2013 Financial Performance Report
Growth strategies: Unlocking the power of the consumer
Based in Washington, D.C., 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 policymakers 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 the GMA Web site at www.gmaonline.org.

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Solicitation
The Grocery Manufacturers Association (GMA) and PricewaterhouseCoopers (PwC) are pleased to present our 2013 financial performance report and overview of the consumer packaged goods (CPG) industry.

Little did anyone realize five years ago that, even as the industry endured the financial crisis and subsequent recession, we were on the brink of a new age: the age of the digital consumer. Able to shop anytime and anywhere, willing to endorse or condemn a product in real time on social media, enjoying access to any number of shopping “channels,” the global consumer over the past several years has become incredibly sophisticated. For manufacturers and retailers, this presents both an opportunity and a challenge.

This year, then, we decided to focus our report on gaining greater consumer understanding and parlaying those insights into profitable innovation. Our articles range from basic questions of how much companies actually know about their typical customers to the ultimate measure of success: balancing operational excellence with innovation. We also touch on subjects such as consumer segmentation, the true nature of consumer loyalty, connecting with consumers on social media, and developing a successful direct-to-consumer model. Our hope is that our benchmarking data and articles will offer dual insights, showing what successful CPG companies are doing financially and how the best are getting to know their consumers.

We used a range of sources to compile our report (see Appendix A), but would especially like to thank the following executives, who participated in our interview process and whose insights appear throughout this report:

Bert Alfonso, The Hershey Company
Thomas Britanik, The Clorox Company
Mike Castle, Continental Mills
Joan Chow, ConAgra Foods, Inc.
John Gehring, ConAgra Foods, Inc.
Andy Heily, Continental Mills
Maria Henry, The Hillshire Brands Company
Dennis Hickey, Colgate-Palmolive Company
Tracey Joubert, MillerCoors
David Marberger, Godiva Chocolatier
Don Mulligan, General Mills, Inc.
Steve Robb, The Clorox Company
Henry Schirmer, Unilever
Bill Schumacher, Sunny Delight Beverages Co.
Steve Voskuil, Kimberly-Clark Corporation
Rick Zimmerman, Sunny Delight Beverages Co.

In addition, we want to highlight the extraordinary contributions of PwC team members Christine Hoyte and Tamara Beresky, who guided the development and refinement of all aspects of this year’s report.

We hope that you find the report insightful and useful. The GMA and PwC look forward to continuing our dialogue with you around these strategies, topics, and analyses.

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# Table of contents

**Executive summary: At last, it’s time for growth**  
Economic growth still moderate  
A top-performing company analysis  

**Section 1: Identify consumers and their changing needs**  
That was then, this is now  
Maximizing return on target segments  
Cultivating loyalists  

**Section 2: Connect and increase engagement with the consumer**  
Accelerating your social journey  
Collaborating with business partners  
Winning from within  

**Section 3: Focus on innovation that goes direct to the consumer**  
Redefining your core  
Balancing operational excellence with breakthrough innovation  
DTC by design  

**Financial performance metrics**  
Retailers and manufacturers  
Overall CPG industry: manufacturers  
Size-specific data: large, medium, and small manufacturers  
Size-specific data: very large manufacturers  
Sector comparison  

**Appendices**
Executive summary: At last, it’s time for growth
Do you know who and where your consumers really are?

In last year’s GMA Financial Performance Report, we focused on the demand chain, that portion of the value chain focused on driving customer interactions with a company’s brands and products. This year, we’ve decided to delve even further into customer demand—by honing in on the actual consumer. But the rub is that there’s no one best way to understand the consumer, nor has anyone yet figured out a sure-fire way to know exactly what consumers want.

In fact, generations of business leaders had ample reason to mistrust consumer sentiment. Gathering consumer data used to be a long and laborious process, and whether sourced from mature and developed markets or from new and emerging markets, the information was oftentimes already outdated before it could be put to use.

Today, though, customized metrics are able to measure everything from the number of Facebook fans to the reach and engagement of advertising campaigns. Facebook and other social networking sites such as Twitter have enabled brands to form direct relationships with millions of consumers—and even tens of millions for ubiquitous brands such as Coca-Cola. A full two-thirds of Internet users worldwide use social media, and many of those users, especially young people, welcome conversations with their favorite brands.

“Consumers today share much more readily with each other and with the companies than in the past,” says Bert Alfonso, President, International, for The Hershey Company. “Their input tends to be about your product’s characteristics and about what they like and don’t like. We see it in North America, China, Brazil, and in other markets which have a high penetration of both mobile and Internet usage. And that’s a rich body of information for companies, which is much more spontaneous and actionable than what you would have had in the past.”

Dennis Hickey, CFO of Colgate-Palmolive Company addressed this emergence. “How do you seize the opportunity of that newer technology? The challenge is that it is moving at light speed. The change is much faster than anyone ever thought it could be. And that’s changing the overall shape of the marketplace. How you interact with consumers both from the front end—reaching them, and then once you’ve got the consumer, how do you keep him? How do you communicate with that consumer?”

How does a company capitalize on the ephemeral relationship between consumer and CPGs, whether it be via a social networking site visit, a retail partner in an emerging market, or a purchase from a company’s website? This year’s report tries to answer that very big question with articles that focus on how manufacturers can better:

• Identify consumers and their changing needs
• Connect and increase engagement with the consumer
• Focus on innovation that goes direct to the consumer

Section 1: Identify consumers and their changing needs

Where the times and trends go, consumers’ incomes, needs, and desires follow. The difference is the pace.

In today’s environment, CPG companies have an enormous opportunity to weave innovative, connected, and personalized experiences that inspire consumers to become advocates for their brands. The challenge is creating experiences that respond to consumers’ changing preferences, while also creating brand value.

The articles in this section ask how well you, as an organization, know your target consumers. Our first article, “That was then, this is now,” addresses the emerging consumer landscape and follows an overriding theme of attaining growth through greater knowledge of the consumer. We start by looking at some macro-trends in the changing consumer landscape, discussing the emerging middle class outside of the US market and assessing the impact of the prolonged economic downturn.

In “Maximizing return on target segments,” we point out the importance of micro-segmentation of consumers. While this includes basic demographic information such as age and household income, it also drills down to uncover the deeper consumer influencers and the experiences consumers value.

The final article in this first section shines light on the often misunderstood concept of consumer loyalty. “Cultivating loyalists” distinguishes the run-of-the-mill points-based loyalty program from true consumer loyalty, a dynamic in which consumer brand advocates enjoy a strong cognitive and emotional association with the brand.
Section 2: Connect and increase engagement with the consumer

Understanding consumer behavior used to be fairly straightforward: Consumers bought stuff in stores. Maybe they bought different foods at different times of the year, and maybe there were several different price points, but purchasing consumer products in stores was pretty much a given. Before the full flourishing of the Internet age, consumers made more than 70% of their purchase decisions in-store. But today, consumers are bypassing the physical store for all kinds of products and information, which places a premium on developing the analytics to understand how consumers discover, research, purchase, and actually take possession of products. According to PwC’s latest global online shopper survey, 45% of consumers who follow brands on social media make an online purchase at least once a week, while 58% of that same group make one purchase in a physical store during the same time period. Though advances in digital technologies are prompting consumers to move more and more toward online purchases, they’re not there yet for groceries. Among survey respondents, more than 70% report that they prefer to research and buy their groceries in-store. But, time will tell.

The article “Accelerating your social journey” points out the folly of trying to respond to the evolving consumer by developing a “check the box” online presence. If social media becomes a checklist of discrete tasks centered on a company’s web presence, consumer engagement will be perfunctory, at best. This article also encourages companies to look at their own social media presence and web properties, examine their level of adoption, and then act accordingly.

The next article in section 2, “Collaborating with business partners,” acknowledges that the tried-and-true methods of manufacturer/retail collaboration have been upended by market dynamics. Sharing point-of-sale data is all fine and good, but along the value chain, housed in the systems of retailers, manufacturers, and suppliers, are consumer insights that can benefit everyone. But how do you break down the barriers?

Section 3: Focus on innovation that goes direct to the consumer

Our third and final section of this report completes the circle: Once companies know who their consumers are and how those consumers behave, how do those companies leverage innovation to develop products that speak directly to their customers’ wants and needs? The article “Redefining your core” proffers that traditional product road maps and planning cycles, while admirably getting increasingly efficient, have spawned entire industries of “me too” products. Solutions to this predicament, which we call “the tragedy of commonness,” include redefining core products with service innovations gleaned from—what else?—insightful consumer knowledge.

The next article in this section, “Balancing operational excellence with breakthrough innovation” points out that the development of breakthrough innovation should not be hindered by a company’s desire to maintain excellent operations internally. The article discusses how breakthrough innovation can come in many forms, and that it is incumbent on companies to develop an innovation strategy that drives its growth toward high advancements in innovation, all while continuing to focus on a lean, efficient business.

In “DTC by design,” we tackle an issue on the minds of many CPG companies: how to make the direct-to-consumer proposition work. This article explains how retailers may no longer own the last-mile relationship with consumers, as dynamics such as shopping and paying via smartphone and tablet are rewriting the traditional rules of retailing and manufacturing. And, since e-commerce is not the only way to enter into a direct-to-consumer relationship, the article reinforces that companies must remain attentive in seizing all opportunities to own the consumer.
Economic growth still moderate
The recovery is slowly gaining momentum, but lingering concerns remain

Overall, both the US and global economies are marginally stronger than they were last year, but neither is yet strong enough to allay persistent uncertainty about the future. “The US economic conditions are stabilizing and there are many measures that look like it’s gradually strengthening,” says Don Mulligan, CFO of General Mills. “The caution I have around that is that there are still a lot of potential pitfalls out there. And quite honestly, this is probably the third spring in a row where ‘the consensus economists’, if you will, have felt that the economy was stabilizing only to have some event take it off the rails later in the year.”

In the US, the federal government’s fiscal policy situation is still unsettled. The implementation of cuts associated with the recent sequester, along with other belt-tightening measures, could slow economic growth in the short run. Worse, they do not represent a long-term solution to the country’s lingering fiscal imbalances. In the European Union, continued market disruptions associated with the sovereign debt crisis remain a drag on growth.

The continued slow recovery has led to correspondingly modest growth for the CPG industry. Fundamentally, the industry will continue to face economic challenges for the foreseeable future, and growth will be at a premium.

Economic indicators are still below pre-recession highs
Within the US, many economic indicators moved in the right direction in 2012; however, many of the numbers have both good-news and bad-news components. For example, the country’s gross domestic product climbed approximately 2% (in real terms) in 2012, but that growth is still below historical norms. Over the past 30 years, the US economy has expanded by an average rate of 2.9% each year.

The labor market showed similar halting progress. Average monthly job creation numbers reached 183,000 in 2012, the highest level since 2005. At the same time, the unemployment rate remains elevated at 7.5%, and almost 40% of those unemployed have been without work for more than six months.
Economic growth still moderate
The recovery is slowly gaining momentum, but lingering concerns remain

Improvement in the US real estate market has been more consistent. In December 2012, housing starts were up 28% compared to December 2011, reaching their highest level since June 2008. But the depth of the housing crisis means that the market still has a sizable hole to climb out of. In March 2013, new home sales on an annualized basis were 417,000—18% higher than the level one year before, but 50% lower than the level in March 2007.

The combination of an improved labor market and a strengthening real estate market has helped boost consumer confidence. Again, however, the gains reflect modest progress at best. Both household spending and per-capita income grew in 2012, yet after adjusting for inflation, neither has returned to pre-recession levels (see Exhibit 1). Average real consumption per person in the US reached $30,562 in 2012, compared to $30,703 in 2007. By comparison, disposable income per person in the US reached $32,788 in 2012, which is below the 2008 high of $33,228.

Given the significance of household consumption to the US economy, improved consumer confidence could provide a boost to growth in 2013.

No post-recovery rebound (yet) for the CPG industry
Within the CPG industry, 2012 did not bring even the modest growth that the overall economy saw for the year. The total value of industry shipments in the US as reported by manufacturers reached $115 billion in August 2011 but has increased only slightly since (see Exhibit 2).

Exports by the industry continued to grow, but at a slower rate than in prior years. Between 2011 and 2012, total industry exports increased 8%, rising from $80.5 billion to $86.9 billion. By comparison, the average overall growth rate in exports over the prior five-year period was 12.8%. The slowdown was consistent across regions (see Exhibit 3).

The growth in exports to the NAFTA countries and the emerging economies exceeded the overall total, at 8.7% and 10.8% respectively. Growth in exports to developed nations (the EU, Japan, and Australia) and selected East Asian countries (China/Hong Kong, Taiwan, South Korea, and the Philippines) was slower than the overall average, at 3.4% and 7.4%, respectively.
The ability of emerging markets to generate reliable sources of growth will depend on their success in creating a new middle class of consumers. Between 2000 and 2011, the share of total employment earning less than the equivalent of US$1.25 per day fell from 26.6% to 12.9%, and this share is projected to fall to 8.7% by 2017. However, there is significant variation by region. For example, the share earning less than $1.25 per day in East Asia is estimated to fall to 1.7% by 2017, while the share in Sub-Saharan Africa is expected to remain above 31%.

**The drought contributes to elevated commodity prices**

One of the key issues faced by food manufacturers during 2012 was the continued rise in commodity prices. Much of CPG manufacturing is concentrated in the food and beverage segment, which relies on basic commodities as important inputs. Over the past several years, commodity prices have tracked upward, a trend that continued in 2012, primarily due to a drought that hit approximately 60% of US farms.

By the end of 2012, crude feedstuff costs had risen 45% above the level seen in January 2010. Specific commodity prices have risen even faster. Corn prices, for example, exceeded $7 per bushel in February 2013, compared to less than $4 in January 2010. Wheat prices have also increased significantly over the past two years, with average prices in February 2013 almost 60% higher than in January 2010. These price increases impact users of these products, such as livestock producers who use corn and grains as feedstocks.

“We think that meat commodities are long-term inflationary,” says Maria Henry, CFO of The Hillshire Brands Company. “It’s our expectation that our input cost will continue to rise. Given what happened with the drought last summer, our expectation is that they will rise throughout 2013.”

“We last two decades, commodities have been pretty stable—up until the last five or six years,” says Bill Schumacher, CFO of Sunny Delight Beverages Co. “For most of that time, people have focused on driving volume in the marketplace. Now you have to find that balance between volume and pricing in terms of how you drive revenue, to deal with some of the inflationary impacts over the last four or five years. We’ve developed much more robust hedging programs with respect to packaging and some of our other raw material costs. In the past, we were probably more in the six-month range on a lot of our key commodities. Because of the volatility recently, we’ve shifted to buying as far out as 9 to 15 months on our commodities.”

There is a limit to how much of these raw material increases the consumer is willing to bear, and as a result the industry has seen a large and growing gap between the prices they must pay for raw materials and the prices they can charge for finished goods (see Exhibit 4).
Only recently—primarily at the end of 2012—have prices charged in later points along the food chain started to rise. It appears that increased commodity prices are driving manufacturers to increase prices along the distribution chain.

“The big impact that the economy has on us is on our input costs,” says Mike Castle, CFO of Continental Mills. “We buy 250 million pounds of flour and 150 million pounds of sugar and the prices of those commodities are driven by a lot of economic factors. Our profitability is highly reliant on commodities, so we do pass on commodity cost increases to the extent that the marketplace will absorb it. Unfortunately, however, you can never recover all the costs.”

The impact of the drought will likely linger throughout 2013, during which time the US Department of Agriculture expects most of the price increases for consumers to appear. As a result, pricing pressure along CPG company supply chains will also continue throughout 2013.

**A bifurcated recovery**

Some in the industry describe a bifurcated recovery, in which affluent consumers are still spending and growth is coming at the lower end of the income spectrum as well, provided operators can tailor low-cost offers for price-conscious shoppers. In other words, within the US, there is little growth in the middle.

The continued strength of a company like Godiva Chocolatier is evidence of this trend. Despite a very shaky economic recovery, the company’s sales are growing faster than GDP expansion. “Comp store sales, which is a key barometer for us, have been growing positively,” says David Marberger, CFO of Godiva. “We’re a premium product, and when people buy chocolate they’re willing to pay a premium price.”
The forecast for 2013: more of the same

The risks to US economic expansion that have been a recurring theme in this report over the past several years are unlikely to change in 2013. The US federal government budget remains a source of significant uncertainty, European governments continue to deal with the sovereign debt crisis, and instability in sensitive regions of the world could imperil emerging-market growth prospects.

As a result, current projections call for modest economic growth in 2013. Government forecasts show real economic growth of approximately 1.5%, partially as a result of the budget sequester. Private sector projections show growth closer to 2%, but many assume that the sequester will be reversed and have factored that into their estimates.

One bright spot is that even with its current challenges, the US economy is still performing better than other developed economies. “We remain cautiously optimistic that the US economy is moving in the right direction,” says Don Mulligan, CFO of General Mills. “It may not be firing on all cylinders, but it’s in the strongest shape of any of the developed markets. And as long as that’s true, it’s going to get more than its fair share of investment.”

Other industry executives agree. “We think that the US is an attractive place to invest,” says Henry Schirmer, CFO of Unilever North America. “It will probably be one of the biggest global GDP generators for the foreseeable future—and therefore overall we are positive about the US.”

In the face of a tepid economic expansion, CPG companies will have to continue to search out new markets for their products, in order to drive top-line growth. Modest but stable growth in the developed countries, especially the US, will provide a relatively steady source of demand, compared to the potentially high but volatile growth in the emerging markets. And given continued high commodity costs and pricing pressure, companies must find ways to increase the productivity of their manufacturing processes, to minimize costs.

The impact of the sequester

In March 2013, the US federal government implemented a budgetary sequester that reduced funding for many programs by an average of 8% across the board. Estimates suggest that such measures could throttle back economic growth by approximately 0.5 to 0.7 percentage points.

Much of the sequester’s impact has been concentrated in government discretionary programs, which are funded on a year-to-year basis. The largest entitlement programs were either exempted from the cuts or subject to far smaller cuts. In the longer term, however, these are the programs that will drive future deficits. Thus far, policymakers have not been able to find consensus on whether or not (or more specifically, how) to reform entitlement programs in the US, though most economists agree that the projected growth of the deficit in the US will continue to hamper economic growth if left unaddressed.
As the economic recovery slowly gathers momentum, CPG companies still face a number of issues that impact both internal operations and the demand for their products. Commodity prices are more volatile than in the past (though long-term trends are clearly moving higher) and the Eurozone region continues to suffer through a prolonged debt crisis, crimping consumer confidence in the region and potentially impacting US CPG exports. In the US, the recent sequester could stifle the country’s economic expansion, which has been lukewarm thus far due largely to persistently high unemployment levels.

Even with such uncertainty, however, some companies managed to outperform the pack. Despite industry sales that were essentially flat for the year, these companies are still growing both sales and operating profits ahead of the overall industry, generating solid margins, and delivering returns to shareholders. A key part of their performance came through building ties to the consumer, in ways that strengthened their brands and their financial performance. Something separates these top performers from their more ordinary peers and, as in previous years, we set out to discover the reasons behind this divide.

**PwC’s performance ranking**

For this year’s analysis, we examined CPG companies using a variety of financial metrics (see Appendix A). We gathered and reviewed publicly available data on a total sample of 144 CPG companies. We then sorted 53 large and very large companies into performance quartiles, and analyzed the results to find the common characteristics linking highest-ranking companies in those areas during 2012 and how those characteristics have changed over the past five years.

We avoided measuring companies primarily on shareholder return. This standard corporate barometer, while obviously important to investors, is relatively narrow. Instead, we took a more balanced approach by assigning scores to the 53 companies based on their relative performance across three fundamental metrics:

- **Economic profit spread**, which is based on return on invested capital (ROIC) and the weighted average cost of capital (WACC)
- **Return on assets**
- **Free cash flow relative to sales**

With the data segmented along these lines, we compared groups of the ranked companies across many different financial indicators, including growth, profitability, liquidity, and leverage. We were particularly interested in looking at the top quartile (best performers) versus the bottom quartile (weakest performers) to isolate the specific business drivers that might better explain such a sizable difference in their relative performance.

Of the 13 top-quartile companies, seven are in the household products sector, three are beverage companies, and three are food companies. The dominance of the household products sector is a change from 2011, when the distribution of the top-performing companies between sectors was more even. Our analysis reveals that in 2012, the top performers were distinguished from the bottom quartile in the following areas:

- **Gross margins**, which remained significantly stronger among top performers than among companies in the bottom quartile
- **Spending on strategic selling, general, and administrative (SG&A) expenses**, which remained relatively flat in the top quartile while decreasing in the bottom quartile
- **Operating profitability**, which remained consistent for our top-performing companies

In addition to our index of the large and very large top performers, we applied a similar scoring methodology to the medium- and small-company segments. As we contrast the performance of the top and bottom quartiles for our large and very large top performers, we will highlight outcomes for medium and small players only where there is a significant difference.

**Net sales growth slowed for both top and bottom performers**

Notably, while net sales had been inching back up following the recession, both top- and bottom-performing groups experienced a slowdown in net sales growth in 2012. Sales growth for top performers contracted to 3.2 % (meaning that overall sales increased but at a slower rate than in the past), while sales growth for bottom performers contracted by 2.5%. As a result, the spread between both groups shrank
A top-performing company analysis
Breaking down the CPG sector’s top-performing companies (TPCs)

as well, from 4.2% in 2011 to just 0.7% in 2012 (see Exhibit 6). Top performers have shown more stability over the years, as the rise and fall of net sales growth for that group has not seen as steep of a change as it has for bottom performers. Nevertheless, the fact that both continued to show growth is consistent with overall industry performance and broader economic trends. The slowdown in GDP growth in 2012 appears to have slowed industry sales.

Net sales is a combination of both volume and pricing, and some in the industry believe that the industry may be through the worst of it. “Our industry experienced a spike in inflation in late 2011 and 2012,” says General Mills CFO Don Mulligan. “We all have very active productivity programs, but when you have inflation in the high single digits or even low double digits, that can’t be offset with just productivity. So that led to pricing increases in the mid single digits across the majority of categories. And as a result, the industry actually saw a drop in volume. People found ways to economize, to actually consume less or to use it more efficiently. But in the past six months, the industry has worked through that, pricing has normalized, and we’ve seen volumes rebound and turn positive again.”

High commodity prices continued to put pressure on the industry’s price structure throughout the year, which will affect the volume of sales if price changes become too dramatic.

Despite the contraction in net sales and commodity price pressure, both top- and bottom-performing companies increased their gross margins. Top performers increased margins by 0.75 percentage points, and bottom performers by 1 percentage point, effectively narrowing the gap between the two (see Exhibit 7). For the bottom group in particular, this represents a rebound from 2011, when gross margins dropped 1.6%. The reluctance of consumers to jump into the market with both feet likely has limited growth amongst these groupings.
Gross margins for the top- and bottom-performing companies amongst the medium and small companies easily fit between the large and very large top- and bottom-performing companies, with gross margins of 44.5% and 33.6%, respectively.

**A look at the generation of cash flows and debt**

Looking at the median free cash flow to sales (see Exhibit 8), there is still a large gap between our top and bottom performers: 15.9% cash flow to sales for the top performers versus 4.4% for the bottom quartile. This tells us that the top performers are continuing to generate more cash and are holding on to their cash. When looking back at 2011’s results, however, we can see that the bottom-performing companies are closing that distinctive gap with the top performers.

For 2012, the gap in median free cash flow to sales for the one-year, three-year, and five-year is 11.5, 11.3, and 10.6 percentage points, respectively. All of these levels are below those of 2011, when the smallest gap noted was 11.8 percentage points (for the one-year free cash flow to sales).

Also interesting to note is the fact that in last year’s report, the gap between the top and bottom performers widened from 11.8 percentage points to 13.2 and then 13.6 for the one-year, three-year, and five-year, respectively. This year, we have seen the complete reverse. Bottom performers are starting to hold on to their cash, almost doubling the ratio for the five-year metrics. This could mean that the bottom performers are ready to start making more investments in research and development (R&D) and marketing to launch new products and position themselves for any other turns the economy might make as it plods toward a full recovery.
A review of the median interest coverage ratio and debt-to-equity ratio (see Exhibits 9 and 10) shows consistent trends compared to the prior year. For the median interest coverage ratio, the top performers continued to hover at 9.6% while the bottom performers held steady at 4.9%. Looking at the debt-to-equity ratio, the gap between the top and bottom performers continued to stay close, with a ratio of 1.1 for the top performers and a ratio of 0.7 for the bottom performers. Both top and bottom performers are maintaining their balance of debt to equity and their ability to cover interest payments; however, going forward, bottom performers should identify ways to increase their interest coverage ratio and position themselves with the ability to cover their debt expenses at the same level as top-performing companies.

**A growing gap in SG&A spending**

In 2012, SG&A spending in the top quartile remained essentially flat, while in the bottom quartile it decreased by 1% (see Exhibit 11). This continues a trend from prior years, in which bottom-performing companies have scaled back spending and top performers have held steady—perhaps because they have the financial resources available to continue reinvesting in the business through R&D, innovation, marketing, and other initiatives that drive future growth.

What is also interesting to note is that both the medium and small top- and bottom-performing companies had a higher percentage of SG&A spending when compared to sales. One might conclude that these are the companies making the real investment in R&D and innovation for growth.
Taking a closer look at R&D, for our large and very large top-performing companies, the average R&D to SG&A percentage for 2012, 2011, and 2010 was 12.2%, 11.8%, and 11.7%, respectively. For our bottom-performing companies, the average R&D to SG&A percentage for 2012, 2011, and 2010 was 5.5%, 6.1%, and 6.1%, respectively—significantly lower than their top-performing peers. While both the top- and bottom-performing companies had a slower net sales growth this year, the bottom-performing companies had a greater decline in net sales growth compared to their top-performing peers, so perhaps this is an instance where top-performing companies are seeing greater return on their investment for developing new products.

Given that economic growth is still not what it used to be, this is an important factor. Steve Robb, CFO of The Clorox Company explains: “One of the biggest lessons we’ve learned during the recession is that providing consumers with meaningful innovation is the key to reinforcing the value proposition of our brands. Today, economic recovery continues to be bumpy and consumers are still cautious with their spending, but we’re seeing that she’s willing to buy products that provide real value—particularly if it’s from a brand and company she trusts.”

Many companies are embracing the need for product innovation as well as understanding consumer and market needs as part of their R&D activities. For example, as noted in Diageo plc’s 2012 annual report, “Innovation forms an important part of Diageo’s growth strategy, playing a key role in positioning its brands for continued growth in both the developed and emerging worlds. The strength and depth of Diageo’s brand range provide solid platforms from which to drive innovation, while insights into shopper trends and changing consumer habits inform product and packaging development.”
A top-performing company analysis
Breaking down the CPG sector’s top-performing companies (TPCs)

The cash conversion cycle amongst the top- and bottom-performing companies within our small and medium manufacturers revealed longer cycles. The bottom-performing companies within the mix have a cash conversion cycle of 70.6 days, almost two-thirds higher than our top-performing quartile in Exhibit 12. This shows that these companies’ cash may be tied up in operations such as payments made for materials and labor. Reducing this number might allow for cash to contribute to other strategic decisions within the company.

A deeper look at profitability
The gap in profitability, already large, grew even wider this year. An analysis of earnings before interest and taxes (EBIT) growth shows that the top performers are more efficient than the bottom. The median company in the top quartile experienced EBIT growth of 6.0% in 2012, while the median company in the bottom quartile saw the rate of growth fall to negative 26.0%. As a result, the overall gap between the two is now at 32.0%, as shown in Exhibit 13. The margin is more volatile for the bottom-performing companies. The rebound in growth in 2010 is partially attributable to the significant drop in 2009, but these companies saw negative growth in 2011 (when several were plagued with large impairment charges) and 2012.

Looking at the net operating profit after tax (NOPAT) margin, as shown in Exhibit 14, our top performers’ margin hovered around 15% for the five-year period, while the bottom performers’ margin ranged between 2% and 5%. Consistent with our findings from prior years, a possible explanation of the gap between the top- and bottom-performing companies may be that the best-performing companies can manage tax rates more effectively through international expansion.

Exhibit 13
TPC median EBIT growth

Exhibit 14
TPC median net operating profit after tax (NOPAT) margin

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.
**Shareholder return**

Shareholder return was similar for the top- and bottom-performing companies in 2012, but the top companies have been able to provide positive returns consistently, while the bottom-performing companies have not (see Exhibit 15). US financial markets have grown as the US economy emerges from the recession and investors began looking for domestic investments in light of the global economic situation.

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**Exhibit 15**

TPC median shareholder return

<table>
<thead>
<tr>
<th>5-year</th>
<th>3-year</th>
<th>1-year</th>
</tr>
</thead>
<tbody>
<tr>
<td>14.2</td>
<td>12.5</td>
<td>10.9</td>
</tr>
<tr>
<td>7.2</td>
<td>-0.8</td>
<td>-7.5</td>
</tr>
</tbody>
</table>

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.
Section 1
Identify consumers and their changing needs

The past five years have seen the rise of the empowered digital consumer. Armed with the ability to shop anytime, across both physical and virtual channels, and with the power of social media amplifying their opinions, consumers are no longer passive receivers of goods and services. Instead, they’re vested partners in the process of satisfying their wants and needs.

This new paradigm creates enormous opportunity for CPG manufacturers and retailers, but to meet that opportunity, companies must take a holistic approach to creating brand value, identifying and connecting with their target consumers to create innovative, personalized shopping experiences. Finding those consumers is the first step, whether they reside in traditional demographic segments, in established or emerging markets, or in segments linked by common attitudes, lifestyles, or shopping behaviors. Once these target segments are known, companies can set about using vehicles such as loyalty programs to align the strengths and features of their brand with the new segments, building a stronger emotional connection between the brand and the consumer.
That was then, this is now
How are consumers changing?

Just as they have always done, consumer profiles, buying behaviors, and demographics continue to shift. During the 2008–09 recession, two-thirds of shoppers changed their behavior. At the same time, other disruptions also added to the complexity of the new business environment—for instance, the explosive global growth in the production of data, expected to jump from 2.7 zettabytes in 2012 to 7.9 zettabytes in 2015 to an estimated 35 zettabytes in 2020.

But the new ways of working also allow CPG companies to influence consumers, drive demand, and reduce risk. For example, quick, automated pattern recognition around complaints due to a product failure will soon allow companies to detect, track, and address the problem in a fraction of the time that is typical today.

In the highly dynamic and increasingly polarized marketplace that is evolving, recession-trained consumers will shop for value, often in stores with no physical footprint. Those brick-and-mortars that do exist will likely be smaller, carrying a more targeted assortment of goods, and all brands will need to find ways to cater to consumers at the ends of the economic spectrum.

Understanding the new consumer is the first step. Once CPG companies gain those insights, they can innovate to create offerings that represent the value of their brand. The more successful companies will figure out what the new consumer wants and needs, then structure their organization to deliver it.

As consumer profiles evolve and fragment ...

As communications technology has evolved over the past seven decades, consumer profiles in the US have similarly undergone dramatic evolution (see Exhibit 16). Current trends and US Census Bureau projections indicate that the coming five years will likely see strong polarization of income, age, and other demographic brackets.

According to data from the US Census Bureau and the Organisation for Economic Co-operation & Development (OECD), the US is the most income-polarized developed economy in the world (see the sidebar “Polarization of the US economy”). By 2020, we expect higher-income families to control 75% of all income earned (compared to 68% in 1970), a concentration that will further impact both middle-income and low-income consumers.

Joan Chow, Chief Marketing Officer of ConAgra Foods, Inc., notes other big changes in US consumer profiles: “If you look at the overall US demographics, there is a lot of talk about millennials, and we also know that boomers will continue to be a very big segment of the population for the next at least 20-plus years. And there are more multigenerational and multi-racial households. Marketers need to look beyond old ideas of what the ‘traditional family’ is, because there’s no ‘one’ consumer anymore.”

Consumer demographics in the country are diversifying, in part because the generations of Hispanic and Asian immigrant children born during the late 1990s and early 2000s are growing up. These emerging consumers, who will soon represent 25% of the US population, are beginning to demand that key elements of their heritage (e.g., music, food, language and literature, celebrations and holiday traditions) be woven into their shopping experience. Simultaneously, Americans over 65—who will make up a large percentage of the population—will likely want to “preserve” what is familiar to them and retain their existing culture.

Technology has empowered consumers, many of whom are perpetually rather than occasionally connected. Indeed, digital is how today’s customers discover, engage, and transact with brands. The shopping journey will never be the same for consumers with smartphones in their hands.

Product packaging can communicate directly with smart devices, for example. Personalized and tailored promotions can be triggered by a shopper’s physical presence. Usage suggestions derived from social media groups provide product information in the last mile prior to purchase. And pricing will soon be fluid, influenced by the interaction with the consumer as well as rewards or special deals offered in real time to close the sale.
Growth strategies: Unlocking the power of the consumer
**Exhibit 16**
The evolution of communication and engagement

<table>
<thead>
<tr>
<th>Decade</th>
<th>National average wage</th>
<th>National population estimate (in millions)</th>
<th>Communication &amp; engagement evolution</th>
</tr>
</thead>
<tbody>
<tr>
<td>1940s</td>
<td>$1,368$</td>
<td>139,678</td>
<td>Commercial television created</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Radio becomes #1 lifeline</td>
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<td></td>
<td></td>
<td></td>
<td>Local newspapers remain an influence</td>
</tr>
<tr>
<td>1950s</td>
<td>$3,341</td>
<td>164,744</td>
<td>Television becomes the dominant mass media</td>
</tr>
<tr>
<td>1960s</td>
<td>$4,763</td>
<td>192,499</td>
<td>Beginning of the consumer movement (Nader)</td>
</tr>
<tr>
<td>1970s</td>
<td>$8,510</td>
<td>215,026</td>
<td>Technology explosion begins with VCRs, email, and barcode scanning</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Sony Walkman is introduced</td>
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<tr>
<td>1980s</td>
<td>$16,420</td>
<td>236,963</td>
<td>Cable TV is created</td>
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<td></td>
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<td></td>
<td>IBM PC is introduced</td>
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<tr>
<td>1990s</td>
<td>$25,004</td>
<td>261,351</td>
<td>World Wide Web (www) created</td>
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<td></td>
<td></td>
<td></td>
<td>Home PC adoption passes 50%</td>
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<td></td>
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<td></td>
<td>Mobile phones gain wide popularity</td>
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<td></td>
<td>Wireless technology standardized</td>
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<td></td>
<td>E-commerce emerges</td>
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<td></td>
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<td></td>
<td>• Amazon (1994)</td>
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<td>• eBay (1995)</td>
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<td>• Paypal (1998)</td>
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<td></td>
<td>Search engines created and vie for popularity</td>
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<td></td>
<td></td>
<td></td>
<td>(Google, Yahoo!, etc.)</td>
</tr>
<tr>
<td>2000s</td>
<td>$36,610</td>
<td>294,366</td>
<td>Technology becomes personal:</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• Social media (MySpace, 2003; Facebook, 2004; Twitter, 2006)</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>• Video sharing (YouTube, 2005)</td>
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<td>• Crowd sourcing (Groupon, 2008)</td>
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<td>- iPod (2001)</td>
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<td>- iPhone (2007)</td>
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<td>- iPad (2010)</td>
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<td></td>
<td></td>
<td></td>
<td>• Smartphones</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>• RFID</td>
</tr>
</tbody>
</table>

Source: PwC.
Globally, the changes in consumer profiles are no less significant (see the sidebar “Global shifts in consumer profiles”). The result is a new consumer paradigm: The consumer base of 2020 will be significantly different from that of 2013. The global middle class, for example, will nearly double (76% increase) between 2009 and 2020. The Asia Pacific region’s share of the global middle class will increase from 28% to 54%, while the European share will decrease from 54% to 32%.28 As these shifts occur, complex demographic markets of consumers will emerge that cross national and cultural boundaries.

A far broader and more informed consumer base around the world will place greater tension on the base commodities needed to support rising consumer expectations. Increasing demand will put a strain on global commodity prices. The result will be further deepening of the divide between the haves and have-nots, as well as further fragmentation of consumers’ decision-making relative to needs/wants and price/value.

**Global shifts in consumer profiles**

The digital world has eliminated many of the barriers that once separated populations in different countries. Culture, as opposed to country of residence, will be the more dominant demographic going forward. As these country barriers—including language—become less of an issue, we’ll see more blending of these cultures. The digital world will be an increasing vehicle to drive and support that blending. Physical, legal, and governmental boundaries will remain, but that will affect the execution aspects (people, place, and promotion) rather than the consumer aspects (product and price).

**... so do their behaviors**

The net result of changing consumer profiles is a set of new consumer behaviors that are likely to remain in place for the next few years, particularly given the modest economic recovery.

It is hard to mass-generalize today’s consumers because they are all moving in different directions. This is the crux of the challenge that CPG brands now face. One size no longer fits most consumers. We can, however, identify three trends in behavior that cross these fragmented consumer segments:

1. **Consumers are easier to influence—but not by mass marketing.**
   
   It takes milliseconds now for consumers to send and receive messages and comments with the potential to influence the behavior of brands and other consumers. Purchase decisions are now more influenced by this flood of data shared among peer groups and strangers than by mass marketing. Further, unless a message comes from a trusted source without an “axe to grind,” it has a hard time being heard above the cacophony of competing conversations in digital channels.

2. **Consumers are hunting for value.**
   
   People are less willing to pay on impulse and more willing to hunt for “value” as they define it.

   “How you reach the consumer, how you interact with the consumer, is completely different,” says Colgate-Palmolive CFO Dennis Hickey. “The consumer today is more discerning, they are seeking greater value; however, value does not always mean lowest price. Consumers are willing to pay more for those products that meet their specific needs or desires.”

   Consumers are making purchase decisions for themselves based on far more information than they had in the past. In addition, they are increasingly distinguishing between what they need and what they want, and they are placing a specific price/value relationship on each category.
That was then, this is now
How are consumers changing?

Polarization of the US economy

The impact of polarization on the CPG industry is widely recognized. Here is a sampling of the commentary we’ve been hearing.

“Consumers are much more price and value conscious. Five years ago, we didn’t have much impact in the value segment. That segment has gone from basically zero to 15–20% of our business, forcing us to ensure we had product offerings suitable for those channels in terms of pack size and price point. We wanted to be sure we held on to our consumer base, and this was a way to do that.”
— Bill Schumacher, CFO, Sunny Delight

“Consumers are holding true to our products because of the nature of our products. For $3 or $4, you can buy a box of Ghirardelli brownies and have a wonderful treat for your family without a significant economic sacrifice. There is still a lot of value in the purchase for the individual, and when they’re making those rationalizations in the grocery store, those aren’t necessarily the things they’re giving up.”
— Mike Castle, CFO, Continental Mills

“There is a big trend in value but also into convenience. Trust is also a trend that crosses everything. Sometimes the same consumer will spend an enormous amount of money on a premium service and the next second goes for the value pack somewhere.”
— Henry Schirmer, CFO, Unilever North America

“Unemployment is high, but we’ve seen a shift to premium or super-premium in the alcohol category. That beer drinker may be drinking a cheaper alcoholic beverage at home and a more expensive product on-premise in order to make an impression. And on the other end of the scale, consumers are looking for higher alcohol content so they can buy one beer instead of two. We are shifting our portfolio into that above-premium market to give our consumers a variety of experiences at the higher end.”
— Tracey Joubert, CFO, MillerCoors

“I think consumers really think about wants versus needs now,” says John Gehring, CFO of ConAgra Foods. “We see a pattern where they’re really trying to save on some of the needs so that they can have some of the wants. We see people stretching their food dollars more than ever, so they can afford things like smartphones.”

Consider this example. In some cases, consumers won’t purchase an offering if it is discounted—they question the value of a luxury product if it is marked down lower than a comparable premium brand, concerned they will be perceived as cheap. Such a purchase also may not enhance their satisfaction in rewarding themselves during “tough times.” Conversely, consumers sometimes defer purchases unless there is a visible discount because they choose never to pay the list price. In these situations, they are attempting to avoid buyer’s remorse and/or avoid appearing uninformed relative to their peer group.

If we consider the hierarchy-of-effects model (awareness, knowledge, liking, preference, conviction, and purpose), consumers will establish their preference/conviction with more time/planning and more information, but emotion will still drive the final purchase decision.

3. The buying journey will continue to evolve, shaped by digital information sources and consumer investment in brands.

Consumers now expect to participate and make a difference in brands. They expect brands to present a single truth—the essence of the brand—across every channel, 24/7. Through social networks, consumers are for the first time interacting with brand employees who in the past had no customer-facing role. These interactions have more influence on consumers’ experience of a brand than the brand’s official marketing messages.
Companies must adapt quickly to win in this highly polarized world

To begin addressing these trends in consumer profiles and behaviors, CPG companies need to personalize their messages for a fragmented collection of markets, locate potential for growth and influence, build their sensing capabilities, create connected experiences for consumers, and find new ways to innovate by leveraging consumer creativity.

Personalize messages for a highly fragmented collection of markets

Micro-markets are the new reality; the days of “stack it high, let it fly” are in the rearview mirror. Brands that can tease apart the dozens of micro-markets in a Super Bowl audience, or all of the different influence points in a consumer lifestyle journey, are on the right track. Ideally, companies should work toward an ability to segment the market so finely that each consumer becomes a market of one.

In this environment, CPG companies must build the organizational muscle to dynamically identify and interact with individual consumers and/or small groups of consumers. For example, they need to price dynamically and present offerings based on sensing a consumer’s physical presence or digitally expressed interest.

Locate potential for growth and influence

In this global economy, many brands operate country-by-country, region-by-region, where they have opportunities for growth and influence. They must decide which markets they are pursuing and align the enterprise accordingly. Those decisions cascade across the company, from new product development, to packaging, to marketing spend, to how companies merchandise stores.

Micro-merchandising has a very significant geographic spin. The target demographic in one city might like a particular size and color combination for a product, while consumers in a different city might like a completely different combination. Companies may also consider how the cost of its products affect the target demographic.

“There is a willingness to spend on the high end and the low end,” says Dennis Hickey, CFO of Colgate-Palmolive. “But you don’t want to be only in the middle. For us, that means we are looking at appropriate offerings at all price points.” To service and connect with a higher number of smaller, often virtual markets, companies will have to be more agile and more collaborative. They will also have to be able to more quickly “connect the dots” internally in order to service customers properly.

Build sensing capabilities

Micro-marketing requires a company to narrowly define a particular audience by a particular characteristic and tailor campaigns for that segment. Micro-merchandising requires modeling and profiling at the individual consumer and store level, as opposed to targeting the average. Analyzing, planning, and executing at this level can be significantly more expensive if not aided by advanced technologies for sensing, in-memory computing, and predictive modeling.

Digital consumers use public search engines as the starting point for discovery 88% of the time. Social channels may prove very influential to the consumer during the purchase decision-making process.

Using readily available social listening tools, CPG manufacturers and retailers can explore what is relevant, trending, and potentially disruptive in the online ecosystem. By integrating this information with new innovation capabilities, planning, and analytics, companies can grow more agile in meeting emerging consumer needs. The key is to not try and sense everything, but instead be choiceful and focus on those products, categories, or consumer types that are most relevant to the brand."
Create connected experiences

Consumers are no longer buying individual products or services; they are buying experiences. While functionality and needs are the price of entry to the purchase decision, CPG companies and retailers need to start working through their categories one by one, figuring out how to:

- **Weave consistent, targeted experiences across all channels within a buyer set.** Connected consumers are more focused on connectivity and relationships. Because buyers interact with brands and stores on the web, on mobile devices, and in person, it is critical to present a consistent brand promise and deliver consistent value in person and digitally.

- **Leverage technology.** There simply are too many consumers connected in too many ways to do things as they have been done in the past. To make better decisions faster, companies need to generate insights through the appropriate use of data capture, analytics, and other technologies, and communicate those messages to consumers across different touchpoints.

- **Integrate consumer insights across the enterprise.** Consumers have always been at the heart of the value chain, but now, with increased connectivity, analytics, and communications, consumer preferences are being integrated in new functional areas. Finance can follow stock trending, for example, Supply Chain can react to rapid shifts in consumer needs, and Marketing can listen for new trends and shift consumer communications to new geographies and channels.

Find new ways to innovate by leveraging consumer connectivity

Companies have worked hard to harvest the ideas of employees and customers. Historically, focus groups and surveys were the primary mechanism used to drive the ideation and collaboration process, but this approach was costly, time consuming, and incomplete at best. Some would say that it was too “managed” and therefore lacked the spontaneity of creation.

Technology (e.g., blogs, social media, content and knowledge management) now makes idea harvesting seamless and natural. Collaboration can be unrestricted, even asynchronous. Companies are deciding what role they will play in this process—whether the dialogue is passive (deductive) or active (directed)—and how they will create new innovation operating models (see “Balancing operational excellence with breakthrough innovation”).

Consumers in control

Decades ago, most consumers were forced to select from the physically available assortment of products. Retailers, manufacturers, and the related logistics determined the choices available. Over time, consumers gained more choices as new highways removed the major barrier of proximity.

The shift to the digital world of retailing began in the late 1970s. Now the consumer’s digital ability and appetite has become a demographic characteristic that must be considered by all consumer product manufacturers and retailers. These companies must know their consumer segments well enough that they’re able to tailor their brand experience to satisfy customers’ digital and physical demands at the micro-market level. The decision of what to buy is now firmly in the hands of the consumer.

Additionally, consumers maintain membership in and communicate with multiple demographic groups simultaneously, and at digital speed. They determine assortments, influence what will be manufactured, and determine how it will be packaged. Companies’ ability to work at a very granular level of detail and at increasing velocity will influence all measures of success. Equally important, the imperative to sustain that success will require constant innovation to maintain alignment of the experience and the expectation.
Could a low-income mom in San Francisco, a 20-year-old man in New York, and a wealthy man in St. Louis all want the same thing? The answer, undoubtedly, is yes. However, these consumers would never fall into the same group if a company were applying traditional segmentation methods.

Many companies have relied on traditional techniques of solely using demographics such as gender, income, and location to drive their segmentation. While basic demographic data is a reasonable first cut at profiling consumers, companies relying exclusively on this approach fail to answer critical questions around where a consumer shops, what she values, and what she buys. As a result, these companies are leaving money on the table.

To craft the kinds of custom-tailored experiences that consumers now demand—and will pay more for and stay loyal to—companies are beginning to reach a finer-grained understanding of their segments’ attitudes, needs, and behaviors. They must know their consumer segments better than their competitors do.

“That’s always been our focus,” says ConAgra CMO Joan Chow. “Starting with the behavior and then let’s learn more and more about what motivates that person and how they consume media. For example, are they more into word of mouth? It all depends, but it all starts with that behavior-based targeting.”

As Henry Schirmer, CFO of Unilever North America, explains, “We have marketers who live with families for weeks, going shopping with them, understanding what drives them. Why are they shopping differently? Is it the end of the month or the beginning of the month? What do they do when the kids have birthdays? We are seeking a very deep consumer understanding.”

Cross the hurdles …

Why do companies struggle with the process of moving beyond basic segmentation? First, it is easy for employees to visualize themselves as consumers and therefore to assume they understand the needs and motivations of target segments. This fallacy is common in traditional businesses even though the dynamics of these marketplaces are changing. For example in the boat business, women have an increasingly large influence over purchase decisions—yet executives in this industry are primarily still men.

Second, while the proliferation of data provides opportunity, looking for qualitative characteristics in mountains of data is daunting. Crunching data (e.g., how old is the consumer? what is her zip code?) is easier and quicker, but the results do not yet create a detailed picture of that consumer. In order to gain insights from unstructured data, companies must have a clear understanding of what they are looking for and how it will fit together.

Finally, many companies perceive segmentation as a one-off exercise, believing that once you have your segments, you are done until you move into a new market. Consumer dynamics and expectations, however, are volatile, and therefore so are their attitudinal profiles (see “That was then, this is now”). Companies need to re-evaluate and validate segmentation on a routine basis, scheduled as appropriate depending on the level of change in the category.

… to reap the benefits

“Experience segmentation” identifies the quality of emotional engagement consumers want from a brand. What companies learn through experience segmentation can be used to create high-value, coherent experiences, weaving together consumer touchpoints in merchandising, product innovation, servicing, and more.

Andy Heily, SVP of Marketing and Sales at Continental Mills, shares one experience his company’s consumers value: “It’s the overall sense of wellness consumers have when they buy our product, which includes feeling like they’re buying from a company that has high uptakes and makes positive contributions to communities, that does the right things up and down the supply chain. And, the product has to be out of this world from a quality standpoint. And it’s not one-dimensional. It’s not about being natural or gluten-free or low fat. It’s not about ethical sourcing. It’s about all of the above. At the end of the day, consumers have to feel good about the brand and the company they’re buying products from, which is a component for wellness equation.”
Let’s look at some of these benefits in more detail:

- **Messaging.** By uncovering what customers care about, experience segmentation can be used to pinpoint which segments matter most and how best to target them. If a company’s most profitable segment, for example, values premium service and a healthy lifestyle, but the brand is known for servicing older people with health problems, an opportunity is presented. The company can take these learnings to adjust its brand messaging and attract more customers in this premium segment.

- **Product innovation.** When mapping its own offerings and its competitors’ offerings onto experience segments, The Clorox Company saw a whitespace in cleaners with scents targeted at the Hispanic community, one of the fastest-growing segments in the US. Clorox CFO Steve Robb shares: “Our Global Insights organization is focused on understanding our consumers at a deep level so we can offer products that meet their needs. Not only do we listen to what consumers say, we also observe how they interact with our products. For example, the insight that Hispanic consumers clean in three steps—they clean, disinfect, and then aromatize—led to the launch of a new line of cleaners called Clorox Fraganzia. The brand combines the strong equity of Clorox with the fragrance experience that appeals to the Hispanic consumer, offering a total solution that addresses how she cleans.” Other CPG companies pursue consumer insights for similar reasons. “At Unilever,” said Consumer Technical Insight Director Bert Nijhuis in 2012, “we are always working hard to engage consumers to predict trends and translate those into new products. Therefore, reliable insights are essential to achieve sustainable profitability.”

- **Portfolio optimization.** Experience segmentation can help CPG companies rationalize their SKUs by cutting out slow-moving products and replacing them with power products that are attractive to target consumers. This streamlining can lead to more profits by helping customers better navigate through product choices and bringing about productivity enhancements. After all, why offer a low-fat, healthy version of a fried product if the target segment does not value that choice? Alternatively, expedited delivery might be added at cost because consumers are far more likely to impulse buy the product if it appears on their doorstep the next day.

- **Servicing.** A major telecom provider looked across various customer demographic and behavioral data points to get a better understanding of its customers. Integrating billing data, customer records, web logs, and social media data, the company segmented its customers and identified those that were most likely to terminate service. The company then redesigned its servicing strategy using these insights, and as a result, cut customer terminations in half in a single quarter.

**Matching benefits to investment**

Using consumer segments to focus strategy is not an all-or-nothing proposition. There are four segmentation stages, and each one has a different risk-return trade-off.

For example, CPG companies can gain tremendous value by moving toward higher precision in their segmentation. They stop looking at consumers’ past behavior and start predicting future needs and treating consumers as dynamic rather than static beings. They learn to sense what consumers want even before they know it and fluidly adapt to consumers’ varying roles. At the same time, however, they must be willing to commit the resources and manage the higher level of complexity to reap these advantages. In other words, companies choose the stage to target by balancing the level of investment they are willing to make with the level of consumer understanding they need to pursue their strategy.

The following road map identifies the effort that CPG companies must expend on each stage, as well as the increasing return on investment through the journey.

**Stage 1: Demographic segmentation**

The most basic, easiest, and cheapest way of grouping consumers is using pre-existing demographic variables such as age, income, and gender. At this stage, companies see little impact on systems, processes, and resources. Although better than pure mass marketing, this segmentation method leads to oversimplification. It assumes that consumers are static and buy or think exactly as their neighbors do.
Stage 2: Behavioral segmentation

At this stage, companies segment consumers based on how they behave or on their usage intensity. Due to the linking of data across different systems, behavioral segmentation allows for more precise targeting. For example, specialized services could be offered to retain profitable customers, self-serving options could be offered to those who are more digitally inclined, and product promotions could be used to increase usage among light users. Behavioral segmentation helps companies figure out what works; however, it does not give them the insight to understand why a tactic works or to optimize further.

One example of behavioral segmentation: A snacks manufacturer at this stage wanted to assess demand for its products across regions. It used sales and consumer behavioral data to develop a model that mapped snack preference and consumption with consumer location. Combining this information with price comparisons across regions, the company was able to develop more effective marketing strategies, thereby increasing purchase lift across its products and regions.

Stage 3: Individual segmentation

At this advanced stage, companies seek to understand what motivates consumer behavior, then group consumers with similar attitudes and lifestyles. These companies approach consumers as individuals based on what they think and feel, not just on who they are. For instance, a Stage 3 segmenter would group consumers who value convenience separately from those who primarily seek price deals.

Attitudinal segments do not easily fit into traditional databases or approaches to targeting, which are often based on demographics. High levels of investment in both talent and resources are necessary to connect this segmentation schema with conventional aspects of the business and then build in the controls to ensure robustness and replicability.

Stage 4: “Divided individual” segmentation

At this most advanced stage, companies view the modern consumer as fluid, with permeable boundaries. In different situations, a single individual may fit into different segments. From professional to family or private to public, consumers define and redefine themselves depending on the role they are filling at the time.

Capturing this complexity in a single dimensional schema is difficult. To target consumers with the most precision, companies at this stage combine attitudinal segmentation with predictive analytics, which requires data collection, statistics, modeling, and deployment capabilities. Predictive analytics is sensitive to context, defined as a collection of factors (e.g., income, attitude, time of year) that influence behavior. Through predictive analytics, companies can personalize offers in real time as well as foresee long-term consumer behavior.

While the most complicated and expensive to implement, this stage of segmentation can uncover powerful insights. Witness a leading US airline that wanted to understand how new product introductions and policy changes would impact brand sentiment and market share. Using consumer psychographics and predictive analytics, the company simulated consumer behavior changes in the short and long term and gained the insights necessary to set a new strategic direction.

As another example, a medical insurance payer based its consumer segmentation on healthy living and life stage to assess existing and potential healthcare demand. Consumer segments were scored to come up with a healthy living matrix, and top segments for medical management initiatives were identified.
Building experience segments

When companies are ready to move beyond basic segmentation, they build experience segments on top of their existing demographic segments. The first step is to look at existing data with the intent of generating hypotheses about consumers’ attitudes, needs, and behaviors. These hypotheses are then tested and refined using both qualitative and statistically significant quantitative methods. Finally, the strengths and features of the brand (and of competing brands) are aligned with the new segments.

Here are the steps to follow in more detail:

1. Evaluate available quantitative data and assess its robustness.

Look at whether companies can identify their most profitable or most loyal consumers. Consider what demographic elements (e.g., geography, age, income) are important to the offering. Are some elements more important than others?

Exhibit 17
Steps to create experience segments

Source: PwC.
2. Build hypotheses based on the available quantitative data along with a set of associated questions to drill down further.

Look for other examples of high or low sales volume or other activity (e.g., enrollment in loyalty programs) that may be triggered by attitudinal reasons in contrast to internal operational decisions or issues.

Sample hypothesis: “Most of our sales are coming from the US West Coast and the state of Florida.” The associated drill-down questions would be: Is this because a majority of our retail locations are in these markets? Is there something unique about these parts of the country that makes our product/service appealing? If so, what is it and where else in the country would we find this same attitude?

3. Explore the hypotheses through qualitative engagement.

Use focus groups, one-on-one interviews, social media, observation, and other methods appropriate to the consumer base and industry to develop an understanding of the consumer. Set goals such as listing the future enhancements consumers would like to see in your or your competitors’ products/services.

4. Refine the original hypotheses based on the richer qualitative understanding.

Hypothesize how consumers might be grouped into psychographic profiles based on similarities and differences in their demographics, needs, attitudes, usage behavior, purchasing behavior, price sensitivity, and so on.

5. Test the hypotheses quantitatively.

Test the segment definitions with a statistically significant sample size, using an online or phone survey, and adjust. Identify segment size as well as the percentage of the experience segment already captured by your company or a competitor.

6. Create experience segments.

Based on the results of steps 1–5.

7. Map brand strengths and attributes to the new experience segments.

Be sure to map competitors’ strengths and attributes as well as those of the brand. Evaluate investments (e.g., in marketing, supply chain, sales, and feature set) and rate whether these investments matter to the target segment.

**Use experience segments to create brand value**

After experience segments are identified, it is time for companies to use them to maximize the value of the brand.

In that light, let’s return to our boat retailer example. The existing demographics identified the age and geographic location of the most valuable segment. After the quantitative and qualitative analysis was complete, the boat company split the segment into two: handy people who like to tinker, and party-goers who tend to buy a boat to impress others.

Based on this distinction, the company positioned boats differently to each segment. Different experiences were offered as well: for the tinkerers, boat shows and seminars on engine performance; for the party-goers, social events, including a boat luau.

A German original equipment manufacturer (OEM) selling cars in China is another good example. This OEM recognized the value of digging deeper incrementally, looking for insights in its experience segments. In this case, the OEM had been selling the exact same car to both German and Chinese consumers. The company wanted to test this hypothesis: “The Chinese consumer is buying this product because they haven’t been given other options. If we understood the segment better, we could tailor this product exactly to their needs.”

The first step was to create an attitudinal profile for that segment, based on a better understanding of the Chinese middle-class consumer. Using that profile, the OEM tailored finishing touches on the car for the segment and highlighted these features in company marketing. Early on, the demographic and experience segments overlapped exactly—but that would change as the OEM delved deeper into the attitudes, needs, and behaviors of Chinese consumers.
CPG companies with multimarket presence can learn an important lesson from this example. As Steve Voskuil, VP of Finance at Kimberly-Clark International, explains, “Winning for us means developing solutions that win in local markets. We have developed brand foundations that outline an architecture for each of our brands. These frameworks define the brand’s promise, which we want to be consistent everywhere. But we give our local teams latitude to position the brands in ways that work best in their local markets. Our local teams are very connected to consumers, what consumers are buying, and how they use products daily. They are very much in touch with what’s on store shelves as well, in terms of competition. We believe strongly in the local team’s ability to position the brand effectively and then react very quickly to changing consumer trends. This local connectivity is fundamental to our success.”

Finally, experience segments can be used to revitalize mature brands, as Kraft is doing with Velveeta. Some may have been surprised that Kraft selected millennials and younger men as the target segments for growing this flagging brand, but the updated product line (e.g., Velveeta Cheesy Skillets) and encouragement to have fun in the kitchen have sparked double-digit sales growth fueled by these segments.31

**Where to go from here**

It sounds like it’s worth diving into experience segments immediately, right? Hold on. First, you need to define what you hope to gain with your segmentation efforts. Many companies jump right in without a well-defined goal, and as a consequence, they fail to see a return on their efforts. In some cases, unfocused efforts can actually worsen the customer experience and raise costs. Once you’ve defined your goals, you need to determine how much you are willing to invest to achieve them.

Your goals and investment parameters should drive the people, processes, and technology you will put in place to support your segmentation efforts. From there, you can unleash the power of your insights by tailoring your products, services, and experiences to your most valuable segments.
Cultivating loyalists
Is your loyalty program a drain on the bottom line?

The number of US loyalty program memberships currently stands at more than 2.1 billion and is still rising. Yet the landscape is littered with programs that provide discounts or free items to consumers but accrue no tangible benefits to their companies. If you asked consumers whether a perk changed their purchasing behavior, they might say, “No, but it’s nice for them to offer it.”

One telltale sign of trouble with a loyalty program is when consumers don’t know they belong. This happens because grocers and retailers excel at getting people to sign up for their programs, but often falter with the next steps. A case in point: An in-store survey of one retailer’s customers revealed that only 20% of the customers in the store during the survey period knew they were program members, while another 60% had no idea. If nothing about a program is valuable enough to remember, it certainly is not effective at influencing behavior.

By the numbers, a committed consumer base is a clear economic advantage:

- Fully engaged consumers are 23% more profitable than average customers, while actively disengaged consumers cost 13%.
- Loyal consumers will pay an 11% higher premium price for brands they believe are superior.
- 12% to 15% of the most loyal consumers generate 55% to 70% of sales.

We also know that acquisition is five times more expensive than retaining existing consumers—but, according to respondents in the most recent PwC Global CEO Survey, it has never been easier for consumers, regardless of industry, to walk away from an established company relationship.

For reasons such as these, companies are now listening harder to consumers’ voices. They are asking questions such as: What do consumers want from the brand? What features do consumers value? At what touchpoints can our brand influence the purchasing decision? Why do consumers stop purchasing our brand?

To cement loyalty, it is essential to create experiences that reflect the answers to these questions. Loyalty programs are one of a portfolio of options for creating these experiences. Their primary value is to build up a bank of emotional and cognitive switching costs so that consumers perceive another choice as too costly to make. Loyalty programs also present behavioral data which can be used by companies to drive the consumer-desired experiences more specifically.

Quite a few retailers and CPG companies—Walgreens, Publix, Walmart, and Unilever, for example—have recently revamped their loyalty programs. Others are launching do-over initiatives now, recognizing that consumers’ needs have changed and that traditional loyalty program tactics have been displaced. Successful revamp efforts start from building the right foundation, asking the right questions, and setting up diagnostics to ensure the programs are enhancing members’ experiences.

Understand consumers’ attitudes, needs, and behaviors ...

Laying the foundation of a strong loyalty program requires companies to understand the attitudes, needs, and behaviors of consumer segments (see “Maximizing return on target segments”). Companies watch, ask, and listen in order to distinguish segments based on behavior rather than simply on demographics or response to marketing messages. They learn by meshing insights from qualitative research with the scale and precision of their quantitative work (e.g., surveys).

Through this process, brands create attitudinal profiles of their target segments. They may discover, for example, that the 79 million millennials exhibit greater brand loyalty for shorter periods of time or that they want exclusivity, recognition, and opportunities to provide feedback more than they want free products.

This work also allows companies to quantify the extent to which all segments value particular features of the brand experience as well as the extent to which some individual segments place more value on a feature than do other segments.
In a recent survey of the grocery industry, for example, we found that 28% of consumers purchase based on convenience and that fast checkout accounts for nearly a third of memorable great experiences. At checkout, three out of four want staff help and are willing to pay a 28% premium to get it. Consumers are willing to pay an 11% premium for knowledgeable staff and a 9% premium on eco-friendly packaging. And middle-aged and middle-income consumers are more likely to be swayed by price than any other segment. Values such as these should be leveraged as companies build their loyalty programs.

Engaging in deep relationships with consumers—and thereby understanding their attitudes, needs, and behaviors—builds loyalty even before additional program perks are added.

As Clorox CMO Tom Britanik says, “The newer types of loyalty programs have less to do with providing a financial benefit and more to do with developing a relationship with consumers, giving them relevant and meaningful information over a long period of time. With Hidden Valley, for example, we’re constantly giving her ideas to make her meals more engaging for the family through recipes, tips and tricks, etc. She opts in on the Hidden Valley website and signs up to be part of our inner circle of consumers.”

... and build a loyalty program strategy to match

Any loyalty program design initiative should begin by asking two critical questions (See Exhibit 18):

1. What do we want to accomplish?
   
   Be a loss leader, betting on a payoff in consumer lifetime value? Generate enough revenue to cover the program’s costs? Or be a profit-generating, self-sustaining business?

2. Which segments is the program targeting, and what behaviors does the program want to incent from those segments?

   Loyalty programs are useful for encouraging consumers to buy more, buy more frequently, or buy over a longer period of time. The keys are linkage to the brand promise and clarity of focus. Too frequently, we see companies set up conflicting goals for their loyalty programs, such as using the same tactics to try and satisfy both high-value, low-frequency consumers and low-spending, high-frequency consumers.

   With these fundamental questions answered, the value proposition of the loyalty program can be articulated. That work includes aligning promotions to support core program strategy and goals. Offers need to be refreshed to renew member engagement and to continually improve the relationship with members. And partners need to be selected to both complement and reinforce the core tenets of the brand and support the channel tactics (see the sidebar “Digital tactics for retailers and CPG manufacturers”).

   As this work is done, consider the following guidelines, which pertain both to the loyalty program and to the larger context of building consumer experiences.

   **Consumers want solutions, not products**

   Nowadays, consumers expect their brands to provide solutions rather than products. That requires brands to know consumers’ problems and to select which of those problems the brand can help solve.

   Walmart, for example, now has a program that allows consumers who typically pay with cash to order online and choose a physical store at which to pick up and pay for the merchandise. And CPG manufacturers are partnering with retailers, insurance providers, and a mobile tool provider to provide discounts on healthy food to consumers at check-out. Program members gain access to a website with guidelines on healthy eating, shopping lists, and recipes for healthy foods, as well as prominent positioning of the brands on discount during a given week.
Cultivating loyalists
Is your loyalty program a drain on the bottom line?

Exhibit 18
Building a loyalty program strategy

**Guiding questions**

**What do you want to accomplish?**

What segments is the program targeting? What behaviors does the program want to incent from those segments?

**Principles**

- Customers want solutions, not products
- Every customer is both a promoter and detractor
- Place a value on the network

**Actions**

1. Select the right metric and cadence
2. Prioritize customer-facing initiatives

Source: PwC.

Strings are attached to the help provided, of course. There is little point to a loyalty program unless consumers are willing to do something for the brand (e.g., buy at a certain price point). In other words, loyalty programs should not primarily be vehicles for giving away free stuff; they should instead be valued as laboratories for producing useful data to drive insights on consumer buying behavior. In Kellogg’s loyalty program, for example, analysis of consumer-entered codes is used to target promotions and offers to different members.41

**Every consumer is both a promoter and a detractor**

Retailers and CPG companies must be able to identify experiences that drive a consumer’s lasting impression of the experience toward the positive or the negative. They can then design pathways of interaction that emphasize the positive. For example, consider a loyalty program member with a complaint: If her segment prefers to explain an issue by voice, then a robust phone capability would be required.

**Place a value on the network**

Ask how target segments network. To whom do they talk? How often? How long do they share good or bad experiences? How much influence do their networks carry? Affluent and educated shoppers, nearing or in retirement, are the most likely segment to spread the word among family and friends when they find a great grocer, for example.42 It would make sense for any retailer targeting this segment to prioritize the building of a capability to participate in and influence these conversations.

**Select the right metric and cadence**

Companies need a metric that seems fair to consumers and that incents the desired consumer behavior. For instance, should a hotel base rewards on money or nights spent at the hotel? Programs such as Hilton HHonors have done better by selecting the former.43
Digital tactics for retailers and CPG manufacturers

Digital coupons, mobile loyalty programs, exclusive content, co-op perks, and hyper-targeted email advertising are a few of the digital tactics now being integrated into the consumer experience as a whole, and specifically into loyalty programs. A cautionary note: CPG companies should not use tools such as these just for the sake of using them. It is important to align tool selection to the strategy rather than the strategy to the tool.

• Digital coupons. Many CPG companies are experimenting with digital coupons. These coupons supplement the traditional paper coupons in weekly circulars. Consumers can browse the coupons online, “cut them out” virtually, and redeem them through their phones. General Mills and Kellogg’s are among the manufacturers using the Shopitize app to offer shoppers cash back on purchases. Unilever’s program offers some additional advantages: Besides being able to browse 10,000 products, shoppers can accumulate rewards across shopping trips as well as across multiple stores (given the propensity of shoppers to buy in multiple locations). This flexibility illustrates how a program can be tailored to the specific buying journeys of the target segment.

“I think what is really going to turn things around for digital is reaching people as they enter the store, and I think that’s going to be delivered via mobile,” says Rick Zimmerman, Senior Vice President of Marketing and Innovation for Sunny Delight. “It’s going to be consumers who opt in to get a coupon or hear from us, and that technology is being tested right now.”

Digital coupons are still in their infancy, with obstacles including lack of distribution control and limited acceptance. Even so, there are positive signs. Redemption rates for digital coupons are higher, for instance, as are the number of incremental sales and new buyers.

• Mobile loyalty programs. Digital coupons are just one of the offerings from mobile startups like Shopkick, Square, and Foursquare. Others include credit card syncing and checking in at retail locations to receive awards. New technologies, and the convergence of social and mobile, are causing market turbulence. By the time the players in this space stabilize, mobile loyalty programs may be transformed.

• Exclusive digital content. Consumers value exclusivity and “special” benefits. Club members of Abercrombie & Fitch, for example, enjoy access to exclusive videos, photo galleries, digital wallpaper, and music playlists along with the privilege of VIP entrance to special events organized by the company.

• Hyper-targeted email. Using this tactic, CPG manufacturers can deliver tailored messages to consumers in a specific region with a narrow set of shopping and personal interests as well as demographics. This is done by adding potentially hundreds of fields to filter email lists.
Cultivating loyalists
Is your loyalty program a drain on the bottom line?

The cadence of the rewards is also important, since too long an interval between promotions and specials reduces consumers’ attention and interest. Walgreens’ Balance Rewards, which successfully attracted 28 million members within only about two months of launch, exemplifies that lesson, offering frequent promotions and specials such as exclusive sales prices in the weekly circular.50

With grocery and fast-moving consumer goods, a quick cadence can have a significant impact on the bottom line. Such a quick cadence is typically followed by a significant increase in profits as customers shop more often for higher-margin goods.51

Prioritize consumer-facing initiatives
Often, companies can easily identify the top couple of initiatives but are fuzzy on how to prioritize the rest of the list. A leading practice here is to look at all of the initiatives in the company, including the loyalty program, as a single portfolio—simply to understand the scope. The next tasks are to remove duplication and prioritize investments based on corporate goals and the attitudinal profiles of the target segments.

Avoiding common program killers
There are three common pitfalls that will kill any program:

1. Designing a loyalty program that tries to be everything to everyone.

No program can serve every consumer and resolve every consumer problem. Companies that cast too wide a net end up offering tepid benefits to many people rather than highly valued benefits to a few. Exclusivity is a powerful incentive for a variety of reasons, including prestige, convenience, and a reduction of stress.

2. Trying to push distressed inventory to your loyalty customers in the guise of a “benefit.”

As a member of a loyalty program focus group once said, “I would love to meet the person who thinks more highly of a company because it offered them a special discount on the things no one else wants.”52 Turning your program into a dumping ground for a broad range of low-resonance products often damages the loyalty instilled by the program. Companies need to offer such inventory only on a highly targeted basis aligned with known customer preferences.


All too frequently, companies assume a large membership base justifies the significant resources they devote to signing up members and maintaining a program. However, unless members appreciate and use a program’s features and the program uses the data, companies receive little or no value from these programs. They miss out on one of the primary benefits of these programs: giving consumers something they value so they will be willing to share purchase and usage information with the brand.

Here is an example: A regional grocer set up a dedicated self-checkout lane to give its most desirable target segment the great experience of fast checkouts. The tactic worked beautifully at first, but other consumers envied the speed at which that line moved. Under pressure, the grocer loosened the restrictions on the line to let more people in. The lines in the lane lengthened, which compromised the experience for the target segment.
Cultivating loyalists
Is your loyalty program a drain on the bottom line?

Diagnostic for success

The success of the loyalty program must be evaluated within the context of creating a consistent consumer experience and engaging program members across all touchpoints. Programs must select channels of interaction in order to convey program offerings and relevance. Once they have done so, they can put the appropriate incentives in place to not only increase member retention and happiness but also drive additional business from those people. Finally, the business collects consumer data to generate insights about the program initiatives and consumer segmentation for further up-sell opportunities.

Godiva CFO David Marberger provides an example: “Our Rewards Club membership is the reason our comp store sales bumped up in the US. We were able to track that the average transaction for a loyalty member was higher than for a non-loyalty member. That is letting us go to the next level of targeting those users and learning more about them. And that’s far better than sending out email blasts that are generic across the board.”

Interactions, incentives, and intelligence can be used as a checklist or diagnostic for assessing the strengths and weaknesses of the loyalty program over time. For example, answers to the questions in Exhibit 19 may show that a

Exhibit 19
Loyalty diagnostic

Interactions

Are you listening and responding to the voice of your customer?

<table>
<thead>
<tr>
<th>Channels and servicing</th>
<th>Touchpoints</th>
<th>Are you saying the right things to the right people at the right time?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Service</td>
<td>Are you able to respond to customer needs? Are you able to identify them?</td>
</tr>
</tbody>
</table>

Incentives

Are you providing what people value?

<table>
<thead>
<tr>
<th>Loyalty marketing</th>
<th>Offers</th>
<th>How do you balance near-term activity with longer-term loyalty? Do you run the risk of the short-term handcuffing the long-term?</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loyalty program</td>
<td>Membership</td>
<td>Are your most valuable customers engaged?</td>
</tr>
<tr>
<td></td>
<td>Recognition</td>
<td>Are you treating customers the way they deserve?</td>
</tr>
<tr>
<td></td>
<td>Partners</td>
<td>Do your partners complement your value proposition?</td>
</tr>
<tr>
<td>Financial management</td>
<td>Finance</td>
<td>Is your division a cost or profit center?</td>
</tr>
<tr>
<td></td>
<td>Currency</td>
<td>Are you getting the most out of your currency?</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Will you have a currency or an un-monetized liability?</td>
</tr>
</tbody>
</table>

Intelligence

How well do you know your customer?

<table>
<thead>
<tr>
<th>Analytics and customer insights</th>
<th>Information</th>
<th>Do you have a 360-degree view of your customers?</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Insights</td>
<td>Are you listening to what your customers aren’t explicitly telling you?</td>
</tr>
</tbody>
</table>

Source: PwC.
loyalty program is doing a great job at reaching out to consumers and distilling insights from membership data, but is doing little to build out a viable partner network. The diagnostic may also show that members have to call the main helpline rather than a dedicated, members-only line.

**The fix is multidimensional**

Consumers often hold contradictory opinions about a brand simultaneously. Inspiring their loyalty is a complex process, particularly when the different needs and desires of increasingly fragmented micro-markets are taken into account (see “That was then, this is now”). As a result, successful loyalty programs also have layers of associated complexity.

It is possible to turn around languishing loyalty programs and achieve the value CPG manufacturers and retailers seek from them, but doing so requires more than a single initiative or pushing forward a single program element. A variety of actions and reactions feed into the emotion of loyalty; in a similar way, success with loyalty programs depends on a holistic, multidimensional approach, measured regularly by a health diagnostic.
Section 2
Connect and increase engagement with the consumer

Close interaction between consumers and CPG companies is now a given, so much so that perfunctory, by-the-book customer communication is no longer an option.

Whether they’re buying products online or in brick-and-mortar stores, consumers are doing ever more of their product discovery and research online, via both company websites and various social media. This offers CPG companies huge opportunities to build authentic, dynamic customer relationships with massive audiences. But as consumers get more and more media savvy, companies have to work harder to achieve breakthrough results.

Building new consumer strategies may require more collaboration with business partners and a change in the companies’ organizational design. By leveraging data-driven insights to bring the right content to the right consumers, creating an active real-time dialogue, and continuously looking for new outreach avenues online, CPG companies can not only grow their brand awareness and reputation but also establish real brand preference and loyalty in their most sought-after consumer segments.
Accelerating your social journey
Create fervent consumer engagement through brand storytelling

Even a consumer who has never tweeted or liked a product on Facebook expects brands to be active online, in the channel of his choice, ready to interact with him at any hour. This is the era of consumer empowerment, and leading companies continue to make gains in their shift from a traditional product and service orientation to true consumer obsession. Social media presents new opportunities for companies to create meaningful, connected experiences for their consumers. These experiences and strengthened consumer relationships, in turn, drive tangible business benefits in the form of increased brand awareness, preference, and loyalty.

For Continental Mills, “Social media is also a great opportunity for consumers to learn more about us as a company,” says Andy Heily, SVP of Marketing and Sales. “We’re a family-owned private business. We’ve been around for 80 years. We do a lot of things the right way and I think it’s a culture that a lot of consumers can identify with.”

However, while most companies have entered the social media arena, they are also discovering that launching Facebook pages, opening Twitter accounts, or building a YouTube presence is not enough to meet consumer expectations. Instead of simply checking off the boxes for basic tactics like these, companies must think about their investment in social media as a journey toward increasing internal capability and true consumer engagement (see Exhibit 20).

Today, table stakes for competitive performance on social channels include clear business objectives, thoughtful presence (i.e., choosing the channels in which a company

Exhibit 20
Social engagement journey

The social engagement journey identifies stages of operational maturity, capability, and performance in the social space. Companies can use it both as a diagnostic and as a planning tool to express how well social is integrated into the fabric of the organization.

<table>
<thead>
<tr>
<th>Stage 1</th>
<th>Traditional</th>
</tr>
</thead>
<tbody>
<tr>
<td>Traditional command and control business operations use one-way communication to drive business outcomes.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Stage 2</th>
<th>Experimental</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dabbling in social engagement occurs but is disconnected from business operations. Fractured tools, siloed efforts, and disparate measures reign.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Stage 3</th>
<th>Operational</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social engagement more embedded in business operations. Internal training, channel alignment, and campaign integration begin to deliver tangible results.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Stage 4</th>
<th>Measurable</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social engagement drives real business results, with systems and tools fully optimized to support confident and competent employees and to more fully harness online relationships.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Stage 5</th>
<th>Fully engaged</th>
</tr>
</thead>
<tbody>
<tr>
<td>Social engagement and customer experience is part of the organization’s DNA. Breakthrough business results—increased revenue and loyalty—are realized.</td>
<td></td>
</tr>
</tbody>
</table>

Source: PwC.
engages based on targeted consumer behavior), sound structure and governance, effective operations, and continuous performance measurement. Leading companies have effectively established that foundation and are now focusing on ways to truly maximize consumer engagement. They have tightly aligned their engagement model with their brand objectives, mastered the art of powerful brand storytelling, and exponentially multiplied the size of their target audience.

The race is on for CPG companies to put aside old ways of doing business and remake themselves as consumer-centric organizations active and effective across the channels in which their consumers engage. Although there are companies already leading in the art and science of social engagement, there is still ample opportunity for others to move to the front and reap the benefits of stronger consumer relationships.

Select an engagement model that supports the brand

Before effectively telling your brand’s story on social channels, consider how your organization is set up to engage consumers online. CPG companies must define a social engagement model that supports their brand objectives and that also represents a level of investment to which they can fully commit. Engagement models answer the questions:

- Should we engage our consumers via one centralized brand voice or through multiple, location-based channels?
- Who will participate in this online conversation on behalf of the brand?

Although there is no one right answer, the one clear wrong answer is to have no defined engagement model in place at all. For example, consider the company division that, independently of its parent company, launched more than 600 branded Twitter handles. Multiple accounts and channels can help a brand engage with its consumers in specific and meaningful ways, but spreading limited resources across too many can weaken or even prevent the relationships the company wants to build.

Companies across industries tend to exhibit one of three basic engagement models: centralized, decentralized, or hybrid (see Exhibit 21). Centralized models are appropriate when consistency in brand voice and consumer experience is paramount. Starbucks has implemented a centralized model because consistency is core to the brand. Whether you walk into a Starbucks in New York, Amarillo, or Beijing, you can be confident that you know “how it works” and what you’re going to get. With a centralized social engagement model, there is one voice and one source of conversation.

Decentralized models, on the other hand, push social engagement out to individual brands, stores, or regions, allowing for more localized conversation with consumers. Whole Foods, for example, has a model in which the company engages across social channels by market or city. This decentralized approach supports a brand rooted in a “go local” philosophy and one that works to establish itself as a valued partner in the community.

We can see an example of this at Kimberly-Clark: “Kimberly-Clark is very active in leveraging social media and we agree it’s an emerging way to engage with target consumers like never before,” says VP of Finance Steve Voskuil. “We empower and encourage our local teams to be creative and leverage social media in ways that work best for them, knowing the approaches are going to be different from market to market. Social media strategies are typically defined by marketplace dynamics. For example, in some markets social media may be used to help build overall category awareness and to generate conversations about using products that are new to their culture—such as tampons or products for adult incontinence. In other markets, social media may be used to engage consumers in conversations about challenges they’re having raising their baby, or insecurities about being the really great mom they want to be. The key is to find what’s relevant and what resonates with the local marketplace. There’s no doubt the most engaging conversations for our categories tend to be local, not global, so we rely on our local teams to figure out what the issues are in their markets.”

Hybrid models walk the line between maintaining a consistent brand voice and providing opportunities for localized content and engagement. In a hybrid model, the consumer engages with one brand voice on primary channels, such as Facebook and Twitter, but can engage locally in ways that are meaningful for the brand.
Growth strategies: Unlocking the power of the consumer

Accelerating your social journey
Create fervent consumer engagement through brand storytelling

Exhibit 21
Three models of social media execution

<table>
<thead>
<tr>
<th>Model</th>
<th>Advantages</th>
<th>Considerations</th>
</tr>
</thead>
</table>
| **Centralized** | • Drives consistent brand voice  
• Rooted in the belief that consistency in consumer experience is paramount  
• Easier to govern and control brand messaging | • Ability to understand needs and expectations of entire consumer base  
• Resourcing for a larger, more dedicated central team  
• Enterprise-level tools and tool training  
• Clear socialization of strategy to ensure compliance |
| **Decentralized** | • Allows localization of content and voice  
• Can increase engagement in ways meaningful to different consumer segments  
• Can improve customer service | • Empowerment and effective governance required  
• Enablement is critical, including clear policy definition, training, and tools  
• Some centralized resource management still required (e.g., listening and monitoring across social channels, performance reporting, etc.) |
| **Hybrid** | • Allows some consistency in brand voice  
• Allows individual locations to build and showcase expertise, furthering consumer trust and loyalty | • Technology implications for enabling localization opportunities such as forums and hosted communities  
• Centralized, enterprise-level insight and investment required as well as decentralized empowerment and enablement |

Source: PwC.

Increase engagement with compelling content and reach

The days of “build it and they will come” are long gone. Now CPG companies know that they must choose where to meet and what to offer consumers on an ever-proliferating number of digital channels. To further complicate matters, companies must be ready for consumer segments to change allegiances as new channels enter the picture.

“Consumers demand more,” says Clorox CMO Tom Britanik. “They want more details and information, they want ratings and reviews, they want to know what other consumers who have used it think, they compare and contrast competitive products, they do pricing online, and so on. And they’re shopping for the best overall value. And when you think of all the different media outlets now available to them, it has exploded exponentially and has gotten much harder for manufacturers to get the right messages out.”

Although the prospect of connecting across a complex landscape may seem daunting, the goal at a high level can be stated simply: Understand your consumers online and connect with them in a meaningful way at scale. Do that successfully and you drive greater consumer awareness, preference, and loyalty to the brand.
Accelerating your social journey
Create fervent consumer engagement through brand storytelling

Relevant, real-time dialogue

Companies leading the way in social media have moved beyond simply promoting their product or service. Instead, social media leaders are engaging consumers in relevant, real-time dialogue across social channels. Social magic springs from providing compelling content that encourages consumer participation. Through intimate interactions, consumers connect to the brand, which can lead to content going viral in the blink of an eye or with the click of a retweet button.

Authenticity and relevance of content are key to igniting consumer engagement. As Continental Mills’ Andy Heily explains, getting real traction with social media “depends on if you have a great story. It’s got to be authentic and a really compelling story to tell, otherwise consumers can see right through that. There’s so much rich content from a functional usage standpoint of our products that social media digital marketing is a huge opportunity for us.”

Relationships deepen as brands showcase their consumers’ creativity, allowing the consumer to become the storyteller and content provider. Leading companies have also been successful leveraging “real” content and imagery that is not overly produced. It is common to see exponentially greater consumer engagement with relevant, “in the moment” images, for example, than with professionally produced or stock photography. Given that social media often sits within traditional marketing organizations, this less formal approach to content development can seem foreign and high risk. Tested application and results assessment, however, can help companies make progress.

Consumers also expect companies to engage in ways not limited to specific products or services. Leading companies offer solution-based content that solves specific problems or provides expert advice to help improve the lives of their consumers. “Consumers don’t just want information, they want to bond with brands,” says Clorox’s Tom Britanik. “They want a relationship. They want their brands to mean more than solving a functional need such as it cleans or it whitens or it tastes good. They are demanding that brands help them solve issues, which can range from spicing up a family meal through online recipes like our Hidden Valley Ranch brand has done, to helping the environment by getting rid of bottled water waste like our Brita brand has done.”

There are other examples that tell the tale. Whole Foods’ “how to” posts and videos develop credibility and authority for the brand while teaching consumers how to cook halibut or create natural-looking makeup. Procter & Gamble (P&G) launched a month-long social media campaign that offered smart living tips, product savings, free samples, and prizes, encouraging consumers to stick to resolutions for a more rewarding and fulfilling life.

Effective dialogue also requires interaction in real time. Engaging and responding to consumers “in the moment” enables a more authentic conversation, sparks energy, builds momentum, and helps sustain the discourse. At MillerCoors, for instance, “We have done a lot of work on the social media front with Miller Lite,” says CFO Tracey Joubert. “For example, we sponsor one of the Nascar drivers, Brad Keselowski. He is obviously in the millennial grouping and he was tweeting when a race was halted for a while and all of a sudden, in a short-time, he had hundreds of followers.”

Engaging with consumers in real time, however, is easier said than done. Being nimble online does not happen by chance or even by the desire of a good social media manager. Companies that effectively engage their consumers in real time have invested in an agile, internal operating model for social media activities, typically including cross-functional organization structures and processes, effective governance and leadership, enabling tools, and practitioners with the skills, knowledge, and experience to make it happen.

Mondelēz-owned Nabisco’s Oreo brand offers a prime example of real-time engagement. Oreo inspired an active social dialogue during its highly successful “Cookie vs.
Maximum reach

Leaders in social media not only have something meaningful to say, but are able to say it to a large target audience. Timely, relevant content that “goes viral” certainly expands a brand’s audience. Another effective way to extend your social reach is to identify key influencers and actively engage them in telling the brand story. Influencers are individuals or groups/organizations (e.g., a retailer) who carry weight with your targeted consumer base or specific segments within that base. When influencers are effectively engaged, the potential social reach is enormous. Leading companies continuously spot and quickly respond to influencer mentions of the brand on social channels. For example, Starbucks recognized an opportunity when pop star Demi Lovato posted a tweet that said, “You know you’ve made it when they get your name at Starbucks....... Still hasn’t happened yet.” The Starbucks brand responded with a personalized tweet and a photo of an employee holding up a branded cup with Demi Lovato’s name correctly spelled across it. The Starbucks response received over 11,000 retweets and the social engagement story was featured on The Huffington Post.

In addition to timely and effective response, companies advanced in social media engage influencers even when the brand is not directly mentioned. Further evidence of the company’s social agility was demonstrated during the Super Bowl, when an unanticipated power outage occurred. Oreo was mobile to seize the social opportunity and delivered a simple message via Twitter. The tweet included a photo of a lone Oreo in the dark, captioned with, “You can still dunk in the dark.” Consumers loved it, and Oreo’s real-time response inspired more than 15,800 retweets as well as generating significant news coverage and praise.

In addition to initiating dialogue with “in the moment” content, brands must respond quickly to consumer input and demonstrate the importance of consumer feedback. For example, when consumers leveraged social channels to protest plans to dilute Maker’s Mark bourbon from 45% alcohol by volume to 42%, the brand got the message. On the brand’s website and Facebook page, Maker’s Mark responded to consumer feedback and backed down on the recipe change. In short, the brand acknowledged, “You spoke. We listened.” Through social media, Maker’s Mark and its consumers engaged in active, meaningful dialogue. More than 8,500 followers shared the brand’s quick Facebook response, 4,300+ left comments on it, and 27,800+ “liked” it.

Creme” campaign launched during Super Bowl XLVII. The campaign focused on the long-standing disagreement among Oreo fans regarding which part of the Oreo is best, the cookie or the creme. Consumers were asked to take a look at the brand’s new Instagram profile and submit photos of objects they love with #cookiethis or #cremethis hashtags. Over the course of a three-day period, Oreo cookie artists created sculptures of selected photos using the fans’ favorite part of the Oreo, cookie or creme. The sculpture creations were then photographed and posted on Instagram and the company’s other social media channels. Consumer engagement skyrocketed, with Oreo’s Instagram account ballooning from 2,200 to 85,000 over the course of a few days.

While the “Cookie vs. Creme” social media campaign was planned, Oreo also has the infrastructure in place to respond and engage effectively online in real time. Further evidence of the company’s social agility was demonstrated during the Super Bowl, when an unanticipated power outage occurred. Oreo was mobile to seize the social opportunity and delivered a simple message via Twitter. The tweet included a photo of a lone Oreo in the dark, captioned with, “You can still dunk in the dark.” Consumers loved it, and Oreo’s real-time response inspired more than 15,800 retweets as well as generating significant news coverage and praise.

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Increase engagement through enabling technologies

Many off-the-shelf tools can help companies determine what content will resonate with their consumers, which groups or individuals exert the most influence, and how they are performing overall on social channels vis-à-vis their competitors. Of course, it’s not just the tool that enables social engagement but a company’s ability to translate data and findings into actionable business insight. Technology today, however, is making that translation a lot easier.

Leading companies in social media are leveraging technology to deliver business insights in three key areas:

1. Social listening/monitoring to assess conversations happening on social channels.

   Tools with traction in this space, such as Salesforce Radian6, Attensity, and Sysomos, perform a brand name and relevant keyword search on social channels and other online sources (e.g., micro-blogs, forums, mainstream news, images, videos, and blogs). Companies can then assess factors that drive volume and changes in specific brand-related mentions. Exhibit 22 shows two competing brands that were mentioned more than 82,000 times in two weeks. The brand represented by the red line had a significantly larger share of voice and their social storytelling is winning against that of their chief competitor (blue line), which achieved an equivalent share of voice for only a single event. Today, leading brands are utilizing this data not just for consumer support and digital marketing but also for product design and development.

2. Social media management to determine campaign effectiveness.

   Solutions such as Spredfast, Simply Measured, Adobe Marketing Cloud, and HootSuite allow brands to assess the return they are receiving on the resources committed to a particular campaign. Now companies can answer questions such as: Who is engaging with this content? On what channels? What do we need to change to have a larger impact? These tools enable companies to track activities and campaign goals at scale, as shown in Exhibit 23.

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Exhibit 22
Share of voice between two competing brands

![Share of voice between two competing brands](source)

Source: Salesforce Radian6.

Exhibit 23
Monitoring accounts and activities

![Monitoring accounts and activities](source)

Accelerating your social journey
Create fervent consumer engagement through brand storytelling

Socially adept companies are getting big value out of the intelligence gathered from social media management solutions. Capturing and interpreting data on consumer behavior helps shape social media engagement strategies, improves content, and extends the brand’s reach online.

3. Tracking to identify and prioritize social influencers.

Leading companies are also using tools such as Little Bird and Traackr to identify who has influence on their consumer base, the nature of that influence, and the influencer’s content and channel preferences. Leveraging this insight, brands can effectively engage with those influencers on social channels, both proactively and reactively, to dramatically extend their reach online. Tracking influencers also provides rich insight into current trends and consumer preferences, which companies can use to improve their products, customer service, and marketing efforts. Exhibit 24 shows how data gathered from influencers can directly impact how brands interact with their consumers.

Engage to succeed

The power of social media for CPG companies lies in the opportunity it presents to build authentic, dynamic consumer relationships at scale. Insights gleaned through rich consumer relationships online can inform corporate marketing efforts, customer service, and even product and service design. Most companies have learned that merely being present on social channels is insufficient to create the kind of experience consumers have grown to expect. Companies adept at and competitive in social are finding that even establishing a solid foundation (clear objectives, sound practices, capable resources, and effective governance) is no longer enough to create breakthrough results. So what accelerates a company’s achievement of high performance in social media? Today’s leaders in the social engagement journey have created rich, connected, authentic experiences for massive online consumer populations by:

- Leveraging data-driven insights to connect with their consumers via relevant content
- Creating active, real-time dialogue
- Continuously extending their reach online

These companies’ investment in social engagement is generating significant return in the form of brand awareness, preference, and loyalty—all critical components of business success in today’s consumer-driven market.

Companies looking to accelerate their social engagement journey are investing in strategies that spread social media capabilities and skill sets across the organization. Creating global playbooks to scale social media operations across verticals or regional markets, consolidating technologies or creating communities of practice around social media activities, and creating training and certification programs to identify and vet social practitioners are all common strategies for companies looking to deepen their consumer social engagement.

Exhibit 24
Connecting with audiences by studying influencers

Source: Little Bird (http://getlittlebird.com/).

Collaborating with business partners
How branded suppliers and their retail customers can gain a deeper understanding of consumers

Branded suppliers and their retailer customers have long collaborated to manage important tactical and transactional concerns, such as inventory levels, volume discounts, and buying cadence. They’ve also worked together to address strategic concerns through top-to-top discussions about category growth and consumer purchasing behavior. But such approaches are based on historical behavior, each side’s shorter-term business priorities, and each side’s respective thinking about what consumers need.

Today’s landscape requires a more robust, dynamic understanding of consumers. E-commerce continues to grow, and is anticipated to account for 12.3% of consumer spend by 2020. Retailers are shrinking their physical formats. Brands are establishing interactive media solutions and primary consumer engagement platforms to build lifestyle-oriented brand affiliations. In today’s changing retail landscape, and with consumers free to engage with brands in different ways, it is more critical than ever to develop a robust, anticipatory consumer understanding.

How can companies achieve that understanding? They must partner in more sophisticated ways to build an integrated picture of consumers and their ecosystem. Evolving their collaboration approach will call for new levels of information and resource sharing, and thus greater levels of trust. In addition, companies may have to adopt new tools, frameworks, and training approaches that strengthen managers’ and employees’ collaborative capabilities.

Making such changes won’t be easy. However, some players in the CPG space have begun paving the way. By understanding what the most common obstacles are and how existing forms of collaboration might evolve, branded suppliers and retailers can take their partnerships to a decidedly new level—one where everyone can benefit.

As Clorox CFO Steve Robb explains, “If you can partner with retailers to grow the category, everyone wins—especially when a company brings meaningful product innovation that a retailer supports. The consumer wins because she’s getting affordable, superior-quality products. And, of course, the company and retailer win because category sales grow. It all starts with the idea of partnership. We’re in it together.”

Obstacles to achieving collaboration 2.0

While more consumer-centered collaboration can yield valuable results, making this leap is challenging for many companies. One barrier has been the focus on one-dimensional, functional interactions—for example, between retail buyers and suppliers’ merchandizers or account managers. These interactions are important, but they tend to focus on near-term, reactive solutions at the shelf.

Another barrier is the lack of integrated consumer data. Traditionally, branded suppliers and retailers have generated and accumulated their own data using point-of-sale (POS) techniques and consumer research. But most have not sat down together to analyze this data and extract actionable insights. Also, companies have struggled with questions about what kinds of data should be captured, how it should be shared, and how often. These challenges are further exacerbated by the nascent understanding of how to collect for emerging consumer engagement platforms such as social media, interactive media, and promotional programs, all of which indirectly drive purchasing behavior across all channels. As a result, retailers and suppliers embark on their respective consumer approaches, gathering separate pools of data with different and sometimes conflicting scopes and objectives.

Additional challenges are rooted in a lack of trust between partners. Whether driven by worries about the security of shared data, uncertainty about the completeness and integrity of the data being shared, or apprehension due to having gotten “burned in the past,” this lack of trust limits the ability for collaboration to be successful. As we move forward into a more multi-channel consumer world—both directly and indirectly related to consumer purchasing behavior—defining a collaborative approach will be more critical than ever.

How collaboration may evolve

To surmount the above-described barriers, branded suppliers and retailers will need to rethink the way they collaborate. Keys to success will include developing a shared picture of consumers’ needs (including micro-demand trends) and shared approaches for generating this picture. The resulting insights can drive the crafting of sustainable
Collaborating with business partners
How branded suppliers and their retail customers can deepen their understanding of consumers

go-to-market strategies centered on those needs and on longer-term business priorities. The outcomes may comprise not only new products but also innovations in services, operations and logistics management, dynamic channel strategies, and adaptive consumer engagement platforms.

But to achieve these gains, companies must share and use consumer insights across all channels—not just distribution channels—as well as across product categories. They also need to collaboratively leverage the massive volumes of historical and real-time data being generated from diverse sources (see Exhibit 25). Companies willing to act as bridges between consumer data and their fellow players in the supply chain will quickly become known as “consumer translators,” creating value across the consumer-facing value chain.

Some companies already have this mindset and have been generating results as well as lessons learned. For example, as Continental Mills CFO Mike Castle notes, “We have a very close relationship with our big customers. Buyers in our categories will work with our folks to develop product

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### Exhibit 25
A wealth of data—illustrative sample

<table>
<thead>
<tr>
<th>Data</th>
<th>Insights generated</th>
<th>Ways to leverage</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Planogram</strong></td>
<td>- Maximize shopper traffic flow</td>
<td>- Develop product positioning strategies</td>
</tr>
<tr>
<td></td>
<td>- Purchase conversion</td>
<td></td>
</tr>
<tr>
<td></td>
<td>- Increase total ticket value</td>
<td></td>
</tr>
</tbody>
</table>
| **Sell-through data** |  - Pricing activity  
                              |  - Assortment preferences                                                        |  - Quantify value of new product innovation                              |
|                       |  - Product placement                                                               |  - Understand consumer preferences for “new”                            |
|                       |                                                                                   |  - Manage SKUs                                                            |
|                       |                                                                                   |  - Make allocation decisions by channel/customer                          |
|                       |                                                                                   |  - Develop pricing tiers                                                  |
|                       |                                                                                   |  - Identify preferred product adjacencies                                |
| **Scorecards**        |  - Stockouts  
                              |  - Performance priorities                                                        |  - Understand customer rules of engagement                              |
|                       |                                                                                   |  - Make allocation decisions by customer/channel                          |
|                       |                                                                                   |  - Manage complexity                                                      |
| **Loyalty programs**  |  - Value of loyalty programs                                                        |  - Develop promotional strategy                                           |
|                       |  - Key consumer behaviors and preferences                                          |  - Measure promotion efficacy                                              |
|                       |                                                                                   |  - Quantify customer loyalty                                              |
|                       |                                                                                   |  - Develop customer segmentation strategy                                 |
|                       |                                                                                   |  - Develop partnership strategy                                           |
| **Channel-level data**|  - Key consumer differences by channel                                            |  - Segment by product/customer/channel                                     |
|                       |  - Click-throughs before purchase                                                  |  - Develop cross-channel platforms/strategies                             |
|                       |  - Browsing versus purchase behavior                                              |  - Track consumer shopping patterns                                       |
|                       |  - Brand/customer/channel associations                                             |  - Measure shopper-to-buyer conversion rates                             |
| **Digital / social media data** |  - Consumer interest in a brand, product, customer experience, etc.  |  - Generate buzz for or interest in a product                            |
|                       |  - Consumer affinities                                                             |  - Co-create products and services with consumers                         |

Source: PwC.

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Collaborating with business partners
How branded suppliers and their retail customers can deepen their understanding of consumers

ideas based on what’s moving in their stores and the types of things their customers are asking for. Some of our larger growth products are outshoots of those relationships. The information flow has been very transparent, but our customers aren’t the consumer, so we need to validate their insights, and there has to be some sharing of risk.”

Rick Zimmerman, Senior Vice President of Marketing and Innovation for Sunny Delight, maintains that things are changing for the better: “There’s been a lot more cooperation recently than 10 or 20 years ago. It used to be more of an us-versus-them kind of thing. I think more retailers are partnering with manufacturers to figure out how to stop making this a zero-sum game.”

What about other parts of the value chain? Highly evolved collaboration between suppliers and retailers can benefit from collaboration done elsewhere in the chain—including among raw materials suppliers, contract manufacturers, wholesalers, and distributors. For example, suppliers can contribute packaging innovation while distributors can speak to preferred selling practices in specific markets. Such examples of value chain knowledge also can be brought to bear as suppliers work to harvest insights. Consumers benefit when use of such insights leads to the creation of new forms of consumer value. And companies benefit when consumers buy more as a result (see “E. & J. Gallo Winery’s story”).

E. & J. Gallo Winery’s story

California-headquartered E. & J. Gallo Winery launched a research project with a major retailer customer aimed at deepening both players’ understanding of consumers and developing strategies to drive new growth in retail wine sales. The research illuminated four phases affecting shoppers’ purchase decisions in the retailer’s stores: pre-shop, shop, purchase, and post-shop.

The two companies paired the research findings with Gallo’s proprietary Customer Health Monitor, which “listens” to hundreds of shoppers every week to learn about their wine-shopping trips. By taking this longer view of what can influence shoppers’ behavior—not just what consumers do once they’re in a store—the two companies gained insights into how best to meet consumers’ needs.

The most intriguing insight was that many shoppers lack confidence while purchasing wine—for example, as regards properly pairing wine with food. Gallo and its retailer used this insight to develop E. & J. Gallo Winery’s “Climb the Vine” initiative. This comprehensive wine-education and merchandising program considers shoppers’ total path to wine purchase. The program is non-branded and incorporates communication strategies during each of the four shopping-process phases. The goal: to demystify wine and make it approachable for the average American shopper.

The initiative included the development of bundled kits that cross-merchandise wine with recipes at a number of locations throughout the retailer’s stores. Printed educational materials that shoppers can take home further build their knowledge of and confidence around wine.

Climb the Vine helped grow wine sales at more than twice the rate of the retailer’s competitive market. Sales of focus items soared more than 31%, and the retailer achieved a 16% jump in household penetration, actually bringing new users to the category. Gallo is now expanding the pilot program to include other retailers.60
"Leading practices for successful collaboration"

Successful collaborative relationships require hefty investments of time and resources, but such investments are necessary if companies want the payoffs promised by more sophisticated collaboration. The good news is that effective collaborations in the CPG sector are stirring interest among suppliers and retailers eager to work together more effectively.

Drawing on our experience with clients and our analysis of positive collaborations within and outside the CPG industry, we offer several suggestions for effective collaboration.

**Start small, then go larger**

Explore possible reasons for collaboration and the potential value it may offer. Start small with potential collaboration partners, testing approaches and practices. Collaboration can practice with traditional topics (e.g., product trials and promotions) or more emerging forms such as social media platforms. Track successes as well as failures, and be sure to conduct postmortems on efforts so that the learnings can contribute to future collaborations. Once you have completed a few iterations with a partner (including generating answers to the “What’s in it for me?” question), broaden your approach to include more scope as well as more sustainable procedures.

**Define the collaborative agenda upfront**

Collaboration often fails when a partner isn’t forthcoming with its priorities, which may or may not align with its counterpart’s priorities. Priorities will differ depending on the form of collaboration involved (retailer, brand, category, consumer—see Exhibit 26), but through open, upfront discussion, collaborators can align their priorities on what each party expects to accomplish together, on what lies within the scope of the partnership, and on what each company expects to achieve individually.

Says John Gehring, CFO of ConAgra Foods, “The focus on the customer and customer strategy is even more important for us now. A big portion of our business is now focused on helping our retailers, who are very focused on their own private labels and their brands. Retailers want to leverage as much resources as possible that their suppliers can bring. How can we help them increase the profit pools for their brands, in a way that will give us an opportunity to share in that profit growth?”

As Exhibit 26 suggests, the parties will also want to discuss what their selected collaboration form implies for their organizational culture, the investments that will be required to support the collaborative agenda, and the data that will be leveraged. For instance, a partner that has a heavily product-focused culture may have difficulty contributing to a collaboration aimed at significantly enhancing consumer value.

Defining what your collaboration agenda is will ensure alignment on the expected investment to be made by each partner.

**Agree on a governance model in advance**

Work with your partner to define management protocols around exceptions from or non-compliance with the collaboration effort. This may seem restrictive, not collaborative; however, it actually ensures the focus stays on the agenda and on what will contribute to that agenda.

**Define quantitative and qualitative goals of the collaboration**

With your partner, quantify the outcomes each business wants to derive from the collaboration (e.g., three new product launches, one blockbuster launch, 20% revenue growth to the category) and the qualitative outcomes (e.g., the buyer and account executive will review promotional results on a quarterly basis or will conduct monthly reviews of social media feeds across the category). A diverse array of goals can help companies generate new insights into consumers’ needs, and keep the collaborative dialogue alive in a variety of ways.
Agree on how success will be defined and measured

Collaborations often stall or are deemed unsuccessful if one party doesn’t win in the way it expected. To keep the collaboration effort aligned with the original agenda, define what success will look like and how it will be measured for each partner. Actively track the collaboration’s outcomes, making adjustments if needed as the effort unfolds. Establish metrics that reflect consumer value—such as net market share growth (by product and by customer/channel), net revenue growth, stock levels, and customer complaints.

Explains Colgate-Palmolive CFO Dennis Hickey, “You have to have mutual or shared accountabilities. When your accounts can tell you what their objectives are in your aisle or category, you can have that open dialogue. And people will be more willing to work together to create a plan for being successful.”

Use data judiciously

As Exhibit 25 shows, there are many forms of consumer data and numerous ways to leverage them. Be clear about what data you will use in the collaboration and how you will use it. Also, given that data collected is predominantly historical, articulate the assumptions the partners will make regarding that data.

Notes Maria Henry, CFO of Hillshire Brands, “Some of our grocer customers have done interesting things with their loyalty data. At the end of the day, we both want the same thing: an engaged, happy consumer who buys our products in our retailer customer’s store. We’re both trying to get velocity, higher volume sales of the product, and optimized margins. So we come together to say, ‘How do we leverage the unique insights that each of us has?”

### Exhibit 26
Forms of collaboration

<table>
<thead>
<tr>
<th>Characteristics</th>
<th>Execution: Revenue targets, sales growth</th>
<th>Consumer: Concepts, value definition</th>
<th>Category: Assortment, new product introduction targets</th>
<th>Brand: Category design</th>
<th>Retailer: Planogram design, service models</th>
</tr>
</thead>
<tbody>
<tr>
<td>Degree and nature of data (See Exhibit 25)</td>
<td>Sell-in Service</td>
<td>Revenue—retail</td>
<td>Revenue—segmented by channel</td>
<td>Category growth</td>
<td>Consumer value</td>
</tr>
<tr>
<td>Culture</td>
<td>Production-focused</td>
<td>Supplier is service provider; brand comes second</td>
<td>Product-focused</td>
<td>Category-focused</td>
<td>Consumer-focused</td>
</tr>
<tr>
<td>Nature of investment</td>
<td>Brand dominant</td>
<td>Brand dominant</td>
<td>Retailer dominant</td>
<td>Equal</td>
<td>Equal</td>
</tr>
<tr>
<td>Degree and nature of data</td>
<td>Limited definition</td>
<td>POS data</td>
<td>POS data</td>
<td>POS data</td>
<td>POS data</td>
</tr>
</tbody>
</table>

Driving consumer value

- **Consumer:** Concepts, value definition
- **Category:** Assortment, new product introduction targets
- **Brand:** Category design
- **Retailer:** Planogram design, service models

Source: PwC.
**A dedication to deeper collaboration**

Consumers are quickly moving away from the world of brands and channels, opting instead for lifestyle affiliations and engagement platforms. They are blending the virtual world with the physical world at an increasingly rapid pace. Retailers and branded suppliers must stop thinking of each other as competing franchises and instead evolve to a value chain view in which the consumer, brand, and retailer form a dynamic and evolving connection.

To do so requires a more dedicated effort toward collaboration, across all forms. Such collaboration will enable the delivery of important outcomes in the form of deeper understanding of consumers’ needs and smarter innovation and go-to-market strategies for serving those needs. It can also help build trust—that key ingredient that was often missing in earlier forms of collaboration. As General Mills’ CFO Don Mulligan explains, “Nothing between two organizations is seamless, and that’s what creates the opportunity. But, you have to have trust to make it work. Over decades, we’ve built up that trust and credibility with our retail customers, in part because we can bring tools and capabilities to these relationships.”

But many CPG companies will find it difficult to take their partnerships to the next level. Keys to success include openness and the ability to forge true partnerships that go beyond simply economic transactions. It also will require the ability for each partner to recognize its strengths and opportunities in really understanding its consumer segments, and the potential value of what a partner can bring to the table. By adopting the leading practices that have made collaboration exemplars so successful, companies can boost satisfaction among consumers, achieve cost-effective growth, and potentially infuse billions of dollars in new sales into this highly competitive and challenging industry.

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**Key questions for executives**

- What can your company contribute to a collaboration effort? Be honest about what you can really provide in terms of data, insights, resources, and other forms of value.
- What level of investment (financial, time, managerial attention) are you willing to make? Be reasonable about what you can afford.
- Is this the right collaboration partner? Many suppliers work with larger customers because they feel they have to. But is it really a collaboration? Know who you’re “dating” and make sure it’s the person you want to “marry.”
- Do you have the right capabilities for this collaboration? Executing functional activities is quite different from managing the unknown, particularly with another business. Make sure you have the right mix of experts and managers to drive desired outcomes.
- What is your timetable for results? Use this timetable to set expectations with the other company.
Winning from within
New consumer strategies require changes in organizational design

The CPG industry has undergone significant changes recently, a pattern that will continue over the coming years. Advances in technology and social media, new distribution channels, new and emerging markets, and changes in consumer behavior (due in part to the sluggish economic recovery) have all created major disruptions—and also significant new opportunities. Yet while many CPG players have taken steps to adapt to these shifts, they have mostly limited themselves to small-scale measures and isolated initiatives that often function in silos.

Leaders have discovered that these efforts are insufficient over the long term, in that they often are not supported by sufficient changes to the organization’s design. The magnitude of the shifts now underway in the CPG space requires more than a “shuffling of the deck” or a few new roles added to the org chart. Ask yourself: Is my organization ready, in terms of talent and structure, to respond to and enable this change? Take heed: The large external changes in the CPG market require correspondingly large internal changes.

The recent shift to omni-channel distribution is a good example. Customers now expect the ability to research, purchase, and return products through any channel—in physical stores, online from personal computers, via mobile devices and tablets, etc.—while receiving a consistent brand experience across them all. In the CPG space, this requires far more collaboration between manufacturers and retailers to assure transparency on inventory, accelerated order processing, and other factors that impact the customer experience. This degree of collaboration will require new roles and the deployment of new technology, and the new elements cannot be simply bolted to the side of the existing organization. Instead, management must decide how to fit them into their enterprise structure, with the appropriate responsibilities, decision rights, motivators, talent development, and other organizational factors.

Already, the industry has seen some major decisions reconsidered or fully reversed, as CPG players seek the right structure to support e-commerce and their digital presence. For example, Target initially outsourced its entire e-commerce platform to Amazon in order to establish an e-commerce presence for a key holiday season. But given the recent push toward omni-channel expansion, the leadership team realized that it needed a more direct relationship between its online operations, merchandise management, and physical stores, and in 2011 Target implemented in-sourced e-commerce capabilities. Similarly, Walmart.com was originally set up as a separate organization from the main brand but was recently reintegrated as a component of the company’s new @WalmartLabs. Formed in 2011 around social media technology start-up Kosmix (which had been acquired by Walmart earlier in the year), @WalmartLabs is tasked with innovating the retailer’s social and mobile data capabilities.

In the case of both Target and Walmart, the companies had to build up the relevant internal digital expertise, through teaming with experienced e-commerce consultants or via focused acquisitions that included both content/talent, to enable faster innovation and support their new e-commerce expansion strategies.

Marketing departments often drive these initiatives, particularly in social media, because they are so much closer to the consumer. “Quite frankly, I think marketing folks have to drag the rest of the organization along and help us understand this stuff,” says ConAgra CFO John Gehring. “They continue to research and push; as a result, they’ve helped us reallocate our resources to spend more time with the consumer.”

ConAgra CMO Joan Chow shares her thoughts from a marketing standpoint: “Years ago, we took senior management through Facebook training, Twitter training, what blogging meant, showed them online bloggers who were writing about food, etc. That’s how we got them to believe in the fact that we needed to invest money and people resources into doing this for our brands. We showed them: This might be one person, but this person has many followers. And through their own Twitter and Facebook followings, the impact of one person could be magnified to a significant extent.”

“We have changed our organization considerably over the last couple of years,” says MillerCoors CFO Tracey Joubert. “We have social media departments in our marketing teams, and they have partnered with vendors and consultants who have helped us track and measure
Winning from within
New consumer strategies require changes in organizational design

engagements on social media. We use Twitter and Facebook and we use consultants to manage those accounts on a 24-hour basis. So we’ve shifted quite a bit of marketing spend and resources to the social media space.”

Another key aspect of organization is considering if you have the right balance between centralization and decentralization—particularly crucial as CPG companies tap into new markets overseas, and for global e-commerce. A high degree of centralization offers advantages in terms of control and faster rollout of new products. However, some divisions or business units may need to move quickly—for example, in order to innovate or respond to rapidly evolving market conditions—and so require a greater degree of autonomy from corporate headquarters.

For instance, we are seeing in the social media space, leading edge companies and brands are moving from a centralized social media response and monitoring team (often within marketing functions) to decentralization, as they want more and more employees across the organization and globe to participate. However this comes with proper training and accountability boundaries. On the other hand, the move to having a shared supply chain and shared go to market organization that transcends business units, is gaining ground. So both front of the house as well as back of the house functions could be centralized or decentralized. In recent times we have seen both retailers (Delhaize Americas) and CPG companies (Coca Cola Americas) go this route.

The challenge is often balancing centralization in some functions while decentralizing others, allowing the company to add value most effectively to its consumers, customers, and shareholders.

All three of these areas—omni-channel fulfillment, direct-to-consumer (DTC), and decentralization—reflect the CPG industry’s attempts to better respond to the changing consumer and technology landscape as well as build competitive advantage. However, the strategic choices made by management are only the first step. As with any business initiative, in any industry, even the most brilliant and timely strategic choice is unlikely to succeed without the right underlying business organization in place to support it.

Five key principles
In redesigning their organizations to support strategic choices and more effectively stay ahead of market shifts, successful CPG companies should ask themselves five key questions.

1. Does my company have a clear strategy in place to capture these new and emerging business opportunities, and does our organizational structure support that strategy?

2. Do we have the right talent in place?

3. Do we deliver a consistent brand experience across all possible technologies and channels?

4. Do we have a clear read on the organization’s culture, and the way that it will support—or undermine—organizational change efforts?

5. Do we have the right metrics in place to gauge success?

Each of these questions serves as a jumping-off point for a more detailed discussion.

1. Does my company have a clear strategy in place to capture these new and emerging business opportunities, and does our organizational structure support that strategy?

Successful organizations start with strategy—form follows function. Regardless of what strategy you choose to capture new market opportunities, you need to be purposeful and intentional about the organizational changes you will need to make in order to support that strategy. Begin with a review of the company’s global footprint and the numerous channels used to engage customers. While there is no one-size-fits-all solution for CPG companies, the right strategy for most companies in the near term will involve some combination of the themes that we have discussed in this report—a closer relationship to the consumer (via DTC initiatives), greater engagement through social media, stronger collaboration with retailers to support omni-channel fulfillment, and a greater ability to harness insights from data. A key stepping stone will be to identify cornerstone roles for your new strategy and start the reorganization process around those.
P&G’s “Connect+Develop” platform is a good model for how a long-established CPG company can make organizational changes to stay ahead of a shifting market. Another good example is Hillshire Brands, which recently created a new role—chief innovation officer—to oversee the company’s innovation agenda and report directly to the CEO. The company moved the consumer insights function under this new leader and funded it with sufficient investment, allowing Hillshire to more effectively capitalize on new opportunities identified through customer feedback. “By bringing in a very senior, very talented leader, we wanted to make sure innovation was integrated throughout the entire company,” says Hillshire CFO Maria Henry. “We’ve completely changed the process and deployed R&D resources. The innovation pipeline is now more significant than in the past, and we have a specific revenue target for new products over the next two years. So we’re seeing the benefits of those moves already, and consumers are as well.”

2. Do we have the right talent in place?

Once they have a more coherent organizational design in place—one that is aligned to support their strategy—companies will need to objectively determine whether they have the right talent in place. In the likely case that they find gaps in key areas, they will need to decide between training current employees or bringing in talent from outside. Often, this decision is driven by timing. Training takes time and requires new curriculum to develop resources toward new roles that have no track record in an organization. Companies that are looking for faster results will likely need to hire from outside the organization.

“We’ve brought in more talent, who are much more comfortable with and really understand the digital technologies,” says Bert Alfonso, President, International, for The Hershey Company. “The talent tends to be younger individuals because they’re not only more savvy about current technologies, but they’re also participants of social media. Having the talent in-house helps us really take advantage of the technologies. They influence our marketers, how senior management thinks, and expose us to how quickly technology is changing.”

The lingering effects of the recession factor into this discussion as well. During the industry’s rocky period of 2008–09, many CPG companies cut costs substantially and laid off workers. Even though the economy has begun to rebound and the industry has nearly returned to its historical growth trajectory, many companies have not returned to their pre-recession workforce. This gives them room, in both headcount and salary costs, to add back strategically. A clear articulation of their strategy—and the skills and capabilities needed to support that—will allow them to be more effective as they scale back up.

A good example of an increasingly critical skill is the ability to harness data. A decade ago, CPG companies were effectively limited to transactional data from syndication agencies: basic metrics such as volume, packaging size, and trade promotion effectiveness for key accounts, with little or no direct interactions with consumers. Today, the emerging omni-channel and DTC approaches to distribution have made consumer insights more complex but also more crucial for success, and collaboration with retailers can yield still more insights. CPG companies can now reach consumers through multiple touchpoints.

For example, the senior marketing people at many CPG companies formerly served primarily to coordinate advertising for the brand. Now, they are shifting to more of a strategic marketing role. In addition to focusing on the company’s outbound branding and marketing messages, they also analyze the inbound consumer insights coming through their various touchpoints. This strategic insights role can fall under multiple areas of the company: sales, marketing, finance. It is essentially an organizational design consideration.
3. Do we deliver a consistent brand experience, both internally and externally, across all possible technologies and channels?

Strong brand promises are seamless, both internally and externally. With consumer technology such as social media and mobile devices on the one hand, and consumers’ expectation of individualized experiences on the other, companies face a heightened need for fine-tuning their brand promise experience and delivery to their most loyal and promising customer segments.

This brand promise has to be understood universally, both externally (by consumers) and internally (by employees). Companies are tweeting back to consumers in real-time, and employees who don’t understand or cannot articulate the brand promise during those exchanges can become a significant liability. In addition, with each consumer empowered by technology to spread the word about his or her brand interactions, a single bad customer experience can quickly escalate into a public-relations firestorm.

In response, many CPG companies have created a dedicated social listening function that monitors social media outlets for any mentions of the company, in order to track trends and spot potential problems before they blow up. Other companies have gone a step further and created more proactive roles within the marketing function: brand ambassadors who receive training and whose sole task is to actively promote the company and shape public opinion of its brand through social media.

Again, this is essentially two decisions. First, the company must make a strategic choice as to how aggressively it will leverage social media. Second, it must decide on the right organizational design to support that choice. There are a number of innovative and nimble external agencies that can handle the entire function for companies that wish to outsource. Other companies—especially larger players—will likely decide that this function is critical enough to establish internally.

In other cases, companies have applied social media internally, to break down barriers, foster collaboration, and offer greater access to information. For example, PwC worked with one CPG manufacturer to develop a proof of concept for the use of Salesforce.com’s Chatter solution on company-provided iPads. The results were greater adoption rates among internal staff, renewed collaboration among siloed business units, a reduction in duplicate efforts and resources, and greater overall productivity.

4. Do we have a clear read on the organization’s culture, and the way that it will support—or undermine—organizational change efforts?

Culture trumps strategy every time! It influences organizations in profound ways, by shaping the way things actually get done on a day-to-day basis. And when that culture changes, things can get pretty sticky.

Do companies need a disciplined approach to managing change throughout the organization? The scenario is all too familiar: A group of employees nods solemnly as an executive presents a new change in the organization…and then they promptly return to the old way of doing things once the meeting is over.

To overcome this tendency, management must ensure that the right culture is in place, in part by setting the right tone from the top. Change management is a strategic agenda for the senior executives today and many organizations look to foster greater engagement among employees at all levels, empowering them with the information and know-how to influence decisions and encourage ownership of the results.

Culture is particularly relevant in the CPG segment, where many long-established companies have strong cultures in place—and where their grocery partners are relatively traditional in their approach to operations. While that history serves as a kind of ballast during disruptions, it also slows the pace of change for organizations and makes large organizational initiatives harder to implement.
Overcoming this inertia often entails a large change-management effort. Companies must identify the new behaviors that they require and alter the rewards (compensation, bonuses, promotions, etc.) to get employees moving in the right direction. The goal is not to implement to a new, ideal end state but rather to create an innovative culture that’s flexible enough to adapt to evolving markets. In large part, that entails attracting diverse thinkers who can challenge the status quo, shed preconceived concepts for delivering value in today’s economy, and drive the new business strategies.

5. Do we have the right metrics in place to gauge success?

Another element of change management is assessing whether the redesign is meeting pre-established goals. To determine this, management will need to determine the right set of metrics and rewards, in order to support the organization design to achieve market success. Successful companies evaluate success by measuring what matters.

Rethink, redesign, connect

The overall goal is not just a set of isolated measures. Instead, management teams should ask themselves these questions to get a big-picture view of whether the organization has the right structure in place to better understand and serve the customer. If not, it will need to make changes, by establishing the right roles, decision rights, and processes. Organizations that rethink the way they work and how decisions get made will position themselves for success.

As Sunny Delight CFO Bill Shumacher notes, this tone often gets established at the top: “Everyone around the organization understands that this is the direction we need to go in—becoming more customer- and consumer-centric—and that’s how we’re going to win long-term. Our CEO’s viewpoint is in alignment with that. His chief concern, as well as mine as CFO, is how can we make sure that we’ve got the right resources and the right investment commitments to make that happen.”
Section 3
Focus on innovation that goes direct to the consumer

Once companies have identified their consumers, understood their motivations, and connected with them in an active real-time dialogue, they have the opportunity to go even further, refining their product offerings and complementing those products with service innovations that enhance value, based on their consumers’ real, identified wants and needs. By listening and becoming even more what their customers want, CPG companies can cement the consumer bond.

But doing so requires a sound framework for creating and commercializing breakthrough innovations—an attribute many large companies have historically lacked. By adding new “intrapreneurial” innovation operating models to the more traditional R&D/M&A mix, CPG companies can more readily identify and commercialize new ideas and value opportunities—without requiring huge transformations and investments, and without disrupting their focus on maintaining a lean, efficient business. Manufacturers have an added innovation imperative: rewriting the rules to seize new direct-to-consumer opportunities and challenge retailers’ traditional last-mile relationship with the consumer.
Redefining your core
Avoiding the tragedy of commonness

For decades now, CPG companies have poured money into product development. This investment has produced some successful incremental innovations—products that are marginally better and cheaper, delivered to market more quickly than previous offerings. However, this single-minded focus on product development has also led to a competitive stalemate: Products have become less and less distinguishable from one another, making it harder for consumers to get the customized solutions they demand and expect.

Moreover, rival companies can quickly match one another’s incremental innovations, which diminishes returns on all players’ innovation investments. When companies make similar heavy investments and follow similar product development road maps, they generate a similar range of new or improved product options. Result? A battery of “me too” products—and a war that nobody wins. We call this predicament the tragedy of commonness.

As Steve Voskuil, Vice President of Finance for Kimberly-Clark International, says, “We use a similar term: the sea of sameness. When you go down the store aisle, everything looks the same—the same kinds of packaging, same kinds of claims. Our goal is always to try to find a way to stand out from the sea of sameness. If we don’t win the battle for the consumer at the point of purchase, there’s a good chance we will lose the war. One of our principles is to leverage local consumer understanding, local market knowledge. This allows us to get much more creative at the point of purchase, to appeal to local consumers in ways that are very relevant to them. If they see our package on the shelf and it stands out because we’re using local idioms or referencing customs or traditions unique to that market, they notice that. Being very local is a differentiating strategic factor for Kimberly-Clark.”

Leading companies both inside and outside the CPG sector have begun taking action to escape the tragedy of commonness. In particular, they are redefining their core business by complementing their product offerings with service innovations that enhance the value provided to customers. A classic, well-established example in the aircraft engines industry is Rolls-Royce’s “Power-by-the-Hour” offering, which celebrated its 50th anniversary in 2012. Introduced to support the company’s corporate jet engine business, Power-by-the-Hour was designed to provide a complete engine and accessory replacement service on a fixed-cost-per-flying-hour basis, allowing operators to remove risks around unscheduled maintenance events. The service is now part of Rolls-Royce’s CorporateCare offering, which also provides engine health monitoring and a global network of authorized maintenance centers.

Steve Voskuil reflects on how Kimberly-Clark has approached service innovation: “In both our Healthcare division and our Profession division (K-C’s B2B business unit) our product portfolio is only one aspect of the total solution. For example, we’ve launched a service program called The Healthy Workplace Project especially for customers with dense employee populations in dynamic office settings. This program helps them engage employees to adopt healthy hand hygiene habits, especially during cold and flu season, to help them reduce absenteeism and turnover. Services like this provide tremendous additional value to our customers, and help differentiate us from our competitors.”

Companies that pair service and product innovation can reap rewards including higher total revenues, better returns on their innovation investments, stronger brand loyalty, and bigger market share. Savvy CPG companies are taking notice and redefining their own core to capitalize on this approach. By learning from leaders in other industries, they’re capturing valuable insights and avoiding roadblocks that the pioneers had to surmount.

Adopting this approach isn’t easy. But companies can make a good start by first understanding the stages of maturity through which solutions innovators must journey. Then, they can familiarize themselves with leading practices essential for successful product-service integration.
The stages of service innovation maturity

Mastering the art of pairing product and service innovation is a process. Our research shows that leading companies advance through four stages of maturity (see Exhibit 27). As companies move through the stages, they add more services to their offering portfolio and capture new sales opportunities.

Stage 1: Product-centric manufacturer

Companies provide basic after-sale support for products, such as listing a toll-free number on products for consumers to call with questions or comments. Product sales are paramount, and a company’s service organization consists of an after-sales department focused on moving and supporting products. Revenues derive primarily from product sales, rather than from services that enhance products or build consumer loyalty.

In this stage, companies have a basic service management system focused on measuring product quality and reliability. Customers typically view a company’s service and product functions as distinct entities.

Stage 2: As-needed service provider

Companies provide a limited number of services based on consumer needs that have always been there but that the businesses had not been meeting. Some of these services complement the products on offer. For example, a pet-supply retailer sells dog grooming services and obedience training classes in its stores and offers free workshops on oral health for pets. Other such services may take the form of new conveniences provided by innovative product packaging or features.

Companies in this stage formalize their service management systems only for the few services they offer, and they measure service quality and reliability against established targets that they’ve defined by using customer feedback. Services generate a relatively small portion of their total revenue but may prompt consumers to buy more of the products on offer. As in Stage 1, consumers still view the service and product functions of these companies as distinct entities.

Stage 3: Full-line service expert

Companies’ portfolios include a full line of services and products aimed at solving customers’ individual problems and providing a differentiated experience. A case in point is P&G’s Mr. Clean Car Wash centers, which provide interior and exterior cleaning, detailing, oil change, and vehicle maintenance services. P&G also launched the online and brick-and-mortar Art of Shaving stores, which sell shaving and skin- and hair-care products, offer guidance for men on how to use the products, and give advice for individuals seeking to buy gifts for men.

Companies in this stage often consolidate their service organization into one distinct business with its own profit and loss (P&L) accountability. Typically, the service organization coordinates with other divisions to keep operations flowing, but is not the primary driver of product and service innovation. Products still hold a pivotal position in the company; however, service organizations often take part in the early stages of product development, with an eye toward enabling individual differentiation.

Consumers perceive no major boundaries between products and services. The service innovation capabilities of the best performers in this stage reflect a strong understanding of customers’ stated as well as unstated needs. Moreover, senior management pays close attention to service quality and reliability data.

To provide consumers with this truly individualized differentiation, companies must excel at “behind the scenes” operational innovations that make it easier for customers to “try and buy” and that enable the company to swiftly address after-sale service challenges. A case in point from the high-tech industry is Dot Hill Systems, which provides software and hardware solutions for storing, sharing, protecting, and managing data. Supervised by an authorized reseller partner and the Dot Hill Channel organization, the Dot Hill Try-and-Buy Program allows qualified end-user customers in North America and Europe to acquire a Dot Hill solution on a 30-day trial basis in order to evaluate the storage system for their specific needs. Dot Hill also offers a trade-in program, applicable to both existing Dot Hill models and storage arrays from other vendors, that offers customers discounts of up to 25% on certain new systems.
Stage 4: Integrated solutions provider

Companies provide integrated solutions that enable customers to extract more value from product and service experiences without having to pay more. Few companies—in any industry—have reached this stage. Those that have are often recognized as market leaders that shape industry thinking through innovative solution approaches, as Rolls-Royce did through Power-by-the-Hour.

Service innovation in this stage is driven by a deep understanding of customers and their needs. Processes used for developing solutions are collaborative and extend to suppliers and customers alike. Moreover, the best innovators integrate solutions while staying true to their brand and their core product competencies. Wine maker E. & J. Gallo has done this through its “Climb the Vine” initiative, which demystifies wine-buying for consumers through education and merchandising campaigns (see “Collaborating with business partners”).

To excel at this type of innovation, companies must alter their traditional business model, whose key components include their value proposition (what they provide customers), their value network (how they provide that value), and their target customer (to whom they provide the value). A company could, for instance, fully integrate its service innovation organization with sales, manufacturing, and other units. As a result, boundaries in the solution supply chain would become invisible to customers. Such companies may also share data about service quality and reliability with external partners to drive innovation.

Leading practices for service innovation management

Producing ever more tightly integrated product/service combinations doesn’t come easily to companies with a long-held product orientation. In fact, the journey is so challenging that most companies in the CPG sector are only at Stage 1 or 2 of the maturity model. We are, however, starting to see some of them edging toward the later stages, following the evolution witnessed in other sectors.

To advance to more mature stages, CPG companies will need to resist any urge to simply bolt services onto their products. Instead, they must co-develop services with products, while keeping a keen eye on customers’ needs. The following leading practices can help them achieve this difficult feat.

Expand your value proposition

To provide customers with new forms of value, companies must gain a detailed, comprehensive understanding of their customers. Traditional approaches to consumer research and analysis have some usefulness, but they don’t help companies uncover all of their customers’ unspoken and unmet requirements.

Uncovering those needs calls for close encounters with customers. Correctly designed, such encounters enable a company to listen and observe as customers use products and services. Several methodologies exist for designing and managing such encounters, including voice of the customer methods and an ethnographic approach. Unlike traditional approaches, these frameworks help companies identify opportunities that reside deep inside customers’ minds, beyond their conscious awareness.

Identifying customers’ unspoken and unmet needs can help companies generate ideas for going beyond merely selling products to create new forms of value for consumers. General Mills CFO Don Mulligan points out that households that are active on the company’s sites, such as Pillsbury.com and BettyCrocker.com, “spend 20% to 25% more annually than average households. Customers get recipe ideas in real time and also share ideas, so they’re part of a community.”

Educating consumers about a product can also create new forms of value. As Godiva CFO David Marberger explains, “There’s a huge opportunity to educate consumers about cocoa and dark chocolate and what the different mixes of cocoa beans mean. Consumers are interested in these things; they’re not just buying a piece of chocolate.”
Create an integrated innovation organization

To reach the more advanced stages of service innovation maturity, companies need to rethink how they structure innovation management responsibilities. While business-model innovation lies at the heart of service innovation, in many companies it is managed in a different part of the organization than product innovation. In traditional product-oriented organizations, R&D groups are responsible for technology and product changes, while strategy-development and brand-management groups manage business-model innovation. This siloed organizational structure impedes integrated development of products and services. To surmount this obstacle, companies need an innovation “center of gravity” to manage both product and business-model innovation.

Establishing a chief innovation officer position and accompanying staff can provide this center of gravity. As Hillshire Brands CFO Maria Henry explains, “Our innovation organization is very integrated with our brand teams, our R&D team, and our sales force. We get a lot of
consumer insights from our brand teams, and the sales force is out there every day with our customers and going head-to-head with our competition. They’re seeing products on the shelf and dealing day-to-day with pricing decisions we make. Our innovation organization, while it’s separate and has pockets of expertise and specific roles, is incredibly collaborative with the other front-facing teams, to bring together all of the best thinking under one umbrella.”

**Develop robust partnerships**

Innovation requires strong partnerships to foster the creativity and commercialization essential for integrating services with products. Many established companies are good at commercializing their incremental products—for example, by partnering with other companies that make components or that provide a new distribution channel into a target market. But because service innovation entails business-model innovation, it calls for new types of partnerships to build novel value networks. Companies that excel at such partnerships extend their collaborative prowess into a wide range of new relationships, from simple vendor arrangements to strategic partnerships built on sharing risks and even intellectual property.

A label company we’ll call Texas Coater is an apt example of how partnering among multiple players in an industry’s value chain can generate win-win solutions for all parties, including end consumers.66 Texas Coater makes adhesive laminates that are then sent to the company’s customer, EZ Printer, to become printed labels on beverage bottles. Laminate labels are superior to paper labels functionally and aesthetically, so a cold-beverage company called Best Beverage wanted to switch to laminate. But EZ Printer would barely break even if it paid the price Texas Coater wanted for the labels and then sold them at a price Best Beverage was willing to pay. To solve the problem, Texas Coater and EZ Printer co-developed a production schedule to maximize runs at both facilities, thus driving down costs. EZ Printer press operators also provided real-time feedback to Texas Coater on problems with the laminate, such as wrinkles in the material. Texas Coater used the feedback to improve the material. In addition, the three companies co-developed a prototyping tool for joint design of labels, which enabled Texas Coater’s label designers and Best Beverage’s marketing team to identify potential design issues before going into production.

Thanks to these partnerships, Texas Coater’s production volume and profitability improved, and EZ Printer’s business with Best Beverage grew. Best Beverage’s time to market for new labels decreased and shop-floor uptime improved. Label quality also improved, which translated into more satisfied customers.

**Getting to service innovation maturity**

When companies embrace integrated product and service innovation, their competitiveness, margins, and growth improve markedly. To be sure, moving through the four stages of service innovation maturity isn’t easy. But expanding a company’s value proposition, creating an integrated innovation organization, and building a wider network of strategic partnerships can all help.

**Five questions for executives**

- What stage in service innovation maturity is your company currently in? If you believe that the company is in Stage 1 or 2, what revenue opportunities might it be missing?
- What returns on product and service innovation does your company typically achieve? How might your company improve those returns?
- In what ways could your company expand its value proposition beyond its existing products, to include services that provide new forms of value to consumers—at no additional cost to them?
- To what degree does your company integrate business model and product technology innovation? If you believe that the company could improve in this area, what changes could it make in terms of organizational structures and roles and responsibilities to create an innovation “center of gravity”?
- How effectively does your organization partner with ecosystem players including suppliers and customers to co-develop integrated products and services? If you believe that your company needs to partner more effectively, what steps could it take to do so?
Balancing operational excellence with breakthrough innovation
Driving profitable growth

During the global economic downturn and the beginnings of recovery, CPG companies have excelled at pursuing operational excellence—deploying practices such as Six Sigma and supply chain optimization to reduce operational expenditures and deliver incremental innovations swiftly, efficiently, and inexpensively. This focus has served many companies very well, by fostering an environment supporting new levels of efficiency in key operations. It has also driven improvements in traditional R&D processes. Armed with diagnostics, benchmarks, and leading practices, companies have boosted the throughput, speed, and yield of their traditional R&D. These gains, in turn, have delivered incremental product and service improvements that have helped companies grow organically, protect their market share, and maintain margins.

However, the focus on operations has also reduced companies’ ability to steadily create and commercialize the breakthrough innovations needed to fuel significant growth over the long haul. Breakthrough innovations constitute major changes to the technologies or business models behind a product or service, typically delivering a 25%-plus improvement in cost, performance, or customer value and creating competitive advantages that drive higher-than-average revenue growth. In their most extreme form, such innovations may introduce entirely new value to customers, new players into the ecosystem, and new technologies for making and delivering a product or service. They may even create new markets.

Companies’ emphasis on operational excellence, while understandable and useful, has left little room for radical innovation in products and services, business processes and models, and new-business creation. Some companies have tried to combat the problem by augmenting traditional R&D with mergers and acquisitions (M&A) aimed at generating inorganic growth (see Exhibit 28). Yet M&A history is mixed. Some acquisitions have proved successful, while others have produced lukewarm results or been outright failures.

Continental Mills has been on the winning side of the battle. According to CFO Mike Castle, the company’s acquisition of WildRoots natural and organic foods “has been focused on innovation and infusing a philosophy and culture of high-speed innovation. It has definitely had an impact on our growth rate, how we look at innovation, and forcing us to look at the rest of our company and ask, ‘How can we get to market faster?’ A very positive influence on the overall innovation of our company.”

M&A can provide immediate lifts to revenues and sometimes set the stage for stronger organic growth by bringing new R&D capabilities into the organization. But the shift to inorganic growth has proved a double-edged sword: New R&D capabilities generally only give companies more incremental innovation. And while large M&A deals may add revenues, only the fortunate few bring breakthrough innovation capabilities into the acquiring business.

Large companies have historically lacked a sound framework for creating and commercializing breakthrough innovations. This lack was partially responsible for the rise of entrepreneurial hotbeds such as Silicon Valley, as well as the notion of the “innovator’s dilemma”: People who had big, entrepreneurial ideas felt constrained inside companies that had no clear avenue for commercializing those ideas. As a result, they left those organizations and formed new ventures, in the process creating the impression that only startups can envision and commercialize the next new big thing.

Exhibit 28
Traditional R&D and M&A as growth drivers

Organic
Traditional R&D
Inorganic
M&A

Profitable growth

Source: PwC.
Experimenting with innovation activities

Some companies have added new innovation capabilities to address the innovator’s dilemma. For example, some have deployed disciplined approaches to identify significant new value opportunities and quickly commercialize promising new ideas. As a result, they’ve improved the balance between their operational and innovation capabilities. This in turn has enabled them to protect their market share and margins in their core businesses while also driving significant new growth.

But no clear road map exists for this change. For this reason, companies began by experimenting with new activities that were added to their traditional R&D and M&A strategies (see Exhibit 29). For instance, some began using rapid prototyping of business models and technology to accelerate development, lower costs, and create breakthrough innovations. Others collaborated with outsiders such as universities and suppliers or used innovation tournaments that encouraged employees and external experts to compete to develop the best breakthrough innovations. Still others created new boundary conditions by pulling new players into their team, and explored data mining as a way to unlock insights that could lead to radical ideas for new products, services, or businesses. Some companies employed ethnography and voice of the customer tools to gain deep insights into customer’s unstated and unmet needs. Others challenged their innovation teams to come up with new answers by constraining the possible solution set. Some companies told their teams to look at markets with fresh eyes and design new products starting with a clean sheet of paper.

Experimentation with these activities has led to a number of successful innovative offerings in the CPG space. Examples include Clorox’s Bleach Pen and Coca-Cola’s Freestyle beverage dispenser. In addition, companies looked at new ways to create value by innovating their business model— their choices about what value proposition they will offer, how they will deliver that value, and who their target customers will be. New business models led to the creation of novel and profitable services and solutions. For example, Walmart and other grocery retailers moved into clinical medical services by building on their pharmacy businesses. And some companies adopted high-speed prototyping of business models and product technology to accelerate development, lower costs, and create radical new offerings. James Dyson, for instance, engineered 5,127 prototypes in five years before releasing his revolutionary—and highly successful—cyclonic upright vacuum cleaner.

Codifying experiments into new innovation operating models

As companies experimented with innovation activities to augment their traditional R&D and M&A tactics, those activities evolved and became codified. This led to the emergence of new innovation operating models such as the use of incubators, open innovation, corporate venturing, and others (see Exhibit 30). None of these new models leapt fully formed into the CPG sector, ready to deliver commercial success. Instead, each has evolved as companies have embraced them, learned from their experiences, and refined the models. Still, the new innovation operating models differ markedly from traditional R&D approaches (see Exhibit 31).
Exhibit 30
New innovation operating models

**Innovation operating model** | **Description**
--- | ---
**Incubators** | Small startups inside a company that provide intrapreneurial zeal and speed through activities such as rapid prototyping, to foster fast commercialization of radical innovations.

**Co-creation** | Systematic development of networks of individuals, stakeholders, and enterprises to create value together through engagement platforms.

**Open innovation** | Use of external and internal resources to generate ideas, support development, and commercialize ideas.

**Corporate venturing** | Investment of corporate funds directly in external startups to gain a specific competitive advantage.

**Reverse innovation** | Development of local products in emerging markets and distribution of successful products globally.

**Design thinking** | Careful observation of users as they engage with a product or service and use of rapid prototyping to drive exploration and development of new offering ideas.

**Frugal innovation** | Economical use of resources and use of strong constraints to stimulate breakthrough innovation.

Source: PwC.

Exhibit 31
Differences between traditional R&D and new innovation operating models

**Traditional R&D**
- Linear process; target oriented
- Slow clock speed; deliberate approach
- Small, measured steps; small improvements
- Find solution: know what it will look like
- Condition driven; develop around existing products/services
- More knowns than unknowns
- Knowledge management
- Well-resourced cross-functional teams
- Disciplined problem solving
- Committee governance
- Smart revenue and talent acquisitions

**New innovation operating models**
- Iterative process; value oriented
- Very fast clock speed through rapid prototyping
- Big improvements from lots of little steps
- Explore aggressively: know when it's done
- Ambition and vision driven; create new platforms and rules of the game
- More unknowns than knowns
- Ignorance management
- Hungry, lean, highly leveraged intrapreneurs
- Disciplined creativity and commercialization
- VC board governance
- Partner of Choice

Source: PwC.
Thanks to these differences, the models have added entrepreneurial, startup capability back into large companies without disrupting businesses’ drive for operational excellence and without requiring companies to make massive transformations. Indeed, the models collectively serve as a new “lever” for breakthrough innovation, augmenting the two incremental innovation levers represented by traditional R&D and M&A (see Exhibit 32).

As companies moved from experimenting with new innovation activities to codifying them into new innovation operating models, they established organizational structures, processes, and roles that further enabled those models. For instance, some companies now have an executive in charge of leading open innovation or other innovation operating models the company has adopted. Others have a business group and processes dedicated to corporate venturing and driving breakthrough innovations outside their traditional core businesses. Take MillerCoors: “We have a department that’s dedicated to looking for new ideas,” says CFO Tracey Joubert. “But the most important thing to us is the quality of our beer; we can’t compromise on it. So we initially separate our innovation brands from our mainstream, using pilot breweries that can experiment with complexity in the production and processes. They make a small volume of an innovation brand, and if we can scale it, we may put it into one of our bigger breweries. This lets our bigger breweries focus on the core and not have to deal with the complexities of small runs and experimental brands.”

Exhibit 32
A third lever: new innovation operating models

Source: PwC.
Striking the right balance

Despite the gains achieved through the adoption of new innovation operating models, CPG companies still face numerous challenges in capitalizing on these models. For one thing, many executives wonder whether their companies should strive to excel at all of the models, focus on just one or two, or combine them strategically to generate the most traction. Each model is equally difficult, and bringing some or all of them into play within a company requires significant effort. Companies must manage them in ways that enable the models to co-exist—and thrive—alongside traditional R&D and M&A activities, all while sustaining operational excellence. Companies that strike this delicate balance succeed in insulating their breakthrough innovation activities from the corporate immune system, without isolating those activities.

To achieve this balance, CPG companies need to make thoughtful choices about a number of interrelated areas of their business: innovation strategy, funding, organizational structure, ecosystem partnerships, and metrics and motivators.

Innovation strategy

Senior managers must decide what types of innovation their company needs most to meet its business objectives, and then formulate an innovation strategy for each business unit or product line. Strategies may range from “play not to lose” (protecting and maintaining market share and margins) to “play to win” (building entirely new growth platforms).

Sunny Delight’s Rick Zimmerman discusses some of the questions his company asks itself around innovation: “SunnyD will celebrate its 50th anniversary next year. Few brands last that long. When you do, the brand becomes more and more ‘owned’ and controlled by its consumers. You might have one impression of the brand and what it stands for, but the consumer might have another. So changes become tricky—the current consumer tends to like the brand just the way it is. Any business with a large installed base has to ask itself: ‘How far away from that base should we go when we innovate? How much effort should we put into making improvements for the current user, versus creating new things to attract new users. Do we want to create new brands? What’s the right allocation of resources? It’s the classic Innovator’s Dilemma.”

The best enterprises support multiple innovation strategies, each tailored to their business units or product lines. “The challenge is how to move from innovation to commercialization faster,” says ConAgra’s CFO John Gehring. “There are a lot of steps that have to be taken. You have to pick your bets, because you can’t launch everything that you’ve come up with all at once. The launch costs are significant. You have to prioritize and really maximize the value of your innovation resources.”

Funding

Companies need to ensure that groups tasked with breakthrough innovation have dedicated funding for activities such as research, concept exploration, and prototyping. Indeed, highly innovative companies typically invest 30% to 40% of their innovation spend on radical ideas. At Sunny Delight, “About half of our annual capital budget is focused on maintaining our operations, equipment, and technologies, as well as cost saving projects,” says CFO Bill Schumacher. “The other half is focused on our innovation pipeline, so we can continue bringing new products to the marketplace, whether they’re flavor options or more innovative packaging options.”

Yet how a company spends its innovation funding matters far more than how much it’s spending. For example, 3M’s allocation of funds has boosted new product sales as a percentage of total sales from 21% in 2005 to an anticipated 40% in 2015.67

Organizational structure

Breakthrough innovation groups may take several forms, including a centralized unit that reports to corporate and serves all strategic business units, and multiple units distributed across strategic business units or geographies. Says Steve Voskuil, VP of Finance at Kimberly-Clark International, “We have innovation centers around the world, in Colombia, in Korea, and Brazil, along with local innovation teams. Our model is not to design at the center and then push a one-size-fits-all solution out to the world.
Instead, our local teams respond to consumer needs to come up with winning ideas that are relevant and cost-effective for the local markets. Of course, if a new idea is successful in one market, we try to globalize it by giving other teams an opportunity to run with it in a way that works in their markets. To make this as efficient as possible, we have vendors around the world that provide materials to help us make the supply chain more efficient. And our global sector team figures out how to make small changes to local ideas so they’re easier to export.”

But regardless of how they’re configured within the organization, these groups should be insulated but not isolated. Companies must ensure that these groups forge internal links to parties such as business units, corporate, and key functions such as sales, procurement, IT, HR, and finance. They need external links as well—to suppliers, customers, venture capitalists, investors, universities, and individual inventors.

David Marberger of Godiva says, “We’re very matrixed here, and you have to be. You have to because the innovation process, why it’s so tricky, is that it touches every function. You come up with a new concept, and right away you say, ‘What’s the consumer proposition? What are the economics like coming out of the gate?’ You have to have a lot of discipline with finance touching innovation with R&D, and with manufacturing. All those functions have to be involved early on, when you’re doing preliminary concepts. And then, when you approve it along the way, there has to be a lot of cross-functional involvement there. I think it’s the hardest process in any company because it’s so cross-functional.”

“Innovation is a team sport,” says Clorox CFO Steve Robb. “It requires collaborative thinking and open communication among cross-functional teams, as well as with management. At Clorox, we recently invested in a new campus in Pleasanton, California, which serves as a hub for much of our innovation work. The open workspace design enables functions like R&D, Global Insights, Product Supply, and Marketing to work together on all phases of innovation—from discovery and development to commercialization.”

**Ecosystem partnerships**

Exemplars of breakthrough innovation excel at partnering with internal and external ecosystem players, and the holy grail of this capability is to achieve “Partner of Choice” status. Partnerships and collaboration in companies are typically distributed responsibilities that no one group owns. But at leading companies, collaboration with key partnerships for innovation is considered a core competency and is managed as an integral part of the innovation function by senior management. Leaders have discovered that excellence in collaboration leads to being a Partner of Choice.

Partners of Choice have several key advantages. They get the best opportunities to collaborate with leading companies to generate the most promising ideas. They gain access to the most valuable channel partners. And they receive support and resources for commercialization of their best ideas. All of this constitutes a major competitive advantage equivalent to gaining first-mover advantage in a market, because it enables Partners of Choice to drive innovation faster, better, and cheaper. The Partners of Choice model has proved effective in industries outside CPG, and CPG businesses are heading in this direction as well. The challenge is to manage the ecosystem of partners effectively, by, for example, clearly defining the goals of each partnership, building internal capabilities via training to make partnering easier and more effective, and managing partner relationships to support strategic objectives—e.g., not treating all partnerships the same or viewing key partners as vendors.
Metrics and motivators

To drive the behaviors needed to create an intrapreneurial culture, companies can benefit by defining metrics that go beyond the traditional return on investment (ROI) and stage-gate metrics. Examples of such metrics include revenue from new offerings, customer satisfaction with new offerings, number of ideas in the pipeline, and profit growth attributable to new offerings. The right motivators can help as well. These may take the form of recognition (such as peer-nominated awards and media mentions), ongoing awards funded by business units (e.g., cash bonuses for qualified ideas and patent filings), and annual awards funded by corporate (e.g., large bonuses for the best innovation launch, patent, or idea).

Clorox’s CFO Steve Robb says, “Historically, we’ve targeted 2 points of sales growth every year from product innovation. For 10 consecutive years, we’ve met or exceeded that target, and even delivered record levels of innovation in the last fiscal year. Given our track record and robust pipeline of new product ideas, we raised our annual target for sales growth from new products to 3 percent. The best-performing companies have clear, well-defined metrics that reflect their priorities. For Clorox, innovation is core to our future growth.”

The path toward balance

Clearly, balancing operational excellence with breakthrough innovation isn’t a destination; it’s a journey, with innovation activities and operating models evolving continuously as companies experiment. But businesses can accelerate their progress along this path by ensuring that radical innovation operating models can function alongside traditional R&D and M&A activities. Making smart choices about key areas of the business—including innovation strategy, funding, organizational structure, ecosystem partnerships, and metrics and motivators—can go a long way toward equipping innovation groups for success, without forcing companies to give up the degrees of operational excellence they have achieved.
Interacting directly with consumers has quickly become an inescapable reality. CPG companies are experimenting with expanding their connections with consumers and building direct, two-way relationships through digital channels. According to a recent Economist Intelligence Unit survey of CPG companies, nearly a third of respondents have made driving consumer loyalty through social media a top priority (up from 17%) and more than 40% expect to sell products directly to consumers in 2013 (up from 24%).

US consumers are proving equally enthusiastic about directly connecting to brands. In fact, 52% say they are already buying direct online from brands they trust, according to our recent global multichannel survey.

The trend is not limited to the US. Consumers around the world are increasingly driving the digital anywhere/anytime economy. In fact, China, India, and other emerging markets may leapfrog developed countries in adopting direct-to-consumer (DTC), given their faster adoption of technology, penetration of mobile devices, and the nascency of modern retail in those geographies.

In addition to driving sales of existing products, DTC is a potent vehicle for testing new-to-the-world products and reaching out to new consumers faster and more effectively than ever before. General Mills took this approach to reach out to the multibillion-dollar market of consumers wanting gluten-free products. The brand’s GlutenFreely online store, launched quickly and inexpensively in 2011 via cloud technologies, demonstrated the strong interest in these products and put General Mills out in front—for a while. But in the fast-moving retail world, that advantage did not last long. Others sensed the opportunity and crowded the stores’ shelves with gluten-free products. This highlights the need to be agile. Other companies seeking to win the DTC game will look for ways to morph sites to offer newer products or online-only products to maintain the digital advantage.

CPG manufacturers are using DTC for more than experimentation. Many have strategically designed robust moves into the DTC world. CPG companies have realized they have a unique opportunity to walk alongside their shoppers in real time, to be a part of consumer conversations and communities, and to engage them in ways that build loyalty, create superior customer experiences, and fuel continuing innovation.

**Shifts in the last mile**

Traditionally, the retail store aisle has been the last mile, the moment of truth over which CPG companies had no control, and manufacturers were mostly blind to the factors that influenced the consumer in these final deliberations.

However, with the advent of DTC, the last mile has quietly moved out of the store and partially into the digital space, giving brands better insights into the minds and habits of their key consumer segments. This new last mile has become a social place, filled with reviews, chattering networks, and location-based digital coupons. This virtualization of the last few steps of the buying journey means that CPG companies can win big at the cash register by figuring out how to use mobile and social channels to their best advantage.

Witness the initiative by Mondelēz International, a manufacturer of chocolate, biscuits, gum, and candy, to partner power brands with startup entrepreneurs and transform these brands’ use of mobile channels. Bonin Bough, Vice President of Global Media and Consumer Engagement at Mondelēz, explains the trigger for the initiative: “American consumers spend more than 23 percent of their daily media consumption on a mobile device. Yet most marketers dedicate less than 1 percent of their media spend to mobile.”

Early pilots of the Mondelēz program will center on impulse purchases and mobile-at-retail consumer experiences. Later pilots are expected to cover social TV and SoLoMo (social/location/mobile). Convenience store retailers Quick Chek and Kum & Go are two of the newer members of the program network.

The shift in the last mile disrupts not only how CPG companies market, advertise, and merchandise; it also changes a myriad of other fundamental elements, including fulfillment management and channel economics. Leaders willing to grapple with this disruption will be able to lay claim to previously uncharted territory for CPG companies.
**Engaging beyond e-commerce**

To unlock value, CPG companies are learning how to unlock the powerful insights DTC can provide.

Steve Voskuil, VP of Finance at Kimberly-Clark International, explains DTC’s role at his company: “Kimberly-Clark has an emerging DTC leg in our e-commerce platform. We fundamentally recognize that mobile devices are becoming an intrinsic part of the consumer’s life—and this brings dynamic new opportunities to connect with them in compelling ways leading up to and at the point of purchase. We see DTC e-commerce as an exciting learning lab and we’re testing new ideas all the time. We can take that learning and apply it when we sit down with our retail partners.”

Additional opportunities to leverage DTC are emerging. We see at least three potent platforms—transactional, relational, and strategic—by which CPG manufacturers may directly engage with consumers and create win-win collaboration with their channel partners. These three platforms are not mutually exclusive. Instead, companies may use multiple platforms to achieve different goals.

**Transactional**

E-commerce can be a powerful sales driver if it is correctly positioned. For example, to drive in-store and online traffic, the DTC channel can allow consumers to try out new products. And there are opportunities to enhance sales with e-commerce based on the product category, price, brand loyalty, convenience, and certain consumer segments. But it is important to remember that 90% of grocery shopping still happens in-store. With that in mind, CPG companies worry that adopting DTC channels will antagonize their retail partners.

We see this becoming less of an issue as retailers’ mindsets change. Retailers are increasingly leveraging direct outreach for private label products. These experiences will make it clear to retailers that, in spite of having strong national brands in those categories, e-commerce is here to stay and needs to be part of the sales equation, despite the initial trepidation. In addition, manufacturer and retailer sharing of new and deeper consumer and shopper insights and collaboration on improved category management will mitigate many of the concerns currently held by retailers. We also believe that the following two platforms can further reduce the concern as they help drive more success for both partners.

**Relational**

Increasingly, we are seeing brands focus more on building relationships with their most valuable consumers (one-to-one), with their communities (one-to-many), and then the reverse (many-to-one). There are several leading-edge examples of brands moving beyond just putting up Facebook pages and getting to the stage where they live seamlessly in the “spaces” inhabited by their consumers.

“We do a lot with our online communities,” says Maria Henry, CFO of Hillshire Brands. “We reach out to get thoughts and ideas. We’re able to test things with them. We’re able to ask questions of them, so it’s like an always-available network of people who are very engaged with our products and our brands and are very loyal users.”

**Exhibit 33**

Reasons consumers purchase direct from brands

<table>
<thead>
<tr>
<th>Reason</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lower price</td>
<td>44%</td>
</tr>
<tr>
<td>Full range or more choices</td>
<td>41%</td>
</tr>
<tr>
<td>That’s all I needed—one brand</td>
<td>30%</td>
</tr>
<tr>
<td>Love of brand/loyalty</td>
<td>29%</td>
</tr>
<tr>
<td>Better warranty/guarantee</td>
<td>24%</td>
</tr>
<tr>
<td>Good stock availability</td>
<td>23%</td>
</tr>
<tr>
<td>Better service</td>
<td>17%</td>
</tr>
<tr>
<td>Customization/personalization</td>
<td>12%</td>
</tr>
<tr>
<td>Better experience</td>
<td>8%</td>
</tr>
<tr>
<td>Other</td>
<td>3%</td>
</tr>
</tbody>
</table>

Sample size: 11,067 online shoppers.
Source: PwC, *Demystifying the Online Shopper: 10 Myths of Multichannel Retail* (January 2013).
The goal is to form a relationship that is natural, two-way, and advantageous to both sides. Brands that create natural, two-way relationships can truly live and breathe their consumers’ lives and understand what makes them tick. Consumers value the relationship because they feel they can influence what the brand delivers to them.

In a recent Wall Street Journal interview with Jean-Marc Duvoisin, the new CEO of Nespresso, it is clear that even though the category is highly competitive, DTC is viewed by him as being beneficial more to the consumer than the company.

WSJ: As the competition heats up, are you going to maintain the direct-to-consumer model, even though it creates extra steps for the customer?

Mr. Duvoisin: Are we going to change the model? No. It’s a very successful model.

You see it as a complication for the customer. I see it as very beneficial for the customer. If you don’t have the direct connection, you can’t ask consumers [what they think] and you don’t have insight. Consumer insight is useful for the business but at the end of the day it’s more useful for the consumer.

So it’s not surprising to see that CPG companies like this beverage company, in this upcoming example, is taking actions internally to make DTC a valuable experience for its consumers. The company is purposely identifying digital key opinion leaders, influencers, and fans, and helping them become the voice of the brand across networks. That creates more opportunities for meaningful consumer-to-consumer exchanges that inform brand decisions. At the same time, this company is training internal brand ambassadors who are empowered to be in constant dialogue with consumers in the digital and mobile spaces.

Strategic (co-creating for the future)

The third powerful DTC platform is engaging consumers and other key stakeholders from the brand’s ecosystem to fuel innovation. What could be better than co-creating with your consumers the products they want? Brands of, by, and for the consumers! Companies like Mondelēz are doing it right now. Engaging consumers in innovation not only creates great products, but also drives growth and loyalty. Consumers who participate tend to become active proponents. And DTC offers brands the opportunity to enter new markets and segments with a low-cost mass marketing option, as well as test new products and services at lower cost.

P&G recently opened its “Connect + Develop” platform to engage consumers, suppliers, universities, and others in driving its product innovation agenda. We see a great benefit of this approach in areas including sustainability, product and food safety, health and wellness, and convenience—areas where the definitions and perspectives of consumers not only vary by demographics, attitude, in-store behavior, and geography, but are also changing dynamically.

Designing the “best-fit” model for your business

There is no “one size fits all” approach to using DTC platforms for e-commerce, relationship building, and innovation. Success depends on tailoring to key customer segments, key markets, and key product lines.

As companies design their DTC model, three questions are critical:

1. What are the key value propositions and the role of the DTC channel in your brand and in your business?

The strength of the brand and the characteristics of the category will determine whether it makes sense to have a retail brand supported by DTC or a DTC brand supported by retail or you need both. All these models exist today in the weight-loss and weight-management category, for example. DTC offers the relational and transactional platforms for this category—for example, Weight Watchers has a relational model supported both through DTC and a physical channel for support groups. They have also leveraged the physical channel for selling their branded products in addition to a grocery presence through licensing arrangements. On the other hand Nutrisystem has had a purely DTC model both for relational and transactional aspects of its business and they only recently forayed into the retail channel to build on the weight management opportunity and wider access to their targeted customer base through a new set of product offerings.

Baby products are another category that is shifting and finding value through DTC and e-commerce, with diapers leading the way.
**Preparing for DTC by design**

To lay a strong foundation for their DTC business, CPG companies need to sense and respond to the landscape around them. Four scans are critical:

1. **Scan consumer needs and competitive positioning** to determine:
   - Which core consumer segments are using which channels
   - The mix of channels (social, e-commerce, mobile, physical, retail) that will drive DTC growth
   - The role of each channel in the consumer purchase journey and in driving revenue
   - Where and how much to invest, and whether a partnership model or going direct is more advantageous in some of these channels

2. **Conduct an internal scan** to determine:
   - Executive commitment (sponsor) as well as board support and willingness to invest in DTC and to make the necessary organizational and business shifts
   - Impact on brand performance and delivery (go-to-market)
   - Technology and consumer analytics required to gain consumer insights
   - Investment level required
   - Operational model that would successfully support and deliver the DTC business (e.g., partnerships, partial outsourcing)
   - Success and failure indicators, performance metrics, and other key components of the DTC business case (these will be far different from those used traditionally)

3. **Conduct an organizational scan** to evaluate:
   - Skills and talent required to support DTC, including how functions will work together and how roles and responsibilities will shift and/or expand
   - Capabilities and performance versus leading practices and companies in your category/sector and marquee players from any industry
   - Establishment of the DTC organization

4. **Conduct an ecosystem scan** to explore:
   - Impact on supply chain partners
   - Impact on traditional channel partners in terms of product mix, pricing and trade dollars, consumer insights, product information, communication, and so on
   - How the nature of competition and partnership are changing, and the effect of these changes on the DTC model selected (the relationship between CPG manufacturers and their channel partners is morphing as both realize their newfound direct access to consumers and the opportunities to win through partnership)
   - Global support for the initiative
   - Financial, risk, and tax implications for all stakeholders and across markets (local and global)
DTC by design
How to win the digital game

2. What platforms or combination of platforms will best serve the value proposition?

If more than one platform (transactional, relational, strategic), what is the right sequence for development? We’ve seen some brands drive e-commerce far better when they first establish the relational and co-creation platforms, rather than transactional. And the relational platform is where many CPG companies first put their toes into DTC waters (e.g., by launching a Facebook page). While most others find it easy to start with the relational platform, those that start with ecommerce may still reap the benefits by further building relational or co-creation platforms to increase engagement with the consumer. Amazon is a prime example: The brand began as an e-commerce site focused on convenience and price, but the real magic happened with the launch of the book and product reviews. That feature changed the equation completely for Amazon, which went from being an e-commerce site to a relationship player.

3. What will be the impact on channel partners?

Is it possible to partner with them differently to co-build the DTC capability? The partnerships model should be driven by how to best serve consumers—whether it is retailers leveraging their brand partners for small-order fulfillment or sharing consumer and shopper insights to not only drive sales, but also influence product assortments, pricing, promotions, and deals by store, site, and consumer.

Flexibility is essential

DTC is here and it is evolving rapidly. CPG manufacturers, retailers, and consumers are dynamically affecting each other and altering the entire shopping journey. And as social/mobile technologies continue to evolve, so will opportunities and business models. There are risks: CPG companies will need to manage a new set of risks and security concerns that will follow from direct exposure of brands to consumers and competitors. However, the barriers to entry are low on the relational and co-creation DTC platforms, so it is possible to continually experiment and evolve. Little investment is required, and insights and results can be available in days or weeks instead of months or years.

But this will not be business as usual. Only agile organizations with a clear DTC intent and purpose and a bias for action will adapt and excel. Put more bluntly, this train is leaving the station. It is time for CPG companies to stop talking about DTC, visualize the desired end-state, pick the platforms where they want to start, and jump in.
Today’s world of deep-discount retailing looks very different from yesterday’s. For one thing, deep-discount shoppers’ thirst for value—made more intense among low-income consumers and general value seekers alike after the Great Recession—has boosted the channel’s popularity and fueled market-share gains. In fact, the number of retail stores in existence has increased by 26% in the last 10 years.76 “Current projections are that there is still room for dollar store expansion in terms of new stores, and they’re one of the few channels that are doing that,” says Bert Alfonso, President, International, The Hershey Company. “That provides not only a good format for shoppers, but also distribution growth from new store openings. We’ve been able to partner pretty effectively with the larger dollar stores and have seen a pretty fast adoption rate. The dollar stores have been a phenomenal growth story, and we believe still have room to grow.”

Meanwhile, owing to stubbornly high gas prices, the lower-income consumers who traditionally form the bulk of such retailers’ customer base are shopping more often at local grocers or urban deep-discounters, rather than driving to farther-flung large supermarkets.

All this spells big opportunities for CPG manufacturers and deep-discount retailers seeking to increase basket size and shopping frequency, further developing a channel that some observers considered tapped out. Some companies are already taking steps—for example, boosting traffic by offering consumables, fresh and refrigerated foods, and tobacco and alcohol products, or by deploying unique packaging and tailored merchandising strategies. Indeed, the changing assortment offered in these stores—characterized by more national brands combined with exclusives and private labels—has begun attracting shoppers from many demographics beyond lower income, radically reshaping the channel’s customer profile.

Says Colgate-Palmolive CFO Dennis Hickey, “From a US standpoint, over the last five years we’ve seen a lot of the growth in the dollar stores. Consumers are mindful of where they have their shopping experience. But when they go into dollar stores, they’re not going to the cheap brands. They want to get the name brands, but at a good price.”

Yet companies have an opportunity to grow the channel even more by capitalizing on an intensifying affinity for technology among low-income consumers, which few observers anticipated. Specifically, smartphone penetration in lower-income households is increasing and now stands at 35%.77 Moreover, lower-income consumers with smartphones are spending more time online—40% of them on mobile Internet and 32% on mobile social networking.78 Such consumers have become tech-savvy, even if they don’t have a TV or personal computer at home. These trends are affecting not only low-income consumers but also young people, minorities, and undereducated individuals, all of whom increasingly visit deep-discount stores as assortments broaden to include targeted products.

With lower-income and general value-seeking consumers alike now armed with smartphones and spending more of their lives online, the message is clear: CPG manufacturers and deep-discounters have a major chance to drive traffic, CPG brand awareness, customer loyalty, and market share by targeting advertising, marketing, and promotions to these shoppers over mobile Internet and social media. With lower-income consumers especially, companies have the opportunity to reach and engage individuals who used to be difficult to “touch” before connectivity became so widespread.

The good news is that many companies have already put the capabilities and infrastructure in place to support online advertising, marketing, and promotions for demographics other than lower-income. Companies that can adapt their use of these assets to target lower-income consumers who deep-discount shop will stand the best chance of capturing the growth possibilities presented by the latest technology trends.
2013 Financial Performance Report
Growth strategies: Unlocking the power of the consumer
Financial performance metrics

- Retailer performance data
- Manufacturer performance data
- Size-specific data
- Sector-specific data
This section contains charts illustrating the 2012 performance of CPG retailers as a whole, relative to the population of manufacturers in our performance database.

From a macroeconomic standpoint, the recovery that began in 2010 continued through the year, albeit at a slow pace and with lingering uncertainty about the future. Our analysis over the past several years has shown that retailer shareholder return has trended along with the state of the economy, with big declines in 2009 during the depth of the recession and then big improvements in 2010 as the industry emerged into recovery mode. In 2011, shareholder returns turned downward as overall economic growth slowed. In 2012, shareholder returns trended back upward for both retailers and manufacturers, while economic growth remained modest and commodity prices of primary industry inputs increased significantly.

A big change from 2011 is that in 2012, manufacturers created a slightly higher shareholder return versus retailers: 15.2% versus 11.5%, a difference of 3.7%. In 2011, by comparison, manufacturers had a lower shareholder return than retailers: 8.7% versus 10.3%. This may be an indication that investors are being more bullish toward the CPG industry as the economy continues to improve. Let’s explore if this sentiment is supported by retailers’ actual financial performance.

Net sales growth declined for manufacturers, from 9.3% to 5.5%, while retailers experienced only a very slight decrease in net sales growth, at 7.2% in 2012 compared with 7.4% in the prior year. A look at margins indicates that manufacturers experienced an erosion of approximately 0.9 percentage point, declining from 36.4% to 35.5%. Retailers maintained a steady margin at 25.3% in 2012 compared with 25.4% in the prior year. These trends could suggest that private label market share penetration is increasing, benefiting retailers and adversely impacting some manufacturers.

Another possible factor impacting margins for manufacturers is rising food costs. Increases in food cost typically have a larger impact on manufacturers than retailers because retailers carry other goods (such as household and personal care products), which generally don’t experience the same level of volatility in input costs that food presents to manufacturers. Manufacturing companies are attempting to introduce more innovative products to differentiate themselves from retailers’ private label products.

**Median EBIT growth** declined for retailers, from 10.9% in 2011 to 7.1% in 2012. This decline is consistent with the slowing growth in the overall economy. To the degree consumers responded to slow income growth by cutting back on high-margin items at the grocery store, quite possibly in their quest to find “value,” growth in EBIT for retailers would fall. At the same time, however, EBIT growth for manufacturers increased from 2% to 3.9%. With a decline in margin and net sales growth, the earnings growth for manufacturers is likely still the result of cost-cutting initiatives.

Retailers have consistently had quicker **cash conversion cycles** compared to manufacturers, principally due to their ability to collect from consumers at the point of sale, yet benefit from 30- to 60-day payment terms with manufacturers. This trend continued during 2012, though both groups saw improvements in conversion periods: Manufacturers improved from 54.7 to 52.2 days, and, impressively, retailers improved from 11.0 to 9.6 days, representing the third year in a row that retailers cut more than one full day out of this cycle.

So, while performance improved for both retailers and manufacturers, as measured by earnings growth, investors remain cautious and are proceeding slowly in rewarding these companies though a modest improvement in shareholder returns. It will be interesting to watch how these consumer sentiments evolve during 2013. Current projections show modest economic growth, but as the variation over the past several years has shown, companies can maintain earnings even in periods of slow growth.
In 2012, shareholder returns trended back upward for both retailers and manufacturers, while economic growth remained modest.
This section contains charts illustrating the 2012 performance of the overall CPG industry, which includes manufacturers with net sales in excess of $50M in our performance database.

In addition, we also will be reflecting on how these manufacturers with global operations compare with those who are predominantly domestic. In last year’s report, we compared companies with “significant” international sales and those without, using 20% as our indicator of “significant.” We continue with that approach this year, but with a focus on those metrics and charts that showed a clear divide between the two.

From a return metrics perspective, median one-year total shareholder return increased from 8.7% in 2011 to 15.2% in 2012. The return on invested capital stayed relatively consistent at 9.6%, compared to 9.4% in 2011. In addition, return on market capital changed direction—from decreasing in the prior year to increasing slightly in 2012 for the median quartile and increasing at a greater level for the top and bottom quartiles. In the last several years, the difference in returns between the top and bottom quartiles narrowed. This convergence in company performance could be a product of the economic slowdown as consumers search for deals, or it could indicate a general increase in the level of competition in the market.

If we take a look and compare the global versus domestic trends, global companies reflect a higher return on invested capital, possibly due to investments being made in emerging markets such as Brazil, India, and China.

From a growth metrics perspective, a notable trend this year is the slowing growth in net sales across all quartiles. For the median quartile, net sales growth went from 9.3% in 2011 to 5.5% in 2012. The top quartile had an even steeper decline in net sales growth, from 16.5% in 2011 to 10.0% in 2012. However, earnings before interest and tax remained strong and continued to increase across all quartiles. The bottom quartile had the largest increase (15.6 percentage points) between 2011 and 2012, but it still left this quartile in the red, with low double digit growth rates.

A review of the CPG manufacturers from a domestic versus global angle shows that while both global and domestic had a decline in net sales growth, the two contrast starkly in EBIT growth. Global companies have experienced volatile net sales growth, and had a much steeper decline from 2011 to 2012 (their performance undoubtedly having been impacted by greater exposure to emerging markets and weakened developed markets); however, these global manufacturers still retain stronger EBIT growth. Domestic companies showed small improvement in EBIT growth after two years of significant declines.

From an income statement metrics perspective, return on sales increased in 2012 from 2011 across all quartiles—an improvement from the prior year, when there was a decline in return on sales. The median quartile showed the largest increase in return on sales, rising by 1.5%. Gross margin showed a slight increase of 1.5 percentage points for the top quartile, while the median and bottom quartiles showed a slight decline. Improved margins likely led to the increase we saw in the effective tax rate across all quartiles, the largest increase being in the top quartile.

The spread between domestic and global companies has widened, in regard to median return on sales, with global companies moving further away and experiencing stronger returns at 11.4% for 2012 versus 6.4% for domestic companies.

Looking at SG&A as a percentage of sales, the median quartile is consistent with our findings from 2011: 24.5% in 2011 to 25.2% in 2012, which indicates some modest increase in spending on marketing initiatives, potentially in areas such as social media, digitalization, and mobilization to meet consumer purchasing behaviors, particularly within the millennial generation. With the economy undergoing constant shifts, manufacturers have been able to maintain their consumer base through focusing on these types of marketing investments.
Looking at liquidity trends, companies have maintained the relationship between debt and equity, as seen in past years. At the same time, companies appear to be locking in historically low interest rates by replacing short-term debt with long-term debt. Improved margins have allowed companies to improve interest coverage ratios.

The balance sheet metrics showed an increase in the return on average assets for the median and bottom quartile, of 1.7% and 1.5%, respectively. A similar upward trend was noticed when looking at global versus domestic manufacturers. The only outlier was reflected in the top quartile, where the return on assets remained flat versus 2011.
Exhibit 35 (continued)
Overall CPG industry, manufacturers (companies > US$50M), including select global versus domestic charts

Growth metrics
Net sales growth

EBIT growth

Median net sales growth

Median EBIT growth

Income statement metrics
Median free cash flow to sales

Sales per employee

Gross margin

Return on sales

SG&A as a percentage of sales

Effective tax rate

Median return on sales

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.

- Median
- Top quartile
- Median
- Bottom quartile
- Domestic
- Global
Exhibit 35 (continued)
Overall CPG industry, manufacturers (companies > US$50M), including select global versus domestic charts

Balance sheet metrics
Inventory turnover

Cash conversion cycle

Return on average assets

Median return on average assets

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.

- Median
- Top quartile
- Median
- Bottom quartile
- Domestic
- Global

Overall CPG industry: manufacturers
Size-specific data: large, medium, and small manufacturers

This section includes charts analyzing the performance of large, medium, and small manufacturers.

Shareholder return has seen clear improvement over 2011’s performance results across all size categories. In 2012, large, medium, and small manufacturers reflected a median shareholder return of 15.3%, 14.9%, and 16.7%, versus 7.5%, 10.8%, and -31.9%, respectively, in 2011. Shareholders’ investments are paying greater rewards in 2012 versus 2011, particularly for small manufacturers.

The same holds true for the one-year median return on invested capital. Looking out further to the 5-year return on invested capital, while small manufacturers show strong long-term returns over the prior year—up from 2.2% in 2011 to 8.3% in 2012—large and medium manufacturers show a slight decrease in return on invested capital, from 8.9% and 7.1% in 2011 to 8.3% and 6.6% in 2012, respectively.

Continuing on with return metrics, small manufacturers boosted their return on market capital in 2012, matching the 10% return generated by large and medium manufacturers. Small manufacturers commonly exhibit more volatility in their output and return measures, given the smaller base.

Small manufacturers showed a lot more growth in 2012 over large and medium manufacturers, as further evidenced by the trend in EBIT growth and net sales growth. Small manufacturers had a strong change in EBIT growth, from -29.2% in 2011 to 5.8% in 2012. Net sales growth rates for small companies accelerated from 4.9% in 2011 to 13.8% in 2012. This was the largest growth rate amongst the three size segments, and the only size segment to increase its growth rates for this year (large and medium manufacturers experienced declines). Small manufacturers are almost back to the growth rates they experienced before the recession, but, with EBIT growth in particular, it seems to have been a bumpy ride.

Gross margin for large, medium, and small manufacturers showed little movement from 2011, continuing a trend that’s been in evidence for the past five years. One might suspect that in the future, the company that differentiates itself from these gross margin trends will have the advantage with the consumer.

One metric that is consistently volatile and ever-changing for small manufacturers is the short-term debt to long-term debt ratio, which plummeted from 1.1 in 2011 to 0.3 in 2012. Taking a look at the underlying data for 2012, the majority of small manufacturers within this population have experienced increases in their long-term debt balances as well as decreases in their short-term debt. Given the decline in interest rates, small companies might be borrowing more. Large and medium manufacturers have been able to maintain this ratio without significant movement, over the last four years in particular.

Shareholders’ investments are paying greater rewards in 2012 versus 2011, particularly for small manufacturers.
Size-specific data: large, medium, and small manufacturers

Exhibit 36
Size-specific data, all sectors

Return metrics
Median shareholder return
Median return on invested capital
Median return on market capital

Liquidity metrics
Median current ratio
Median interest coverage ratio
Median debt-to-equity ratio
Median short-term debt to long-term debt ratio

Growth metrics
Median net sales growth
Median EBIT growth

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.

Large manufacturers
Medium manufacturers
Small manufacturers
Large manufacturers
Medium manufacturers
Small manufacturers
Size-specific data: large, medium, and small manufacturers

Exhibit 36 (continued)
Size-specific data, all sectors

Income statement metrics
Median free cash flow to sales
Median return on sales
Median sales per employee

Median SG&A as a percentage of sales
Median effective tax rate
Median gross margin

Balance sheet metrics
Median inventory turnover
Median return on average assets
Median cash conversion cycle

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.

Large manufacturers
Medium manufacturers
Small manufacturers

Large manufacturers
Medium manufacturers
Small manufacturers
Size-specific data: very large manufacturers

This section includes charts analyzing the performance of the largest of the large manufacturers, those with reported net sales of greater than $10 billion in the latest reported fiscal year.

When performing a stand-alone review of the very large manufacturers, one clear message from the majority of the metrics is the ability of these manufacturers to maintain consistency year over year. While the performance of the very large manufacturers has been stable over the last several years, some metrics stand out, both within the very large manufacturer population and as compared with the large, medium, and small manufacturers previously discussed. Here are a few notable swings.

Very large manufacturers have experienced the highest return on invested capital and the most consistent return on invested capital when compared to large, medium, and small manufacturers. However, return on market capital—which has hovered around 10% for the past four years—fell to 8.5% in 2012. When comparing to the large, medium, and small manufacturers, very large manufacturers were the only group to have a decrease on return on market capital, falling even lower than medium manufacturers’ 9.5%. What seems to be fueling this decline is the decrease in EBIT growth experienced this year, a reversal of the increasing trend we’d seen since 2008.

The growth metrics for this group have both experienced a decline. From 2011 to 2012, median EBIT growth declined from 7% to 1.2% and net sales growth declined from 11.6% to 3.2%. What’s clear here is that even though the economy is making its way back up, the residual effects of the past few years are still having an impact across the board, and particularly for the very large manufacturers.

Gross margin increased in 2012 and overall has stayed consistent, rising to 43.6% among very large manufacturers.

When reviewing balance sheet metrics, return on assets and cash conversions cycles are strong and better than the results for large, medium, and small manufacturers. However, it is noticeable that very large manufacturers’ return on assets dipped further this year, while return on assets increased for large, medium, and small manufacturers. Inventory turns have remained steady, so it appears that very large manufacturers should focus on increasing the productivity of their assets to assist in regaining the increasing growth rates that they previously held.
Size-specific data: very large manufacturers

Exhibit 37
Very large manufacturers, all sectors

Return metrics
Median shareholder return
Median return on market capital
Median return on invested capital

Liquidity metrics
Median current ratio
Median interest coverage ratio
Median debt-to-equity ratio
Median short-term debt to long-term debt ratio

Growth metrics
Median net sales growth
Median EBIT growth

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.

Very large manufacturers
Very large manufacturers
Size-specific data: very large manufacturers

Exhibit 37 (continued)
Very large manufacturers, all sectors

Income statement metrics
- Median free cash flow to sales
  - 1-year: 10.0%
  - 3-year: 9.4%
  - 5-year: 9.6%

- Median return on sales
  - 5-year: 15.0%
  - 3-year: 15.5%
  - 1-year: 15.0%

- Median sales per employee
  - $0K
  - $200K
  - $400K
  - $600K

- Median SG&A as a percentage of sales
  - 2012: 11.1%
  - 2011: 11.6%
  - 2010: 11.6%
  - 2009: 11.6%
  - 2008: 12.5%

- Median effective tax rate
  - 2012: 3.2%
  - 2011: 1.2%

- Median gross margin
  - 2012: 43.6%
  - 2011: 40.1%

Balance sheet metrics
- Median inventory turnover
  - 2012: 9
  - 2011: 7
  - 2010: 6

- Median return on average assets
  - 2012: 11.1%

- Median cash conversion cycle
  - 2012: 48.1

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.

Very large manufacturers
This section analyzes the performance of companies that produce primarily beverages, companies that produce primarily food, and companies that produce primarily household products. All the metrics are based on median values.

We have also taken a look at total volume trends amongst the following subcategories within the CPG industry: soft drinks (million liters), alcoholic drinks (million liters), packaged foods (metric tons), home care (metric tons), and beauty and personal care (million units). This data represents that of the industry within the US, covering a larger population than the 144 manufacturers reflected in the sector charts.

In 2012, all sectors experienced an increase in shareholder return. Possible explanations for the increase include share repurchase activity and post-recession recovery as GDP growth has resumed, unemployment has moderated, and consumer sentiment has improved.

Each of the sectors experienced a downtick in net sales growth after two years of increasing growth rates. One must consider how total volume within the subsectors might have been impacted by economic conditions over the past few years and contributed to the declines in net sales growth (see Exhibit 38). Household products have consistently seen the lowest net sales growth. Coinciding with that, the volume in home care shows a consistent decline, with growth rates constantly in the negatives. Beauty and personal care products have only shown slight increases in volume the past few years, and leveled off between 2011 and 2012. Total volume measures for the alcoholic drinks and packaged foods subcategories have experienced some ups and downs, but both experienced positive growth rates from 2011 to 2012. Given the positive total volume growth rates for the soft drinks, alcoholic drinks, and packaged goods subcategories, this probably contributed to the food and beverage sector posting stronger net sales growth rates over household products.

Despite the overall slowing of net sales growth rates, beverage, food, and household products companies experienced positive net sales growth of 5.5%, 7.0%, and 3.2%, respectively. EBIT growth varied widely by sector, with beverage and household products companies each showing increases (household products more so than beverage), while food companies saw a decline, continuing a three-year downward trend.
For the third straight year, the beverage sector posted a strong performance, with productivity improving (as measured by sales per employee) and return on sales continuing a steady upward trend. The sector’s positive outlook also benefited from several additional metrics when compared to the food and household products sectors. These include a one-year free cash flow to sales of 7.9%; a more efficient cash conversion cycle, which decreased from 45.7 days in 2011 to 45.0 days in 2012; a higher inventory turnover, which increased slightly in 2012 from 2011; and stronger returns on invested capital. These higher relative metrics may be driving this sector’s stronger shareholder returns. Also notable is the continued decrease in beverage companies’ effective tax rate, which moved from 26.9% in 2011 to 25.9% in 2012 and made the beverage sector the only sector to experience a decreased rate.

The food sector, when compared to the beverage and household products sectors, is benefiting from higher sales per employee (although that number held flat from 2011 to 2012) and lower SG&A as a percentage of sales. The food sector’s inventory turnover and cash conversion cycle stayed relatively flat from 2011 to 2012, but they remain stronger relative to the household products sector. This is the second consecutive year in which the food sector has experienced a decline in EBIT growth, causing it to dip into the red at -3.4%. This year, food was the only sector to experience an EBIT growth decline. The food sector also continued its two-year decrease in return on sales, but gross margins experienced a slight positive movement, from 25.7% in 2011 to 26.9% in 2012.

The household products sector experienced better results in 2012 than it did in 2011. EBIT growth rate increased sharply and took the sector back into the black, rising from -5.6% in 2011 to 11.0% in 2012. Return on sales also increased steeply, from 7.7% in 2011 to 10.9% in 2012. Gross margin remained relatively flat, while SG&A as a percentage of sales continued its decrease. Inventory turnover within the household products sector is the weakest relative to the beverage and food sectors; however, this is expected due to the nature of the products sold. Household products generally have a longer shelf life and can be stored for a longer period of time before wasting away, whereas products in the beverage and food sector are more perishable. Nevertheless, the household products sector has experienced improved inventory turns over the last two years. The sector has also improved its cash conversion cycle, though it continues to take more time to convert inventory to cash relative to the beverage and food sectors.
Sector comparison

Exhibit 39
Sector-specific data, all sectors

Return metrics
- Median shareholder return
- Median return on invested capital
- Median return on market capital

Liquidity metrics
- Median current ratio
- Median interest coverage ratio
- Median debt-to-equity ratio
- Median short-term debt to long-term debt ratio

Growth metrics
- Median net sales growth
- Median EBIT growth

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.
Sector comparison

Exhibit 39 (continued)
Sector-specific data, all sectors

Income statement metrics

- Median free cash flow to sales
- Median sales per employee
- Median return on sales

Balance sheet metrics

- Median inventory turnover
- Median return on average assets
- Median cash conversion cycle

Source: Reuters Fundamentals, Reuters Pricing, and PwC analysis.
Appendix A: Research and metrics methodology

In compiling and preparing this year’s financial performance report, we used a number of sources: interviews with senior leadership (including GMA members and members of the GMA CFO Committee; see page 105 for listing), publicly reported company financial data, government statistics, analyst reports, and other published material. The manufacturing analyses are based primarily on public information from 144 manufacturers. In the Financial Performance Metrics section we present key industry metrics, some of which are discussed throughout the report, based on an analysis of financial data for these manufacturers and a set of CPG retailers (see Appendix B and Appendix C). In this appendix, we describe the data sources used and the data preparation steps taken to produce these metrics.

Data sources

Reuters Fundamentals data was the primary source of data for the analysis presented in the Financial Performance Metrics section of this report. This Reuters dataset includes annual financial data from 2007 through 2012, by fiscal year, for publicly traded companies. The report uses restated data that accounts for mergers, acquisitions, divestitures, and accounting changes. Additionally, there is one year of financial data remaining for one private-sector manufacturer that was obtained though a survey administered by the GMA four years ago.

Exhibit 40
Primary manufacturer NAICS codes by sector

<table>
<thead>
<tr>
<th>Sector</th>
<th>NAICS code</th>
<th>NAICS description</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beverage</td>
<td>312111</td>
<td>Soft drink manufacturing</td>
</tr>
<tr>
<td>Beverage</td>
<td>312112</td>
<td>Bottled water manufacturing</td>
</tr>
<tr>
<td>Beverage</td>
<td>312120</td>
<td>Breweries</td>
</tr>
<tr>
<td>Beverage</td>
<td>312130</td>
<td>Wineries</td>
</tr>
<tr>
<td>Beverage</td>
<td>312140</td>
<td>Distilleries</td>
</tr>
<tr>
<td>Food</td>
<td>311211</td>
<td>Flour milling</td>
</tr>
<tr>
<td>Food</td>
<td>311225</td>
<td>Fats and oils refining and blending</td>
</tr>
<tr>
<td>Food</td>
<td>311230</td>
<td>Breakfast cereal manufacturing</td>
</tr>
<tr>
<td>Food</td>
<td>311314</td>
<td>Cane sugar manufacturing</td>
</tr>
<tr>
<td>Food</td>
<td>311351</td>
<td>Chocolate and confectionery manufacturing from cacao beans</td>
</tr>
<tr>
<td>Food</td>
<td>311352</td>
<td>Confectionery manufacturing from purchased chocolate</td>
</tr>
<tr>
<td>Food</td>
<td>311411</td>
<td>Frozen fruit, juice, and vegetable manufacturing</td>
</tr>
<tr>
<td>Food</td>
<td>311421</td>
<td>Fruit and vegetable canning</td>
</tr>
<tr>
<td>Food</td>
<td>311511</td>
<td>Fluid milk manufacturing</td>
</tr>
<tr>
<td>Food</td>
<td>311514</td>
<td>Dry, condensed, and evaporated dairy product manufacturing</td>
</tr>
<tr>
<td>Food</td>
<td>311520</td>
<td>Ice cream and frozen dessert manufacturing</td>
</tr>
<tr>
<td>Food</td>
<td>311611</td>
<td>Animal (except poultry) slaughtering</td>
</tr>
<tr>
<td>Food</td>
<td>311612</td>
<td>Meat processed from carcasses</td>
</tr>
<tr>
<td>Food</td>
<td>311615</td>
<td>Poultry processing</td>
</tr>
</tbody>
</table>

Source: PwC.
Appendix A: Research and metrics methodology

Company choice
The companies analyzed in the Financial Performance Metrics section were identified as companies that operate in the CPG manufacturing or retail industries. This designation is generally based on a company’s primary industry, identified using the North American Industry Classification System (NAICS) as designated by each company and reported in Reuters.

Manufacturers
A core group of NAICS codes was used to categorize companies according to CPG industries, including food, beverage, and household products manufacturing activities. After reviewing this list, we excluded a handful of companies, either because they predominantly do business outside the United States or because their primary activities did not align with the CPG sector. Additional food, beverage, and household products companies were included in the analysis based on the nature of their products, given diverse manufacturing activities.

Exhibit 40 lists the manufacturer NAICS codes and NAICS code descriptions by sector used in the Financial Performance Metrics section of this report.

Retailers
A group of core NAICS codes that represent GMA retail activities were identified and used to generate a list of retail companies for inclusion in the analysis.

Exhibit 41 lists the retailer NAICS codes and NAICS code descriptions used in the Financial Performance Metrics section of this report.

Exhibit 41
Primary retailer NAICS codes

<table>
<thead>
<tr>
<th>NAICS code</th>
<th>NAICS description</th>
</tr>
</thead>
<tbody>
<tr>
<td>424410</td>
<td>General line grocery wholesalers</td>
</tr>
<tr>
<td>445110</td>
<td>Supermarkets and other grocery (except convenience) stores</td>
</tr>
<tr>
<td>445120</td>
<td>Convenience stores</td>
</tr>
<tr>
<td>445299</td>
<td>All other specialty food stores</td>
</tr>
<tr>
<td>446110</td>
<td>Pharmacies and drug stores</td>
</tr>
<tr>
<td>446120</td>
<td>Cosmetics, beauty supplies, and perfume stores</td>
</tr>
<tr>
<td>446191</td>
<td>Food (health) supplement stores</td>
</tr>
<tr>
<td>447110</td>
<td>Gasoline stations with convenience stores</td>
</tr>
<tr>
<td>452110</td>
<td>Department stores (excluding leased departments)</td>
</tr>
<tr>
<td>452910</td>
<td>Warehouse clubs and superstores</td>
</tr>
<tr>
<td>452990</td>
<td>All other general merchandise stores</td>
</tr>
<tr>
<td>453910</td>
<td>Pet and pet supplies stores</td>
</tr>
<tr>
<td>454110</td>
<td>Electronic shopping and mail-order houses</td>
</tr>
</tbody>
</table>

Source: PwC.
Data preparation and metric construction

The following data preparation steps were necessary before calculating financial metrics.

Currency exchange rates were applied to financial data fields denominated in non-US currencies. Conversions were computed based on the annual averaged exchange rate for each fiscal year operating period.

Companies that changed their reported fiscal year starting and ending dates for at least one of the reporting periods resulted in duplicate data across fiscal years. The duplicate fiscal year observation was removed by annualizing the reported financials where necessary.

Data elements associated with companies that have reporting periods markedly different from the standard length of a calendar year (i.e., 12 months or 52 weeks) were either annualized or dropped.

Data used to calculate metrics presented in this report was compared with 10-K filings for selected firms to check for inconsistencies. The quartiles were determined based on the companies with reported data for each financial metric. Definitions for each metric can be found in Appendix D.

Data reporting

Reported results utilize median figures in order to reduce the effect of performance outliers on the overall metrics. When the count of companies with reported data is large enough, we also report quartile figures at the 25th and 75th percentile observations.

In the industry benchmark, firms with more than US$10 billion in net sales in their most recent reported fiscal year are highlighted in a separate “very large” grouping, but are also included in the “large manufacturers” results.

Other size-based segmentations were defined using the benchmarks noted in Exhibit 42.

### Exhibit 42
Size segmentations for financial reporting metrics

<table>
<thead>
<tr>
<th>Size segmentation</th>
<th>Net Sales Range</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very large manufacturers</td>
<td>Net Sales &gt; $10B</td>
</tr>
<tr>
<td>Large manufacturers</td>
<td>Net Sales &gt; $4B</td>
</tr>
<tr>
<td>Medium manufacturers</td>
<td>$500M &lt; Net Sales ≤ $4B</td>
</tr>
<tr>
<td>Small manufacturers</td>
<td>$50M &lt; Net Sales ≤ $500M</td>
</tr>
</tbody>
</table>

Source: PwC.

Companies with net sales of less than $50 million for the most recent reported fiscal year were excluded.

Counts for the number of manufacturers included in each size- and industry-based segment are included in Exhibit 43.

### Exhibit 43
Manufacturing companies by industry size and segment

<table>
<thead>
<tr>
<th>Industry</th>
<th>Small</th>
<th>Medium</th>
<th>Large (very large)</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beverage</td>
<td>8</td>
<td>12</td>
<td>15 (11)</td>
<td>35</td>
</tr>
<tr>
<td>Food</td>
<td>17</td>
<td>25</td>
<td>32 (17)</td>
<td>74</td>
</tr>
<tr>
<td>Household products</td>
<td>6</td>
<td>11</td>
<td>18 (11)</td>
<td>35</td>
</tr>
<tr>
<td>Total</td>
<td>31</td>
<td>48</td>
<td>65 (39)</td>
<td>144</td>
</tr>
</tbody>
</table>

Source: PwC.
### Appendix B: Manufacturer company list

<table>
<thead>
<tr>
<th>Company Name</th>
</tr>
</thead>
<tbody>
<tr>
<td>AgFeed Industries, Inc.</td>
</tr>
<tr>
<td>Agria Corporation (ADR)</td>
</tr>
<tr>
<td>Ajinomoto Co., Inc.</td>
</tr>
<tr>
<td>Alberto-Culver Company</td>
</tr>
<tr>
<td>American Italian Pasta Company</td>
</tr>
<tr>
<td>Anheuser-Busch InBev NV</td>
</tr>
<tr>
<td>Archer Daniels Midland Company</td>
</tr>
<tr>
<td>Associated British Foods plc</td>
</tr>
<tr>
<td>Avon Products, Inc.</td>
</tr>
<tr>
<td>B&amp;G Foods, Inc.</td>
</tr>
<tr>
<td>Bare Escentuals, Inc.</td>
</tr>
<tr>
<td>BASF SE (ADR)</td>
</tr>
<tr>
<td>Beam Inc.</td>
</tr>
<tr>
<td>Birds Eye Foods, Inc.</td>
</tr>
<tr>
<td>Boulder Brands, Inc.</td>
</tr>
<tr>
<td>Bridgford Foods Corporation</td>
</tr>
<tr>
<td>Brown-Forman Corporation</td>
</tr>
<tr>
<td>Bunge Limited</td>
</tr>
<tr>
<td>Bush Brothers &amp; Company</td>
</tr>
<tr>
<td>CAA Industries, Inc.</td>
</tr>
<tr>
<td>Cadbury plc (ADR)</td>
</tr>
<tr>
<td>Cagle’s, Inc.</td>
</tr>
<tr>
<td>Campbell Soup Company</td>
</tr>
<tr>
<td>Chiquita Brands International, Inc.</td>
</tr>
<tr>
<td>CHS Inc.</td>
</tr>
<tr>
<td>Church &amp; Dwight Co., Inc.</td>
</tr>
<tr>
<td>Coca-Cola Bottling Co. Consolidated</td>
</tr>
<tr>
<td>Coca-Cola Enterprises, Inc.</td>
</tr>
<tr>
<td>Coca-Cola FEMSA, S.A.B. de C.V. (ADR)</td>
</tr>
<tr>
<td>Coca-Cola Hellenic Bottling Company S.A.</td>
</tr>
<tr>
<td>Coffee Holding Co., Inc.</td>
</tr>
<tr>
<td>Colgate-Palmolive Company</td>
</tr>
<tr>
<td>ConAgra Foods, Inc.</td>
</tr>
<tr>
<td>Constellation Brands, Inc.</td>
</tr>
<tr>
<td>Cott Corporation (USA)</td>
</tr>
<tr>
<td>Craft Brew Alliance, Inc.</td>
</tr>
<tr>
<td>Crystal Rock Holdings, Inc.</td>
</tr>
<tr>
<td>Cuisine Solutions, Inc.</td>
</tr>
<tr>
<td>Dakota Growers Pasta Co., Inc.</td>
</tr>
<tr>
<td>Darling International Inc.</td>
</tr>
<tr>
<td>Dean Foods Company</td>
</tr>
<tr>
<td>Del Monte Corp</td>
</tr>
<tr>
<td>Del Monte Pacific Limited</td>
</tr>
<tr>
<td>Diageo plc (ADR)</td>
</tr>
<tr>
<td>Diamond Foods, Inc.</td>
</tr>
<tr>
<td>Diedrich Coffee, Inc.</td>
</tr>
<tr>
<td>Dole Food Company, Inc.</td>
</tr>
<tr>
<td>Dr Pepper Snapple Group, Inc.</td>
</tr>
<tr>
<td>DSG International (Thailand) PCL</td>
</tr>
<tr>
<td>Ecolab Inc.</td>
</tr>
<tr>
<td>Elizabeth Arden, Inc.</td>
</tr>
<tr>
<td>Energizer Holdings, Inc.</td>
</tr>
<tr>
<td>Exide Technologies</td>
</tr>
<tr>
<td>Farmer Bros. Co.</td>
</tr>
<tr>
<td>Feihe International, Inc.</td>
</tr>
<tr>
<td>Flowers Foods, Inc.</td>
</tr>
<tr>
<td>Fomento Económico Mexicano S.A.B. de C.V. (ADR)</td>
</tr>
<tr>
<td>Foster’s Group Limited</td>
</tr>
<tr>
<td>General Mills, Inc.</td>
</tr>
<tr>
<td>Golden Enterprises, Inc.</td>
</tr>
<tr>
<td>Greatbatch Inc.</td>
</tr>
<tr>
<td>Green Mountain Coffee Roasters Inc.</td>
</tr>
<tr>
<td>Groupe Danone SA (ADR)</td>
</tr>
<tr>
<td>Gruma, S.A.B. de C.V. (ADR)</td>
</tr>
<tr>
<td>H.J. Heinz Company</td>
</tr>
<tr>
<td>Heineken N.V. (ADR)</td>
</tr>
<tr>
<td>Hormel Foods Corporation</td>
</tr>
<tr>
<td>Imperial Sugar Company</td>
</tr>
<tr>
<td>Ingredion Incorporated</td>
</tr>
<tr>
<td>Inter Parfums, Inc.</td>
</tr>
<tr>
<td>Interstate Bakersies Corp.</td>
</tr>
<tr>
<td>Inventures Foods, Inc.</td>
</tr>
<tr>
<td>J&amp;J Snack Foods Corp.</td>
</tr>
<tr>
<td>Jamba, Inc.</td>
</tr>
<tr>
<td>Jarden Corporation</td>
</tr>
<tr>
<td>John B. Sanfilippo &amp; Son, Inc.</td>
</tr>
<tr>
<td>Johnson &amp; Johnson</td>
</tr>
<tr>
<td>Kellogg Company</td>
</tr>
<tr>
<td>Kerry Group plc</td>
</tr>
<tr>
<td>Kimberly-Clark Corporation</td>
</tr>
<tr>
<td>Kirin Holdings Company, Limited (ADR)</td>
</tr>
<tr>
<td>Kraft Foods Group, Inc.</td>
</tr>
<tr>
<td>Lancaster Colony Corporation</td>
</tr>
<tr>
<td>Land O’Lakes, Inc.</td>
</tr>
<tr>
<td>Lifeway Foods, Inc.</td>
</tr>
<tr>
<td>L’Oreal</td>
</tr>
<tr>
<td>Marine Harvest ASA</td>
</tr>
<tr>
<td>McCormick &amp; Company, Incorporated</td>
</tr>
<tr>
<td>Mead Johnson Nutrition</td>
</tr>
<tr>
<td>Medifast, Inc.</td>
</tr>
<tr>
<td>MGP Ingredients, Inc.</td>
</tr>
<tr>
<td>Molson Coors Brewing Company</td>
</tr>
<tr>
<td>Mondélez International, Inc.</td>
</tr>
<tr>
<td>Monster Beverage Corporation</td>
</tr>
<tr>
<td>Monterey Gourmet Foods, Inc.</td>
</tr>
<tr>
<td>National Beverage Corp.</td>
</tr>
<tr>
<td>Nestlé SA</td>
</tr>
<tr>
<td>Newell Rubbermaid Inc.</td>
</tr>
<tr>
<td>Novartis AG (ADR)</td>
</tr>
<tr>
<td>Overhill Farms, Inc.</td>
</tr>
<tr>
<td>Owens-Illinois, Inc.</td>
</tr>
<tr>
<td>Parlux Fragrances, Inc.</td>
</tr>
<tr>
<td>Peet’s Coffee &amp; Tea, Inc.</td>
</tr>
<tr>
<td>PepsiAmericas, Inc.</td>
</tr>
<tr>
<td>PepsiCo, Inc.</td>
</tr>
<tr>
<td>Physicians Formula Holdings, Inc.</td>
</tr>
<tr>
<td>Pilgrim’s Pride Corporation</td>
</tr>
<tr>
<td>Pinnacle Foods Finance LLC</td>
</tr>
<tr>
<td>Post Holdings, Inc.</td>
</tr>
<tr>
<td>Ralcorp Holdings, Inc.</td>
</tr>
<tr>
<td>Reckitt Benckiser Group plc</td>
</tr>
<tr>
<td>Reddy Ice Holdings, Inc.</td>
</tr>
<tr>
<td>Revlon, Inc.</td>
</tr>
<tr>
<td>SABMiller plc</td>
</tr>
<tr>
<td>Sanderson Farms, Inc.</td>
</tr>
<tr>
<td>Seaboard Corporation</td>
</tr>
<tr>
<td>Seneca Foods Corporation</td>
</tr>
<tr>
<td>Shiseido Co., Ltd. (ADR)</td>
</tr>
<tr>
<td>Smithfield Foods, Inc.</td>
</tr>
<tr>
<td>Solo Cup Company</td>
</tr>
<tr>
<td>Spectrum Brands Holdings, Inc.</td>
</tr>
<tr>
<td>SunOpta, Inc. (USA)</td>
</tr>
<tr>
<td>Synder’s-Lance, Inc.</td>
</tr>
<tr>
<td>Synutra International, Inc.</td>
</tr>
<tr>
<td>Tasty Baking Company</td>
</tr>
<tr>
<td>Tate &amp; Lyle PLC (ADR)</td>
</tr>
<tr>
<td>The Boston Beer Company, Inc.</td>
</tr>
<tr>
<td>The Clorox Company</td>
</tr>
<tr>
<td>The Coca-Cola Company</td>
</tr>
<tr>
<td>The Estée Lauder Companies Inc.</td>
</tr>
<tr>
<td>The Hain Celestial Group, Inc.</td>
</tr>
<tr>
<td>The Hershey Company</td>
</tr>
<tr>
<td>The Hillshire Brands Company</td>
</tr>
<tr>
<td>The J.M. Smucker Company</td>
</tr>
<tr>
<td>The Pepsi Bottling Group, Inc.</td>
</tr>
<tr>
<td>The Procter &amp; Gamble Company</td>
</tr>
<tr>
<td>Tootsie Roll Industries, Inc.</td>
</tr>
<tr>
<td>TreeHouse Foods, Inc.</td>
</tr>
<tr>
<td>Tyson Foods, Inc.</td>
</tr>
<tr>
<td>Ultralife Corporation</td>
</tr>
<tr>
<td>Unilever PLC (ADR)</td>
</tr>
<tr>
<td>Vina Concha y Toro S.A. (ADR)</td>
</tr>
<tr>
<td>Wyeth</td>
</tr>
<tr>
<td>Zep Inc.</td>
</tr>
</tbody>
</table>
Appendix C: Retailer company list

99¢ Only Stores
ALCO Stores, Inc.
Alimentation Couche-Tard Inc.
Alimentation Couche-Tard Inc. (USA)
Amazon.com, Inc.
Arden Group, Inc.
Big Lots, Inc.
B.J.’s Wholesale Club, Inc.
Cargills (Ceylon) PLC
Casey’s General Stores, Inc.
Cost Plus, Inc.
Costco Wholesale Corporation
CVS Caremark Corporation
Dairy Farm International Holdings Limited
Delhaize Group (ADR)
Dollar General Corporation
Dollar Tree, Inc.
drugstore.com, inc.
Duane Reade Holdings, Inc.
Empire Company Limited
Family Dollar Stores, Inc.
Fred’s Inc.
GNC Holdings, Inc.
Harris Teeter Supermarkets, Inc.
Harry & David Holdings, Inc.
Ingles Markets, Incorporated
J Sainsbury plc (ADR)
Koninklijke Ahold N.V. (ADR)
Loblaw Companies Limited
Magnit OAO
Medco Health Solutions Inc.
Metro Inc.
Nash-Finch Company
Omnicare, Inc.
Perfumania Holdings, Inc.
PetSmart, Inc.
PharMerica Corporation
PriceSmart, Inc.
Publix Super Markets, Inc.
Rite Aid Corporation
Safeway Inc.
Sally Beauty Holdings, Inc.
Sears Holdings Corporation
Shoppers Drug Mart Corporation

Spartan Stores, Inc.
Starbucks Corporation
Stater Bros. Holdings Inc.
SUPervalu INC.
Susser Holdings Corporation
Target Corporation
Tesco PLC (ADR)
The Great Atlantic & Pacific Tea Company
The Jean Coutu Group (PJC) Inc.
The Kroger Co.
The Pantry, Inc.
The Penn Traffic Company
TravelCenters of America LLC
Ulta Salon, Cosmetics & Fragrance, Inc.
Unified Grocers, Inc.
United Natural Foods, Inc.
Village Super Market, Inc.
Vitacost.com, Inc.
Vitamin Shoppe, Inc.
Walgreens Company
Wal-Mart de Mexico, S.A.B. de C.V. (ADR)
Wal-Mart Stores, Inc.
Weis Markets, Inc.
Whole Foods Market, Inc.
Winn-Dixie Stores, Inc.
Appendix D: Definitions

Beverage manufacturers
Manufacturers of beverage products, including breweries, distilleries, and wine producers.

Book capital
The sum of total debt and the book value of equity.

Cash conversion cycle
Sum of days sales outstanding and days inventory outstanding minus days payable outstanding for the same fiscal year.

Cost of goods sold
The total cost of the inputs to producing products, including excise tax payments.

CPG manufacturers
(referred to in this report as “manufacturers”) Companies that manufacture food, beverage, and household and personal care products.

CPG retailers
(referred to in this report as “retailers”) Companies that sell manufactured food, beverage, and household and personal care products.

Current ratio
Current assets for a reported fiscal year divided by the current liabilities for that same year.

Days sales outstanding
The average of the previous fiscal year’s and reported fiscal year’s accounts receivable divided by the reported fiscal year’s average daily net sales.

Debt-to-equity ratio
Total debt for a reported fiscal year divided by the total book equity for that same year.

Domestic companies
Companies with less than 20% of their revenues coming from international sales.

EBIT
Earnings from continuing operations, before interest and taxes.

EBITDA
Earnings before interest, taxes, depreciation, and amortization.

Economic profit
Economic profit spread is calculated by taking return on invested capital (ROIC) and subtracting the weighted average cost of capital (WACC).

Effective tax rate
Income tax divided by earnings before tax for the same fiscal year.

Food manufacturers
Manufacturers of food products, including dry coffee and tea producers; frozen fruit, juice, and vegetable producers; and dry, condensed, and evaporated dairy product manufacturers.

Free cash flow as a percentage of sales
One-year, three-year, or five-year cumulative cash from operating activities, less capital expenditures plus cash interest paid as a percent of cumulative net sales, for the same time period.

Global companies
Companies with greater than or equal to 20% of their revenues coming from international sales.

Gross margin
Ratio of net sales minus cost of goods sold to net sales, for the same fiscal year.

Household products manufacturers
Manufacturers of household and personal care products, including primary battery producers and dog and cat food producers.

Interest coverage ratio
EBIT for a reported fiscal year divided by interest expense on debt for that same year.

Inventory turnover
Cost of goods sold for a reported fiscal year divided by the average of the previous fiscal year’s and reported fiscal year’s total inventory.

IRR
Internal rate of return, used in capital budgeting to measure the profitability of investments.

Large companies
Companies with greater than $4 billion in net sales in their last reported fiscal year.
Appendix D: Definitions

**Market capital**
Sum of total debt and total market value of equity.

**Medium companies**
Companies with greater than $500 million and less than or equal to $4 billion in net sales in their last reported fiscal year.

**Net sales**
Net revenue as reported by a company.

**Operating cash flow ratio**
Cash flow from operations divided by current liabilities.

**Return on average assets**
EBIT for a reported fiscal year divided by the average of the previous fiscal year’s and reported fiscal year’s total assets.

**Return on invested capital**
Net operating profit after taxes for a reported fiscal year divided by the average of the previous fiscal year’s and reported fiscal year’s book capital.

**Return on market capital**
EBITDA for a reported fiscal year, divided by the average of the previous fiscal year’s and reported fiscal year’s market capital.

**Return on sales**
EBIT for a reported fiscal year divided by net sales for that same year.

**Sales per employee**
Net sales for a given year divided by the average of the previous year’s and reported fiscal year’s total number of employees.

**SG&A expense as a percentage of sales**
Ratio of selling, general, and administrative (SG&A) expense to net sales, for the same fiscal year.

**Shareholder return**
Annualized percentage return from stock prices and reinvested dividends for a fiscal year-end.

**Short-term to long-term debt ratio**
Short-term debt for a reported fiscal year divided by long-term debt for that same year.

**Small companies**
Companies with greater than $50 million and less than or equal to $500 million in net sales in their last reported fiscal year.

**Total debt**
Total debt outstanding, including notes payable/short-term debt, current portion of long-term debt/capital leases, and total long-term debt.

**Very large companies**
Companies with greater than $10 billion in net sales in their last reported fiscal year.
Unless noted otherwise, quotes from the following business leaders were sourced from interviews conducted by PwC on the following dates:

• Bert Alfonso, President, International, The Hershey Company (May 9, 2013)
• Thomas Britanik, CMO, The Clorox Company (April 29, 2013)
• Mike Castle, CFO, Continental Mills (April 9, 2013)
• Joan Chow, CMO, ConAgra Foods, Inc. (May 1, 2013)
• John Gehring, CFO, ConAgra Foods, Inc. (March 27, 2013)
• Andy Heily, SVP of Marketing and Sales, Continental Mills (April 24, 2013)
• Maria Henry, CFO, The Hillshire Brands Company (March 28, 2013)
• Dennis Hickey, CFO, Colgate-Palmolive Company (April 4, 2013)
• Tracey Joubert, CFO, MillerCoors (April 9, 2013)
• David Marberger, CFO, Godiva Chocolatier (April 5, 2013)
• Don Mulligan, CFO, General Mills, Inc. (April 4, 2013)
• Steve Robb, CFO, The Clorox Company (April 22, 2013)
• Henry Schirmer, CFO, Unilever North America (March 28, 2013)
• Bill Schumacher, CFO, Sunny Delight Beverages Co. (April 9, 2013)
• Steve Voskuil, VP of Finance, Kimberly-Clark International (April 19, 2013)
• Rick Zimmerman, SVP of Marketing and Innovation, Sunny Delight Beverages Co. (April 15, 2013)

2. “4,200 Shoppers Interviewed in Massive 1995 POPAI Consumer Buying Habits Study; More than 70% of Brand Purchase Decisions Are Made In-Store” Business Wire (October 2, 1995)
3. PwC, Demystifying the Online Shopper: 10 Myths of Multichannel Retail (January 2013).
5. US Bureau of Economic Analysis, National Income and Product Accounts, Tables 1.1.6 (accessed March 2013), and PwC calculations.
9. These values are real, per capita amounts, so they measure average amounts per US population after adjusting for inflation. Disposable income represents income after taxes and personal consumption excludes interest payments.


24. Ibid.


29. Ibid.


34. PwC client research.

35. Ibid.


49. GetResponse news release, “GetResponse Advanced Segmentation Increases Email Relevance and ROI with Hyper-Targeted Email Campaigns,” PR Newswire (October 5, 2010).
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54. PwC client research.
57. Jackie Huba, “Maker’s Mark Listens to Customers, Reverses Course on Diluting Bourbon,” churchofthecustomer.com (February 17, 2013).
60. GMA news release, “GMA Honors E. & J. Gallo Winery and PepsiCo Inc. with CPG Awards for Innovation and Creativity” (August 27, 2012).
64. PwC 2007–08 analysis of 20 US and European companies including assessment of strategy, organization, operational model, characteristics of value-added services, service revenues, total revenues, margins, customer response to solution offerings, and technical complexity of solutions.
69. PwC, Demystifying the Online Shopper: 10 Myths of Multichannel Retail (January 2013).
71. GlutenFreely.com has now been subsumed into General Mills’ www.livebetteramerica.com, which provides information on healthy eating and lifestyle.
78. Ibid.
Acknowledgements

We would like to thank a number of people for their contributions and for providing their input. Through their collaborative efforts, the core team members have been instrumental in the success and completion of the 2013 Financial Performance Report. We would also like to acknowledge the contributions made by our subject-matter specialists, knowledge managers and researchers, and administrative personnel, and thank them for their ongoing level of commitment. More than 50 people were involved in creating this report. A project of this magnitude required passion and dedication from all involved.

Subject-matter specialists

Economic growth still moderate
John Stell

That was then, this is now: How are consumers changing?
Jerry Blaesing
Patrick Yost

Maximizing return on target segments:
What you need to keep your strategy on point
Liz Mountjoy
Shaivali Shah

Cultivating loyalists: Is your loyalty program a drain on the bottom line?
Aarti Bhatnagar
Mark Jenson
Rik Reppe

Accelerating your social journey: Create fervent customer engagement through brand storytelling
Sam Eder
Jasmine Jaco

Collaborating with business partners: How branded suppliers and their retail customers can gain a deeper understanding of consumers
Carla DeSantis
Anbu Mani

Winning from within: New consumer strategies require changes in organizational design
Sabina Saksena
Diane Youden

Redefining your core: Avoiding the tragedy of commonness
Scott Constance
Rob Shelton

Balancing operational excellence with breakthrough innovation: Driving profitable growth
Kevin Schwartz
Rob Shelton

DTC by Design: How to win the digital game
Joshua Goldman
Anbu Mani
Sabina Saksena

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2013 Financial Performance Report
Growth strategies: Unlocking the power of the consumer