

Consumer Packaged Goods Practice

Reinvigorating growth in the consumer-goods industry

In this episode of the *McKinsey on Consumer and Retail* podcast, three senior partners discuss the changes that will fuel the next generation of growth for consumer-packaged-goods companies.



The consumer-packaged-goods (CPG) industry can no longer count on historical sources of growth. In this episode of the *McKinsey on Consumer and Retail* podcast, McKinsey senior partners Udo Kopka, Ed Little, and Jessica Moulton explain why, and they describe a new model for where to play and how to win in the next normal. An edited transcript of their conversation with McKinsey executive editor Monica Toriello follows. Subscribe to the podcast on McKinsey.com.

Podcast transcript

Monica Toriello: Hello, everyone. Thanks for joining us today. We'll be talking about the consumer-packaged-goods industry, which has struggled to grow in the past decade after about 40 years of strong growth. Its recent struggles are because of a confluence of large-scale trends, many of which have seen an acceleration during the COVID-19 crisis. On today's episode, we'll be talking to three of the authors of a new article titled "What got us here won't get us there: A new model for the consumer-goods industry." It's about the trends that have disrupted the CPG industry and the changes that CPG companies now need to make in order to compete effectively.

Let's meet our guests for today. We have Udo Kopka, a senior partner in the Hamburg office. We also have Ed Little, a senior partner based in the Dallas office. And last but not least, Jessica Moulton, a senior partner in London.

Let's start by talking about what got us here: the old model for CPG growth. Later on, we'll talk about why that model won't work anymore, but first, describe for us what the old model was.

Jessica Moulton: The consumer-goods industry is unusual for having had a very stable model for a very long time, which most industry players used. There were five elements to it. First, these players were focused on mass-market brand building and product innovation. That helped them generate stable growth and also gross margins that were usually about 25 percentage points above their

nonbranded peers. It was also about partnering closely with grocers and other elements of the mass channels in order to gain broad distribution. These companies also really thrived in developing markets by building brands and distribution as consumers became more able to pay for consumer goods. It was also about driving cost out of the operating model. And finally, it was about using M&A to consolidate markets and generate more organic growth.

All of these five elements remain important to consumer-goods companies, but they're being affected by the 12 trends [described in our article], which are growing in strength and have been particularly accelerated by COVID-19.

Ed Little: At the highest level, what's happened in many ways relates to fragmentation of consumer preferences, of the retail landscape, and of marketing models. Basically, you have an old model which was based on scale and barriers to entry which have either gone away or have significantly eroded, so that the idea of mass audiences supported by expensive media and promotions, and products sold through a relatively consolidated retail base with which a manufacturer had an advantaged relationship—that all has faded away. And that's allowed new and small players to come in and capture a lot of the growth. They can get on shelf; they can capture eyeballs; they can more specifically meet the needs of specific consumer segments in a way that mass brands no longer do.

Monica Toriello: Udo, what's your take on why the old model doesn't work anymore?

Udo Kopka: Let me start by saying the past years have been difficult for the industry, obviously. I call 2000 to 2010 the "Warren Buffett years." If you invested in consumer-goods companies, you outperformed the S&P by far—roughly by 8 percent. Now, in the last ten years, from 2010 to 2020, you underperformed the S&P. So the old rationale didn't work anymore. Why is that? It's because we have two trends coming in at the same time. First, a new consumer segment, the millennials, are coming in. And that's not only 19- or

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—Jessica Moulton

20-year-olds; it's 23- to 35-year-olds. Second, we have many more competitors for share of wallet of traditional consumers. It's not only traditional CPG companies, but it's apps, it's media like Netflix, and it's electronic gadgets. So all that together creates the perfect storm, and that's why we argue there is some change needed.

Monica Toriello: Let's talk about that first trend that Udo just mentioned: the millennial generation. Your article lays out 12 trends that have essentially made the old model obsolete. We won't talk about all 12 on this podcast—listeners can read your article on McKinsey.com—but we'll talk about a few of them. One of the 12 trends is the millennial and Gen Z effect. Say more about what that means and the implications for CPG companies.

Jessica Moulton: Millennials are different from older generations in many ways. They prefer special, different, authentic—and sustainability is important to them. They tend to be more conscious eaters. But maybe most importantly for this context, they are four times more likely than older consumers to say that they resist buying mass brands.

Ed Little: They have very different preferences and demands, and they're in many ways more varied. I think it is going to be interesting how those demands and needs evolve, because you have two things going on. One is, when you think about millennials

making purchases based on things like purpose, what does purpose mean? Does sustainability, for example, have the same relevance that it did prior to COVID-19 versus value or safety or hygiene? That's one. The second thing is, millennials cover that wide age range, and many are going into family formation, which generally can change substantially what consumers want and demand. Those two things—COVID-19 and family formation—could be a force for change, which some CPGs will navigate the right way and others will navigate the wrong way.

Udo Kopka: The old days are gone. Why is that? Because the millennials are coming in as a new consumer segment. To start the transformation, three questions. First, what percentage of your product and service portfolio is really made for the segment of millennials? Second, what percentage of your marketing spending and resources, including HR resources, is really geared to capture the millennials? And that means two-way communication, social media, less above-the-line and eventually more below-the-line [marketing], or just more social media. I do not know the answer, but I am asking the question: What percentage of your marketing budget is really focused on capturing this new, not-going-away consumer segment? Third question: What percentage of your sales budget and resources, including HR resources, is focused on creating sales in those channels where we see the millennials shopping?

These are the three questions. And mostly, if people are honest, they would say, “Well, actually, it’s 0 percent.” So how powerful would it be if we would be able to say, “In two years from now, we want to have 20, 30, and 10 percent of our budget focused on millennials.” This would be the start of a terrific transformation capturing this new segment.

Monica Toriello: I just want to pick up on a couple of things you’ve said. Jess, you mentioned that millennials are much more likely to resist buying mass brands. And indeed, another one of the 12 trends in your article is “the explosion of small brands.” That trend is the only one, as far as I can see, that hasn’t been accelerated by COVID-19. There’s been this resurgence of large brands—a shift toward A brands. Do you see that as a blip? Is that a temporary thing, just because large brands have been more available in stores during the pandemic? Or do you think that will be a more durable trend?

Jessica Moulton: I think there are a few reasons why large brands did well during the lockdown period. One is because their supply chains and their commercial operations were able to pivot much better and faster than small brands were. And so, yes, they had much higher availability. When retailers were zooming in on core assortment, they were focusing on those large brands. And that gave the large brands a lot of lift, not just during the pantry-loading period, but actually for a good period afterward and continuing into today.

The big question is whether or not large brands can retain those gains. Certainly, some will. Some will do a great job of capitalizing on all this “forced trial.” Others will have trouble doing so, especially when we see more and more recessionary pressures crop up and more consumers think more about private label—when they’re really watching every dollar or pound that they spend.

Ed Little: It is interesting that when we survey people, there is a lot of brand switching and channel switching and store switching going on. A lot of it is driven by availability. But when we ask consumers if they intend to continue that behavior post-COVID-19, a lot—more than half, on the brand dimension at least—say yes, they will continue to use these new brands. And as Jess pointed out, they’re often larger brands.

One implication is how consumer companies think about innovation—de novo innovation versus renovation. This is an opportunity for renovation, to lock in people who are now using your brands or returning to your brands and renovate those brands to make the value proposition stronger.

Jessica Moulton: We have a lot of large consumer-goods players who’ve been working on renovating their brands—in particular, making them more purpose led. One particularly inspiring story is Reckitt Benckiser [RB], which has brands like Dettol and Lysol, which are right in the core of consumer needs these days. When the crisis hit, some of RB’s factories were actually in hard-hit areas in China. They had to mobilize with incredible speed to keep their supply going and keep their products out on shelves. And I think that upfront action and the company rallying around these objectives really jolted everyone into living their purpose. I think it’s a real opportunity for the industry more broadly to operate in that mode.

Udo Kopka: I think what we are going to see in the future—based on, again, what millennials are looking for—is more than a functional definition of a value proposition of a product. Take the water category: we all know that we should drink two liters of water every day. Now, this is a value proposition for a water company to develop something—an IoT device, let’s say, on the cap of a mineral-water bottle to measure that I’m really drinking two liters of water

every day. That's just a completely different purpose. And that moves the needle because this is what millennials are looking for. And by the way, it also creates brand loyalty.

Monica Toriello: So we've touched on a couple of the 12 trends: millennials, small brands. Do you think any of the trends are misunderstood or underestimated or overlooked by consumer-goods CEOs and executives today?

Ed Little: I think value is one. I wouldn't say it's overlooked, but it's becoming more important. There's a lot of uncertainty in how long the COVID-driven recession will last, but it may be here for a while. And it's different from the Great Recession in that it's much more labor led, with unemployment rates that are much higher and GDP declines that are much greater than in 2007 and 2008. In those years, we saw an uptick in private label. We saw a lot of trading down. And I think those effects are going to be even more pronounced as we get through the work-from-home, pantry-loading aspect of this and get into the recession. I think the ability to serve value segments profitably and to create value propositions there will become more important.

Jessica Moulton: It's really clear what the number-one trend on the planet is, and it's rising wealth in developing markets. What we see in developing markets is the continuing rising importance of

emerging Asia and the real battle for attention of the consumer in those markets.

I think the trends affecting the channels that consumer-goods players sell through are very important as well. And the one I'd highlight, because it's the one that's really barreling down the pike, is the growth of the e-marketplaces. Here I mean Amazon, Alibaba, JD.com, Pinduoduo. Those four players have made up 65 percent of revenue growth over the past five years. And this is an area where COVID-19 is really accelerating things. During the crisis, we saw Amazon surging by 65 percent in grocery categories in the United States and 80 percent in major European markets. Consumer-goods players need to be really aware of the rising importance of e-marketplaces in many markets around the world.

Monica Toriello: So the importance of value, rise of e-marketplaces, battle for emerging Asia, millennials and Gen Z—these are some of the 12 trends. In your article, you urge CPG companies to confront these trends and face these challenges in part by rethinking their where-to-play strategies. And you say that for a CPG company to create a strong where-to-play strategy, one critical input is “a privileged view of what's happening to consumers in the market.” Elsewhere in the article, you call it consumer closeness. How can companies do this better? What are companies meant to do differently,

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going forward, to get closer to consumers and to find out how their needs are evolving?

Jessica Moulton: Well, consumer-goods companies are very used to studying what's happening in the grocery channel, and they get an unusual amount of data on it from the syndicated sources. Most of their internal processes are oriented around this precious data. But it's incomplete. A lot of growth is happening in other channels, and most CPG companies are still not looking very carefully at that other growth. So the first step is to take a much broader view of where the consumer is purchasing and engaging.

Udo Kopka: If you're looking at the total returns to shareholders of the most successful and most valuable companies over the past five years, those that own proprietary customer data are the most successful ones. Now, if we look at our industry, we are still using averages, and at best we are looking at six different consumer segments defined very, very broadly. So this is light-years away from $n = 1$ and from collecting real customer data. In most cases, we are still using some type of agency-based market data.

My question is, how real do we want to get to collect customer data and really know our customers? From the small brands and the small companies, we know that some of them know their customers by name, by everything, $n = 1$, because they have a direct relationship into that. For the big brands, it will be close to impossible to ever get there. But are we aspiring to get close to that?

Monica Toriello: Customer data and managing data for proprietary insights, like Udo was just talking about, is one of 18 required capabilities that you list in your article that CPG companies need to thrive in the next normal. And these capabilities encompass almost every functional area within an organization. A CPG leader reading your article or listening to this

podcast might think, "Well, geez, that is a lot to do. Where do I start, and how do I start?" That's my final question for you on this podcast: What's your advice to CEOs about where to start?

Ed Little: I think one place to start is [that] "where to play" does represent the majority of growth outcomes, on average, across CPG. The role of inorganic growth and portfolio shaping is hugely important—and many players are not particularly good at it. It should be a capability. It should be an always-on capability, as opposed to something that is reactive or a once-in-a-blue-moon event. I think for a programmatic M&A or divestment program to be effective, you've got to have some sort of advantage, because everybody's looking at the same assets. So why are you the natural owner? Or what do you know that others don't know? Or what perspective do you have about growth that others don't have?

I think that means that you need to break out of the traditional category view and think much more consumer-back—not be so category based. Be more needs based or occasion based. Think in terms of ecosystems. Think in terms of solutions that extend beyond the product. How are you going to put different pieces together to form something that is greater than the sum of its parts? You can't be reactive. You need to be proactive and cultivate different sources, channels, and relationships, so that you can be the lead when something becomes available.

Jessica Moulton: I agree with Ed that where to play is critical in consumer goods. Most consumer-goods companies need to go through a good bit of portfolio-composition improvement. Many consumer-goods companies have low-growth large brands that no longer fit their business model.

On how to play, consumer-goods companies need to digitize most aspects of their model to a much

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greater degree than they have. And the good news is that a lot of the digitization capabilities and tools out there are becoming more and more mature and easy to implement. In the new model, consumer-goods companies need to embrace data-driven marketing, which makes their marketing far more personalized, reaching consumers with the relevant messages, even while they don't necessarily proliferate their product offerings. Second, they need to digitize their sales channels, especially to be successful in emerging Asia and some other developing markets, but also to work with key accounts in the Western markets better.

Another really important aspect of the new model that consumer-goods companies need to put in place is a more local operating model. Many consumer-goods companies swung the pendulum way too far toward being centralized and lost the ability to take advantage of opportunities with consumers and channels at the local level. They need to reinvest, to put more power back into the hands of local decision makers, to stay close to the consumer, and to respond to local competitors.

Ed Little: If I'm a CEO, I'm also, of course, always thinking about “How do I create talent advantages and get the best talent?” And now I'm thinking

about that more than ever, because there may be a lot of talent becoming available from other sectors. And especially in the digital space and some commercial capabilities, CPG is really not the leader. So I'd be thinking, “How do I get that talent into my organization?” The second thing is [that] talent may be becoming less geographically oriented. So I think talent is an interesting one, particularly now, to think about in a time of disruption, as an opportunity to build out the next-generation commercial capabilities that are more data enabled and analytically enabled in revenue management, in marketing, in e-commerce, et cetera.

Udo Kopka: I'm looking at this as the opportunity of a lifetime. Just to go full circle to where we started this discussion, what got us here won't get us there. If you look at the real numbers, how much of the budget is shifted to new opportunities, to new countries, to new categories, to M&A? On average, we found that it's less than 2 percent. Most of the CPG companies are investing one quarter per year on financial planning, on budgeting, on revisions of budgets and so forth. All that effort only to move 2 percent to new areas of opportunities? This is what I see as the biggest challenge to move from the old model to building up new capabilities and to really make the new model work.

What do we want to change? Where do we want to be different? And what are the skills and capabilities that we want to bring and build up? That's, for me, the big question. And please do not shift only 1 percent of your budget next year. Make a big bet and a big move.

Monica Toriello: A big bet and a big move—that's a good note to end on. Thanks again to Ed, Jess, and Udo for being with us today. And to all our listeners, thanks for sticking around. Join us again in a few weeks for the next episode of the *McKinsey on Consumer and Retail* podcast.

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