Value management beyond pricing and promotions
Value management beyond pricing and promotions

A truism of today’s economy is that everyone is looking for value. The question for consumer-packaged-goods manufacturers (CPGs) is how to deliver this to consumers and customers. Their answer is too often to combine low prices with promotions—but the solution to the problem is not that simple. Our analysis of category trends over the past five years suggests that CPGs that focus on this combination as their primary lever frequently destroy value if they fail to address important consumer needs, driving down profits for manufacturers and retailers alike. Avoiding this outcome is easier said than done, especially as manufacturers are facing increasing pressure from customers. In 2011, the Sales Committee of the Grocery Manufacturers Association (GMA) asked McKinsey & Company and Henry Rak Consulting Partners (HRCP) to develop a practical framework for thinking about delivering value in different categories that integrates consumer and customer perspectives. This paper provides a brief overview of a simple approach that aims to help CPGs and their retail partners think about value-creation strategies across categories. It is important to note, however, that this approach does not replace deeper work on developing a comprehensive category strategy; rather, it provides a starting point for productive dialogues about providing value for CPGs and their retail partners.

Consumers are looking for value. Manufacturers and retailers often interpret this search for value as a search for low price. As a result, 55 percent of US CPG categories have seen increased levels of pricing promotions for two consecutive years, and the share of value for private labels increased by 1.2 percentage points (from 17.3 percent in 2008 to 18.5 percent in 2011).1 But research suggests that for consumers, value extends beyond low prices. In a recent shopper survey,2 while 24 percent of respondents ranked “low price” number one, “trust in brand/company” and “experience” each received a number-one ranking from 17 percent of respondents.

Not surprisingly, the brands and categories that recognize different components of value can break the cycle of overpromotion and create value for themselves and for consumers. The yogurt category provides an example of how value can mean more than just price when translated into real-world decisions. Since 2008, consumers’ interest in functional yogurts has led to a 3 percent compound annual growth rate (CAGR) increase in volume and a 4 percent CAGR increase in price in the yogurt category; private-label share decreased (from 12 percent value share in 2006 to 10 percent in 2010), and the share of promotions stayed flat (at about 38 percent).3 Delivering the right bundle at the right price meant that yogurt manufacturers excited consumers and increased their own and their retailers’ profit pools.

The three steps outlined in Exhibit 1 make up a simple approach for optimizing the bundle of price and benefits that delivers value to consumers.

---

1 SymphonyIRI Group.
2 McKinsey US Consumer Sentiment and New Normal Survey, wave VII results; this survey was fielded in September 2011 and included about 1,000 respondents.
3 IRI InfoScan Reviews.
Step 1: Understand the consumer’s perception of value in a category

We used a “value matrix” (Exhibit 2) to map consumer perceptions of value drivers for a category or brands within a category. This matrix assumes that consumers are willing to pay a price premium for categories and brands that have certain emotional benefits (for instance, those that instill trust) or functional benefits (for example, those that offer superior performance). This is a critical assumption; CPGs should focus on the benefits for which consumers will pay a premium for differentiation.

Within the matrix, four general types of categories and brands exist:

- **‘Good enough’ (bottom left).** Consumers see little reason to pay any price premium for extra benefits; there is low functional and emotional differentiation.

- **‘Appeal focused’ (top left).** Consumers pay a premium for an emotional connection with the brand, for example, because they trust it; at the same time, they see little value in its functional benefits.

- **‘Functionally focused’ (bottom right).** Consumers are willing to pay a premium for functional differences but see little value in emotional differentiation.

- **‘Total package’ (top right).** Consumers are willing to pay a premium for emotional and functional differentiation.

We used data from a Firm survey on consumer sentiment to understand perceptions of value across 30 grocery categories. Exhibit 2 shows the placement of some of these categories.

By definition, the majority of the volume for any category will be derived from brands and products that meet the criteria for the category in the value matrix. For example, most volume for cookies will come from products and brands that are appeal focused, as Exhibit 2 indicates. This placement speaks to the high emotional value of cookies for consumers; it also

---

**Exhibit 2** A value matrix maps consumer perceptions.

Illustrative categories/All consumers

Source: McKinsey US Consumer Sentiment and New Normal Survey, wave VII results
reflects the perception that ingredients, baking methods, freshness, and the like may differ by brand and product, but all are desirable traits. Nonetheless, some brands will operate outside the general rule. In the cookie category, for example, Pepperidge Farm Milanos appear to offer the “total package,” combining high emotional appeal and chocolate that consumers perceive as superior quality, thus supporting a higher price per ounce. Milanos appeal to a select part of the cookie franchise in which products have a higher bar.

On the other end of the spectrum, most pet foods also fall into the appeal-focused quadrant because consumers largely treat their pets with love and want high-quality, pet-appropriate food combinations. But not all consumers feel that way. Some consumers keep pets as guard animals or care for them to help someone else. In such cases, pet food falls in the “good enough” quadrant.

The importance of understanding the general value perception of the category for manufacturers is that it makes clear what can be expected if the rules are followed—and if they are not. Following the rules means CPGs must establish the value of their brand within the dimensions of the quadrant, along with most other brands. Manufacturers will share in the largest part of the volume, but the field will be crowded. On the other hand, if the brand’s value is perceived as either higher or lower than the “rules” indicated by the category, it may be easier to differentiate the brand, but the size of the opportunity is usually smaller.

Step 2: Understand the retailer’s perception of value

The expectations of consumers are only part of the story for CPGs; they must also know what their retail partners’ expectations are for the category. Not surprisingly, retailers that target different shopper segments will put the same category in different places on the matrix. Pet food is a good example. Dollar-store customers generally will be looking for “good enough” products—for them, the pet-food category is a staple, and they want a basic product for the lowest possible price. Shoppers at specialized outlets, like PetSmart or Petco, usually want the total package, because their shoppers care about the functional and emotional benefits of pet food and are willing to pay for them.

Understanding value perception by category and brand is critical for retailers. They need an assortment in which most brands and products abide by the rules of the quadrant for the category, but they should have some offerings that appeal to consumers who have perceptions that deviate from the norm. As in the example above, PetSmart and Petco generally have appeal-focused consumers for pet food, but even these specialized retailers will need some “good enough” products for consumers who shop the outlets out of convenience rather than for premium offerings. CPGs employing a retailer-centric category view can better position their own offerings and help retailers optimize their category strategies.

Step 3: Develop a strategy for maximizing category value

The understanding of general value perception of the category can be used to outline value-creation priorities for brands and categories and to ensure alignment on these priorities with customers. First, understanding a brand or category’s position on the matrix provides a company with a view on its starting point, because different quadrants reflect different performance trends and different challenges. For example, brands and categories in the “good enough” quadrant tend to show moderate growth rates driven by volume, high levels of private-label penetration, and high consumer willingness to trade down; those in the “total package” quadrant have moderate to high growth driven by both price and volume, no (or limited) share of private label, and less trading down.

Second, analyzing case studies from all quadrants suggests that CPGs that understand their position on the matrix can win no matter what quadrant they are in; in other words, optimizing strategies for a company’s position on the value matrix can allow it to beat category averages. As such, being in a “good enough” category does not mean performance will be poor—it just means that the focus areas should differ from those for brands in “total package” categories.
Exhibit 3 highlights the guiding principles for actions to optimize value based on matrix position, drawn from case studies that demonstrate how value can be driven in different quadrants (see sidebar 1).

Third, CPGs can shift their categories to another, more attractive position on the value matrix by offering consumers benefits that are valued. For example, CPGs can pursue product innovations that cater to new occasions, deliver new benefits (for example, novel experiences, convenience, or personalization), or reach out to new consumers (say, through different distribution channels). Although “jumping quadrants” is not easy, examples abound: antibacterial cleaning wipes, functional water, craft beer, and iPhones demonstrate but a few ways this can be done. Jumping quadrants can create a differentiated and competitively sustainable position, and it can also increase the profit pool. For the manufacturer, it is critical to understand whether the innovations are big enough to change the rules of the entire category (as the iPhone did) or whether they simply appeal to a set of category consumers who think differently from the majority (as craft beers do). Changing the rules is a bigger opportunity, but it also takes more time and is more costly; taking advantage of a niche opportunity may be smaller but is often more easily accessed (see sidebar 2).

Sidebar 1. Winners exist in every quadrant: Case studies

Three case studies offer examples of how different companies have found success in different parts of the value matrix.

‘Good enough’ quadrant. Kimberly-Clark gained 3 percentage points of the $3 billion diaper category by agreeing to manufacture Costco’s Kirkland Signature private-label diapers. It markets and provides customer call-center support for the brand; in return, Costco delisted other brands in 70 percent of its stores and may do so in the remainder.

‘Functionally focused’ quadrant. Unilever partnered with Plus Supermarkets to improve sales in its savory categories by providing a one-stop-shopping solution for convenience-driven daily shoppers. This solution included a permanent off-shelf fixture that crossed categories, co-branded in-store recipe cards, and cooking suggestions online.

‘Appeal focused’ quadrant. Sony reached female electronics buyers and Target shoppers by designing an exclusive line of small electronics for Target, Sony Liv. This was the first time Sony designed such a line for a single retailer. It included CD players, radios, alarm clocks, and a universal remote in lime-green and white finishes; it targeted female buyers, and each product retailed for less than $150.
Bringing your retail partner on board

CPGs cannot maximize their category value without their retail partners. However, sales forces sometimes find it difficult to move conversations beyond price and promotions. Manufacturers can overcome this challenge by understanding retailers’ needs and concerns, as well as by leveraging shopper insights and analytics to help them find solutions.

To start a value-management conversation, we recommend that CPGs jointly review a number of questions with their retail partners:

- Do we have a shared understanding of where our categories and brands are positioned on the value matrix for shoppers?
- Can we partner to move a category to a higher-value-added quadrant?
- Have we explored all opportunities to leverage our shared cost structure to enhance margins and deliver on shopper value needs?
- Have we optimized assortment based on the categories’ positions on the value matrix (for example, reducing complexity in “good enough” categories or maximizing availability in “total package” categories)?
  - Do retailers’ planograms match the value positioning of categories and brands?
  - Is marketing and promotional execution consistent with shoppers’ value needs?
  - Can we work together to develop promotions that focus on delivering category value to differentiate shoppers’ experience beyond price?
- Are we overpromoting some of the higher-value-added categories?
- Is the role of private label aligned with the category’s value positioning?

Sidebar 2. Trash-bag case study

Trash bags historically were a highly commoditized category with high household penetration, which severely limited growth through volume. Retailers treat this category as an important traffic driver and use private labels extensively. Nonetheless, trash-bag manufacturers found ways to partner with retailers to create category offerings in three quadrants of the value matrix:

- ‘Good enough’ quadrant. This quadrant is largely composed of private labels with twist ties (basic products that use the simplest closure).
- ‘Functionally focused’ quadrant. In this area, more secure closure options are offered (quick-tie closures and handles or drawstrings). Both brands and private labels are represented; there are also more premium-branded options that offer additional benefits, such as extra strength or scent.
- ‘Total package’ quadrant. In this quadrant, Glad provides premium options with additional benefits, such as unique strength and scent technology. It also provides environmental benefits, offering stronger bags with less plastic.

Five primary levers helped trash-bag manufacturers and retailers move into new areas:

1. A number of incentives enticed retailers to cooperate. Private labels were offered to provide an attractive proposition for price shoppers and to drive profits for retailers (because private labels have higher penny and percent margins than other brands); manufacturers counted on brands to drive top-line sales. The resulting category blended retail margins are 25 to 30 percent (above average for most grocery items).
2. Branded players made consistent, substantial investments in advertising.
3. The private-label price gap was strictly managed (20 to 25 percent).
4. The promotion strategy focused on frequency, visibility, and co-promotions, not on depth.
5. Manufacturers helped retailers understand the roles of brands in each quadrant and focus on category performance.
CPGs can excel if they go beyond low price and promotions. Understanding their position with consumers and customers will allow CPGs and their retail partners to use a common framework for maximizing category value. This framework can then become a basis for building in-depth category strategies (from assortment planning and pricing to the innovation agenda) and identifying CPG-retail partnership opportunities to grow.

Authors

Kari Alldredge (kari_alldredge@mckinsey.com) is a senior expert in McKinsey’s Minneapolis office; she can be reached at +1 (612) 371-3188.

Jayne Eastman (jayne_eastman@mckinsey.com) is a partner at HRCP, a wholly owned subsidiary of McKinsey & Company; she is located in New Jersey and can be reached at +1 (973) 549-6260.

Brian Lynch (blynch@gmaonline.org) is the senior director of business and industry development for the Grocery Manufacturers Association.

Alok Sharma (alok_sharma@mckinsey.com) is a partner at HRCP, a wholly owned subsidiary of McKinsey & Company; he is located in Chicago and can be reached at +1 (312) 551-7828.

Tanya Sivaeva (tatiana_sivaeva@mckinsey.com) is an associate principal in McKinsey’s New Jersey office; she can be reached at +1 (973) 393-5745.
Acknowledgments

GMA and McKinsey & Company would like to thank the following project steering-committee members:
David Arbanas, senior vice president, business development, Advantage Sales and Marketing
Scott Cameron, senior vice president, sales, Bumble Bee Foods
Tom Corley, president of sales, Kraft Grocery Company, Kraft Foods Global
Grant LaMontagne, senior vice president and chief customer officer, The Clorox Company
Bob Richardson, director of sales and customer and industry development, The Clorox Company
Bob Wallach, senior vice president, marketing and sales, Continental Mills

McKinsey & Company. McKinsey & Company is a global management consulting firm dedicated to helping the world’s leading organizations address their strategic challenges. With consultants deployed in more than 50 countries around the globe, McKinsey advises on strategic, operational, organizational and technological issues. For more than eight decades, the firm’s primary objective has been to serve as an organization’s most trusted external advisor on critical issues facing senior management.

Grocery Manufacturers Association. Based in Washington, DC, the Grocery Manufacturers Association is the voice of more than 300 leading food, beverage, and consumer-product companies that sustain and enhance the quality of life for hundreds of millions of people in the United States and around the globe. Founded in 1908, GMA is an active, vocal advocate for its member companies and a trusted source of information about the industry and the products consumers rely on and enjoy every day. The association and its member companies are committed to meeting the needs of consumers through product innovation, responsible business practices, and effective public-policy solutions developed through a genuine partnership with policy makers and other stakeholders. In keeping with its founding principles, GMA helps its members produce safe products through a strong and ongoing commitment to scientific research, testing, and evaluation and to providing consumers with the products, tools, and information they need to achieve a healthy diet and an active lifestyle. The food, beverage, and consumer-packaged-goods industry in the United States generates sales of $2.1 trillion annually, employs 14 million workers, and contributes $1 trillion in added value to the economy every year. For more information, visit www.gmaonline.org.