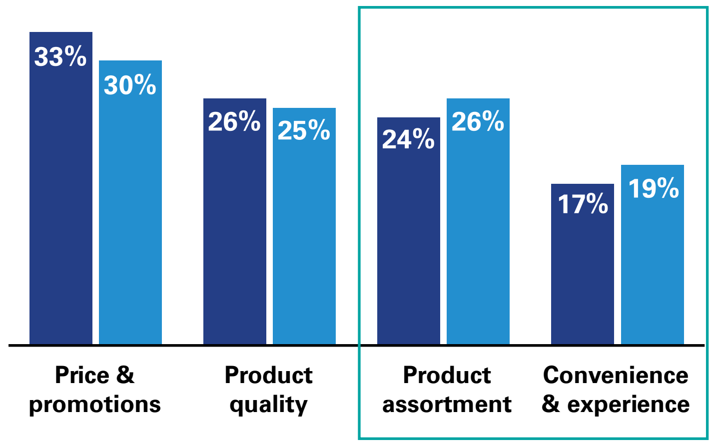


Source: KPMG 2018 Grocery Retail Consumer Perception Survey, n=2,019

2 Fully integrating digital strategy into the business

Different customer segments have very varied preferences in both how they shop and what is important to them, so it is critical to understand which customers you serve. According to our survey results, convenience and choice are more important to heavy online shoppers than to in-store shoppers.

Importance of factors in grocery shopping



Source: KPMG 2018 Grocery Retail Consumer Perception Survey, n=2,019

While price is still a critical factor for online shoppers, the increasing price transparency through access to mobile apps and websites is making even less price-sensitive customers price savvy. Therefore, CPGs need to focus on their digital strategies and update their business and operating models. This will place them in a better position to compete and seize opportunity in the increasingly popular online grocery marketplace.

3 Driving future growth through mergers and acquisitions

As customer expectations and the business environment continue to evolve, many traditional CPG companies lack in-house resources and capabilities to address them. Many CPG executives are finding that rather than growing organically and onboarding new resources, it is faster and more effective to acquire them through M&A. Hence, they need to assess making strategic investments in the areas that would help them achieve the online and offline integration most effectively.

I. Evolving trade planning approaches

Eating away profits in real time

Online grocery adoption in the U.S. lagged, in large part, due to its impact on profitability. For any retailer, the cost to add dark stores or distribution centers with capabilities, logistics, and a digital supply chain are substantial. Add to that the complexity of last-mile delivery in a catchment area that could be anywhere from 3 miles to 25 miles wide, the proposition becomes less and less attractive.

On the flip side, given the extremely thin margins of the average U.S. grocery retailer, missing out on a market share shift could be a critical mistake. As illustrated below, the profitability of a grocery retailer is highly dependent upon a stable and growing top line and it does not take a substantial market share shift to wipe out a retailer's profit margins.

Traditional grocer economics

2% EBIT

and

22% Volume variable margin

Example: Hypothetical grocer analysis

Historical P&L Summary		
Sales	$100B	100%
COGS	$78B	78%
EBIT	$2B	2%

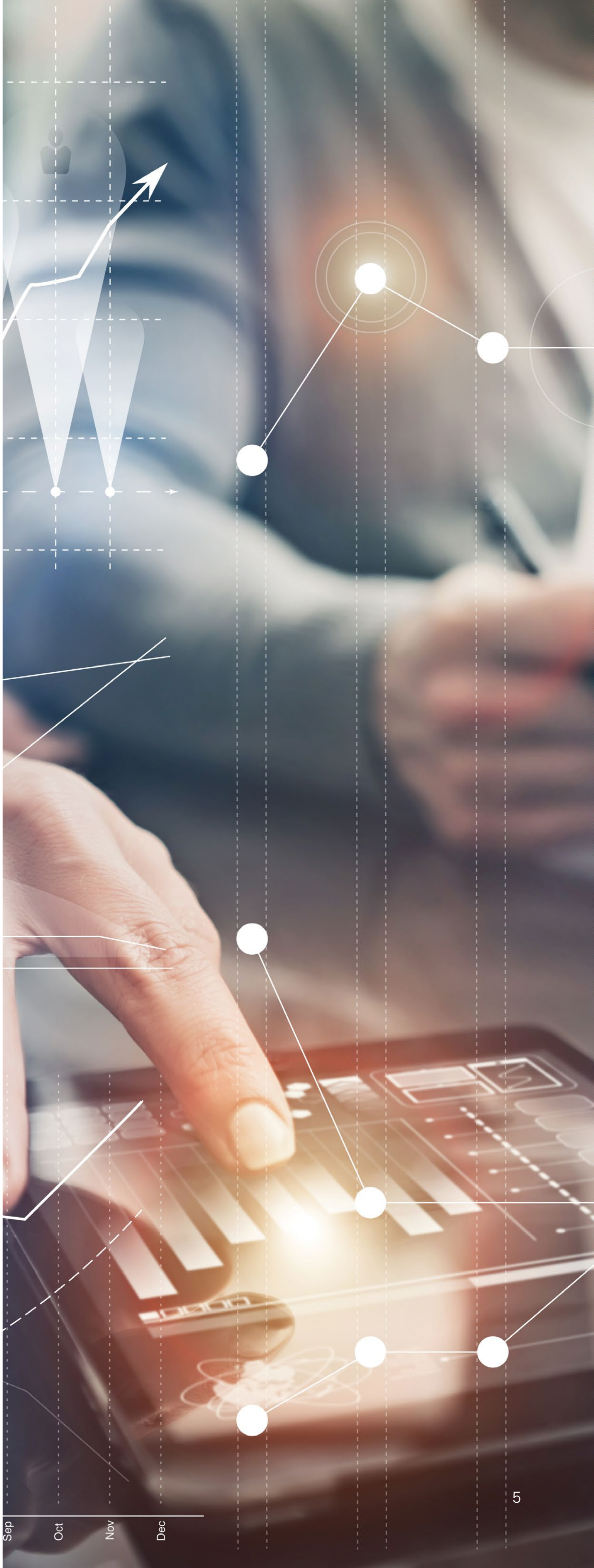
Analysis	
Market share loss	0.4%
Sales loss	$7B
EBIT loss	$1.6B
New EBIT	$0.4B

Assumptions	
Volume variable margin	22%
Potential share loss	0.4%

As a result, we expect many retailers to continue increasing pressure on trade terms with their CPG partners. Whether it's investment in new areas, like digital marketing, higher online listing fees, or simply an ask for more funding to run a promotion, CPGs should expect pressure to mount quickly, without necessarily seeing a big jump in top-line numbers.

And it's easy to see why. Although the majority of shopping is still done in stores, consumers are turning to online research to determine what is most important to them. This new scenario creates dual priorities for retailers. They need to invest in creating better customer experiences while simultaneously investing in their core price proposition—all while facing a rapidly growing marketplace ripe with new, more nimble, digital-first competitors. As retailers look to fund these priorities, CPGs could likely be left holding the bag, with such costs being passed on to them through trade agreements.

That's why, moving forward, CPGs should explore new trade relationships with retailers. This may mean increasing the collaboration and sharing of data to gain new insights and opportunities and developing stronger owned knowledge of the end consumer's buying behavior. By teaming together in strategic data partnerships, CPGs can create detailed, scalable customer data assets and strategies that will better meet customer needs, develop customer relationships, and offer the potential for innovative new streams of revenue.



II. Fully integrating digital strategies

One size does not fit all

While it's certainly tempting to assume that you can monitor the overall trends of the market and create a single digital strategy, it's increasingly clear that there is no one-size-fits-all digital strategy for a CPG company. As such, the need to know who your online consumers are takes on even greater importance as they may differ considerably from your brick-and-mortar consumers.

This is evident in our survey results, which reveal that consumers who are heavy users of online grocery, and those who are willing to consider it, are two very different buying segments. Upon closer look, we found several distinct segments of consumer buying behaviors that can help drive your strategy.

> "In the end, the key to 'winning' this game may not be solely focused on winning just the digital race. For many retailers, the key will be to also retain the in-store shop when consumers begin narrowing their choice of the brick-and-mortar stores that they visit."

We've broken them down into four key shopper segments, which include:

1. **Online pioneers** – This group does the largest portion of its shopping online today and plans to shop online even more in the future. On average, over 40 percent of their grocery spend is done online, but it varies widely by individual retailer and market. Interestingly, these shoppers spend the most on food consumption—both groceries and dining out. While they place the highest importance on product quality and assortment in determining where to shop, they are also more interested in promotions than other segments.

2. **Next-in-line adopters** – This is the fastest growing segment of consumers, who are dabbling in online shopping but not yet fully committed. This segment predominantly lives in the suburbs. They primarily shop a mix of traditional grocery and warehouse clubs or big box retailers.

3. **Online dabblers** – This group shops online today and plans to shop a bit more online in the future, but they have no plans for it to be the majority of their shop.

4. **The in-store crowd** – This segment prefers to shop in brick-and-mortar stores and does not show signs of shifting much of their spending online in the future. As you might expect, this is an older generation that is less tech savvy and tends to be more price sensitive.

Online pioneers

The majority are **under age 35**

Spend the most on food consumption:

- 80 percent spend more than $250/month on groceries
- 79 percent spend more than $100 dining out each month

60 percent have a club membership

Focused on promotions and shopping experience

Next-in-line adopters

Do less than 20 percent of their shopping online today and plan to increase

67 percent have a club membership

Product assortment is the most important shopping criteria

This segment is the **least concerned on price and promotion** of all segments

Online dabblers

Do a limited amount of shopping online

Similar to those who do not shop online at all, except that they:

- Spend more per month on groceries
- Live in slightly more densely populated areas
- Shop around a lot more
- Are much more likely to have a club membership

In-store crowd

Do almost all their shopping in brick and mortar and plan to continue

Older – almost 80 percent are over age 35

Spend the least on food consumption:

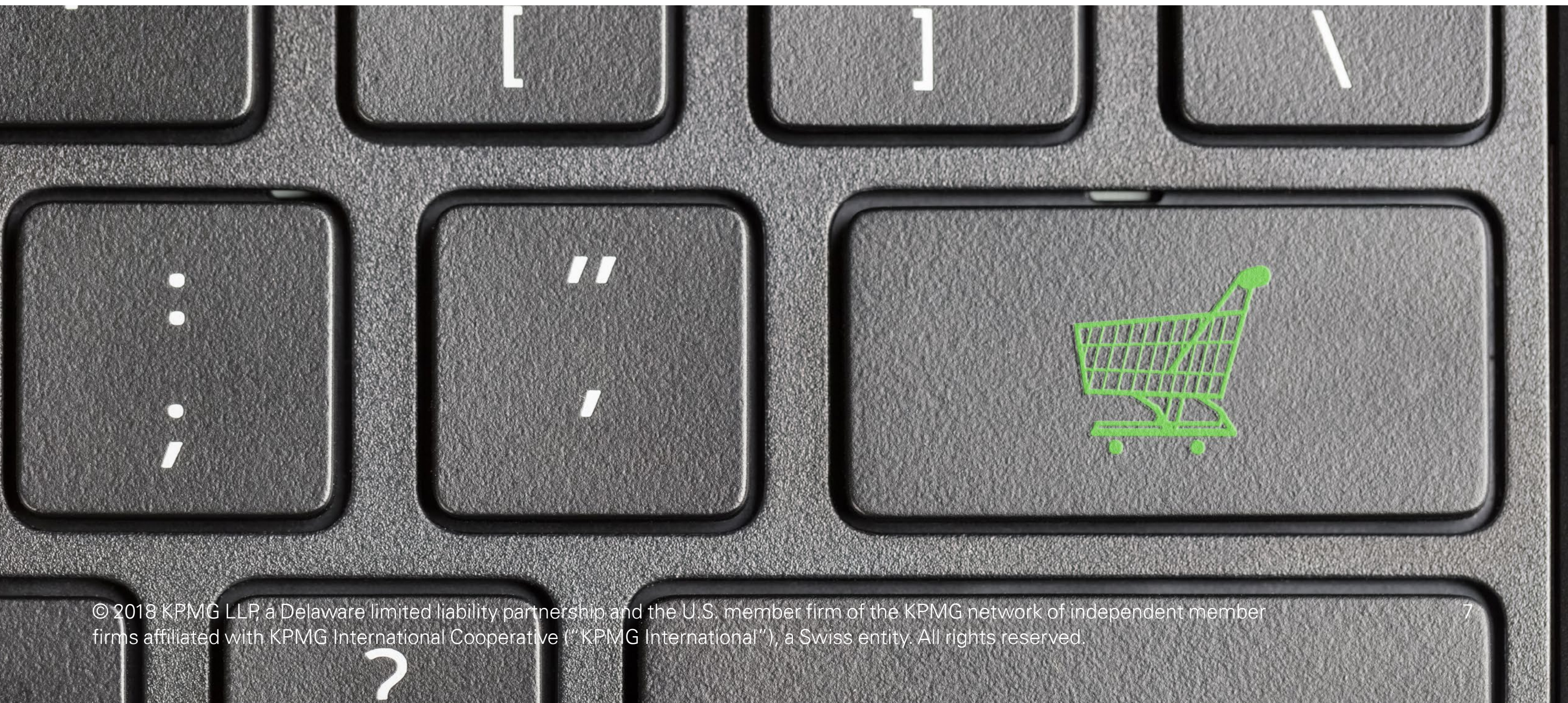
- 40 percent spend less than $250/month on groceries
- 47 percent spend less than $100 eating out each month

Most concerned about price and quality

Source: KPMG 2018 Grocery Retail Consumer Perception Survey, n=2,019

Although these segments have dramatically different behaviors, the one thing that they have in common is that they all still shop in stores. Perhaps, even more interesting, though, is that within each segment, consumers who shop digitally shop a fewer number of retailers.

So, in the end, the key to "winning" this game may not be solely focused on winning just the digital race. For many retailers, the key will be to also retain the in-store shop when consumers begin narrowing their choice of the brick-and-mortar stores that they visit. And that will have a significant impact on a CPG company's future strategy, in which customer data and insights will be crucial to success.



Serve your digital customers well too

CPGs need to know who their customers are so they can serve them well. It's no longer enough for CPGs to rely on traditional research. And with retailers primarily owning the point-of-sale data, there's a definite need for CPGs to build out, acquire, or partner with others to gain the advanced data and analytics capabilities needed for the customer data and actionable insights that will drive competitive advantage.

Such data will prove invaluable for CPG companies, who increasingly realize that size and scale are no longer the differentiators they once were, especially in the online grocery sector. By knowing your target customer segments and using data and analytics to glean insights on shopping behaviors, CPGs can develop and market products aligned to customer preferences.

Digital natives have a head start. They already know the value of using technology to personalize customer experiences. Since their launch, they've been using data effectively to build relationships with customers and encourage long-term loyalty. CPG companies must act fast to follow suit, using digital disruption as an opportunity to manage and use consumer data to set prices, study customer preferences, and generate targeted promotions/offers based on new insights.

This is a big contrast from the traditional retail setting where CPGs are beholden to retailer's rules. However, like retailers, CPGs will also have to invest in maintaining online listings and improving their appearance on digital sites. Both can leverage third-party online retail platforms such as Amazon, but doing so means relinquishing control of data and the ability to customize customer experience. In addition, prime digital real estate on a large layer like Amazon requires that a company has robust supply chain metrics, broad reach, and a popular brand. So, the conundrum for CPGs in online grocery is a tighter squeeze on trade profits, a need to leverage technologies to simplify and diversify their supply chain, and a need to build their digital brand.

Case study

Exploring new options drives healthy gains

Even with a solid growth history, it's important to explore new options in an evolving business landscape.

That's exactly what one CPG company did after acquiring a successful animal health company with a strong track record for growth. Initially, the company planned to focus on traditional channel growth, which relied on sales to professionals and specialty retailers. However, the sector's strong growth in e-commerce threatened its value delivery. Essentially, if they moved to a leading player liked Amazon, they would no longer have a strong value proposition.

The company faced some tough decisions and turned to KPMG for help. The assessment started with creating a customer segmentation based on multiple customer attributes. This enabled the development of multiple channel growth strategy options. A profitability analysis was also conducted to understand the drivers of margin growth and compression to test the financial viability of different scenarios. This resulted in a restructuring of the channel pricing strategy to improve customer profitability and establish a new go-to-market model to drive future growth.

By implementing these changes, the company immediately saw improvements, ultimately achieving $20 million in new margin while achieving top-line growth with a cost and revenue delivery program.

III. Driving new growth through M&A

Pursue viable growth opportunities

It's not surprising that CPG M&A activity is expected to increase as more companies look to enter growth categories, add new product lines, increase digital presence, and invest in new technology capabilities. According to KPMG's 2018 CEO Survey[2], when asked about the top growth drivers over the next three years, U.S. retail and CPG CEOs cited M&A as their primary driver of growth (38 percent), followed by strategic alliances (23 percent). These CEOs predict M&A will transform their business models faster than organic growth, reducing costs, and onboarding new technologies.

When it comes to the online grocery sector, the need for CPGs to act with speed and agility cannot be understated. CPGs increasingly face competition from retail private labels and digital natives, who have many inherent advantages. In addition, many traditional CPG companies lack the updated infrastructure, technology skills, and digital operations needed to move at online market speed. M&A deals will enable CPGs to keep pace with a rapidly evolving digital marketplace. Instead of starting anew, companies can leapfrog the competition by acquiring digital start-ups offering the speed, agility, and personalization needed while also providing the degree of scale that start-ups seek.

At the same time, some CPGs are pursuing a variety of new go-to-market approaches, such as selling direct to consumer. However, selling small quantities of products online is an expensive model that is limited by supply chain complexity and outdated infrastructure. If they haven't already, these CPGs should look to strategically invest in their supply chain and operations by introducing automation and emerging technologies that integrate online and offline operations. As such, many CPG companies will likely look outside to bring their digital operations up to speed, acquire the necessary skill sets and technology capabilities, and achieve growth opportunities.

Case study

Relishing the win with a clear M&A strategy

It pays to have a forward-looking approach. That's what one food company quickly realized by having a clear M&A strategy.

The company wanted to add a popular product line with strong growth potential to its portfolio of assets. The company's management team wanted to expand into an adjacent category, which it had little experience in, but felt it complemented the existing portfolio. And, they believed that the company's unique skills in food service and culinary experience could be leveraged to accelerate overall brand growth.

They were not alone as many others were also interested in the same product line. Competing on the bid, the food company needed to win without overpaying.

They turned to KPMG for help. Using data and analytics, a detailed bottom-up cost analysis was performed at the transactional level to find incremental synergy opportunities. In addition, a detailed category analysis combined with proprietary research and analytical tools enabled the development of new ideas that identified large international growth opportunities and operational network consolidation. Finally, the synergy delivery program was linked to the annual operating plan to increase transparency and give confidence that the plan would deliver the value needed.

By identifying the added business value and opportunities for growth, the company felt comfortable increasing their offer price and ultimately, they won the bid.

[2]Source: KPMG U.S. CEO Outlook 2018

Three courses for action

Against this rapidly evolving backdrop of disruption and opportunity, achieving profitable growth within the grocery market will be increasingly difficult for CPG companies. In search of sustainable growth, CPGs will need to have a clear view on who their primary customers are and where they are coming from in order to best interact with them.

They must embrace the need to think differently, innovate approaches, and be able to adapt quickly as the rules change. The following three action steps can help CPGs improve results as they move forward.

1

Take a new approach on trade planning

Many CPGs have adopted revenue management teams to address increasing internal margin pressures against the desire to stimulate demand with their retail partners. Particularly as grocery retailers have become much more sophisticated with analyzing their own internal data, the need to have defensible and profitable trade plans has become even more critical.

However, as we work with clients, we often find they treat online as a different business unit and don't fully integrate them into the revenue management team. This creates a difficult challenge considering online retailers, such as Amazon, which have a much different mentality about trade spend, which will be hard to compete against. Amazon and others think more about consumer acquisition to grow market share and drive loyalty rather than optimizing trade for the current base business. As a result, online trade spend rates are likely lower today than they will be in the future, which makes a typical CPG company's three-year growth and margin plan unrealistic.

Key takeaway: CPGs should rethink how revenue management teams are organized, how channel pricing architectures will have more online emphasis, and how returns are measured in the near and medium term to fully understand the impact of online growth.

2

Differentiate your digital strategy

Every CPG company has a digital strategy today. However, we often see what qualifies as a "strategy" is often just meeting today's digital table stakes, such as social media accounts, richer content-focused brand Web sites, etc. Not having a carefully thought out digital strategy can result in incremental funding of these table stakes, which reduce margins, but don't have a material impact on volume growth or share improvements. At the same time, what's needed in a digital strategy is dependent on the customer being served and what they expect. It's critical to understand these customers and how they are researching and shopping online to identify the right path forward. Investing in data and analytics will be critical to effectively support your digital strategy and improve your customer experiences.

Key takeaway: Step back and understand how your customer is going to change in the future and what that means for your digital strategy. Evaluate this against the volume and share implications of various digital tactics in terms of how they fit in with a long-term growth strategy. Don't succumb to false wisdom that "something is better than nothing," and ensure that these tactics are fully backed and integrated into brand growth plans.

3

Shop around for M&A

For many CPG companies, their current portfolio of legacy products isn't well suited for online growth or the consumer of the future. Perhaps the products and brands don't appeal as well to online shoppers, or maybe online sales cannibalize their business in traditional brick-and-mortar channels. In such cases, we see many of our clients turning to M&A to redefine their brand portfolio or quickly bring new offerings to consumers.

Yet, it's worth noting that consumer goods have attracted a lot of interest in the capital markets and deal multiples are high, making it difficult to create accretive value. Our research indicates that a typical CPG company only delivers approximately 40 percent of forecasted synergies after three years. This can dilute deal value, often driven by a desire to "leave alone" a high-performing niche brand rather than fully integrate it into the parent company.

The key to making the strategy work is the ability to complete detailed analytics of a target from the bottom up and to drive your value targets off of this data rather than simply pinning a number to an overall strategy. Ensuring that this same analysis underpins integration and operational budgets after close is often the key to realizing targeted value. When the right target comes around, having a clear M&A strategy with the ability and analysis to drive the right bid will be instrumental in making the overall strategy work.

Key takeaway: CPGs need to revisit their current brand portfolios with an eye to the future and divest those brands that no longer have a clear role. At the same time, it's necessary to take a systemic approach to identifying synergies and delivering real business value. Additionally, the delivery of a thoughtful, well-planned operating model design for newly acquired brands is needed. Companies that have been able to develop this new approach are outperforming their peers.

Conclusion

Customers are changing. The increasing popularity of the online grocery market illustrates how fast disruption takes hold and upends business models. Moving forward, CPGs will need to better understand customer buying habits, know who their customers are, and where they are from. In order to succeed, they will need to figure out how to adopt agile operating models and bring them to life.

How KPMG can help

Trade planning

Working with and understanding the perspectives of both CPG companies and retailers, our team uses advanced analytical and visualization tools to analyze the transactional data and assess the consumer buying behavior. These analyses help sales and marketing teams of CPG companies work with merchants and reach mutually beneficial decisions on trade spends.

Digital strategy

Collaborating with CPG companies, our team defines a projected model that meets targeted business and operating model ambitions associated with digital investments. We support our clients in developing a strategy where digital platforms are factored in to all aspects of the business.

Mergers and acquisitions

Helping companies both evaluate synergies in a pre-deal setting as well as capture deal value post-close for both strategic and private equity investors. Leveraging our fully integrated team and proprietary advanced data and analytics capabilities, we help our clients win the bid, execute the deal and realize on the value promised.

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Focused on the consumer and retail sectors, Katherine is a principal in KPMG's Strategy practice with over 20 years of experience in customer analytics as both a consultant and practitioner. She specializes in using insights to drive transformational growth strategies across a range of topics such as customer strategy, collaborative trade planning, localized assortment and differentiation, mergers and acquisitions, personalized communications, loyalty strategies, assortment, pricing, and promotions. She has led major engagements with retail clients in North America, the U.K., and Ireland.

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A range of pressures—from rapid technology change and digital disruption, empowered consumers, rising costs, increased speed to market, and significant shifts in brand loyalty and purchasing behavior—are impacting today's consumer businesses.

KPMG LLP works with consumer and retail companies, from small start-ups to large multinational operations, to develop and implement innovative, customer-led growth strategies and tightly aligned business operations. With customized, industry-focused audit, tax, and advisory services, KPMG helps to drive greater shareholder value and embed and sustain positive change.

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