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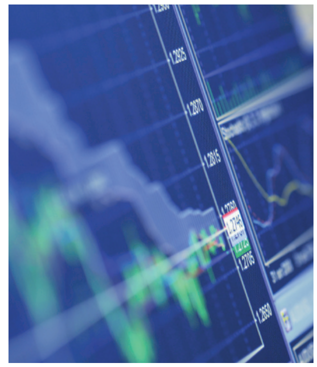


A long-term decline in US retail-food volume? What food companies can do

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In the 20 years prior to the global recession of 2008, food manufacturers saw a steady increase in the volume of product they sold through America's retail stores. But by 2005, growth in the US food-at-home (FAH) segment had begun to stall. As one might expect, FAH sales volume picked up during the heart of the recession, from 2009 to 2011, as households made efforts to save money by eating out less. Then, as the economy improved, consumers loosened their purse strings and dined out more frequently, and FAH volume once again declined.

Now, consumer food companies are wondering: will the slowdown continue? Where does the market go from here? Our answers to these questions—based on extensive analysis of the economic, demographic, and consumer trends that have driven US FAH sales volume in the last three decades—could give food companies pause. Our research shows that the 2005–06 period marked the beginning of a structural shift in the US food market, and all indications are that the nearly decade-long slump in FAH volume will continue in the near term.

But food manufacturers need not resign themselves to flat or negative growth. In this article, we present the highlights of our research; offer a forecast for the US FAH market in the near term, including an analysis of the factors that drive growth; and suggest four strategic moves that could help food manufacturers generate growth in the context of that forecast.

The drivers of food volume: 1985–2012

Between 1985 and 2005, a combination of demographic and economic trends helped generate growth in FAH consumption in the United States. Population growth was steady. Caloric intake per capita was rising. Both input prices and retail-food prices remained fairly stable; in fact, the consumer price index during this period was below 3 percent on average across food categories. Consumer trends also contributed to robust growth: food away from home (FAFH) still gained ground, but not quite as quickly as it did in the mid-1970s.

But by the mid-2000s, the trends that had helped fuel steady FAH-volume growth throughout the 1980s and 1990s were eclipsed by a new set of powerful long-term trends. Population growth slowed; further, demographic groups that tend to consume fewer calories—namely, Hispanics and older people—began to account for a larger proportion of the overall population. (According to the most recent National Health and Nutrition Examination Survey, Hispanics consume on average nearly 70 fewer calories per day than non-Hispanic whites for example, and both men and women age 70 and older consume far fewer calories than their younger peers.[1]) Commodity prices were much less stable by the mid-2000s, and because higher commodity prices were passed on to the consumer, retail-food prices rose faster than wages. And then, in 2008, the recession hit. US consumers, on tighter budgets, ate more leftovers and wasted less food.

But somewhat paradoxically, the full impact of the slowdown in FAH growth was hidden from view during the worst part of the recession, largely because of three short-term trends brought about by the recession itself. First, in an effort to support struggling households, the government more than tripled its spending on the Supplemental Nutrition Assistance Program (SNAP), or food stamps. Between 2009 and 2011, funding for the food-stamp program increased by $22.1 billion.[2] (Between 2005 and 2008, that number was only $6.6 billion.[3]) Second, consumers across income levels ate more meals at home during the recession instead of eating out. And finally, retail-food prices remained relatively flat between 2009 and 2011 as manufacturers absorbed higher commodity costs, which encouraged consumers to buy more (Exhibit 1).

Where do we go from here?

Based on our findings, we believe the decline that began in 2005 was just the start of a long-term structural shift in FAH consumption. Even the most optimistic growth scenarios are grim: if current trends continue, food manufacturers should expect unit sales growth to be flat at best in the near term, but a shrinking market is much more likely.

Our projections are based on the likely evolution of specific trends (Exhibit 2). Data indicate that population growth will continue to slow. Commodity prices will be increasingly volatile. The SNAP program, which boosted FAH volume during the worst part of the recession, is unlikely to expand, given the US government's budget constraints. In fact, the program is likely to decrease in size over the next decade.

1 "What we eat in America," National Health and Nutrition Examination Survey, 2009–10.
2 US Department of Agriculture Food and Nutrition Service, www.fns.usda.gov.
3 Ibid.

Exhibit 1 There were three distinct periods of food volume growth from 2005 to 2012.

ESTIMATES

	Prerecession (2005–08)	Recession (2009–11)	Postrecession (through Sept 2012)
Overall US retail-food volume % unit sales CAGR[1]	~+0.2%	~+1.0%	~–1.5%
Proportion of food eaten at home (% CAGR in food eaten at home as a % of total food consumed)	+0.2%	+0.8%	+0.1%
FAH[2] price % CAGR avg price per unit	+4.4%	+1.5%	+3.7%
FAFH[3] price % CAGR avg price per unit	ΔFAH ≈ ΔFAFH	ΔFAH < ΔFAFH	ΔFAH > ΔFAFH
Wage inflation %	+3.5%	+0.8%	+0.7%
Food-stamp funding incremental increase ($ billion)	+$6.6	+$22.1	+$1 B (E)

1 Compound annual growth rate.
2 Food at home.
3 Food away from home.

Offsetting some of the likely decline in FAH sales growth will be decreasing competition from FAFH. The NPD Group, a market-research firm, predicts an increase of just 4 percent for meals and snacks consumed in restaurants through 2022, while purchases of prepared meals for at-home consumption will increase by 10 percent. Most grocery stores and big-box retailers are already capitalizing on the appeal of convenient, quick, healthy meals by offering prepared foods alongside more standard grocery fare.

Four ways to spur growth

Despite the downbeat forecast, we believe there is still tremendous opportunity for food companies to grow. Most industry players have so far taken an ad hoc approach to addressing the impact that sluggish FAH growth has had on their business—through small product innovations or reductions in package size, for example. To create sustainable growth in the challenging years ahead, consumer food companies should consider taking a broader, longer-term view of the market and making bold strategic moves, including new types of partnerships and collaborations.

Take a granular view of growth

Despite the overall decline in FAH volume, some subcategories have in fact grown in recent years, driven in part by the aforementioned demographic shifts. For example, dried fruit, a subcategory especially popular with older people, has grown since 2005. By combining data on consumer attitudes, purchasing behaviors, and product usage with information about demographic and economic trends, food companies can identify pockets of growth. Our research shows that companies that invest in—and actively shift their portfolios toward—higher-growth subcategories consistently outperform their peers.

In our view, foods that are highly regarded for their nutritional content offer two distinct benefits. First, such foods compose a fast-growing subcategory. Second, they present an opportunity for CPG companies to take an active role in combating the nation's obesity epidemic. Indeed, several food companies have helped drive—and continue to benefit from—the trend toward healthier food choices. Chobani, for example, went from start-up to $1 billion brand in less than five years by marketing its Greek-style yogurt as an all-natural, nutritious, great-tasting, and affordable product. Greek-style products now account

Exhibit 2 We project flat or negative volume growth.

Current hypothesis (shaded: Demographics – Flat-volume; Per-capita consumption – Decline; Price overall vs. FAFH – Decline; Wage inflation – Flat-volume; Food-stamp expenditures – Flat-volume; FAFH competition – Growth)

Core assumptions for each scenario	Decline assumptions	Flat-volume assumptions	Growth assumptions
Demographics (i.e., population growth)	<1%	~1%	>1%
Per-capita consumption	Declining	Stable	Increasing
Price overall vs. FAFH[1]	**Increase** (Commodity prices are volatile)	**Stable** (Commodity prices stabilize)	**Decrease** (Commodity prices fall)
Wage inflation	**Stable** (Consistent with recession)	**Increase** (Consistent with recovery)	**Significant increase** (Rises greater than historic levels)
Food-stamp expenditures	**Significant decrease** (Below prerecession levels)	**Decrease** (Return to prior levels)	**Flat/increase** (Remain flat/increase)
FAFH competition	**Increase** (Continued proliferation of FAFH options)	**Stable** (FAH[2] options keep pace with FAFH options)	**Decrease** (FAH options increase relative to FAFH options)

1 Food away from home.
2 Food at home.

for more than a third of the US yogurt market. Established food manufacturers are expanding their healthy offerings as well. The Campbell Soup Company's acquisition of Bolthouse Farms, a company known primarily for its natural juices and smoothies, is one example.

Even as they look for growth categories, companies should pay attention to their portfolio's underperformers: they should identify the categories in which sales volume or profits are declining and consider divesting them. Unilever, for example, recently sold its global Skippy Peanut Butter business to Hormel Foods.

Rethink your supply chain to mitigate commodity risks

Consumer food companies should understand their full exposure to commodity-price fluctuation and be willing to make aggressive supply-chain moves that will help them better manage volatility. One such move might be backward vertical integration: some chocolate manufacturers, for instance, are securing their cocoa supply by owning and operating cocoa farms. In 2013, Starbucks purchased its first coffee farm.

Other companies are pursuing innovative joint ventures. For example, ConAgra Foods, Cargill, and CHS plan to combine their flour-milling capabilities to create Ardent Mills; if the joint venture is approved, Ardent Mills will be the flour-milling industry's largest player and will offer its members increased collective-bargaining and purchasing power.

Food companies can also design product formulations that better respond to commodity volatility. In May 2013 PepsiCo announced plans to change several of its processes in an effort to lower costs—one such change will be the creation of a flexible product formulation that allows for the use of lower-cost ingredients.

Finally, some companies are experimenting with ways to drive a more circular economy in ways that reduce costs while also generating environmental benefits. Coca-Cola, for example, is partnering with some of its bottlers and investing in a recycling plant in Mexico to increase the company's recycling capabilities. It will then incorporate recycled materials into new, sustainable packaging for Coke products.

Create new types of partnerships with retailers

Food retailers and food manufacturers will face many of the same challenges in the years ahead. Leading retailers are already deeply invested in the private-label and prepared-foods businesses, both of which present opportunities for mutually beneficial partnerships with food companies. Retailers and manufacturers are also working together on the placement of new products. Kraft's newly launched Recipe Maker packaged dinner kit, for example, will be placed near tomato sauces in the grocery store to make the easy-to-prep meal feel more homemade.

But we believe winning food companies will be those that seek new ways to collaborate with retailers. Delicatessen-products provider Boar's Head offers a case in point. The company works closely with top-level managers at supermarkets, delivering directly to stores and providing on-site training and assistance for deli supervisors. Boar's Head is now involved in every part of the deli program at many supermarkets. It has also expanded its distribution network beyond the supermarket deli counter by partnering with other types of retail outlets, such as upscale and small neighborhood retailers, sandwich shops at train stations, kiosks at sporting events, and other places sandwiches are sold.

Pursue food service as a potential market

For the last decade, most branded food players have paid little attention to the food-service industry as a potential market. But in light of declining FAH volume, food companies should look for potential innovations within the food-service channel alongside those in the retail channel. Some food manufacturers have already had success: in 2012, PepsiCo partnered with Taco Bell to create Doritos Locos Tacos, a menu item featuring a taco shell made out of Doritos chips. The restaurant sold more than 325 million Doritos Locos Tacos in the first year. It was the most successful product launch in Taco Bell's history, and expanded PepsiCo's presence in this food-service channel.

By understanding the trends that have driven food-volume growth in the recent past and how those trends will likely evolve, consumer food companies can better prepare for the road ahead. Despite the challenging outlook for FAH-volume growth, consumer food manufacturers can win—but only if they pay close attention to shifts in the market, think long term, and are willing to make bold bets.

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