

Retail Practice

What got us here won't get us there: A new model for the consumer goods industry

COVID-19 is amplifying 12 trends that have been disrupting consumer goods for the last decade. Leaders will adopt a new model for 'where to play' and 'how to win' that gets their evergreen brands on the right side of the trends and helps their small brands scale up more quickly. Together these changes will fuel the next generation of industry growth.

by Udo Kopka, Eldon Little, Jessica Moulton, René Schmutzler, and Patrick Simon



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After 40 years of outperformance enabled by a widely used five-part success model, the global consumer packaged goods (CPG) industry struggled to grow over the last decade. Why? Because 12 disruptive trends have diluted the old success model for growing mass brands. Now the COVID-19 crisis is amplifying many of these trends, triggering an industry imperative to change.

CPG players need to rethink their portfolio priorities and ‘where to play’ choices to increase their exposure to growing markets, channels, and sub-categories. These shifts will necessitate more dynamic resource allocation and greater use of mergers, acquisitions, and divestitures (M&A&D) to improve portfolio composition.

CPG companies also need to adopt a new how-to-win model that reinvents marketing to focus on consumer relevance and builds new, largely digital commercial capabilities to grow with growing channels and markets, especially in emerging Asia. CPGs need to enable these new commercial capabilities with an evolved operating model that prioritizes consumer closeness and local decision-making in key markets, as well as intelligent productivity gains to fuel commercial investments.

Together, these shifts will help CPG players establish a contemporized virtuous cycle to replace the old model that worked so well for so long. The new model will help CPGs get their evergreen brands on the right side of the disruptive trends and help their small brands scale faster, fueling the next era of industry growth.

The rise and fall of the traditional CPG success model

The global CPG industry performed very well for a very long time, building many of the world’s top brands. The industry generated the second highest total return to shareholders (TRS) across industries in the 40 years before the global financial crisis

(GFC) of 2008–2009—15 percent, topped only by the materials industry.

CPG value creation model for Western brands

This success owed much to a five-part model that fueled the growth of leading brands. Pioneered just after World War II, the model has seen little change since then. This model entails:

- *Mass-market brand-building and product innovation*, generating stable growth and gross margins typically 25 percent above non-branded competitors
- *Partnering closely with grocers and other mass channels to gain broad distribution* as the grocers grew
- *Building brands and distribution in developing markets* as consumers became wealthier, capitalizing on the #1 trend on the planet—rising wealth—that accounted for 70 percent of revenue growth in the CPG sector over the past two decades (and will continue to do so for the next decade)
- *Driving cost out of the operating model*, often through increased centralization of marketing, among other functions
- *Using mergers & acquisitions* to consolidate markets and enable organic growth post-acquisition.

This model created a virtuous cycle—strong brand equity and broad distribution generated higher margins that in turn allowed for more brand equity investment. Scale provided a critical competitive advantage.

The struggle to find growth

However, over the last decade, industry performance has faltered in terms of fundamentals and stock market performance. Economic profit¹

¹ Economic profit is NOPLAT less cost of capital.

Zooming in on large CPG companies in the US from 2017–2019, all of their organic volume growth and almost 90 percent of their value growth came from small and medium-sized brands.

growth has nosedived. From 2000 to 2009, economic profit grew 10.4 percent per year; from 2010 to 2019, it dropped to 3.2 percent per year. Similarly, industry stock market performance went from outperforming the S&P 500 by 7.2 percentage points per year from 2000 to 2009 to underperforming by 2.8 percentage points per year from 2010 to 2019.

In more recent years, some players began pulling ahead of the pack in economic profit contribution. But margin, not growth, drove almost all of this improvement. In fact, for the top 30 CPG companies

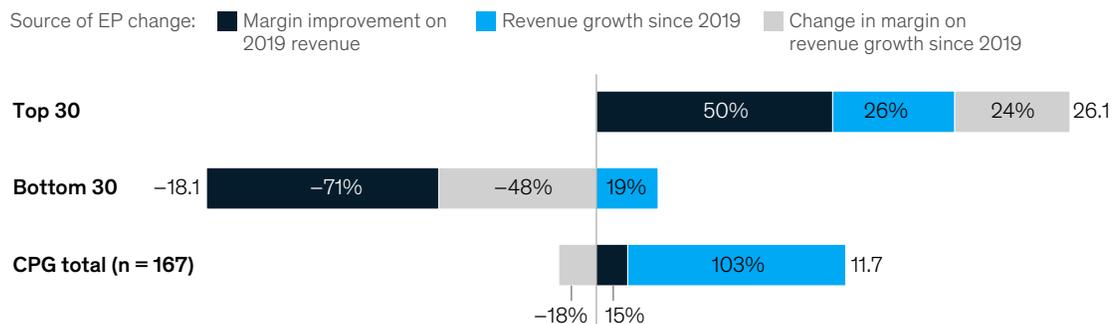
in absolute economic profit growth, margin expansion contributed twice as much as growth to value creation (Exhibit 1). Many of these players made major SG&A reductions emerging from the GFC and have sustained them since then—by 3.3 percentage points of sales since 2010.

The central problem is large brands, which are struggling to create unit growth. A closer look at the US market before COVID-19 is revealing. From 2017 to 2019, large brands (>\$750 million in revenue) in the US lost volume at the rate of 1.5 percent a year. At the same time, small brands grew 1.7 percent, and

Exhibit 1

For the Top 30 CPGs, margin expansion contributed twice as much value as growth—50 percent, versus 26 percent.

Change in economic profit 2009–2019, \$ billion



Source: McKinsey Corporate Performance Analytics; McKinsey analysis

private label grew 4.3 percent.² Zooming in on the large CPGs (>\$2.5 billion in US revenue), we see that all of their organic volume growth and almost 90 percent of their overall value growth came from their small and medium-sized brands (<\$750 million in revenue), even though those brands contributed only 42 percent of 2016 revenues. Small brands (<\$150 million in revenue) especially outperformed: they contributed 50 percent of value growth, while contributing only 11 percent of 2016 revenues.

As a result, in recent years the leading brands in each CPG category have generated only 25 percent of value growth in US Nielsen-covered channels.³ Meanwhile, small and medium-sized brands captured 45 percent of growth, and private-label products captured 30 percent. This underperformance by leading brands varies by category, with household care performing best, but

leading brands in all categories captured less than their fair share of growth (Exhibit 2).

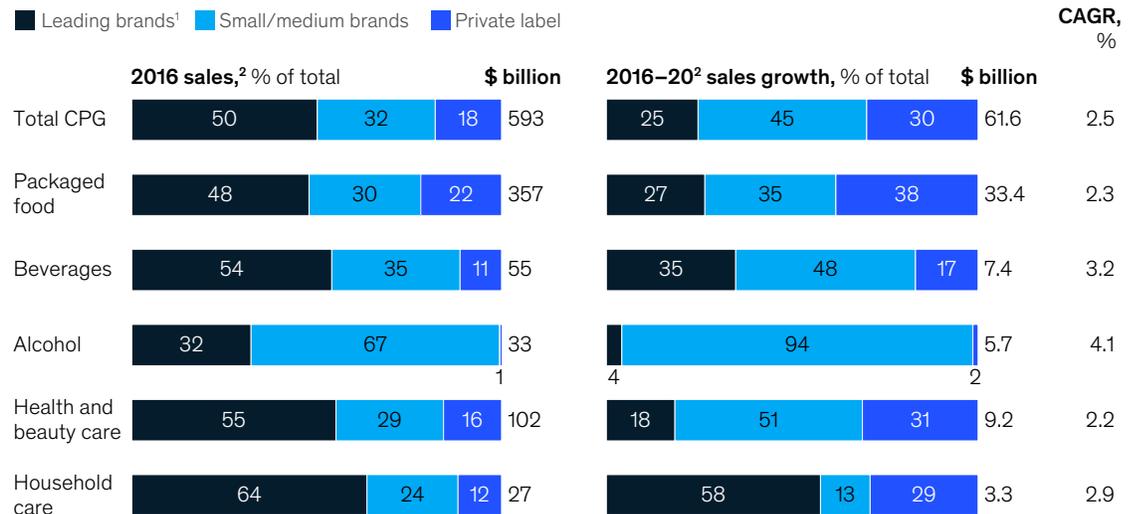
Industry performance mismatch with high market expectations

The market expects CPG leaders to overcome this growth challenge. We analyzed the valuations of 155 listed CPG companies. Their December 2019 aggregate market cap—chosen to avoid the distorting impact of COVID-19—suggests that investors expect significant performance improvements. Assuming constant margins, CPG players need to achieve 1.0–1.5 percentage points higher organic growth rates than they did in the last decade to meet investor expectations. Maintaining their recent growth rate of 2.6 percent risks a ~25 percent reduction in market cap (Exhibit 3).

Exhibit 2

In recent years, leading brands in each CPG category have generated only 25 percent of growth in US Nielsen-covered channels, despite being 50 percent of sales.

Sales growth across US Nielsen-covered stationary channels by type of brand (2016–20²), % of total



¹Leading Brands defined as the top 3 brands by TTM 04/2016 Sales by sub-category (eg, whiskey, hair care), small / medium brands as remaining brands apart from Private Label.

²Includes food/grocery, drug, mass merchandisers, Walmart, club stores, and dollar stores. Years refer to 12 months, ending in April of that year (eg, 2016 = 12 months from 05/2015 to 04/2016).

Source: Nielsen

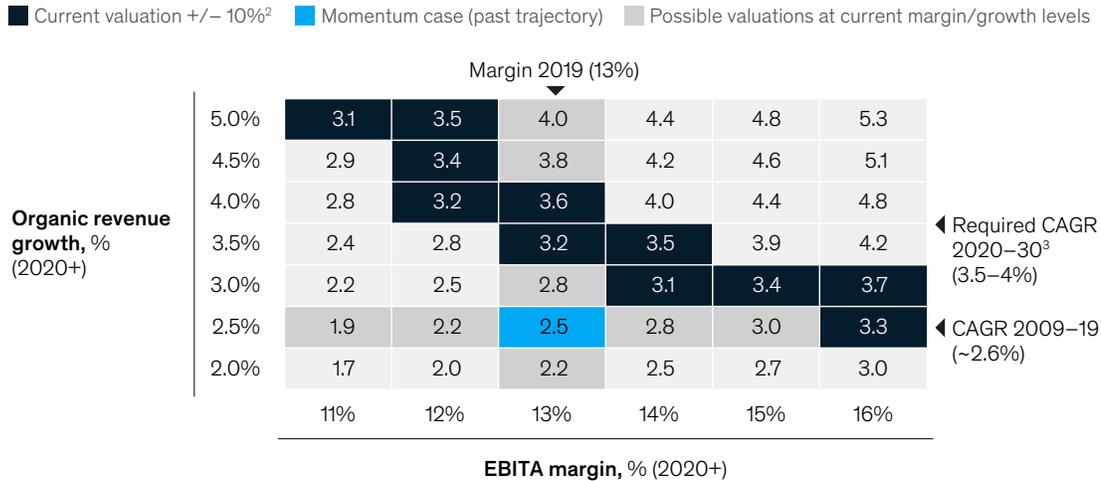
² US Nielsen data includes food/grocery, drug, mass merchandisers, Walmart, club stores, and dollar stores; *leading brands* defined as top three brands in each category, by 2016 sales.

³ US Nielsen data includes food/grocery, drug, mass merchandisers, Walmart, club stores, and dollar stores; *leading brands* defined as top three brands in each category, by 2016 sales.

Exhibit 3

Assuming constant margins, CPGs need to deliver ~1–1.5 percentage points higher organic growth than in the last decade to meet investor expectations.

Large CPG companies—aggregate market cap at different growth and margin scenarios,¹ \$ trillion



¹Based on DCF analysis using aggregated financial performance and assuming WACC of ~7.5% (D/E of 25%), tax rate of 24%, IC/Revenue ratio of 42% (based on last 5 years average), perpetuity growth beyond 10 years capped at 4%.
²Aggregate Market cap of \$3.4 trillion as of Dec 31, 2019 (pre-COVID-19 impact).
³Assuming constant margin.
 Source: S&P CapitalIQ, company reports, McKinsey analysis

Accelerating growth by ~40–60 percent is a tall order. To stay healthy and relevant to consumers, CPG companies must confront the challenge.

12 trends disrupting the traditional model

Why has the old success model stopped generating growth? Because 12 disruptive trends have battered the model over the last decade. Now COVID-19 is amplifying many of them (Exhibit 4).

Five of those trends are disrupting CPGs' traditional mass market brand-building. Digital media and the ubiquity of digital data are transforming how consumers learn about brands. Price sensitivity is skyrocketing in importance in the wake of COVID-19. In Western markets, what consumers value is shifting, with younger consumers seeking brands they see as special, different, and authentic. About half of Western consumers across age

groups are prioritizing conscious eating and living, preferring purpose-driven brands that help them meet personal goals like reducing meat consumption. Small brands are rushing in to deliver on these brand values (although execution challenges during the COVID-19 crisis have held them back, growing at only their fair share, instead of outgrowing large brands).

Four of the 12 trends are transforming selling channels. E-marketplaces have experienced meteoric growth of 17 percent over the last five years, generating 65 percent of the growth among the top 150 retailers across the globe (and across all categories). E-marketplaces surged in grocery categories during the COVID-19 crisis, with Amazon's grocery business growing 45 percent in the US and 80 percent in the UK, according to Stackline. Meanwhile, discounters are continuing their steady rise, especially in Europe and some developing markets. As a result, grocers are

squeezed and responding in ways that make them increasingly challenge trading partners. Now COVID-19 is driving foodservice market contraction—a major challenge, particularly for beverage players.

While developing markets will continue to account for 70 percent of consumer goods growth, the mix of geographies has shifted, with emerging Asia generating far more growth than other developing markets (representing about half of global private consumption growth over the next 10 years). Local

competitors and digitization of the trade structure are key dynamics in emerging Asia.

Of course, all trends vary by market. Averaging can risk masking the intensity of trends in leading countries— for example, China for digital sales, South Korea for beauty regimen, and Germany for price and value. We advocate monitoring lead markets to see and seed the future in others.

See the “Twelve disruptive trends” summary table for a more complete trend analysis.

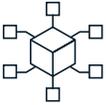
Exhibit 4

Why has the old model stopped generating growth? Because 12 disruptive trends have battered the model over the last decade—now, COVID-19 is turbocharging many of them.

Moderate  very high 

The old value-creation model	Disruptive trends	Trend impact		Disruption due to COVID-19
		Past 10 years	Next 10 years	
Mass-market brand-building and product innovation	1 Digital ubiquity (data, mobile, and the Internet of Things)	2	5	↑↑
	2 Importance of value/price sensitivity	4	5	↑↑
	3 The millennial and Gen-Z effect	2	4	→
	4 Conscious eating and living	3	5	↑
	5 The explosion of small brands	3	4	↓
Partnering closely with grocers to gain broad distribution	6 Meteoric rise of e-marketplaces	3	5	↑↑
	7 Steady rise of discounters	3	4	↑
	8 Mass-merchant squeeze	2	5	↑
	9 Foodservice challenges	2	3	New
Building brands and distribution in developing markets	10 Battle for emerging Asia	3	4	↑
Driving cost out of the operating model, often through centralization	11 Pressure for profit from activist investors	2	3	Jury's out
Using M&A&D to consolidate markets and enable organic growth post-acquisition	12 Rising competition for deals	3	3	Jury's out

Twelve disruptive trends

Old value creation model	Disruptive trend	Key facts
Mass-market brand-building and product innovation	Digital ubiquity 	<ul style="list-style-type: none"> • Digital (data, mobile, and the Internet of Things [IoT]) has been revolutionizing how consumers and brands learn about and engage with each other • Under stay-at-home mandates triggered by COVID-19, digital engagement surged across all platforms
	Importance of value 	<ul style="list-style-type: none"> • After the GFC, consumer confidence did not rebound to prerecession levels until 2011 in Germany, 2014 in the UK and the US, and 2017 in China • COVID-19 will likely trigger a much deeper recession than the GFC. Currently, 65 percent of European consumers surveyed said they were very or extremely concerned about the economy
	The millennial and Gen-Z effect 	<ul style="list-style-type: none"> • US Millennials are almost four times more likely than Baby Boomers to avoid buying products from “the big food companies” and almost six times more likely to find newer brands “better or more innovative”¹
	Conscious eating and living 	<ul style="list-style-type: none"> • Conscious eating and living are gaining traction, driven by three consumer desires—reduce meat consumption, contribute to sustainability, and accommodate dietary needs and preferences • 50 percent of UK consumers across the economy are conscious eaters, with 38 percent eating less meat, 30 percent factoring sustainability into food choices, and 24 percent accommodating a food intolerance or preference (with considerable overlaps) • Conscious eating is redefining what <i>healthy</i> means
	The explosion of small brands 	<ul style="list-style-type: none"> • Small brands have seen high growth, growing four times faster than large brands, 2018-2019, although they struggled with availability and execution during the COVID-19 crisis • Venture capitalists have provided \$18 billion of funding to small CPG brands in the past five years • Large CPGs acquired small brands successfully in the last few years, often accelerating their growth and helping them over the \$100 million scale barrier
Partnering closely with grocers to gain broad distribution	Meteoric rise of e-marketplaces 	<ul style="list-style-type: none"> • E-marketplace/online-to-offline (O2O) giants have generated 65 percent of the top 150 global retailers' growth, growing at 17 percent, 2014–2019, versus grocers' 0.8 percent • Three e-marketplace/O2O giants—Amazon, Alibaba Group, and JD.com—account for almost all of the growth • COVID-19 helped e-marketplace/O2O giants surge in grocery. Amazon grew its grocery business 45 percent in the US and 80 percent in the UK, according to Stackline • This disruption will accelerate as e-marketplace/O2O giants increase their geographic reach and move into brick-and-mortar

¹ McKinsey, “Millennial Survey,” 2019.

Old value creation model	Disruptive trend	Key facts
	<p>Steady rise of discounters</p> 	<ul style="list-style-type: none"> • ALDI and LIDL grew 6.7 and 7.1 percent, respectively, 2013–2018 • Discounters typically grow to secure market share of 20 percent or more in each grocery market they enter
	<p>Mass-merchant squeeze</p> 	<ul style="list-style-type: none"> • The rise of the e-commerce giants and the discounters is squeezing grocers and other omni-channel mass merchants • Together, the 76 largest mass players saw revenue growth of just 0.8 percent, 2014–2019 • This pressure is forcing mass merchants to become tougher trading partners, including participating in buying alliances, which accounted for 55 percent of retail value from multinational CPGs in Europe in 2019 and are projected to exceed 95 percent by 2025
	<p>Foodservice challenges</p> 	<ul style="list-style-type: none"> • The COVID-19 crisis is triggering foodservice consolidation • The ongoing economic impact and increase in remote working will further challenge foodservice
Building brands and distribution in developing markets	<p>Battle for emerging Asia</p> 	<ul style="list-style-type: none"> • China, India, and emerging Asia Pacific will generate more than 50 percent of the world's growth in real private consumption, between 2019 and 2029. Yet they account for only 20 percent of private consumption today • Within a decade, 75 percent of Chinese households and almost 60 percent of Indian households will be part of the consuming class • The growth rates of other developing markets have nearly halved since 2009 so they will contribute only 12 percent of real private consumption growth, 2019-2029 • The US remains a key market, generating 20 percent of global growth (the bulk of the 35 percent developed market share of growth) • Channels in developing markets are evolving differently than they did in the West, e.g. emerging Asia's fragmented trade is digitizing
Driving cost out of the operating model	<p>Pressure for profit from activist investors</p> 	<ul style="list-style-type: none"> • Activists ran more than 110 campaigns per year against CPG players, 2016-2019, increasing attention to SG&A industry-wide • Activist investors encouraged some short-sighted choices from which the industry is still recovering
Using M&A&D to consolidate markets and enable organic growth post-acquisition	<p>Rising competition for deals</p> 	<ul style="list-style-type: none"> • Competition for deals has sustained high EV/EBITDA multiples in CPG of 10.1x-11.8x since 2013 • Despite the COVID-19 crisis, deal competition will increase as large assets grow scarce and private equity firms sit on an estimated \$1.6 trillion in dry powder

Tough questions and strategic choices

Before the COVID-19 crisis, major CPG companies were evolving toward a new model. They were sharpening their execution of the old value creation model, experimenting with ways to own the explosion of small brands in their categories, and pulling the lever of productivity more than ever to meet investor expectations.

Then COVID-19 hit. Grocery volumes surged 20 percent with pantry loading and then settled at 5–10 percent, while restaurants remained closed or tightly restricted. Through this period, large CPG companies mobilized their supply chains and concentrated on top lines, while small players struggled to pivot. Further, 15 percent or more of consumers changed their primary grocery store, generating a shock to loyalty and lots of forced trial. This has created a powerful opportunity for brand leaders to get closer to the consumer, while reasserting the benefits of scale in the supply chain and key account relationships. But the crisis is also accelerating consumer demand for value and reliance on digital. All of this constitutes a call to action for the industry.

CPG companies need to confront these challenges by rethinking their ‘where to play’ growth strategies across categories and brands to get more exposure to growing markets channels and brands. And they need to shift much faster to a new ‘how to win’ model that embraces digital marketing, sales, and operations, creating a new virtuous cycle that works for today’s consumers and trade. We outline questions to ask and moves to consider below.

Portfolio and category strategies

For each of our category franchises, where is the growth, and how well positioned are we to capture it with our current mix of evergreen brands and small brands, especially in the shadow of COVID-19? How are consumers changing? How are channels changing? How well-suited are our competitive advantages to these changes? Therefore, where should we play? In particular, should we participate in the value segment or allow the “good enough”

portion of our categories to grow without us? And do we need to divest any brands because they no longer fit our growth requirements or our business model? What capability improvements and what big bets, including true business model change, could unlock a new wave of growth for us?

Great portfolio and category strategies start with two inputs: a privileged view of what is happening with the consumer and the market and a deep understanding of the company’s competitive advantages. With these in hand, a company can determine how well-suited its current evergreen brands and small brands are to capturing growth and therefore what strategic goals to set for them. The company can then identify what new business models, external partnerships, and M&A&D agendas could generate exciting new growth.

Evergreen brand growth strategies

How relevant are our evergreen brands to growing consumer segments, especially those under 35? What will it take to get our evergreen brands on the right side of consumer and channel trends and accelerate their growth?

Many CPG companies have been renovating the brand equity of their large brands, imbuing them with more purpose, more originality, and more relevance. This is the right place to start. Particularly in the context of COVID 19, delivering on the brand’s promise is necessary but not sufficient. Consumers, especially younger consumers, want brands that understand them and share their values. They also want to know that the brand is virtuous on local community contributions, equitable commerce, and environmental performance. Trust and purpose matter more than ever.

Of course, superior functional performance is also essential for evergreen brands, and the bar keeps rising as private-label contract manufacturers mature. Evergreen brands must obsess over their functional performance across all consumer occasions, using innovation as needed to retain leadership.

Getting evergreen brands on the right side of marketing and sales trends is also vital. Marketing must be tailored by audience, delivering relevant messages through relevant channels in a granular way, while the product line of the evergreen brand remains appropriately streamlined. Evergreen brands must also embrace high-growth sales channels and retail formats, even when they require a different commercial model than grocery. Channel strategies will need to be even more customized to each country and category trend. For example, in Brazil, the cash-and-carry format should prove resilient in the aftermath of the COVID-19 crisis. In all cases, evergreen brands must shape the execution of their categories in their relevant channels.

Above all, evergreen brands must lead in consumer closeness, to guard against small competitive brands popping up in segments left unattended and against retailers offering good enough alternatives at lower prices.

Small brand growth strategies

What will it take to help our small brands achieve scale rapidly? How can we make small brand acquisitions successful?

Driving the explosion of small in your categories is an exciting prospect, offering the potential to extend category leadership with concepts that appeal to engaged niches and can command a

premium. Major CPG companies are getting the hang of it. In the US, small brands acquired by large CPGs grew faster than other small brands, 2018–2020. But many small brands struggle to get over the \$100 million barrier so acquiring the right challenger brands is not easy. Would-be acquirers should look for the three hallmarks of a truly scalable proposition—longevity (fit with a growing lifestyle or consumer mindset), breadth (a natural direction for expansion into adjacent categories, channels, geographies, or needs), and momentum (loyalty that secures high returns through repeat purchase or word of mouth).

Acquirers can scale a small brand over time by guiding, intervening in, or integrating it, but they must act at the right time and remember why small brands often initially succeed on their own. On the journey to scale, small brands need to win on their proposition, be disciplined on commercial levers, and build the backbone for scaling. The small brand proposition is usually the “sparkle”—often predicated on new, niche consumer insights or a business model that big brands typically lack the authenticity to offer. The scaling risk lies in expanding beyond the core too early, before a small brand has earned the right to offer the adjacency.

Successful stand-alone small brands are very disciplined and very careful about spending. Small brands usually market efficiently with the core consumer in mind. As they grow, they leverage

The new model uses digital to move away from mass marketing and sales and toward targeted commercial execution.

their community and loyalty to “export” the brand. They also tend to focus on a key channel to deliver and delight the core audience before expanding distribution points to increase purchase frequency. An acquirer can open the door to a few thoughtful channel expansions, as well as guide the small brand in pulling commercial levers (i.e., pricing and promotional optimization) before scale takes hold, keeping the brand efficient.

The supply chain and the operating model are often a secondary focus for a small brand but essential for scaling. An acquirer can provide supply chain instruction or even integration support to help the small brand build a strategic and responsive supply chain. This is especially helpful in categories with long lead times, highly regulated environments, or fluctuating raw material costs.

The new model

To execute these category and brand growth strategies, CPGs need to adopt a new model—a new ‘how to win’—that looks quite different from the old model. The new model continues to leverage scale advantages in marketing spend, distribution, supply chain, and back office but uses digital to move away from mass marketing and sales and toward targeted commercial execution. The new five-part model, which requires building or strengthening 16 individual capabilities, looks like this (Exhibit 5).

Relevance-led brand building, innovation, and marketing

Relevance-led brand building is vital for both evergreen brands and small brands. Most CPG companies need to do much more to sharpen their consumer targeting, enabled by new digital media. This targeting needs to cross all touch points and include personalized point-of-sale

Exhibit 5

Getting on the right side of trends: Revamping ‘where to play’ and ‘how to win.’

Degree of change versus the old model: ● Extensive ● Moderate

Where to play	How to win	
Portfolio, category and brand strategies	The new model	Required capabilities
Portfolio strategy	● Relevance-led brand building, innovation and marketing	<ul style="list-style-type: none"> •Occasion- and purpose-led portfolio, innovation and design •Data-driven marketing
Category strategy	● Partnering with all growing channels and embracing digital sales	<ul style="list-style-type: none"> •Precision revenue growth management •E-marketplace management •Building omnichannel and DTC businesses •Digital route-to-market and customer contact
Brand strategy	● Evolving the operating model to excel at local consumer closeness and ever greater productivity	<ul style="list-style-type: none"> •Local success models •Fitter, flatter, faster organization •Agile sprints to accelerate innovation and change •Next-generation design and procurement •Intelligent supply chain •Tech overhaul •Back-office automation •Agile budgeting and resource allocation
	● Using programmatic M&A&D to acquire small brands and capabilities and to divest low growers	<ul style="list-style-type: none"> •Programmatic M&A&D for small brands and capability •Divestment of low-growth brands

marketing, which remains very underdeveloped today. Insights from the vast amounts of data that consumers create then need to loop back into innovation priorities and results, maximizing the brand's relevance to micro-segments and micro-occasions, while keeping the product line focused on an efficient core.

Partnering with all growing channels and embracing digital sales

While grocers will remain CPG companies' most important and strategic trading partners in most markets, CPGs also need to ensure that they achieve pervasive distribution of their evergreen brands, which requires embracing many channels, including e-marketplaces. Small brands need to be present in their best-fit distribution channels. Therefore, most CPGs need to strengthen four digital-driven commercial capabilities.

Precision revenue growth management (RGM).

Leading CPG players unlock the next growth curve by linking the core levers of RGM—pricing, assortment, promotion, and trade investment—to the company's occasion expansion and activation strategy. Precision RGM is powered by advanced analytics tools that automate key analyses at a very granular level and enable simulation and foresight.

E-marketplace management. Maximizing success on these platforms without triggering cannibalization of more profitable sales requires appropriate, tailored messaging and assortment at the point of sale. CPGs need to build developer teams that produce the necessary assets (pictures, videos, and key words) and drive technical execution, day in and day out. These teams need to be fully integrated with the business and prioritized as a critical capability required to maximize growth.

Building omni-channel and D2C businesses.

CPGs need to excel at omni-channel category management, setting the goal of overtrading versus each retailer's brick-and-mortar business, particularly given the expected 2–3 percentage point share gain that online will enjoy in most markets post-crisis. Direct-to-consumer (D2C) businesses are commercially viable for only

select CPG propositions—namely, those with an average basket and purchase frequency high enough to justify customer acquisition costs and make per-order economics viable. Categories like pet care and non-OTC consumer health offer abundant opportunities. For other categories, D2C propositions may still be worthwhile to acquire proprietary consumer data and create a test-and-learn opportunity.

Managing data for proprietary insights. CPG manufacturers must become experts on retailers' big data in order to keep their seat at the table. They must demonstrate expertise in big data analytics, insight generation, and ROI tracking of investments, particularly for e-marketplaces since these retailers often do not value traditional CPG category management.

Building brands and distribution in developing markets

Participating in developing markets of course requires deep local consumer understanding. Companies need to rebuild entrepreneurial, dedicated local organizations that can execute impactful global marketing campaigns in locally relevant ways.

CPG companies also need to evolve their routes to market as the trade changes. In emerging Asia, e-marketplace/online-to-offline (O2O) giants will continue to lead, while digital enablement of the fragmented trade will strengthen that format, leaving less room for Western-style modern trade.

For CPG players, early adopters of digital-led route-to-market models will have a clear advantage, both in shaping point-of-sale service level expectations and in leveraging the power of analytics. The value proposition to the fragmented trade will be increasingly customized, enabled by advanced recommendations on assortment and pricing that require different back-end processes in CPG commercial teams.

Evolving the operating model to excel at local consumer closeness and productivity

Historically, some CPG companies went too far in

pursuing a global one-size-fits-all model and lost ground to more locally relevant competitors. Going forward, CPG players need to reinvest in local talent and decision rights in priority growth markets and use them as lead markets for understanding consumers and channels in the region or sub-region. The local GM should own the game plan for winning in the market.

Companies at the forefront of implementing this more unbundled operating model have, for example, abandoned traditional paradigms of how to organize for innovation. Instead of driving innovation out of global R&D centers, they identify innovation needs by local market, with employees at all tenures having nomination rights. Then they form a cross-functional team within days, fast-track funding, and, with the help of global R&D capabilities pulled into the process, develop a marketable product in weeks, rather than years.

This operating model uses technology and digitizes wherever possible, from automating standardized tasks in HR, finance, and IT to supporting the decision-making of signature roles, such as equipping brand managers with KPI cockpits and consumer insights dashboards.

Great operating models are adept at promoting change. We advocate establishing a high-profile, institutionalized sprint process that identifies, resources, and sponsors new capability-building and other priorities across the business in short-burst cycles. One CPG company, for example, identified mission-critical tasks in marketing and organized cross-functional teams in six-week sprints around each task. Coupled with senior sponsorship and a “fast-track removal of barriers” spirit, all the teams completed their tasks, which otherwise might have taken years. Such success makes it easy to rally the rest of the organization around the coming change and create a pull, rather than a push, transformation.

Operating models also need to unlock the next wave of productivity. We see several opportunities.

Next-generation design and procurement.

Product design needs to get closer to what the consumer values and reduce all other costs by modularizing, tearing down, and benchmarking every element in new designs. Even leading CPG companies still lag behind industries like automotive and medical products in embracing design-to-value. Indirect procurement often offers another substantial savings opportunity. Most CPGs can achieve savings of 3–7 percentage points on their addressable direct and indirect procurement base.

Intelligent supply chain. Today it is possible to realize the aspiration of an intelligent supply chain in which an integrated planning process takes relevant data from the demand side and turns it into reality on the supply side. Success requires harnessing digital data throughout the value chain and using it in an integrated, automated corporate planning process. A major benefit of this shift is the ability to move from monthly to more frequent S&OP cycles that maximize sales, while reducing obsolescence and working capital.

Tech overhaul. Tomorrow's supply chain must operate in real time and with insufficient information to enable cost reduction, resilience, flexibility, and traceability, especially post-COVID-19. Most mature CPG players need to jettison their legacy IT set-up, taking a zero-based approach and moving into a cloud scenario focused on customer-driven processes built for machines talking to each other, not humans emailing Excel spreadsheets.

Back-office automation. In the past 20 years, SG&A cost reductions came from doing the mess for less, making operations cheaper but not better. Now is the time to overhaul the processes built for the ERP environment of the 1990s and use emerging technologies like intelligent automation and artificial intelligence to modernize the back office, creating a service-oriented, low-touch/low-code environment to democratize automation, analytics, and artificial intelligence.

Agile budgeting and resource allocation. Our research shows that top performers reallocate 2–3 percent of resources per year, removing unproductive costs and channelling funds to priority initiatives. The zero-based budgeting processes that many CPG companies have implemented make this ambitious goal more achievable than in the past.

Programmatic M&A&D

CPG companies have been using M&A&D extensively to pivot their portfolios toward growth and add capabilities rapidly. In the last decade, leading CPGs players turned over their portfolios at more than twice the rate of other large listed firms.⁴

The strongest CPG players will continue to develop the skills of serial acquirers adept at acquiring both small and large assets and at using M&A&D to achieve visionary and strategic goals—redefining categories, building platforms and ecosystems, scaling quickly, and accessing technology and data through partnerships. The most successful players employ a programmatic M&A approach focused on snapping up challengers, rather than market consolidation or expansion into adjacencies

(8.3 percent TRS, 2013–2018, compared with 6.1 percent and –7.8 percent, respectively).⁵ These players often complement their M&A&D programs with incubators or accelerators for small players, that, at their best, leave ample time to fully understand the success drivers of the brand and help the organization scale the brand without overburdening it with inflexible operating procedures.

After a period of disruption intensified by the COVID-19 crisis, the CPG industry is entering a new era. CPGs that prosper in the 2020s will make ‘where to play’ choices that strengthen their portfolios and get their categories and brands on the right side of the disruptive trends. They will also adopt a new ‘how to win’ model that focuses on relevant consumer marketing and selling across growing channels, and they will embrace an operating model that prioritizes consumer closeness and intelligent productivity gains to fuel commercial investments. These shifts will help industry leaders unlock growth with brands and business models, old and new.

⁴ McKinsey analysis.

⁵ McKinsey, “The next wave of consumer M&A: Executing for value,” October 21, 2019 (median TRS data refers to programmatic M&A approach only).

Udo Kopka is a senior partner in McKinsey’s Hamburg office; **Eldon Little** is a senior partner in the Dallas office; **Jessica Moulton** is a senior partner in the London office; **René Schmutzler** is an associate partner in the Hamburg office; and **Patrick Simon** is a partner in the Munich office.

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