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Consumer Packaged Goods

Growth in the packaged-food industry

Insights from our research

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Yuval Atsmon
Rogerio Hirose
Greg Kelly
Udo Kopka
Anne Martinez
Subho Moulik

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Growth in the packaged-food industry: Insights from our research

When it comes to revenue growth, it is often the case that where you play matters more than how well you execute.[1] This broad conclusion about what makes companies grow certainly applies in today's packaged-food industry: the fastest-growing companies are those that have chosen to compete in the fastest-growing product categories and geographic regions. M&A has also contributed to growth but to a much lesser extent.

These insights into packaged-food companies' sources of growth are among the findings from our latest work in Granular Growth Decomposition, the proprietary approach that underpins our granularity-of-growth thinking (see sidebar, "What is Granular Growth Decomposition?"). Through this analysis, we disaggregated companies' positive and negative revenue growth into three sources:

- portfolio momentum, or the growth attributable to market expansion in the categories and countries in which a company plays
- M&A and divestitures
- execution, measured by market-share gains or losses

In this article, we present the findings from our analysis of packaged-food companies' performance in the most recent five-year period available (2008 to 2012). Our sample of 20 companies consists of a diverse mix of fast-growing regional market leaders and major global players, as well as companies that focus on only one product category and companies that play in many categories.

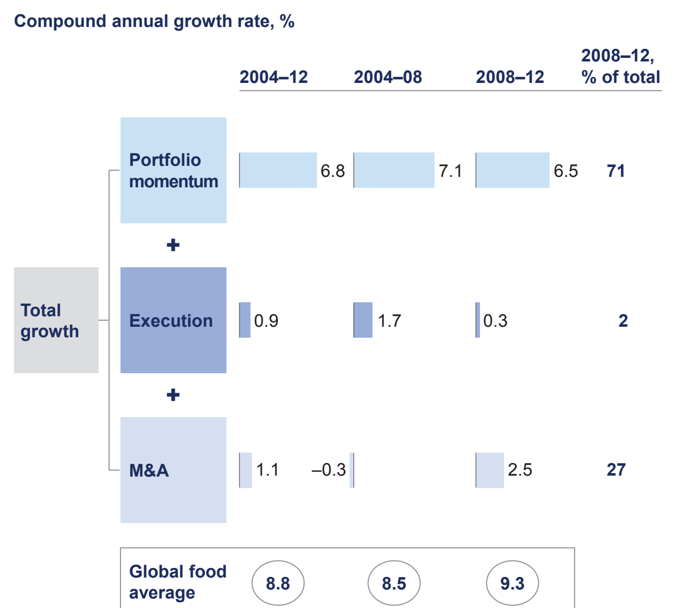
The granularity of the data allows for deep, nuanced analysis. Instead of simply analyzing the broad category of bakery products, for example, we can drill down several more levels into subcategories: from biscuits to sweet biscuits, and then to chocolate-coated biscuits. We also examine companies' performance by country, not just by region. This fine-grained view yields detailed and highly specific insights as to which factors drive a company's growth and which factors slow it down. Our findings underscore the strategic imperatives that packaged-food companies must heed in order to grow: zero in on high-growth categories and countries, build M&A capabilities, and take a pragmatic approach to execution.

Portfolio momentum: Still by far the primary growth driver

The geographic markets and product categories in which a packaged-food company competes have historically been, and still are, its most important strategic choices. Portfolio momentum remains by far the largest driver of revenue growth for packaged-food companies. Between 2008 and 2012, it accounted for 71 percent of total growth (Exhibit 1).

The data show that companies doing business primarily in emerging markets enjoyed higher portfolio-momentum growth. Specifically, companies that generate more than 80 percent of sales from emerging-market countries grew three times as much as companies with a more geographically dispersed customer base. The top five growth performers in our sample are all relatively small companies headquartered in emerging markets,[2] and all five generate more than half their revenues from their home countries.

Exhibit 1 Portfolio momentum is the largest driver of growth, contributing 71 percent of total growth for 2008–12.



Source: Euromonitor; McKinsey Granular Growth Decomposition database (packaged food only)

1 This conclusion was first put forward by Mehrdad Baghai, Sven Smit, and Patrick Viguerie in their seminal book, *The Granularity of Growth: How to Identify the Sources of Growth and Drive Enduring Company Performance* (John Wiley & Sons, 2008).

2 All five companies are headquartered in either Asia or Latin America and have annual sales of $6 billion or less.

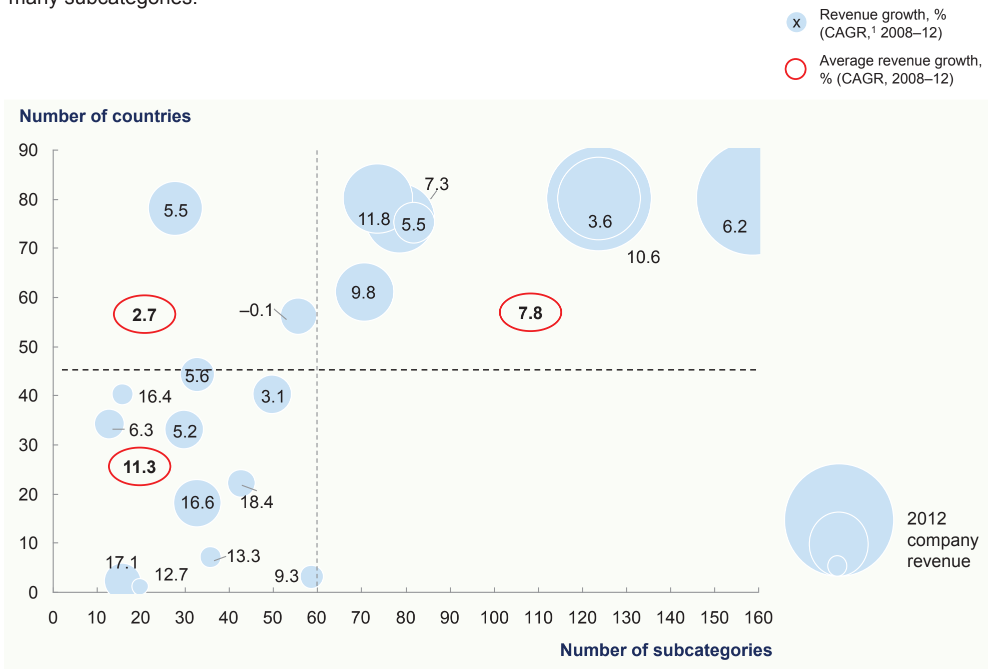
Exposure to emerging markets is the single biggest factor in revenue growth, but another significant factor is category mix. For companies in which high-growth categories account for more than 75 percent of sales, portfolio-momentum growth was thrice that of more diversified companies.

Interestingly, the companies that achieved the most growth follow one of two models. The first model, represented in the bottom-left quadrant of Exhibit 2, calls for a focus on a select set of high-growth subcategory and country combinations (such as sugar-free gum in China or fruited spoonable yogurt in Brazil and the United States). Emerging-market companies in expansion mode typically follow this model, and we expect that they will expand into even more subcategories and countries as they continue to pursue growth. The second model, as shown in the top-right quadrant, is one that a number of leading developed-market players have followed: they build a presence in a much larger set of both subcategories and countries, replicating their category footprint in higher-growth emerging markets. But we expect that these large companies, rather than expanding into even more subcategories and countries in the future, will instead abandon the least promising areas and choose to concentrate their resources on the highest-growth subcategories and countries.

Companies that play in only a few subcategories but are present in many countries (upper-left quadrant) achieved very little revenue growth. No major companies have pursued a strategy of playing in many subcategories within a limited geographic scope.

These findings prove yet again that applying a granular approach to growth is crucial to gaining competitive advantage. In a business environment where executing better than the competition offers little reward, a disciplined and data-driven methodology for identifying the categories and geographies with the highest growth potential is of utmost importance.[3]

Exhibit 2 Geographic expansion leads to strong growth only for companies that play in many subcategories.



1 Compound annual growth rate.

Source: Euromonitor; McKinsey Granular Growth Decomposition database (packaged food only)

3 Claudia Benshimol Severin, Rogerio Hirose, Udo Kopka, Subho Moulik, Taro Nordheider, and Fábio Stul, “Finding profits and growth in emerging markets,” January 2012, mckinseyonmarketingandsales.com.

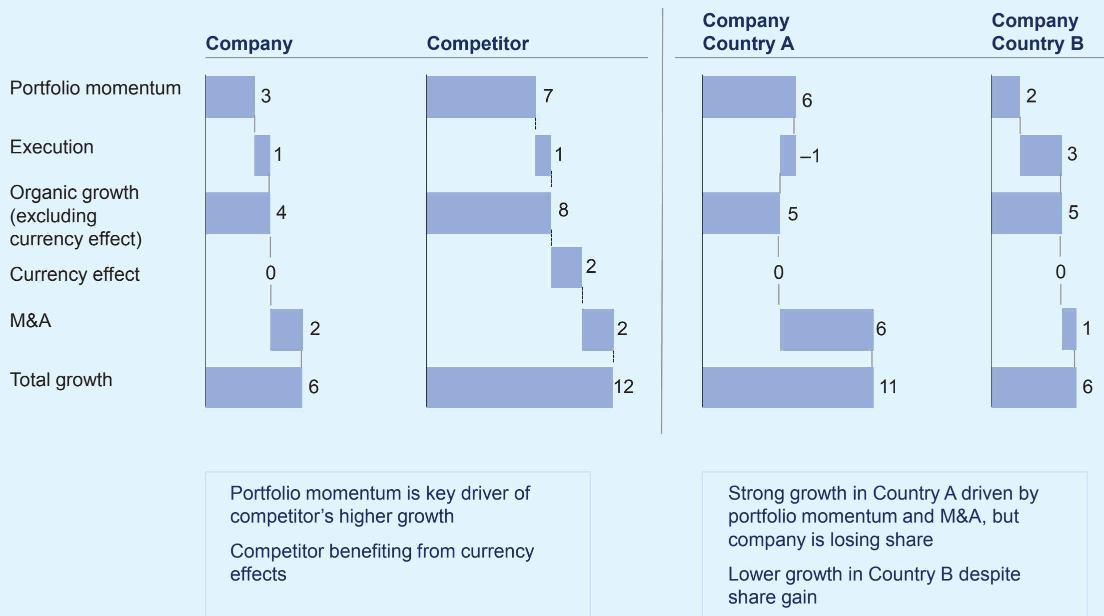
What is Granular Growth Decomposition?

Since 2005, McKinsey has maintained a database containing performance information on the portfolios of more than 700 global public companies. Granular Growth Decomposition (GGD) is our analytical technique for breaking down companies' revenue growth into three sources: portfolio momentum, M&A, and changes in market share. For the consumer-packaged-goods sector, our GGD analysis also incorporates detailed industry data from third-party sources.

Companies can use the data to compare their own sources of growth with those of specific competitors or their industry as a whole; further analyses can also be conducted on each geographic, customer, and product segment in a company's portfolio of businesses, thereby revealing where the company is under- and overinvesting (exhibit).

Exhibit Benchmarking of companies and markets reveals important differences in growth performance.

Compound annual growth rate, %, 2008–12



GGD analysis for a healthcare-products manufacturer and six of its competitors, for instance, revealed that the company was allocating disproportionate resources to low-growth categories and geographies. The analysis also showed that the company was losing share in emerging markets, particularly to aggressive local players. Based on these insights, the company shifted more than 10 percent of its annual budget toward higher-growth categories and markets, set new targets at both category and country levels, and is now on track to increase its growth rate by one to two percentage points.

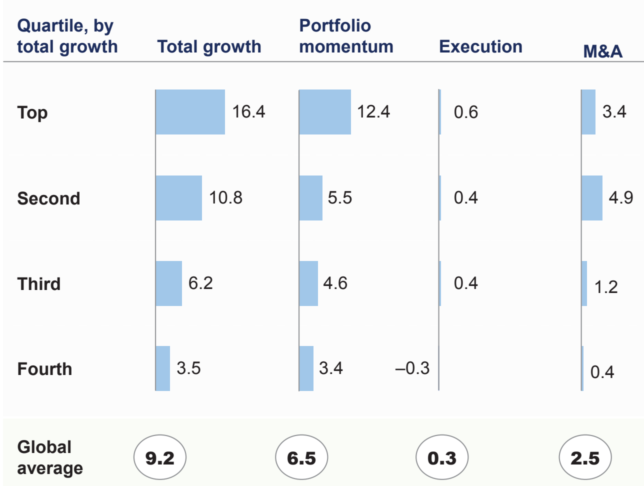
Then, once a company has pinpointed the most promising countries and categories, it must act on that knowledge. Company leaders should establish a set of routines for periodic resource reallocation. They should create mechanisms that allow them to regularly and swiftly move resources—not just capital spending but also personnel, marketing dollars, and other expenditures—away from low-growth areas and toward high-potential markets and segments.[4] Research has shown that, across industries, active resource reallocation plays a critical role in corporate performance.

M&A can partially offset a lack of organic growth

The top two quartiles in our sample were able to wield M&A as a competitive weapon, with deal activity accounting for almost one-third of their total growth. In particular, companies in the second quartile were able to leverage M&A to partially offset lower portfolio-momentum growth (Exhibit 3).

Exhibit 3 Top growth performers leverage M&A more.

Average company growth, compound annual growth rate, %, 2008–12



Source: Euromonitor; McKinsey Granular Growth Decomposition database (packaged food only)

That said, a handful of packaged-food manufacturers in our sample achieved above-average revenue growth with little to no M&A activity. Not surprisingly, these manufacturers were rising emerging-market players buoyed almost exclusively by portfolio momentum.

We expect that the M&A landscape will evolve in the next few years, as today's nascent emerging-market companies grow in both size and aspiration and as multinationals refine their strategies in response to these new competitors. At the very least, packaged-food companies—particularly those with significant exposure in slower-growth countries and categories—should consider incorporating inorganic growth into their growth models. They would do well to build and professionalize their deal-making skills so that M&A can become a more reliable and consistently profitable growth driver across business segments and markets.[5]

Execution: Table stakes, but rarely a differentiator

As the packaged-food industry becomes increasingly global and more competitive, execution is becoming simultaneously more challenging and less of a differentiator: execution outperformance accounted for a scant 2 percent of total growth in the 2008–12 period. All but four of the companies in our sample recorded lower execution-driven growth for 2008–12 compared with 2004–08. Winning market share away from competitors has only gotten harder.

Some companies look to new-product introductions as a way to spur growth. But the data show no correlation between execution-related growth and the number of new-product introductions per $1 billion in net revenue. In other words, large companies that introduced twice as many new products as their similarly sized peers didn't fare any better or worse in revenue-growth terms. These findings indicate that innovation plays an important role when it comes to maintaining share and keeping developed-market consumers interested in a category (think the US cereal market), but in general, companies haven't built product-development and product-launch capabilities that are differentiated enough to help them capture market-share gains.

4 Michael Birshan, Marja Engel, and Olivier Sibony, "Avoiding the quicksand: Ten techniques for more agile corporate resource reallocation," *McKinsey Quarterly*, October 2013, mckinsey.com.

5 For more on how to treat M&A as a strategic capability, see Cristina Ferrer, Robert Uhlaner, and Andy West, "M&A as competitive advantage," *McKinsey on Finance*, August 2013, mckinsey.com.

Excellence in execution is table stakes, not a trump card. Companies should therefore take a pragmatic approach to execution, prioritizing execution levers in the categories and markets that matter most. A US-based food manufacturer, seeking international growth in one of its core categories, first identified the fastest-growing markets and subcategories. It then assessed its execution in every part of the value chain—including its innovation process, pricing, distribution, and in-store operations—and implemented a series of high-impact improvements only in the selected markets and subcategories. Early results indicate that the company could double its international business in the category within five years.

Unquestionably, packaged-food companies that examine their business results up close can make wiser portfolio choices. Companies must not be content with high-level data. They should instead scrutinize the performance of each of their geographic markets and subcategories to gain a deeper understanding of the true sources of growth. Otherwise, they risk investing in the wrong things, missing valuable opportunities, and ultimately losing out to more attentive and analytical rivals.

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Yuval Atsmon is a principal in McKinsey's London office, **Rogerio Hirose** is a principal in the São Paulo office, **Greg Kelly** is a director in the Atlanta office, **Udo Kopka** is a director who splits his time between the Hamburg and Shanghai offices, **Anne Martinez** is a specialist in the Stamford office, and **Subho Moulik** is an associate principal in the Chicago office.

Contact for distribution: Anne Martinez
Phone: +1 (203) 977-6758
E-mail: Anne_Martinez@mckinsey.com

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